

New FinCEN Action Is A Warning To P2P Crypto Exchangers

By **Wade Thomson** and **E.K. McWilliams** (April 22, 2019, 4:44 PM EDT)

Late last week, the Financial Crimes Enforcement Network announced that it assessed a \$35,000 fine against Eric Powers of Kern County, California. The action against Powers marks the first time that FinCEN has assessed a civil penalty against a peer-to-peer exchanger of convertible virtual currency, and is also the first instance where FinCEN has penalized such an exchanger for failing to file currency transaction reports, or CTRs.

A P2P cryptocurrency “exchanger” is a person who buys and sells convertible virtual currency such as bitcoin, and typically markets services through classified ads, specifically designed web platform websites, online forums, other social media, and word of mouth. Cryptocurrency exchangers are subject to the Bank Secrecy Act’s anti-money laundering regulations because they are considered money transmitters and are treated as “financial institutions” under the BSA. In this way, cryptocurrency exchangers are distinct from “users” of virtual currency, who are not subject to the BSA’s AML requirements, because they do not obtain and use virtual currency to purchase goods or services solely for their own benefit.

The BSA requires cryptocurrency exchangers to register with FinCEN as a money services business, or MSB, and — as required of other financial institutions such as banks and casinos — to develop and maintain an effective written AML program.

Under the BSA’s implementing regulations, Powers was required to implement a written AML program that, at a minimum: (1) incorporates policies, procedures and internal controls reasonably designed to assure ongoing compliance; (2) designates an individual responsible to assure day-to-day compliance with the program and BSA requirements; (3) provides training for appropriate personnel, including training in the detection of suspicious transactions; and (4) provides for independent review to monitor and maintain an adequate program. Powers’ BSA obligations also included implementing know-your-customer programs to ensure buyers or sellers of virtual currency have a legitimate source of funds, identifying and reporting suspicious transactions, and filing CTRs on certain transactions.

Between Dec. 6, 2012, and Sept. 24, 2014, Powers advertised his intent to purchase and sell bitcoin on online forums, and ultimately purchased and sold millions of dollars of bitcoin in over 1,700 separate transactions. FinCEN fined Powers for violating the BSA’s registration, program and reporting requirements by failing to register as an MSB. FinCEN also penalized Powers for failing to have any



Wade Thomson



E.K. McWilliams

written AML compliance policies or procedures in place, failing to conduct know-your-customer due diligence, and failing to report suspicious transactions and currency transactions.

As background on the BSA's application to virtual currency exchangers, in 2011, FinCEN issued a final rule amending definitions and other BSA regulations relating to MSBs to provide that money transmission covers the acceptance and transmission of value that substitutes for currency. Virtual currency is such a substitute and is covered by that regulation.

In March 2013, FinCEN issued guidance further clarifying this point. The March 2013 guidance provides that the BSA's AML provisions apply to all transactions involving money transmission — including the acceptance and transmission of value that substitutes for currency, which includes virtual currency. FinCEN's March 2013 guidance clarifies that the BSA and FinCEN's implementing regulations cover both transactions where the parties are exchanging government issued and convertible virtual currency, but also to transactions from one virtual currency to another virtual currency.

FinCEN's action against Powers indicates that virtual currency exchanges of any size who fail to register as MSBs and implement AML policies and procedures do so at their peril, especially if such exchangers willfully fail to honor their registration and know-your-customer obligations under the BSA or fail to file CTRs or suspicious activity reports.

In fact, FinCEN Director Kenneth A. Blanco warned that the enforcement action against Powers is a warning that "[o]bligations under the BSA apply to money transmitters regardless of their size." Blanco emphasized that "[i]t should not come as a surprise that we will take enforcement action based on what we have publicly stated since our March 2013 Guidance — that exchangers of convertible virtual currency, such as Mr. Powers, are money transmitters and must register as MSBs."

FinCEN's press release on the action against Powers states that "there were indications that Mr. Powers specifically was aware of his BSA obligations, but willfully failed to honor them." For instance, FinCEN's civil assessment against Powers provides that he participated in online discussions pertaining to AML compliance, including specific conversations about registering as an MSB, and that such discussions demonstrated his awareness of the relevant BSA requirements. Nevertheless, Powers failed to register as an MSB with FinCEN. Similarly, in March 2013 Powers publicly stated on the Internet he would assist customers that wanted to circumvent AML obligations.

In addition, FinCEN's civil assessment against Powers provides that he conducted more than 200 transactions which involved the physical transfer of more than \$10,000 in currency but did not file a single CTR. Per FinCEN's BSA regulations, an MSB is required to file a CTR on each transaction conducted "by, through, or to" the MSB that involves the physical transfer of more than \$10,000 in currency. A CTR must be filed within 15 calendar days after the transaction occurs. Multiple transactions must be treated as a single transaction if the MSB has knowledge that the transactions are conducted by or on behalf of the same person and result in currency received or currency disbursed totaling more than \$10,000 during any one business day.

According to FinCEN, Powers conducted numerous transactions involving the physical transfer of more than \$10,000 in currency, yet failed to file a single CTR. For instance, Powers conducted approximately 160 purchases of bitcoin for approximately \$5 million through in-person cash transactions, conducted in public places such as coffee shops, with an individual identified through a bitcoin forum. Of these cash transactions, 150 were in-person and were conducted in separate instances for over \$10,000 during a single business day. Each of these 150 transactions necessitated the filing of a CTR.

FinCEN also found that Powers processed numerous transactions that bore strong indicia of illicit activity without conducting know-your-customer due diligence or filing a SAR. The BSA requires MSBs to file SARs on transactions that the MSB “knows, suspects, or has reason to suspect” are suspicious, if the transactions are conducted or attempted by, at, or through the MSB, and the transactions involve or aggregate to at least \$2,000 in funds or other assets. The BSA’s implementing regulations provide that a transaction is “suspicious” if the transaction: (1) involves funds derived from illegal activity; (2) is designed to evade reporting requirements; (3) has no business or apparent lawful purpose, and the MSB knows of no reasonable explanation for the transaction after examining the available facts, including background and possible purpose; or (4) involves use of the money services business to facilitate criminal activity.

In violation of the BSA, Powers processed over 100 suspicious transactions without ever filing a SAR, including with customers whose bitcoin wallet addresses showed that they had entered transactions in the darknet marketplace Silk Road, which was a widely known marketplace for narcotics and other illicit products and services.

Moreover, Powers conducted over 50 transactions with two customers who had email addresses that had been anonymized through The Onion Router, which directs internet traffic through a series of layers to conceal a user’s location and identity, and is often used to facilitate illicit transactions on the darknet. In its civil assessment against Powers, FinCEN stated that while use of TOR in and of itself is not suspicious, transactions through a torrent service are a red flag for potential illicit activity. Powers violated the BSA by failing to conduct any know-your-customer due diligence to determine the identities of the anonymous customers and to discern whether or not their funds were derived from illegal activity.

Federal law enforcement’s crackdown on individual cryptocurrency exchanges for money laundering violations should serve as a warning to new entrants to the cyptocurrency bonanza that the U.S. government is following up on its warnings to enforce the BSA across the new landscape, including for failing to register as an MSB and failing to conduct adequate know-your-customer. Indeed, the enforcement action against Powers may indicate that federal law enforcement is shifting toward more aggressive enforcement against P2P currency exchangers — particularly those who facilitate transactions supporting illicit activity — through the application of the BSA.

Wade A. Thomson is a partner and E.K. McWilliams is an associate at Jenner & Block LLP.

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