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**THE VIRTUAL ECONOMY: POTENTIAL, PERPLEXITIES AND PROMISES
UNITED STATES INSTITUTE OF PEACE**

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Good afternoon. It is a pleasure to be joining you at this event to discuss the potential, perplexities, and promises of the virtual economy. I would like to thank our co-hosts, Thomson Reuters, as well as the International Centre for Missing & Exploited Children, for inviting me to join you today. I would also like to thank the U.S. Institute of Peace for providing us with such a beautiful venue for our discussions.

First, a few headlines from the past several weeks, which not only sum up the very theme of today's discussions, but also illustrate how different our perspectives can be:

"Is the Government Trying to Kill Digital Currency?"

"Feds shut down payment network Liberty Reserve. Is Bitcoin next?"

"FinCEN's New Regulations Are Choking Bitcoin Entrepreneurs."

Or, on the other hand:

"A little regulation may boost Bitcoin's Main Street cred."

"New Money Laundering Guidelines Are a Positive Sign for Bitcoin."

"Feds don't plan to take down Bitcoin or other currencies."

But, my personal favorite has to be, *"FinCEN boss lays out Bitcoin rules."* If only it was that easy.

One thing is clear – depending on what you read, FinCEN's virtual currency guidance has been the worst thing, or the best thing, to ever happen to virtual currency, and Bitcoin in particular.

Taking a step back, for those of you who might not be as familiar with the work of FinCEN, let me take a moment to give you a quick overview.

FinCEN is a bureau of the Treasury Department, and reports to the Office of Terrorism and Financial Intelligence. With approximately 340 employees, we are relatively small considering our broad responsibilities. Our mission is to safeguard the financial system from illicit use and combat money laundering and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.

A key aspect of FinCEN's mission is to administer and issue regulations pursuant to the Bank Secrecy Act (BSA). The BSA requires a broad range of U.S. financial institutions -- including banks, money services businesses, casinos, insurance companies, securities and futures brokers, and some trades or business, like car dealerships -- to assist U.S. government agencies in the detection and prevention of money laundering. Financial institutions do this by instituting effective anti-money laundering (AML) programs, and maintaining records and filing reports with FinCEN. FinCEN, along with its law enforcement partners, uses the data contained in these reports to detect and deter money laundering, terrorist financing, and other financial crime.

Now, back to those headlines I mentioned at the outset. It is in FinCEN's regulatory area that our interests first intersected.

This March, FinCEN issued interpretive guidance to bring clarity and regulatory certainty for businesses and individuals engaged in money transmitting services and offering virtual currencies.

Some in the press speculated that our guidance was an attempt to clamp down on virtual currency providers. I will not deny that there are some troublesome providers out there. But, that is balanced by a recognition of the innovation these virtual currencies provide, and the financial inclusion that they might offer society. A whole host of emerging technologies in the financial sector have proven their capacity to empower customers, encourage the development of innovative financial products, and expand access to financial services. And we want these advances to continue.

However, equally important is the need to ensure integrity and transparency. Because the fact is, being a financial institution comes with certain responsibilities. And our recent guidance is an important step to get us there.

FinCEN's guidance explains that administrators or exchangers of virtual currencies have registration requirements and a broad range of AML program, recordkeeping, and reporting responsibilities. Those offering virtual currencies must comply with these regulatory requirements, and if they do so, they have nothing to fear from Treasury.

The guidance explains how FinCEN's "money transmitter" definition applies to certain exchangers and system administrators of virtual currencies depending on the facts and circumstances of that activity. Those who use virtual currencies exclusively for common personal transactions like buying goods or services online are not affected by this guidance.

Those who are intermediaries in the transfer of virtual currencies from one person to another person, or to another location, are money transmitters that must register with FinCEN as MSBs, unless an exception applies. Some virtual currency exchangers have already registered with FinCEN as MSBs, though they have not necessarily identified themselves as money transmitters. The guidance clarifies definitions and expectations to ensure that businesses engaged in similar activities are aware of their regulatory responsibilities and that all who need to, register appropriately.

It is in the best interest of virtual currency providers to comply with these regulations for a number of reasons. First is the idea of corporate responsibility. Legitimate financial institutions, including virtual currency providers, do not go into business with the aim of laundering money on behalf of criminals, such as those who would exploit children. Virtual currencies are a financial service, and virtual currency administrators and exchangers are financial institutions. Any financial institution and any financial service could be exploited for money laundering purposes. What is important is for institutions to put controls in place to deal with those money laundering threats, and to meet their AML reporting obligations.

At the same time, being a good corporate citizen and complying with regulatory responsibilities is good for a company's bottom line. Every financial institution needs to be concerned about its reputation and to go out of its way to show it is operating with transparency and integrity within the bounds of the law. Customers are going to be drawn to a virtual currency administrator or exchanger where they know their money is safe and where they know the company has a reputation for integrity. And banks will want to service administrators or exchangers that show great integrity, innovation, and transparency.

But those institutions that choose to act outside of their AML obligations and outside of the law are going to be held accountable. FinCEN will act to stop abuses of the U.S. financial system.

Just a few weeks ago FinCEN named Liberty Reserve as a financial institution of primary money laundering concern under Section 311. Liberty Reserve operated as an online money transmitter deliberately designed to avoid regulatory scrutiny and tailored its services to illicit actors looking to launder their ill-gotten gains. According to the allegations contained in a related criminal action brought by the U.S. Department of Justice, those illicit actors included criminal organizations engaged in credit card fraud, identity theft, investment fraud, computer hacking, narcotics trafficking, and most relevant for today's purposes, child pornography.

The 311 action taken by FinCEN was designed to protect the financial system from the risk posed by Liberty Reserve – an online, virtual currency, money transfer system that was conceived and operated specifically to allow – and encourage – illicit use because of the anonymity it offers.

Let me go back to the guidance I discussed earlier. FinCEN has been out front in issuing our guidance to make it clear that we see virtual currency administrators and exchangers as a type of money services business. These businesses are as much a part of the financial framework as any other type of financial institution. As such, they have the same obligations as other financial institutions, and the same obligations as any other money services business out there.

But keep in mind: this action was taken against one financial institution and one type of financial service. That's what a criminal case is, and that's what a regulatory action is – an action against a particular violator. With this action we were not painting with a broad brush against an entire industry. I do not think that is fair to any industry in any situation, let alone this one.

I do want to address the issue of virtual currency administrators and exchangers maintaining access to the banking system in light of the recent action against Liberty Reserve. Again, keep in mind the combined actions by the Department of Justice and FinCEN took down a \$6 billion money laundering operation, the biggest in U.S. history.

We can understand the concerns that these actions may create a broad-brush, reaction from banks. Banks need to assess their risk tolerance and the risks any particular client might pose. That's their obligation and that's what we expect them to do.

And this goes back to my earlier points about corporate responsibility and why it is in the best interest of virtual currency administrators and exchangers to comply with their regulatory responsibilities. Banks are more likely to associate themselves with registered, compliant, transparent businesses. And our guidance should help virtual currency administrators and providers become compliant, well-established businesses that banks will regard as desirable and profitable customers.

Every financial institution, whether a brick and mortar bank or a virtual currency administrator or exchanger, should be concerned about its reputation. Integrity goes a long way. I recently heard a banker say that there is a reason that financial institutions have to obtain licenses. It is a great bestowal of trust that enables banks to be part of the U.S. financial system, to be part of the global financial system. And that trust -- that privilege -- comes with obligations. One of those obligations is a responsibility to put effective AML controls in place so that the type of criminal actors that showed up in the Liberty Reserve case are not able to operate with impunity in the U.S. financial system.

In closing, I just want to circle back to the themes of today's event. Much of what I discussed today focuses on how we are approaching the "perplexities" of virtual currencies, and those are discussions we need to continue to have going forward. But the "potential" and "promise" these advances offer our economy are equally important. The innovations we are seeing within the financial services industry are a benefit to commerce on many levels. From providing services to the unbanked, to the development of new financial products, the virtual economy holds great promise. However, I would like to close with a challenge to our great innovators: extend your focus to devising creative solutions for preventing the abuse of virtual currencies by criminals, such as those who would exploit children. We all stand to benefit from such innovation, and the related transparency and integrity to our financial system.

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