Davis Polk

GENIUS Act: AML/CFT and sanctions compliance

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State of play

- Today the President signed the Guiding and Establishing National Innovation for U.S. Stablecoins Act (**GENIUS Act**) (available here) after it was passed through Congress with strong bipartisan support.
- In this memo we describe the key components of the anti-money laundering and countering the financing of terrorism (**AML/CFT**) and sanctions compliance requirements under the GENIUS Act. An important insight and key theme is that many of the AML/CFT and sanctions compliance expectations are not set out in the legislation, and will instead need to be determined through implementing regulations.
- A companion memo provides a broader overview of the key components of the GENIUS Act, along with charts detailing the various regulations and reports required by the Act (available here).

Key definitions

- The GENIUS Act's definition of the **Bank Secrecy Act (BSA)** aligns with the standard scope of laws that comprise the BSA, including:
  - Section 21 of the Federal Deposit Insurance Act (12 U.S.C. 1829b);
  - Chapter 2 of title I of Public Law 91– 8 508 (12 U.S.C. 1951 et seq.); and
  - Subchapter II of chapter 53 of title 31, United States Code (53 U.S.C. 5311 et seq.).
- Compliance under the BSA would necessarily include complying with the BSA's implementing regulations, which generally apply to the following "financial institutions," as defined in 31 CFR 1010.100(t):
  - Banks;
  - Broker dealers;
  - Money services business (including money transmitters, check cashers, providers of prepaid access and foreign exchange dealers;
  - Futures commission merchants;
  - Introducing brokers; and
  - Mutual funds.
- As discussed on the following slides, the GENIUS Act provides that "a permitted payment stablecoin issuer shall be treated as a financial institution for purposes of the Bank Secrecy Act."

Key definitions

- The GENIUS Act defines a **"lawful order"** as:
  - any final and valid writ, process, order, rule, decree, command, or other requirement issued or promulgated under Federal law:
    - Issued by a court of competent jurisdiction or by an authorized Federal agency pursuant to its statutory authority, that:
      - requires a person to seize, freeze, burn, or prevent the transfer of payment stablecoins issued by the person;
      - specifies the payment stablecoins or accounts subject to blocking with reasonable particularity; and
      - is subject to judicial or administrative review or appeal as provided by law.
- Lawful orders would likely include, but may be broader than, Office of Foreign Assets Control (**OFAC**) sanctions prohibitions.

AML/CFT and sanctions regulatory framework

- Under the GENIUS Act, permitted payment stablecoin issuers will be "***treated***" as financial institutions under the BSA.
  - The GENIUS Act does not amend the BSA and thus the AML/CFT compliance framework is not self-executing, as the BSA and its implementing regulations only apply to "financial institutions," as defined in 31 U.S.C. 5312 and 31 CFR 1010.100(t).
  - The GENIUS Act implies that "treatment" under the BSA is a trigger for the application of U.S. economic sanctions, which is likely an effort to explicitly establish that payment stablecoin issuers are subject to U.S. economic sanctions. However, this is unnecessary because under existing law, **U.S. economic sanctions apply to all U.S. persons and all activity within U.S. jurisdiction**, regardless of the applicability of the BSA and its implementing regulations.
- The **Treasury Secretary** is required to issue implementing regulations under the GENIUS Act, which would presumably be issued by the Financial Crimes Enforcement Network (**FinCEN**), to which Treasury has delegated the authority to administer the BSA.
  - FinCEN has authority to define a business as a "financial institution" under the BSA and its implementing regulations if the business engages in any activity determined by regulation "to be an activity which is similar to, related to, or a substitute for any activity" in which a "financial institution" is authorized to engage. Presumably such implementing regulations will determine that permitted payment stablecoin issuers are "financial institutions" under the BSA.
  - The BSA also explicitly authorizes Treasury—and thereby FinCEN—to "prescribe minimum standards" for AML/CFT programs.
  - Similarly, under the BSA, Treasury, and thus FinCEN, is authorized to require SAR filings.

AML/CFT and sanctions regulatory framework

- A payment stablecoin issuer's AML/CFT and sanctions regulatory framework will be administered by its primary regulator (i.e., a federal stablecoin regulator in the case of federally licensed issuers, and a state stablecoin regulator in the case of state-licensed issuers).
- The **primary federal and state payment stablecoin regulators** are required to issue implementing regulations that establish BSA and sanctions compliance standards that:
  - Are tailored to the business model and risk profile of permitted payment stablecoin issuers; and
  - Are consistent with applicable law.
- The federal and state regulators' standards will presumably address secondary market transfers of stablecoins.
- It is unclear whether the GENIUS Act envisions the federal banking agencies and state regulators to establish separate AML compliance requirements for permitted payment stablecoin issuers or simply "BSA and sanctions compliance standards," which are undefined.
- For context, as required under the Federal Deposit Insurance Act, the federal banking agencies concurrently maintain AML/CFT compliance requirements that largely mirror those maintained by the FinCEN and often issue separate compliance guidance to regulated entities.
- While the Stablecoin Certification Review Committee is required to certify that a state's regulatory framework (including for AML/CFT and sanctions compliance) is "substantially similar" to the federal regime, in theory, administration and regulatory expectations could differ at the federal vs. state levels.

AML/CFT and sanctions compliance requirements

GENIUS Act compliance requirement	Considerations
"Effective" **AML/CFT compliance program**, which must include appropriate risk assessments and a designated officer to supervise the program	– An "effective" AML/CFT compliance program is an existing regulatory expectation; however, FinCEN and the federal banking agencies have yet to codify an "effectiveness" standard. – FinCEN issued a proposed rule in 2024 that would establish risk assessments as an additional compliance program pillar and establish standards for "effectiveness" but has not yet issued the final rule. – Under the BSA and its implementing regulations, risk assessments are not currently an AML compliance program pillar, but financial institutions are expected to conduct risk assessments, as the compliance program should be "risk-based." – Unclear why the GENIUS Act would mandate two pillars without reference to the remaining standard AML compliance program pillars: internal controls, independent testing, training and, for covered financial institutions, and customer due diligence. Stablecoin issuers should expect their compliance program requirements to include, at a minimum, the standard pillars.
Appropriate record retention	– Unclear what "appropriate record retention" means in practice, but presumably payment stablecoin issuers will be required to comply with the BSA's reporting and recordkeeping requirements, such as the Travel Rule, Currency Transaction Reports, etc.
Suspicious activity monitoring and reporting	– Consistent with the requirements applicable to all financial institutions regulated under the BSA, payment stablecoin issuers would be required to monitor transactions and file SARs.
Technical capabilities, policies, and procedures to block, freeze, and reject specific or impermissible transactions that violate Federal or state laws, rules, or regulations	– Financial institutions generally maintain internal controls that allow the institutions to block, freeze and/or reject transactions, as such controls are imperative for sanctions compliance. – The language in the requirement is broad and unclear whether this requirement extends to secondary transactions (i.e., whether payment stablecoin issuers would be expected to block, freeze and/or reject transactions "in the wild").

AML/CFT and sanctions compliance requirements

GENIUS Act compliance requirement	Considerations
Maintain the technological capability to comply with the terms of any lawful order.	– As noted, “lawful orders” are defined as orders requiring a payment stablecoin issuer to seize, freeze, burn, or prevent the transfer of payment stablecoins issued by the person. – The intention is that Treasury will, to the best of its ability, coordinate with a payment stablecoin issuer before taking any action to block and prohibit transactions in the property and interests in property of a foreign person to ensure that the issuer is able to effectively block a payment stablecoin of the foreign person upon issuance. – Notably, however, the GENIUS Act states that Treasury *is not required* to notify a payment stablecoin issuer that it intends to block or prohibit transactions of a particular foreign person. – A failure to comply with a lawful order could result in enforcement actions authorized under the GENIUS Act, which include suspension or revocation of a payment stablecoin issuer’s registration and ability to issue stablecoins, a cease and desist order, and/or civil money penalties. – Unclear whether the net effect of the lawful order requirements will result in a regulatory expectation that payment stablecoin issuers maintain the ability to block all primary and secondary transactions involving their stablecoin. – Notably, the GENIUS Act prohibits digital asset service providers from offering or selling a stablecoin issued by a foreign payment stablecoin issuer unless the foreign issuer has the technological capability to comply with the terms of any lawful order. – Treasury may also issue determinations and notifications that will bar secondary trading in a foreign issuer’s payments stablecoins if the issuer does not comply with a lawful order. This may be a mechanism to, among other things, force foreign issuers to comply with U.S. sanctions.

AML/CFT and sanctions compliance requirements

GENIUS Act compliance requirement	Considerations
Maintenance of an effective customer identification program, including identification and verification of account holders with the permitted payment stablecoin issuer, high-value transactions, and appropriate enhanced due diligence	– FinCEN's Customer Identification Program (**CIP**) and Customer Due Diligence (**CDD**) Rules only apply to "covered financial institutions," which include banks, broker dealers, futures commission merchants, introducing brokers and mutual funds. – Unclear whether the GENIUS Act directs FinCEN to amend the definition of "covered financial institution" or separately issue CIP and CDD requirements for payment stablecoin issuers. – Unclear whether CIP requirements related to "high-value transactions" would only apply to customers involved in the transaction or to customers *and* counterparties.
Maintenance of an effective economic sanctions compliance program, including verification of sanctions lists, consistent with Federal law	– OFAC does not require U.S. persons (including U.S. financial institutions) to maintain sanctions compliance programs or screening processes. – Instead, OFAC's "A Framework for OFAC Compliance Commitments" "strongly encourages" U.S. persons to "employ a risk-based approach to sanctions compliance by developing, implementing, and routinely updating a sanctions compliance program." – While not required by specific regulation, as a matter of sound banking practice and in order to mitigate the risk of noncompliance with OFAC requirements, the federal banking agencies expect banks to establish and maintain an effective, written OFAC compliance program that is commensurate with their OFAC risk profile (based on products, services, customers, and geographic locations). The GENIUS Act extends those expectations to payment stablecoin issuers. – We do not expect that Treasury or OFAC will issue regulations prescribing sanctions compliance program requirements but instead will rely on existing guidance.

AML innovation provisions

- In addition to AML/CFT and sanctions compliance requirements, the GENIUS Act also includes provisions that require Treasury and FinCEN to identify and implement novel and innovative methods for detecting illicit finance.
- 30 to 60 days after the GENIUS Act is enacted, Treasury must seek public comment to identify innovative or novel methods, techniques, or strategies that financial institutions use, or have the potential to use, to detect illicit activity, such as money laundering, involving digital assets. Comments can include topics such as:
  - application program interfaces;
  - artificial intelligence;
  - digital identify verification; and
  - blockchain technology and monitoring.
- After Treasury completes the public comment period, it is required to conduct research on the innovative and novel methods, techniques and strategies identified during the comment period.
- As part of its National Strategy for Combatting Terrorist and Other Illicit Financing Strategy, Treasury is also required to evaluate, among other things, the impact of existing regulatory frameworks on the use and development of innovative methods, techniques or strategies by regulated financial institutions.

AML innovation provisions

- No later than three years after the GENIUS Act is enacted, FinCEN is required to issue guidance and rulemaking based on the results of Treasury's research and risk assessments relating to the following:
  - Implementing novel and innovative methods, techniques, or strategies for detecting illicit finance activity involving digital assets;
  - Standards for payments stablecoin issuers to identify and report illicit activity, including fraud, cybercrime, money laundering, terrorism financing, sanctions evasion or insider trading;
  - Standards for monitoring transactions on blockchains, digital asset mixing services, tumblers and other similar services; and
  - Tailored risk management standards for financial institutions interacting with DeFi protocols.
- The Treasury Secretary must also submit a report and recommendations to Congress on these topics.

Davis Polk contacts

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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