Client Alert

October 29, 2014

FinCEN Rulings Designate Certain Virtual Currency Businesses as Money Transmitters

By Obrea Poindexter, Jeremy Mandell, and James Nguyen

On October 27, 2014, the Financial Crimes Enforcement Network ("FinCEN") issued two administrative rulings regarding virtual currency. The first administrative ruling concerns a proposed virtual currency trading and booking platform, and the second administrative ruling concerns a proposed virtual currency payment system. In both cases, FinCEN determined that the proposed activities would be considered money transmission and, thus, the companies involved (each, "company") would be viewed as money transmitters under the Bank Secrecy Act ("BSA").

VIRTUAL CURRENCY TRADING PLATFORM

The proposal considered in the first administrative ruling involves a virtual currency trading and booking platform ("Platform") that matches offers to buy and sell virtual currency for real currency. If a match is found between a buy and sell order, the Platform will use previously deposited customer funds held in a customer account to purchase the currency from the seller. If a match is not found, the customer may elect to withdraw funds from the customer account or keep them on deposit for future orders. Payments to or from customer accounts would be sent and received through the Automatic Clearinghouse ("ACH") system or by wire transfers from U.S. banks.

The company requesting the administrative ruling asserted that:

- The company should not be regulated as a money transmitter because the company would act in a manner similar to securities or commodities exchanges, and there is no money transmission between the company and any counterparty;
- If the company was determined to be a money transmitter under the proposal, the company asserts that certain exemptions to the definition of money transmitter should apply; and
- If one of the exemptions does not apply, the company should be viewed as a "user" of virtual currency, and not an "exchanger" or "administrator."

FinCEN was not persuaded by any of these arguments. While the company asserted that there would be no transmission when there is no match found, FinCEN determined that there is no "element of conditionality" in determining whether an activity constitutes money transmission. Moreover, FinCEN determined that, in connection with each trade conducted through the Platform, two money transmission transactions occur: one between the company and the buyer, and another between the company and the seller.

FinCEN also determined that the company is not eligible for the asserted exemptions from the definition of "money transmitter." Specifically, services offered via the Platform are not "integral to the … provision of other

services, other than money transmission services," because the transmission is the sole purpose of the company's Platform.[1] Moreover, the company is not a "payment processor" because, among other reasons, the company is not operating through a clearing or settlement system that admits only BSA-regulated financial institutions[2]—that is, while customer account funding may take place on other systems, the buy and sell transactions take place on the Platform itself.

Finally, FinCEN rejected the argument that the company should be considered a "user," rather than an "exchanger" or "administrator," and, therefore, not a money transmitter subject to BSA requirements. The company asserted that, because it does not have "its own reserve of virtual currency and dollars that it would buy and sell in order to fund exchanges with its users," it should be considered a "user." FinCEN concluded instead that "the method of funding the transactions is not relevant" to the determination of whether the company is acting as an exchange and a money transmitter.

VIRTUAL CURRENCY PAYMENT SYSTEM

The second administrative ruling considered a proposal in which a company would provide a virtual currency payment system ("System") that enables virtual currency payments to merchants in the United States and Latin America. The company would receive payment in real currency from the buyer or debtor (i.e., the customer) and transfer an equivalent value in virtual currency to the seller or creditor (i.e., the merchant), minus a transaction fee. Payments to the merchants would be funded from the company's inventory of virtual currency.

The company asserted that it should not be an exchanger because the System does not convert real currency into virtual currency. Instead, the company would hold large quantities of virtual currency that it would use to pay merchants. FinCEN was not persuaded by this argument and determined that "[t]he fact that the Company uses its cache of [virtual currency] to pay the merchant is not relevant to whether [the Company] fits within the definition of money transmitter." Instead, FinCEN concluded that, because the System would accept real currency from one party and convert it into virtual currency for transmission to another party, the company would be viewed as a money transmitter.

The company also asserts that it should be eligible for the "integral to the … provision of other services" exemption or the "payment processor" exemption from the definition of money transmitter. However, because the company is not operating through a clearing or settlement system that admits only BSA-regulated financial institutions and money transmission is the sole purpose of the System, FinCEN determined that the company would not be eligible for the exemptions.

TAKEAWAYS

FinCEN's administrative rulings do not appear to break new ground or signal any change in its application of the BSA requirements to entities engaged in a virtual currency business. Each of the proposed services contemplated the exchange of virtual currency for real currency and, thus, money transmission. However, other

[1] *See* 31 CFR § 1010.100(ff)(5)(ii)(F).

[2] *See* 31 C.F.R. § 1010.100(ff)(5)(ii)(B); *see also* FinCEN Ruling FIN-2013-R002 (clarifying that for the payment processor exemption to apply, the entity must use a clearance and settlement system that intermediates solely between BSA-regulated institutions).

activities in the virtual currency space—for example, software development, certain investment activities, etc.[3]—are not the focus of FinCEN's actions, because they do not constitute "acceptance and transmission" of value and are not money transmission under the BSA.

Contact:

Obrea Poindexter
(202) 887-8741
opoindexter@mofo.com

Jeremy R. Mandell
(202) 887-1505
jmandell@mofo.com

James C.H. Nguyen
(202) 778-1656
jamesnguyen@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for 11 straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.

[3] *See* FinCEN Ruling FIN-2014-R002 (Jan. 30, 2014), http://www.fincen.gov/news_room/rp/rulings/pdf/FIN-2014-R002.pdf.