

Alert

FinCEN Identifies Bitzlato as a “Primary Money Laundering Concern” in First-Time Use of Section 9714(a) and DOJ Charges Its Founder with Owning an Unlicensed Money Transmitting Business

February 3, 2023

On Jan. 18, 2023, the U.S. Department of the Treasury’s Financial Crimes Enforcement Network (“FinCEN”) issued an order¹ (“Order”) identifying Bitzlato Limited (“Bitzlato”), a Hong Kong-based virtual currency exchange with global operations, as a financial institution of “primary money laundering concern” in connection with illicit Russian finance. FinCEN’s Order bars any covered financial institution from engaging in certain transmittals of funds involving Bitzlato. FinCEN’s Order marks the first order issued under Section 9714(a) of the Combating Russian Money Laundering Act.

In a coordinated action, the Department of Justice (“DOJ”) arrested Bitzlato’s founder and majority-owner, Anatoly Legkodymov, for conducting an unlicensed money transmitting business under 18 U.S.C. § 1960.² Both the Order and the DOJ’s complaint and arrest warrant highlight that Bitzlato had severe and pervasive anti-money laundering (“AML”) deficiencies and significant connections to Russia and Russian illicit finance.

Section 9714(a)

The Combating Russian Money Laundering Act (“Act”) was enacted in 2021 as part of the 2021 National Defense Authorization Act, which included other notable anti-money laundering-related legislation (such as the Anti-Money Laundering Act of 2020 and the Corporate Transparency Act). Section 9714(a) of the Act allows FinCEN to, upon determining “reasonable grounds for concluding” that one or more covered financial institutions operating outside of the U.S. is of “primary money laundering concern in connection with Russian illicit finance,” prohibit or impose conditions upon certain transmittals of funds by any domestic financial institution . . . ”³

Noting that FinCEN has long interpreted the term “financial institutions” to cover “money transmitters,” including entities that accept and transmit value that substitutes for currency (like convertible virtual

¹ U.S. Department of the Treasury, Financial Crimes Enforcement Network, Imposition of Special Measure Prohibiting the Transmittal of Funds Involving Bitzlato, 88 Fed. Reg. 3919 (Jan. 23, 2023), available [here](#) [hereinafter “Order”]; Press Release, Financial Crimes Enforcement Network, FinCEN Identifies Virtual Currency Exchange Bitzlato as a “Primary Money Laundering Concern” in Connection with Russian Illicit Finance (Jan. 18, 2023), available [here](#).

² Press Release, U.S. Department of Justice, Founder and Majority Owner of Bitzlato, a Cryptocurrency Exchange, Charged with Unlicensed Money Transmitting (Jan. 18, 2023), available [here](#).

³ Section 9714 (as amended) can be found in a note to 31 U.S.C. § 5318A.

currencies (“CVCs”)),⁴ FinCEN highlights Bitzlato’s exchange and peer-to-peer (“P2P”) services as reason for Bitzlato to constitute a “financial institution” for the purposes of Section 9714(a) of the Act.

FinCEN’s Findings

To support its conclusion that Bitzlato is a “financial institution operating outside of the United States of primary money laundering concern in connection with Russian illicit finance,” FinCEN alleges four separate patterns of behavior underlying its assessment.

- *Facilitating Processing and Laundering of Funds Used to Finance Ransomware Attacks.* The Order asserts that Bitzlato plays a significant role in facilitating transactions for various ransomware groups that have connections to illicit Russian finance, including Conti. Specifically, FinCEN notes that it has documented transactions between Conti-associated CVC addresses and Bitzlato. In addition, the Order indicates that, based on blockchain analysis, other ransomware groups and OFAC-designated virtual asset service providers (“VASPs”) have used Bitzlato to facilitate transactions. FinCEN notes that Bitzlato “provides an enabling environment for such ransomware criminals to utilize its services to cash out ransomware proceeds due to its minimal Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) protocols, solidifying its reputation as a go-to CVC exchanger for such groups.”⁵
- *Facilitating Darknet Markets and Scams.* The Order also finds that Bitzlato’s incoming and outgoing transactional activity reflect connections to counterparties that are associated with darknet markets and scams with connections to and operations in Russia. In particular, the Order states that certain of Bitzlato’s top incoming and outgoing counterparties (such as Hydra, a Russia-connected darknet market, and the alleged Russia-based Ponzi scheme “TheFiniko”) are associated with such illicit activities.
- *Engaging in Illicit Russian Finance Transactions.* FinCEN alleges that, based on analysis conducted by a blockchain analytics company, the value of transactions that involve illicit Russian finance or “otherwise risky sources” made up 48 percent of all Bitzlato transactions between 2019 and 2021.⁶
- *Failing to Combat Anti-Money Laundering and Illicit Finance.* According to the Order, publicly-available information indicates that, despite featuring a “Know Your Client [(KYC)] policy” on its website, Bitzlato does not implement effective policies and procedures to combat AML and illicit finance.⁷ Specifically, the Order highlights language on Bitzlato’s website that suggests “simple registration” that only requires an email address to create an account on the platform.⁸ Such a procedure runs counter to common, effective AML controls, such as collecting more thorough identifying information about the customer.

In addition, the Order describes Bitzlato’s policy of user privacy and anonymity, allowing users to exchange fiat currency and cryptocurrency directly with another person, as well as transfers to

⁴ Order, 88 Fed. Reg. at 3920.

⁵ *Id.* at 3922.

⁶ *Id.*

⁷ *Id.* at 3923.

⁸ *Id.*

and from financial institutions and other methods. Bitzlato advertises that its users do not need to go through the same KYC procedures that are typically required on other exchanges. FinCEN notes that this anonymous exchange policy, along with the advertised “simple registration” process, is indicative of ineffective AML/CFT controls.

Order Requirements and Penalties

The Order prohibits “covered financial institutions,” which are defined to include, among other entities, banks, broker-dealers, money services businesses, mutual funds, futures commission merchants and introducing brokers in commodities,⁹ from engaging in transmittals of funds to or from Bitzlato, as well as to or from “any account or CVC address administered by or on behalf of Bitzlato.”¹⁰ Should a covered financial institution receive CVC from Bitzlato or from an account administered by or on behalf of Bitzlato, FinCEN notes that it would not be a violation of the Order for the covered financial institution to “reject” the transaction by: “(1) preventing the intended recipient from accessing such CVC; and (2) returning the CVC to Bitzlato, or to the account or CVC address from which the CVC originated.”¹¹ FinCEN also notes that covered financial institutions are not required to reject such CVC transfers where doing so would violate sanctions laws.¹²

FinCEN notes that previous transactions involving Bitzlato do not violate the Order, but expects covered financial institutions to “take such steps that a reasonable and prudent financial institution would take to identify any transactions that are prohibited by the Order, including determining risk exposure with any person associated with Russian illicit finance or violations of applicable law.”¹³ In addition, FinCEN underscores that the Order does not impose any additional Suspicious Activity Reporting (“SAR”) requirements on covered financial institutions but encourages covered financial institutions to “consider, as warranted and appropriate, Bitzlato’s identification as a primary money laundering concern related to Russian illicit finance” in connection with existing SAR obligations.¹⁴

The terms of the Order became effective Feb. 1, 2023, with no cessation date. Penalties for noncompliance with the Order, which applies to officers, directors, employees and agents of covered financial institutions, could include civil or criminal penalties under 31 U.S.C. §§ 5321 and 5322.

Conclusion

The Order, as well as the fact that it marks FinCEN’s first action under Section 9714(a) of the Act, reflect an aggressive stance by FinCEN to take action against entities engaging in Russian illicit finance as its jurisdiction permits. In light of the deficiencies identified by FinCEN — primarily as it relates to AML/KYC policies and procedures — non-U.S. VASPs and covered financial institutions should take care to ensure their AML/KYC controls are up-to-date, efficient and effective. In addition, covered domestic financial

⁹ 31 C.F.R. § 1010.100(t).

¹⁰ Order, 88 Fed. Reg. at 3926.

¹¹ U.S. Department of the Treasury, Financial Crimes Enforcement Network, Frequently Asked Questions: Section 9714 Order Prohibits Certain Transmittals of Funds Involving Bitzlato (Jan. 18, 2023) [hereinafter FAQs], available [here](#), at 4.

¹² *Id.*

¹³ *Id.* at 5.

¹⁴ *Id.* at 5.

institutions should ensure that, beginning on February 1, they are not engaging in covered transactions with Bitzlato.

Schulte Roth & Zabel's lawyers are available to assist you in addressing any questions you may have regarding these developments. Please contact the Schulte Roth & Zabel lawyer with whom you usually work, or any of the following attorneys:

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