

Outside Counsel

Funds Travel Rule: A Headache For Cryptocurrency Transmitters

Over the past few years, investor money has been flooding into cryptocurrency transmission businesses. Entrepreneurs and investors have been moving quickly to capture market share in this potentially massive market. However, it looks like some of those businesses—perhaps most—have moved a little too quickly. In short, businesses built platforms focused on the efficient transmission of cryptocurrency that appear to lack an effective means to comply with what banks commonly refer to as the Funds Travel Rule. This misstep has the potential to shake up the industry and create new market leaders. In the short run, it may also result in a few enforcement actions. If the problem is not addressed quickly and effectively, it may have a substantial impact

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on the future of cryptocurrency as a regulated industry in the United States.

FinCEN Regulations Apply

Businesses that provide money transmission services denominated in convertible virtual currency (CVC) must register with the Financial Crimes Enforcement Network (FinCEN) as money services businesses (MSBs) and comply with the Bank Secrecy Act (BSA) and FinCEN's implementing regulations, including the Funds Travel Rule.

FinCEN defines "money transmission services" as "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." CVC, meanwhile, is virtual currency that has an equivalent value as currency or acts as a substitute for currency (e.g., Bitcoin). In its May 2019 guidance on the *Application of FinCEN's Regulations to Certain Business Models Involving Convert-*

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ible Virtual Currencies (the May Guidance), FinCEN confirmed that "other value that substitutes for currency" includes CVCs because they are a type of value that substitutes for currency.

As a result, *all* regulations that generally apply to money transmitters also apply to transmitters of cryptocurrency. At the November 2019 Chainalysis Blockchain Symposium, FinCEN Director Kenneth Blanco noted:

Money transmission denominated in convertible virtual currency is money transmission pure and simple. Therefore, every regulatory requirement, piece of guidance, administrative ruling, or enforcement action ever conducted in the money transmission space has a bearing on transmittals of value denominated in convertible virtual currency.

Application of the Rule

The Funds Travel Rule is one notable such regulatory requirement. According to Director Blanco, the Funds Travel Rule is the violation most commonly cited by examiners against MSBs engaged in CVC transmission. Moreover, he emphasized that MSBs engaged in CVC transmission “can count on being asked about” how they ensure compliance with the Funds Travel Rule during examinations.

The Funds Travel Rule, 31 C.F.R. §1010.410(f), requires a financial institution (including an MSB) to include certain information on a “transmittal order” for a “transmittal of funds” sent to another financial institution. The term “transmittal order” is defined to include an instruction by a “transmittor” (sender) to pay “a fixed or determinable amount of money” to a recipient. “Transmittal of funds,” meanwhile, is defined as “[a] series of transactions beginning with the [sender’s] transmittal order, made for the purpose of making payment to the recipient of the order,” that

is completed by acceptance of the transmittal order by the recipient’s financial institution.

Under the Funds Travel Rule, the sender’s financial institution must obtain and include in the transmittal order the following information on transmittals of funds of \$3,000 or more:

- Name and account number of the sender (the latter only if the payment is ordered from an account);
- The address of the sender;
- The amount of the transmittal order;
- The execution date of the transmittal order;
- The identity of the recipient’s financial institution;
- If received with the transmittal order, the name and address of the recipient, the account number of the recipient, and any other specific identifier of the recipient; and
- Either the name and address or the numerical identifier of the sender’s financial institution.

A financial institution acting as an intermediary financial institution must include in its respective transmittal order to the next receiving financial institution the same data points listed above, if received from the sender.

It should be noted that “electronic fund transfers,” as defined in section 903(7) of the Electronic Funds Transfer Act, 15 U.S.C. §1693a(7), that instruct a financial institution to debit or credit a consumer asset account established primarily for

personal, family, or household purposes are excluded from the definition of “transmittal of funds.”

There are also related record-keeping requirements for initiating, intermediary, and recipient financial institutions under 31 C.F.R. §1010.410(e) that FinCEN refers to as the “Funds Transfer Rule.” Notably, the Funds Transfer Rule requires a sender’s financial institution and a recipient’s financial institution to “verify” the sender or recipient’s identity, as appropriate, if the sender or recipient is not an “established customer.” In the case of transmittal orders not made in person, for example, verification of the sender requires that the sender’s financial institution obtain and retain a record of the sender’s name and address (e.g., a driver’s license or passport); obtain and retain the sender’s taxpayer identification number (e.g., social security or employer identification number for U.S. persons), or note in the record the lack thereof; and retain or record the sender’s method of payment (e.g., check or credit card).

Headaches for Cryptocurrency Transmitters

The application of the Funds Travel Rule to CVCs creates significant headaches for MSBs engaged in the transmission of cryptocurrency. First, these MSBs must collect information, such as sender name and physical address and the identity of the recipient’s

financial institution. Second, they must verify the identities of senders and recipients who are not established customers under the related Funds Transfer Rule. Third, they must transmit and receive the information that the Funds Travel Rule requires to “travel” to an intermediary or recipient financial institution.

The burden of transmitting and receiving the information required to “travel” is particularly acute because blockchain protocols were not designed to facilitate the transmission of this information. There are no fields in existing blockchain protocols to include the information required to “travel” by the Funds Travel Rule. By contrast, the FedWire Funds Service (Fedwire) message format utilized for U.S. dollar settlement by participating financial institutions contains standard fields for the information required to “travel.”

Moreover, while blockchains are designed in a manner that could enable an application running on the blockchain to include such fields, there currently is no uniform application or protocol for doing so. Accordingly, different transmitters trying to follow the Funds Travel Rule are likely to use different, and potentially incompatible, means for receiving and transmitting such information. While it might be efficient if a central authority or dominant entity developed and imposed upon CVC transmitters a single, consistent mechanism for complying with the Funds Travel

Rule, the cryptocurrency industry has strenuously resisted reliance on centralized authority.

It is notable that when the Funds Travel Rule was originally proposed by FinCEN in the 1990s, banks and traditional MSBs argued that the proposed rule was overly burdensome. FinCEN had four main responses. First, the Funds Travel Rule was necessary to assist law enforcement investigations of money laundering and to deter money laundering. Second, while the Funds Travel Rule would impose compliance costs on financial institutions, a \$3,000 threshold would be added

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to the final Rule to exclude small dollar transmittals of funds, substantially reducing the compliance burden. (The Funds Travel Rule, as originally proposed by FinCEN, would have applied to all transmittals of funds regardless of amount).

Third, the Federal Reserve Board was simultaneously adopting an expanded format for Fedwire to permit the inclusion of complete sender and recipient information. Fourth, the effective date of the Funds Travel Rule was approximately one year from promulgation, giving financial institutions time to adapt,

and financial institutions utilizing Fedwire were not required to include all available information in Fedwire payment orders until they had implemented the new, expanded Fedwire format.

There is no one-year grace period for MSBs engaged in CVC transmission. The Funds Travel Rule has applied to each of these businesses from the first day of operation, and examiners are currently citing MSBs engaged in CVC transmission for violations of the Rule. MSBs engaged in CVC transmission must therefore develop processes and procedures to ensure compliance with the Funds Travel Rule or stop accepting transmittal orders and transmittals that fall within the scope of the Rule. If cryptocurrency transmitters cannot figure out how to resolve the challenges created by the Funds Travel Rule, the ability of U.S. businesses to participate in the global cryptocurrency market may be severely constrained.