Combatting Money Laundering
A Talk with Alex Zerden

- High profile instances of criminal uses of cryptocurrency
    - Silk Road darknet market operated from 2011-2013, taken down by law enforcement in October 2013. Ross Ulbricht, owner and operator, was found guilty of multiple charges in 2015, including conspiring to commit money laundering.
- Money laundering process
    - Placement: placing the illicit funds into the legitimate financial system
    - Layering: engaging in multiple unnecessary financial transactions often across different jurisdictions to obscure the flow of funds to make it more difficult to trace the origins
    - Integration: funds are returned to the wrongdoer through legitimate sources. Once the funds are fully integrated into the legitimate financial system, it may be used for any purpose.
- Attributes of cryptocurrency or other digital assets
    - Despite widespread belief that cryptocurrency is an effective tool for money laundering, certain key attributes of some cryptocurrency and other digital assets may not lend itself well to money laundering.
    - Key features:
        - Blockchain is append-only, an immutable distributed ledger
        - Public keys are viewable on public blockchains
    - Money laundering with cryptocurrency
        - Mixing or tumbling: mixes crypto assets and tokens into a private pool (that may be decentralized or centralized) and returned in other forms of assets to obscure their traceable origin.
        - Cryptocurrency with enhanced privacy and anonymity, e.g., ZCash
    - NFT market
        - May be used to launder money in the same way physical art can be
        - Treasury Department Study of the Facilitation of Money Laundering and Terror Finance Through the Trade in Works of Art (February 2022)
            - Includes a section on NFTs in which the Treasury highlights potential money laundering challenges in the space
- Regulatory framework
    - AML regime
        - Bank Secrecy Act of 1970 (BSA)
            - Established recordkeeping and reporting requirements for private individuals, banks, and other financial institutions.
            - Required financial institutions to keep records of cash transactions, file reports of cash transactions exceeding $10,000, and to report suspected money laundering, tax evasion, or other criminal activities.

- - - [California Bankers Association v. Shultz, 416 U.S. 21 (1974)](): The Supreme Court upheld the BSA.
    - [Money Laundering Control Act of 1986]()
      - Made money laundering a federal crime
      - Required banks to establish and maintain procedures to ensure and monitor compliance with the reporting and recordkeeping requirements of the BSA
    - Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 [USA PATRIOT Act]()
      - Expanded scope of BSA by strengthening customer identification procedures and requiring all financial institutions to abide by AM program requirements
      - Required by the BSA and amended by the USA PATRIOT Act, requires suspicious activity reports (SARs) detailing the financial institution's suspicion that a customer may be engaged in money laundering or other prohibited activities.
    - [2020 Anti Money Laundering Act]() passed
      - Includes the Corporate Transparency Act (CFT)
    - Financial Crimes Enforcement Network (FinCEN)
      - Created in 1990 to analyze information required under the BSA to fight money laundering.
      - 2013 FinCEN guidance [Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies](): clarified the applicability of the BSA to the crypto industry.
      - [FinCEN 2015 enforcement action against Ripple Labs](), a virtual currency exchange
        - First civil enforcement action against virtual currency exchange
        - Ripple fined $700,000 for failing to register with FinCEN and for a deficient AML program
  - Criminal enforcement
    - Generally comes into play in 3rd jurisdictions where the AML framework is lacking.
    - [DOJ charged operator of Bitcoin Fog in 2021 for money laundering]()
      - Roman Sterlingov, a Russian-Swedish national was arrested and charged with money laundering, operating an unlicensed money transmitting business, and money transmission without a license in D.C. Bitcoin Fog was a mixer that was alleged to have facilitated money laundering of over 1.2 million bitcoin since its inception in 2011.
  - [Financial Action Task Force (FATF)]()

- Formed in 1989, inter-governmental policymaking body created to establish international standards to combat money laundering and terrorism financing.
- Has issued 40 recommendations for member countries to integrate into their domestic legal regimes to improve their AML capabilities.
- Enforcement mechanism is a peer review process where members review other members for compliance and adequacy. If member countries are found inadequate, they may be put on a "gray list." For financial institutions, transacting or engaging with entities within countries on the gray list may result in increased costs associated with various compliance obligations, and those costs will be passed onto those entities in the form of higher fees or interest rates.
  - 2019 update to Recommendation 16 on wire transfers ("travel rule"): set of standards to provide certain information and ensure transactions are prohibited with designated entities indicated in the relevant UN Security Council resolutions relating to prevention of suppression of terrorism and terrorist financing. Guidance for how crypto currency companies can comply with the travel rule.
    - Crypto companies, or Virtual Asset Service Provider (VASP), required to share originator's name, account number, and unique identifiable information with beneficiary VASP. Beneficiary VASP must share beneficiary name and account number.
- Sanctions
  - Office of Foreign Assets Control (OFAC)
    - Administers and enforces sanctions against targeted foreign countries, regimes, terrorists, and others.
    - Applicable to all U.S. persons and businesses. Apply to foreign branches of American businesses and overseas subsidiaries.
    - Crypto companies should be aware that even if they may not be subject to AML laws, they are subject to sanctions obligations. Even if they're not subject to AML laws but are going to be subject to sanctions obligations.
  - Guidance specifically for the crypto industry:
    - OFAC, Updated Advisory on Potential Sanctions Risks for Facilitating Ransomware Payments (Sep. 21, 2021)
    - OFAC, Sanctions Compliance Guidance for the Virtual Currency Industry (Oct. 15, 2021)
  - Enforcement actions
    - 2021, OFAC added SUEX, a Russian virtual currency exchanges, to its Specially Designated Nationals and Blocked Persons List. Later also sanctioned a second crypto exchange, Chatex, for providing material support to SUEX.

- 2022, OFAC sanctioned BitRiver and its subsidiaries for facilitating Russian sanctions evasion.
- 2021, American national Virgil Griffith pled guilty to charges stemming from providing technical advice to North Korea on using cryptocurrency and blockchain technology to evade sanctions.

- Future
  - Executive Order on Ensuring Responsible Development of Digital Assets (March 9, 2022)
    - Purpose is to outline approach to addressing risks and harnessing potential benefits of digital assets
    - Key priorities include:
      - Protecting U.S. consumers, investors and businesses
      - Protect U.S. and global financial stability and mitigate systemic risks
      - Promote U.S. leadership in technology and economic competitiveness to reinforce U.S. leadership in the global financial system
      - Promote equitable access to safe and affordable financial services
      - Support technological advances and ensure responsible development and use of digital assets
      - Explore a U.S. Central Bank Digital Currency (CBDC)
  - States' focus on digital assets
    - NY Attorney General Letitia James warned investors about risk of investing in crypto currency (March 1, 2021)
    - NY Attorney General Letitia James required Bitfinex and Tether to end all trading activities in New York the state found illegal (February 23, 2021)
    - CA Attorney General Xavier Becerra warned investors about digital asset scams (August 7, 2020)
    - Wyoming enacted a host of legislation to lure crypto companies to the state: e.g., HB 1 (2021) created a cryptocurrency staking program and advisory council and provides matching funds related to carbon capture; HB 74 (2019) authorized the Special Purpose Depository charter to provide a regulatory framework to support digital asset banking activities.