

# Client Alert

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## “Firsts” for the World of Virtual Currencies

By **Obrea Poindexter, Jeremy Mandell, and James Nguyen**

There have been two recent virtual currency-related actions worthy of note: (1) the Financial Crimes Enforcement Network (“FinCEN”) announced its first civil enforcement action against a virtual currency exchanger, and (2) the New York Department of Financial Services (“NYDFS”) granted its first license to a Bitcoin exchange.

### FIRST VIRTUAL CURRENCY EXCHANGER ENFORCEMENT ACTION

On May 5, 2015, FinCEN announced an enforcement action against a virtual currency exchanger to settle alleged violations of the Bank Secrecy Act (“BSA”) and its implementing regulations. The virtual currency exchanger facilitates the sale and exchange of a particular virtual currency for fiat currency. A Statement of Facts and Violations issued concurrently alleges that the virtual currency exchanger previously engaged in these activities without registering as a money services business (“MSB”) and failed to comply with other BSA requirements. Under the terms of the settlement, the virtual currency exchanger agreed to pay a \$700,000 civil money penalty and take certain remedial actions. A settlement between the virtual currency exchanger and the U.S. Attorney’s Office was also announced to resolve criminal charges associated with the alleged BSA violations.

FinCEN alleges that the virtual currency exchanger facilitated transfers of virtual currency and provided virtual currency exchange transaction services without registering as an MSB from March 2013 through April 2013. During this time period, FinCEN alleged that the virtual currency exchanger “sold convertible virtual currency” in violation of the BSA. FinCEN also alleged that the virtual currency exchanger failed to comply with BSA requirements during this period because it:

- Failed to develop a written anti-money laundering (“AML”) program;
- Failed to report transactions at or above \$2,000 in value that it knew, suspected, or had reason to suspect were suspicious; and
- Engaged in a series of transactions in which the virtual currency exchanger either failed to file suspicious activity reports, or filed them in an untimely manner.

The enforcement action follows FinCEN’s March 2013 guidance, which clarified the application of the BSA and its implementing regulations to virtual currency businesses. Based on the March 2013 guidance, an “exchanger” or “administrator” of virtual currency is considered a money services business (“MSB”), and as such, must register with FinCEN, develop and implement an AML program, report suspicious transactions, implement know-your-customer procedures, and comply with the Funds Transfer Rule, which requires that an MSB obtain, verify, and keep certain information about individual transactions of \$3,000 or above.

It is important to note the virtual currency exchanger registered as an MSB on September 4, 2013, developed a written AML program on September 26, 2013, and hired an AML compliance officer in January 2014. However, the settlement agreement focused on violations that preceded these actions.

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## Settlement Terms

Under the terms of the settlement, the virtual currency exchanger agreed to pay a civil money penalty of \$700,000, \$450,000 of which was deemed to be partially satisfied upon payment to the U.S. Attorney's Office as part of a separate settlement of criminal charges. In addition, the virtual currency exchanger agreed to take remedial steps to ensure compliance with BSA requirements, as well as to implement "enhanced" remedial measures, including:

- Conducting a three-year "look-back" to require suspicious activity reporting for prior suspicious transactions;
- Retaining external independent auditors to review compliance with the BSA every two years until 2020; and
- Enhancing the protocol that the virtual currency exchanger uses by improving existing analytical tools applicable to the protocol, including the reporting of "any counterparty using" the protocol, the reporting of the "flow of funds within" the protocol, and the reporting of "the degree of separation."

FinCEN's action underscores the increasing focus of FinCEN and other law enforcement agencies on virtual currency and the access points to virtual currency systems, and could represent the first of a series of enforcement actions against exchangers or administrators aimed at ensuring compliance with the BSA.

## ITBIT LICENSING

The other notable "first" occurred on May 7, 2015, when the NYDFS granted a charter under the New York Banking Law to itBit Trust Company, LLC ("itBit"), a commercial Bitcoin exchange. Following the NYDFS approval, itBit becomes the first virtual currency company to receive a charter from NYDFS.

itBit had been operating in Singapore since November 2013, but now will be able to operate as a limited-purpose trust company under the New York Banking Law. itBit submitted its application following the NYDFS March 2014 order that initiated a process for accepting licensing applications from virtual currency exchanges under the New York Banking Law. According to its press release announcing the approval, the NYDFS "conducted a rigorous review of that application, including, but not limited to, the company's anti-money laundering, capitalization, consumer protection, and cyber security standards."

As a limited-purpose trust, itBit will have to meet, among other things, capital requirements and AML requirements. itBit will also be obligated to meet any additional obligations imposed under the final New York BitLicense regulation.<sup>1</sup> However, the requirements that apply to limited-purpose trust companies will likely be at least as stringent as those that apply to BitLicensees. The NYDFS expects to issue its final BitLicense regulation later this month.

We will continue to follow the efforts of the NYDFS and other state regulators as they relate to virtual currencies.

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<sup>1</sup> Additional information on the NYDFS proposed BitLicense regulation is available [here](#) and [here](#).

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