

December 29, 2020

FinCEN Proposes New Requirements for Reporting and Recordkeeping on Certain Transactions Involving Convertible Virtual Currency and Digital Asset Transactions

On December 18, 2020, the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued a notice of proposed rulemaking that would require financial institutions, including money services businesses (MSBs), "to submit reports, keep records, and verify the identity of customers" related to certain transactions involving convertible virtual currency (CVC) or digital assets with legal tender status (which are called "legal tender digital assets" or LTDA).¹ Under the proposed rule, financial institutions would be required to submit reports, keep records, and verify the identity of customers for transactions above certain monetary thresholds involving CVC/LTDA wallets not hosted by a financial institution (known as "unhosted wallets") or CVC/LTDA wallets hosted by a financial institution in certain jurisdictions identified by FinCEN.

Instead of the normal 60-day period for public comment, FinCEN is providing an abridged 15-day period that closes on January 4, citing "significant national security imperatives that necessitate an efficient process for proposal and implementation of this rule."² Some market participants, including digital currency exchange Coinbase, are seeking to extend the comment period to 60 days. In a letter sent to FinCEN Director Kenneth Blanco, Coinbase's Chief Legal Officer, Paul Grewal, formally requested the extension, noting the 15-day period occurring during holidays leaves "just a handful of days for comments."³ As of the date of the publication of this memorandum, there has been no extension of the comment period.

Key Takeaways:

- If adopted, the proposed rule will impose new, and potentially significant burdens on financial institutions involved in digital asset transactions. Financial institutions that operate in the digital asset space may want to consider assessing their level of exposure to determine how and whether their current reporting and recordkeeping systems would need to change to meet the requirements.
- Since first issuing guidance on CVCs in 2013,⁴ and more recently in 2019,⁵ FinCEN has recognized the risks of illegal activity involving digital assets. Given the continued growth and acceptance of digital assets, we expect to see further guidance and regulations by FinCEN and other federal agencies in 2021 and beyond.
- This proposed rule comes a month after another proposed rule by FinCEN and the Board of Governors of the Federal Reserve System which would amend the Bank Secrecy Act to clarify that it applies to

transactions in CVC or LTDA, and to lower the monetary threshold that triggers the rules for certain transactions.⁶

The Proposed Extension of the BSA's Reporting and Recordkeeping Requirements

The proposed rule would extend existing Bank Secrecy Act ("BSA") reporting requirements on financial institutions to include CVC and LTDA transactions exceeding \$10,000 in value, as well as extending existing BSA recordkeeping requirements to include CVC transactions greater than \$3,000 when a counterparty uses an unhosted or otherwise covered wallet.⁷ The proposed rule defines "otherwise covered" wallets as those held at a financial institution that is not subject to the BSA and is located in a foreign jurisdiction identified by FinCEN as a jurisdiction of primary money laundering concern, including Burma, Iran, and North Korea.⁸

Pursuant to the proposed rule, financial institutions will have 15 days from the date on which a reportable transaction occurs to file a report with FinCEN.⁹ Information to be collected includes:

- The name and address of the financial institution's customer;
- The type of CVC or LTDA used in the transaction;
- The amount of CVC or LTDA in the transaction;
- The time of the transaction;
- The assessed value of the transaction, in U.S. Dollars, based on the prevailing exchange rate at the time of the transaction;
- Any payment instructions received from the financial institution's customer;
- The name and physical address of each counterparty to the transaction of the financial institution's customer;
- Any other information that uniquely identifies the transaction, the accounts, and, to the extent reasonably available, the parties involved; and
- Any form relating to the transaction that is completed or signed by the financial institution's customer.¹⁰

The proposed rule would establish a "reasonable basis" standard on financial institutions in assessing whether the counterparty has an account/wallet hosted by a BSA-regulated institution or covered foreign financial institution.¹¹ For example, it indicates that the financial institution should check FinCEN for the registration of a counterparty that purports to be a regulated MSB and for foreign financial institutions, and

“would need to apply reasonable, risk-based, documented procedures to confirm that the foreign financial institution is complying with registration or similar requirements that apply to financial institutions in the foreign jurisdiction.”¹²

Further, the proposed rule would impose an aggregation requirement if the financial institution has knowledge that a transaction is one of multiple CVC/LTDA transactions involving a single person within a 24-hour period that aggregate to value in or value out of greater than \$10,000.¹³

Written comments on the proposed rule must be submitted no later than January 4, 2021.

We will continue to monitor these efforts to regulate the digital asset space, and the enforcement actions that are likely to follow based on existing and newly developed laws and regulations.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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¹ FinCEN, *Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets* (Dec. 18, 2020), <https://public-inspection.federalregister.gov/2020-28437.pdf>.

² *Id.*

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- ³ Coinbase, *Coinbase's Response to Recent Proposed Rulemaking from the U.S. Treasury and FinCEN* (Dec. 21, 2020), <https://blog.coinbase.com/coinbases-response-to-recent-proposed-rulemaking-from-the-u-s-treasury-and-fincen-109dd7477d31>.
- ⁴ FinCEN, *Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies* (May 9, 2019), <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>.
- ⁵ Paul, Weiss Client Alert, *Federal Agencies Issue Joint Statement on AML/CFT Obligations, and IRS Updates Guidance, for Digital Assets* (Oct. 15, 2019), https://www.paulweiss.com/practices/litigation/economic-sanctions-aml/publications/federal-agencies-issue-joint-statement-on-amlcft-obligations-and-irs-updates-guidance-for-digital-assets?id=30069#_ednref6.
- ⁶ Federal Register, *Threshold for the Requirement To Collect, Retain, and Transmit Information on Funds Transfers and Transmittals of Funds That Begin or End Outside the United States, and Clarification of the Requirement To Collect, Retain, and Transmit Information on Transactions Involving Convertible Virtual Currencies and Digital Assets With Legal Tender Status* (Oct. 27, 2020), <https://www.federalregister.gov/documents/2020/10/27/2020-23756/threshold-for-the-requirement-to-collect-retain-and-transmit-information-on-funds-transfers-and#footnote-8-p68007>.
- ⁷ FinCEN, *Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets* (Dec. 18, 2020), <https://public-inspection.federalregister.gov/2020-28437.pdf>.
- ⁸ *Id.*
- ⁹ *Id.*
- ¹⁰ *Id.*
- ¹¹ *Id.*
- ¹² *Id.*
- ¹³ *Id.*