



Comments to the Financial Crimes Enforcement Network on Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets

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

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To whom it may concern:

LexDAO is an association of legal engineers researching and developing solutions related to digital contracts on public blockchain ledgers like Bitcoin and Ethereum. As part of this mission, LexDAO and its members believe it is a public good to summarize our findings for U.S. policy-makers in order to guide efficient conclusions that protect consumers and the larger goals of national security and orderly markets. The proliferation of digital contracts in the last two years has demonstrated how people can exchange and build value peer-to-peer without discrimination or reliance on third-parties. These social innovations deserve representation and committed protection.

With respect to the recently proposed rule to establish recordkeeping requirements under the Bank Secrecy Act for “convertible virtual currency” (CVC) transactions over \$3,000 and ordinary currency transaction report (CTR) compliance for those over \$10,000 (the “Proposed Rule”),¹ LexDAO provides this letter to comment on the overall substance and technical assumptions being made in this rushed rulemaking process.

Proposed Rule Should Adopt Common Terms in Describing Regulated Assets

First, it seems helpful to conform any proposed rulemaking to the terms commonly used by the public, *particularly so when the timeline for comment is accelerated*. The following terms in the Proposed Rule could be improved to this end:

¹ “Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets,” Notice of Proposed Rulemaking, Financial Crimes Enforcement Network of the U.S. Treasury Department, <https://www.federalregister.gov/public-inspection/2020-28437/requirements-for-certain-transactions-involving-convertible-virtual-currency-or-digital-assets>.

PROPOSED RULE	SUGGESTION
“anonymity-enhanced cryptocurrency”	“privacy currency”
“convertible virtual currency”	“digital currency”
“legal tender digital assets”	“central bank digital currency”
“hosted wallet”	“custodial wallet”
“unhosted wallet”	“digital wallet” or simply “wallet”

It is important to note the normative impact of terminology when regulators discuss new technologies and how this affects consumer choices and related perceptions of risk. In the case of “unhosted wallet,” this description may cause some new blockchain users to determine that these wallets are insecure.

Indeed, where the traditional “web2” infra often require servers and other data hosting services to make applications secure, the impression of “unhosted” is that these sovereign web3 wallets are based on a shakier foundation, when in technical reality, they are in fact more secure based on the maintenance of a private key rather than trusting a “hosted wallet” or custodial solution to protect this same data among others. Though users will always bear their own risks in protecting their exclusive access to their own wallets, the examples of hosted wallets becoming large and enticing targets for hackers should factor in how the Proposed Rule gauges the relative benefits of “unhosted wallets,” which really, are just the preferred way most transact on public blockchains, treating CVC as cash.

Similarly, the use of “anonymity-enhanced” in the Proposed Rule rather than the more commonly used “private” to describe digital currency features speaks to different cultural impressions--many might assume an “anonymity” emphasis means actively hiding and suggests furtive intentions, whereas “private” is the ordinary, and preferred passive state of most. When the public trusts institutions to define their best interests, words matter a great deal. Rather than making seemingly opinionated new definitions, tracking more common terms (see above) should make regulation more informative and friendlier to receive public comment.

Accelerated Timeline for Proposed Rule Comment Period Lacks Sufficient Basis

FinCen has determined for “national security” interests, the window for input on the Proposed Rule shall be only 15 days. The use of CVC to facilitate illegal transactions and suggestion that “this proposal involves a foreign affairs function of the United States” are deemed sufficient cause here for such fast track. This urgency lacks real weight considering the relatively minor size of digital currencies in illicit markets compared to traditional assets and payment systems. More importantly, the greater context of how the Proposed Rule affects *domestic affairs*, like

U.S. citizens' privacy and many of their current activities online warrant much greater discussion (see below), not to mention that the Proposed Rule is being made by an executive administration in transition following the outcome of the most recent U.S. presidential election.

It bears special note that in an age of increasing cynicism and political division within the United States, the powers delegated to federal agencies by the public should be wielded in a manner that commands respect and speaks to fair application--such unelected powers should emphatically *not be extended in a reckless manner that invites even greater cynicism*, particularly where the regulated industries in this case are largely spirited by seeking "credible neutrality."²

It surely was not lost on many citizens that this accelerated timeline is over the course of the winter holidays and new year celebrations--a time of common repose and "turning off." This does not feel like an opportunity to be heard on a complex and novel issue for many citizens. LexDAO joins the concerns of Coin Center on this preliminary point of respecting the purposes of the Administrative Procedure Act and "notice and comment" rulemaking,³ as 30 days minimum (49 days on average) are given to the public to voice their concerns against federal agencies extending their reach outside the normal electoral process. Further, 9 members of Congress have already signed onto similar concerns on this acceleration in a letter directed to Secretary of the Treasury Steven Mnuchin, asking that "15 days [extend] to 60 days so that stakeholders have a meaningful opportunity to evaluate how the proposed rule will impact their businesses and customers."⁴ Altogether, these factors weigh against the perceived urgency for shortening the normal comment period prior to implementing the Proposed Rule. LexDAO joins the recommendation of the Congressional Letter to ask for 60 days to be provided in consideration of the Proposed Rule.

Proposed Rule Challenges Public Value Exchange Upgrades

It is not controversial to say that payment technology has not caught up to the needs of a more global and connected market³ that runs at speed of information shared on the internet. Chasing this need, public blockchains provide a ledger and logic to settle payments between accounts anywhere in the world subject to the constraints it takes to reach consensus on the state of such accounts. These settlements have become quite efficient and competitive to the rates and security offered by banks and more traditional payment services managed by people rather than computers. Today, anyone can quickly start a business and grant permissions to a set of

² "Credible Neutrality As A Guiding Principle," NAKAMOTO, Vitalik Buterin, <https://nakamoto.com/credible-neutrality/>.

³ "Comments to the Financial Crimes Enforcement Network on Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets," Coin Center, <https://www.coincenter.org/app/uploads/2020/12/2020-12-22-comments-to-fincen.pdf>.

⁴ "Congressional Letter to Treasury," Tom Emmer, https://emmer.house.gov/_cache/files/8/a/8a474348-cf14-467d-8c1d-bdc9c221df0a/7A3776731990BD312FCCF841E096D82B.congressional-letter-to-treasury-123120done.pdf.

accounts using the smart contract capabilities of public blockchains like Ethereum, as well as receive payments and program conditional logic (*i.e.*, business requirements) from their laptop in minutes. Still, there are practical benefits and gap-filling services provided by institutions that exist on parallel payment rails--these "centralized exchanges" (as opposed to smart-contract-based "decentralized" exchanges) are managed by more familiar and regulated companies who handle legal tender, such as USD, and allow their users to exchange into CVC, hold balances, and effectuate transfers. These exchange "hosted wallets" are the nexus and point of access for many non-technical public blockchain users who might want to avoid the operation of an unhosted wallet, or otherwise want a convenient way to track and convert into legal tender to pay taxes and complete other "off chain" transactions.

The Proposed Rule seems to impose special requirements on CVC exchanges to record and report their external customer transactions above certain amounts. Common sense dictates that the mere announcement of the Proposed Rule would have led to the exodus of questionable accounts from these exchanges, and that going forward, users who want to avoid detection will further retreat from the observable zones of centralized exchanges into unhosted wallets and "anonymity-enhanced cryptocurrency." Therefore, the regulatory brunt of the Proposed Rule will actually be borne by citizens who want to simply swap among and adopt CVC currencies as a part of their business and live "above board."

Practically speaking, requiring CVC exchanges to introduce new legal and documentation processes will increase fees to these CVC users and discourage the use of wallets in other applications, such as social media which is seeing interesting applications of public ledgers to record social value exchanges, "tipping" behavior and other rapid donations to charitable causes. It is also not clear how CVC exchanges can effectively obtain identifying information on external accounts, and therefore, how the Proposed Rule might not just be a secret ban that nudges CVC exchanges to disallow transfers into unhosted wallets altogether. Other jurisdictions will likely see much greater opportunity against U.S. directives in allowing their citizens' digital lives to become more natively financial and embrace the rails of blockchains and user-controlled wallets without special documentation requirements. These should not be desired outcomes without due public consideration (see above on "Acceleration" of timeline).

Certainly, sending info that represents a picture of a cat versus a family inheritance represents different regulatory concerns. Nonetheless, LexDAO joins with Coin Center's recommendations for parity in treatment between CVC and legacy payments, particularly, to not impose any additional recordkeeping requirements related to CVC payments over \$3,000, and otherwise follow the ordinary CTR requirements for transactions over \$10,000.

Sincerely,

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