March 29, 2021

Kenneth A. Blanco,
Director
Financial Crimes Enforcement Network
P.O. Box 39
Vienna, VA 2218

Re: Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets [Docket Number FINCEN–2020–0020]

Filed via Federal E-rulemaking Portal: http:// www.regulations.gov

Dear Mr. Blanco:

I am pleased to file these comments regarding the FinCEN proposed rule "Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets."[1]

Combatting the financing of terrorism and other illicit finance is an important function. Rules and reporting that *actually* help to accomplish this objective in a cost-effective manner constitute sound policy. These are smart regulations. Conversely, rules and reporting that do not *actually* further the objective of countering terrorism or other illicit finance and merely add substantial costs to the operations of law-abiding businesses are dumb regulations. Then there are rules that may actually impede law enforcement objectives. This proposed rule, in its current form, falls in the one of the two latter categories. It would do almost nothing to combat terrorism and illicit finance. In fact, there is strong reason to believe that it will make countering terrorism and illicit finance substantially more difficult. It is likely to have a devastating economic impact on the responsible actors in the virtual currency, alternative currency or digital asset field and drive virtual currency users to engage in peer-to-peer transactions via unhosted wallets that cannot be effectively supervised by regulators. Finally, it will serve to protect legacy financial institutions from competition from disruptive FinTech newcomers to the detriment of the broader public. Ergo, the rule is quite literally counterproductive if one assumes the actual objective of the rule is to combat terrorism and illicit finance.

Stated a little differently, you can interpret this rushed rulemaking[2] in one of two ways. Perhaps FinCEN actually wants to combat terrorism financing and other illicit finance in the virtual currency space and the agency just made a mistake in how to go about it. Or perhaps what FinCEN really cares about is either creating the *appearance* of action by generating some press

[1] "Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets," Financial Crimes Enforcement Network (''FinCEN''), Treasury, Proposed Rules, *Federal Register*, Vol. 85, No. 247, December 23, 2020 (RIN 1506–AB47) https://www.govinfo.gov/content/pkg/FR-2020-12-23/pdf/2020-28437.pdf; "Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets," Financial Crimes Enforcement Network (''FinCEN''), Treasury, Notice of Proposed Rulemaking; Extension of Comment Period, *Federal Register*, Vol. 86, No. 17, January 28, 2021 https://www.govinfo.gov/content/pkg/FR-2021-01-28/pdf/2021-01918.pdf.

[2] The proposed rule was pushed out in the closing days of the Trump administration with, initially, a highly truncated comment period.

or protecting legacy financial institutions from disruptive competition. After all, few, if any, journalists will take the time a few years hence to see if the rule actually worked. If it is the former, then, as explained below, FinCEN should withdraw this rule and start over. If it proceeds with this ill-advised rule, then it will be clear that it is either appearances, a desire to protect existing financial institutions from competition or a simple lack of understanding and sophistication that govern FinCEN's actions.

Disparate Treatment for Legacy Financial Institutions and Virtual Currency

The proposed rule treats traditional financial transactions and virtual currency transactions in a radically different fashion. It will have a dramatic adverse impact on this burgeoning industry and serve well to protect legacy financial institutions from disruptive FinTech competition.

The proposed rule at §1010.410(g)(1)(vvi) (see language below), would require banks or MSBs to keep records regarding the name and physical address of counterparties. Counterparties means non-customer payees. This is somewhere between impossible and extraordinarily expensive.

Such a rule is comparable to requiring a bank to know the name and address of every payee to whom its checking account customers wrote checks. Such a rule would not make checking accounts illegal *per se* but it would make them expensive and rare. Of course, neither the existing nor proposed regulation impose any such requirement on checking accounts or any other means of payment except for virtual currencies and digital assets. The proposed rule would not make it illegal for banks or MSBs to engage in virtual currency transactions. But it will make such transactions expensive and rare. It serves to shut down competition to traditional financial institutions using traditional means of payment.

The relevant language of the proposed rules is as follows.

> Proposed §1010.410 Records to be made and retained by financial institutions.
> * * * * *
> (g) **Each bank or money services business**, as defined by 31 CFR 1010.100, is subject to the requirements of this paragraph (g) **with respect to a withdrawal, exchange or other payment or transfer, by, through, or to such financial institution which involves a transaction in convertible virtual currency** or a digital asset with legal tender status, as those terms are defined in § 1010.316(c), **with a value of more than $3,000**.
>
> (1) Recordkeeping Requirements: For each withdrawal, exchange, or other payment or transfer, by, through, or to such financial institution which involves a transaction in convertible virtual currency or a digital asset with legal tender status, as those terms are defined in § 1010.316(c), **a bank or money services business shall obtain and retain an electronic record of the following information**:
> * * * * *
>
> (vii) **The 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);
* * * * *

Note to paragraph (g)(2): **If a bank or money services business has knowledge that a person has accessed the bank's or money services business's customer's wallet to conduct a transaction for which records must be maintained who is not the bank's or money services business's customer, the bank or money services business should treat that person as a customer for the purposes of this paragraph, and verify both the person accessing the account and the customer.**

{Emphasis Added}

The "as a customer" requirement in the note presumably triggers the voluminous know your customer requirements.

Similarly, the proposed rule at §1010.316 (see language below), would require banks or MSBs to file reports regarding the name and physical address of counterparties. There is no such requirement for non-virtual currency transactions.

Proposed §1010.316 Filing obligations for reports of transactions in convertible virtual currency and digital assets with legal tender status.

(b) Except as exempted by paragraph (d) or otherwise exempted by regulation, **each bank or money services business**, as defined in § 1010.100, **shall file a report of each deposit, withdrawal, exchange, or other payment or transfer, by, through, or to such financial institution which involves a transaction in convertible virtual currency** or a digital asset with legal tender **status with a value of more than $10,000**. **Such report shall include, in a form prescribed by the Secretary, the name and address of each counterparty, and such other information as the Secretary may require.**

{Emphasis Added}

Paragraph (d) generally provides an exemption with respect to reporting but not recordkeeping regarding counterparty accounts held at BSA-regulated financial institutions.

Proposed §1010.314(b) imposes similar counterparty reporting obligations with respect to structured transactions. Again, there is no comparable requirement for legacy means of payment.

The Proposed Rule Reduces the Effectiveness of AML Rules

The proposed rule appears to rest on the utterly false premise that virtual currency cannot be transferred in the absence of an intermediary or virtual asset service provider (VASP).[3] Peer-to-

[3] VASP is the terminology that FATF uses. See, e.g., *12-Month Review Of The Revised Fatf Standards On Virtual Assets And Virtual Asset Service Providers*, The Financial Action Task Force, June 2020 http://www.fatf-

peer transactions between unhosted wallets are relatively easy to effect. The primary effect of the rule will be to drive virtual currency transactions from banks and MSBs (or in FATF terminology from Virtual Asset Service Providers or VASPs) to peer-to-peer transactions via unhosted or private wallets. This is because of the expense, administrative hassle and delay that the rule will impose on VASPs that will not have to be incurred in those using P2P transactions.

Obviously, some of the virtual currency transactions will bleed back into the legacy payment system because it is not subject to the counterparty reporting and record-keeping requirements. But many others will simply use the P2P unhosted wallet approach to avoid the cost, hassle and delay that the rule will introduce to VASP transactions. P2P transactions between unhosted wallets are not, under current law, subject to BSA reporting and even if they were, such a law would be very hard to enforce. Thus, the rule will make the job of law enforcement more difficult.

In summary, the proposed rule:

> (1) accords a competitive advantage to legacy payment methods by imposing an expensive counterparty record keeping and reporting requirement only on virtual currencies;
> (2) will crush the virtual currency service providing business and drive users to unhosted wallet peer-to-peer transactions; and
> (3) will therefore make it substantially more difficult to track and impede terrorism financing and other illicit finance.

The proposed rule should be withdrawn. It is a lose-lose proposition and a mistake. It will harm and probably crush law-abiding, responsible virtual asset service providers, artificially protect legacy payment systems by imposing a uniquely adverse rule only on virtual currency and drive transaction to private, unhosted wallets where it is much more difficult for law enforcement to track and impede terrorism financing and other illicit finance.

Sincerely,

David R. Burton
Senior Fellow in Economic Policy
The Heritage Foundation
214 Massachusetts Ave., NE
Washington, DC 20002

David.Burton@heritage.org

---

gafi.org/media/fatf/documents/recommendations/12-Month-Review-Revised-FATF-Standards-Virtual-Assets-VASPS.pdf.