

Posted on ACAMS|Moneylaundering.com May 31, 2013

Insights: Did FinCEN Just Burst Bitcoin's Bubble?

May 31, 2013

By Ross Delston, CAMS*

When FinCEN issued its innocuously entitled guidance, "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies" on March 18, an already speculative currency may have received its death blow.

It's not as if the U.S. dollar and the euro are no longer the reserve currencies of choice or that the euro is seriously threatened by the breakup of the currency zone. And there's not exactly a paucity of ways to pay for online purchases, from PayPal to prepaid cards, or credit and debit cards.

That leaves anonymity as the mark of distinction for Bitcoin, or as Bitcoiners have been heard to say, it can be used in the virtual world just as cash is used in the "real" world that we inhabit when we're not in front of a computer, tablet or smartphone.

So what did FinCEN do that was so damning for Bitcoin? It all comes down to FinCEN's definitions of "participants in generic virtual currency arrangements":

A *user* is a person that obtains virtual currency to purchase goods and services.

An *exchanger* is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency. 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.

So why do these definitions matter? Because according to the FinCEN guidance, anyone who acts as an exchanger or administrator is a money transmitter. Money transmitters are money services businesses (MSBs) and are subject to anti-money laundering (AML) rules, particularly the four pillars of an AML program: internal policies, procedures and controls; appointment of a compliance officer; training of appropriate staff; and a periodic independent review of the program and procedures.

MSBs also must file suspicious activity reports (SARs) and currency transaction reports (CTRs), and may be subject to an onsite examination by federal examiners, in this case, the IRS since they are responsible for MSB oversight. MSBs are also required to register with FinCEN and failure to do so can result in civil money penalties, criminal fines and imprisonment. And yes, money transmitters are also required to keep records of the identities of clients who send transactions over \$3,000.

So what does it all mean for the Bitcoin community?

- Exchangers and administrators operating in the U.S. must register as MSBs, adopt an AML program including procedures to file SARs and CTRs, and submit to inspections by the IRS, or they can expect civil enforcement actions and criminal prosecutions.

- Exchangers and administrators with accounts at U.S. banks can expect to be subjected to additional customer due diligence (CDD) by their bank. They are also likely to be subject to transaction monitoring based on a determination that they are high-risk customers and there is always the possibility the bank will decide not to do business with them at all.
- Exchangers and administrators that have accounts or operations with online payment systems that are themselves considered money transmitters face a similar outcome, although different rules apply to MSBs than to banks.
- Exchangers and administrators doing business outside of the United States will need to stay out of the country completely to avoid possible civil action or criminal prosecution (see, e.g., the recent U.S. Department of Homeland Security action against the accounts of Mt. Gox, a Japanese company and the leading Bitcoin exchange). They can also expect any Bitcoin transactions involving U.S. dollars to be heavily scrutinized, if not by their bank then by the U.S. bank that eventually clears the transaction, since all dollar transactions, no matter where in the world they are initiated, are eventually cleared by an American bank.
- Merchants accepting Bitcoin for goods and services should expect greater scrutiny from their banks or other financial intermediaries. Such merchants have, at a minimum, become high-risk and, in the worst case, toxic. The more that Bitcoin is associated with financial crime, the greater the risk for established financial institutions. And banks, as we all know, don't like this kind of risk. It's bad for business.

If nothing else, the Bitcoin phenomenon has that frothy feel of too much money chasing the next big thing, and we all know how such things end—not with a bang or a whimper but with the hissing sound of a burst balloon. Other speculative bubbles dating back to the tulip market in the early 17th century (considered the first such bubble) didn't result in the end of tulips, but they never again became an investment asset or a store of value. Fast forward 375 years to Bitcoin, the e-tulip of the 21st century, and the next phase could be similar, i.e., the use of Bitcoin for small online transactions, but nothing more.

So does the issuance of FinCEN's guidance mean the end of Bitcoin? I'm not a prognosticator of markets or a bettor, so let's just say possibly but not necessarily and leave it at that, at least for now.

*Ross Delston, CAMS, is a Washington, DC-based attorney, expert witness and former banking regulator at the FDIC. The views expressed here are those of the author and not necessarily of ACAMS moneylaundering.com or ACAMS, nor do they constitute legal, consulting or professional opinions or advice and should not be relied on by any person for such purposes.

ROSS S. DELSTON, CAMS
ATTORNEY + EXPERT WITNESS
WASHINGTON, DC
(202) 494-5835 (O)
(202) 280-1465 (F)
Ross@GlobalAML.com
ANTI-MONEY LAUNDERING COMPLIANCE
WITH A GLOBAL PERSPECTIVE
www.linkedin.com/in/rossdelston