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Policy Division
Financial Crimes Enforcement Network
P.O. Box 39
Vienna, VA 22183

Via Federal E-Rulemaking Portal

Re: FinCEN Docket Number FINCEN-2020-0020, RIN 1506-AB47, "Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets"

To Whom It May Concern:

CohenWilson LLP, a Washington, D.C. limited liability partnership which does business under the name DLx Law ("**DLx Law**"), is pleased to submit this letter for consideration by the Financial Crimes Enforcement Network ("**FinCEN**") of the U.S. Department of the Treasury (the "**Treasury**") with respect to the above-referenced Notice of Proposed Rulemaking regarding "Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets" (the "**NPRM**").

DLx Law was formed in May 2018 and is recognized as one of the leading law firms focusing on clients using blockchain, distributed ledger technology and digital assets, including cryptocurrencies.[1] Our clients range from large, traditional corporations and regulated financial institutions to technology start-ups, and include many entities that will be affected by the NPRM, including digital asset exchanges, state and nationally chartered banks providing services to customers investing in and/or utilizing digital assets, developers of blockchain-based networks, managers and sponsors of digital asset funds, proprietary trading firms dealing in cryptocurrencies and other digital assets, issuers of digital asset securities, and many more.

We actively engage on behalf of our clients with a wide variety of federal and state regulatory agencies and are strong proponents of the innovative power and benefits of blockchain and related technologies, as well as the importance of utilizing the technology

[1] *See*, Chambers and Partners, FinTech Legal: Blockchain and Cryptocurrencies rankings, available at https://chambers.com/law-firm/dlx-law-fintech-49:23065361.

in a manner that complies with existing laws and regulations. We frequently find ourselves at the "coalface" of assisting clients seeking to engage with these new technologies in an environment of uncertain, equivocal, or even inconsistent regulatory frameworks.

Many commentators have already observed that the 15-day period provided by FinCEN to respond to the 72-page NPRM is inadequate to address the wide-ranging issues raised for current (and potential) users of blockchain technology.[2] We endorse those concerns. Our experience working with U.S. businesses utilizing digital assets has demonstrated the challenges these companies face when seeking to comply with the many different regulatory frameworks applicable to their businesses.[3]

Our clients and other businesses we regularly interact with in this sector very much want to comply with both present and future regulatory frameworks and strongly support the goals of combatting money laundering, terrorist financing, and other illicit uses of digital assets. Participants in the digital asset sector are ready and willing to invest the resources necessary to achieve these goals as most understand that a well-regulated market will only enhance adoption of these new technologies. However, FinCEN should seek to strike the appropriate balance between establishing a regulatory framework that provides the tools necessary to achieve the goals set out above and the regulatory burdens imposed on the use of a still nascent technology.

Meeting these regulatory burdens takes resources, planning and forethought. Many businesses in the digital asset ecosystem are start-ups and do not have the resources to navigate multiple regulatory "blind alleys". The 15-day comment period provided by FinCEN is not remotely sufficient for the digital asset industry to digest fully and respond to the many issues raised in the NPRM so as to ensure that any regulations adopted reflect the actual issues faced and effectively address the underlying concerns raised. Legitimate questions have also been raised about whether the notice and comment process proposed for the NPRM complies with the requirements of the Administrative Procedure Act.[4]

Given that these procedural points have been covered in detail elsewhere, we would like to focus our comments on two areas, based on our firm's experience representing numerous clients and interacting with many other participants in the digital asset ecosystem. First, the extent to which implementation of the NPRM in its current form would facilitate or, alternatively, would adversely

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[2] *See, e.g.*, Coin Center, "Comments to the Financial Crimes Enforcement Network on Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets", December 22, 2020 (the "**Coin Center Letter**"), available at: https://www.coincenter.org/app/uploads/2020/12/2020-12-22-comments-to-fincen.pdf and Chamber of Digital Commerce, "The Chamber of Digital Commerce Delivers Letter to U.S. Treasury Secretary Steven Mnuchin Urging Extension of NPRM Comment Period" (the "**Chamber Letter to Secretary Mnuchin**"), December 22, 2020, available at: https://digitalchamber.org/letter-to-secretary-mnuchin/.

[3] In addition to compliance with the requirements of the Bank Secrecy Act (31 U.S.C. §§ 5311-5330) (the "**BSA**") and state-level money transmitter licensing requirements (as well as bespoke requirements applicable to businesses utilizing cryptocurrencies, such as the New York State BitLicense (23 NYCRR Part 200 under the New York Financial Services Law), businesses seeking to implement business models using blockchain and digital assets also need to consider federal and state securities laws, federal regulation of swaps and certain other derivatives transactions involving commodities, and similar laws in each other jurisdiction in which they may be deemed to do business.

[4] 5 U.S.C. § 551 et seq. *See, e.g.*, Coin Center Letter and Letter of Kirkland & Ellis LLP on behalf of the Blockchain Association dated December 30, 2020 (the "**Kirkland Letter**"), available at: https://theblockchainassociation.org/wp-content/uploads/2020/12/Blockchain-Association-Letter-re-Comment-Period.pdf.

impact, the achievement of its stated objective of aiding law enforcement in the reduction of the illicit use[5] of convertible virtual currency ("**CVC**") held in "unhosted wallets" or in wallets hosted in a jurisdiction identified by FinCEN.[6] Second, we will address what we see as a concerning lack of equivalence between the NPRM's proposed strict recordkeeping requirements by financial institutions for transfers of CVCs and the more flexible rules currently applicable to transfers of dollars or other fiat currencies by customers of financial institutions.

Impact of Implementation of NPRM on Effective Law Enforcement

We believe there is a significant likelihood that implementation of the NPRM, as proposed, would have a paradoxical effect. Rather than placing FinCEN, the Federal Bureau of Investigation, the Secret Service, and other relevant law enforcement agencies in an improved position to curtail the illicit use of CVCs, it may make the job of law enforcement more difficult and could put American interests at greater risk than they would have been had the NPRM not been adopted.

The rigid recordkeeping requirements of the NPRM[7] do not seem to align with the recommendations of the Bank Secrecy Act Advisory Group ("**BSAAG**")[8] as reflected in FinCEN's recent Advance Notice of Proposed Rulemaking (the "**ANPRM**")[9] which solicited public comment on a wide range of questions pertaining to potential regulatory amendments under the Bank Secrecy Act ("**BSA**"). In the ANPRM, FinCEN recognized the need for an "effective and reasonably designed" AML program component to empower financial institutions to allocate resources more effectively and sought to impose minimal additional obligations on AML programs that already comply under the existing supervisory framework.[10] However, the NPRM with its prescriptive requirements does not empower digital asset businesses to allocate their resources effectively in order to assure that they address their unique AML challenges and to assure the reporting of valuable and useful information to government authorities.

Furthermore, if FinCEN believes that more prescriptive standards are needed for transfers of CVCs, the NPRM does not present evidence to suggest that U.S. regulated digital asset exchanges are not meeting their existing regulatory obligations under the BSA by assessing and reasonably mitigating the risks resulting from illicit financial activity—including terrorist financing, money laundering, and other related financial crimes—consistent with both their risk profile and requirements of various federal and state supervisory governmental authorities, including

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[5] Throughout this letter, we use the shorthand phrase "illicit use" to refer to any unlawful use of CVCs or other monetary instruments, including for money laundering, terrorist finance, ransomware or other criminal activity.

[6] The NPRM also addresses "legal tender digital assets" ("**LTDAs**"). However, as this type of digital asset does not have significant use at this time, we limit this letter to CVCs.

[7] *See* proposed 31 C.F.R. § 1010.410 ("Records to be made and retained by financial institutions") (the "**New Recordkeeping Rule**").

[8] The Annunzio-Wylie Anti-Money Laundering Act of 1992 required the Secretary of the Treasury to establish the BSAAG, which was to consist of representatives from federal regulatory and law enforcement agencies, financial institutions, and trade groups with members subject to the requirements of the BSA, 31 CFR §1000-1099 *et seq*. or Section 6050I of the Internal Revenue Code of 1986. The BSAAG is the means by which the Treasury receives advice on the operations of the BSA. As Chair of the BSAAG, the Director of FinCEN is responsible for ensuring that relevant issues are placed before the BSAAG for review, analysis, and discussion.

[9] 85 FR 58023, Docket No. FinCEN-2020-0011 (September 17, 2020).

[10] *Id*. at 58024.

FinCEN's CVC Guidance.[11]

In addition, the rigid recordkeeping requirements of the NPRM[12] for customer transfers of CVCs may potentially have a number of presumably unintended consequences. Firstly, if the NPRM is adopted as proposed, the significant increases in upfront and ongoing costs imposed on regulated digital asset exchanges of complying with the New Recordkeeping Rule will cause many of such entities to elect not to service customers who wish to send CVC from their account with the exchange to anywhere other than another regulated financial institution or a known unhosted wallet previously identified by the customer to the exchange. If this happens, there may be less information available to regulatory authorities than there is today.

The practical and technological challenges for digital asset exchanges in complying with the proposed strict requirement that the exchange record "[t]he name and physical address of each counterparty to the transaction of the financial institution's customer, as well as other counterparty information the Secretary may prescribe as mandatory on the reporting form for transactions subject to reporting pursuant to § 1010.316(b)"[13] when such information may be unavailable to the exchange (and, perhaps, even to the exchange's customer) may cause many exchanges and other providers of hosted wallet services to dramatically curtail the ability of their customers to offboard their own property.

At the same time, these foreseeable limitations, together with legitimate customer privacy and other concerns, will cause an increasing number of customers to cease using the services of regulated digital asset exchanges and switch to self-hosted options for storing their digital assets, particularly as the technological solutions available for these customers continues to improve in response to demand. An unknown number of other potential customers may simply never even begin to explore the benefits of utilizing digital assets, irreparably harming the growth of this technology in the United States, and benefiting businesses based in other jurisdictions that adopt a more considered approach to achieving the laudable objectives of the NPRM.

The likely result of these actions will be that, with far less CVC maintained and traded on regulated U.S. exchanges, users of cryptocurrencies and other digital assets will turn to alternatives, including "smart contract" based peer-to-peer ("**P2P**") exchange tools that are not owned or controlled by any one or more identifiable persons or businesses and which are likely beyond the practical reach of U.S. law enforcement agencies. With an increase in the use of non-regulated storage solutions and P2P exchange services, law enforcement will lose access to information generated by centralized and regulated exchange platforms, the primary target of the NPRM and one of law enforcement's most valuable partners. CVC that remains "off-grid" on self-hosted wallets is more difficult to track and will dimmish, not enhance, the amount of information

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[11] FinCEN, Guidance on the Application of FinCEN's Regulations to Persons Administering, Exchanging or Using Virtual Currencies, FIN-2013-G001 (Mar. 18, 2013), available at https://www fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf (the "**2013 Guidance**") and FinCEN, Guidance on the Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies, FIN-2019-G001, at 21-22 (May 9, 2019), available at https://www fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf (the "**2019 Guidance**").

[12] *See* proposed 31 C.F.R. § 1010.410 ("Records to be made and retained by financial institutions") (the "**New Recordkeeping Rule**").

[13] Proposed 31 C.F.R. § 1010.410(g)(1)(vii).

available to law enforcement. This point was recently recognized in a report prepared by the Cyber-Digital Task Force of the Office of the Deputy Attorney General:[14]

> [U]nlike centralized virtual asset exchanges, P2P exchange platforms may operate without an intermediary that will accept and transmit virtual assets in exchange for fiat or another type of virtual asset, or that will collect customer identification information. Individual exchangers—as well as platforms and websites—that fail to collect and maintain customer or transactional data or maintain an effective AML/CFT program may be subject to civil and criminal penalties.[15]

A rushed process that does not adequately take into account the concerns and likely reactions of cryptocurrency users and service providers increases the likelihood that these well-intentioned regulations will drive users toward more opaque means of transacting and frustrate the legitimate regulatory policies behind the NPRM.[16]

Stricter Recordkeeping Standards for Customer Transfers of CVCs Disadvantage Use of New Technologies

Part of the ostensible justification of the NPRM is to bring the reporting and recordkeeping requirements for transactions involving CVC in line with those involving the use of fiat currency.[17] We generally support technology-neutral reporting and recordkeeping requirements and a level playing field for both legacy systems and novel technologies. We note that the NPRM may result

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[14] *See* "Report of the Attorney General's Cyber Digital Task Force" (the "**Cyber Task Force Report**"), available at: https://www.justice.gov/ag/page/file/1326061/download.

[15] Cyber Task Force Report at p. 38. Where the exchange platform is a decentralized computer protocol rather than a business or individual, there may be no one to collect information or to maintain transaction records, nor anyone to prosecute for not doing so.

[16] A rough analogy to the paradoxical effects of overly strict regulation of individuals' behavior can be found in the consequences of the ratification of the 18th Amendment to the United States Constitution in 1919, which banned the manufacture, sale, or transportation of "intoxicating liquors". As Daniel Okrent, author of "Last Call: The Rise and Fall of Prohibition" observed:

> The most ambitious, most widely supported, and most uncompromising attempt to modify the behavior of Americans was, of course, Prohibition. Not at all incidentally, it was also a colossal failure. … [I]f people really want to do something, and there isn't an immediate and universally acknowledged victim, they will find their way to do it, irrespective of laws and regulations.

"The Paradox of Prohibition", The New York Times, June 2, 2012 available at: https://www.nytimes.com/roomfordebate/2012/06/02/whats-the-best-way-to-break-societys-bad-habits/the-paradox-of-prohibition#:~:text=It%20was%20actually%20harder%20to,prohibition%20was%20replaced%20with%20regulations.&text=The%20great%20paradox%20of%20Prohibition,for%20Americans%20to%20acquire%20alcohol.

[17] The Executive Summary of the NPRM states:

> FinCEN proposes to address this threat by establishing a new reporting requirement with respect to certain transactions in CVC or LTDA, that is *similar to the existing currency transaction reporting requirement*, and by establishing a new recordkeeping requirement for certain CVC/LTDA transactions, that is *similar to the recordkeeping and travel rule regulations pertaining to funds transfers and transmittals of funds*. (Emphasis added).

in further uncertainty due to the fact that FinCEN has already proposed certain requirements for the collection, retention and transmission of information involving CVCs.[18] The NPRM would require strict recordkeeping requirements for transfers of CVCs with a value of more than $3,000.[19] In particular, as noted above, if implemented, financial institutions (including regulated digital asset exchanges) would be required to capture and retain, among other things, "[t]he name and physical address of each counterparty to the transaction of the financial institution's customer, as well as other counterparty information the Secretary may prescribe as mandatory on the reporting form for transactions subject to reporting pursuant to § 1010.316(b)".[20]

Adding enhanced and inflexible recordkeeping for CVCs is misguided, however. FinCEN has broadly defined "convertible virtual currency" in the NPRM to include "[A] medium of exchange, such as a cryptocurrency, that either has an equivalent value as currency, or acts as a substitute for currency, but lacks legal tender status.[21] This broad definition (which, it should be noted, is not limited to digital or intangible items) is understandable, given the legitimate anti-avoidance concerns that a narrower definition might raise.

However, the result is that many digital assets of all types could conceivably fall within the definition's broad ambit. Unlike fiat currency currently subject to transaction reporting and recording by financial institutions, digital assets that may be considered CVCs have a much wider set of use cases other than just payment. In fact, just because a given digital asset could act as a "substitute" for a real currency, does not mean that this is its primary or regular function. For example, ether, the native digital currency of the Ethereum network would likely be considered a CVC but will also soon be used to secure the Ethereum network through a staking mechanism that does not involve use of ether for payments. Other digital assets believed to be CVCs by the public may later be deemed by the Securities and Exchange Commission (the "**SEC**") to be "securities" (and thus only traded on an exchange that is registered with the SEC or exempt from such registration), further muddying the interpretation of when transfers of a particular digital asset would fall within the scope of the new enhanced recordkeeping requirements.

In order for the use and benefits of blockchain technology to flourish in the United States, we should not implement regulations that treat digital assets with a fluid nature and which may or may not be used to effect payments or transfers of value more strictly than we treat fiat currency which always and inherently is used for payments and no other meaningful purpose.[22] Accordingly, we would urge the elimination of proposed 31 C.F.R. §1010.410(g) from the NPRM prior to its implementation.

Finally, in addition to the above two concerns and the procedural issues noted at the start of this letter, there are many other concerns about the NPRM that have been, or will be, raised by other commentators, many of which we support as well, including:

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[18] *See* 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, 85 Fed. Reg. 68,005 (Oct. 27, 2020) (the "**Funds Transfer / Funds Travel Rule NPRM**").
[19] Proposed 31 C.F.R. §1010.410(g).
[20] Proposed 31 C.F.R. § 1010.410(g)(1)(vii).
[21] *See also* the Funds Transfer / Funds Travel Rule NPRM, 85 Fed. Reg. at 68,006.
[22] We exclude for this purpose numismatic interest in the collecting of units of fiat currency for their own sake.

- The unique impact on the privacy of users of digital assets by retaining the blockchain address of an identified customer and counterparty;
- The cybersecurity risks of both FinCEN and private financial institutions' "honeypots" of customers' private financial data;
- The implications of the NPRM on the development of decentralized finance technology; and
- How use of so-called "layer 2" technologies intended to accelerate use of certain digital assets for payments would be reconciled with the currently proposed rules.

Conclusion

We appreciate the opportunity to provide this input from the perspective of a law firm actively engaged with clients working with CVCs and other digital assets and repeat our observation that the vast majority of businesses we encounter in our practice want to comply with any and all regulations that may be promulgated in this space. We hope that FinCEN will take the time needed to consider this and the many other comment letters that have been submitted to re-examine the proposal contained in the NPRM and engage in a more fulsome manner with all stakeholders in this critical initiative.

Very truly yours,

Angela Angelovska-Wilson

Cc: Lewis Rinaudo Cohen, Esq.
Gregory Strong, Esq.