



The FIAU Regulations and its Guidelines

BlockFinance: Innovative Technology Arrangements & AML Challenges
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VFA Subject Persons

- **Relevant Financial Business**

- ☐ Any activity of a VFA agent carried out by a person or institution registered or required to be registered under the provisions of the Virtual Financial Assets Act;
- ☐ VFA services carried out by a person or institution licensed or required to be licensed under the provisions of the Virtual Financial Assets Act;
- ☐ The issue of virtual financial assets for offer to the public in or from Malta in terms of the Virtual Financial Assets Act.

Legal Notice 430 of 2018

Prevention of Money Laundering and Funding of Terrorism Regulations

AML/CFT Obligations in the VFA Space (1)

AML/CFT Obligations

(Customer Due Diligence/Record Keeping/Reporting)

Business Relationship

VFA Agent (art 7 of the VFA Act)
VFA Licence Holders

Occasional Transaction

VFA Agent (art 14 of the VFA Act)
VFA Issuers
VFA Licence Holders

- In the case of occasional transactions AML/CFT obligations are applicable independently of the amounts involved – no threshold is applicable.

AML/CFT Obligations in the VFA Space (2)

- Revision of the Implementing Procedures (Part I) to apply the risk-based approach - more resources/stronger controls where ML/FT risk is higher.
 - ☐ Business Risk Assessment – What is the ML/FT risk your activity is exposed to? How can it be abused for ML/FT?
 - ☐ Controls, Measures, Policies and Procedures (Customer Acceptance Policy) - How do you intend to effectively mitigate the ML/FT risks associated to your business?
 - ☐ Customer Risk Assessment – What are the specific ML/FT risks associated with a given business relationship or occasional transaction?
 - ☐ Vary the extent and timing of Customer Due Diligence measures on the basis of the ML/FT risk level resulting from the Customer Risk Assessment and in line with pre-set policies and procedures.

AML/CFT Obligations in the VFA Space (3)

Customer Due Diligence (“CDD”) Measures

- ☐ Identification and Verification of Identity of the Customer, its Agent and its Beneficial Owner(s)
- ☐ Understanding the Intended Purpose and Nature of the Business Relationship
(Source of Wealth and Expected Source of Funds)
- ☐ On-Going Monitoring in the case of a Business Relationship
 - ❖ Information, Documentation and Data kept up-to-date
 - ❖ Transactions and/or Activities are in line with expectations (Source of Funds)
 - ❖ Review and Update of the Customer Risk Assessment
- In the case of VFA Agents on-going monitoring does not include the on-going monitoring of transactions/activities as they do not have visibility of transactions.

AML/CFT Obligations in the VFA Space (4)

- **Low Risk Scenario**
 - **Simplified Due Diligence**
 - **Identification of Individual Customer**
(Full Name/Permanent Residential Address/Date of Birth)
 - **On-Going Monitoring to ensure that situation is still low risk**
(E.g.: Checks to detect when pre-set thresholds are met and systems to prevent their circumvention)
- **High Risk Scenario**
 - **Enhanced Due Diligence**
 - **Source of Wealth and Source of Funds**
(Occasional Transaction – request information and documentation
Business Relationship – obtain supporting documentation)
- **Situations which the law considers as *a priori* high risk and require the application of EDD.**

AML/CFT Obligations in the VFA Space (5)

- **Deployment of Technological Solutions**
 - ☐ Understand capabilities and calibrate according to subject person's requirements
 - ☐ Reviews of the technological solutions deployed and address any shortcomings identified
 - ☐ Manual overwrite possible
- **Outsourcing**
 - ☐ Clear understanding of functions being outsourced and those retained in-house
 - ☐ Is the service provider reputable, reliable and capable of delivering?
 - ☐ Subject person (and authorities) are to have access to records at all times
 - ☐ Document the relationship in writing
 - ☐ Some functions cannot be outsourced (e.g. MLRO)
- **The subject person remains at all times responsible to ensure compliance with and fulfilment of AML/CFT obligations.**

Pseudo-Anonymity – DLT Analytical Tools

- **Distributed Ledger Technology**

- ☐ Allows for transactions to be recorded and therefore reconstructed - wallets can be linked one to the other.
- ☐ Link between the virtual and the physical worlds missing, leading to pseudo-anonymity.

How to address this new challenge?

- DLT analytical tools do not address pseudo-anonymity *per se* but provide useful information on VFAs, transactions, wallet addresses etc.
- Helpful in determining whether there may be a suspicion of ML/FT and therefore whether to submit a Suspicious Transaction Report to the FIAU.

Pseudo-Anonymity – Source of VFAs

- How were the VFAs generated/obtained?
- Mining
 - (1) Document that the VFAs were actually mined.
 - (2) Document the mining operation on a risk-sensitive basis.
- Do the explanations provided make sense given the background of the customer?

WHY?

- ☐ VFAs as proceeds of criminal activity;
- ☐ Proceeds of criminal activity used to finance cloud mining and/or acquired VFAs, especially with no history;
- ☐ Cryptojacking.

Pseudo-Anonymity - Wallet Verification

- Can a wallet be linked to a physical individual?
 - ☐ Message signature.
 - ☐ Transfer a minimal amount to the issuer's/licence holder's own wallet.
- Issues encountered:
 - ☐ Custody wallets - Not all service providers are subject to legally binding AML/CFT obligations and supervision.
 - ☐ Multi-sig wallets – Is there one holder with multiple keys or multiple holders each with its own private key?

Risks and Supervision in the VFA Sector

- VFAs present a challenge for supervisors especially in terms of Human Resources:
 - ☐ Highly dependent on technology - requires specialised knowledge.
 - ☐ Ever evolving area that presents opportunities but also challenges in terms of ML/FT risk.
- Business Risk Assessment – Review every 6 months as against every year for other subject persons.
- Annual audit of the Issuer/Licence Holder's AML/CFT controls, measures, policies and procedures.

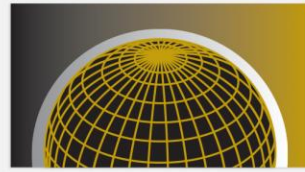
Virtual Financial Assets and AML/CFT Gaps and Challenges

- Decentralisation / P2P
 - ☐ What happens in the secondary market when no intermediary is involved?
 - ☐ How to enforce AML/CFT obligations on a decentralised activity (e.g. DEXs)?
- Initial Virtual Financial Asset Offerings with less than 150 investors.
- Are there any other VFA service providers that should be subject to AML/CFT obligations?
- How will DLT impact AML/CFT within the investments/securities sector?
- Culture change from the supervisory point of view.



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Thank You



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