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Request for Administrative Ruling on the Application of FinCEN's Regulations to a Virtual Currency Trading Platform

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FIN-2014-R011
Request for Administrative Ruling on the Application of FinCEN's Regulations to a Virtual Currency Trading Platform
Issued Date: October 27, 2014

Dear []:

This responds to your letter of December 3, 2013, seeking an administrative ruling from the Financial Crimes Enforcement Network ("FinCEN") on behalf of [] (the "Company"), about the Company's possible status as a money services business ("MSB") under the Bank Secrecy Act ("BSA"). Specifically, you ask whether the convertible virtual currency trading and booking platform that the Company intends to set up (the "Platform") would make the Company a money transmitter under the BSA. Based on the following analysis of the description of the Platform as presented in your letter, FinCEN finds that the Company would be a money transmitter pursuant to our regulations.

You state in your letter that the Company wishes to set up a Platform that consists of a trading system (the "System") to match offers to buy and sell convertible virtual currency for currency of legal tender ("real currency"), and a set of book accounts in which prospective buyers or sellers of one type of currency or the other ("Customers") can deposit funds to cover their exchanges. The Company will maintain separate accounts in U.S. dollars and a virtual wallet, both segregated from the Company's operational accounts and protected from seizure by the Company's creditors (the "Funding Accounts"), in which Customers will deposit their U.S. dollars or convertible virtual currency to fund the exchanges. The Company will maintain the funding received from each Customer in its separate book entry account (the "Customer Account").

Once the exchange is funded, the Customer will submit an order to the Company to purchase or sell the currency deposited at a given price. The Platform will automatically attempt to match each purchase order of one currency to one or more sell orders of the same currency. If a match is found, the Company will purchase from the Customer acting as seller and sell to the Customer acting as buyer, without identifying one to the other. If a match is not found, the Customer may elect to withdraw the funds or keep them in its Customer Account to fund future orders.

According to your letter, the Company will not allow inter-account transfers, third-party funding of a Customer Account, or payments from one Customer Account to a third party. Payments to or from the Customer are sent or received by credit transmittals of funds through the Automatic Clearinghouse (ACH) system or wire transfers from U.S. banks. In addition, you note that the Platform will not allow any Customer to know the identity of another Customer, and Customers must conduct transactions exclusively through their formal agreements with the Company.

In your letter, you state that the Company is already registered with FinCEN as a money transmitter and a dealer in foreign exchange. However, you assert that the Company should not be regulated as a money transmitter for the following reasons:

- The Company acts in a similar manner to securities or commodities exchanges, and there is no money transmission between the Company and any counterparty.
- If FinCEN were to find that the Company is engaged in money transmission, then such activity would be integral to the Company's business or eligible for the payment processor exemption.
- Lastly, should FinCEN find that the above exemptions do not apply, the Company fits the definition of "user" rather than "exchanger" or "administrator" pursuant to FinCEN's guidance.¹

This letter first will address the application of the definition of money transmission and its exemptions to the Company's activities, and then address whether the Company should be considered a user rather than an exchanger or administrator of virtual currency.

FinCEN's definition of money transmission and existing exemptions

In your letter, you reference language from FinCEN's definition of money transmitter that existed prior to FinCEN's 2011 amendments to the MSB definition. On July 21, 2011, FinCEN published a Final Rule amending definitions and other regulations relating to MSBs (the "Rule").² The amended regulations define an MSB as "a person wherever located doing business, whether or not on a regular basis or as an organized or licensed business concern, wholly or in substantial part within the United States, in one or more of the capacities listed in paragraphs (ff)(i) through (ff)(7) of this section. This includes but is not limited to maintenance of any agent, agency, branch, or office within the United States."³

The Rule defines the term "money transmitter" to include a person that provides money transmission services, or any other person engaged in the transfer of funds. The term "money transmission services" means the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.⁴ The regulations also stipulate that whether a person is a money transmitter is a matter of facts and circumstances, and identifies circumstances under which a person's activities would not make such person a money transmitter.⁵

You argue that the Platform renders exchanges anonymous among Customers in the same way open exchanges for publicly traded equities keep the identity of each member's counterparty confidential. At this time, your analogy to the securities and futures industries and their traditional methods for buying and selling securities and commodities is not relevant for analysis of the Company's obligations under the BSA. FinCEN's guidance issued on a product or service under one set of specific facts and circumstances should only be relied upon when applied to another product or service that shares the same specific facts and circumstances.

As explained in the Guidance, a person is an exchanger and a money transmitter if the person accepts convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency.⁶ We disagree with your contention that there is no money transmission when the instructions of the Customers are issued subject to the condition of finding an offsetting match. The regulatory definition of money transmission does not contain any element of conditionality before it applies. A person that accepts currency, funds, or any value that substitutes for currency, with the intent and/or effect of transmitting currency, funds, or any value that substitutes for currency to another person or location if a certain predetermined condition established by the transmitter is met, is a money transmitter under FinCEN's regulations. The fact that such a transmission sometimes may not occur in your business model if no match is found does not remove the Company from the scope of the regulations for those transactions that do occur.

You state that if money transmission occurs at all, it occurs between the Customer that sells and the Customer that purchases virtual currency. Your letter clearly describes the Company's Platform as consisting of two parts: an electronic matching book for offers of buying and selling virtual currency and a set of book accounts that pre-fund the transactions ordered by Customers that want to exchange virtual currency for real currency (and, on the other hand, by Customers that want to exchange real currency for virtual currency). You state that a key feature of the Platform is that Customers are never identified to each other, even after the buyer and the seller are matched. The fact that Customers are never identified to each other does not affect FinCEN's analysis of the transactions. FinCEN finds that in each trade conducted through the Platform, two money transmission transactions occur: one between the Company and the Customer wishing to buy virtual currency, and another between the Company and the Customer wishing to sell such virtual currency at the same exchange rate.

With regard to whether the money transmission is integral to the provision of the Company's service, and thus potentially eligible for exemption, FinCEN has concluded that the money transmission that takes place within the System does not qualify for the exemption. There are three fundamental conditions that must be met for the exemption to apply:

- The money transmission component must be part of the provision of goods or services distinct from money transmission itself.
- The exemption can only be claimed by the person that is engaged in the provision of goods or services distinct from money transmission.
- The money transmission component must be integral (that is, necessary) for the provision of the goods or services.

In FinCEN's view, the payment service that the Company intends to offer meets the definition of money transmission. The Company is facilitating the transfer of value, both real and virtual, between third parties. Such money transmission is the sole purpose of the Company's System, and is not a necessary part of another, non-money transmission service being provided by the Company. Although rendered before the 2011 modifications to MSB definitions and in some cases involving a different type of MSB, FinCEN reached the same conclusion in several administrative rulings that apply to this particular point.⁷

As you noted in your letter, FinCEN stipulates four conditions for the payment processor exemption to apply to a particular business pattern:⁸

- the entity providing the service must facilitate the purchase of goods or services, or the payment of bills for goods or services (other than money transmission itself);
- the entity must operate through clearance and settlement systems that admit only BSA-regulated financial institutions;
- the entity must provide the service pursuant to a formal agreement; and
- the entity's agreement must be at a minimum with the seller or creditor that provided the goods or services and receives the funds.

Despite your assertion that this exemption would apply to the Platform, the Company fails to meet two of the conditions for the exemption. Specifically, the Customer is not receiving payment as a seller or creditor from a buyer or debtor for the provision of non-money transmission related goods or services (FinCEN does not consider providing virtual currency for real currency or vice versa as a non-money transmission related service), and the Company is not operating through a clearing and settlement system that only admits BSA-regulated financial institutions as members. Although, according to your letter, payments to or from the Customer Accounts may take place in part using a clearing and settlement system such as EPN, FedACH, or FedWire, the Platform itself is not a clearance and settlement system that admits only BSA-regulated financial institutions, and the payments of convertible virtual currency to and from the Customers, by definition, take place outside such a clearance and settlement system.

For the above reasons, FinCEN has determined that the Company is engaged in money transmission, and such activity is not covered by either the integral exemption or the payment processor exemption.

FinCEN's Virtual Currency Guidance

On March 18, 2013, FinCEN issued guidance on the application of FinCEN's regulations to transactions in virtual currencies (the "Guidance").⁹ FinCEN's regulations define currency as "the coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance."¹⁰ In contrast to real currency, "virtual" currency is a medium of exchange that operates like a currency in some environments, but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction. The Guidance addresses "convertible" virtual currency. This type of virtual currency either has an equivalent value in real currency, or acts as a substitute for real currency.

For purposes of the Guidance, FinCEN refers to the participants in generic virtual currency arrangements, using the terms "exchanger," "administrator," and "user." 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. A *user* is a person that obtains virtual currency to purchase goods or services on the user's own behalf.

The Guidance makes clear that an administrator or exchanger of convertible virtual currencies that accepts and transmits a convertible virtual currency, or buys or sells convertible virtual currency in exchange for currency of legal tender or another convertible virtual currency for any reason is a money transmitter under FinCEN's regulations, unless a limitation to or exemption from the definition applies to the person.¹¹ The guidance also makes clear that "a user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not an MSB under FinCEN's regulations."

How a user engages in obtaining a virtual currency may be described using any number of other terms, such as "earning," "harvesting," "mining," "creating," "auto-generating," "manufacturing," or "purchasing," depending on the details of the specific virtual currency model involved. The label applied to a particular process of obtaining virtual currency is not material to its characterization under the BSA. Whether a person is deemed to be an MSB depends on how that person uses the convertible virtual currency, and for whose benefit. The mechanism by which the virtual currency is obtained is not material in determining MSB status.

FinCEN does not accept the Company's argument that it should be considered a user and not an exchanger, because "a true virtual currency exchange would have its own reserve of virtual currency and dollars that it would buy and sell in order to fund exchanges with its users." As explained in the Guidance and indicated above, a person is an exchanger and a money transmitter if the person accepts convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency. The method of funding the transactions is not relevant to the definition of money transmitter. An exchanger will be subject to the same obligations under FinCEN regulations regardless of whether the exchanger acts as a broker (attempting to match two (mostly) simultaneous and offsetting transactions involving the acceptance of one type of currency and the transmission of another) or as a dealer (transacting from its own reserve in either convertible virtual currency or real currency). Therefore, FinCEN finds that the Company is acting as an exchanger of convertible virtual currency, as that term was described in the Guidance.

When engaging in convertible virtual currency transactions as an exchanger, a person must register with FinCEN as a money transmitter, assess the money laundering risk involved in its non-exempt transactions, and implement an anti-money laundering program to mitigate such risk. In addition, the Company must comply with the recordkeeping, reporting, and transaction monitoring requirements under FinCEN regulations. Examples of such requirements include the filing of Currency Transaction Reports (31 CFR § 1022.310) and Suspicious Activity Reports (31 CFR § 1022.320), whenever applicable, general recordkeeping maintenance (31 CFR § 1010.410), and recordkeeping related to the sale of negotiable instruments (31 CFR § 1010.415). Furthermore, to the extent that any of the Company's transactions constitute a "transmittal of funds" (31 CFR § 1010.100(d)(ddd)) under FinCEN's regulations, then the Company must also comply with the "Funds Transfer Rule" (31 CFR § 1010.410(e)) and the "Funds Travel Rule" (31 CFR § 1010.410(ff)).¹²

This ruling is provided in accordance with the procedures set forth at 31 CFR Part 1010 Subpart G. In arriving at the conclusions in this administrative ruling, we have relied upon the accuracy and completeness of the representations you made in your communications with us. Nothing precludes FinCEN from arriving at a different conclusion or from taking other action should circumstances change or should any of the information you have provided prove inaccurate or incomplete. We reserve the right, after redacting your name and address, and similar identifying information for your clients, to publish this letter as guidance to financial institutions in accordance with our regulations.¹³ You have fourteen days from the date of this letter to identify any other information you believe should be redacted and the legal basis for redaction.

If you have questions about this ruling, please contact FinCEN's regulatory helpline at (703) 905-3591.

Sincerely,
/signed/
Jamal El-Hindi
Associate Director
Policy Division

1 FIN-2013-G001, "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies," March 18, 2013 (the "Guidance").

2 Bank Secrecy Act Regulations - Definitions and Other Regulations Relating to Money Services Businesses, 76 FR 43585 (July 21, 2011).

3 31 CFR § 1010.100(ff).

4 31 CFR § 1010.100(ff)(5)(i)(A).

5 31 CFR § 1010.100(ff)(5)(ii).

6 See FIN-2013-G001.

7 See FIN-2008-R007 ("Whether a Certain Operation Protecting On-line Personal Financial Information is a Money Transmitter"-06/11/2008); FIN-2008-R004 ("Whether a Foreign Exchange Consultant is a Currency Dealer or Exchanger or Money Transmitter"-05/09/2008); FIN-2008-R003 ("Whether a Person That is Engaged in the Business of Foreign Exchange Risk Management is a Currency Dealer or Exchanger or Money Transmitter"-05/09/2008); FIN-2008-R002 ("Whether a Foreign Exchange Dealer is a Currency Dealer or Exchanger or Money Transmitter"-05/09/2008).

8 FIN-2013-R002 ("Whether a Company that Offers a Payment Mechanism Based on Payable-Through Drafts to its Commercial Customers is a Money Transmitter"-11/13/2013).

9 See footnote 1.

10 31 CFR § 1010.100(m).

11 The definition of "money transmitter" in FinCEN's regulations defines six sets of circumstances - variously referred to as limitations or exemptions - under which a person is not a money transmitter, despite accepting and transmitting currency, funds, or value that substitutes for currency. 31 CFR § 1010.100(ff)(5)(i)(A)-(F).

12 For example, the definition of transmittal of funds involves unconditional transmittal orders. Please note that FinCEN does not consider some predetermined conditions (such as "at market") to exempt a series of transactions involving the acceptance and transmission of currency, funds, or value that substitutes for currency from a transmitter to a recipient from the definition of transmittal of funds and its related recordkeeping requirements.

13 31 CFR §§ 1010.711-717.

Accessibility

Financial Institutions:

Money Services Businesses

