

Thematic dossier:
Regulation of Virtual Assets under FATF's New Standards

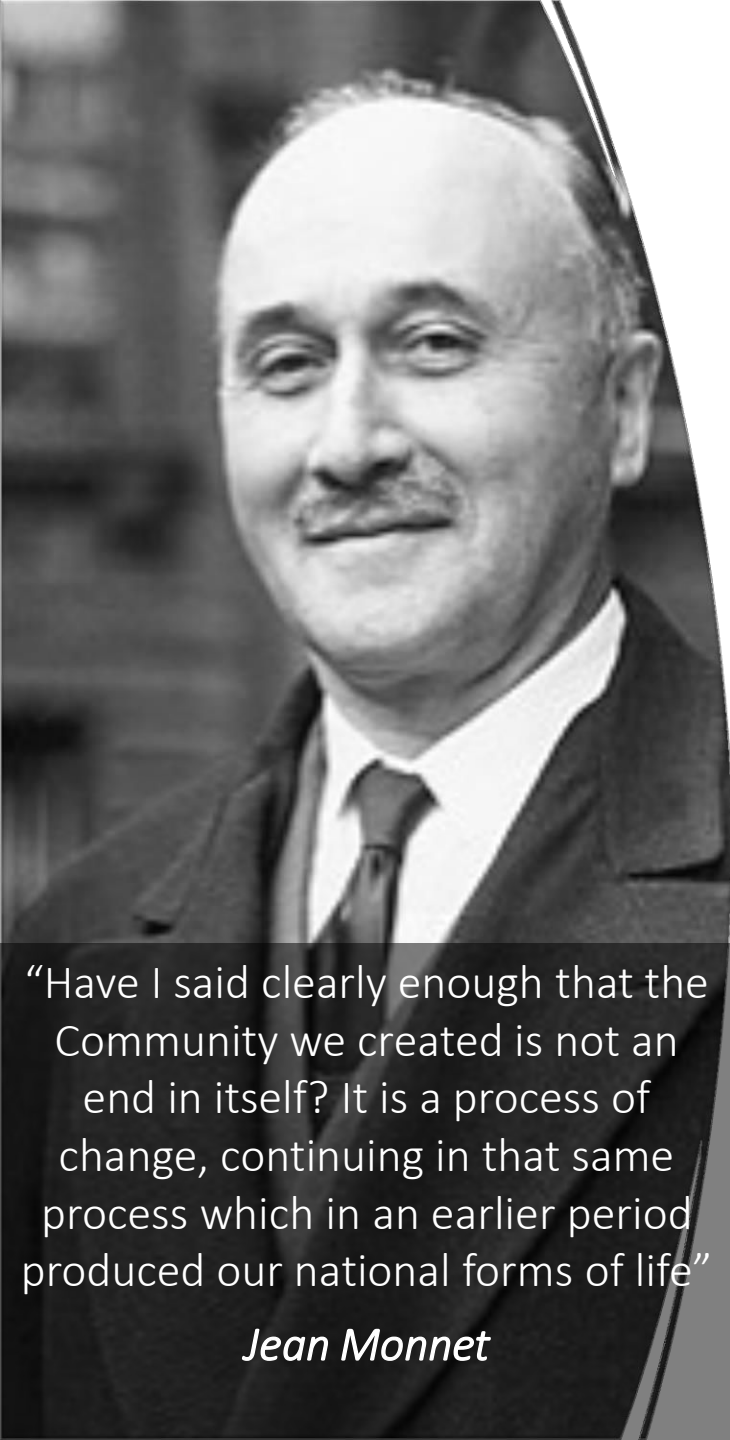
Developed by Dr. Georgios Pavlidis, Jean Monnet Chair, NUP

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“Have I said clearly enough that the Community we created is not an end in itself? It is a process of change, continuing in that same process which in an earlier period produced our national forms of life”

Jean Monnet

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About this OER



About this OER

1. **Author:** This OER has been developed by Dr Georgios Pavlidis, Assistant Professor of International and EU law at NUP, Cyprus as part of the activities of the Jean Monnet Chair. You can find more information about this projects at <https://www.nup.ac.cy/jean-monnet-chair/>
2. **Methodology:** This OER was developed in accordance with the principles of the UNESCO Recommendation on Open Educational Resources, as well as the Cape Town Open Education Declaration and the Paris OER Declaration, which deal with the application of open licenses to educational materials.
3. **Target audience:** This OER is designed for undergraduate students in the fields of law, political sciences, social sciences, etc, as well as for lawyers, judges, prosecutors and practitioners who are interested in the EU action in the areas of asset recovery and AML.
4. **The topic of this OER:** This OER deals with the need to mitigate money laundering risks associated with virtual assets (see sections **Learning Objectives** and **Learning Outcomes**)



About this OER

5. **Navigation:** This OER is structured into several sections, including an introduction, main content, learning activities, and additional resources. Use the table of contents provided to navigate through the OER and locate specific sections of interest.
6. **Reading and Understanding:** Begin by reading the introduction to gain an overview of the OER's purpose and learning objectives. Proceed to the main content, where you will find in-depth information and key concepts related to the topic. Take your time to understand the presented information and ensure comprehension before moving forward.
7. **Learning Activities:** In this OER you will encounter learning activities designed to enhance your understanding and application of the concepts covered. Engage with these activities to reinforce your learning and test your knowledge. Feel free to discuss the activities with peers or seek additional resources to deepen your understanding further.
8. **Reflection and Critical Thinking:** As you progress through the OER, take the opportunity to reflect on the concepts presented and consider their implications. Encourage critical thinking by asking questions, analyzing examples, and connecting the information to real-world scenarios.



About this OER

9. **Additional Resources:** The OER provides a list of additional resources, such as books, articles, websites, or videos, that you can explore for further study or to delve deeper into specific topics covered. Take advantage of these resources to expand your knowledge and explore related areas of interest.
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11. **Continuous Learning:** The field of knowledge covered by this OER is continually evolving. Stay updated by seeking current research, publications, or news related to the topic. Consider engaging in discussions or attending relevant events to stay connected with advancements in the field.

We hope that this OER serves as a valuable resource for your learning journey. If you have any questions or require further assistance, please reach out to us at: g.pavlidis@nup.ac.cy

Enjoy your exploration and learning!

Georgios Pavlidis

Jean Monnet Chair, NUP

Learning Objectives

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Learning Objectives

1. Understand the scope and limitations of monitoring and supervision of virtual assets according to FATF standards.
2. Explore the complexities and challenges involved in regulating virtual asset activities.
3. Recognize the importance of balancing innovation, financial services, and financial inclusion with AML/CFT regulations.
4. Identify the risks associated with the lack of global regulation and jurisdiction-shopping by money launderers.
5. Gain insight into the different methods used by money launderers to exploit weaknesses in AML/CFT controls.

Learning Outcomes

The background of the slide is dark grey. At the top, there are several light bulbs hanging from above. On the left, there are four unlit light bulbs with white outlines. On the right, there are three unlit light bulbs with white outlines. In the center-right, there is a single lit light bulb with a yellow glow and radiating lines. The main content area is a white rectangle with a torn bottom edge.

Learning Outcomes

1. Explain the scope and limitations of monitoring and supervision of virtual assets as per FATF standards.
2. Analyze the complexities and challenges in regulating virtual asset activities.
3. Evaluate the balance between innovation, financial services, and financial inclusion with AML/CFT regulations.
4. Assess the risks posed by the lack of global regulation and jurisdiction-shopping by money launderers.
5. Describe the different methods employed by money launderers to exploit weaknesses in AML/CFT controls.

Main Content

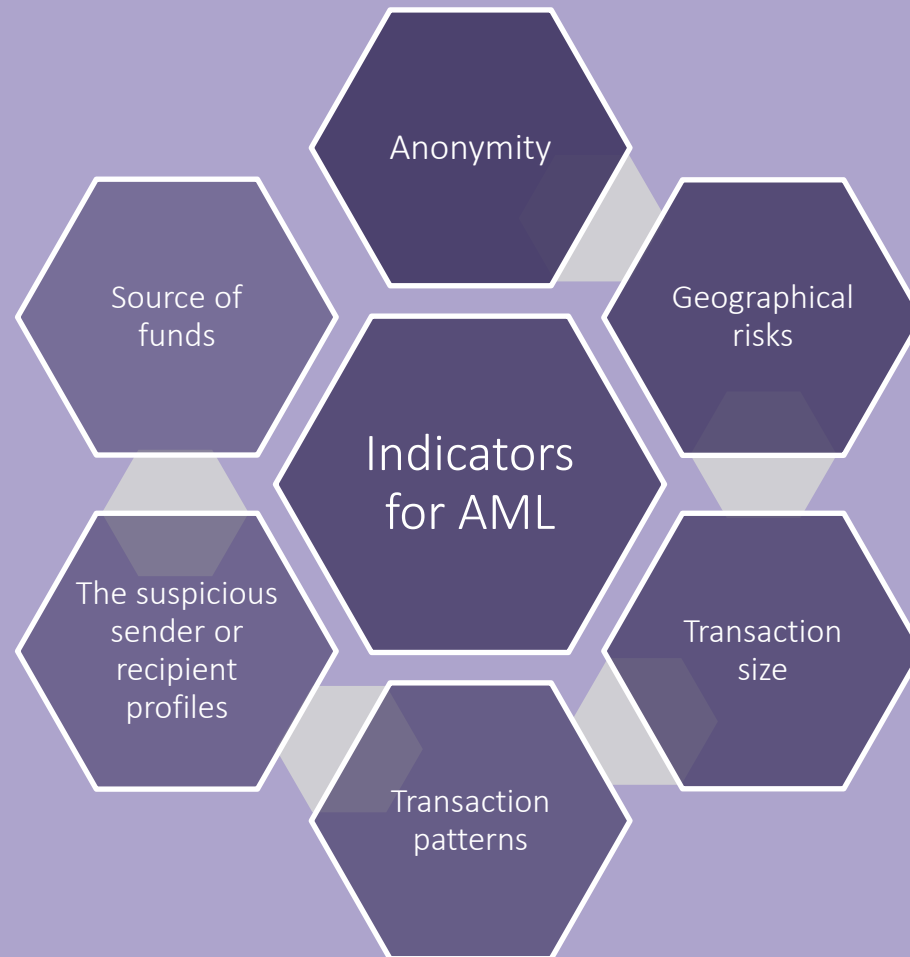
Virtual assets and money laundering risks

- The FATF defines virtual assets as digital representations of value used for payment or investment purposes.
- Virtual assets rely on cryptography and distributed ledger technology.
- There are three main categories of virtual assets: payment/exchange-type tokens, investment/security-type tokens, and utility tokens.
- Virtual assets are not issued or guaranteed by central banks or public authorities and are not legal tender.
- Despite risks and efficiency problems, demand for virtual assets, particularly through initial coin offerings (ICOs), grew in 2018.

Virtual assets and money laundering risks

- Over 5,100 crypto-assets exist with a total market capitalization exceeding \$250 billion in 2020.
- Three main approaches to dealing with virtual assets have been proposed: financial innovation, risk mitigation due to misuse by criminals and terrorists, and skepticism regarding their long-term viability.
- There is consensus on the need for vigilant monitoring and assessment of emerging risks associated with virtual assets.
- Global regulators, such as the FATF, play a crucial role in preventing criminal exploitation of the anonymity provided by crypto-assets.
- A policy of cracking down on digital currencies is not considered justified due to the scale of risks and the relatively small size of the crypto-assets market.

Important indicators





Examples of red flags



Frequent transactions below the reporting thresholds

Making several high-value transactions in a short time

Transactions from/to wallet with detected stolen funds

Transactions from countries with no advanced AML regulations

Instant withdrawal of crypto assets after transaction

Multiple transactions without a commercial explanation

Cryptocurrency accounts that don't match the customer profile.

Approaches to Regulating Virtual Assets

- Some jurisdictions, including global financial centers, already regulate activities in crypto-assets.
- In the US, cryptocurrency exchangers and administrators are considered money transmitters and are subject to AML/CFT requirements.
- FinCEN has updated its rules and provided guidance on virtual currencies, including digital assets.
- The number of suspicious transaction reports (SARs) involving virtual currency has increased, requiring financial institutions to identify emerging threats and typologies.
- Reporting requirements may vary slightly depending on the type of financial institution involved in the US.



Approaches to Regulating Virtual Assets

Registration and
licencing

KYC regulations

AML compliance
procedures
(submission of
SARs)

Traceability of
crypto-asset
transactions

Effective
supervision and
sanctions

Risk-Based
Approach

Approaches to Regulating Virtual Assets

- KYC regulations and AML compliance procedures developed by VASPs can vary widely.
- ESMA and EBA recommend including VASPs and ICO service providers within the scope of AML/CFT obligations in the EU.
- The Fifth Money Laundering Directive increases the traceability of crypto-asset transactions in the EU.
- EU member states have varying levels of strictness in their regulations for the registration and licensing of VASPs.
- The lack of a uniform global regulatory approach to virtual assets increases the risk of money laundering and terrorism financing, and a global framework is needed to mitigate these risks.

The FATF Forges a New International Approach

- FATF revised Recommendation No 15 in October 2018 to cover activities involving virtual assets and called for regulation and licensing of virtual asset service providers (VASPs) for AML/CFT purposes.
- The implementation of new standards for virtual assets will be monitored by FATF through the mutual evaluations process.
- Virtual assets are considered "property," "proceeds," "funds," or a "corresponding value" under the new FATF standards, clarifying their legal nature and coverage by AML/CFT rules.

The FATF Forges a New International Approach

- A risk-based approach (RBA) must be applied to virtual assets and VASPs, with enhanced due diligence for higher-risk virtual currencies.
- VASPs must be licensed or registered in the jurisdiction where they are created and may also need registration in jurisdictions where they operate.
- Authorities need to identify unregistered VASP activities and apply sanctions. Changes in VASP ownership and structure require prior approval.

The FATF Forges a New International Approach

- Competent national authorities should supervise and monitor VASPs on a risk-based basis, with powers to ensure compliance and impose sanctions.
- Preventive measures, such as customer due diligence and obtaining originator and beneficiary information, apply to VASPs under certain conditions.
- International cooperation should be provided by FATF member countries for money laundering and terrorist financing offenses involving virtual assets.

The FATF Forges a New International Approach

- Information sharing between financial intelligence units and law enforcement authorities is crucial for investigations and preventing jurisdiction-shopping.
- Prompt and effective exchange of information between VASP supervisors is encouraged.
- Compliance with FATF standards will create a level regulatory playing field globally.

The way forward

- The scope of monitoring or supervision of virtual assets according to FATF standards is limited to AML/CFT purposes and does not cover financial stability or consumer/investor protection.
- Regulating virtual asset activities involves multiple stakeholders and is a complex task.
- The new AML/CFT regulatory environment should not hinder innovation, financial services expansion, and financial inclusion.

The way forward

- Lack of specific reporting requirements for crypto-asset activities prevents competent authorities from monitoring and addressing AML/CFT risks.
- Inconsistent global approaches increase the risk of jurisdiction-shopping by money launderers and terrorists who exploit jurisdictions with weak regulation of crypto-asset activities.
- Money launderers may utilize "crypto to crypto" services and anonymizing techniques such as tumblers and mixing services offered on the Dark Web, further complicating AML/CFT efforts.
- As a result, there is a need to establish a unified global approach within the framework of FATF to mitigate money laundering risks associated with crypto-assets.

Key Takeaways



Key Takeaways

1. FATF's monitoring and supervision of virtual assets are primarily focused on AML/CFT purposes, not overall financial stability or consumer/investor protection.
2. Regulating virtual asset activities is a complex task involving multiple stakeholders.
3. Balancing regulation with innovation and financial inclusion is crucial, but refraining from regulating virtual asset activities in the AML/CFT area is not an option.
4. The lack of a global approach increases the risk of money laundering and terrorism financing through jurisdiction-shopping.
5. Money launderers can exploit weak AML/CFT controls by utilizing crypto-to-crypto services, tumblers, and mixing services on the Dark Web.

Learning Activity

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Learning Activity

Title: Exploring Regulatory Frameworks for Virtual Asset Activities

Research: Conduct independent research on the regulatory frameworks of different jurisdictions (e.g., United States, European Union, Japan, Singapore, etc.) regarding virtual asset activities. Explore the AML/CFT regulations and guidelines specific to each jurisdiction.

Comparative Analysis: Compare and contrast the regulatory approaches taken by the selected jurisdictions. Consider factors such as the scope of regulation, requirements for virtual asset service providers, customer due diligence measures, and reporting obligations.



Learning Activity



Risk Assessment: Evaluate the potential risks and benefits associated with the different regulatory frameworks. Analyze how well these regulations address money laundering risks and terrorist financing concerns.

Group Discussion or Written Reflection: Engage in a group discussion or write a reflective essay addressing the importance of a global approach in mitigating money laundering risks related to crypto-assets. Discuss the challenges of harmonizing regulatory frameworks across jurisdictions and the potential benefits of enhanced international cooperation.

Critical Analysis: Critically analyze the effectiveness of the regulatory frameworks in addressing AML/CFT concerns. Assess the strengths and weaknesses of the selected jurisdictions' approaches, and identify areas for improvement or potential best practices.

Self-Assessment Questions

Self-Assessment Questions

What is the scope of monitoring and supervision of virtual assets according to FATF standards?

Why is regulating virtual asset activities a complex task?

How can the new international AML/CFT regulatory environment balance innovation and financial inclusion?

What are the risks associated with the lack of a global approach to regulating crypto-assets?

What methods do money launderers use to exploit weaknesses in AML/CFT controls?

Additional Resources

Additional
Resources at EU
level

Directive 2018/843
of the European
Parliament and
Council of 30 May
2018 amending the
Anti-Money
Laundering Directive
2015/849, OJ L
156/43 of 19.6.2018

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Thank you once again for being part of our educational journey. We are grateful to have had the opportunity to inspire and empower you and we wish you success in all your future endeavors.

With gratitude,

Georgios Pavlidis

Jean Monnet Chair, NUP

Open Educational Resources (OER) NUP Jean Monnet Chair

The Jean Monnet Chair at NUP

Since 2020, Neapolis University Pafos has the honor to be the host of a prestigious Jean Monnet Chair, which has been awarded to Dr. George Pavlidis to further promote his teaching and research into innovative methods for “Targeting Criminal Assets in the European Union”. The Jean Monnet Chair at NUP fosters the development of existing and new teaching, including Open Educational Resources (OER), while research activities and events give greater visibility to this field of study at national and regional level. The promotion of knowledge sharing through OERs, a working papers series and a knowledge database on asset recovery fall within the mission objective of the NUP School of Law, which aims to consolidate a strong contribution to the discussion on the future of the European integration.

