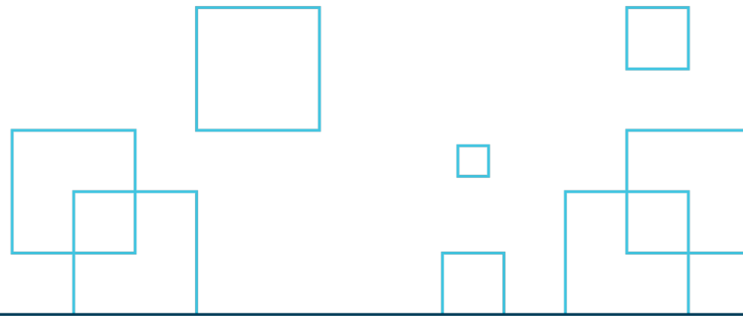
CHAMBER OF DIGITAL COMMERCE



January 22, 2023

Via Federal E-Rulemaking Portal and
Via Email: frc@fincen.gov

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

Re: Proposal of Special Measure Regarding Convertible Virtual Currency Mixing, as a Class of Transactions of Primary Money Laundering Concern (Docket No. FINCEN-2023-0016)

To Whom It May Concern:

The Chamber of Digital Commerce (the "Chamber") welcomes the opportunity to submit this letter for consideration by the Financial Crimes Enforcement Network ("FinCEN") with respect to the Notice of Proposed Rulemaking regarding the "Proposal of Special Measure Regarding Convertible Virtual Currency Mixing, as a Class of Transactions of Primary Money Laundering Concern" (the "NPRM").[1]

A. Introduction and Executive Summary

The Chamber is the world's largest blockchain trade association. Our mission is to promote the acceptance and use of digital assets and blockchain technology, and we are supported by a diverse membership that represents the blockchain industry globally. The Chamber represents more than 200 members in the blockchain industry, including the world's leading innovators, operators, and investors in the blockchain ecosystem, such as leading-edge startups, software companies, global IT constituencies, financial institutions, insurance companies, law firms, and investment firms.

All of our members are guided by the principle that industry compliance with applicable law is critical and the Chamber's members are committed to combating illicit activities on the blockchain, including through the misuse of blockchain services commonly referred to as "mixers" ("Traditional Mixers")—services that are specifically intended to enable individuals to obfuscate the details of otherwise public blockchain transactions.

Pursuant to its mission, the Chamber sponsors several compliance-focused initiatives. These include the Blockchain Alliance, which since 2015 has combated criminal uses of blockchain technology,

[1] *Proposal of Special Measure Regarding Convertible Virtual Currency Mixing, as a Class of Transactions of Primary Money Laundering Concern*, 88 Fed. Reg. 72701 (Oct. 23, 2023) [hereinafter, "NPRM"].

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providing technical assistance and information-sharing resources. This initiative serves over 100 governmental and commercial entities, including FinCEN.

The Chamber welcomes efforts by FinCEN and others to combat illicit finance and understands the position that transactions involving Traditional Mixers present elevated risks of illicit financial activities. But the Chamber is concerned that core elements of FinCEN's proposal to require reporting of transactions involving "CVC mixing" with a foreign nexus are overbroad, ambiguous, or both.

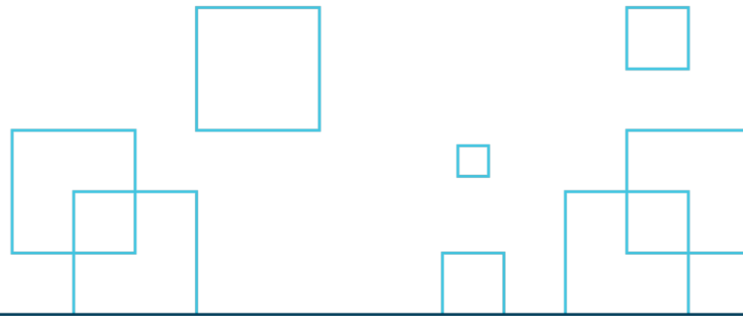
The definitions at the heart of FinCEN's proposal—namely, "CVC mixing" and "CVC mixers"—are particularly problematic. These terms already have established meanings within the blockchain ecosystem, but FinCEN's proposed definitions in the NPRM depart from this shared understanding and defines those terms to capture not just transactions involving Traditional Mixers but to also sweep in swaths of transactions that do not present the same risk profile. Under a broad reading of the proposal, domestic financial institutions would be required to report to FinCEN significant volumes of common, generally innocuous activities on the blockchain that U.S. persons engage in, such as simply converting one form of CVC to another.

Other aspects of the proposal amplify the burden on domestic virtual asset service providers ("VASPs"), such as exchanges and hosted wallet services, which are the financial institutions most affected by the proposal. For instance, the proposed reporting requirement contains no dollar threshold, unlike existing Bank Secrecy Act ("BSA") reporting requirements and requires VASPs to file a discrete report with a narrative on any transaction that involves "CVC mixing" with a foreign nexus. Moreover, the Section 311 designation as being of "primary money laundering concern" appears to create a presumption that transactions involving "CVC mixing" with a foreign nexus are *de facto* suspicious, requiring a separate suspicious activity report ("SAR") and countermeasures to allow the customer to continue transacting on the platform.

The additional monitoring and reporting load that would be required to effectively implement FinCEN's proposal would be significant, not incremental. The challenges created for VASPs by the NPRM's breadth are multiplied by its ambiguities, which are likely to create a misalignment between stakeholders on implementation and its impact on the rest of a financial institution's anti-money laundering ("AML") compliance program. As a result, the NPRM is likely to result in overreporting and de-risking of customers, as well-meaning financial institutions seek to avoid regulatory ambiguities rather than risk facing regulatory criticism around reporting regime requirements.

For those reasons, the Chamber would support a reporting requirement that tailors its scope to the particular risks as follows:

- Limits the definition of CVC mixing to transactions involving Traditional Mixers.
- Sets a dollar threshold of $10,000 under which reports of covered CVC mixing transactions ("CVC Mixing Reports") are not required.



- Provides relief from the reporting burden by allowing for financial institutions to upload batch CVC Mixing Reports, rather than requiring a discrete report for each reportable transaction.
- Treats CVC Mixing Reports as "unified filings" that will not require duplicative SAR reporting except where the transaction is independently suspicious.
- Outlines a clear test for when a transaction is reportable that addresses key ambiguities that are unique to transactions in CVC.
- Limits the scope of the reporting requirement to just CVC mixing involving those jurisdictions that are of most concern to FinCEN and providing clear criteria, consistent with the legal authority in Section 311, to ensure only CVC mixing transactions within or involving those jurisdictions are required to be reported.

The Chamber recommends that FinCEN implement timing limitations or a revisiting of the Section 311 designation, including a public notice and comment process, every three years to re-evaluate the value of the reporting and the amount of legitimate activity being reported, as well as consider technological advances that may be available in the future.

In the sections below the Chamber presents its concerns with the proposal in detail, the unintended consequences that are likely to occur if the current proposal were to take effect, and its recommendations for how FinCEN can revise the NPRM to better target the illicit activity driving this proposal.

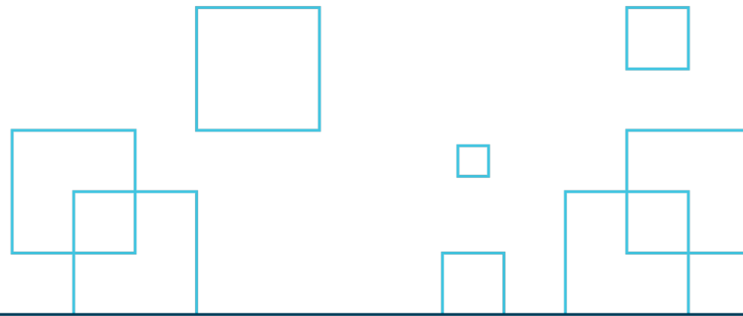
B. The NPRM Is Equal Parts Overbroad and Ambiguous

1. The Definition of CVC Mixing Stretches Too Broadly

At the core of the Chamber's concerns with the proposal is its definition of "CVC mixing." The NPRM sends mixed signals about what activities on the blockchain are captured by the proposed definition, rendering the proposed definition both ambiguous and overbroad, and likely to cause misalignment between key stakeholders as to which transactions in CVC would require reporting and which transactions would not.

Central to the potential for confusion is the NPRM's adoption of terminology—namely, "CVC mixers" and "CVC mixing"—that already have a common definition within the blockchain ecosystem. Indeed, FinCEN starts the NPRM by conceptualizing a CVC mixer as "a service that is intended to obfuscate transaction information," and mixing—in turn—is simply the service provided by a CVC mixer, all of which aligns with the definition of a Traditional Mixer.[2] And much of FinCEN's grounding for

[2] NPRM, 88 Fed. Reg. at 72702.



implementing a regime targeting foreign CVC mixing is based upon examples of misuse of Traditional Mixers by bad actors to launder the proceeds of their illicit activities.[3]

Prior government formulations of the terminology are similar. For instance, in FinCEN's 2019 CVC guidance, mixers were defined as "persons that accept CVCs and retransmit them in a manner designed to prevent others from tracing the transmission back to its source . . . ."[4] More recently, in the 2023 risk assessment of decentralized finance, the Department of the Treasury ("Treasury Department") defined mixing as a process to "functionally obfuscate the source, destination, or amount involved in a virtual asset transaction."[5] The assessment was careful to separately categorize services that are intended to be used to obfuscate transaction information—*i.e.*, Traditional Mixers—from other blockchain services that have features that *incidentally* make transactions harder to trace but which are not intended to obfuscate transaction information.[6]

Rather than align with the established definition of a Traditional Mixer or mixing activities, the proposal deviates from it and sweeps more broadly and defines CVC mixing to mean the "facilitation of CVC transactions in a manner" that "obfuscates the source, destination, or amount involved in one or more transactions, regardless of the type of protocol or service used . . . ."[7]

The proposed definition omits the intent element central to the definition of Traditional Mixer. Therefore, the definition includes transactions through any service that processes transactions in a manner that has the *effect* of obfuscating the source, destination, or amount of one or more transactions, not just the processing of transactions *in order to* obfuscate those details (*i.e.,* the service provided by Traditional Mixers).

Divorced from the intent element that limits the breadth of the definition, the examples embedded in the proposed rule's definition of CVC mixing capture common transaction patterns and functionality within the blockchain ecosystem that have not historically been considered mixing activities:

- **Pooling or aggregating CVC from multiple persons, wallets, addresses, or accounts.** This functionality describes most CVC exchanges—whether centralized or decentralized—because those exchanges or services often use pooled wallets to facilitate trading on the exchange.

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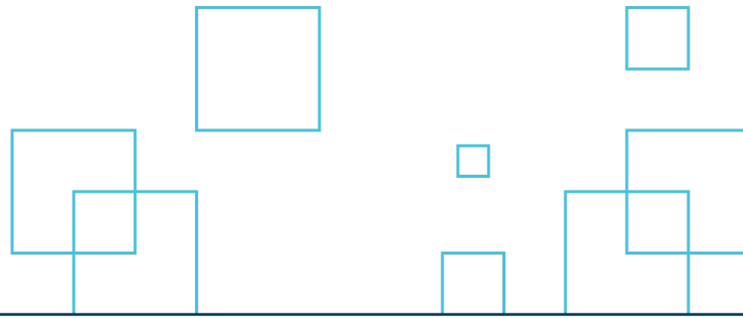
[3] *See, e.g., id.* at 72703-04.
[4] FinCEN, *Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies,* at 19, FIN-2019-G001 (May 9, 2019), https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-certain-business-models
[5] U.S. Department of the Treasury, *Illicit Finance Risk Assessment of Decentralized Finance* (Apr. 2023), at 8, https://home.treasury.gov/system/files/136/DeFi-Risk-Full-Review.pdf.
[6] *Id.* at 8.
[7] NPRM, 88 Fed. Reg. at 72702.



FinCEN also indicates that this category is intended to cover the pooling of CVC from multiple persons into a smart contract.[8]

- **Using programmatic or algorithmic code to coordinate, manage, or manipulate the structure of a transaction.** This broad definition may capture innocuous use of smart contracts to manage or interact with digital assets, such as the use of smart contracts to automate contractual lockups and programmatic releases of digital assets.
- **Splitting CVC for transmittal and transmitting the CVC through a series of independent transactions.** Splitting CVC for transmittal is a common activity for logistical or risk management reasons. For instance, participants may split up major transfers to avoid the risks created by the irrevocable nature of blockchain transactions.
- **Creating and using single-use wallets, addresses, or accounts and sending CVC through such wallets, addresses, or accounts through a series of independent transactions.** Creation and use of a single-use wallet is often an important security measure used to protect digital assets, in addition to being a method used to address the financial privacy concerns that are important to many. Just as most people would not want the contents or size of their bank accounts to be publicly and easily accessible for privacy and security reasons, CVC users are similarly concerned with being targeted by thieves on-chain and in the physical world.
- **Exchanging between types of CVC or other digital assets.** The fungible nature of CVC and the proliferation of platforms and assets leads CVC exchanges to be a common occurrence. As with the first bullet, this example would seemingly encompass a broad range of pedestrian activity, as well as non-fungible token ("NFT") marketplaces because those services often enable users to exchange CVC for NFTs (*i.e.*, another type of digital asset).
- **Facilitating user-initiated delays in transactional activity.**[9] As mentioned above, commercial parties may engage in user-initiated delays for commercial, practical, legal, compliance, or risk-based reasons. These could include prearranged delivery schedules, a choice to avoid fees, or preferences for timing of payments like scheduling a bill payment.

None of the functionality or transaction patterns identified by FinCEN as examples of CVC mixing are exclusive to a Traditional Mixer. Instead, as shown above, these examples also encompass common transaction patterns or blockchain functionality that CVC users engage in for reasons other than to obfuscate transaction details and which do not raise the same money laundering risks as transactions involving Traditional Mixers.

The proposed exception from the reporting requirement does little to compensate for its potential overbreadth while simultaneously confusing the application of the definition in other instances. FinCEN proposes to except the use of internal protocols or processes to execute transactions by banks,

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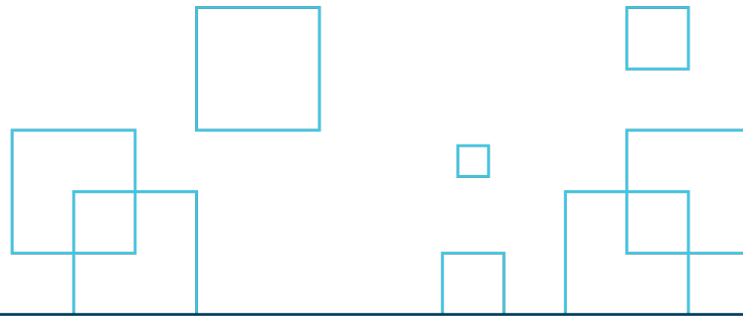
[8] *Id.* at 72703 ("This method involves combining CVC from two or more persons into a single wallet or smart contract and, by pooling or aggregating that CVC, obfuscating the identity of both parties to the transaction by decreasing the probability of determining both intended persons for each unique transaction.").
[9] *Id.*



broker-dealers, or money services businesses, including VASPs, that would otherwise constitute CVC mixing, provided these financial institutions preserve records of the source and destination of CVC transactions when using such internal protocols.[10]

But the exception would seemingly only apply to banks, broker-dealers, or money services businesses subject to U.S. jurisdiction. Thus, transactions with a foreign-operated CVC exchange that operates exclusively outside the United States would seemingly not qualify for the exception because the exchange would not fit within the BSA's definition of a "financial institution."[11] As a result, it is unclear whether routine transactions involving foreign CVC exchanges would also be considered mixing and subject to reporting since these institutions would fall outside the definition of a "covered financial institution" in the NPRM.

It is ultimately far from clear what activities FinCEN is targeting with the NPRM, as FinCEN—via the NPRM—adopts terminology for CVC mixing and CVC mixers that goes well beyond the Traditional Mixer definition. But, for the reasons discussed below, the definitions of CVC mixing and CVC mixers within the NPRM should be revised to make clear that the proposal only covers transactions with Traditional Mixers.

2. The Proposed Rule Is Inconsistent with a Risk-Based Approach to Fighting Illicit Finance

A core statutory purpose of the BSA is the establishment of risk-based programs to combat money laundering and the financing of terrorism.[12] In practice, a risk-based approach means that a financial institution's compliance program should "allocate compliance resources commensurate with its risk profile."[13]

Yet a broad construction of the NPRM would require financial institutions to deviate from a risk-based approach and instead require them to report to the government any transaction directly (or potentially indirectly) involving CVC mixing and a foreign nexus. For instance, the proposal lumps in transactions with services that have not traditionally been considered to be Traditional Mixers and which do not present the same level of risk as Traditional Mixers, including transactions with:

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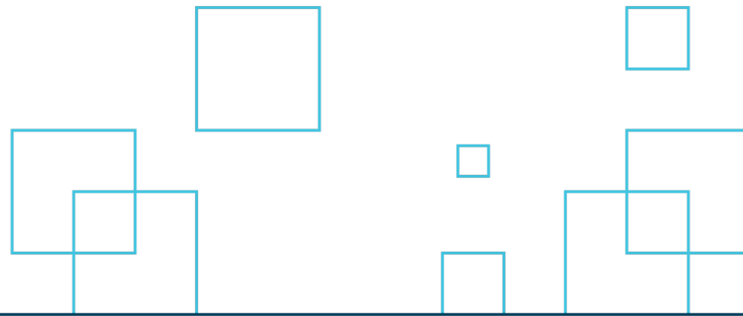
[10] *Id.* at 72709.
[11] 31 C.F.R. § 1010.100(t).
[12] *See* 31 U.S.C. § 5311(2) (declaring that covered institutions should "prevent the laundering of money and the financing of terrorism through the establishment by financial institutions of *reasonably designed risk-based programs* to combat money laundering and the financing of terrorism") (emphasis added).
[13] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, FinCEN, *Joint Statement on Risk-Focused Bank Secrecy Act/Anti-Money Laundering Supervision,* at 1 (Jul. 22, 2019), https://www.occ.gov/news-issuances/news-releases/2019/nr-ia-2019-81a.pdf.



- VASPs operating in low-risk jurisdictions;
- NFT marketplaces;
- CVC payment processors and gateways;
- CVC staking pools; and
- CVC crowdfunding platforms.

These services often contain features or functionality that may have the effect of making CVC transactions harder to trace, but any obfuscation is incidental and, unlike Traditional Mixers, not the core functionality of these services. But branding transactions through such services as being of primary money laundering concern if there is a foreign nexus inherently requires VASPs to treat these services as presenting levels of risk that are equivalent to the illicit finance risks posed by Traditional Mixers.

The NPRM's omission of a reporting floor further deviates from a risk-based approach to combatting illicit financial activity. The currency transaction reporting and SAR reporting thresholds reflect a recognition that not all transactions bear the same risk profile and not all transactions—even some transactions that a financial institution has determined are suspicious—are worth reporting to FinCEN. But the NPRM includes no such threshold and would require reporting of transactions even if $1 worth of foreign CVC mixing was involved—creating a burden not just for reporters but also significantly diluting the utility of the data reported to FinCEN.

Taken together, the NPRM requires covered financial institutions to report to the government any transaction directly (or potentially indirectly) involving CVC mixing, irrespective of whether the transaction involves suspicious activity, the risk profile presented by the transaction, the amount of the transaction, or the value to law enforcement of the report.

3. Key Portions of the Proposal Are Vague

The NPRM contemplates that covered financial institutions must report transactions "by, through, or to the covered financial institution that the covered financial institution knows, suspects, or has reason to suspect involves CVC mixing within or involving a jurisdiction outside the United States."[14] The proposal spotlights two compliance challenges that are unique to financial institutions processing blockchain transactions—post-transaction alerts and indirect exposure to high-risk activities—without providing clarity as to how the proposed reporting regime applies to or rectifies such scenarios.

a. Post-Transaction Alerts

Sophisticated blockchain analytics tools can allow financial institutions (as well as regulators and law enforcement) to tie the pseudonymous addresses shown on the blockchain to the individual or entity

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[14] NPRM, 88 Fed. Reg. at 72709-10.

behind it. These tools inarguably play a key role in helping the public and private sectors combat illicit activities on the blockchain.

But because these tools frequently rely on intelligence-based information to make attributions, there can often be a lag between the time when the activity occurs on the blockchain and the time the analytics provider attributes an address to high-risk activities. In practice, this lag means that a financial institution may be alerted to a high-risk transaction (based upon a new or updated attribution by the analytics provider) months or even years after the transaction took place.

Neither the text of the proposed rule nor FinCEN's commentary in the NPRM addresses whether FinCEN expects financial institutions to file reports on transactions that presented no nexus to foreign CVC mixing at the time of the transaction if the financial institution subsequently receives an alert based upon an updated attribution.

The trigger for the proposed reporting requirement—"whether the financial institution knows, suspects, or has reason to suspect" that a transaction involves foreign CVC mixing—appears to be derived from the SAR rules. At the time those rules were published FinCEN explained that a SAR reporting obligation is only triggered when "reason to suspect" suspicious activity existed at the time of the transaction.[15]

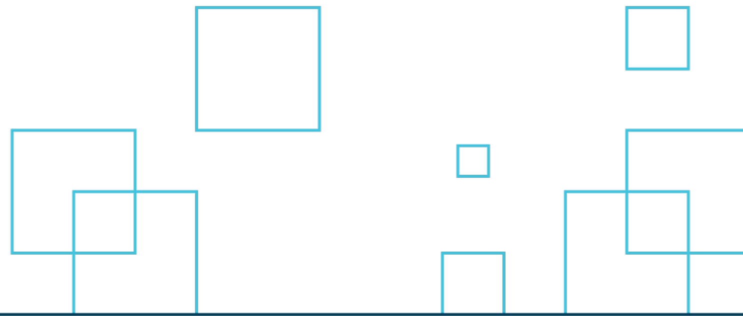
Presumably, the same "time of the transaction" test would apply to the proposal since it borrows its trigger from the SAR rules, but FinCEN should clarify this to prevent misalignment between stakeholders as to how financial institutions would be expected to process post-transaction alerts for CVC mixing exposure that were not present at the time of the transaction.

b. Indirect Exposure

Indirect exposure presents its own challenges. For many public blockchains, analytics tools often allow financial institutions to assess their indirect exposure to addresses tied to high-risk activities. For instance, these tools can often assess whether CVC received by a financial institution was, at some prior point in its history, involved in high-risk activities; and, if so, how much of the CVC can be traced to such activities.

But the fact that some portion of the CVC involved in a transaction can be traced to high-risk activities does not mean that a financial institution's customer or their counterparty is inherently engaging in those activities, much in the same way that possessing cash with trace amounts of narcotics residue does not inherently mean that someone is *ipso facto* involved in drug trafficking—indeed, studies have

[15] *Amendments to the Bank Secrecy Act Regulations; Requirement That Casinos and Card Clubs Report Suspicious Transactions; Request for Additional Comments*, 67 Fed. Reg. 15138, 15138-39 (Mar. 29, 2002) ("The determinative question, in all cases, is whether a 'reason to suspect' existed at the time and in the circumstances, in which the transaction occurred whenever and by whomever the question is asked.").



shown that "up to 97% of all bills in circulation are contaminated by cocaine."[16] It may very well be the case that the customer or their counterparty just simply happened to receive CVC that was previously involved in high-risk activities. Determining whether the VASP's customer is engaged in high-risk activities or innocuously received CVC with historical exposure to such activities is frequently a highly manual task.

As a threshold matter, the NPRM is unclear about the extent to which the reporting requirement applies to indirect exposure to CVC mixing transactions. On one hand, the NPRM only applies to transactions "by, through, or to" a covered financial institution that involves CVC mixing with a foreign nexus.[17] One reading of that language is that the obligation only applies to transactions to or from covered financial institutions that directly involve Traditional Mixers. Yet FinCEN's discussion of the burden appears to presume that covered entities will be obligated to report indirect exposure.[18]

If FinCEN intends for financial institutions to report transactions with indirect exposure to CVC mixing with a foreign nexus it should revise the proposal to state as such and additionally clarify how it expects financial institutions to address indirect exposure. Applied to the proposed reporting regime, it is easy to forecast scenarios in which a financial institution receives CVC where less than 10% of the assets have indirect exposure to a transaction through a Traditional Mixer that involves a foreign nexus. For instance, in a $1,000 deposit of CVC at a VASP, blockchain analytics tools might alert the financial institution to the fact that $10 of that CVC might have had exposure to a Traditional Mixer with a foreign nexus while the other $990 is clean. In the SAR context, VASPs have been able to utilize risk-based thresholds to determine which indirect exposures warrant a change of custody analysis to determine whether the transaction to or from the VASP involved suspicious activity. But it is not clear whether that same approach is viable when the reporting requirement applies to a transaction that has been branded as being of primary money laundering concern.

C. The Proposal Goes Beyond the Statutory Language in the Section 311 Special Measure on Reporting

Section 311 has historically been used to address foreign threats that are of primary money laundering concern. To date, the focus has been on particular foreign jurisdictions and financial institutions. This proposal constitutes the first time that FinCEN is using Section 311 to address a certain "class of transactions." Although the Chamber appreciates FinCEN's use of the full scope of its authorities, we

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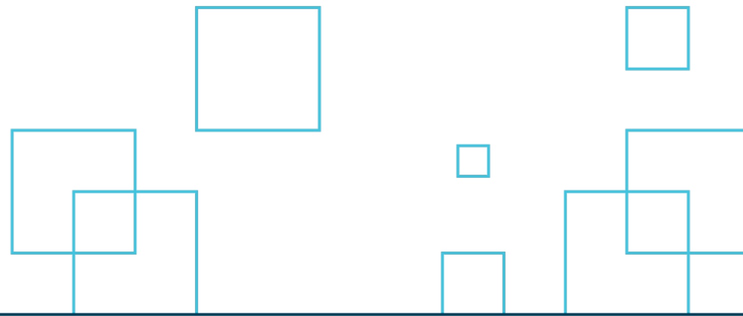
[16] *U.S. v. $639,558.00 in U.S. Currency*, 955 F.2d 712, 714 n.2 (D.C. Cir. 1992).
[17] NPRM, 88 Fed. Reg. at 72709-10.
[18] *Id.* at 72718 ("FinCEN expects that the largest portion of the novel costs incurred in complying with the first special measure will be associated with indirect exposure to CVC mixing at financial institutions not currently operating primarily in the provision of virtual asset services and cases where the jurisdictions involved or under which CVC mixing occurs are particularly difficult to ascertain").



are concerned that the proposed class of transactions goes beyond the scope of what Congress intended for Section 311.

Per the legislative history of Section 311, it is clear that Congress wanted to provide the Treasury Department with authorities that it could use to address particular foreign threats and to "close overseas loopholes through which U.S. financial institutions are abused."[19] By particular threats Congress meant threats related to particular foreign jurisdictions and "transactions involving *such* jurisdictions or institutions."[20]

FinCEN's failure to provide an appropriately limited geographic scope results in two serious flaws. First, it treats "CVC mixing" activity (which we have previously pointed out is defined too broadly) happening anywhere in the world as posing the same risks regardless of the steps that a jurisdiction may have taken to regulate it or enforce against illicit use of it. This not only is counter to a risk-based approach generally, but it is also counter to Congress's call for FinCEN to use Section 311 on a targeted basis.

Second, although we read the proposal to indicate that CVC mixing in the United States is outside of the scope of the regulation because Section 311 is intended to focus on foreign threats rather than domestic threats, FinCEN's acknowledgement in the NPRM that no Traditional Mixers have registered in the United States despite being required to do so is an indication that FinCEN is inappropriately addressing a domestic threat through the Section 311 action, rather than FinCEN using other authorities to do so. The most obvious of these authorities is FinCEN's ability, with the assistance of others, to enforce its existing regulations domestically to ensure that Traditional Mixers register with FinCEN and abide by BSA requirements to have AML programs, keep records, and make appropriate reports to FinCEN.

The result of this is that FinCEN, through a proposed rule that is ostensibly targeting a foreign threat, is shifting its burden of enforcement to the private sector, giving them the difficult if not impossible task of discerning whether a transaction involves CVC mixing in the United States or involving an unspecified jurisdiction outside the United States.

Indeed, it is unclear from the proposal what FinCEN believes constitutes "involvement" of a foreign jurisdiction or is "within" a foreign jurisdiction. Tornado Cash showcases the blurriness of the foreign and domestic threats within a blockchain environment. In justifying the need for the proposed special measure, FinCEN highlights the threats Tornado Cash[21] poses indicating that FinCEN expects that transactions through Tornado Cash would be captured under the proposed rule. But the U.S. Department of Justice alleges in its indictment related to Tornado Cash that one of the creators of the

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[19] USA PATRIOT Act of 2001, H.R. 3162, 107th Cong. 10990-02 (2001) (statement of Sen. Carl Levin), https://www.govinfo.gov/content/pkg/CREC-2001-10-25/html/CREC-2001-10-25-pt1-PgS10990-2.htm.
[20] *Id.*
[21] NPRM, 88 Fed. Reg at 72705-06.

service is a naturalized U.S. citizen who conspired to operate an unregistered U.S. money services business, muddying the analysis for financial institutions as to how the proposal's jurisdictional element should be applied to Tornado Cash.[22]

The proposal's lack of jurisdictional clarity is likely to result in financial institutions de-risking their exposure to CVC mixing generally, regardless of the jurisdictional nexus. Such an outcome is particularly problematic because of the overbreadth of the NPRM's definition of CVC mixing.

Ultimately, a better approach more in line with the purpose and scope of Section 311 would be to clarify those jurisdictions in which CVC mixing is of greatest concern and limit the scope of the reporting requirement to just CVC mixing involving those identified jurisdictions. To do so, however, any final rule must clearly specify how financial institutions are to determine whether a transaction involves CVC mixing within or involving those specified jurisdictions.

D. FinCEN Underestimates the Burden of the Reporting Requirement

FinCEN explains that the NPRM should not impose any "undue costs or burdens" on covered institutions.[23] It asserts that the burden of this reporting requirement is low because: (1) according to FinCEN, a VASP's exposure to CVC mixing is minimal; and (2) the financial institutions most affected by this rule—VASPs—would already have the tools in place to comply.

But there are numerous flaws with FinCEN's assertions. First, given the overbreadth of FinCEN's definition of CVC mixing, FinCEN's assertion that a VASP's exposure to CVC mixing is low is likely incorrect if CVC mixing captures the broad swath of activity identified in Section B.1. FinCEN provides little detail to support this assertion,[24] but it is likely basing this conclusion upon an analysis of transactions involving Traditional Mixers—despite crafting a rule that appears to apply much more broadly. In reality, the burden is likely much higher because, as explained in Section B.1, the transactions which may fit within the definition of CVC mixing are commonplace, including simply maintaining multiple wallets or maintaining a single wallet with CVC received from multiple sources.

Second, FinCEN underestimates the costs and the additional work that VASPs would need to undertake to comply with the NPRM. Although FinCEN asserts that VASPs already have tools in place to comply, the NPRM would require tremendous additional effort and resources on the part of covered institutions. Specifically, those with monitoring systems will need to adjust them to address the broader scope, while those that do not have sophisticated monitoring systems will need to obtain them. There will also be testing and ongoing monitoring of these systems, training of employees to use them effectively, filing discrete reports with a narrative, as well as the burden of conducting an additional SAR review that will

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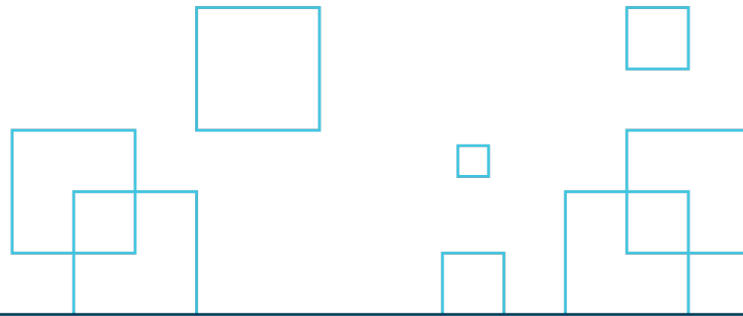
[22] Indictment, *United States v. Storm*, No. 23-cr-430, at 1, 15 (S.D.N.Y. 2023), https://www.justice.gov/media/1311391/dl?inline.
[23] NPRM, 88 Fed. Reg. at 72707.
[24] *See, e.g.*, *id.* at 72717.



most often result in additional SAR filings. Significant additional specialized staffing resources will be required for both the information technology as well as the BSA compliance expertise.

The narratives required by the NPRM are themselves burdensome. The NPRM contemplates discrete reports that will include a narrative, even though the narrative is unlikely to be of value to FinCEN. It states that covered entities should provide a "description of the activity observed by the covered financial institution, including a summary of investigative steps taken, provide additional context of the behavior, or other such information the covered financial institution believes would aid follow on investigations of the activity."[25] Given the high number of transactions that would be reportable, providing a detailed and individualized narrative for each transaction would be prohibitively expensive. Covered institutions are more likely to eventually use standardized language that meets technical requirements but provides little value to FinCEN.

While covered entities already invest significant resources conducting SAR reviews and filing SAR reports, the NPRM seemingly expands SAR requirements while creating duplicative filings since, under the current proposal, the obligation to file a CVC Mixing Report would be separate from the obligation to file a SAR.

Historically, FinCEN's guidance has been that the decision to file a particular SAR, however, is based on of the surrounding facts and circumstances, "[a]s no single red flag is necessarily indicative of CVC activity linked to illicit conduct."[26] But labeling a class of transactions which present varied money laundering risks as being of primary money laundering concern, appears to create a presumption that the transactions falling within that defined class are suspicious and implicitly require a SAR and countermeasures to allow the customer to continue transacting on the platform, irrespective of the actual illicit finance risks presented by those transactions individually. Because labeling a *class* of transactions as being of primary money laundering concern is fundamentally different than FinCEN identifying transactions as being high risk, financial institutions are likely to file SARs under the NPRM solely on the basis of exposure to CVC mixing with a foreign nexus.

E. Unintended Consequences of the NPRM

The collective flaws in the NPRM are also likely to lead to a number of deleterious unintended consequences if adopted as written, including the overreporting and de-risking of customers by VASPs and additional de-risking of the VASPs themselves by their banks.

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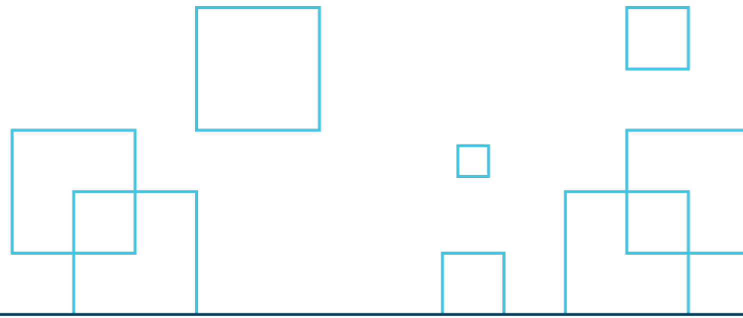
[25] *Id.* at 72711.

[26] FinCEN, *Advisory on Illicit Activity Involving Convertible Virtual Currency*, at 7, FIN-2019-A003 (May 9, 2019), https://www.fincen.gov/sites/default/files/advisory/2019-05-10/FinCEN%20Advisory%20CVC%20FINAL%20508.pdf.



1. Overreporting

When regulatory standards are unclear, financial institutions will typically file reports to avoid being criticized by FinCEN or their federal functional regulators. Financial institutions will file reports that may not be required to avoid this type of regulatory scrutiny. This phenomenon is known as "defensive filings" or "excessive filings," and this issue has been addressed by FinCEN when the then-Director noted that unclear regulatory standards will likely lead to defensive filings and stated that "[f]inancial institutions from the smallest community banks and credit unions to the largest international banks are telling us that they would rather file than face potential criticism after the fact. . . . It is no great insight to conclude that the conception of a single, clear policy on suspicious activity reporting combined with consistency in the application of that policy is the solution to the defensive filing phenomenon."[27]

In the SAR context, the Bank Secrecy Act Advisory Group has warned that defensive filings over-populate government databases and "have little value, degrade the valuable reports in the database and implicate privacy concerns."[28] And where there are a number of stakeholders that need to have a clear picture of the obligations imposed and how they should be implemented, an unclear regulatory obligation is going to further exacerbate the problem of overreporting.

Here, due to the ambiguities in the NPRM—specifically the overbroad definition of "CVC mixing," the lack of guidance with regard to the timing of reports, the manner in which subsequent information should be addressed, and the challenges in determining whether a transaction has a foreign nexus—covered entities inherently are incentivized to make defensive filings.

2. De-Risking of Customers

In addition to overreporting, FinCEN's current proposal is likely to result in VASPs broadly de-risking customers exposed to transactions that fall within the proposed definition of CVC mixing.

Indeed, the Treasury Department has been clear that the phenomenon of de-risking is counter to the goals of the AML/CFT regulatory framework for U.S. financial institutions under the BSA.[29] As part of its broader goal to combat de-risking, the Treasury Department outlined the factors driving its occurrence:

> The review identifies profitability as the primary factor in financial institutions' de-risking decisions. However, the review also finds that profitability is influenced by a range of factors, such as a financial

[27] FinCEN Bank Secrecy Act Advisory Group, *The SAR Activity Review Trends, Tips & Issues*, Issue 8, at 4 (Apr. 2005), https://www.fincen.gov/sites/default/files/shared/sar_tti_08.pdf.
[28] *See id*. at 3.
[29] U.S. Department of the Treasury, *ALMA*, *The Department of the Treasury's De-Risking Strategy*, at 39 (Apr. 2023), https://home.treasury.gov/system/files/136/Treasury_AMLA_23_508.pdf [hereinafter "De-Risking Strategy"].

> institution's available resources and the cost of implementing AML/CFT compliance measures and systems commensurate with the risk posed by a customer. The perceived potential for AML/CFT failures to result in fines also affects the profitability calculus. Other factors causing de-risking include reputational risk, risk appetite, a lack of clarity regarding regulatory expectations, and regulatory burdens, including compliance with sanctions regimes. [30]

Many of the factors that lead to de-risking are relevant here, such as regulatory burdens and costs, uncertainties about regulatory expectations with respect to compliance, and the risk of fines or penalties if the regulators, often acting with the benefit of hindsight, take a different view of what the law requires or how it should be implemented. It is foreseeable that the weaknesses of the current proposal will lead to significant de-risking, as well-meaning financial institutions seek to avoid regulatory ambiguities rather than risk future criticism from regulators about what the reporting regime requires.

Because of the potential breadth of the proposed definition of CVC mixing, and the ambiguities surrounding its parameters, de-risking will likely be extended to customers that heretofore generally have been viewed as low-risk but which, in light of the proposal, have exposure to a class of transactions that are of primary money laundering concern because of the NPRM's expansive definition of CVC mixing.

Reporting regimes established under the BSA have significant impacts on customer behaviors and this NPRM has the implied goal of directing CVC users towards U.S. financial institutions operating underneath robust AML/CFT regimes.[31] But the de-risking that we anticipate will result from the current proposal is likely to undercut the achievability of this goal. As Thomas Curry, the former Comptroller of the Currency, noted, "decisions to terminate relationships can have regrettable consequences . . . Transactions that would have taken place legally and transparently may be driven underground."[32] And, here, de-risking is likely to result in CVC transactions being pushed away from regulated U.S. financial institutions and into the less regulated portions of the blockchain ecosystem.

The NPRM includes a burden assessment but does not address the issue of de-risking and the impact that de-risking may have on those that rely on CVC as opposed to traditional banking for their financial activities, including remittance type transfers and other uses that will impact communities in need. Indeed, the Department of the Treasury's De-Risking Strategy recognizes that "the U.S. government

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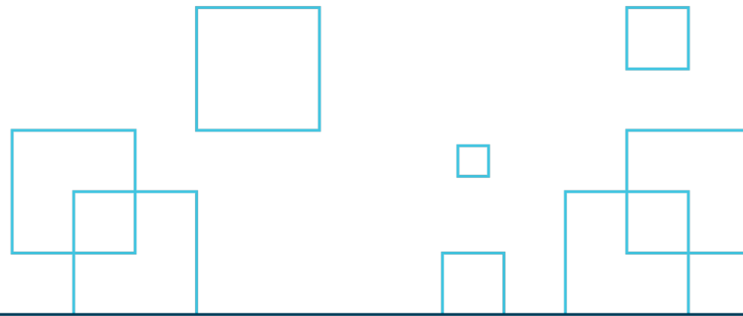
[30] *Id*. at 2.
[31] There is a federal crime known as "structuring" to address persons that structure their transactions to evade BSA reporting. *See* 31 U.S.C. § 5324.
[32] Thomas J. Curry, *Remarks Before the Institute of International Bankers,* Office of the Comptroller of the Currency (Mar. 7, 2016), at 5, https://www.occ.treas.gov/news-issuances/speeches/2016/pub-speech-2016-25.pdf [hereinafter "Curry Remarks"].



has emphasized that the implementation of reasonably designed and risk-based AML/CFT measures helps ensure humanitarian assistance flows to those most in need."[33]

The NPRM must be revised to avoid repeating this documented trend. As currently drafted, the NPRM will result in de-risking, which may result in the termination of certain financial relationships, and the subsequent increase of illicit actors moving outside of regulated institutions.

3. De-Risking of VASPs

For decades, money services businesses—the class of non-bank financial institutions that most VASPs fall within—have experienced de-risking by banks due to their perceived AML/CFT risks and the lack of clarity surrounding regulatory standards.[34] Over this time period, FinCEN and federal banking agencies have attempted to address these problems, including through a specific strategy for combatting de-risking.[35]

Stable access to banking services is critical for VASPs (and money services businesses generally) to offer their services. Indeed, some state money transmitter statutes require that the fiat funds used to satisfy customer liabilities be kept in federally insured banking accounts.[36] But any uncertainties about what a VASP's obligations would be will flow down to their banking partners as well by creating a corresponding uncertainty for banks about what *their obligations* are to supervise their VASP customers' compliance with the proposed reporting regime. Banking options for VASPs are already limited, but the uncertainty for banks created by this proposal is likely to increase their reluctance to provide banking services to VASPs.

F. Recommendations

FinCEN acknowledges that this NPRM would result in unprecedented recordkeeping and reporting requirements, stating: "FinCEN is not aware of any other nation or multilateral group that has imposed, or is currently imposing, similar recordkeeping and reporting requirements relating to transactions

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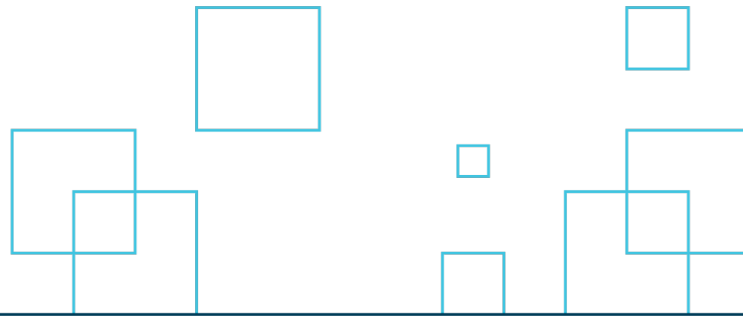
[33] De-Risking Strategy, *supra* note 29, at 26, *see also* Curry Remarks, *supra* note 32, at 6 (explaining that de-risking may result in real instances of human hardship "that results when customers find themselves unable to transmit funds to family members in troubled countries.").
[34] *See, e.g.*, De-Risking Strategy, *supra* note 33, at 44; *see also* FinCEN, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, *Joint Statement on Providing Banking Services to Money Services Businesses* (Mar. 30, 2005), https://www.fincen.gov/resources/statutes-regulations/guidance/interagency-interpretive-guidance-providing-banking.
[35] *See generally* De-Risking Strategy, *supra* note 39.
[36] *See, e.g.,* Fla. Stat. § 560.208 (requiring Florida money services licensees "to place assets that are the property of a customer in a segregated account in a federally insured financial institution").



involving CVC mixing."[37] While FinCEN asserts that these unprecedented requirements would impose only incremental compliance burdens, that assumption is not supported for the reasons discussed above.

Although the concerns outlined by the Chamber are significant, we believe they can be addressed through a revised final rule that is tailored to the threats that are the primary drivers for this rulemaking, namely, the misuse of Traditional Mixers. That tailored approach would provide clear boundaries as to which transactions require reporting and which transactions do not, mitigating the risk of unintended consequences relative to the current proposal's broader, more ambiguous structure. In particular, the Chamber would be supportive of a narrower reporting requirement that:

- **Tailors the definition of CVC mixing to only encompass transactions involving Traditional Mixers.** Doing so matches with the traditional understanding of the terminology used by the ecosystem and targets the proposed reporting requirement at activities that are the primary focus of the proposal—namely, the misuse of Traditional Mixers. A narrower definition also fosters certainty for affected financial institutions and the regulators that will supervise their compliance with any final rule implementing this proposal.
- **Addresses key ambiguities that are unique to transactions in CVC.** To ensure consistent application of the proposal's reporting requirements, any final rule should clarify: (i) the extent to which indirect exposure to covered CVC mixing would require reporting and (ii) whether and when financial institutions would be required to file reports on covered CVC mixing alerts months or years after the transaction took place.
- **Limits the jurisdictional scope of the reporting requirement to jurisdictions that are of most concern to FinCEN and which provides a clear test for identifying which transactions implicate those jurisdictions.** Narrowing the jurisdictional scope aligns with a risk-based approach to combatting illicit financial activities and is consistent with Section 311's aim of addressing foreign threats, helping avoid inappropriately sweeping up domestic activities. Additionally, any final rule should outline clear and repeatable criteria for evaluating whether a CVC mixing transaction involves a covered foreign jurisdiction.
- **Sets a $10,000 threshold under which transactions involving covered CVC mixing activities are not reportable.** Setting a reporting floor would align any requirement to file CVC Mixing Reports with existing BSA reporting obligations, in addition to supporting a risk-based approach to combatting illicit financial activities. In this case, a $10,000 reporting floor matches the threshold set for other class-of-transaction reporting requirements, namely the existing currency transaction and currency monetary instrument reporting requirements.[38]
- **Treats CVC Mixing Reports as "unified filings" that will not require separate SAR reporting except where the transactions are independently suspicious.** Labeling a class of transactions as being of primary money laundering concern is likely going to result in a

[37] NPRM, 88 Fed. Reg. at 72708.
[38] *See* 31 C.F.R. §§ 1010.310, .340.

presumption that the transactions falling within that defined class are suspicious and implicitly require a SAR. In many cases, the exposure to a transaction of primary money laundering concern would be the financial institution's sole basis for filing a SAR. In such cases, the resulting SAR will be of marginal value to FinCEN and financial institutions will bear the additional administrative burden of filing a second, discrete report on the transaction. To foster reporting efficiencies, FinCEN should allow a CVC Mixing Report to act as a "unified filing" that will not require separate SAR reporting except where the financial institution has additional reasons to believe the transaction is suspicious.

- **Allows for the filing of batch CVC Mixing Reports**. Because the Chamber forecasts that a narrative component materially increases the compliance burden for financial institutions and, in most cases, will be of little value for FinCEN and law enforcement, any final rule should remove the narrative component and allow financial institutions to file batch reports that include all reportable CVC mixing transactions within the covered period. Permitting covered financial institutions to file batch reports will create efficiencies for filers and for FinCEN.
- **Requires a reconsideration of the Section 311 designation every three years**. Implementation of either timing limitations or a revisiting of the Section 311 designation—including a public notice and comment process—at least every three years, would allow FinCEN to (i) re-evaluate the value of the reporting, (ii) evaluate the amount of legitimate activity being reported, and (iii) consider technological advances that may be available in the future that obviate the need for the Section 311 designation.

We thank you for the opportunity to comment on the NPRM. We look forward to collaborating with FinCEN in further endeavors to enhance its law enforcement objectives. If you have any questions at all, please do not hesitate to reach out to us.

Respectfully,

Kristopher Klaich
Policy Director
Chamber of Digital Commerce