

# Applying the Bank Secrecy Act, FinCEN Regulations, and Sanctions to the Nascent NFT Market



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## Introduction

Non-fungible tokens (NFTs) often involve two areas with known money laundering and terrorist financing risks: cryptocurrencies and high-value assets, like art. As detailed below, the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) has provided guidance on the applicability of statutes related to anti-money laundering and terrorist financing (AML) to cryptocurrencies. Recent actions and statements from Congress also show an increased AML focus on the art world, suggesting that the industry may be subject to more AML regulation, as are other industries with high-value assets, like precious metals, stones, and jewels. While there is far less regulatory guidance on NFTs specifically, the rules and regulations for these related asset classes, together with recent statements on NFTs by regulators, can provide insight into the AML considerations that NFT market participants should bear in mind and what precautions they may wish to take currently.

## The Bank Secrecy Act

The primary tools that the U.S. government uses to fight money laundering and terrorism financing are the Bank Secrecy Act,<sup>1</sup> related federal AML laws, and regulations promulgated thereunder by FinCEN (collectively, the BSA Provisions). Among other things, the BSA Provisions

<sup>1</sup> 31 U.S.C. § 5311, *et seq.*



place registration, recordkeeping, and AML reporting obligations on entities that qualify as money services businesses (MSBs).

## 1. Money Services Businesses and Money Transmitters

### a. Definitions

The BSA Provisions define an MSB as a person,<sup>2</sup> wherever located, doing business wholly or in substantial part within the United States, acting in certain kinds of capacities, including a dealer in foreign exchange, a provider of prepaid access, and a “money transmitter.”<sup>3</sup> Subject to certain exemptions, a money transmitter is a person engaged in the (i) acceptance and (ii) transmission of currency, funds, or other value that substitutes for currency from one person or location to another.<sup>4</sup>

### b. The Integral Exemption

The term “money transmitter” does not include persons that sell goods or services (other than money transmission services) and only transmit funds as an integral part of that sale of goods or services.<sup>5</sup> This exemption is commonly referred to as the “integral exemption.” FinCEN has explained: “In order to be exempt from status as a money transmitter under the integral exemption, the person’s business must be different from money transmission itself, and the money transmission activity must be necessary for the business to operate.”<sup>6</sup>

## 2. Registration, Recordkeeping, and Reporting Obligations for MSBs

### a. Register with FinCEN and Applicable State Agencies

Under the BSA Provisions, MSBs are required to register with

<sup>2</sup> Throughout the BSA Provisions “person” is defined as an individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, an Indian Tribe (as that term is defined in the Indian Gaming Regulatory Act), and all entities cognizable as legal personalities. 31 C.F.R. § 1010.100(mm).

<sup>3</sup> See *Bank Secrecy Act Regulations, Definitions and Other Regulations Relating to Money Services Businesses*, 76 Fed. Reg. 43585 (July 21, 2011); see also 31 C.F.R. § 1010.100(ff).

<sup>4</sup> 31 C.F.R. § 1010.100(ff)(5).

<sup>5</sup> FinCEN, FinCEN Ruling 2004-4: Definition of Money Services Business (Debt Management Company) (Nov. 24, 2004), [https://www.fincen.gov/sites/default/files/administrative\\_ruling/fincenruling2004-4.pdf](https://www.fincen.gov/sites/default/files/administrative_ruling/fincenruling2004-4.pdf).

<sup>6</sup> FinCEN, FIN-2019-G001: Application of FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies (May 9, 2019), <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf> (hereinafter “2019 Guidance”).

FinCEN and maintain a list of agents. MSBs must also register with each individual state where they are servicing customers.<sup>7</sup>

### b. Develop and Implement an Effective AML Compliance Program

The BSA Provisions also require MSBs to develop, implement and maintain an ongoing AML compliance program that includes the following components: (i) written policies, procedures and internal controls designed to comply with the BSA Provisions, including verifying customer identities, detecting and reporting suspicious activity, retaining certain records, and responding to law enforcement requests; (ii) a designated AML compliance officer; (iii) an ongoing training program for appropriate personnel; and (iv) periodic independent reviews of the AML compliance program.<sup>8</sup> MSBs that fail to comply with these obligations, or that fail to properly register, are subject to civil money penalties and federal criminal prosecution.<sup>9</sup>

### c. FinCEN Guidance for Cryptocurrencies

#### 1. 2013 Guidance

In 2013, FinCEN issued its first interpretive guidance (2013 Guidance) aimed at clarifying the applicability of the BSA Provisions to those persons creating, obtaining, distributing, exchanging, accepting, or transmitting “virtual” currency, which FinCEN defined as a medium of exchange that operates like a currency in some environments but does not have all the attributes of real currency, like legal tender status.<sup>10</sup> The 2013 Guidance also coined the term “convertible virtual currency” (CVC) as a type of virtual currency.

The 2013 Guidance established a multitiered system to (i) identify and categorize those who interact with virtual currencies and (ii) determine which categories qualify persons as money transmitters subject to the reporting and registration obligations of MSBs under the BSA Provisions. FinCEN outlined three categories of participants in generic virtual currency arrangements:

<sup>7</sup> See 31 C.F.R. § 1022.380.

<sup>8</sup> See 31 C.F.R. § 1022.210; 31 C.F.R. § 1010.311; 31 C.F.R. § 1010.410(e); and 31 C.F.R. § 1010.415.

<sup>9</sup> See 31 U.S.C. § 5330(e) and 31 C.F.R. § 103.41(e); 18 U.S.C. § 1960(a); and 18 U.S.C. § 1960(b)(1)(B).

<sup>10</sup> FinCEN, FIN-2013-G001: Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (March 18, 2013), <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>.

- a. Administrator.** An administrator is a person engaged as a business in issuing (putting into circulation) a virtual currency, and who has the authority to redeem (to withdraw from circulation) such virtual currency.
- b. Exchanger.** An exchanger is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency.
- c. User.** A user is a person that obtains virtual currency to purchase goods or services.

Under the 2013 Guidance, persons operating as Administrators and Exchangers constitute money transmitters, which requires registration as an MSB and adherence to the BSA Provisions' AML reporting and recordkeeping obligations. In contrast, Users of CVCs do not qualify as money transmitters and are, therefore, exempt from these AML requirements.

## 2. 2019 Guidance

In 2019, FinCEN issued additional guidance further clarifying the application of the BSA Provisions to certain business models engaged in the growing virtual currency market.<sup>11</sup> Key takeaways include the following:

- a. CVC Definition: CVC is a type of virtual currency that either has an equivalent value as currency, or acts as a substitute for currency, and is therefore a type of "value that substitutes for currency."**  
"Digital currency," "cryptocurrency," "cryptoasset," and "digital asset," as conventionally understood, fall under the umbrella of CVC if they have an equivalent value as currency or act as a substitute for currency, although labels are not dispositive.
- b. MSB Status Is Fact Specific**  
Whether one qualifies as a money transmitter under FinCEN regulations is a matter of fact and circumstance determined by the actions and functions conducted. Additionally, a person who is engaged in more than one type of business model at the same time may be subject to more than one type of regulatory obligation or exemption.
- c. Money Transmitter Examples**  
The 2019 Guidance provides specific examples of CVC money transmitter activities. Some of these include

persons: (i) operating as peer-to-peer CVC exchangers; (ii) hosting CVC wallets;<sup>12</sup> (iii) operating a decentralized application (DApp) that both accepts and transmits value; (iv) operating a CVC payment processor; and (v) engaging in certain activities involving what FinCEN describes as initial coin offerings (ICO) and pre-mined CVC.

### d. CVC Matching Forum

The 2019 Guidance notes the following exemption: "[A] person is exempt from money transmitter status if the person only provides the delivery, communication, or network access services used by a money transmitter to support money transmission services. Consistent with this exemption, if a CVC trading platform only provides a forum where buyers and sellers of CVC post their bids and offers (with or without automatic matching of counterparties), and the parties themselves settle any matched transactions through an outside venue (either through individual wallets or other wallets not hosted by the trading platform), the trading platform does not qualify as a money transmitter under FinCEN regulations."

## OFAC Sanction Lists


The U.S. Treasury Department's Office of Foreign Assets Control (OFAC) administers and enforces economic and trade sanctions against targeted foreign countries, terrorists, and other criminals that pose threats to national security, foreign policy, or the U.S. economy.<sup>13</sup> As part of its enforcement efforts, OFAC publishes the Specially Designated Nationals and Blocked Persons List (SDN List), publicly available on the U.S. Treasury website, which contains the names of individuals and entities sanctioned due to their nexus with a targeted country, geographic region, or regime. Assets of SDNs are blocked, and all U.S. persons are generally prohibited from dealing with them. Moreover, a strict liability standard applies to unauthorized dealings with sanctioned parties; lack of knowledge is not a defense, and violations carry civil and criminal penalties.<sup>14</sup>

<sup>12</sup> Under the 2019 Guidance, FinCEN suggests that an unhosted wallet provider (e.g., MetaMask) would likely not qualify as a MSB, as there is no centralized entity conducting the acceptance and transmission of currency. However, a multi-signature wallet provider may qualify as a MSB depending on whether the wallets are hosted or unhosted.

<sup>13</sup> OFAC, *Office of Foreign Assets Control - Sanctions Programs and Information*, <https://home.treasury.gov/policy-issues/office-of-foreign-assets-control-sanctions-programs-and-information> (last accessed May 22, 2022).

<sup>14</sup> See 31 C.F.R. Part 501, App. A.

<sup>11</sup> See 2019 Guidance, *supra* note 6.



The prohibition of dealing with SDNs and associated assets applies in the digital context. In October 2021, OFAC published “Sanctions Compliance Guidance for the Virtual Currency Industry,” directed specifically to all members of the industry, including technology companies, exchangers, administrators, miners, wallet providers, and users.<sup>15</sup> The guidance reiterates the five essential components of any AML compliance program: (1) management commitment, (2) risk assessment, (3) internal controls, (4) testing and auditing, and (5) training. It further emphasizes that the obligation to comply with OFAC sanctions applies equally to transactions involving virtual currencies and traditional fiat currencies.

The application of OFAC’s policies to the crypto space has been evident in subsequent actions taken by the agency. For example, in November 2021, OFAC sanctioned a Latvia-based cryptocurrency exchange, its associated support network, and two ransomware operators for facilitating financial transactions for ransomware actors. OFAC designated the exchange and 57 cryptocurrency addresses associated with digital wallets as SDNs. According to reports, the addresses listed by OFAC held 42 NFTs, reportedly worth \$531,600 at the time.<sup>16</sup> Because U.S. persons are prohibited from transacting with individuals and entities associated with the SDN-designated cryptocurrency addresses, any interaction or trade involving the NFTs held by the listed addresses would also be prohibited.

### FATF Guidance

In October 2021, the Financial Action Task Force (FATF), an intergovernmental organization designed to combat money laundering and terrorism financing, released “Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers” (FATF Guidance).<sup>17</sup> The FATF Guidance, which is persuasive and not binding on the United States, underscores the need for countries, virtual asset service providers (VASPs), and other entities involved in virtual asset activities to both understand and mitigate money laundering and terrorist financing

risks. The FATF Guidance also provides specific examples of risk indicators that should be considered in a virtual asset context, with an emphasis on identifying factors that might obfuscate transactions or inhibit VASPs’ ability to properly diligence customers.

Importantly, the FATF Guidance arguably calls for a presumption that NFTs are not virtual assets, due largely to the fact that they are non-fungible. “Digital assets that are unique, rather than interchangeable, and that are in practice used as collectibles rather than as payment or investment instruments, can be referred to as non-fungible tokens (NFT) or crypto-collectibles. Such assets, depending on their characteristics, are generally not considered to be virtual assets under the FATF definition.”<sup>18</sup> However, the FATF Guidance opens the door for FATF members to regulate NFTs as virtual assets if the NFTs are used for payment or investment purposes and concludes that regulators consider the application of the FATF standards to NFTs on a case-by-case basis.

### Money Laundering Risks in the Art Industry

As it has with MSBs, FinCEN can place additional AML obligations on participants in certain industries in order to combat money laundering and terrorist financing. For example, in 2005, FinCEN issued an interim final rule requiring certain dealers in precious metals, stones, or jewels to establish specifically enumerated AML programs.<sup>19</sup> In its press release about the rule, FinCEN noted that “[t]he characteristics of jewels, precious metals and precious stones that make them valuable also make them potentially vulnerable to those seeking to launder money. This regulation is a key step in ensuring that the Bank Secrecy Act is applied appropriately to these businesses.”<sup>20</sup>

There are signs that Congress may likewise require increased AML obligations from participants in the artworld. The Anti-Money Laundering Act of 2020, enacted as part of the National Defense Authorization Act on January 1, 2021,<sup>21</sup> includes a provision that

<sup>15</sup> [https://home.treasury.gov/system/files/126/virtual\\_currency\\_guidance\\_brochure.pdf](https://home.treasury.gov/system/files/126/virtual_currency_guidance_brochure.pdf).

<sup>16</sup> Elliptic Blog, *Crypto Addresses Holding NFTs Worth \$532k are Among the Latest Sanctioned by OFAC*, Elliptic.co (Nov. 9, 2021), <https://www.elliptic.co/blog/crypto-addresses-holding-nfts-worth-532k-are-among-latest-sanctioned-by-ofac>.


<sup>17</sup> FATF, *Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers* (Oct. 2021), <https://www.fatf-gafi.org/media/fatf/documents/recommendations/Updated-Guidance-VA-VASP.pdf>.

<sup>18</sup> *Id.* at 24.

<sup>19</sup> See 31 C.F.R. § 103.

<sup>20</sup> Press Release, *Dealers in Precious Metals, Stones or Jewels Required to Establish Anti-Money Laundering Programs*, FinCEN (June 3, 2005), [https://www.fincen.gov/sites/default/files/news\\_release/20050603.pdf](https://www.fincen.gov/sites/default/files/news_release/20050603.pdf).

<sup>21</sup> Anti-Money Laundering Act of 2020, H.R. Res. 6395, 116th Cong. § 6003 (2020) (as enacted, Pub. L. No. 116-283).



the U.S. Treasury Department must study the “facilitation of money laundering and terror finance through the trade in works of art,”<sup>22</sup> which could encompass NFTs. In July 2020, two U.S. senators released a report concluding that a lack of regulation allows the art industry to avoid the same AML requirements that apply to financial institutions.<sup>23</sup> The Senate’s Permanent Subcommittee on Investigations found that the art industry’s secretive nature allowed U.S. intermediaries to purchase more than \$18 million in high-value art using shell companies that were linked to Russian oligarchs who had been previously sanctioned by the United States.<sup>24</sup> The report concluded that changes are needed in the art world, and that Congress should add high-value art trading to the list of industries that must comply with the BSA Provisions.<sup>25</sup>

After the release of the 2020 report, the Congressional Research Service (CRS), a public policy research institute of the U.S. Congress, published a report in March 2021 on money laundering, sanctions evasion, and terrorist financing. The report noted the propensity for these crimes to be accomplished through the trafficking of arts and antiquities.<sup>26</sup> That same month, FinCEN issued a notice to financial institutions warning that they should be on alert for illicit activity associated with the trade in antiquities and art.<sup>27</sup>

Most recently, in February 2022, the U.S. Treasury Department published a study on the facilitation of money laundering and the financing of terrorism through the trade in works of high-value art.<sup>28</sup> The study specifically addressed NFTs, noting the following:

1. “[T]he emerging online art market may present new risks ... (i.e., the purchase of non-fungible tokens [NFTs], digital units on an underlying blockchain that can represent ownership of a digital work of art).”
2. “Depending on the nature and characteristics of the NFTs offered, [NFT trading] platforms may ... come under FinCEN’s regulations.”
3. “NFTs ... that are used for payment or investment purposes in practice may fall under the virtual asset definition, and service providers of these NFTs could meet the FATF definition of a VASP.”
4. “[P]latforms or other persons doing business transferring virtual assets during the buying or selling of NFTs may have U.S. AML/CFT obligations under FinCEN’s rules for money service businesses ....”
5. “NFTs can be used to conduct self-laundering, where criminals may purchase an NFT with illicit funds and proceed to transact with themselves to create records of sales on the blockchain.”
6. “The ability to transfer some NFTs via the internet without concern for geographic distance and across borders nearly instantaneously makes digital art susceptible to exploitation by those seeking to launder illicit proceeds of crime ....”

### Applying AML Regulations to NFTs

FinCEN has broadly defined what constitutes a CVC. In general, based on FinCEN guidance, it appears that whether an NFT qualifies as a CVC will turn on whether, if examined by FinCEN, the NFT would be deemed to be “value that substitutes for currency.” On one hand, the FATF Guidance seems to indicate that an NFT should not be considered “value that substitutes for currency.” On the other hand, the February 2022 study published by the U.S. Treasury Department indicates that depending on an NFT’s characteristics and how that NFT is used, it may fall within the definition of a CVC.

The question of whether NFTs meet FinCEN’s definition of CVCs is critical for NFT marketplaces and other business models that facilitate the minting, initial sale, and secondary trading of NFTs. These businesses should conduct a careful analysis of their specific activities and the specific NFTs they support to determine whether, if examined by FinCEN, they

22 *Id.* at § 6110(c).

23 See Staff of S. Perm. SubComm. Investigations, 116 Cong., Rep. on The Art Industry and U.S. Policies That Undermine Sanctions, available at <https://www.hsgac.senate.gov/imo/media/doc/2020-07-29%20PSI%20Staff%20Report%20-%20The%20Art%20Industry%20and%20U.S.%20Policies%20that%20Undermine%20Sanctions.pdf>.


24 See *id.* at 1.

25 See *id.* at 147.

26 See Cong. Research Serv., IF11776, Transnational Crime Issues: Arts and Antiquities Trafficking (Mar. 1, 2021), available at <https://crsreports.congress.gov/product/pdf/IF/IF11776>.

27 FinCEN, FIN-2021-NTC2: FinCEN Informs Financial Institutions of Efforts Related to Trade in Antiquities and Art, (Mar. 9, 2021), available at [https://www.fincen.gov/sites/default/files/2021-03/FinCEN%20Notice%20on%20Antiquities%20and%20Art\\_508C.pdf](https://www.fincen.gov/sites/default/files/2021-03/FinCEN%20Notice%20on%20Antiquities%20and%20Art_508C.pdf).

28 U.S. Dep’t. Treas., Study of the Facilitation of Money Laundering and Terror Finance Through the Trade in Works of Art (Feb. 2022), available at [https://home.treasury.gov/system/files/136/Treasury\\_Study\\_WoA.pdf](https://home.treasury.gov/system/files/136/Treasury_Study_WoA.pdf).



might be considered a CVC Administrator or Exchanger – and therefore an MSB. Among other things, NFT marketplaces and related businesses should specifically analyze whether their facilitation of CVC payments in NFT sales creates MSB obligations. Additionally, NFT marketplaces and related businesses should analyze whether the integral exemption or other exemptions are available to exempt their activities – or at least certain portions of their activities – from MSB obligations.

Unlike FinCEN regulations, which apply only to certain entities, OFAC regulations apply to all U.S. citizens and lawful permanent residents as well as to all entities organized or substantially operating under the laws of the U.S. Whether an NFT is a CVC is irrelevant under OFAC. The key issue is whether *any* transaction – regardless of currency or denomination – occurs with a sanctioned party. OFAC regulations apply to NFT transactions just like any commercial activity.

### Takeaways and Best Practices

The BSA Provisions are designed to help law enforcement and the U.S. government identify and deter financial crimes. NFTs share qualities of CVCs and certain high-value assets, such as art and gemstones, that already draw increased AML attention from regulators. Accordingly, while the BSA Provisions do not explicitly address NFTs, in certain circumstances they may be applied under existing guidance. From a practical perspective, the applicability of the BSA Provisions to the NFT market will likely be determined on a case-by-case, fact-specific basis. Additionally, given the goal of AML regulation and the characteristics of NFTs that overlap with those of CVCs and other high value assets, further AML regulations or guidance addressing NFTs may be forthcoming.

Violations of FinCEN and OFAC regulations carry both civil and criminal penalties. To avoid potential issues, the best practice is for those who mint, sell, trade, or custody NFTs to work under the assumption that the BSA Provisions may apply. In this regard, NFT market participants should:

#### 1. Work with Registered MSBs

Work with registered MSBs whenever possible. The best practice is to engage a registered MSB to handle all NFT transactions – especially the acceptance and transmission of cryptocurrency and the hosting of NFT-storing wallets. When working with MSBs, confirm that they have implemented an AML program that covers NFT transactions, including potential royalty payments that may be made on subsequent sales.

#### 2. Understand and Apply MSB Exemptions

The NFT market is multifaceted and constantly evolving. Invest time and effort into understanding the exemptions to the MSB definition and how those exemptions apply to the cryptocurrency space. Analyze NFT market activities and identify whether and where certain exemptions are available.

#### 3. Identify and Mitigate OFAC Risks

The NFT market is borderless, and blockchain transactions are pseudo-anonymous. This makes OFAC violations a higher risk than in traditional commercial markets. Mitigate this risk by ensuring policies, procedures, and technical controls are in place to prevent transactions with OFAC-sanctioned countries and persons on the OFAC SDN List.

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