



Digital Currencies: FinCEN Shuts Down Foreign Exchange for Anti-Money Laundering Violations – Another Mt. Gox?

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On July 27, 2017, the Financial Crimes Enforcement Network for the Department of Treasury (FinCEN) seized the website of the digital currency exchange BTC-e for allegedly operating a multi-billion dollar money laundering scheme since 2011. In conjunction, the Department of Justice brought an indictment against BTC-e's founder and lead operator, Alexander Vinnik. This seizure is arguably the most significant blow to consumer confidence in the digital currency market since the 2014 bankruptcy filing by Mt. Gox, which was then the world's largest Bitcoin exchange. In the void left by Mt. Gox, BTC-e became one of the largest exchanges for Bitcoin, as well as other digital currencies. Last week, an unverified spokesperson using a Bitcoin forum account long-known to be associated with BTC-e reported that the exchange has regained access to its servers and currently controls approximately 55% of customer wallets and deposits. The same account also reported that BTC-e was in the process of going through a rebranding with the help of investors and would be issuing temporary "BTE" digital tokens to partially compensate customers for lost fiat currencies. But, even if this report is accurate, it may be too little, too late to re-establish consumer confidence in the exchange service.

In its July 27, 2017 assessment, FinCEN found that "(a) BTC-e and Alexander Vinnik willfully violated money services business (MSB) registration requirements; (b) BTC-e willfully violated the requirement to implement an effective anti-money laundering (AML) program, the requirement to detect suspicious transactions and file suspicious activity reports (SARs), and the requirement to obtain and retain records relating to transmittals of funds in amounts of \$3,000 or more; and (c) Alexander Vinnik willfully participated in violations of AML program and SAR requirements."¹ As a result, FinCEN shut down the BTC-e website and issued civil monetary penalties of \$110,003,314 against BTC-e and \$12,000,000 against Vinnik. FinCEN's investigation² into BTC-e has been seen by some in the digital currency industry as a needed intervention³, while others in this space have raised concerns that the investigation has caused uncertainty in both legitimate user access to currencies and liquidity in digital currency markets. Whether the investigation was called for or not, with this event and the recent splitting of Bitcoin [Prior QuickStudy Cite], public opinion in digital currencies is potentially at its most volatile since the Mt. Gox bankruptcy filing.⁴

FinCEN reiterated its position that it considers "exchangers of convertible virtual currency"⁵ as potential "money transmitters"⁶ and also as "financial institutions"⁷, and therefore they are money services businesses (MSBs) subject to regulation by FinCEN pursuant to the Bank Secrecy Act.⁸ From FinCEN's perspective, the definition of a "money transmitter" does not differentiate between real currencies and "convertible virtual currencies", and, therefore, any exchange that "(1) accepts and transmits a convertible virtual currency or (2) buys and sells convertible currency for any reason is a money

¹BTC-E a/k/a Canton Business Corporation, 2017-03, *3 (FinCEN) (July 26, 2017)

²The criminal investigation of BTC-e and Alexander Vinnik was conducted by the Internal Revenue Service-Criminal Investigation Division, Federal Bureau of Investigation, United States Secret Service, and Homeland Security Investigations.

³Investors have been particularly supportive, with Bitcoin hitting new price records over the weekend.

⁴Unlike BTC-e, Mt. Gox's suspension of trading and ultimate bankruptcy was largely a result of the exchange's failure to meet customer withdrawal demands allegedly due to significant deposit losses incurred from cyber-thefts of a massive amount of Bitcoins.

⁵An "exchanger" is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency. FIN-2013-G001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, *2, March 18, 2013.

⁶As defined by 31 C.F.R. § 1010.100(ff)(5).

⁷As defined by 31 C.F.R. § 1010.100 (t).

⁸See Treasury Order 180-01 (March 24, 2003); *Bank Secrecy Act Regulations – Definitions and Other Regulations Relating to Money Services Businesses*, 76 FR 43585 (July 21, 2011); FIN-2013-G001.



transmitter under FinCEN's regulations, unless a limitation to or exemption from the definition applies."⁹ Consequently, such exchanges are subject to MSB registration, reporting, and recordkeeping requirements.¹⁰ FinCEN determined that BTC-e was a "exchanger of convertible virtual currencies", because it purchased and sold fiat and digital currencies, along with offering to send and receive fiat currencies for users. FinCEN further concluded that BTC-e met the definition of a "money transmitter" and accordingly was subject to FinCEN regulation.

Furthermore, even though BTC-e is a foreign-located business, FinCEN noted that BTC-e (i) has customers in the United States, who have conducted Bitcoin transactions worth over \$296,000,000, (ii) transfers funds between US customers, and (iii) processes transactions through servers located in the US. Therefore, BTC-e qualified as an MSB and was required to register with, report to, and keep adequate records for FinCEN – which the exchange did not do previously.

FinCEN also identified other deficiencies of BTC-e in its security protocols. BTC-e failed to implement and execute a written AML program that at a minimum: "(a) incorporates policies, procedures and internal controls reasonably designed to assure ongoing compliance; (b) designates an individual responsible to assure day to day compliance with the program and BSA requirements; (c) provides training for appropriate personnel, including training in the detection of suspicious transactions; and (d) provides for independent review to monitor and maintain an adequate program."¹¹ FinCEN found that BTC-e lacked even basic level internal controls, as it allowed customers to conduct transactions in virtual incognito, using only a username, password, and email without having to provide any personal identifying information. BTC-e also did not conduct any due diligence or monitoring of money laundering or other illicit activity and failed to file any suspicious activity reports. As a result, according to FinCEN, "the virtual currency exchange attracted and maintained a customer base that consisted largely of criminals who desired to conceal proceeds from crimes such as ransomware, fraud, identity theft, tax refund fraud schemes, public corruptions, and drug trafficking."¹² Interestingly, BTC-e even had a direct connection to the Mt. Gox bankruptcy, as FinCEN revealed that BTC-e was used extensively by bad actors seeking to launder Bitcoin stolen during the Mt. Gox hack that pushed the now-defunct exchange into insolvency.

With its investigation of BTC-e, FinCEN signaled that it intends to prosecute unregistered exchanges both inside and outside of the country, so long as there are sufficient contacts with the United States. As to BTC-e specifically, it is not yet clear whether FinCEN will wrap up its pursuit of that exchange or continue until all digital currencies held by BTC-e are frozen. At minimum, BTC-e users can expect a long delay before reacquiring full access to their assets.

Related Links:

<https://www.fincen.gov/news/news-releases/fincen-fines-btc-e-virtual-currency-exchange-110-million-facilitating-ransomware>

https://www.fincen.gov/sites/default/files/enforcement_action/2017-07-26/Assessment%20for%20BTCeVinnik%20FINAL%20SignDate%2007.26.17.pdf

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors.

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⁹FIN-2013-G001 at 3.

¹⁰See id. at 2.

¹¹BTC-E a/k/a Canton Business Corporation, 2017-03, *4. Id.

¹²Id.



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