

Bitcoin Regulatory Update



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Topics for Discussion

- › The ever expanding definition of “money transmission”
- › How money transmitters are regulated in the U.S.
- › United States regulation of “Foreign Located MSBs”
- › Case studies
- › Partnerships
- › Changing of the Guard at DOJ

Regulation driven by use, not the thing itself...

- › SEC
- › CFTC
- › IRS
- › CFPB
- › FinCEN
- › States (MD vs. NY)
- › International regulation



18 U.S.C. § 1960: Prohibition of unlicensed money transmitting businesses

- Whoever knowingly conducts, controls, manages, supervises, directs, or owns all or part of an unlicensed money transmitting business, shall be fined in accordance with this title or imprisoned not more than 5 years, or both.



18 U.S.C. § 1960

- Statute may be violated in three distinct ways:
- A **money transmitting business** which
 - a. operates without a license in a state which requires a license;
 - b. fails to register with FinCEN; or
 - c. “otherwise involves the transportation or transmission of funds that are known to the defendant to have been derived from a criminal offense or are intended to be used to promote or support unlawful activity.”
- ***No specific intent required***

What is a Money Transmitting Business?

- › 31 U.S.C. § 5330(d):
 - › Any business which --
 - › 1. Provides money transmitting services
 - › 2. Is required to file Currency Transaction Reports
 - › 3. Is not a depository institution.
- › **But**, § 5330(d) does not control § 1960; *United States v. e-gold*, 550 F.Supp.2d 82 (D.D.C. 2008)

What is a Money Transmitting Business?

- › 18 U.S.C. 1960(b)(2):
 - › “the term ‘money transmitting’ includes transferring funds on behalf of the public **by any and all means** including but not limited to transfers within this country or to locations abroad by wire, check, draft, facsimile, or courier;”

FinCEN's treatment of Bitcoin-related transactions as "money transmission"

- › FinCEN Administrative Rulings
 - › FIN-2013-G001: Administering, Exchanging or Using Virtual Currencies
 - › FIN-2014-R011: Virtual Currency Trading Platforms
 - › FIN-2014-R012: Virtual Currency Payment System
 - › FIN-2015-R001: Negotiable Certificates of Ownership of Precious Metals
- › Ripple Labs. Civil Money Penalty (May 2015)

Foreign Located MSBs

- FinCEN Final Rule, July 21, 2011
- Entity may now qualify as MSB regardless of physical presence
- Foreign located MSBs must a) register with FinCEN, b) become licensed in applicable jurisdictions, c) fully comply with U.S. AML laws, and d) designate agent in U.S.
- Activity in the U.S. is the driving factor

Foreign Located MSBs (cont'd)

- U.S. bank account **alone** will not trigger registration requirement; however
- “We intend to include an entity that has a presence in the U.S. by means of the internet or similar mechanism, or by means of an account with a U.S. financial institution **and** who, for instance, is transmitting money through the account with U.S. customers or recipients.”
- Fact intensive analysis
- U.S. customers **or** recipients a key factor

More about U.S. bank accounts...

- › Severe criminal consequences for opening bank accounts under false pretenses
 - › 18 U.S.C. § 1344 (Bank fraud)
 - › 18 U.S.C. § 1014 (False statements)
 - › 18 U.S.C. § 1956 (Money laundering)
 - › 18 U.S.C. § 1960

United States v. Mazza Alaluf

- › *U.S. v. Mazza Alaluf* (2d Cir. 2010)
- › Turismo Costa Brava, S.A. (Chile)
 - › Three storefronts in Chile
 - › Full-service financial services company
 - › Local currency exchange
 - › *Casa de cambio*

United States v. Mazza Alaluf

- › Nexus to the United States
 - › Step 1: Physical delivery of currency into the US by Turismo couriers (all deliveries declared at Customs)
 - › Step 2: Delivery via armored car to AFEX
 - › Step 3: Electronic delivery via AFEX to Turismo's three US bank accounts (accounts in Illinois, Michigan and New York)
 - › Step 4: Electronic delivery from US bank accounts to third party recipients on behalf of Turismo's clients

United States v. Mazza Alaluf

- › Convicted at trial (SDNY)
- › Second Circuit: Turismo Costa Brava was
 - › (a) a money transmitting business;
 - › (b) an ***unlicensed*** money transmitting business;
 - › (c) required to become licensed in each of the three states where it maintained a bank account.
- › Mazza Alaluf sentenced to 42 months imprisonment, forfeiture of \$10 million
- › More to come...

State Laws

- In practice, federal laws, regulations, guidances and exceptions are ***not relevant*** in state regulatory inquiries.
- Federal and state money transmitting laws serve different purposes.
- Different states may regulate similarly situated businesses differently.
- Among others, Square, BitCoin Foundation, NetSpend, foreign currency dealers, and prison commissary operators have received Cease & Desist letters, many of which resulted from the filing of license applications.
- With each state law violation, federal law has ***technically*** been violated.

Bitcoin + § 1960 + Mazza Alaluf + State Laws:

- › 1. No allegations of ill-gotten gains, underlying criminal activity or money laundering needed to pursue **criminal** charges;
- › 2. Physical location of company irrelevant;
- › 3. FinCEN exceptions of very little value;
- › 4. A company will be deemed to be a money transmitting business based solely on its activity;
- › 5. A company will be deemed to be a money transmitting business **in the U.S.** based upon its U.S. nexus, if any.



Partnerships...

- › “Authorized Delegates” or “Agents”
- › Agents of licensees can avoid licensure in certain circumstances
 - › Relationship must be governed by written contract
 - › Transaction must mirror governing contract
- › Permitted under federal law
- › Governed on a state-by-state basis
 - › BitLicense?
 - › Texas Supervisory Memorandum - 1038

Changing of the Guard at DOJ

- › AG Eric Holder, resigned September 25, 2014
 - › see, “Eric Holder, Wall Street Double Agent, Comes in from the Cold,” Rolling Stone, July 8, 2015
- › AG Loretta Lynch, sworn in April 27, 2015
 - › FIFA Indictment, May 22, 2015
- › Yates Memo, September 9, 2015
 - › “Individual Liability for Corporate Wrongdoing”
- › New “Compliance Counsel” position created
 - › Hui Chen, September 2015

DOJ Compliance Counsel

- › Why was this role created?
- › Issue: ***“Paper” Programs***
- › Compliance Counsel will “look not only at how the policy reads on paper, but also at the messages conveyed to employees, including through in person meetings, emails, telephone calls and compensation. We look at whether...a company tolerated compliance failures year after year because the alternative would have meant a reduction in revenues or profits.”



DOJ Compliance Counsel (cont'd)

- › Why was this role created?
- › Compliance Counsel will help DOJ “review companies’ compliance programs as one of the many factors to be considered when deciding whether to criminally charge a company or how to resolve criminal charges. ***Our hiring of a compliance counsel should be an indication ...about just how seriously we take compliance.***”

DOJ Compliance Counsel: Issue Spotting

- › Does the institution provide strong, explicit and visible support for its compliance policies?
- › Do the people who are responsible for compliance have stature within the company?
- › Are the institution's compliance policies clear and in writing? Are they easily understood?
- › Does the institution ensure that its compliance policies are effectively communicated to all employees?

DOJ Compliance Counsel: Issue Spotting (cont'd)

- › Does the institution review its policies and practices to keep them up to date with evolving risks and circumstances?
- › Are there mechanisms to enforce compliance policies? Is discipline even handed?
- › Will the institution terminate business relationships with third parties based on compliance concerns?

DOJ Compliance Counsel: Special Concerns for AML Compliance

- › What does the institution's "know your customer" policy look like?
- › Compliance with BSA requirements:
 - › Information sharing
 - › SARs and CTRs
 - › Handling of "particularly suspicious" activity
- › Is the institution candid with regulators?

*Bitcoin + § 1960 + Mazza Alaluf + State
Laws + Loretta Lynch + Yates Memo +
Compliance Counsel...*



Thank you.



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