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Introduction

- Digital currency is an asset with monetary characteristics which is only available in digital, rather than physical form.
- Crypto assets is a broad term covering all assets that are stored in distributed ledgers. This includes all crypto currencies and non-currency assets such as security tokens.
- Crypto currency is a class of digital currency that does not possess a legal status of currency or money but can be accepted by persons as a means of exchange and can be transferred, stored and traded electronically.

Introduction

- Distributed Ledger Technology functions as a database or an accounting system implemented across a network to allow participants to track ownership and transfer of crypto-assets and tokens from one party to another in the absence of traditional financial intermediaries. Blockchain is a type of distributed ledger technology.
- Tokens are digital representations of crypto-assets, sometimes conferred during the process of sale with the aim of raising capital.
- A custodian wallet provider is an entity that provides online crypto asset account services. Customers are able to use their digital wallet to hold, store and transfer crypto-assets.

Introduction

- This presentation aims to provide a high-level view of how the emerging crypto asset sector intersects with AML regulations and the risk-based approach in Mauritius and in some other jurisdictions.
- Regulated financial institutions face the challenge of expanding the opportunities presented by crypto assets and distributed ledger technology and abiding to regulatory framework in their jurisdiction including the implementation of AML and CFT.

Why is AML/CFT compliance important when dealing with crypto assets and fintech products?

- Money laundering is the process by which criminals attempt to conceal the true origin and ownership of the proceeds of their criminal activities.
- An effective money laundering operation will normally follow 3 stages:
  - Placement
  - Layering
  - Integration
- Crypto-assets may be abused by money launderers and may be involved in any of the stages of money laundering.

Illegal Activity involving Digital Assets

Crypto assets may be used for various illegal activities by criminals or criminal organisations.

Examples of bad actors include:

- Individuals : a person who buys or sells illegal goods on the dark web in return for CryptoAssets;
- Small groups: hacking groups who use ransomware or blackmail a person over personal information and seek to be paid in CryptoAssets
- Organised crime: for instance, a group who launder crypto-asset proceeds of crime in exchange for fiat on behalf of smaller criminal organisations.

Why is AML/CFT compliance important when dealing with crypto assets and fintech products?

- There are many risks that are associated with crypto assets and fintech products.
- Peer-to-peer transaction authentication in crypto assets transactions permit asset holders to bypass institutional intermediaries, who serve as essential gatekeepers in global AML regimes.
- The absence of in-built geographic limitation makes it difficult to resolve which jurisdiction or jurisdictions may regulate each underlying activity.

Legislations in Mauritius

- Financial Services Act 2007 - Custodian Services (digital assets) and Digital Asset Marketplace included in the Second Schedule.
- Guidance note on Recognition of Digital Assets as asset-class for investment by Sophisticated and Expert Investors.
- Financial Services (Custodian services (digital asset)) Rules 2019
- Guidance note on securities token offering
- FIAMLA 2002 and the rules/ regulations thereunder – The holder of the Custodian Services (Digital Asset) Licence and the Digital Asset Marketplace Licence will also be considered as a "financial institution".

AML/CFT Risks

- A licensee has to ensure strict adherence to the appropriate laws, regulations and codes relating to AML/CFT in Mauritius including the FSC Code on the Prevention of Money Laundering and Terrorist Financing, the FIAMLA and regulations made thereunder.

AML/CFT treatment in CryptoAssets in the EU

- In early 2018, Europol estimated that £3-4 billion was being laundered using CryptoAssets each year in Europe.
- Relatively small proportion of total funds estimated to be laundered in Europe (standing at about £100 billion) but believed to be rapidly growing.
- Indeed, a recent Financial Action Task Force (FATF) report to the G20 noted that suspicious transaction reporting linked to CryptoAssets is rising globally.

AML/CFT treatment in CryptoAssets in the EU

European Union's Fifth Money Laundering Directive (5MLD)

- First pan-European Law dealing with the characterisation and regulation of CryptoAssets
- The 5MLD requires Member States to apply AML obligations:
  - to CryptoAsset exchanges (involving an exchange between crypto and fiat currencies); and
  - to custodian wallet providers who provide services to safeguard cryptographic keys on behalf of customers, to hold, store, and transfer virtual currencies.
- European jurisdictions must introduce local legislation implementing the 5MLD by January 2020.

The Financial Action Task Force

- Changes to the FATF Recommendations on Combatting Money Laundering adopted to clarify how FATF Recommendations apply to financial activities involving CryptoAssets
- Principal change was to require that jurisdictions ensure that "virtual asset service providers" are made subject to AML requirements including conducting:
  - customer due diligence;
  - on-going monitoring;
  - record-keeping; and
  - reporting of suspicious transactions.

The Financial Action Task Force

The definition of a "virtual asset service provider" is broad covering:

- exchange between virtual assets and fiat currencies;
- exchange between one or more forms of virtual assets;
- transfer of virtual assets;
- safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and
- participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.

The Financial Action Task Force

- In contrast, as explained previously, the 5MLD requirements apply only to exchanges (involving the exchange between crypto and fiat currencies) and wallet providers.
- The 5MLD therefore covers only two of the previous five activities.
- FATF also recommended that virtual asset service providers should be licensed or registered and subject to monitoring to ensure compliance.
- However, this Recommendation relates to licensing only for AML and CFT compliance purposes as opposed to for broader financial services regulatory type obligations such as consumer and investor protection safeguards.

AML/CFT treatment in CryptoAssets in the UK

- Initially considered as 'low risk' following reports on their use for criminal activity in 2015 and 2017
- As well as becoming subject to supervision for compliance, CryptoAsset firms within scope will have to introduce AML policies, procedures, and controls.
- These include matters such as:
- mandatory customer due diligence/KYC on customers;
- obligations to monitor transactions and record keeping;
- the reporting of suspicious transactions;
- training and staff vetting;
- and the registration of senior individuals involved in the business with the local regulator.

AML/CFT treatment in CryptoAssets in the UK

The UK Government is considering materially gold-plating the EU rules to cover the following matters not covered by the 5MLD:

- The UK may apply regulation to all digital assets and not just crypto-currencies (including, utility tokens);
- UK laws might apply extra-territorially to service providers outside the UK providing services to persons in the UK; and
- The UK might apply regulation to exchanges which do not involve exchange of crypto to fiat currency.

The UK is committed to transposition by January 2020 notwithstanding any Brexit developments.

Thank you!

The ALN Network

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