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January 4, 2021

Submitted electronically

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

Re: FinCEN Docket Number FINCEN-2020-0020; RIN 1506-AB47; Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets

Dear Ladies and Gentlemen:

Fidelity Digital Asset Services, LLC ("Fidelity Digital Assets") appreciates the opportunity to comment on the Financial Crimes Enforcement Network's ("FinCEN") notice of proposed rulemaking, *Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets* ("Proposed Rule" or "CTR rule"), published in the Federal Register on December 23, 2020. FinCEN's notice provides that written comments on the Proposed Rule may be submitted on or before January 4, 2021.

Fidelity Digital Assets, an affiliate of Fidelity Investments ("Fidelity"),[1] is a New York state limited liability trust company that provides custody and trade execution services for digital assets, currently limited to Bitcoin. As a highly regulated banking institution supervised by one of the leading state banking regulators in the country, Fidelity Digital Assets considers itself a partner to FinCEN and to the broader regulatory and law enforcement community in the fight against money laundering and terrorist financing. To that end, Fidelity Digital Assets is committed to working with FinCEN and the digital asset industry to facilitate the adoption of, and widespread compliance with, meaningful digital asset anti-money laundering regulations.

Fidelity Digital Assets submits this letter due to serious concerns that the limited comment period will deprive FinCEN of important feedback from industry partners, resulting in a less effective rule that will create significant barriers to widespread compliance. FinCEN's failure to engage with its industry partners through ordinary notice and comment

[1] Fidelity Investments is one of the world's largest providers of financial services, including investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 30 million individuals and institutions, as well as through 13,500 financial intermediary firms.

procedures marks a sharp departure from established practice, and risks imposing sweeping new requirements without addressing critical ambiguities and barriers to implementation, several of which are discussed below.

I. Background on Fidelity's Digital Assets Platform

Fidelity has long believed that blockchain technology has the transformative power to improve financial inclusion, broaden the range of products available to investors, and lower transaction costs worldwide. The Fidelity Center for Applied Technology ("FCAT") began exploring the application of blockchain technology to financial services in 2014. Four years later, Fidelity launched Fidelity Digital Assets, a full-service enterprise-grade platform for storing, trading, and supporting certain digital assets. Last year, Fidelity announced the formation of Fidelity Digital Funds to develop digital asset investment products. Simply put, we believe that blockchain technology is a new operating system for financial services. The initial expression of this capability is through Bitcoin, Ethereum and other native digital assets but we expect that other traditional forms of value—notably certain types of securities and possibly fiat currencies—will be issued on blockchains in the future.

II. FinCEN's Limited Comment Period Will Result in a Less Effective Rule

Fidelity has a strong tradition of Bank Secrecy Act compliance and approaches the proposed CTR Rule with an appreciation for FinCEN's desire to ensure appropriate oversight over digital asset transactions across all risk profiles, including self-hosted wallets. Fidelity Digital Assets is committed to working with regulators, policymakers, and industry groups to ensure that digital asset innovation is consistent with efforts to combat money laundering and the financing of terrorism. However, Fidelity Digital Assets has serious concerns that the limited comment period—two weeks over the holidays—will result in a rule with significant ambiguities and weaknesses, and will deprive FinCEN of important feedback from the industry necessary to ensure the rule is effective.

To start, the preamble of the Proposed Rule does not accurately reflect FinCEN's engagement with the industry on the content of the Proposed Rule. Fidelity Digital Assets is not aware of opportunities open to the public or the industry at large for discussion on the new requirements in the Proposed Rule and saw no indication that FinCEN was developing a rule related to self-hosted wallet recordkeeping or reporting. The 2019 and 2020 meetings referred to by FinCEN in the preamble were limited to a subset of invited Virtual Asset Service Providers ("VASPs"), and—although FinCEN has not made notes of those discussions available publicly—there is no indication the meetings focused on the Proposed Rule. Fidelity Digital Assets does not believe these limited steps are a meaningful substitute for a real opportunity for public comment.

FinCEN's approach to the Proposed Rule, moreover, is starkly at odds with established practice. Fidelity notes, for instance, that it had meaningful opportunities to discuss potential Travel Rule solutions with FinCEN. Fidelity participated in an industry roundtable hosted by the Treasury Department on March 2, 2020, to discuss the national security implications of digital assets. At that meeting, Fidelity and other industry leaders met with Secretary Mnuchin, who described Treasury's desire to work with Fidelity and other institutions to address concerns about terrorist financing. Fidelity Digital Assets and others formed a working group to develop an industry platform to facilitate compliance with the Travel Rule. In large part due to continued engagement with FinCEN staff, the industry is working toward a Travel Rule solution—a prime example of how the industry can help drive solutions that balance regulatory concerns with innovation. This roundtable, convened in the spirit of collaboration and good faith, would have been an optimal forum to address the concerns FinCEN is attempting to solve in the Proposed Rule. Indeed, there are numerous industry groups currently focused on developing Travel Rule and other compliance solutions, and FinCEN's engagement with groups working on those issues is the most effective approach. This missed opportunity, combined with issuance of the Proposed Rule on an expedited schedule seemingly designed to limit meaningful comment, undermines what has been a fruitful collaboration between FinCEN and leading financial institutions in achieving important shared goals.

An exceptionally short comment period for a rule with wide-ranging impacts on VASPs is also inconsistent with FinCEN's past practices. In establishing new industry requirements, FinCEN has always afforded a robust opportunity for engagement. For example, prior to issuing the Customer Due Diligence for Financial Institutions final rule—which similarly included measures to prevent terrorists and criminal organizations from abusing the financial system—FinCEN issued an advanced proposal, a proposed rule, and held five public hearings.[2] Likewise, FinCEN held public meetings to give members of the money services business industry a meaningful opportunity to engage with FinCEN on registration and suspicious activity reporting obligations.[3]

Further, fifteen days is insufficient by the Proposed Rule's own terms. FinCEN's justification for the shortened comment period is inadequate. The notice of the Proposed Rule includes a list of 24 separate questions on which FinCEN encourages comment, including a number of questions that suggest potential expansion of what is already an extensive new rule. Providing FinCEN with meaningful answers, whether related to burden and cost or related to the implications of expansion, requires a collection and analysis of data that is impossible over just eight business days interspersed with major national holidays.

[2] FinCEN, *Customer Due Diligence Requirements for Financial Institutions*, 81 Fed. Reg. 29398, 29402 (May 11, 2016).

[3] FinCEN, *Bank Secrecy Act Regulations: Definitions and Other Regulations Relating to Money Services Businesses*, 76 Fed. Reg. 43585, 43586 (July 21, 2011).

Critical omissions in the Proposed Rule also make it impractical to timely respond to FinCEN's questions. For instance, the industry cannot meaningfully respond to questions about the Proposed Rule's burden because FinCEN has not provided information on the form, manner, or specific data fields that it will require in the proposed reports.

Finally, FinCEN's justification for the shortened comment period is not compelling. While Fidelity Digital Assets shares FinCEN's goals of protecting the U.S. financial system from abuse, the Proposed Rule's use of outdated examples of illicit activity, some over three years old, does not establish an emergency sufficient to bypass the Administrative Procedure Act's mandate to offer a fair opportunity for notice and comment.[4] And while FinCEN points to $119 billion of suspicious activity reports related to digital asset transactions in 2019, that shows only that the virtual currency industry is *already* reporting such transactions—it does not justify the need for emergency action. Indeed, for true emergencies, Congress authorized FinCEN to impose temporary reporting and recordkeeping obligations on financial institutions under the BSA.[5] If this were a true emergency, we would not expect to see FinCEN providing any notice period, but instead taking action such as imposing a temporary reporting obligation concurrent with the Proposed Rule.[6]

III. Several Aspects of the Proposed Rule Require Further Consideration

The Proposed Rule raises serious practical and technical concerns that reveal robust industry feedback and engagement is necessary before effective implementation is possible. Below, Fidelity Digital Assets describes a handful of instructive examples.

A. Determining whether transactions involve an "unhosted" wallet.

The proposed recordkeeping and reporting requirements mandate that VASPs differentiate between hosted and "unhosted" wallets, although the rule does not directly refer to or define those terms, relying instead on exempting categories of transactions that necessarily involve only hosted wallets. The rule does not reflect an understanding of the immense practical and technical challenges VASPs face in differentiating transactions on their platforms that involve unhosted wallets from transactions that do not. Further, the

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[4] *American Federation of Government Employees v. Block*, 655 F.2d 1153 (D.C. Cir. 1981) (noting that exemptions from ordinary notice and comment procedures mandated by the APA are "narrowly construed and only reluctantly countenanced")
[5] *See* 31 U.S.C. §§ 5318A and 5326.
[6] *See* FinCEN *Order Imposing Recordkeeping and Reporting Obligations on Certain U.S. Financial Institutions With Respect to Transactions Involving Halawi Exchange Co. as a Financial Institution of Primary Money Laundering Concern*, 78 Fed. Reg. 24601 (April 25, 2013) ("This Order addresses FinCEN's concern that Halawi Exchange may continue to be involved in transactions that present a substantial money laundering risk prior to any implementation of the proposed rule.").

proposed text offers nothing about what mechanisms a VASP should or may use to bridge that gap.

Whether a wallet is "hosted" is not apparent from transaction details on the blockchain and would require the collection of additional information that both institutions and customers generally do not have and cannot readily access. To identify the hosting status of a particular wallet, VASPs will have to explore untested methods of obtaining information from third parties, either via acknowledgement from another VASP hosting the counterparty wallet or by third-party blockchain analytics providers. The cost, efficiency, and feasibility of such solutions are largely unknown.

The Proposed Rule fails even to acknowledge this central practical challenge, and bypassing ordinary notice and comment deprived the industry of any meaningful opportunity to discuss workable solutions with FinCEN. Providing such a meaningful opportunity for industry engagement and feedback, by contrast, would have allowed for close consideration of, among other things: (i) risk-based compliance standards for identifying a wallet's status as hosted or unhosted; (ii) determining the status of a counterparty's wallet based on information a VASP "knows or has reason to know"; (iii) the role and reliability of information from third-party blockchain analytics firms, particularly given FinCEN's acknowledgment in the Proposed Rule that reliance on such firms is frequently ineffective based on a number of factors, including failure to cover all virtual currency tokens and an inability to provide real-time data; and (iv) recognition that an "unhosted" wallet is not synonymous with illicit activity, as there are legitimate business and personal reasons for utilizing self-hosted wallets.

B. Obtaining required counterparty information.

The Proposed Rule mandates that VASPs obtain the name, address, and other unique identifiers of the counterparty to unhosted wallet transactions. Such a requirement would be the first Bank Secrecy Act recordkeeping rule commanding a financial institution to obtain specific information about customers' counterparties with whom the institution has no relationship. Given the costs of such a rule, FinCEN should reconsider imposing such a sweeping obligation—particularly without any significant comment period.

Because VASPs are unlikely to know counterparties' physical addresses or unique identifiers, the proposed requirement would effectively mandate reliance on customers' personal knowledge or investigation of a counterparty's physical addresses and other details—a requirement that would cause significant delay and pose new potential privacy and security risks related to the holding of non-customer personal information, with little guarantee that the information received would be reliable. Indeed, any information about a counterparty's physical address that a customer does manage to obtain will likely be far less valuable to law enforcement than other information about the relevant transaction.

FinCEN should therefore reconsider imposing the novel counterparty identification rule. The strongest defense to money laundering and terrorist financing is well-known: a robust customer identification and verification program that account-based financial institutions already implement. This tried-and-true approach is also warranted to achieve FinCEN's asserted goal of reducing infiltration of the U.S. financial system by illicit actors dealing in digital assets. Focusing recordkeeping obligations on a financial institution's own customers will provide reliable information and enhance reporting under the existing suspicious activity reporting regime, which FinCEN has already publicly acknowledged as being successful.[7]

C. The scope and nature of exemptions under the Proposed Rule.

The Proposed Rule limits reporting exemptions for banks transacting with other banks or certain government entities. The Proposed Rule does not, however, extend bank exemptions to publicly listed corporations or their subsidiaries, established customers, or reports filed with state regulatory agencies. As these exemptions exist for other similarly situated financial institutions, FinCEN should add them to its final rule.

The BSA mandates that FinCEN exempt depository institutions from the reporting requirements imposed by 31 U.S.C. § 5313 for transactions between the depository institution and "any business or category of business the reports on which have little or no value for law enforcement purposes."[8] In its 1996 interim rule implementing statutorily-mandated exemptions, FinCEN defined listed corporations and subsidiaries of listed corporations as businesses for which the reports have little or no value to law enforcement because they are subject to a variety of external and internal controls that render the additional CTR reporting requirements superfluous.[9] The same logic applies to reports on digital asset transactions involving the same companies, and FinCEN has offered no rationale for its decision not to extend the exemption to transactions with such companies in the Proposed Rule.

The Proposed Rule likewise provides inadequate justification for the failure to extend the discretionary exemption provisions for transactions between banks and certain business customers contained in 31 C.F.R. § 1020.315(b)(6). The discretionary exemption is an

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[7] FinCEN, *Prepared Remarks of FinCEN Director Kenneth A. Blanco, delivered at the Consensus Blockchain Conference* (May 13, 2020) (Recognizing the "high quality information" and "valuable reporting" through SARs provided by the virtual currency industry), accessed at https://www.fincen.gov/news/speeches/prepared-remarks-fincen-director-kenneth-blanco-delivered-consensus-blockchain.

[8] 31 U.S.C. § 5313(d)(1)(D). Although section 5313 refers to "depository institutions," FinCEN has always applied these exemptions to the regulatory definition of banks contained in 31 C.F.R. § 1010.100(d). *See* FinCEN, *Amendment to the Bank Secrecy Act Regulations -- Exemptions From the Requirement To Report Transactions in Currency,* 61 Fed Reg. 18204, 18206 (April 24, 1996).

[9] *Id.* at 18207.

important aspect of the BSA intended to ease unnecessary reporting. In fact, in 1994,[10] 1998,[11] and 2008,[12] the Government Accountability Office ("GAO") repeatedly issued reports highlighting the importance of CTR exemptions and recommending that FinCEN *expand* their use. In response, FinCEN issued new regulations in 2008 that addressed GAO's recommendations to expand CTR exemptions and made the discretionary exemption process easier.[13] For institutions that custody digital assets on behalf of corporate customers, some of whom rely on self-hosted wallets to diversify their digital assets in custody, the discretionary exemption will significantly reduce the need to report daily limited-value reports involving the same customer and counterparty. Considering the well-established congressional and oversight record supporting CTR exemptions, the absence of these exemptions in the Proposed Rule without justification further demonstrates the need for industry engagement.

Further engagement is also required to address whether the Proposed Rule should add exemptions based on existing state regulations. The BSA authorizes FinCEN to exempt financial institutions from reporting transactions if they are subject to state requirements that are substantially similar to those imposed under the subchapter and there are adequate provisions for enforcement.[14] This provision is intended to reduce duplicative reporting requirements for financial institutions. For instance, FinCEN exercised this authority for the casino industry when it faced a reporting requirement similar to the CTR in Nevada.[15] The potential for duplicative state and federal reporting highlights another area where further time and engagement is necessary.[16]

D. The Proposed Rule's expansion of the term "monetary instrument" contradicts FinCEN's own definition of that term.

The Proposed Rule extends currency transaction reporting requirements of 31 U.S.C. § 5313 to transactions in digital assets by determining, solely for purposes of that provision, that digital assets qualify as monetary instruments under 31 U.S.C. § 5312(a)(3), since "monetary instruments" are defined to include "similar material" to coins and currency, *id.* §

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[10] GAO, *The Volume of Currency Transaction Reports Filed Can and Should be Reduced*, T-GGD-94-113, (Mar. 15, 1994).
[11] GAO, *Money Laundering: FinCEN Needs to Better Communicate Regulatory Priorities and Time Lines*, GAO/GGD 98-18 (Feb. 6, 1998).
[12] GAO, *Increased Use of Exemption Provisions Could Reduce Currency Transaction Reporting While Maintaining Usefulness to Law Enforcement Efforts*, GAO-08-355 (Feb. 2008).
[13] *See* FinCEN, *Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations--Exemptions from the Requirement to Report Transactions in Currency,* 73 Fed. Reg. 74010 (Dec. 4, 2008).
[14] 31 U.S.C. § 5318(a)(5).
[15] *See* 31 CFR § 1010.970.
[16] For example, similar to the Proposed Rule, New York already requires certain VASPs to report virtual currency-to-virtual currency transactions over $10,000. 23 CRR-NY 200.15(e)(2).

5312(a)(3)(B). This definition of "monetary instruments," however, is at odds with FinCEN's own characterization of these transactions, creating inconsistencies within the BSA, and confusion as to how BSA regulations apply to digital assets.

FinCEN has previously explained that "similar material" refers to a payment device that provides the bearer immediate access to funds payable on demand "without a record of the chain of title," such as "traveler's checks."[17] Unlike currency and other monetary instruments described in 31 U.S.C. § 5312(a)(3), transfers of digital assets between wallets (hosted *or* unhosted) *are* subject to chain-of-custody records inherent in blockchain technology. Thus, transactions between wallets are far more analogous to transactions between "accounts" than the physical exchange of currency or similar bearer instruments that permit truly anonymous transfers without any record. Indeed, FinCEN refers to wallets as "accounts" without distinguishing between hosted and unhosted wallets.[18] For the past five years, and in the Proposed Rule itself, FinCEN has interpreted transfers of digital assets between wallets as transmittals of funds, not as a transfer of monetary instruments.[19]

The Proposed Rule thus redefines "monetary instruments" to impose currency transaction reporting requirements on what FinCEN itself has consistently deemed a transmittal of funds, creating confusion and inconsistency by conflating two distinct concepts and bases for its regulatory authority. Unlike currency reporting requirements, FinCEN's authority to require the reporting of transmittals of funds comes from 31 U.S.C. § 5318(n), and is limited to cross-border electronic transmittals of funds. Prior to issuing regulations on transmittal of funds, FinCEN is required to report the feasibility of such a requirement to Congress and to certify FinCEN's technological ability to effectively and efficiently receive, keep, and exploit the required reports.[20] FinCEN cannot bypass such requirements by advancing a novel and expansive new definition of a statutory term that flatly contradicts its own stated definition of that term.

The Proposed Rule's unsupported redefinition of digital assets as "monetary instruments" and confused description of digital asset exchange as involving both a

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[17] FinCEN, *Bank Secrecy Act Regulations: Definition of "Monetary Instrument"*, 76 Fed. Reg. 64049, 64051 (Oct. 17, 2011).
[18] FinCEN notes that the ability to pass a digital private key is similar to the physical exchange of currency, the Proposed Rule does not cover the transfer of private keys, but rather the transfer of digital assets between wallets.
[19] *See* FinCEN. *In Re Ripple Labs Inc.: Attachment A: Statement of Facts*, paras. 14 and 25, and *Attachment B: Remedial Framework*, para. 11 (May 5, 2015), available at https://www.fincen.gov/sites/default/files/shared/Ripple_Facts.pdf and https://www.fincen.gov/sites/default/files/shared/Ripple_Remedial_Measures.pdf. *See also* FinCEN, *FIN-2019-G001 Application of FinCEN's Regulations to Certain Business Models Involving Convertible Virtual Currencies* at 11 (May 9, 2019).
[20] *See* 31 U.S.C. § 5318(n).

transmittal of funds and a transaction involving monetary instruments underscores the need for additional time for comment and engagement with the industry.

IV. Conclusion

Fidelity takes its partnership with FinCEN seriously, and stands ready to engage meaningfully to assist in the development of clear rules that will both have a material impact on the fight against money laundering and the financing of terrorism and foster responsible innovation. Fidelity respectfully contends that the existing comment period is far too short to allow for meaningful notice and comment on the Proposed Rule, and requests that FinCEN provide additional time for feedback and engagement before finalizing the rule.

Sincerely,

Tom Jessop
President, Fidelity Digital Assets