

# AML and Cryptocurrency

Prepared for State Bar of Texas, Corporate Counsel Section

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ALVAREZ & MARSAL



# Contents

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1 Introductions

---

2 AML/Sanctions 101

---

3 Cryptocurrency 101

---

4 Where Crypto Meets AML

---

5 Q&A

01

Introductions

## 01. Introductions

# A&M Introductions



**JONATHAN ZATZ**  
NEW YORK

- 17+ years of experience in financial services consulting and cryptocurrency/web3
- Specializes in risk and compliance operations, technology and product/tooling delivery, providing data-driven insights to facilitate strategic, operational and regulatory transparency and improvements
- Leads transformation and remediation programs and data analytics



**RISHI CHHATWAL**  
HOUSTON

- Specializes in forensic technology, eDiscovery and legal operations
- Primary areas of concentration are regulatory risk, mergers and acquisitions discovery and information management and fintech investigations

# 02

AML 101

# AML: Key Concepts Covered

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- **Anti-Money Laundering**

- Laws vary by country, but in the U.S. the main regulatory statutes are the Bank Secrecy Act (BSA) and the USA PATRIOT Act
- Federal Regulators, State Regulators and FinCEN oversee compliance
- FinCEN receives reports by regulated institutions
- Infrequent changes to the laws on the books
  
- **Think: Criminal Proceeds & Tax Evasion**

- **Sanctions**

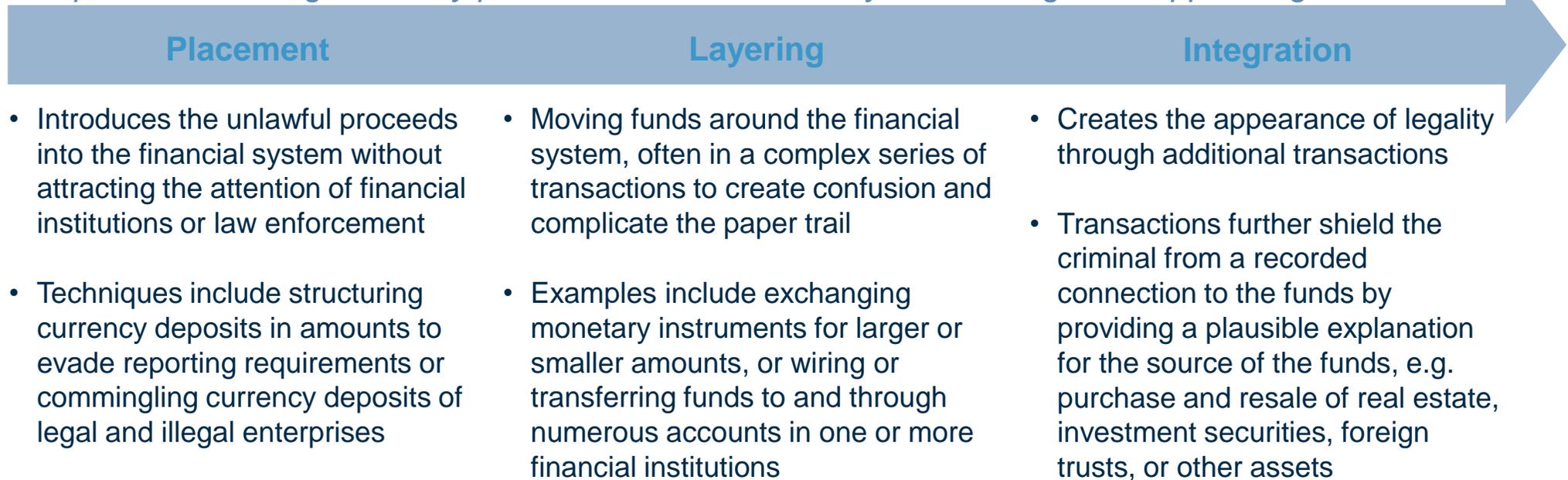
- Regulated by OFAC & DOJ, ensures that U.S. companies and citizens does not do business with sanctioned individuals, companies or countries
- Based on U.S. foreign policy and national security goals against targeted foreign countries, terrorists, international drug traffickers and those engaged in activities related to the proliferation of weapons of mass destruction
- Frequent changes to the sanctions programs depending on Executive branch
  
- **Think: Blacklists & Enemies of the State**

## 02. AML 101

# What is AML?

Anti-Money Laundering (AML) compliance has become a buzzword over the past several years; but what is it, and what does it mean for financial institutions?

*The process of taking monetary proceeds of criminal activity and making them appear legal.*



*As transactions go through the phases, it gets more difficult to determine whether the source of the funds comes from illegal activity or not.*

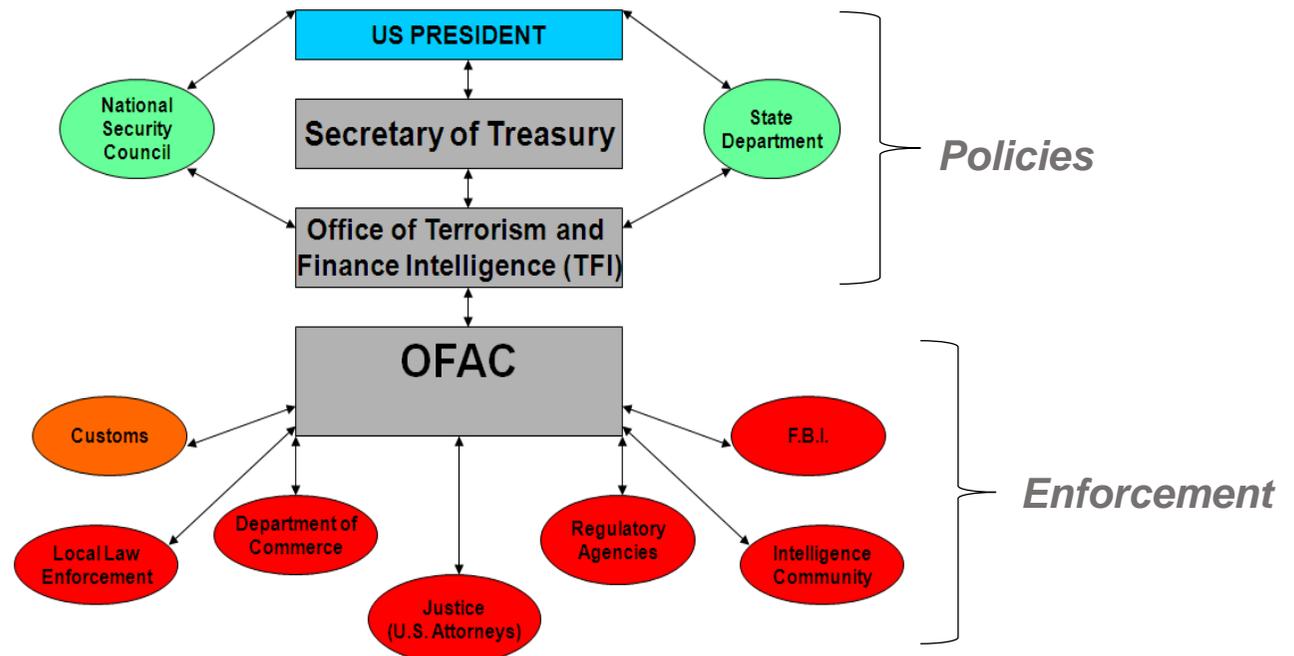
# What are Sanctions?

In the U.S., the Office of Foreign Assets Controls (OFAC) plays the pivotal role in Sanctions regulations

- Administers and enforces economic sanctions programs primarily against countries, individuals and groups of individuals – such as terrorists and narcotics traffickers
- Issues sanctions that can be comprehensive (entire nations) or selective/limited (individuals); have broad subpoena powers;
- Imposes civil fines for violations; criminal penalties imposed by U.S. Department of Justice
- Dates back prior to the War of 1812, but was formally created in December of 1950; it is now part of the US Department of Treasury

## Obligations of all U.S. Entities with respect to Sanctions:

- OFAC lists checks against:
  - (1) new accounts,
  - (2) existing accounts
  - (3) ongoing transactional activity
- Block (“freeze”) or reject property / payments / funds transfers / transactions and notify OFAC within 10 days
- File an annual report on blocked property held as of June 30 (by Q3 each year)
- Maintain records for five years





# The Financial Impact of Non-Compliance

2019	Over \$ 8 Billion in Fines in US + UK
2020	Over \$ 11 Billion in Fines in US + UK
2021	Over \$ 2.5 Billion in Fines in US

Financial Institution	Date	Headline
 HSBC	12/11/2012	HSBC agrees to <b>\$1.92 Billion</b> in fines for enabling money laundering and violating U.S. sanctions; must retain an independent Monitor
 Bank of Tokyo-Mitsubishi UFJ	06/23/2013	- Bank Of Tokyo-Mitsubishi UFJ to pay <b>\$315 Million</b> to State for violations of NY Banking Law
 pwc	09/11/2014	- PwC Fined <b>\$25 Million</b> for removing preliminary draft findings from the final BTMU report
 TD Bank	09/25/2013	FinCEN fines TD Bank <b>\$52.5 Million</b> for alleged role in Ponzi scheme; failing to uncover and report suspicious activities
 JPMorganChase	01/08/2014	JP Morgan fined <b>\$2.05 Billion</b> by FinCEN, OCC and DOJ for Failed Madoff Oversight
 BNP PARIBAS	07/01/2014	BNP Paribas fined <b>\$8.9 Billion</b> for sanctions violations
 Standard Chartered	08/15/2012	- Standard Chartered to Pay <b>\$667 Million</b> to NY and US regulators in sanctions case and requires independent Monitor to be instated
 Deloitte.	12/11/2012	- Deloitte fined <b>\$10 Million</b> over Standard Chartered
	06/18/2013	- Standard Chartered to pay <b>\$300 Million</b> for Transaction Monitoring System
	08/20/2014	
 COMMERZBANK	03/19/2015	Commerzbank agrees to pay <b>\$1.45 Billion</b> to settle both sanctions violations and money laundering allegations
 Banamex USA	07/22/2015	Citigroup fined <b>\$140 Million</b> and forced to close subsidiary due to deficiencies in its AML Program
 citibank	12/27/2017	OCC levies Citibank a Civil Money Penalty of <b>\$70 Million</b> for non-compliance with BSA C&D
 Deutsche Bank	05/26/2017	Federal Reserve Board fines Deutsche Bank A.G. <b>\$41 Million</b> penalty for AML deficiencies
 usbank	02/15/2018	FinCEN, OCC & DOJ collectively fine U.S. Bank NA <b>\$598 Million</b> for BSA/AML failings
 Capital One	10/23/2018	OCC has assessed a <b>\$100 Million</b> civil money penalty against Capital One, N.A., and Capital One Bank (USA), N.A. for deficiencies in BSA/AML

# 03

## Cryptocurrency 101

## 03. Cryptocurrency 101

# Types of Money

There are several terms used to describe modern money. However, there are very slight differences in each of these terms that necessitate some careful review.



**Fiat Money** – currency that a government has declared to be legal tender that can be used to exchange goods, debt or services, but is not backed by a physical commodity; example: USD

**Electronic Money** – A subset of fiat money, this exists only in banking computer systems and is not held in any physical form (but is convertible to physical form at any given time); example: receiving paychecks through direct deposit

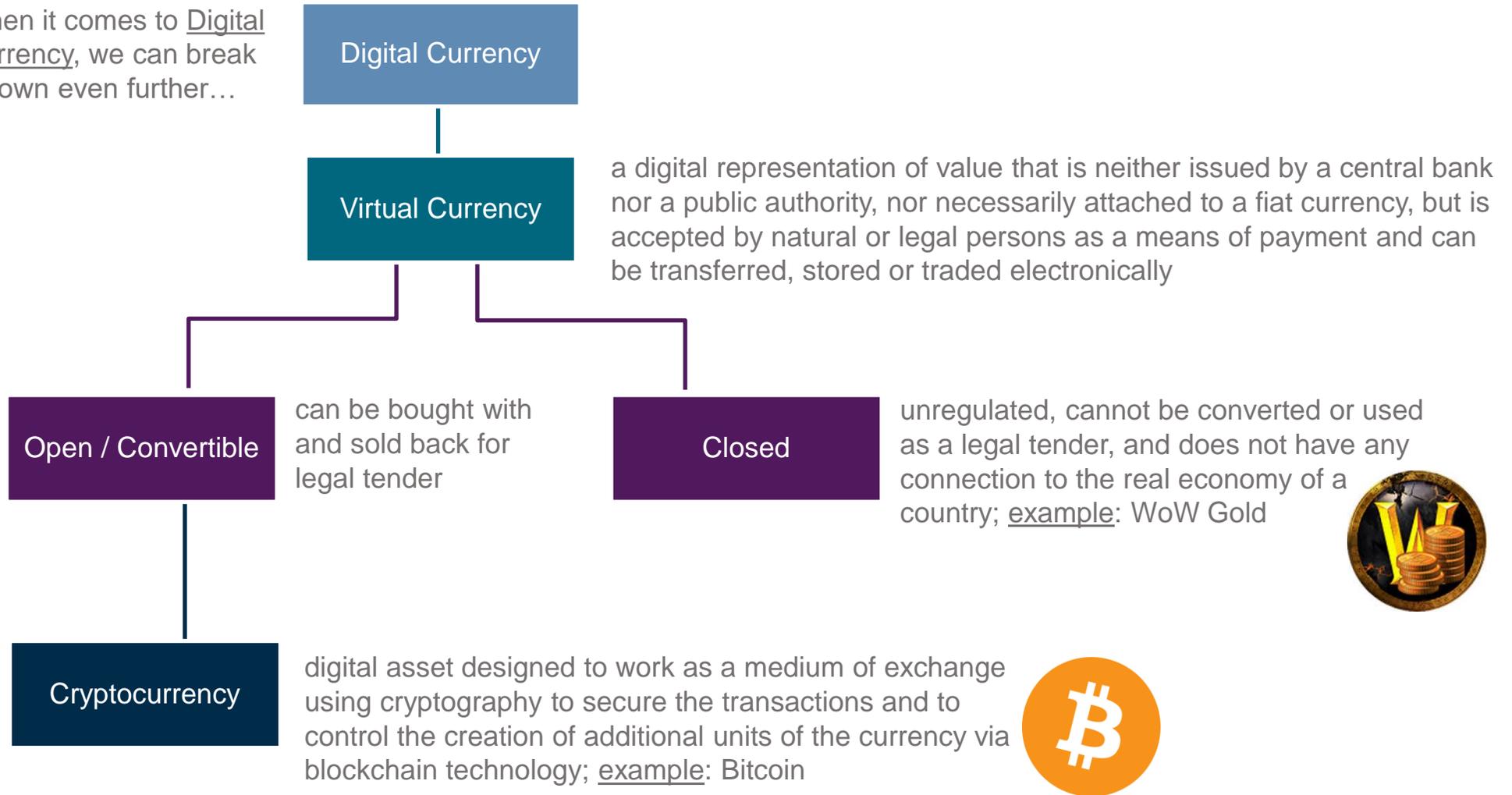


**Digital Currency** – any means of payment that exists purely in electronic form. It is accounted for and transferred using computers. Digital money is exchanged using technologies such as smartphones, credit cards and the internet. It can sometimes be turned into physical money by withdrawing cash at an ATM; example: exchanging digital currency via PayPal

# 03. Cryptocurrency 101

## Digital Currency

When it comes to Digital Currency, we can break it down even further...



## 03. Cryptocurrency 101

# Centralized vs. Decentralized

All currency falls into two categories when it comes to who is overseeing and controlling the currency:



### Centralized Currency

has a centralized repository and a central administrator; example: USD



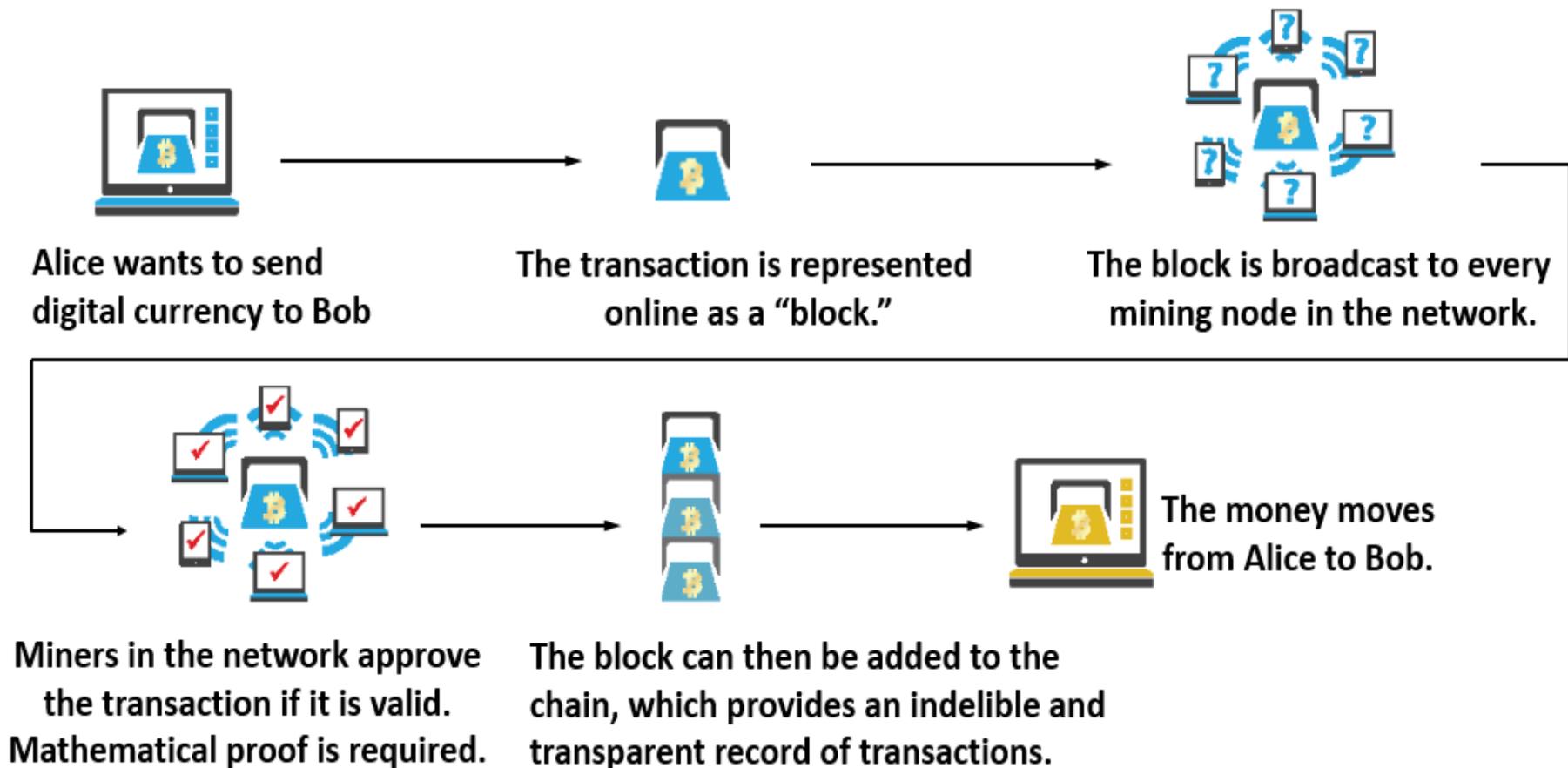
### Decentralized Currency

does not have a centralized repository or a central administrator, rendering it theoretically immune to government interference or manipulation and depends instead on a distributed system of trust. Persons may obtain by their own computing or manufacturing effort rather than relying on confidence in a central authority; example: Bitcoin

## 03. Cryptocurrency 101

# A Cryptocurrency Transaction

The Blockchain permits decentralized TRUST.



<https://www.accountexnetwork.com/blog/2017/01/promise-blockchain-technology/howblockchainworks/>

## 03. Cryptocurrency 101

# Where does Cryptocurrency come from?

### Cryptocurrency comes into existence via 'mining':

- Cryptocurrencies use 'mining' to **verify** bitcoin transactions that have been added to the blockchain
- 'Miners' are **rewarded** with new coins
- Mining is performed by **high powered computers**



## Mining

noun

1. Cryptocurrency mining is a process in which transactions for various forms of Cryptocurrency are verified and added to the **blockchain** digital ledger.<sup>1</sup> This is done using computers to solve complex mathematic problems.

<sup>1</sup> <https://www.webopedia.com/definitions/cryptocurrency-mining/>

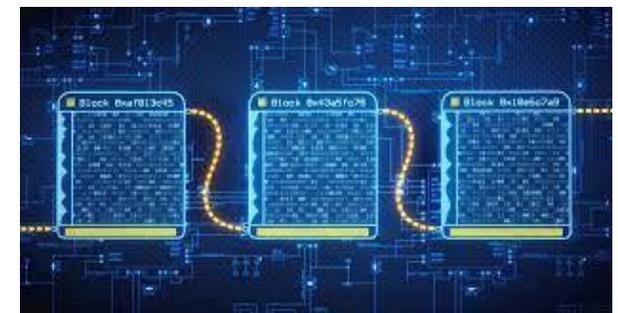
## 03. Cryptocurrency 101

# What is Blockchain?

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**Blockchain is a publicly accessible **database** that has the following attributes:**

- A blockchain is a growing list of records, called blocks, that are linked together using cryptography
- It is a distributed **public** ledger that contains every historical transaction, recorded chronologically and irreversibly
- Any user can view and access the ledger
- It is **pseudo-anonymous**: contains a record of all transactions that are traceable, but not linked to real identities
- Today's most popular cryptocurrencies are based on blockchain technology, e.g. Bitcoin, Ether



## 03. Cryptocurrency 101

# Smart Contracts – Automating the Blockchain

How do smart contracts work?



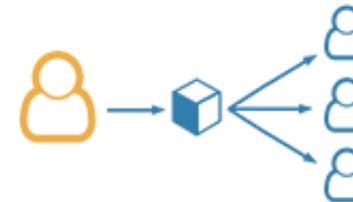
1. Rights holder publish ownership information on the blockchain

Alice is listed as the owner of her home on a hypothetical “Home Ownership” Blockchain. Data is decentralized and not controlled by any one single entity, but perhaps privately with access provided to government entities.



2. Use policies for registered works are written into smart contracts that automatically transfer usage rights

Availability, price, key transfers, obligations, and a recourse mechanism are all specified in code running on decentralized nodes, and thus introduce efficiencies and automation that enable **peer-to-peer** transactions.



3. Royalties and fees are delivered instantly, transparently and automatically based on the stakeholder information contained in the blockchain database

Digital keys and payments are transferred between Alice and Bob based on the smart contract code details agreed upon.



Ethereum is a decentralised, open-source blockchain with smart contract functionality. Ether (ETH) is the native Cryptocurrency of the platform. Ethereum was originally proposed in 2013 by programmer Vitalik Buterin.

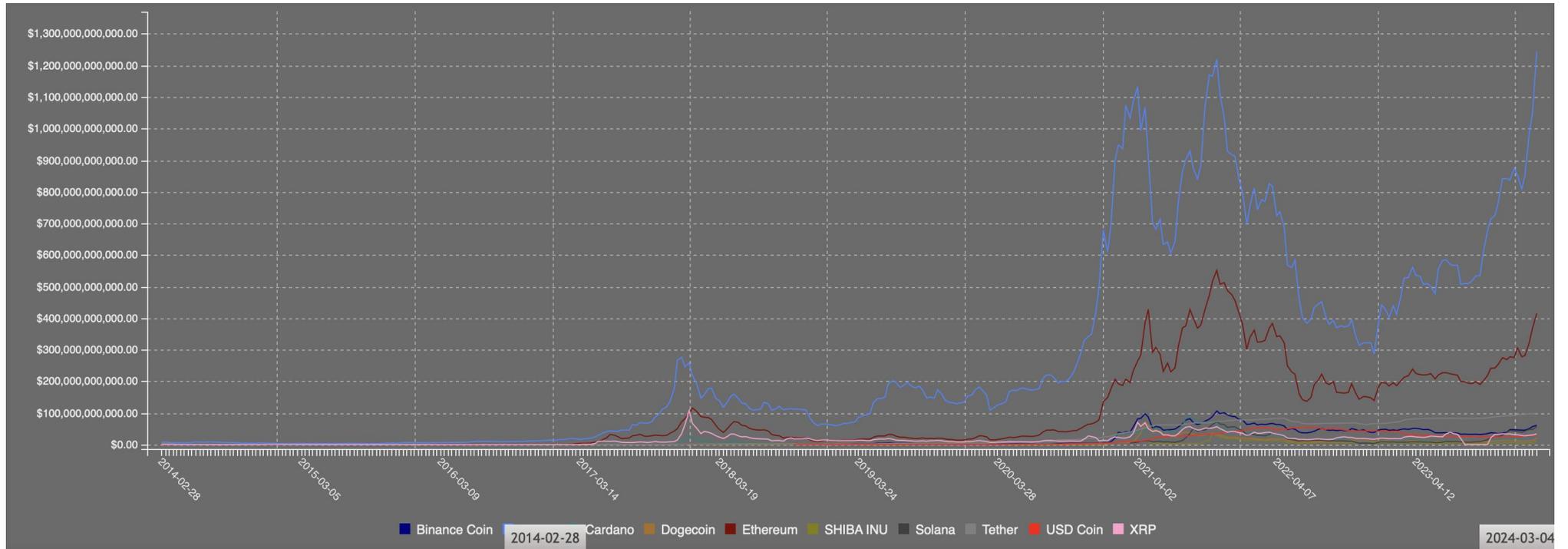
What is a smart contract?  
A smart contract is a self-executing contract with the terms of the agreement between buyer and seller being directly written into lines of code.

<http://sebfor.com/how-does-the-technology-behind-the-blockchain-work/>

# 03. Cryptocurrency 101

## 10-Year Growth in Market Cap

~\$10Bn to ~\$2.2Tn in top 10 coins only



<https://www.cryptocurrencychart.com/top/25>

## 03. Cryptocurrency 101

# Common Actions: Banks/Brokerages vs. Cryptocurrency

Customer Action	Bank Accounts	Brokerage Accounts	Centralized Exchange Wallets	Self-Hosted Wallets
<b>New Account Creation</b>	Dictated by KYC policies of Bank & jurisdiction	Dictated by KYC policies of Brokerage & jurisdiction	Dictated by KYC standards of Exchange & jurisdiction	Dictated by Individuals – (unlimited #, with no KYC)
<b>Deposit / Withdrawal of Fiat</b>	Teller (ATM / Branch)	via Bank	via linked Bank Account / ATM	via Crypto ATM
<b>Transfer Funds</b>	ATM, ACH, Wire Transfer	ACH, Wire Transfer	Wallet to Wallet	Wallet to Wallet
<b>Account Administration</b>	Secured by Bank branch / web / mobile platform	Secured by Brokerage office / web / mobile platform	Secured by Exchange web/mobile platform	Secured by private key holder of wallet
<b>Exchange / Trade</b>	N/A	Fee-based transactions on listed securities	Fee-based transactions on listed tokens	Initiated directly from a wallet connected to a centralized / decentralized exchange
<b>Arbiter of Transactions</b>	Bank	Brokerage	Account Holder / Smart Contract	Wallet holder / Smart Contract
<b>Seizure / Termination / Closure of Accounts</b>	At Bank's discretion	At Brokerage's discretion	At Exchange's discretion	Wallet holder
<b>Federal Regulators</b>	FDIC, FRB, OCC	SEC, FINRA	(depends)	(none)
<b>Venue for Transactions</b>	Core Banking Systems	Core Brokerage Systems	Internal Systems & Blockchains	Blockchains

# 04 Where Crypto Meets AML

## 04. Where Crypto Meets AML

# Cryptocurrency: Regulation & Accounting

Regulation		Accounting	
Topical Area	Things to Consider	Topical Area	Things to Consider
<b>SEC</b>	<ul style="list-style-type: none"> <li>Have already pursued multiple enforcement actions as a security</li> </ul>	<b>AICPA</b>	<ul style="list-style-type: none"> <li>Blockchain splits</li> <li>Airdrops</li> <li>Indefinite-lived intangible assets (e.g. trademarks and website domains)</li> </ul>
<b>CFTC FINRA</b>	<ul style="list-style-type: none"> <li>Have already pursued multiple enforcement actions as a commodity</li> </ul>	<b>FASB (Financial Accounting Standards Board and U.S. GAAP)</b>	<ul style="list-style-type: none"> <li>No official position – but has been pursuing a research study and is seeking public commentary</li> <li>Defer to rules in place for existing assets – but is generally subject to the circumstances around how the cryptocurrency is held</li> </ul>
<b>DOJ (Department of Justice)</b>	<ul style="list-style-type: none"> <li>Have already pursued multiple seizures and enforcement actions around potential Fraud, Money Laundering and Tax Evasion</li> </ul>	<b>IASB (International Accounting Standards Board and IFRS)</b>	<ul style="list-style-type: none"> <li>Not currently a priority</li> <li>Does not fit nicely into the framework, but is generally subject to the circumstances around how the cryptocurrency is held</li> <li>Leaning toward treatment as an intangible asset</li> </ul>
<b>IRS (Internal Revenue Service)</b>	<ul style="list-style-type: none"> <li>Virtual currency is treated as property for federal tax purposes</li> </ul>		
<b>FDIC OCC FRB</b>	<ul style="list-style-type: none"> <li>Case-by-case regulation</li> <li>Allows bank's to perform certain actions with respect to cryptocurrency with explicit approval (e.g. custody)</li> </ul>		
<b>US Treasury (FinCEN &amp; OFAC)</b>	<ul style="list-style-type: none"> <li>Considers Cryptocurrency as money for AML purposes</li> <li>Have already pursued potential breaches and violations of Sanctions</li> </ul>		
<b>US Executive Branch</b>	<ul style="list-style-type: none"> <li>Executive order calling for coordination around standards and outlining key priorities for cryptocurrencies</li> </ul>		

# 04. Where Crypto Meets AML

## Recent Crypto AML Headlines

### Sam Bankman-Fried convicted of multi-billion dollar FTX fraud

### Coinbase Reaches \$100 Million Settlement With New York Regulators

The U.S. crypto exchange will pay a \$50 million fine for letting customers open accounts with few background checks and spend \$50 million to improve compliance.

**FINANCIAL CRIMES ENFORCEMENT NETWORK**



FinCEN Announces \$100 Million Enforcement Action Against Unregistered Futures Commission Merchant BitMEX for Willful Violations of the Bank Secrecy Act

**The Washington Post**  
*Democracy Dies in Darkness*

### Coinbase to pay \$100 million over lax money laundering safeguards

New York financial regulators identified 'significant failures' in the company's efforts

**Chainalysis** Products Customers Services Insights Company

### Crypto Money Laundering: Four Exchange Deposit Addresses Received Over \$1 Billion in Illicit Funds in 2022

**USA TODAY**

TAX SEASON 2024 Where's my refund? EXPERT PICKS: TOP-RATED CARDS Choosing a credit card FIND BEST OPTIONS FOR Best CD rates

U.S. Elections Sports Entertainment Life [Money] Tech Travel Opinion

### Cryptocurrency exchange Binance pleads guilty along with CEO to money laundering charges

*Binance, the operator of the world's largest crypto exchange, pleaded guilty along with its CEO, Changpeng Zhao, to failing to maintain an anti-money laundering program.*

**CNBC** MARKETS BUSINESS INVESTING TECH POLITICS CNBC TV INVESTING CLUB PRO

CRYPTO WORLD

### 'Crypto Couple' appear set to plead guilty in bitcoin hack money laundering case

PUBLISHED FRI, JUL 21 2023-12:28 PM EDT | UPDATED MON, JUL 24 2023-AT 9:58 EDT

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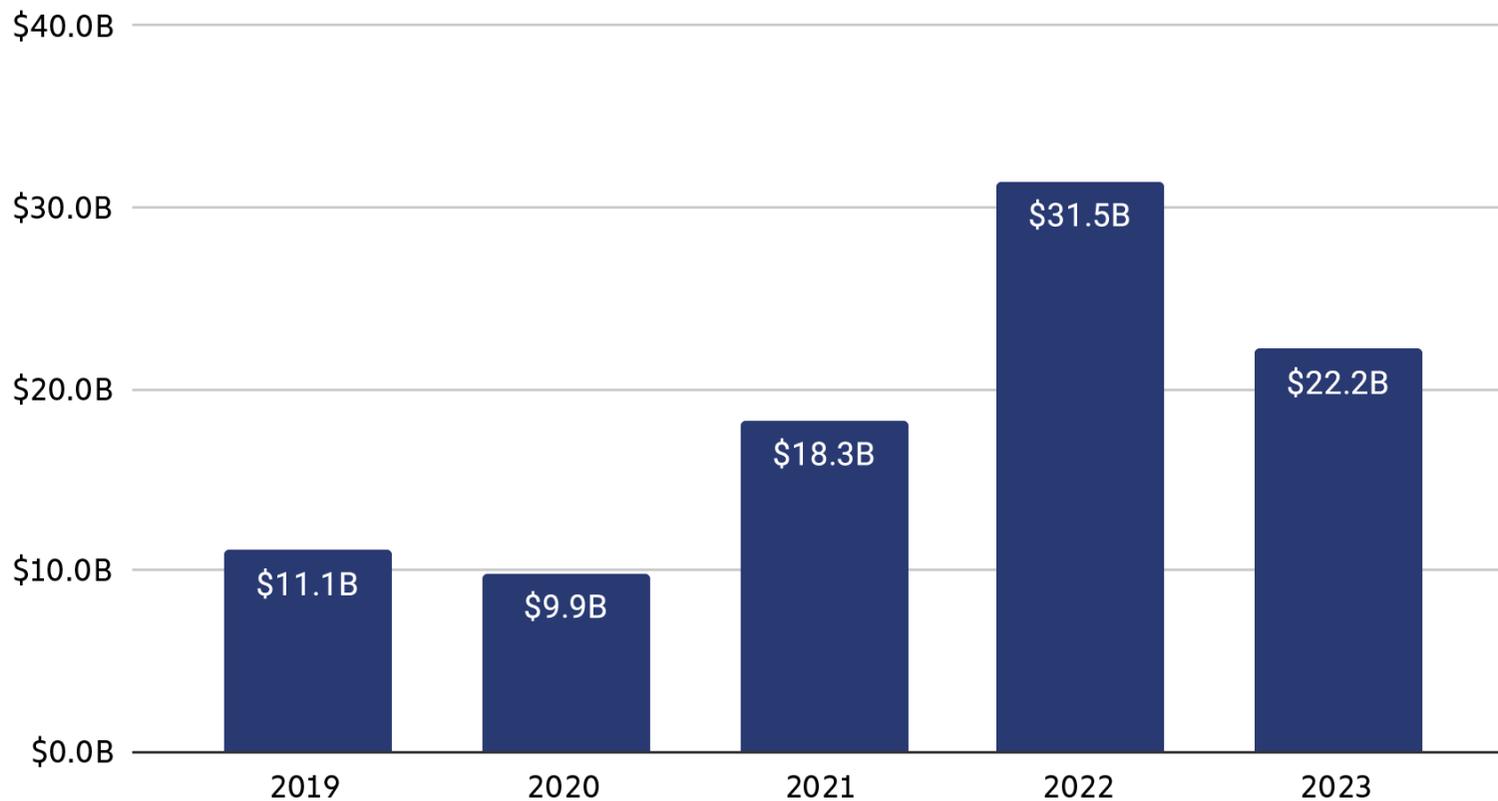
### Chinese Gangs Use Cryptocurrencies to Launder Billions

Tether and other tokens are allowing criminal organizations linked to the country to cover their tracks

## 04. Where Crypto Meets AML

# Laundered Crypto

Total cryptocurrency laundered by year, 2019 - 2023



© Chainalysis

<https://www.chainalysis.com/blog/2024-crypto-money-laundering/>

## 04. Where Crypto Meets AML

# What Makes Crypto Popular for Money Launderers?

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- **(Pseudo)anonymity** – unlike traditional bank accounts, not all crypto wallets require an associated name, account number, or verification to create
- **Cross-border transactions** – the ability to transfer crypto between two wallets in any jurisdictions is a big draw for legitimate users, but also for criminals, and expands their access to funds
- **Lack of central oversight** – decentralized virtual currencies make it difficult for law enforcement to determine jurisdictional ownership over wallets and transactions

*Thus, it is critical for exchanges to comply with regulations, preventing anonymity.*

## 04. Where Crypto Meets AML

# Traditional AML/KYC Processes and Crypto Considerations

KYC Process	Key Activities	Crypto Considerations
<b>Interpret local laws and regulations</b>	<ul style="list-style-type: none"><li>• Legal involvement</li><li>• Balkanize vs. choosing highest standard</li></ul>	Some jurisdictions use existing regulations while others creating new crypto-specific regulation
<b>Define company AML/KYC policy</b>	<ul style="list-style-type: none"><li>• Lay out goals</li><li>• Set thresholds and risk tolerances</li></ul>	
<b>Customer Onboarding/KYC</b>	<ul style="list-style-type: none"><li>• Collect customer information (i.e. name, documentation, source of funds)</li></ul>	Some crypto wallets, such as those on decentralized exchanges, can't be KYC'd since funds held by customer
<b>Screening</b>	<ul style="list-style-type: none"><li>• Check customer against sanctions, PEP, and adverse media watchlists</li></ul>	Crypto wallet addresses now on these lists, as well
<b>Risk Scoring / Enhanced Due Diligence</b>	<ul style="list-style-type: none"><li>• Assign each customer a risk score</li><li>• Request additional information if high risk</li></ul>	
<b>Transaction Monitoring</b>	<ul style="list-style-type: none"><li>• Continuously check for unusual or suspicious transaction activity</li></ul>	In addition to monitoring traditional bank account transactions, now also need to monitor on-chain transactions and wallets
<b>Case Management</b>	<ul style="list-style-type: none"><li>• Tiered manual review of potentially suspicious activity</li></ul>	
<b>Suspicious Activity Reporting (SARs)</b>	<ul style="list-style-type: none"><li>• File SAR with FinCEN for activity agreed to be suspicious</li></ul>	
<b>Re-KYC</b>	<ul style="list-style-type: none"><li>• Perform KYC again on existing customer based on pre-defined frequency at each risk level</li></ul>	
<b>Annual AML Risk Assessment</b>	<ul style="list-style-type: none"><li>• Provide a review of company's AML program and improvement areas for coming year</li></ul>	

## 04. Where Crypto Meets AML

# A&M Disputes & Investigations Team

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- We work with clients who are **Cryptocurrency exchanges** (Chief Compliance Officers, Chief Risk Officers or the Board of Directors), but also with **Attorneys** (representing Cryptocurrency clients) on matters including:
  - ***Investigations,***
  - ***Regulatory response,***
  - ***Employee misconduct (asset misappropriation),***
  - ***Compliance system reviews***
- We work in both the **proactive** and **reactive** context with respect to the Cryptocurrency landscape
- We have worked with many of the Tools common in Cryptocurrency compliance (MaxMind, Chainalysis, CipherTrace, Acuant IdentityMind, ComplyAdvantage, Notabene, etc.)
- A&M Data Analytics value proposition: AML Compliance + Crypto + Data
  - Consolidate data across disparate third-party vendors
  - Document key risks, controls, and direct insights accordingly
  - Offer proactive insights to support internal initiatives and regulatory response

# 05 Q&A

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