January 22, 2024

Via Federal E-rulemaking Portal

U.S. Department of Treasury – Financial Crimes Enforcement Network
P.O. Box 39
Vienna, VA 22183

RE: Docket Number FINCEN–2023–0016 - Proposal of Special Measure Regarding Convertible Virtual Currency Mixing, as a Class of Transactions of Primary Money Laundering Concern

Ladies and Gentlemen:

The Clearing House Association, L.L.C. ("TCH")[1] submits this comment letter to the U.S. Department of Treasury – Financial Crimes Enforcement Network ("FinCEN") in response to the Proposal of Special Measure Regarding Convertible Virtual Currency Mixing, as a Class of Transactions of Primary Money Laundering Concern (the "Proposal") issued pursuant to Section 311 of the USA PATRIOT Act. TCH appreciates the opportunity to provide comments on the Proposal.

Balancing Anti-Money Laundering Benefits and Burdens

TCH recognizes the serious money laundering risk presented by convertible virtual currency ("CVC") mixing. As FinCEN explains in the supplementary information to the Proposal (the "Supplementary Information"), CVC mixing is used by criminals and state actors to obfuscate the source, destination, or amount involved in CVC transactions for the purpose of money laundering, sanctions evasion and other illicit conduct. TCH commends FinCEN for proposing reporting and recordkeeping measures that are designed to mitigate this risk and otherwise assist law enforcement. However, as discussed below, TCH believes that these important objectives can be achieved in a manner that is more tailored than the Proposal.

The adoption of CVC for mainstream payment activities is in an early stage of development as U.S. banks and other regulated U.S. financial institutions continue to explore the legitimate uses of CVC. At this point in time, it is difficult to know how CVC uses may evolve. But, we do know that some of the largest U.S. banks are committing resources to blockchain technology, and we do not want the regulation of CVC to foreclose unnecessarily opportunities to improve payment services and infrastructure. Hence, we strongly encourage FinCEN to strike a balance with respect

[1] TCH, the country's oldest banking trade association, is a nonpartisan organization that provides informed advocacy and thought leadership on critical payments-related issues. Its sister company, The Clearing House Payments Company L.L.C., owns and operates core payments system infrastructure in the U.S., clearing and settling more than $2 trillion each day. See The Clearing House's web page at www.theclearinghouse.org.

to CVC mixing[2] that addresses money laundering concerns without placing U.S. financial institutions at a significant competitive disadvantage to their non-U.S. banking competitors.

In our view, this requires a fair consideration of the burden that the Proposal would impose on U.S. banks in light of the anti-money laundering benefit that would result from the Proposal. Based on information provided by FinCEN in the Proposal, it appears that the anti-money laundering benefit will be limited to a very small number of transactions. In particular, the Proposal explains that among the largest registered CVC exchanges – which are the covered financial institutions with the highest expected exposure to transactions involving CVC mixing – the average daily volume of transactions directly involving CVC mixing was 0.010% and indirectly involving CVC mixing was 0.234%. Thus, it can reasonably be inferred that the relative percentage of U.S. bank CVC transactions that involve CVC mixing will be even smaller. As FinCEN describes it, "the number of transactions that would require reporting and recordkeeping as a unique consequence of adopting special measure one as proposed is extremely low in relative terms."[3]

However, FinCEN acknowledges that the cost of compliance is unknown – "it is unclear whether this proportion of novel compliance costs [related in particular to detection of indirect exposure to CVC mixing] would itself be large."[4]

We believe compliance cost will be *significant* for U.S. banks. Even if U.S. banks ultimately determine that only a relatively small number of CVC transactions need to be reported, they will need to hire an expert vendor specializing in CVC transaction analysis, screen every transaction for CVC mixing and then perform manual reviews to identify indirect exposure to CVC mixing. These are not activities for which U.S. banks would "largely rely on use of the same activities, technology, and services" that are used for pre-existing Bank Secrecy Act compliance.[5] Moreover, it is not correct that "the existing risk-based approach to AML/CFT compliance used by covered financial institutions already largely encompasses the information FinCEN is requesting" or that there is "ready availability" to U.S. banks and other covered financial institutions of the information requested by the Proposal.[6] In other words, if FinCEN finalizes the Proposal as drafted, FinCEN will be requiring covered financial institutions to implement a costly and burdensome review process.

Pursuant to Section 311 of the USA PATRIOT Act, FinCEN must consider whether "the imposition of any particular special measure would create a significant competitive disadvantage, including any undue cost or burden associated with compliance, for financial institutions organized or licensed in the United States."[7] The novel and additional measures U.S. banks would need to implement with respect to all CVC transactions to comply with the Proposal would subject U.S. banks to significant costs and burden, resulting in the exact type of significant competitive

[2] In this letter, "CVC mixing" refers to CVC mixing (as defined in the Proposal) within or involving a jurisdiction outside the United States.
[3] 88 Fed. Reg. 72701, 72717 (Oct. 23, 2023).
[4] *Id*. at 72718.
[5] *See id*. (expressing uncertainty regarding whether banks would be able to rely on existing activities, technology, and services and thereby avoid new costs).
[6] *Id.* at 72707.
[7] 12 U.S.C. § 5318A(a)(4)(B)(ii).

disadvantage Section 311 sought to prevent. As FinCEN notes in the Supplementary Information, it 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 involving CVC mixing."[8] Accordingly, TCH encourages FinCEN to revise the Proposal to reduce the potentials costs and burden on U.S. banks.

Specific Comments

I. ***Definitions***

A. ***"CVC"***

TCH encourages FinCEN to clarify the meaning of CVC when it finalizes the Proposal. The definition of CVC in the Proposal describes in affirmative terms what constitutes CVC. Because CVC use is in a nascent stage and terminology is developing, it would be helpful to amend the definition so that it also provides examples of digital assets that are not within the meaning of CVC. Specifically, we suggest that a tokenized deposit that is a representation of a claim on a bank for fiat currency and can only be transferred within the "[Know-Your-Customer] boundary of the issuer,"[9] or to the customers of other banks through bank-approved wallets be excluded from the definition of CVC. Transactions involving such deposit tokens would not involve mixing services, would be subject to banks' AML monitoring programs, and do not implicate the AML challenge that the Proposal addresses. [10]

B. ***"Involves CVC Mixing"***

The term "covered transaction" is defined in the Proposal as a transaction in CVC that a covered financial institution knows, suspects, or has reason to suspect "involves CVC mixing."[11] The Proposal does not define the phrase "involves CVC mixing," but the Supplementary Information indicates that a transaction can involve CVC mixing directly or indirectly.[12] FinCEN explains that a transaction directly involves CVC mixing if "CVC is sent from one CVC wallet address to another CVC wallet address, without the use of an intermediary" and indirectly involves CVC mixing if "CVC is sent from a CVC wallet address through at least one other wallet address to arrive at the intended recipient."[13]

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[8] 88 Fed. Reg. at 72708.

[9] *See* Rodney Garrat and Hyun Song Shin, *"Stablecoins versus tokenized deposits: implications for the singleness of money*" BIS Bulletin No. 73 (Apr. 11, 2023) available at: https://www.bis.org/publ/bisbull73.pdf. The Bank for International Settlements describes this type of tokenized deposit as the "non-bearer instrument model." It is possible for this type of tokenized deposit to reside on a permissioned blockchain or in a permissioned space on a public blockchain.

[10] As FinCEN explains, "The critical challenge is that CVC mixing services rarely, if ever, provide to regulators or law enforcement the resulting transactional chain or information collected as part of the transaction." 88 Fed. Reg. at 72703. In the tokenized deposit transaction, the bank will know the identity of sender/recipient or that person's bank; hence, the risk of an information deficit is not present.

[11] 88 Fed. Reg. at 72722 (Oct. 23, 2023) (both "transaction" and "covered financial institution" are in turn defined in the Proposal by reference to existing FinCEN regulations).

[12] *Id.* at 72717.

[13] *Id.*

FinCEN should add a definition of the phrase "involves CVC mixing" when it finalizes the Proposal to clarify the scope of covered financial institution obligations, and FinCEN should set thresholds for what constitutes indirect exposure to CVC mixing. Consistent with the Supplementary Information's description of a transaction that directly involves CVC mixing, the definition of the phrase 'involves CVC mixing' should include a transaction in which CVC is sent from a wallet address of an identified CVC mixer to another CVC wallet address, without the use of an intermediary. To address indirect exposure to CVC mixing in a clear and tailored manner, the definition also should include a transaction in which CVC is sent from a wallet address of an identified CVC mixer through at least one other CVC wallet address before being sent to the wallet address of the intended recipient, if the percentage of the transaction value that is exposed to the CVC mixer exceeds a stated threshold and is within a stated number of steps from the intended recipient's CVC wallet address. We encourage FinCEN to develop these parameters in consultation with blockchain analysis experts, giving due consideration to the balance between anti-money laundering risk mitigation and "undue cost or burden associated with compliance, for financial institutions organized or licensed in the United States."[14]

This proposed definition should be drafted in a manner that creates reasonable parameters around the transactional analysis that U.S. banks will need to perform on CVC transactions. It should not require reporting for immaterial indirect exposures. It also should avoid uncertainty regarding how far back a U.S. bank must trace the path of CVC that is being transacted by, through, or to the U.S. bank. This is important because a unit of a CVC may have exposure to CVC mixing at some point in its transaction history that is distant from the transaction by, through, or to a U.S. bank and the burden of analyzing for exposure to CVC mixing will increase over time as the number of transactions in the life of a unit of CVC grows. The burden will be particularly acute with respect to CVC that has an unusually limited supply and/or the usage of which is uncommonly high.

C. *"In CVC"*

The Proposal does not define the phrase "in CVC" that is used in the definition of "covered transaction," but the Supplementary Information indicates that it refers to a covered financial institution directly engaging with CVC transactions, "such as a CVC exchange."[15] FinCEN should clarify that a transaction "in CVC" does not include the component of a CVC transaction involving payment to network validators in the native virtual currency of a blockchain (*i.e.*, payment of network fees). All blockchain transactions require the buyer or seller of CVC to pay the validators on the network to validate the transaction. This is the so-called "gas fee" on the Ethereum blockchain or the "miner fee" on the Bitcoin blockchain, and these fees are paid in Ether and Bitcoin, respectively.[16] These validator payments are a necessary incident to all CVC buying and selling activity, and they do not raise the money laundering concerns FinCEN is seeking to address

[14] *See* n. 7.
[15] *Id.* at 72710. FinCEN has thoughtfully excluded fiat transactions from the scope of the Proposal, and we understand this to mean that a covered financial institution would not be required to file a report under the Proposal if it were to establish a fiat deposit account for a CVC exchanges or other virtual asset service provider.
[16] *See e.g., Gas and Fees*, ETHEREUM, https://ethereum.org/en/developers/docs/gas/ (last visited Dec. 4, 2023) ("Since each Ethereum transaction requires computational resources to execute, those resources have to be paid for to ensure Ethereum is not vulnerable to spam and cannot get stuck in infinite computational loops. Payment for computation is made in the form of a gas fee.").

with the Proposal. Further, analyzing the CVC paid to validators will substantially increase the burden on U.S. banks in their performance of CVC transaction analysis because it will double the work per transaction.

II. *Reporting/Recordkeeping Requirements*

A. *Reporting Requirements After Transaction Settlement*

TCH recommends that FinCEN clarify that a covered financial institution only needs to report whether a CVC transaction by, through, or to it involves a CVC mixer (1) at a point in time before the transaction occurs (when a covered financial institution receives CVC) and (2) in a transaction to which the covered financial institution is a party (when a covered financial institution sends CVC). We believe that these parameters reflect obvious limitations on a covered financial institution's ability to analyze a transaction. A covered financial institution cannot reasonably be expected to track CVC that it has purchased or sold for a customer in all future transactions occurring after the purchase or sale. We believe that this proposed clarification aligns with FinCEN's approach generally. For example, under the Recordkeeping Rule, FinCEN does not require a covered financial institution to conduct ongoing analysis and reporting with respect to future transactions in fiat currency after the financial institution credits a transfer of funds to the beneficiary's fiat-based account or has otherwise paid the beneficiary in fiat currency, unless those future transactions themselves fall under recordkeeping requirements.[17]

B. *Transaction Sequence*

FinCEN should also clarify that the reporting and recordkeeping requirements of the Proposal require covered financial institutions to provide and retain information regarding only the CVC mixer that is closest in the sequence of parties to the covered financial institution. For example, if CVC travels through a set of transactions in which Person A sends the CVC to CVC Mixer 1, which sends the CVC to Person B, and Person B sends the CVC to CVC Mixer 2, which sends the CVC to Person C, and Person C has a CVC wallet provided by a covered financial institution, the cover financial institution should only be required to report and keep records on CVC Mixer 2. We believe that this is the intent of the Proposal, but a clarification would be helpful to covered financial institution with respect to developing their compliance policies, procedures, and systems.

C. *Presumption of Compliance*

We encourage FinCEN to develop a program by which FinCEN or an independent third party would certify vendors that provide CVC transaction analysis and, relatedly, we request that FinCEN add a presumption to the Proposal that covered financial institutions may rely on the identification of CVC mixers provided by certified vendors. Analysis of CVC transactions through blockchains is a recent development. There is a small number of well-recognized firms and many lesser-know firms that perform this service, and most if not all of the companies operating in this field were established within the last ten years. The technology and expertise required for this analysis is substantial and specialized. We believe that it is not reasonable for FinCEN to expect covered financial institutions to have in-house expertise to identify transactions involving CVC

[17] *See* 31 C.F.R. § 1010.410.

mixers. Additionally, it will be challenging for covered financial institutions to meaningfully assess the performance quality of a CVC analysis vendor. By implementing a vendor certification process and creating a compliance presumption, FinCEN can maximize the likelihood of achieving the Proposal's anti-money laundering objective by motivating covered financial institutions to use the highest quality service providers.

D. ***IP Addresses***

FinCEN should remove IP addresses associated with a CVC transaction from the list of reportable information.[18] This is not a piece of information that a U.S. bank will have or that a vendor will provide, except in the unlikely event that in the future a U.S. bank operates a market-facing CVC exchange. Accordingly, covered financial institutions will be unable to satisfy a requirement that they report IP addresses associated with a CVC transaction.

E. ***Narrative***

TCH encourages FinCEN to remove the requirement that a description of activity observed be provided.[19] While the Proposal does not specify the elements of the narrative, the Supplementary Information explains that the narrative would require "a description of 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."[20] Narrative information will need to be manually prepared, and it will be duplicative of work that a covered financial institution will be required to perform in connection with the filing of Suspicious Activity Reports for suspicious transactions that involve CVC mixers.[21]

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We believe that implementation of these comments will lessen the cost and burden of the special measure without lessening its effectiveness as an anti-money laundering measure. If there are any questions regarding our comments, please do not hesitate to contact the undersigned at (336) 769-5302 or alaina.gimbert@theclearinghouse.org.

Sincerely,

Alaina M. Gimbert
Senior Vice President & Associate General Counsel

[18] 88 Fed. Reg. at 72722.
[19] *Id.*
[20] *Id.* at 72711.
[21] *Id.* As FinCEN explained in the Supplementary Information, "[i]mportantly, under the proposed rule, covered financial institutions would continue to have an obligation to file a SAR when warranted, regardless of whether the covered financial institutions also filed a report required under the proposed rule."