

# An Overview of the AML-CFT Landscape in the Blockchain Sector

*BlockFinance: Innovative Technology Arrangements & AML  
Challenges  
FinanceMalta*

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# Blockchain and AML/CFT

- This event focuses on the whole **DLT and smart contract sector** and not only on ITAs as platforms
- It is evident that the Innovative Technology sector is part of Malta's international offering and is affected by what is happening around us, generally
- Malta is facing **unprecedented reputational challenges** on the money laundering front and therefore **material action must be taken**
- Legislation is up to standard but **implementation** seems to be **lacking** and there appears to be a **lack of adequate resources**
- **Institutional strengthening** is necessary on several fronts

# Purpose of the meet up

- We must consider what is stated by **international bodies** and relate this to **who they are** and **what their focus is**
- We can then **respond and reduce confusion** resulting from political generalizations and some misinterpretations. We get the impression there is focus on Malta and cases which are much bigger by far in other EU States seem to be given far less importance
- We need to ensure there is **full awareness and engagement** with the subject of **AML-CFT by all players in our industry** as often it is at our level that the problem starts
- It is **critical we engage much more with governmental institutions** to ensure we keep the **pace of development** in sight as well as the **pace of reaction** in focus

# Some History – Consultation and 3 new Laws

- It all started from the **EBA 2014 Opinion on Virtual Currencies** identifying, amongst other matters, the risks relating to virtual currencies
- Malta issued its **Consultation paper** on Blockchain- **2018**
- Laws and guidelines were drafted to be supportive of innovation but **AML-CTF was central and addressed in an EXPRESSED and focused manner in March-June 2018.**
- It was a burden we had to carry because the alternative was to leave the sector to crypto **UNREGULATED** and under the radar, **which we were not willing to do**
- Malta has **gone beyond the 5<sup>th</sup> AML Directive** (we included all services and also caught issuers of tokens to the public)

# ICOs, Crypto Services and VFA agents

- We regulated ICOs and crypto services under a **mandatory law**
- A regulated professional intermediary was created in the VFA Act to act as a **filter** to ensure that AML-CFT compliance takes place so **no structure can be established in Malta and no token issued WITHOUT A SUBJECT PERSON being involved to filter the activity**
- Could we have done more? Will this come at a cost to the potential growth of the industry in Malta?
- In support – though the approach is more GENERAL - **MFSA, FIAU and Ministry of Finance have recently taken specific initiatives** which need to be disseminated and critically analysed by the industry. Are the initiatives of good enough quality?

# The environment around us

- There is **a lot of noise internationally speaking**
- **Few have taken concrete and qualitative action**
- We should **query** whether all these international institutions covering the same space are useful for appropriate and directed action in the crypto space
- Would it not be better to have them all refer the matter to **one group of experts to have one consistent strategy** to study and assess the sector and its features, challenges, risks and opportunities?
- Malta addressed the **regulatory overlap** risk in the MDIA Act as the first project target!

# Financial Action Task Force (FATF) (1)

- **July 2018: FATF Report to G20 Finance Ministers and Central Bank Governors** - sets out FATF's ongoing work to fight money laundering and terrorist financing, in particular in the area of **virtual currencies/crypto assets**
- **October 2018: FATF Recommendations on Regulating Virtual Assets - amended Recommendation 15** to clarify how the FATF standards apply to activities or operations involving virtual assets
- **February 2019: Public Statement – Mitigating Risks from Virtual Assets - Interpretive Note on Recommendation 15** - sets out more detailed implementation requirements for effective regulation and supervision/monitoring of virtual asset services providers (worked on Interpretive Note to Recommendation 15)
- **June 2019: Interpretive Note will be formally adopted as part of the [FATF Standards](#)**

# FATF Recommendations (2)

(February 2019)

## **15. New technologies**

..... To manage and mitigate the risks emerging from virtual assets, countries should ensure that virtual asset service providers are regulated for AML/CFT purposes, and licensed or registered and subject to effective systems for monitoring and ensuring compliance with the relevant measures called for in the FATF Recommendations.

- **2016 Commission Staff Working Document Impact Assessment accompanying the proposal for amending the 4th AMLD**

- This impact assessment, proposing modifications to Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, **consists of two parts.**
- **Part 1 relates to five targeted amendments to this Directive** to strengthen the EU's existing framework to fight terrorism and terrorist financing.
- Problem 2: **Suspicious transactions made through Virtual Currencies are not sufficiently monitored by the authorities, which are unable to link identities and transactions**
- **Part 2 concerns targeted amendments to the Directive to enhance transparency of beneficial owners** of corporate entities and trusts.

# 5<sup>th</sup> AML Directive

- **July 2018:** 5<sup>th</sup> AMLD includes definition of virtual currencies and subjects exchange services and custodian wallet providers to CDD and to the duty to report suspicious transactions to FIUs.

# EU Parliament

- . **July 2018:** Study by the European Parliament - ***Cryptocurrencies and blockchain: Legal context and implications for financial crime, money laundering and tax evasion*** – contains policy recommendations for future EU standards:
  - Consider a system of mandatory registration of **users**;
  - **Expand list of obliged entities** to cover weak spots including miners
  - Impose a **specific ban** on aspects of cryptocurrencies that are aimed at making it impossible to verify users
  - Consider extending the Funds Transfer Regulation to ensure that information accompanying cryptocurrency transactions is there allowing for AMLCFT checks
  - Consider developing a tailored framework for cryptocurrencies

# European Banking Authority (EBA)

- **December 2013:** Issued **warning on Virtual Currencies** to make consumers aware of the risks
- **July 2014:** EBA Opinion on 'virtual currencies'
- **August 2016:** Opinion of the European Banking Authority on the EU Commission's proposal to bring Virtual Currencies into the scope of Directive (EU) 2015/849 (4AMLD)
- **February 2018:** ESMA, EBA and EIOPA **warn consumers on the risks of Virtual Currencies**
- **January 2019:** **Report with advice for the European Commission on crypto-assets** - examines the recommendations adopted by the FATF in 2018 to mitigate the risks of ML and FT arising from specified activities involving virtual assets

# ESMA

**February 2017:** 'The Distributed Ledger Technology Applied to Securities Markets' highlighted challenges in DLT

- **November 2017** (two statements):
  - ESMA alerts investors to the high risks of ICOs
  - ESMA alerts firms involved in ICOs to the need to meet relevant regulatory requirements
- **February 2018:** ESMA issues joint-Warning on Virtual Currencies (VCs) together with EBA and EIOPA
- **Summer 2018:** ESMA undertook a survey of National Competent Authorities of Member States using a sample set of crypto-assets to better understand the circumstances under which crypto-assets may qualify as financial instruments in the EU
- **January 2019:** Advice Initial Coin Offerings and Crypto-Assets - provides its position on gaps in the EU financial regulatory to ensure adequate investor protection across the EU

- **European Supervisory Authorities (ESMA, EBA, EIOPA):  
Report FinTech: Regulatory sandboxes and  
innovation hubs, 2018**

- set out a comparative analysis of the innovation facilitators established to date in the EU

- set out 'best practices' regarding the design and operation of innovation facilitators (to provide indicative support for competent authorities when considering the establishment of, or reviewing the operation of, innovation facilitators)

- set out options, to be considered in the context of future EU-level work on innovation facilitators

- the development of Joint ESA own-initiative guidance on cooperation and coordination between innovation facilitators

- the creation of an EU network to bridge innovation facilitators established at the Member State level

- OECD - Initial Coin Offerings (ICOs) for

- **January 2019-** discusses tokenomics and limitations in ICO structuring which can give rise to conflicts of interest and expose investors subscribing to ICO offerings and SMEs issuing tokens to significant risks.
- 5.2.4. Corporate governance and regulatory compliance
- In terms of regulatory compliance, Know Your Customer (KYC) and Anti-Money Laundering (AML) are a big area of concern for ICO offerings, and current requirements may be inadequate. Depending on the case, there may be no requirement for ICO issuers to identify and verify the identity of participants in the ICO, including for compliance with AML/CFT requirements. Anonymity of the funding process can be addressed in "whitelisted" ICOs where a register of participants is kept, especially when issuers want to control participation (see Section 3.1).
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- ICOs may non-deliberately contribute to (and participate in) money laundering or financing of terrorism by allowing investors to invest funds that have not gone through AML/CFT control checks. By way of example, in the absence of KYC performed, a money launderer can buy tokens in the ICO or in secondary markets, trade those tokens for other cryptocurrencies with no trace of illicit activity and eventually trade for fiat. AML issues around crypto-assets in general have been a major source of concern, adding another layer of concern to the ICO market (FATF, 2018a).
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# IMF Country Report No. 19/69 (February 2019) Malta

**February, 2019:** Malta: Selected Issues: Country Report No. 19/69

**48. A multi-prong strategy is needed to address deficiencies in the AML/CFT framework, with particular focus on preventive measures.**

The authorities should continue addressing ML/TF risks related to expanding blockchain technologies and virtual assets. It is important **to close any related gaps in the AML/CFT framework** and ensure that **the definition and AML/CFT oversight** of a “subject person” are in line with the requirements of the Financial Action Task Force regarding virtual asset service providers. Immediate action is also needed **to strengthen resources** for AML/CFT oversight of virtual asset service providers.

# Local actions

Action taken locally by:

- Ministry of Finance
- MFSA
- FIAU
- Register of Beneficial Owners – Regulations being amended

Enforcement: Government has announced split in AG functions which means that a director of public prosecutions will not have conflicts of interest if appropriately independent and resourced.

# OUR NEXT STEPS

1. GAP ANALYSIS – on a continuing basis
2. Who is doing this? We are playing our part?
3. IMPLEMENT THE MEASURES TO BRIDGE THE GAPS – legislation/guidelines and implementing measures/training

# Thank you.

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