With the increased use of sanctions as a foreign policy tool by western states, individuals and entities transacting with virtual and digital currency, but especially virtual and digital currency service providers, should be aware of their sanctions obligations. Sanctioned individuals, entities and countries have warmed to the idea that such currencies may be used to bypass the global financial system, through which sanctions are imposed. Flagrant examples of sanctions evasion are causing regulators to pay increasing amounts of attention to virtual and digital currencies.

Notwithstanding that the use of cryptocurrency to evade sanctions remains difficult to detect (given its decentralized nature, limited requirements of digital keys to process transactions, and frequently concealed identities), those who transact in such currency, or facilitate transactions, risk inadvertently dealing with a designated person and assisting prohibited activities in breach of their obligations under sanctions law.

US sanctions and virtual/digital currency

The United States Office of Foreign Asset Control (OFAC) has previously acted on the use of virtual or digital currencies to evade sanctions. In November 2018, OFAC sanctioned two Iran-based individuals for exchanging Bitcoin into Iranian Rials on behalf of malicious cyber actors. As a first, in addition to adding the two individuals to the Specially Designated Nationals (SDN) List (the list of individuals and entities subject to US sanctions), OFAC included the virtual currency wallet addresses, a unique alphanumeric identifier associated with the wallet, that had been used in the virtual currency exchange, in their respective entries on the SDN List. The specific individuals and wallets were identified by pattern recognition across roughly 7,000 transactions in Bitcoin equivalent to millions of dollars. Other actions taken against the use of virtual currency include a 2019 executive order, by which President Trump prohibited US persons from transacting with Venezuela’s newly issued Petro cryptocurrency.

OFAC’s FAQs confirm that US entities are prohibited from facilitating or engaging in unauthorized digital currency transactions, which include transactions that evade or avoid sanctions or attempt to do so, dealings with blocked persons or property, and/or engaging in prohibited trade or investment-related transactions. For the avoidance of doubt, OFAC also clarified that such obligations extend to technology companies, administrators, exchangers, and users of digital currencies and other payment processors. Entities who find that wallets are owned by, or otherwise associated with, a designated individual or entity, should take the necessary steps to block the relevant virtual asset and file a report with OFAC.

Virtual or digital currency service providers that are not US nationals, and not operating within the US, need to be aware of US secondary sanctions, which target non-US persons and financial institutions with no connection to the US that engage in transactions related to specified economic sectors, as well as individuals and entities included on the SDN List. Penalties for a breach of secondary sanctions include being added to the SDN List, freezing of property and interests in property within the US, denial of visas to the US and restrictions on entry into the US, exclusion from...
Canadian sanctions and virtual/digital currency

Canada has yet to provide authoritative guidance on the application of sanctions to virtual or digital currencies, however, the general prohibitions included in nearly all Canadian sanctions are broad enough to include any entities operating in the virtual/digital currency space, given that they apply to “any person in Canada or any Canadian outside Canada.” Canadian entities may be in breach of sanctions if they have carried out or facilitated a prohibited transaction.

Recent amendments to the Regulations Amending Certain Regulations Made under the Proceeds of Crime (Money Laundering) and Terrorist Financing, published on July 10, 2019, further regulate virtual currencies, and facilitate any potential investigation into the use of virtual currency to evade or attempt to evade sanctions. These changes will generally enter into force on June 1, 2021.

Once effective, dealers in virtual currencies will be required to register with FINTRAC as money services businesses (MSB), and meet the requirements under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act applicable to MSBs, including having a compliance program in place. Entities that deal in virtual currency will also be subject to record-keeping and reporting requirements that include the maintenance of large virtual currency transaction records for transactions valued at or more than CA$10,000, and virtual currency exchange transactions, where virtual currency is exchanged for funds, another virtual currency, or vice versa. All entities subject to such regulations should consider sanctions avoidance best practices in their required compliance programs to avoid any inadvertent transaction or business with a sanctioned individual or entity.

Additional compliance issues and best practices

Virtual and digital currencies may also generate sanctions compliance exposure through investment in such services among other acts. For example, administrators and investors in Initial Coin Offerings (ICO) may find themselves subject to potential sanctions liabilities if designated individuals or entities are able to participate in the ICO, or trade tokens issued after the ICO is completed. Further, any virtual or digital currency payment, including crowdfunding, has potential for sanctions liability, if proper screening is not completed to ensure sanctioned participants are not behind such payments.

Best practices for sanctions compliance in transactions with virtual and digital currencies include the use of Know Your Customer, Know Your Transaction, and contractual safeguards.

- Know Your Customer procedures identify counterparties to transactions and match encrypted keys with individuals in the transaction. This can provide certainty that any counterparty is not a listed individual or entity;
- Know Your Transaction procedures, including due diligence procedures, can provide a greater understanding of the transaction and underlying business involved; and
- Contractual safeguards can govern the intended use of any payment in virtual or digital currencies, and ensure that any payment in such currencies is sanctions compliant.

Generally, increased regulatory scrutiny in this area can be expected, alongside similar anti-money laundering trends. Regulators will continue to pursue individuals that transact, attempt to transact, or facilitate transactions with entities or individuals targeted by sanctions programs. Service providers, and individuals and entities that transact with virtual and digital currencies, should take the appropriate technical and legal safeguards for navigating sanctions.
compliance.

If you have any questions with respect to the foregoing, or would like further information, please contact Paul Lalonde or Sean Stephenson.

1. [OFAC defines virtual currency as a “digital representation of value that functions as (i) a medium of exchange; (ii) a unit of account; and/or (iii) a store of value; is neither issued nor guaranteed by any jurisdiction; and does not have legal tender status in any jurisdiction.” OFAC defines digital currency to include “sovereign cryptocurrency, virtual currency (non-fiat), and a digital representation of fiat currency.” See OFAC FAQ 559]

2. [The term “foreign financial institution” has been defined in various US sanctions to mean “any foreign entity that is engaged in the business of accepting deposits, making, granting, transferring, holding, or brokering loans or credits, or purchasing or selling foreign exchange, securities, commodity futures or options, or procuring purchasers and sellers thereof, as principal or agent. It includes, but is not limited to, depository institutions, banks, savings banks, money service businesses, trust companies, securities brokers and dealers, commodity futures and options brokers and dealers, forward contract and foreign exchange merchants, securities and commodities exchanges, clearing corporations, investment companies, employee benefit plans, dealers in precious metals, stones, or jewels, and holding companies, affiliates, or subsidiaries of any of the foregoing.” See Executive Order 13846, Reimposing Certain Sanctions with Respect to Iran]

3. [The regulations define virtual currency as “(a) a digital representation of value that can be used for payment or investment purposes that is not a fiat currency and that can be readily exchanged for funds or for another virtual currency that can be readily exchanged for funds; or (b) a private key of a cryptographic system that enables a person or entity to have access to a digital representation of value referred to in paragraph (a).”]

4. [We note that the 2014 legislative amendments to the Proceeds of Crime (Money Laundering) and Terrorist Financing Act require virtual currency dealers to register as money services businesses and comply with other legislative obligations, such as suspicious transaction reporting and implementing a compliance program.]

Your Key Contacts

Paul M. Lalonde
Partner, Toronto
D +1 416 361 2372
M +1 416 414 5833
paul.lalonde@dentons.com

Sean Stephenson
Senior Associate, Toronto
D +1 416 863 4519
sean.stephenson@dentons.com

Noah Walters
Associate, Toronto
D +1 416 361 3418
noah.walters@dentons.com

© 2022 Dentons. Dentons is a global legal practice providing client services worldwide through its member firms and affiliates. Please see dentons.com for Legal Notices.