VIRTUAL CURRENCY: An Overview of FinCEN’s Regulatory Guidance and Current Issues

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Overview

- **Summary of the Financial Crimes Enforcement Network’s (“FinCEN”) Virtual Currency Guidance**
  - Background
  - The Three Roles in Virtual Currency Arrangements
  - Three Categories of Virtual Currencies

- **Current Issues**
  - Virtual Currency Guidance and the Prepaid Access Rule
  - Virtual Currency Guidance and State Money Transmitter Statutes
FinCEN’s Virtual Currency Guidance

Background

- Issued on March 18, 2013

- Under the Bank Secrecy Act (“BSA”), “currency” is defined as “the coin and paper money of the United States or of any other country that (i) is designated as legal tender and that (ii) circulates and (iii) is customarily used and accepted as a medium of exchange in the country of issuance.”

- The FinCEN Guidance defines “virtual currency” as “a medium of exchange that operates like a currency in some environments but does not have legal tender status in any jurisdiction.”
  
  - “Convertible virtual currency” is virtual currency that has an equivalent value in real currency, or acts as a substitute for real currency.

- The Guidance explains the regulatory treatment of persons engaged in virtual currency transactions under the definitions of dealers in foreign exchange and money transmitters under the BSA.
FinCEN’s Virtual Currency Guidance

The Three Roles in Virtual Currency Arrangements

1. “User” is a person that obtains virtual currency to purchase goods or services.
   - A user is NOT an MSB under the FinCEN regulations because such activity, in and of itself, does not fit within the definition of money transmission.

2. “Exchanger” is a person engaged as a business in the exchange of virtual currency for real currency, funds, or other virtual currency.

3. “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.
FinCEN’s Virtual Currency Guidance

- An Administrator or Exchanger that:
  1. Accepts and transmits a convertible virtual currency; or
  2. Buys or sells 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.

- “Accepting and transmitting anything of value that substitutes for currency makes a person a money transmitter under the regulations implementing the BSA.”

- FinCEN Guidance does NOT apply to:
  - Virtual currency that does not have either an equivalent value in real currency, or acts as a substitute for real currency (i.e., is not convertible virtual currency).
  - “Users” of virtual currency.
FinCEN’s Virtual Currency Guidance

Three Categories of Virtual Currencies

1. E-Currencies and E-Precious Metals:

   If a broker or dealer transfers funds between a customer and a third party that is not part of the currency or commodity transaction, such transmission is money transmission.

   - Examples:
     - The transfer of funds between a customer and a third party by permitting a third party to fund a customer’s account;
     - The transfer of value from a customer’s currency or commodity position to the account of another customer;
     - The closing out of a customer’s currency or commodity position with a transfer of proceeds to a third party.
FinCEN’s Virtual Currency Guidance

Three Categories of Virtual Currencies

2. Centralized Virtual Currencies: Convertible virtual currency that has a centralized repository.

   - The Administrator of the central repository will be a money transmitter to the extent that it allows transfers of value between (a) persons or (b) locations, regardless of whether the value is denominated in real currency or convertible virtual currency.

   - An Exchanger that uses its access to the convertible virtual currency services provided by the Administrator to accept and transmit the convertible virtual currency on behalf of others, including transfers intended to pay a third party for virtual goods or services, is also a money transmitter.

   - Examples:
     - A seller of virtual currency that accepts real currency or its equivalent from a purchaser and transmits the value of that real currency to fund the purchaser’s convertible virtual currency account with the Administrator.
     - An exchanger accepts currency or its equivalent from a user and privately credits the user with the appropriate portion of the exchanger’s own convertible virtual currency held with the Administrator of the repository, then transmits the internally credit value to a third party at the user’s direction.
Three Categories of Virtual Currencies

3. De-Centralized Virtual Currencies: Virtual currency that:
   - Has no central repository and no single Administrator
   - Persons may obtain by their own computing or manufacturing effort.
   - Examples:
     - A person that creates units of convertible virtual currency and sells those units to another person for real currency or its equivalent is a money transmitter.
     - A person that accepts de-centralized 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 is a money transmitter.
     - A person that creates units of convertible virtual currency and uses it to purchase real or virtual goods and services is a user of convertible virtual currency and not subject to regulation as a money transmitter.
Current Issues

Virtual Currency Guidance and the Prepaid Access Rule

- “A person’s acceptance and/or transmission of convertible virtual currency cannot be characterized as providing or selling prepaid access because prepaid access is limited to real currencies.”

- “Prepaid Access” under FinCEN’s regulations is limited to access of funds or value of funds.

- “If FinCEN had intended prepaid access to cover funds denominated in a virtual currency or something else that substitutes for real currency, it would have used language in the definition of prepaid access like that in the definition of money transmission, which expressly includes the acceptance and transmission of “other value that substitutes for currency.”
Current Issues

Virtual Currency Guidance and State Money Transmission Statutes

- State money transmission laws do not generally define “virtual currency.”
- Many state money transmission statutes include “prepaid access”
  - Example: Texas money transmission statute defines “stored value” as “monetary value evidenced by an electronic record that is prefunded and for which value is reduced on each use. The term includes prepaid access as defined [under FinCEN regulations]. The term does not include an electronic record that is:
    - Loaded with points, miles, or other non-monetary value;
    - Not sold to the public but distributed as a reward or charitable donation; or
    - Redeemable only for goods or services from a specified merchant or set of affiliate merchants such as: (i) a specified retailer or retail chain; (ii) a set of affiliated companies under common ownership; (iii) a college campus; or (iv) a mass transportation system.”
Current Issues

Virtual Currency Guidance and State Money Transmission Statutes

- Recent state regulatory and enforcement actions relating to virtual currencies:
  - **California**: Issued a cease and desist letter to the Bitcoin Foundation in May 2013 regarding potential unlicensed money transmission under California law
  - **New York**: Issued *Notice of Inquiry on Virtual Currencies* in August 2013, stating that, at a minimum, virtual currency exchangers may be engaged in money transmission requiring a license from the DFS
    - Also indicated that the DFS is considering whether it should issue new regulatory guidelines specific to virtual currencies
    - Subpoenas issued to several companies offering Bitcoin related payments or exchange services
  - **Virginia**: issued letter to Bitcoin exchanger in June 2013 indicating that the company may be issuing Bitcoins which the Bureau believed may constitute “stored value” requiring a money transmitter license in Virginia.
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