

INTERNATIONAL ANTI-MONEY LAUNDERING  
REGULATION OF VIRTUAL CURRENCIES  
AND ASSETS

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## I. INTRODUCTION

“Money laundering is the processing of assets generated by criminal activity to obscure the link between funds and their illegal origins.”<sup>1</sup> The laundering process is essential for lawbreakers to avoid suspicion about the criminal origins of their ill-gotten gains.<sup>2</sup> By obscuring the illegal origin of funds through money laundering, criminals hide underlying criminal activity from law enforcement. Anti-money laundering (AML) regulation is a means of reducing this information asymmetry by flagging suspicious transactions for law enforcement to investigate for potential underlying crimes.<sup>3</sup>

Virtual assets represent a new channel through which criminals can launder their illegal proceeds.<sup>4</sup> Virtual assets are created and managed through advanced encryption and often run on a decentralized network known as the blockchain.<sup>5</sup> They are used for a variety of purposes including cryptocurrencies (e.g. bitcoin, ether, etc.), initial coin offerings (ICOs),

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1. *The IMF and the Fight Against Money Laundering and the Financing of Terrorism*, INTERNATIONAL MONETARY FUND (Mar. 8, 2018), <https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/31/Fight-Against-Money-Laundering-the-Financing-of-Terrorism>.

2. *What is Money Laundering?*, FATF-GAFI (2019), <https://www.fatf-gafi.org/faq/moneylaundering/> (last visited May 19, 2020).

3. Christian Brenig et al., *Economic Analysis of Cryptocurrency Backed Money Laundering*, EUR. CONF. ON INFO. SYS. COMPLETED RES. PAPERS (May 29, 2015), [http://aisel.aisnet.org/ecis2015\\_cr/20](http://aisel.aisnet.org/ecis2015_cr/20) (explaining that “[t]he process of ML is characterized by asymmetric information between criminals and law enforcement.”).

4. See Dong He et al., *Virtual Currencies and Beyond: Initial Considerations*, 2016 IMF STAFF DISCUSSION NOTE 27, <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1603.pdf> (“[Virtual currencies] can be used to conceal or disguise the illicit origin or sanctioned destination of funds, thus facilitating the money laundering (ML), terrorist financing (TF), and the evasion of sanctions.”); see also FIN. ACTION TASK FORCE, *VIRTUAL CURRENCIES: KEY DEFINITIONS AND POTENTIAL AML/CFT RISKS* 3 (2014), <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>. (“[V]irtual currencies provide a powerful new tool for criminals, terrorist financiers and other sanctions evaders to move and store illicit funds, out of the reach of law enforcement and other authorities.”) [Hereinafter 2014 FATF REPORT].

5. See generally Adam Barone, *The Future of Cryptocurrency in 2019 and Beyond*, INVESTOPEDIA (June 25, 2019), <https://www.investopedia.com/articles/forex/091013/future-cryptocurrency.asp> (providing background information on the mechanics of cryptocurrencies).

and other digital payment and investment technologies.<sup>6</sup> Given the decentralized nature of the underlying blockchain, virtual assets can operate without a central authority enforcing a regulatory framework.<sup>7</sup> Changes to the underlying architecture of the blockchain must receive a majority of consensus from all operating nodes, not just agreement from a singular central authority, making changes difficult to incorporate and impossible to mandate.<sup>8</sup> Further, the anonymous nature of virtual assets is particularly concerning to regulators as effective AML measures rely on identity verification.<sup>9</sup> Therefore, even if regulators can identify troubling transaction patterns, the lack of ability to link virtual asset transactions to specific individuals means regulators cannot link those transactions to specific persons. Further, individuals may have multiple online accounts, making it easier to obscure transactions.

Because there is not an internationally uniform understanding of what constitutes a virtual asset and a virtual asset service provider, money launderers will likely be able to find and exploit potential regulatory gaps.<sup>10</sup> Differences between national schemes present opportunities for criminals to take advantage of open or non-regulated virtual assets to continue to launder profits. Although the Financial Action Task Force (FATF), the international body primarily responsible for promulgating non-binding international AML regulation, has

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6. See David Carlisle, *The FATF: Getting Serious about Virtual Assets*, ELLIPTIC (Oct. 25, 2018), <https://www.elliptic.co/our-thinking/fatf-virtual-assets> (“[V]irtual assets . . . include cryptocurrencies, initial coin offerings (ICOs) and a broad array of other digital payment and investment technologies.”).

7. See James McWhinney, *Why Governments are Afraid of Bitcoin*, INVESTOPEDIA (Nov. 1, 2019), <https://www.investopedia.com/articles/forex/042015/why-governments-are-afraid-bitcoin.asp> (“That lack of central authority is the primary reason governments are afraid of the cryptocurrency.”).

8. See SATOSHI NAKAMOTO, *BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM* 8 (2008), <https://bitcoin.org/bitcoin.pdf> (“Any needed rules and incentives can be enforced with this consensus mechanism.”).

9. See Dong He et al., *supra* note 4, at 27 (“[Virtual currency] traceability is limited due to user anonymity and anonymizing service providers that obfuscate the transaction chain.”).

10. See CIPHERTRACE, *CRYPTOCURRENCY ANTI-MONEY LAUNDERING REPORT: 2019 Q2 31* (2019), <https://ciphertrace.com/wp-content/uploads/2019/09/CipherTrace-Cryptocurrency-Anti-Money-Laundering-Report-2019-Q2-3.pdf> (“The gaps in these regulations present risky avenues that can be exploited by money launderers and terrorist organizations.”).

taken steps to unify definitions of virtual assets and virtual asset service providers, the most recent guidance leaves room for different interpretations across jurisdictions. Even though the FATF applied the money travel rule, which identifies fiat currency transactions above a certain threshold as potentially suspicious, to virtual assets in its most recent guidance, there is an inherent difficulty in applying this rule to virtual assets. This awkward fit prevents the rule from being an effective tool in the fight against virtual money laundering.

This note will proceed in four sections. Section II addresses the FATF's attempts to define these new technologies. Section III observes how the regulatory examples cited in the most recent FATF guidance create differing approaches to AML policy. This includes open questions across countries on what constitutes a virtual asset and how they should be regulated. Section IV investigates the implications of the FATF's application of the fiat currency "money travel rule" to virtual assets. The conclusion looks at possible reactions to the money travel rule and proposed FATF regulations, predicting that they may push customers away from transacting on registered entities towards unregistered entities, but also recognizing that they provide law enforcement with a means of capturing illicit activity and bestowing more legitimacy on virtual currencies.

## II. FINANCIAL ACTION TASK FORCE RECOMMENDATION AND GUIDANCE ON VIRTUAL CURRENCIES AND ASSETS

### A. *Background on the Financial Action Task Force*

The FATF was established at the 1989 Paris G-7 Summit to mitigate global concern over money laundering.<sup>11</sup> The membership of the FATF has expanded from the original sixteen founding members to thirty-nine current members.<sup>12</sup> The primary objective of the FATF is "to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international

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11. *History of the FATF*, FATF-GAFI, <https://www.fatf-gafi.org/about/historyofthefatf/> (last visited May 19, 2020).

12. *See* FATF Members and Observers, FATF-GAFI, <https://www.fatf-gafi.org/about/membersandobservers/> (last visited May 19, 2020) ("The FATF currently comprises 37 member jurisdictions and 2 regional organisations, representing most major financial centres in all parts of the globe.").

financial system.”<sup>13</sup> The FATF sets “the international anti-money laundering and combatting the financing of terrorism and proliferation (AML/CFT) standards” through the issuance of recommendations.<sup>14</sup> Although FATF guidance is not legally binding, member countries “almost universally” implement FATF recommendations into national policy for fear of potential economic sanctions from total non-compliance.<sup>15</sup> The FATF monitors member compliance through mutual evaluations, which score a nation’s policy for specific measures.<sup>16</sup> Different levels of compliance will yield varying responses from the FATF and other member countries, ranging from “increased ‘scrutiny’ of financial transactions” to revocation of membership and sanctions.<sup>17</sup>

### B. *The Move from Virtual Currencies to Virtual Assets*

In June 2014, the FATF began issuing AML/CFT guidance as virtual currencies emerged as a “new method of

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13. *What We Do*, FATF-GAFI, <https://www.fatf-gafi.org/about/whatwedo/> (last visited May 19, 2020).

14. *FATF Recommendations*, FATF-GAFI, [http://www.fatf-gafi.org/publications/fatfrecommendations/?hf=10&b=0&s=desc\(fatf\\_releasedate\)](http://www.fatf-gafi.org/publications/fatfrecommendations/?hf=10&b=0&s=desc(fatf_releasedate)) (last visited May 19, 2020); see also Kristin Broughton, *Crypto Firms Assess How to Comply with Anti-Money-Laundering Standards*, WALL STREET J. (Sept. 16, 2019, 5:30 AM), <https://www.wsj.com/articles/crypto-firms-assess-how-to-comply-with-anti-money-laundering-standards-11568626200> (“The FATF is the global standard-setter for anti-money-laundering.”).

15. Katherine Kirkpatrick et al., *FinCEN ‘Travel Rule’ Update Sets Challenge for Crypto Cos.*, LAW360 (Oct 11, 2019, 5:28 PM), <https://www.law360.com/articles/1207330> (“Although FATF guidance does not have the force of law, FATF member countries almost universally implement laws based closely upon its recommendations.”); see also Megan Gordon, Ellen Lake & Jesse Overall, *Industry Sceptical [sic] About how ‘Travel Rule’ Recommendation Will Apply to Crypto*, CLIFFORD CHANCE (June 27, 2019), <https://talkingtech.cliffordchance.com/en/industries/fintech/industry-sceptical-about-how-travel-rule-recommendation-will-a.html> (“It may be called a recommendation, but the fact that FATF’s recommendations are not binding international law does not mean they can be ignored . . . Jurisdictions who do not bring their systems into line with FATF’s standards risk are not being placed on the FATF grey list, which is a yellow card on the way to the black list.”).

16. Kathryn L. Gardner, *Fighting Terrorism the FATF Way*, 13 GLOBAL GOVERNANCE 325, 332–33 (2007); *Mutual Evaluation*, FATF-GAFI, [http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc\(fatf\\_releasedate\)](http://www.fatf-gafi.org/publications/mutualevaluations/?hf=10&b=0&s=desc(fatf_releasedate)) (last visited May 19, 2019).

17. *Id.* at 333.

transmitting value over the internet.”<sup>18</sup> Although not binding, the FATF’s guidance is usually heeded by member states, either in whole or in part. As part of a “staged approach” to address the money laundering and terrorist financing risks associated with virtual currency,<sup>19</sup> the FATF released guidance in June 2015 (FATF 2015 Guidance) primarily focused on convertible virtual currencies.<sup>20</sup> The FATF 2015 Guidance targeted the intersection points between virtual currencies and the traditional banking system.<sup>21</sup> However, this guidance addressed only the entry and exit points of the virtual currency marketplace; it did not attempt to provide recommendations for internal marketplace transfers, thus leaving a large number of transactions unregulated. Virtual currency was understood in this initial guidance as a “digital representation of value” that functions as “(1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status.”<sup>22</sup> Some countries have retained this definition of virtual currency despite the recent developments outlined below.

The most recent FATF update, along with new guidance issued in 2019 (FATF 2019 Guidance) is driven by developments within the virtual asset industry which eliminate the need for consumer interaction with the traditional banking system, thus leaving large regulatory gaps in the “on and off ramp[ ]” approach.<sup>23</sup> In response to the rapid development of

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18. *Guidance for a Risk-Based Approach to Virtual Currencies*, FATF-GAFI, <https://www.fatf-gafi.org/publications/fatfgeneral/documents/guidance-rba-virtual-currencies.html> (last visited June 11, 2020).

19. FIN. ACTION TASK FORCE, *VIRTUAL CURRENCIES: GUIDANCE FOR A RISK-BASED APPROACH* 3 (2015), <https://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf> [hereinafter 2015 FATF GUIDANCE].

20. *See* 2014 FATF REPORT, *supra* note 4, at 3 (“While the 2013 NPPS Guidance broadly addressed internet-based payment services, it did not define ‘digital currency,’ ‘virtual currency,’ or ‘electronic money.’”).

21. *See* 2015 FATF GUIDANCE, *supra* note 19, at 4 (“The focus of this Guidance is on convertible virtual currency exchangers which are points of intersection that provide gateways to the regulated financial system (where convertible VC activities intersect with the regulated fiat currency financial system).”).

22. *Id.* at 26.

23. FIN. ACTION TASK FORCE, *VIRTUAL ASSETS AND VIRTUAL ASSET SERVICE PROVIDERS: GUIDANCE FOR A RISK-BASED APPROACH* 6 (2019) [hereinafter FATF 2019 GUIDANCE].

the virtual currency ecosystem, the FATF formally adopted a new vocabulary in 2018, introducing the terms “virtual assets” and “virtual asset providers” (VASPs) into the official glossary.<sup>24</sup> The FATF amended Recommendation 15 to now include VASPs alongside traditional banking institutions and imposes similar monitoring obligations upon them. Further, in the interpretive note to the amended recommendation, VASPs are now subject to the money travel rule, which states the threshold transfer value triggering customer identification requirements.<sup>25</sup>

In addition to exchanges between virtual/fiat and virtual/virtual currencies and assets, the new FATF guidance captures entities involved in the transfer of virtual assets, the safekeeping of virtual assets, and the provision of financial services related to an issuer’s offer or sale of virtual asset within the definition of VASPs.<sup>26</sup> This broadens the FATF’s initial understanding of regulated entities and expands coverage to mixers and tumblers<sup>27</sup> as well as ICOs and other virtual asset investment technologies not captured in the 2015 guidance.<sup>28</sup>

The FATF 2019 Guidance also defines virtual assets more broadly than its predecessor term, virtual currency, to include any “digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes.”<sup>29</sup> This new definition does not require recognition, meaning that a state-sponsored virtual currency would be sub-

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24. *Id.* at 6 (“[I]n October 2018, the FATF adopted two new Glossary definitions—‘virtual asset’ (VA) and ‘virtual asset service provider’ (VASP) . . .”).

25. *See id.* at 56 (noting that the threshold above with VASPs must conduct customer due diligence is 1,000 USD/EUR).

26. *Id.* at 57.

27. Cryptocurrency mixers and tumblers are commonly used to further ensure the privacy of transactions by mixing coins from various users. *See generally What are Bitcoin Mixers*, BITCOIN MAG., <https://bitcoinmagazine.com/guides/what-are-bitcoin-mixers> (last visited May 19, 2020) (explaining how bitcoin mixers function and why people use them).

28. *See* FATF 2019 GUIDANCE, *supra* note 23, at 6 (noting that since 2015, “the virtual asset space has evolved to include a range of new products and services, business models, and activity and interactions, including virtual-to-virtual asset transactions.”).

29. *See id.* at 13 (“Virtual assets do not include digital representations of fiat currencies, securities, and other financial assets that are already covered elsewhere in the FATF Recommendations[.]”).

ject to similar regulation. This indicates that FATF may be anticipating that countries will begin to either create their own or recognize other types of virtual assets. Most notably, however, the term includes any digital value that can be used for “investment purposes.”<sup>30</sup> This understanding greatly increases who is subject to mandatory registration as a VASP, sweeping many cryptocurrency investment-based services into the FATF regulatory framework and imposing a substantial regulatory burden on the industry.

As FATF recommendations are not binding and allow members to implement national policy, the shift from virtual currency to the broader understanding of virtual assets may result in specific countries adopting different regulatory interpretations. Different national understandings of what a virtual asset is will lead to a disparate international AML regulatory framework, allowing money launderers to take advantage of differences across borders and evade law enforcement.<sup>31</sup>

### III. FATF-CITED EXAMPLES OF DIFFERENT VIRTUAL ASSET AND VASP REGULATORY APPROACHES

Section V of the FATF 2019 Guidance provides specific examples of risk-based approaches to regulating virtual assets and VASPs adopted in different jurisdictions.<sup>32</sup> These examples are included to provide member states with guidelines “when developing or enhancing their own national frameworks.”<sup>33</sup> Although the FATF qualifies that these countries have not yet been assessed for compliance with the latest recommendations,<sup>34</sup> their inclusion in the guidance still demonstrates that, even in ideal circumstances, there is significant potential for virtual assets to be understood in different ways that create regulatory gaps between jurisdictions.

The FATF cites regulatory approaches in Italy, Norway, Sweden, Finland, Mexico, Japan, and the United States. An in-

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30. *Id.* at 57 (emphasis added).

31. *See infra* Section III (analyzing examples of the differences between national AML regulations).

32. FATF 2019 GUIDANCE, *supra* note 23, at 46 (summarizing country examples of risk-based approach to virtual assets and virtual asset service providers).

33. *Id.*

34. *Id.*



depth analysis of these approaches reveals that, in practice, the international community is far from a universal understanding of what virtual assets are and when they should be regulated. Specifically, there are key differences among the legal definitions of virtual currency and virtual asset and disagreement about whether regulations should only apply to transactions between fiat and virtual currencies. Furthermore, there are open questions regarding regulations for virtual asset custodians, virtual assets for investment purposes, utility tokens, and ICOs. Virtual asset custodians function similarly to other asset custodians and are primarily “responsible for the safekeeping of their clients’ assets, as well as the processing of transactions.”<sup>35</sup> The only difference is that the underlying assets are virtual in this context. A utility token “enable[s] access to a specific product or service,”<sup>36</sup> while an ICO is a different capital-raising technique by which projects sell their own cryptocurrency,<sup>37</sup> which may then have a variety of uses as an investment tool, a payment tool, or as a utility token itself.<sup>38</sup> Differing attitudes regarding ICOs and utility tokens provide a clear gap for money launderers to exploit an unregulated market.

#### A. E.U. AML Directives

As members of the European Union, Italy, Sweden, and Finland are obligated to incorporate the E.U. interpretation of FATF recommendations. While each takes a slightly different national approach, they are heavily influenced by the E.U. understanding. The E.U. Fifth AML Directive retains the 2015 FATF Guidance definition of virtual currency, now replaced in the FATF 2019 Guidance. Motivated by a concern that “the anonymity of virtual currencies allows their potential misuse

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35. BENJAMIN COLLETTE ET AL., DELOITTE, THE EVOLUTION OF A CORE FINANCIAL SERVICE: CUSTODIAN & DEPOSITARY BANKS 3 (2019), <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/lu-the-evolution-of-a-core-financial-service.pdf>.

36. DIRECTORATE-GENERAL FOR FINANCIAL STABILITY, FINANCIAL SERVICES AND CAPITAL MARKETS UNION, EUR. COMM’N., ON AN EU FRAMEWORK FOR MARKETS IN CRYPTO-ASSETS 8 (2019), [https://ec.europa.eu/info/sites/info/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/2019-crypto-assets-consultation-document\\_en.pdf](https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2019-crypto-assets-consultation-document_en.pdf).

37. *Id.* at 27.

38. *Id.* at 8.

for criminal purposes,” the European Union has sought to include “providers engaged in exchange services between virtual currencies and fiat currencies and custodial wallet providers” within its AML regulations.<sup>39</sup> Although the intent of the regulation is to cover non-payment uses of virtual currencies such as “exchange, investment, [and] store-of-value products,” it still requires interaction with the traditional financial sector as a prerequisite for regulation.<sup>40</sup> This more closely matches the entrance and exit approach of the FATF 2015 guidance, as it does not clearly cover transactions solely between virtual assets.

A new directive, the Sixth E.U. AML Directive, urges member state action to account for the amended FATF recommendations and ensure that the risks of combatting money laundering posed by virtual currencies “are addressed appropriately.”<sup>41</sup> However, unlike the detailed discussion of virtual currencies in the Fifth E.U. AML directive, the new directive only provides two short sentences. While acknowledging the need to adapt to the amended FATF recommendations, the European Union has notably maintained the previous definition of virtual currency. Moreover, the new directive gives countries no advice on how to interpret the new guidance in order to “appropriately address” the “new risks and challenges” of virtual currencies.<sup>42</sup>

### B. *Italy*

Legislative Decree No. 90/2017 was the first Italian legislative act related to virtual currency.<sup>43</sup> It defined virtual currency services to include “any natural or legal person providing pro-

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39. Directive 2018/843, of the European Parliament and of the Council of 30 May 2018 amending Directive 2015/849 on the Prevention of the Use of the Financial System for the Purposes of Money Laundering or Terrorist Financing, and Amending Directives 2009/138/EC and 2013/36/EU, 2018 O.J. (L 156) 43, 44.

40. *Id.* at 45.

41. Directive 2018/1673, of the European Parliament and of the Council of 23 October 2018 on Combating Money Laundering by Criminal Law, 2018 O.J. (L 284) 22, 23.

42. *Id.*

43. See Daniele Pozzi, *Crypto-Italy: Institutions, Politics, Business and Society*, COINTELEGRAPH (May 26, 2019), <https://cointelegraph.com/news/crypto-italy-institutions-politics-business-and-society> (“The very legal nature of cryptocurrencies remains blurred, as the only explicit mention to them in

fessional services to third parties functional to the utilization, the exchange, or the storage of virtual currencies, and to their conversion from or in currencies having a legal tender.”<sup>44</sup> Although this decree explicitly brought virtual currency services within the scope of Italian AML regulation,<sup>45</sup> it only regulated exchanges between virtual assets and fiat currency, not exchanges between virtual assets. However, with the passage of Legislative Decree No. 125/2019, which incorporates the Fifth E.U. AML Directive, Italy’s definition of virtual currency services expanded.<sup>46</sup> Exchanges between virtual assets and custodian wallet providers are now included in the Italian definition of virtual currency service providers,<sup>47</sup> which is roughly equivalent to the FATF approach.

Unfortunately, the FATF’s reference to Italy as a model regulatory system preceded the passage of Decree No. 125/2019, and it thus lacks any discussion of regulation of exchanges of virtual-to-virtual currencies for AML/CFT purposes. Italy’s inclusion as an example jurisdiction in the FATF guidance is therefore confusing, as Italy had not yet incorporated the most recent FATF recommendations.

Even with the most recent Italian legislative developments, there are still open questions in the regulations. For example, whether utility tokens should be classified as financial products remains unclear. Further, how tokens purchased for investment purposes fall within the scope of Italian regula-

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the Italian statutory body at the moment is among the preliminary definitions of the Decree 25/05/2017 no. 90”).

44. Decreto Legislativo 25 maggio 2017, n.90, art. 1 ¶ 2(ff) G.U. June 19, 2017, n.140 (It.).

45. *Id.*; Giulia Arangüena, *Distributed Ledgers in Italy: Regulatory Framework and Pipeline*, MEDIUM (Oct. 31, 2018), <https://medium.com/legal-block/distributed-ledgers-in-italy-regulatory-framework-and-pipeline-7790a5c0fa7b>.

46. Decreto Legislativo 4 ottobre 2019, n.125, art. 1 ¶ 1(f), G.U. Oct. 26, 2019, n.252 (It.).

47. Jeffrey Greenbaum, et al., *Italian AML Rules Capture Providers of Services Related to the Use of Virtual Currencies and Custodian Wallet Providers*, HOGAN LOVELLS (Nov. 5, 2019), <https://www.hlogage.com/italian-aml-rules-capture-providers-of-services-related-to-the-use-of-virtual-currencies-and-custodian-wallet-providers>.

tion (and the Sixth E.U. AML Directive) remains another open question.<sup>48</sup>

### C. Norway

With the adoption of new Norwegian AML regulations in 2018, providers of exchange and storage services for virtual currency were brought within the scope of the Norwegian Money Laundering Act, the primary legislation detailing AML regulations.<sup>49</sup> Section 1-3 of the Norwegian Regulation on Anti-Money Laundering and Terrorist Financing Measures explicitly applies the Money Laundering Act to providers of exchange services and virtual currency storage services.<sup>50</sup> The Act's definition of virtual currency closely resembles the FATF 2015 Guidance's definition, as it (1) uses the same terminology (i.e. virtual currency) and (2) defines the term to include "digital expressions of value" which do not have the legal status of currency but can be "accepted as a means of payment, and can be transferred, stored or traded electronically."<sup>51</sup>

The Act only explicitly covers exchanges between virtual and fiat currencies and custodial wallets.<sup>52</sup> Contrary to the most recent FATF guidance, the Act does not regulate virtual-to-virtual exchanges. Further, because of how narrowly virtual currency is defined, Norwegian regulation may exclude the use of coins as investment instruments or utility tokens, as neither have been captured by other legislation. The obligations of ICOs as utility tokens in Norway remain vague.

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48. See Francesco Dagnino, *Italy*, LEGALICO (May 4, 2018), <https://www.legalico.io/italy/> (discussing the possible application of Italian financial products regulation on digital token sales).

49. *Application of the Money Laundering Act for Virtual Currency*, FINANSTILSYNET (Apr. 14, 2020), <https://www.finanstilsynet.no/nyhetsarkiv/nyheter/2018/hvitvaskingslovens-anvendelse-for-virtuell-valuta/>.

50. § 1-3(1) Forskrift om tiltak mot hvitvasking og terrorfinansiering (hvitvaskingsforskriften) [Regulation on Measures on Money Laundering and Financing of Terrorism (Money Laundering Regulation)], Oct. 15, 2018, [https://lovdata.no/dokument/SF/forskrift/2018-09-14-1324/KAPITTEL\\_2#KAPITTEL\\_2](https://lovdata.no/dokument/SF/forskrift/2018-09-14-1324/KAPITTEL_2#KAPITTEL_2).

51. *Id.* §1-3(2).

52. Klause Henrick Wiese-Hansen & Vegard André Fiskerstrand, *Norway*, in *THE VIRTUAL CURRENCY REGULATION REVIEW* 222, 222 (Michael S. Sackheim & Nathan A. Howell eds., 2d ed. 2019), [https://thelawreviews.co.uk//digital\\_assets/079249ba-c1fd-43cb-b3ad-6c23efb53357/The-Virtual-Currency-Regulation-Review—Edition-2.pdf](https://thelawreviews.co.uk//digital_assets/079249ba-c1fd-43cb-b3ad-6c23efb53357/The-Virtual-Currency-Regulation-Review—Edition-2.pdf).

Certain activities may nevertheless be subject to other regulation.<sup>53</sup> For example, the Norwegian Financial Supervisory Authority, the Finanstilsynet, references warnings by the European Securities and Exchange Commission (ESMA) regarding ICO regulation.<sup>54</sup> The ESMA is “an independent EU authority” which creates a “single rulebook for EU financial markets.”<sup>55</sup> Although not a member of the European Union, Finland is on the Board of Supervisors for the ESMA and so contributes to and is subject to ESMA “policy decisions.”<sup>56</sup> The ESMA currently takes the position that an ICO may be subject to E.U. regulations depending on how the activity is structured.<sup>57</sup> ICOs involving coins or tokens which largely resemble financial instruments are very likely subject to E.U. securities law, including AML directives.<sup>58</sup>

#### D. Sweden

In January 2020, Sweden considered Swedish law aligned with the Fifth E.U. AML Directive.<sup>59</sup> Sweden now regulates vir-

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53. *Id.* (“There are no specific securities and investment laws in Norway with respect to virtual currencies or the offering of such currencies.”).

54. *Initial Coin Offerings (ICOs) – Alert to Investors and Companies*, FINANSTILSYNET (Nov. 20, 2017), <https://www.finanstilsynet.no/markedsadvarsler/2017/initial-coin-offerings-icoer—advarsel-til-investorer-og-foretak/>.

55. *Who We Are*, EUR. SEC. AND MKTS. AUTHORITY, <https://www.esma.europa.eu/about-esma/who-we-are> (last visited May 20, 2020).

56. *See Board of Supervisors*, EUR. SEC. AND MKTS. AUTHORITY, <https://www.esma.europa.eu/about-esma/governance/board-supervisors-and-ncas> (“The main role of the Board of Supervisors is to make all policy decisions of ESMA.”) (last visited May 20, 2020).

57. *See ESMA Alerts Firms Involved in Initial Coin Offerings (ICOs) to the Need to Meet Relevant Regulatory Requirements*, EUR. SEC. AND MKTS. AUTHORITY (Nov. 13, 2017), [https://www.esma.europa.eu/sites/default/files/library/esma50-157-828\\_ico\\_statement\\_firms.pdf](https://www.esma.europa.eu/sites/default/files/library/esma50-157-828_ico_statement_firms.pdf) (“Depending on how they are structured, ICOs may fall outside of the scope of the existing rules and hence outside of the regulated space.”).

58. *Id.* (“[W]here the coins or tokens qualify as financial instruments it is likely that the firms involved in ICOs conduct regulated investment activities . . . key EU rules [like the EU AML Directive] are then likely to apply.”).

59. *See Ted Menmuir, Spelinspektionen Demands Tightening of Sweden’s AML Codes*, SBC NEWS (Jan. 16, 2020), <https://www.sbcnews.co.uk/europe/2020/01/16/spelinspektionen-demands-tightening-of-swedens-aml-codes/> (discussing the alignment of Swedish AML law with the Fifth EU Directive in the context of gambling transactions); *The Fifth EU Anti-Money Laundering Directive Takes Effect*, MAYER BROWN (Jan. 14, 2020), <https://www.mayerbrown.com/en/perspectives-events/publications/2020/01/the-fifth-eu-anti->

tual currency custodian wallet providers and exchanges between fiat and virtual currencies, as well as exchanges between virtual currencies, similarly to the current FATF regulation.<sup>60</sup>

The Swedish Financial Supervisory Authority (FI), the primary regulator of the financial industry, adopted Proposal 2018/19: 150 which subjects traders of virtual currency to the same AML requirements as other banking and securities entities.<sup>61</sup> Although the FI currently regards ICOs as investment products, just like the FATF, it cites to the warnings issued by the ESMA rather than promulgating its own guidance on ICOs.<sup>62</sup>

The Swedish Enforcement Authority, the government agency responsible for debt collection, has also acknowledged the money laundering risks associated with cryptocurrency.<sup>63</sup> Although the Enforcement Authority has foreclosed on virtual assets, such as Bitcoin, and later sold them at public auction, it recognizes that virtual currency is attractive for activities like money laundering and considers locating Bitcoin an important part of “obstructing and countering organized crime.”<sup>64</sup> The Enforcement Authority justifies its own auctions of virtual assets by emphasizing the lack of an existing exchange with a secure infrastructure.<sup>65</sup>

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money-laundering-directive-takes-effect (noting that Sweden was one of eleven countries to have already implemented AML 5 in its legislation).

60. Niclas Rockborn, *Sweden*, in *THE VIRTUAL CURRENCY REGULATION REVIEW* 270, 275–76 (Michael S. Sackheim & Nathan A. Howell eds., 2d ed. 2019), [https://thelawreviews.co.uk//digital\\_assets/079249ba-c1fd-43cb-b3ad-6c23efb53357/The-Virtual-Currency-Regulation-Review—Edition-2.pdf](https://thelawreviews.co.uk//digital_assets/079249ba-c1fd-43cb-b3ad-6c23efb53357/The-Virtual-Currency-Regulation-Review—Edition-2.pdf).

61. *See id.* at 276 (“Virtual currency providers within the scope of the Currency Exchange Act must consequently comply with the rules of the AML Act, which include requirements to prepare a risk assessment, conduct customer due diligence, and monitor and report suspicious transactions.”).

62. *Warning of Risks with Initial Coin Offerings (ICO)*, FINANSINSPEKTIONEN (Nov. 7, 2017), <https://www.fi.se/sv/publicerat/nyheter/2017/varning-for-risker-med-initial-coin-offerings/>.

63. *About Us*, KRONOFOGDEN, <https://kronofogden.se/Omoss.html> (last visited May 20, 2020).

64. Press Release, Kronofogden, Now You Can Buy Bitcoin from Kronofogden—Again (Oct. 10, 2019), <https://www.kronofogden.se/80666.html>. The Enforcement authority has acknowledged the difficulty of obtaining access to encrypted digital wallets. *Id.*

65. *Id.*

### E. Finland

Passed in 2019 to incorporate the Fifth E.U. AML directive, Finland's Act on Virtual Currency requires registration of virtual currency providers, a term which includes virtual currency exchange services, custodian wallet providers, and issuers of virtual currencies.<sup>66</sup>

In June 2019, the Finnish Financial Supervisory Authority (FIN-FSA) announced new regulations and guidelines for virtual currency providers pursuant to the new Act.<sup>67</sup> However, unlike the FATF recommendations, the FIN-FSA does not consider all virtual currencies to be assets.<sup>68</sup> Although the FIN-FSA acknowledges that its terminology differs from the FATF's, it considers the difference to be of minimal importance as it ultimately believes virtual currencies are "a relatively small phenomenon" that for now "have no impact on financial markets or financial stability."<sup>69</sup>

Finland broadly defines a virtual currency exchange services to include the actual exchange of virtual currency into either fiat or virtual currency and the operation of a marketplace where such activities occur.<sup>70</sup> Only "a trader who provides virtual currency services within a limited network," a

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66. Press Release, FIN-FSA Financial Supervisory Authority, Virtual Currency Providers to Be Supervised By FIN-FSA—Briefing for Virtual Currency Providers on 15 May (Apr. 26, 2019), <https://www.finanssivalvonta.fi/en/publications-and-press-releases/supervision-releases/2019/virtual-currency-providers-to-be-supervised-by-the-fin-fsa—briefing-for-virtual-currency-providers-on-15-may/>.

67. FIN-FSA FIN. SUPERVISORY AUTHORITY, REGULATIONS AND GUIDELINES 4/2019: VIRTUAL CURRENCY PROVIDERS (2019), [https://www.finanssivalvonta.fi/globalassets/en/regulation/fin-fsa-regulations-and-guidelines/2019/04\\_2019/2019\\_04.m1\\_en.pdf](https://www.finanssivalvonta.fi/globalassets/en/regulation/fin-fsa-regulations-and-guidelines/2019/04_2019/2019_04.m1_en.pdf).

68. See *Frequently Asked Questions on Virtual Currencies and Their Issuance (Initial Coin Offering)*, FIN-FSA FIN. SUPERVISORY AUTHORITY (May 10, 2019), <https://www.finanssivalvonta.fi/en/banks/fintech—financial-sector-innovations/virtuaalivaluutan-tarjoajat/frequently-asked-questions-on-virtual-currencies-and-their-issuance-initial-coin-offering/> ("Bitcoin and other virtual currencies can be considered as a form of asset, but only as long as they have a functioning market . . . For example, the Financial Action Task Force (FATF) . . . uses in its recommendations and guidance the terms virtual asset and virtual asset service provider (VASP).").

69. *Id.*

70. *Virtual Currency Providers*, FIN-FSA FIN. SUPERVISORY AUTHORITY (May 10, 2019), <https://www.finanssivalvonta.fi/en/banks/fintech—financial-sector-innovations/virtuaalivaluutan-tarjoajat/>.

trader who occasionally provides virtual currency services in connection with other authorized professional activities, and virtual currencies issued by central banks are currently exempt from registration.<sup>71</sup> Registered virtual currency providers must comply with Finland's AML/CFT regulations.<sup>72</sup> Since the passage of the Act, Finland has approved the registrations of five virtual currency providers.<sup>73</sup>

The press release accompanying the FIN-FSA regulations concerning virtual currency providers explicitly calls attention to the FATF 2019 Guidance, as well as the fact that regulation of virtual currencies is still subject to "extensive international debate,"<sup>74</sup> indicating the Finnish view that international regulation in this area remains unsettled.

#### F. *Mexico*

Mexico's Federal Law for the Prevention and Identification of Transactions with Resources of Illicit Origin, the main legislation addressing money laundering regulations, was amended in March 2018 to explicitly cover transactions with virtual assets.<sup>75</sup> The law specifically identifies services involving virtual assets as an activity vulnerable to money laundering.<sup>76</sup> Virtual assets are defined as "representations of value electronically registered and utilized by the public as a means of payment for all types of legal transactions, which may be trans-

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71. *Id.*

72. Kevin Helms, *Finland Begins Regulating Crypto Service Providers*, BITCOIN.COM (Apr. 27, 2019), <https://news.bitcoin.com/finland-regulating-cryptocurrency/>.

73. Kevin Helms, *Finland Approves First 5 Crypto Service Providers*, BITCOIN.COM (Nov. 5, 2019), <https://news.bitcoin.com/finland-approves-first-5-crypto-service-providers/> ("The registrants are Localbitcoins, Northcrypto, Prasos, Prasos Cash Management, and Tesseract Group.").

74. Press Release, FIN-FSA Financial Supervisory Authority, FIN-FSA Regulations and Guidelines 4/2019 Concerning Virtual Currency Providers Enter into Force On 1 July 2019 (July 1, 2019), <https://www.finanssivalvonta.fi/en/publications-and-press-releases/supervision-releases/2019/fin-fsa-regulations-and-guidelines-42019-concerning-virtual-currency-providers-enter-into-force-on-1-july-2019/>.

75. Gustavo Guerra, *Mexico: Amendment to Anti-Money Laundering Law Pertaining to Cryptocurrencies*, L. LIBR. CONG. (May 22, 2018), <https://www.loc.gov/law/foreign-news/article/mexico-amendment-to-anti-money-laundering-law-pertaining-to-cryptocurrencies/>.

76. *Id.*



ferred only electronically.”<sup>77</sup> Although this uses the more recent FATF language of virtual asset instead of virtual currency, Mexico’s narrow definition of virtual assets leaves open the possibility that a wide array of virtual assets, including ICOs and utility tokens, may not be covered by the text of the statute. This would represent a departure from the FATF recommendation that these assets be regulated.

Virtual currencies are also regulated in Mexico under the *Ley de Instituciones de Tecnología Financiera* (Fintech Law) which grants the Mexican central bank, the Banxico, enforcement authority over these transactions and assets.<sup>78</sup> Banxico’s regulatory approach has been to maintain distance between virtual currencies and the traditional financial system.<sup>79</sup>

In March 2019, Banxico proposed regulations which have since been criticized by the cryptocurrency industry as overly burdensome and restrictive to the point of being prohibitive.<sup>80</sup> These regulations would require any digital assets used by Fi-

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77. *Id.*

78. See Miguel Ángel Peralta García et al., *Mexico*, in BLOCKCHAIN & CRYPTOCURRENCY REGULATION (Joe Dewey ed., 2020), <https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/mexico> (noting that the Banxico is required to “expressly authorise the digital assets being used by Financial Technology Institutions (‘Fintechs’) and other financial institutions.”).

79. See Tim Alper, *Mexico Looks to Bolster Crypto Regulations*, CRYPTONEWS.COM (Mar. 11, 2019), <https://cryptonews.com/news/mexico-looks-to-bolster-crypto-regulations-3499.htm> (“Per news outlet Imparcial, Banxico is seeking to ensure that companies dealing with cryptocurrencies ensure their crypto-dealings are kept ‘at a healthy distance’ from their conventional financial operations.”).

80. See, e.g., Diana Aguilar, *Experts Say Mexico’s Regulations Raise the Bar ‘Too High’ for Crypto Entrepreneurs*, COINDESK.COM (Aug. 6, 2019), <https://www.coindesk.com/experts-say-mexicos-regulations-raise-the-bar-too-high-for-crypto-entrepreneurs> (explaining that “law came out very restrictive, especially for cryptocurrencies to the point where an exchange can’t work under the Mexican law”); Jimmy Aki, *Mexico’s Proposed Crypto Laws Create New Barriers for Exchanges, Adoption*, BITCOIN MAG. (Mar. 22, 2019), <https://bitcoinmagazine.com/articles/mexicos-proposed-crypto-laws-create-new-barriers-for-exchanges-adoption> (discussing that the reforms would “limit the use of cryptocurrencies to internal use only for banks and regulated FinTech companies”); Kevin Helms, *Bank of Mexico’s Attempt to Regulate Crypto ‘Is a Disaster,’ Exchange CEO Explains*, BITCOIN.COM (Mar. 18, 2019), <https://news.bitcoin.com/bank-of-mexicos-attempt-regulate-crypto-disaster/> (noting that “[i]n a way, [Banxico’s circular] is preventing institutions from offering virtual assets to end consumers”).

nancial Technology Institutions, Mexico's version of a VASP, to be expressly authorized by Banxico. Many anticipate the need for official recognition will essentially grind exchange activity in Mexico to a near halt.<sup>81</sup> Although regulations do not prohibit such activity,<sup>82</sup> they impose a high regulatory cost to entry into the market because of Banxico's current unwillingness to authorize digital assets. Since the announcement of these regulations, some cryptocurrency exchanges have disconnected wallets with Mexican pesos from their platforms or converted pesos into USD Coin which only then can be used to buy other cryptocurrencies.<sup>83</sup> However, some exchanges have circumvented many of these new regulations by taking advantage of Mexico's "sandbox" regulatory exemptions, which allow smaller start-ups to operate without full regulations as a means to test novel ideas,<sup>84</sup> thus permitting these companies to build physical crypto exchanges in Mexico.<sup>85</sup>

### G. Japan

Japan has been working to impose effective regulation on the cryptocurrency market since 2016, in response to several

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81. See Aki, *supra* note 80 (noting that the new law will severely impede access); see also Jerry Brito & Peter Van Valkenburgh, *New Regulation Would Effectively Ban Crypto Exchanges in Mexico*, COINCENTER (Mar. 21, 2019), <https://coincenter.org/entry/new-regulation-would-effectively-ban-crypto-exchanges-in-mexico> ("The Mexican central bank, acting under authority from a recently enacted fintech law, proposed new regulations last week that would effectively ban cryptocurrency exchanges in the country.").

82. JP Buntinx, *Central Bank of Mexico's New Guidelines Will Not Result in a Crypto Ban*, MERKLE (Mar. 15, 2019), <https://themerke.com/central-bank-of-mexicos-new-guidelines-will-not-result-in-a-crypto-ban/>.

83. *Mexican Fintechs Making Major Mods Ahead of Key Regulatory Deadlines*, BNAMERICAS (Sept. 6, 2019), <https://www.bnamericas.com/en/news/mexican-fintechs-making-major-mods-ahead-of-key-regulatory-deadlines>.

84. David Feliba, *LatAm Turns To Mexico's Year-Old Fintech Law As A Model for Regulation*, S&P GLOBAL (Mar. 7, 2019), <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/50081755> ("The regulation does provide a so-called 'sandbox' mechanism, which offers small and especially novel startups to test and refine their ideas outside of the full regulatory environment, though it expires after a year.").

85. See Diana Aguilar, *Mexico is Getting Eight New Cryptocurrency Exchanges*, COINDESK (June 4, 2019), <https://www.coindesk.com/mexico-is-getting-eight-new-cryptocurrency-exchanges> ("Amero-Isatek will open its first physical cryptocurrency exchange in Nuevo León, Monterrey, on June 21, part of a plan to expand into another seven locations across Mexico.").

large hacks of Japanese exchanges.<sup>86</sup> Japan is amongst the strictest regulators of virtual assets.<sup>87</sup> However, the FATF 2019 Guidance does not include discussion of the most recent amendments and instead focuses on the prior version of the Payment Services Act (PSA) which was based on the FATF 2015 Guidance.<sup>88</sup> This is unfortunate, as Japan amended the PSA and the Financial Instruments Exchange Act in 2019 with the aim of serving as a model of cryptocurrency regulation for the international community.<sup>89</sup> The amendments thus provide a useful demonstration of how the new FATF guidance may be incorporated into national regulatory schemes.<sup>90</sup> These laws, which came into effect in April 2020, ensure that fiat to virtual and virtual to virtual exchanges are regulated and that restrictions on custodial service providers are increased by requiring registration.<sup>91</sup>

The recent revisions to the PSA replace the term virtual currency discussed in the FATF discussion of Japan with the term “cryptographic asset.”<sup>92</sup> While this change in terminology has no substantive implications, it closely tracks the FATF’s pivot in language from virtual currency to virtual asset.<sup>93</sup> The

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86. See *Cryptocurrency in Japan: A Regulatory Overview*, WIREX (Aug. 15, 2019, 4:40 AM), <https://wirexapp.com/blog/post/cryptocurrency-in-japan-a-regulatory-overview-0159> (explaining that Japan’s regulatory decisions were “a direct response to several high-profile crimes involving crypto-assets.”).

87. *Id.*

88. FATF 2019 GUIDANCE, *supra* note 23, at 49–50.

89. Hishashi Oki, *Japan Hopes to Set Global Crypto Law Benchmark with Latest Regulatory Update*, COINTELEGRAPH (June 5, 2019), <https://cointelegraph.com/news/japan-hopes-to-set-global-crypto-law-benchmark-with-latest-regulatory-update> (“On May 31, the Japanese House of Representatives amended two cryptocurrency-related laws, the Payment Services Act and the Financial Instruments and Exchange Act[.]”).

90. See Kevin Helms, *Japan to Provide G20 with Solution for Crypto Regulation*, BITCOIN.COM (Apr. 23, 2019), <https://news.bitcoin.com/japan-g20-cryptocurrency-regulation/> (discussing Japan’s leadership role amongst the G20 for cryptocurrency regulation).

91. Oki, *supra* note 89.

92. Ken Kawai & Takeshi Nagase, *Japan, in THE VIRTUAL CURRENCY REGULATION REVIEW* 170, 171 (Michael S. Sackheim & Nathan A. Howell eds., 2d ed. 2019), [https://thelawreviews.co.uk/digital\\_assets/079249ba-c1fd-43cb-b3ad-6c23efb53357/The-Virtual-Currency-Regulation-Review—Edition-2.pdf](https://thelawreviews.co.uk/digital_assets/079249ba-c1fd-43cb-b3ad-6c23efb53357/The-Virtual-Currency-Regulation-Review—Edition-2.pdf)

93. See generally FATF 2019 GUIDANCE, *supra* note 23, at 57 (defining virtual asset).

Japanese Financial Services Agency (FSA), the regulator behind many of the new amendments, believes the term virtual currencies is misleading as most crypto assets are not designed to be used solely for payment purposes.<sup>94</sup> Further, it cited the shift in the international community (i.e., the G-20 and the FATF) toward using asset instead of currency as a rationale for the amendment.<sup>95</sup> Japan's adoption of this new language may be significant if its approach is indeed followed by other nations.

The Japanese Virtual Currency Exchange Association (JVCEA) is a self-regulatory monitoring entity recognized by the FSA that was formed by the Japanese cryptocurrency industry in response to the hacking of a large Japanese cryptocurrency exchange.<sup>96</sup> Although the FATF 2019 Guidance specifically recommends that countries conduct oversight through a financial authority and not a self-regulatory body, the Guidance nevertheless mentions the JVCEA in its discussion of the Japanese regulatory scheme.<sup>97</sup> The JVCEA is influential in recommending regulations to the FSA and has proven to be an integral part of the Japanese crypto asset regulatory scheme.<sup>98</sup> Although the FATF specifically included Japan, and a discussion of JVCEA, in its discussion of exemplary regimes, it seems to be directly contradictory to its guidance that countries not use this type of self-regulation. This contradiction demonstrates that disparate interpretation of FATF guidance, or outright rejection, is not only possible, but does actually occur and is acknowledged, and even lauded, by the FATF itself.

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94. See Oki, *supra* note 89 (explaining that “the use of ‘virtual currency’ may mislead the public into thinking that cryptocurrencies function or hold the same status that is associated with fiat currencies.”).

95. *Id.*

96. *Japan Virtual Currency Exchange Association (JVCEA)*, CRYPTOMARKETSWIKI (July 5, 2019, 1:42 PM), [http://crypto.marketswiki.com/index.php?title=Japan\\_Virtual\\_Currency\\_Exchange\\_Association\\_\(JVCEA\)](http://crypto.marketswiki.com/index.php?title=Japan_Virtual_Currency_Exchange_Association_(JVCEA))

97. Compare FATF 2019 GUIDANCE, *supra* note 23, at 50 (“The JFSA also closely co-operates with the Japan Virtual Currency Exchange Association (JVCEA), the self-regulatory body certified in October 2018, for prompt and flexible response to VASP-related issues.”), with *id.* at 5 (“Regarding VASP supervision, the Guidance makes clear that only competent authorities can act as VASP supervisory or monitoring bodies, and not self-regulatory bodies.”).

98. See generally FATF 2019 Guidance, *supra* note 23, at 50 (describing the role of the JVCEA and its relationship with the JFSA).

## H. *United States*

The FATF 2019 Guidance spends the most time discussing the U.S. cryptocurrency regulatory scheme, which may generously be described as complex.<sup>99</sup> The U.S. Financial Crimes Enforcement Network (FinCEN) issued guidance in May 2019 clarifying that regulations relating to money-services businesses apply to virtual currency transmissions.<sup>100</sup> FinCEN's understanding of convertible virtual currency does not denote that its regulatory treatment will be akin to that of currency.<sup>101</sup> Depending on the nature of the virtual currency in question and its related activities, it may be identified as money transmission, a securities activity, and/or a commodities and derivatives activity and thus subject to regulatory supervision by FinCEN, the Securities and Exchange Commission (SEC), and/or the Commodity Futures Trading Commission (CFTC).<sup>102</sup> Navigating the disjointed regulatory landscape to determine how and when a virtual asset is monitored remains difficult given the different substantive positions of each agency.<sup>103</sup>

U.S. anti-money laundering regulations include application of the travel rule, which requires verification of customer identities, as well as the identities of “beneficiaries of transfers \$3,000 or higher.”<sup>104</sup> The FATF recommends a travel rule with

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99. See generally *id.* at 50–54 (describing the U.S. virtual asset regulatory system).

100. FINANCIAL CRIMES ENFORCEMENT NETWORK, FIN-2019-G001, APPLICATION OF FINCEN'S REGULATIONS TO CERTAIN BUSINESS MODELS INVOLVING CONVERTIBLE VIRTUAL CURRENCIES (2019), <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>.

101. *Id.* at 7 (“[T]he label applied to any particular type of CVC (such as ‘digital currency,’ ‘cryptocurrency,’ ‘cryptoasset,’ ‘digital asset,’ etc.) is not dispositive of its regulatory treatment under the BSA.”).

102. See FATF 2019 Guidance, *supra* note 23, at 54 (noting that FinCEN, CFTC, SEC, and DOJ authorities may all prosecute digital asset providers).

103. See Max Yakubowski, *Why Is the US Not Yet a Leader in Crypto Regulation? Experts Answer*, COINTELEGRAPH (Aug. 4, 2019), <https://cointelegraph.com/news/why-is-the-us-not-yet-a-leader-in-crypto-regulation-experts-answer> (“Specific to the U.S., the sheer number of regulatory bodies and variety of interpretations has made it difficult for U.S. firms to operate.”).

104. Gertrude Chavez-Dreyfuss, *U.S. to Strictly Enforce Anti-Money Laundering Rules in Cryptocurrencies: FinCEN Chief*, REUTERS, Nov. 15, 2019, <https://www.reuters.com/article/us-crypto-currencies-fincen/u-s-to-strictly-enforce-anti-money-laundering-rules-in-cryptocurrencies-fincen-chief-idUSKBN1XPIYR>.

a lower triggering threshold value of \$1,000.<sup>105</sup> This difference in triggering thresholds is yet another example of a discrepancy between national approaches and FATF recommendations that the FATF surprisingly includes in its guidance examples.

It is notable that the FATF 2019 Guidance was passed during the FATF presidential term of Marshall Billingslea, a nominee of the United States.<sup>106</sup> Clarification of the FATF standards for virtual currency and virtual currency providers was cited as a main initiative of Billingslea's presidency.<sup>107</sup> FinCEN has domestically regulated virtual currency administrators and exchanges since 2013.<sup>108</sup> Perhaps unsurprisingly, the new FATF regulations impose an understanding more in line with the U.S. approach on the international community.

### I. Conclusion

Comparison of international regulations reveals unsettled issues regarding whether virtual assets should be considered investment products, whether utility tokens should be regulated as virtual assets, and whether ICOs fall within regulatory jurisdiction. A broad understanding of virtual assets for investment purposes as promulgated by the FATF would expand the circumstances when virtual assets may be regulated for AML purposes. The current disparate national understandings create the potential for regulatory arbitrage by malicious actors who wish to evade national AML policy through the use of virtual assets. Open questions on how ICOs and utility tokens are regulated and what constitutes an investment purpose for a

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105. FATF 2019 Guidance, *supra* note 23, at 56.

106. *See generally Mr. Marshall Billingslea (2018-2019)*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/pages/marshallbillingslea.html> (last visited May 21, 2020) (providing a biography of Marshall Billingslea).

107. Paper by the Incoming President, Marshall Billingslea, Fin. Action Task Force, OBJECTIVES FOR FATF—XXX (2018–2019) ((2018), [http://www.fatf-gafi.org/media/fatf/content/images/Objectives-FATF-XXX-\(2018-2019\).pdf](http://www.fatf-gafi.org/media/fatf/content/images/Objectives-FATF-XXX-(2018-2019).pdf)).

108. *See generally FINANCIAL CRIMES ENFORCEMENT NETWORK, FIN-2013-G001, APPLICATION OF FINCEN'S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES (2013)*, <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf> (providing guidance to the Bank Secrecy Act, which applies to “persons creating, obtaining, distributing, exchanging, accepting, or transmitting virtual currencies.”).

virtual asset present an opportunity to evade AML restrictions by taking advantage of laxer regulatory schemes.

	Terminology	Fiat to Virtual Transfers	Virtual to Virtual Transfers	Virtual Asset Custodians	Virtual Assets for Investment Purposes	Utility Tokens	ICOs
FATF	Virtual Asset	X	X	X	X	?	X
Italy	Virtual Currency	X	X	X	?	?	?
Norway	Virtual Currency	X		X		?	?
Sweden	Virtual Currency	X	X	X	?	?	?
Finland	Virtual Currency	X	X	X	?	?	X
Mexico	Virtual Asset	X		?	?	?	X
Japan	Cryptographic Asset	X	X	X	?	?	?
U.S.	Virtual Currency	X	X	X	?	?	?

?: AML Regulation remains an open question as it heavily depends on the nature of the underlying asset

X: AML Regulation covers the topic

#### IV. INTERPRETIVE NOTE TO RECOMMENDATION 15: APPLYING THE TRAVEL RULE TO VIRTUAL ASSETS

The interpretive note to FATF Amended Recommendation 15 obligates VASPs to comply with the travel rule detailed in Recommendation 16 which requires financial entities to maintain a record of customer information when transactions exceed a certain threshold.<sup>109</sup> The money travel rule is an important tool in addressing the information asymmetry inherent in money laundering by identifying customers and thus making suspicious transactions easier to track. However, the nature of virtual assets makes application of this rule problematic.

109. See FATF 2019 GUIDANCE, *supra* note 23, at 17 (“[T]he FATF does not exempt specific assets based on terms that may lack a common understanding across jurisdictions or even among industry (e.g., ‘utility tokens’) . . . the framing of the Recommendations, including Recommendation 15, is activity-based and focused on functions in order to provide jurisdictions with sufficient flexibility.”).

Under the FATF recommended “travel rule,” VASPs must transmit customer data when a customer sends a value above the de minimis 1,000 USD/EUR threshold in a cross-border transfer between VASPs.<sup>110</sup> FATF Recommendation 16 mandates the information accompanying a wire transfer above the de minimis threshold contain: “(a) the name of the originator, (b) the originator account number where such account is used to process the transaction; (c) the originator’s address, or national identity number, or customer identification number, or date and place of birth; (d) the name of the beneficiary; and (e) the beneficiary account number where such an account is used to process the transaction.”<sup>111</sup> The interpretive note accompanying Recommendation 15 specifies that VASPs must collect the travel rule information or “the equivalent information in a virtual asset context.”<sup>112</sup> Further, intermediary financial institutions must maintain the originator and beneficiary information that accompanies the transfer.<sup>113</sup> Complying with the travel rule and FATF customer due diligence requirements typically involves know your customer (KYC) processes, which are used to verify the identity of customers.<sup>114</sup>

A. *Issues with Compliance: Technical Limitations and Threats to Privacy*

In light of the pseudo-anonymity associated with virtual assets, there was immediate outcry from the cryptocurrency in-

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110. See Kristin Broughton, *Crypto Firms Assess How to Comply with Anti-Money-Laundering Standards*, WALL STREET J. (Sept. 16, 2019, 5:30 AM), <https://www.wsj.com/articles/crypto-firms-assess-how-to-comply-with-anti-money-laundering-standards-11568626200> (“The standards, adopted in June by the Financial Action Task Force, require cryptocurrency exchanges, some digital wallet providers and other firms to send customer data—including names and account numbers—to institutions receiving transfers of digital funds, similar to a wire transfer at a bank.”).

111. See FINANCIAL ACTION TASK FORCE, INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION: THE FATF RECOMMENDATIONS 73 (2019), <http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> (“Countries may adopt a de minimis threshold for cross-border wire transfers (no higher than USD/EUR 1,000)[.]” [hereinafter ML & CFT RECOMMENDATIONS]).

112. *Id.*

113. *Id.* at 71 n. 37.

114. *Id.* at 74.



dustry that the travel rule, which was originally created for traditional financial institutions, would be ill-fitting and technically insurmountable as adapted to virtual exchanges.<sup>115</sup> Although regulators have said the expansion of the money travel rule to include virtual assets “is meant to level the playing field between different financial platforms,”<sup>116</sup> in practice, it imposes a much more onerous burden on virtual asset providers than it does on financial institutions. The information the travel rule requires is already necessary for traditional financial institutions to complete transactions, but VASPs typically do not need to collect such information due to the technical protocols inherent in a blockchain.<sup>117</sup>

Further, not every virtual asset transfer will be between VASPs, which thus creates the risk that private transactional information will be sent to unregulated entities.<sup>118</sup> This becomes further complicated by the disparate understandings of VASPs in different countries as cross-border transfers between VASPs may be difficult to identify.<sup>119</sup>

Collecting KYC information would require modifying existing blockchain protocols given that the underlying architecture does not currently require such data to complete a transaction. However, modifying existing blockchain protocols for currently active virtual currencies and assets to collect KYC information seems highly unlikely given the need for consensus when modifying a blockchain.<sup>120</sup> Firms, such as Netki, are attempting to overcome this obstacle by creating an architecture that would essentially lie on top of the blockchain to transmit

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115. Shani Koren, “*Know Your Consumer (KYC)*”, NEUFUND (Mar. 5, 2018), <https://blog.neufund.org/know-your-customer-kyc-3c5d32897983>.

116. See King & Spalding, *Fake it Till You Make it: The Travel Rule and Virtual Currencies*, JDSUPRA (Oct. 2, 2019), <https://www.jdsupra.com/legalnews/fake-it-till-you-make-it-the-travel-76027/> (noting that the “inherent difference between conventional platforms and cryptocurrency platforms, especially in light of the pseudonymous nature of wallet addresses, makes compliance with the Travel Rule exceptionally challenging for virtual currency businesses.”).

117. *Id.*

118. *Id.*

119. JJ, *CipherTrace Announces Travel Rule Information Sharing Architecture (TRISA)*, CIPHERTRACE (Aug. 23, 2019), <https://ciphertrace.com/travel-rule-info-sharing-architecture/>.

120. *Supra* Section III.

required information between VASPs.<sup>121</sup> However, the adoption of a parallel network lying on top of the blockchain increases security and privacy concerns because any network error could potentially result in personal data breaches.<sup>122</sup>

### B. *The Death of Privacy (Coins)?*

Unlike many other coins which can be identified through a public address and then linked to an actual identity, privacy coins are designed specifically to hide customer data.<sup>123</sup> The nature of privacy coins thus seems directly at odds with the goals of addressing information asymmetry through AML regulation, as they are impossible to monitor with KYC protocols. While there has been a significant loss of market value amongst prominent privacy coins, it is important to note that the FATF 2019 Guidance does not outright ban their usage. Privacy coins may be permitted if accompanied by appropriate risk mitigation measures that ensure that AML/KYC protocols are heeded.<sup>124</sup> However, if such mitigation measures cannot be accomplished, the FATF urges that VASPs “should not be permitted to engage in such activities” related to anonymity-enhancing technologies.<sup>125</sup> Therefore, depending on technological capabilities, mitigation for privacy coins might be prohibitively burdensome for VASPs to undertake.<sup>126</sup> Further, while the potential for privacy coins as a mechanism for circumventing AML/CTF regulations is frequently cited, the use of such coins in dark markets and ransomware attacks is still

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121. See JJ, *supra* note 118 (explaining that “trying to modify the existing blockchain protocols is bound to fail, as there are many different protocols, and forcing hard forks is simply not feasible.”).

122. See Nathan DiCamillo, *Netki Retools Digital ID Service for FATF’s New Crypto ‘Travel Rule’*, COINDESK (Sept. 9, 2019), <https://www.coindesk.com/netki-retools-digital-id-service-for-fatfs-new-crypto-travel-rule> (noting that Netki’s technology encrypts exchanges of personal identity information while “maintaining the integrity of the blockchain.”).

123. See Kirkpatrick, et al., *supra* note 15.

124. *Privacy Coin*, DECRYPTIONARY, <https://decryptionary.com/dictionary/privacy-coin/> (last visited May 21, 2020).

125. *Id.*; FATF 2019 Guidance, *supra* note 23, at 28 (a privacy coin is a type of anonymity-enhancing cryptocurrency).

126. FATF 2019 GUIDANCE, *supra* note 23, at 28.

vastly overshadowed by the use of Bitcoin, which has no anonymity-enhancing features.<sup>127</sup>

In response to the FATF travel rule, the South Korean OKEx exchange announced its intention to delist five cryptocurrencies that provide extra privacy features (i.e. privacy coins) due to a concern that KYC user information could not be collected from these assets.<sup>128</sup> However, this concern may be unsubstantiated due to the potential technical possibility of making privacy coins compatible with AML/CFT standards.<sup>129</sup> Zcash, a “privacy-protecting, digital currency,” has appealed its delisting and is currently working with South Korean authorities to prove its compatibility with the FATF travel rule.<sup>130</sup> This compliance comes at the cost of the total anonymity often associated with privacy coins, since companies like Zcash must now identify the payment address that a withdrawal is sent to in order to be compliant with the travel rule. However, source address visibility remains, for now, at the customer’s “opt-in” discretion,<sup>131</sup> so although the recipient address may no longer remain entirely private, Zcash still offers the option to shield source address.

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127. See Brian Monroe, *CipherTrace Tackles Impending FATF Crypto ‘Travel Rule’ Obligations with ‘Travel Rule Information Sharing Architecture’ Whitepaper*, ASS’N OF CERTIFIED FIN. CRIME SPECIALISTS (Aug. 29, 2019), <https://www.acfcs.org/ciphertrace-tackles-impending-fatf-crypto-travel-rule-obligations-with-travel-rule-information-sharing-architecture-whitepaper/> (Noting that the crypto travel information requirement “comes with inherent technical, privacy and cost challenges.”).

128. CIPHERTRACE, CRYPTOCURRENCY ANTI-MONEY LAUNDERING REPORT, 2019 Q2 6 (2019), <https://ciphertrace.com/wp-content/uploads/2019/09/CipherTrace-Cryptocurrency-Anti-Money-Laundering-Report-2019-Q2-3.pdf> (“Bitcoin remains the coin of the realm in this shady world with BTC used in 76% of dark market cases[.]”).

129. Daniel Palmer, *OKEX Korea Drops 5 Privacy Cryptocurrencies Citing FATF Rules*, COINDESK (Sept. 17, 2019, 08:26 AM), <https://www.coindesk.com/okex-korea-drops-5-privacy-coins-citing-fatf-rules>.

130. See, e.g., Rachel Wolfson, *CipherTrace Urges Crypto Companies to Prepare for Anti-Money Laundering Compliance*, COINTELEGRAPH (Nov. 8, 2019), <https://cointelegraph.com/news/ciphertrace-urges-crypto-companies-to-prepare-for-anti-money-laundering-compliance> (noting that “compliance is indeed possible, as a number of privacy coins are already listed in U.S. exchanges regulated by the Financial Crimes Enforcement Network”).

131. William Foxley, *OKEx Korea Reviewing Decision to Delist Privacy Coins Zcash and Dash*, COINDESK (Oct. 10, 2019, 11:20 PM), <https://www.coindesk.com/okex-korea-reviewing-decision-to-delist-privacy-coins-zcash-and-dash>.

South Korea delisting privacy coins is not an isolated incident, and since the announcement of the FATF travel rule, exchanges have been subject to increased pressure to drop these types of assets.<sup>132</sup> While thirty-two percent of exchanges still have privacy coins listed, of those, sixty-three percent have “weak or porous KYC.”<sup>133</sup>

In addition to privacy coins, cryptocurrency mixing services or tumblers are used to obscure the asset’s original source as another means to enhance anonymity.<sup>134</sup> Such services are widely used by actors engaged in illicit activity.<sup>135</sup> However, there may also be legitimate reasons to use such services for those who value privacy in financial transactions.<sup>136</sup> The FATF recommends that mixing services be considered VASPs and accordingly subject to AML/CFT regulation.<sup>137</sup> Although not per se illegal, FATF recommends that such services be subject to the same risk mitigation strategy as privacy coins, and if risks cannot be managed, then such services should not be permitted.<sup>138</sup> The future of these mixing technologies remains in flux given that their main business function—to ob-

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132. See ZCASH, ZCASH REGULATORY & COMPLIANCE BRIEF, (2019), <https://z.cash/wp-content/uploads/2019/09/Zcash-Regulatory-Brief-201909.pdf> (noting that Zcash offers both transparent and shielded transactions).

133. See Graham Smith, *FATF-Driven Delistings Capture the Criminalization of Privacy*, BITCOIN.COM (Sept. 17, 2019), <https://news.bitcoin.com/state-of-the-privacy-coin-fatf-pushes-delisting-and-exclusion/> (“The delisting of privacy coins like monero, zcash, and dash is becoming something of a trend in Asia, and could soon expand elsewhere.”).

134. CIPHERTRACE, CRYPTOCURRENCY ANTI-MONEY LAUNDERING REPORT, 2019 Q3 16 (2019), <https://ciphertrace.com/wp-content/uploads/2019/11/CipherTrace-Cryptocurrency-Anti-Money-Laundering-Report-2019-Q3.pdf>.

135. See Press Release, Europol, Multi-million Euro Cryptocurrency Laundering Service Bestmixer.io Taken Down (May 22, 2019), <https://www.europol.europa.eu/newsroom/news/multi-million-euro-cryptocurrency-laundering-service-bestmixer-io-taken-down> (“A cryptocurrency tumbler or cryptocurrency mixing service is a service offered to mix potentially identifiable or ‘tainted’ cryptocurrency funds with others, so as to obscure the trail back to the fund’s original source.”).

136. *Bitcoin Mixers: Assessing Risk in Bitcoin Transactions*, ELLIPTIC (May 7, 2018), <https://www.elliptic.co/our-thinking/bitcoin-mixers-assessing-risk-bitcoin-transactions> (“Our recent research into bitcoin laundering revealed how bitcoin mixers are widely used by dark market users, ransomware operators, and others engaged in illicit activity.”).

137. *Id.*

138. FATF 2019 GUIDANCE, *supra* note 23, at 12.

scure funds—may be inherently incompatible with FATF regulations.

## V. CONCLUSION

There is a heightened concern that the most current iteration of AML regulation for cryptocurrency will simply “drive customers toward less transparent . . . person-to-person transfers,”<sup>139</sup> meaning that customers will turn away from registered exchange entities, like VASPs, in favor of unregistered exchange entities. Unlike the traditional financial system, which largely relies on institutional intermediaries, virtual asset transactions can occur through mechanisms other than registered exchanges.<sup>140</sup>

However, if a workable technical solution is implemented for travel rule compliance, attempts to circumvent the AML regulatory framework actually “may provide law enforcement with new investigative opportunities.”<sup>141</sup> In theory, “if the majority of users make no change” to their behavior in response to the new AML regulations, those seeking an alternative means to avoid the travel rule will likely be those trying to avoid law enforcement detection, creating a new identifiable pattern for malicious transactions.<sup>142</sup>

There is also the potential that more stringent standards in the virtual asset industry will legitimize the usage of such assets and spur adoption of these technologies by the conventional financial sector.<sup>143</sup> In response to a stronger regulatory framework, investors may be more likely to invest in the virtual asset industry, and the market may expand.<sup>144</sup>

139. *Id.* at 28.

140. Julie Myers Wood, *Preparing for the New World of Crypto Compliance*, FORBES (Aug. 19, 2019, 02:14 PM), <https://www.forbes.com/sites/juliemyerswood/2019/08/19/preparing-for-the-new-world-of-crypto-compliance/#22aaadb6329c>.

141. See Megan Gordon, Ellen Lake & Jesse Overall, *supra* note 15 (“[V]irtual asset transactions can occur not just through crypto exchanges or other businesses, but also from person to person, person to machine, machine to machine, via smart contracts and through multiple other combinations and potential endpoints.”).

142. Kirkpatrick, et al., *supra* note 15.

143. *Id.*

144. Yaya Fanusia, *Stronger AML Enforcement Might Actually Save Crypto*, FORBES (May 29, 2019, 7:40 PM), <https://www.forbes.com/sites/yayafanusie/2019/05/29/stronger-aml-enforcement-might-actually-save-crypto/> (dis-

Ideally, a technical solution to these regulations would operate within an internationally uniform framework, reducing the arbitrage opportunities for money laundering using virtual assets.<sup>145</sup> But if countries adopt different understandings of when virtual assets are subject to money transfer rules, the potential for regulatory arbitrage increases while simultaneously creating a complex web of regulations that firms trying to be compliant must navigate. While regulations may bring legitimacy to the marketplace, a disparate regulatory framework increases the potential for arbitrage and high compliance burdens for little actual gain in the fight against money laundering. Since the announcement of the FATF 2019 Guidance, there have already been efforts by cryptocurrency exchanges to relocate to countries with laxer regulations.<sup>146</sup>

The FATF recognizes the need for international cooperation in effective regulation of virtual assets and related activities through a “level regulatory framework across jurisdictions.”<sup>147</sup> However, an analysis of the regulatory frameworks cited by the FATF reveals that the international community is

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cussing how “stricter standards . . . actually legitimize cryptocurrencies globally as a form of value transfer and set the stage for the conventional financial sector to use the technology”); *see also* *Can FATF’s New ‘Travel Rule’ Help Build a Better Crypto Ecosystem?*, PYMNTS.COM (Nov. 20, 2019), <https://www.pymnts.com/cryptocurrency/2019/can-fatfs-new-travel-rule-help-build-a-better-crypto-ecosystem/> (“The guidance marks a step toward more clarity and consistency when it comes to digital currencies—which, in turn, could result in more use and innovation for those payment methods.”).

145. *See* Oki, *supra* note 89 (“Most Japanese crypto exchanges have welcomed the changes, since they expect more institutional investors to join the crypto industry.”).

146. *See* CIPHERTRACE, *supra* note 134 at 10 (“If the industry can quickly adopt a common technical protocol for off-chain compliance, the FATF’s new regulations will potentially create a consistent international framework for virtual assets. This framework could significantly reduce criminal use of jurisdictional arbitrage to find the path of least resistance for money laundering[.]”).

147. *See, e.g.,* Takero Minami, *Japan Eyes Cryptocurrencies as it Toughens Money Laundering Laws*, NIKKEI ASIAN REV. (May 22, 2019, 3:57 PM), <https://asia.nikkei.com/Spotlight/Cryptocurrencies/Japan-eyes-cryptocurrencies-as-it-toughens-money-laundering-laws> (“[C]ryptocurrency exchanges are relocating to countries with looser regulations, like the Mediterranean country of Malta.”).

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far from a common understanding of what these assets are and when they should be monitored, creating real potential for the exploitation of regulatory differences across jurisdictions.

