Op Ed: FinCEN Policy Positions Offer Murky Guidance for ICOs

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Authors:

John S. Wagster

The Financial Crimes Enforcement Network (FinCEN) appears to be taking steps to eliminate some of the ambiguity surrounding the status of ICOs as money services businesses (MSBs).

On March 6, 2018, FinCEN released a letter it sent in February to U.S. Senator Ron Wyden (the "Wyden Letter"). The letter stakes out a policy position that could be seen as somewhat inconsistent with prior FinCEN guidance and could foreshadow potential avenues of enforcement. ICOs would be wise to monitor FinCEN's public statements and, if they haven't already, should consider developing Bank Secrecy Act compliance programs to protect themselves from substantial fines and criminal liability associated with FinCEN actions.

In the Wyden Letter, FinCEN ostensibly reiterates its position that that virtual currency developers and other businesses that sell virtual currency are Money Services Businesses (specifically money transmitters) under the Bank Secrecy Act and that they "must comply with AML/CFT requirements that apply to this type of MSB."

Ambiguities and Contradictions

While FinCEN frames the Wyden letter as a reiteration of its previous position, the application of the Bank Secrecy Act to ICO activities has been less clear than FinCEN claims in the Wyden Letter due to its own previously issued interpretive rulings.

In its 2013 Guidance (FIN-2013-G001 "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies"), FinCEN stated that "a person that creates units of convertible virtual currency and sells those units to another person for real currency or its equivalent is engaged in transmission to another location and is a money transmitter." However, in a later interpretive ruling, FIN-2014-R001 (referred to as the "Mining Ruling"), FinCEN appeared to partially contravene that statement from the 2013 Guidance.

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In the Mining Ruling, FinCEN addressed questions regarding a virtual currency miner's use of mined virtual currency and seemed to indicate in its analysis that a business's useof a token was the primary factor in determining the application of the Bank Secrecy Act as opposed to the origin of the token.

The Mining Ruling suggested that so long as a token was sold for a person or business's own uses, such as for the payment of debts or to make distributions to shareholders, the person or business would be deemed a "user" of virtual currency rather than an "exchanger" or "administrator" of virtual currency.

"Users" of virtual currency are not MSBs, but "exchangers" and "administrators" are MSBs under the 2013 Guidance. This interpretation of the Mining Ruling was somewhat undercut by the Ripple Labs enforcement action (which was settled via an agreement with Ripple), but there has been no additional formal guidance or interpretative rulings by FinCEN to limit or reject an extension of the reasoning in the Mining Ruling to ICO activities.

FinCEN does not address the discrepancies between the 2013 Guidance and the Mining Ruling in the Wyden Letter, but the letter does cite the Mining Ruling in a footnote. Confusingly, FinCEN's footnote summary of the Mining Ruling seems inconsistent with the conclusions drawn in its full analysis. It may be that FinCEN is attempting to square the circle and is choosing to categorize developers as "administrators" of a virtual currency anytime they conduct a sale of their tokens regardless of the use of the proceeds.

Considerations for ICOs

While the Wyden Letter is not a formal interpretative ruling or formal guidance, this letter should be seen as a warning to all current ICOs and prospective ICOs that FinCEN is paying attention and expects full compliance with the Bank Secrecy Act.

If FinCEN acts according to the interpretation set forth in the Wyden Letter, ICOs that choose or have chosen not to fully comply with the substantive requirements of the Bank Secrecy Act (including registration as an MSB), could face serious consequences including criminal liability and extensive fines.

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Token developers should consult with legal counsel or other consultants to develop a Bank Secrecy Act compliance plan as part of their ICO offering. Some of the requirements of a well-designed compliance plan are

(i) conducting a risk assessment;

(ii) developing an effective anti-money laundering program;

(iii) appointing a compliance officer;

(iv) engaging in know-your-customer activities;

(v) complying with recordkeeping and reporting requirements;

(vi) registering with FinCEN as a money transmitter.

These activities represent a significant, but important, additional investment by developers to ready their tokens and applications for their prospective users.

On a final note, the Wyden Letter does not address the application of limitations or exemptions to the Bank Secrecy Act. ICOs may wish to consult with legal counsel to analyze their plans for raising capital associated with tokens to determine which options are best for them.

This is a guest post by Patrick Burnett and John Wagster of Frost Brown Todd, LLC. Views expressed are their own and do not necessarily reflect those of BTC Media or Bitcoin Magazine. This article is for information purposes only and should not be construed as legal advice.

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