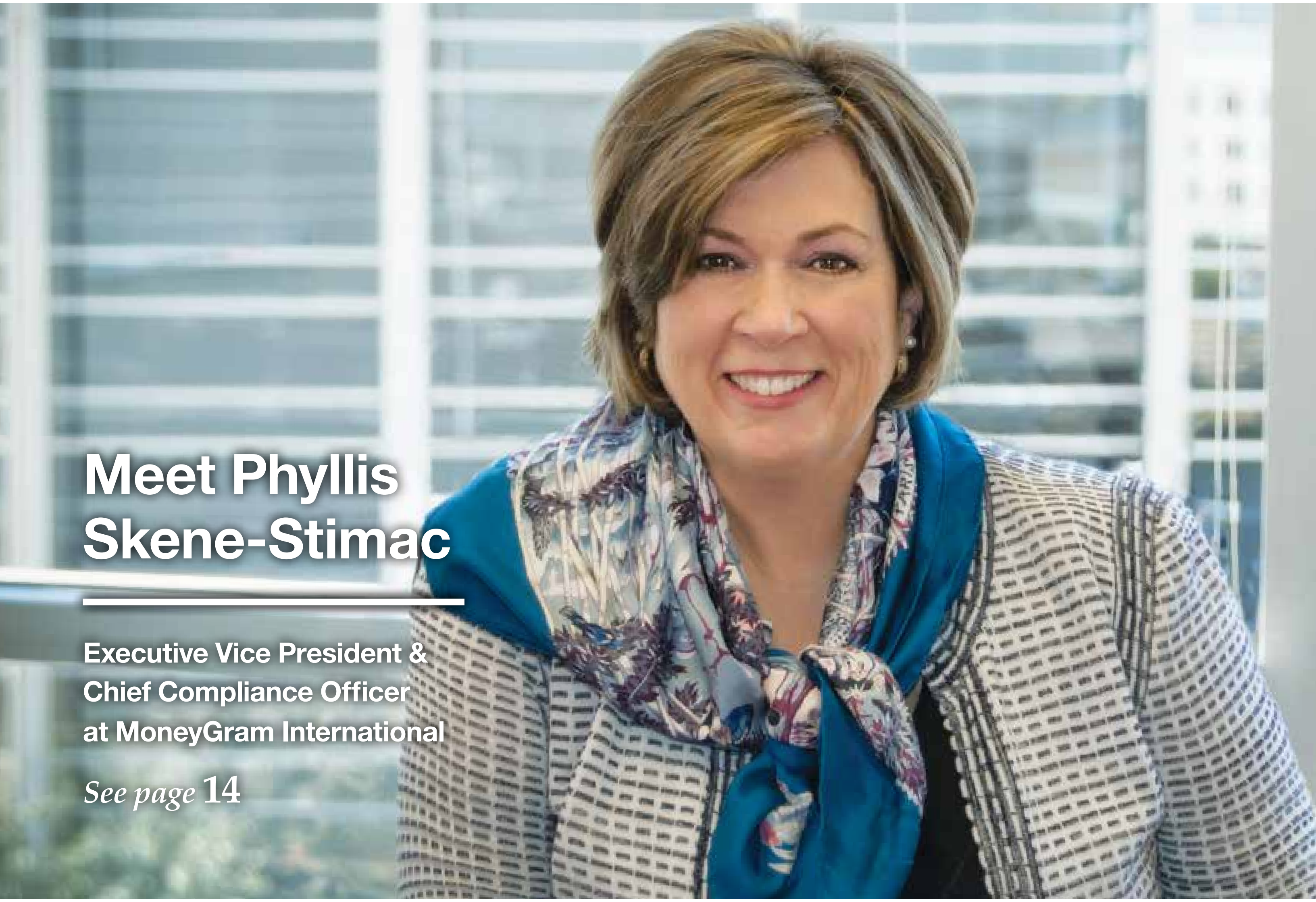
Compliance & Ethics Professional

May
2015

A PUBLICATION OF THE SOCIETY OF CORPORATE COMPLIANCE AND ETHICS www.corporatecompliance.org



by Mónica Ramírez Chimal

The electronic side of the coin... the bitcoin

» Many countries already regulate virtual currencies. A company in the Australian Stock Exchange and another in Spain were incorporated 100% by bitcoins.

» The US Financial Crimes Enforcement Network has classified exchangers and administrators as "money business services" (MbS). Any company issuing, redeeming, or exchanging virtual currencies must be registered and comply with applicable MbS laws.

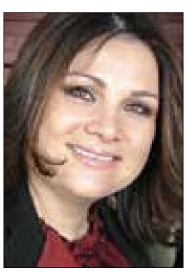
» MbS should have a compliance program according to Bank Secrecy Act requirements.

» Due to bitcoin´s characteristics, the compliance officer should adapt a different profile but should have authority, independence, budget, and sufficient training—just like any other company.

» Knowing your customer and monitoring your customer´s transactional behavior are key controls to comply with the regulation and avoid money laundering charges.

13,987,725.[1] This is the number of bitcoins issued while I am writing this article. The price is $247 (USD) per bitcoin.[2]

When Bitcoin started in 2008-2009, nobody figured out how much impact they would have in the world. Many believed it would be another virtual currency experiment that would die in the near future. Guess what? It instead took over the world with so much force that many countries are working on regulations for it.



Ramírez Chimal

But, what it is? What are its main characteristics?

Bitcoin is among the 30 most-used types of popular virtual currencies in the world. It is used between companies and individuals, and between individuals. Using a bitcoin does not require a third party, a contract, an agreement, or a notary. It has been named as the virtual currency without nationality, without borders.

It is a transfer, an interchange of some asset to another. Every transaction is transparent: Bitcoin has an open and published accounting feature known as the "block chain" in which every person can check and see how many transactions are taking place, by whom, and when, all in real time.

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Bitcoin can be compared to loyalty programs in companies such as Amazon that give you points, depending upon what you buy. Then you can exchange points for any item. It is not so difficult to understand how it works and that several schemes work like it. The difference is that bitcoin can be used worldwide.

Regulation

Countries can be divided into four bitcoin camps:

1. Countries that forbid using bitcoin or discourage its use, such as Bangladesh, Bolivia, Ecuador, India, Mexico, and Thailand, among others.
2. Countries that are "neutral" to its use, such as Poland and China.
3. Countries that have declared that regulation is not necessary, such as Hong Kong and Italy.
4. Countries that already accept bitcoin, and have regulated it or are working on regulating it, such as:

The UNITED STATES Financial Crimes Enforcement Network (FINCEN) has issued several regulations toward money business services (MbS). It regulates (1) Exchangers: any company that exchanges virtual currencies for others or for real money; and (2) Administrators: any company that issue or redeem virtual currencies.

Both exchangers and administrators are considered MbS, so they must comply with the Bank Secrecy Act (BSA). Users are not consider MbS. Knowing your customer and applying due diligence are key controls to comply with BSA regulations to avoid money laundering charges. FINCEN manages bitcoin as a financial asset, because it has a benefit, a capital gain. Bitcoins can´t be used to pay taxes, but for any trading, it must be included in the tax declaration. IRS Form 1099 must be used for any individual who gained more than US$600 annually in bitcoins, as well as Form W2 for employers that pay wages with bitcoins.

SPAIN manages bitcoin as an intangible asset. Spain saw the first successful case in which a company was established by funding 100% of its capital and operations requirement entirely with bitcoin.[3] If any trading represents more than 1,600 euros annually, that company has an obligation to declare it. Transactions in bitcoin are subject to value added tax (VAT).

ENGLAND manages bitcoin as a financial asset and it is working on its regulation. The latest news states that the government is planning to launch its own virtual currency: the "britcoin" and for its first phase, it will only be offered to and managed by its citizens. Depending on how well it goes, it may be offered for use by foreign nationals.

JAPAN will be the first country to manage bitcoin as "gold". Its objective is to be the most "friendly" country to use bitcoin. They are working on how to diminish the bitcoin volatility.

GERMANY manages bitcoin as Other Assets. If you hold bitcoins for at least one year, then there is no need to pay taxes for it. If not, you pay 25%. There is a project to establish a bitcoin bank.

CANADA's government said bitcoin is included already in anti-money laundering regulation (refered to as "digital currency") and it is managed as a financial asset. However, has enacted new policies that mandate virtual currency ATM operators and virtual currency trading platforms obtain a license. Companies are allowed to pay wages with bitcoin.

AUSTRALIA has the first company to be listed on the stock exchange.[4] Any bitcoin transaction is subject to VAT.

Other countries in Group 4 include: Austria, Belgium, Brazil, Bulgaria, Czech Republic, Israel, Kenya, Malaysia, Norway, Romania, Russia, and Switzerland.

How to comply

Taking some important steps will help you comply with the law, whether you are thinking about starting to accept bitcoins in your business or already are accepting them.

1. **Register with FINCEN if you are an exchanger or administrator.** It is a felony to run an MbS without FINCEN approval. Punishment may vary from fines to imprisonment.
2. **Know each state's laws.** In addition to complying with FINCEN, make sure that you know what each state requires. They vary across the country. New York, California, and Virginia are ahead of the curve when it comes to implementing FINCEN regulations, but South Carolina, New Mexico, and Montana do not regulate any type of money transmitting businesses.[5] Those companies that want to have customers within the U.S. must have a license for all states (it will take companies between 1 and 3 years to obtain it). The requirements include being audited by a third party.

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3. **Implement a Compliance function or hire a compliance officer (CO)**, depending upon the size of your company and/or needs. The profile for any compliance officer within a company with substantial bitcoin business should be a mix of an accountant, internal auditor, and systems engineer; but above all, the CO should know what bitcoin is, how it functions, and the company's processes. The CO should be independent and report to the CEO and, ideally, to a compliance committee.
4. **Develop a business risk administration program.** The CO should start by mapping all processes; how many persons are involved in which area; how the information, money, and virtual currencies go through it; and which are manual or automatic activities. Then, identify the risks as well as the controls. Are the controls efficient? In which processes is the company vulnerable to money laundering risk? Or terrorist financing? Consider the inherent risks bitcoin has, such as the location of the users or use of multiple locations, multiple transfers going to one common end user, use of multiple devices, how the real owner of the resources may be able to stay hidden, the origin of the funds, whether those funds are used to buy illegal products, volatility of its price, the lack of security controls that may lead to lost bitcoins, chances of tax evasion, etc. If you are an exchanger, the risk of a cyber-attack is more probable, but it all depends on the security controls you have.

The CO should design tests to verify control effectiveness so it can be decided if the risks are high, medium, or low. A heat map can then be used to determine the risk level, and a business risk model and related policies and procedures (P&P) can be tailored to manage the risk. Companies cannot manage risks and comply with regulations if they do not understand what those risks are and how they impact compliance with regulations.

5. **Develop a compliance program,** which according to Bank Secrecy Act (BSA) should include:
   - Internal Controls – a company should have P&P to manage risks identified in the heat map, should enable them to identify their customers, and include due diligences and data privacy, among other concepts.
   - Training – should be done at least annually and must be documented.
   - Compliance officer – must have authority, budget, and sufficient training.
   - Independent testing – a company must be independently audited.
6. **Develop policies and procedures,** which should be in accordance with applicable regulation to comply with federal, state, and local laws. If your company has a presence in the countries that accept virtual currencies, your P&P should cover anti-money laundering, data protection, the various lines of business, applicable controls, and compliance with the code of ethics. If your company does not have a code of ethics, develop one.

You can rely on software, depending on your budget, but make sure that in the country where you have presence (or in other countries where you have locations) sanctions lists are taken into consideration when performing KYC.

Duties of the compliance officer

From this point, we will assume you already have the foundations of a compliance framework, licenses, a compliance officer, a business risk administration program, a compliance program, policies and procedures, and a code of ethics. Now, let´s get to the details of the CO's duties and responsibilities.

Know your customer

Start applying Know your Customer (KYC) to all existing customers and new ones. It will be hard, because of the so called "anonymity" and the customer may not appear in person, but it is not impossible. The regulation requires obtaining the minimum data: name, date of birth, address, and identification number. Get a copy of an official ID and corroborate the information. Depending upon your services and products, if the customer is not appearing in person, you may apply a policy of appearing on a webcam so identity can be checked.

Run the customer data over the most important sanctions lists, such as OFAC, CIA, UN, PEP, UK, etc. You can rely on software, depending on your budget, but make sure that in the country where you have presence (or in other countries where you have locations) sanctions lists are taken into consideration when performing KYC. If possible, check customer information in public databases or references with financial institutions. A best practice is to require two sources of verification rather than one. For any negative results, escalate it to the governance body, committees, or higher authority, depending on the nature of the transaction.

Keep records updated

Whether it is Excel, software, or a physical file per client, it should be safeguarded and updated at all times. Consider data privacy regulations, depending on the countries in which your company has a presence, and comply with those. Remember, records are your "life insurance" for any audit, revision, or investigation. Internationally "speech slips" because words are taken by the wind, but writing preserves the evidence.

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Monitor client´s transactional behavior

As time goes by, a profile for each client can be performed. The CO should be able to know in real time any discrepancy or establish red flags which may make this work easier. For any negative results, escalate it to the governance body, committees, or to higher authority, depending on the nature of the transaction. File any transaction or suspicious activity that you know, suspect, or have any reason to suspect involving aggregate funds or other assets of $2,000 (USD) or more in a "suspicious activity report" (SAR) and send it to the appropriate authorities. This should be done within 30 days of initial detection.

Know your employees and third parties

Know not just customers, know your employees and know your third parties, including vendors, strategic alliances, counterparties, etc. Depending upon your products and services as well as how bitcoin is used, determine if, for example, a foreign counterparty should be investigated. Keep in mind FINCEN´s three types of parties in regulating bitcoin: exchangers, administrators, and users.

Keep information organized

Be organized so you can have time to perform all duties and to be able to promptly respond to any request from the authorities. Remember that the CO is the person not only responsible for reporting to the authorities, but also the one to respond for any information needed.

Training

It is mandatory for companies to be updated on the use of bitcoin and new regulations towards bitcoin. Best practices mention that training should be 80 hours yearly, as a minimum, but since bitcoin information changes so quickly, it is better to have training on a recurrent basis. Yesterday´s data may be obsolete today. Ensure that training is conducted by the right provider, the content is of the best quality, and it is relevant to the companies' processes. Keep in mind that bitcoin is highly associated with money laundering, so ensure that both the CO and personnel with more exposure to money laundering risks are trained. This will help your company's employees be aware of any symptom of money laundering, and what they should do about it. Make them look into and uphold your company's ethics. Also, ensure your P&P are correctly disseminated and understood.

If you are part of the governance body in a company, change your thinking about training: You are investing rather than generating an expense. Your CO or Compliance function is your protection and your shield, but in order for this function to perform correctly, the employees running the Governance and Compliance functions should be trained constantly.

Independent auditing

Encourage an audit of the Compliance area or CO´s work by an independent department such as Internal Audit (if the company has it) and/or an external consultancy firm at least once a year. Make sure to implement the recommendations.

Continuous improvement

Improve continuously the CO function, as well as the companies' processes, and strengthen controls based upon CO reports provide to management, internal audits, operation flaws, external revisions (a firm or authority) news, risks, etc. Make sure to update your business risk model once a year such as the compliance program and any other document that goes with it (i.e., P&P). Make every document within the company be consistent with those.

Other important facts to consider

Bitcoin is generating a competitive advantage for any company, similar to when credit cards were launched. According to Overstock's CEO,[6] companies such as theirs (which accepts bitcoin) stated that it notably increased its income.

It is innovating international transactions, digital commerce, and global economy. The force of the market is boosting governments, because of the increase in its use worldwide. Although governments still need to standardize how to regulate bitcoin, companies using it should nevertheless comply with existing laws, especially laws in the U.S.

Statistics show that bitcoin is used and will be used every day by more and more people around the world; the European Central Bank has published a report on virtual currencies that recognizes their dramatic growth in recent years.[7] Even if for some reason it gets finished, it will be the most important background and framework worldwide of all virtual currencies. The US Bank Regulator has said: "Virtual currencies could be revolutionary"[8]; meanwhile, the Swift Panel sees a future for bitcoin in international banking.[9]

Nowadays, International Monetary Fund, World Bank,[10] private banks, and Bill Gates[11] have already acknowledged the efficiency of its system.

Let´s keep in mind that England is already working to launch its own virtual coin. So, bitcoin will be here to stay. ✳

1. Blockchain: Total bitcoins in circulation as of March 2015. Chart available at http://bit.ly/bitcon-circulation
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3. For more detail see: (available only in Spanish) http://bit.ly/abanlex-bitcons
4. Cryptocoins News: "Bitcoin Group's IPO on the Australian Stock Exchange." October 2014. Available at http://bit.ly/cryptocoinsnews
5. Shipkevich PLLC website: Licensing laws for non-bank money transmitters. Available at http://bit.ly/money-law
6. Pete Rizzo: "Overstock CEO Patrick Byrne Reports $1.6 Million in Bitcoin Sales." *CoinDesk*, May 27, 2014. Available at http://bit.ly/coin-desk
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9. Evander Smart: "Swift Panel Sees a Future for Bitcoin in International Banking." *Cryptocoins News*, "http://bit.ly/swift-panel" March 6, 2015. Available at http://bit.ly/swift-panel
10. Nermin Hajdarbegovic: "IMF and Word Bank Annual Meetings Explore Block Chain's Potential." *CoinDesk*, October 14, 2014. Available at http://bit.ly/imf-world-bank
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