US regulators assert jurisdiction on several fronts regarding digital assets

Securities Enforcement Alert

16 October 2019
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On October 11, 2019, the chairs of the US Commodity Futures Trading Commission (CFTC) and the US Securities and Exchange Commission (SEC) and the Director of the Financial Crimes Enforcement Network (FinCEN) issued a joint statement regarding activities involving digital assets.[1] The joint statement follows previous statements by US regulators concerning digital assets, including a statement from the SEC and the Financial Industry Regulatory Authority, as they continue to work jointly to address issues in this rapidly evolving industry.

The joint statement is another reminder of the regulatory view that digital assets often fall into the categories of securities or commodities, despite the label or terminology used to describe them. As such, they fall under the jurisdiction of applicable US securities, commodities, and other laws and regulations. Importantly, irrespective of how they choose to label them, companies working with digital assets are required to comply with anti-money laundering (AML) and counter-terrorist financing (referred to as "countering the financing of terrorism" or CFT) obligations under the Bank Secrecy Act (BSA), which applies to "financial institutions." "Financial institutions" are defined under the BSA to include entities required to register with the CFTC or the SEC, such as futures commission merchants, broker-dealers, and mutual funds, as well as money services businesses (MSBs) as defined by FinCEN.

And, later on October 11, the SEC repeated the message of the joint statement with its emergency enforcement

action and temporary restraining order against two offshore entities connected to the “Telegram Open Network” or “TON Blockchain.” The SEC’s complaint charges both defendants with violating the registration provisions of Sections 5(a) and 5(c) of the Securities Act of 1933. The SEC is seeking to prevent the distribution of approximately 2.9 billion digital tokens called “Grams.” In a press release related to the action, the co-director of the SEC’s Enforcement Division reiterated the message of the joint statement: “We have repeatedly stated that issuers cannot avoid the federal securities laws just by labeling their product a cryptocurrency or digital token."

Separate from SEC registration requirements, under the BSA, financial institutions are required to establish and implement an effective AML program, as well as comply with suspicious activity reporting obligations and other recordkeeping and reporting requirements. Additional obligations are imposed by various federal agencies, depending on the type of activity being conducted, and companies may be overseen by more than one agency. Many of the BSA obligations that apply to CFTC and SEC regulated entities, such as developing an AML program or reporting suspicious activity, apply very broadly and without regard to whether the particular transaction at issue involves a “security” or a “commodity” as those terms are defined under the federal securities or commodities laws.

As FinCEN Director Kenneth A. Blanco noted in the joint statement, even companies involved with digital assets that are not required to be registered with the SEC or CFTC should nevertheless be aware of FinCEN’s definition of MSBs, which includes the business of providing money transmission services. Such companies should review FinCEN’s 2019 CVC Guidance, which provides an overview of many types of businesses related to digital assets and the applicability of FinCEN regulation to such businesses, including decentralized application (DApp) developers and users, mining pools, cloud miners, and digital wallet providers.

Failure to implement an AML program or register with FinCEN as an MSB can result in both criminal and civil penalties, and the joint statement follows a recent increase in enforcement actions against MSBs involved with digital assets. For example, on April 8, 2019, Jacob Burrell Campos was sentenced to two years in prison and ordered to forfeit over $800,000 in illicit profits connected to the operation of his unlicensed MSB. Mr. Burrell advertised his services on Localbitcoins.com and exchanged bitcoins and fiat currency, but had never implemented an AML or “know your customer” program or performed due diligence on the source of his customers’ money. Assistant US Attorney Robert Ciaffa stated that Mr. Burrell’s “no questions asked” activities “blew a giant hole” through the legal framework of US AML laws.

Additionally, on April 18, 2019, FinCEN announced its first ever enforcement action against a peer-to-peer (P2P) virtual currency exchanger as well as its first penalty against a virtual currency exchanger for failure to file Currency Transaction Reports, a core requirement of the BSA. Eric Powers, who ran a P2P virtual currency exchange business that exchanged bitcoin and fiat currency via the Internet, in person, through the mail, or by wire through depository institutions, was fined and barred from the MSB industry for willfully violating the BSA’s registration program and reporting requirements.

If you are concerned that your business falls within the BSA’s definition of “financial institution” or has issued tokens that may be considered securities, or if you would like to learn more about the obligations imposed on such businesses, please contact the authors or any member of DLA Piper’s Blockchain and Digital Assets group, FinTech group, Financial Services group or Investment Management group.

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[1] Digital assets may be referred to by such terms as “cryptocurrencies,” “digital coins,” “digital currencies,” “digital tokens,” “crypto-assets,” “convertible virtual currencies” or “virtual assets.”

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