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FATF Expands AML Recommendations to Cover Cryptocurrencies and Other Virtual Assets

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The global effort to combat money laundering through virtual assets such as cryptocurrencies took a significant step forward on June 21, 2019, when the Financial Action Task Force (FATF) released new anti-money laundering (AML) guidance. By approving a new interpretive note, the FATF extended its existing AML recommendations to explicitly address financial activities involving virtual assets (VAs) and virtual asset service providers (VASPs). The FATF also issued updated comprehensive guidance explaining how the FATF's historical recommendation of a risk-based approach to AML should be applied to VAs and VASPs.

What Is the Impact of the FATF Guidance Generally?

The FATF is an intergovernmental group composed of the governments of many of the world's industrialized nations, including the United States, China, Japan, Russia, Germany, and United Kingdom. The FATF's recommendations, interpretive notes, and guidance do not have the force of law. Nonetheless, the FATF's actions have a significant impact on the global financial system since member countries are obligated to implement FATF recommendations or risk expulsion from the group. The impact of FATF guidance is felt by global financial institutions as member countries take the necessary steps to implement the guidance—and to penalize those who fail to comply with it.

What Did the FATF Change with Its Guidance?

The FATF has long had recommendations, interpretive notes, and guidance requiring member countries to implement robust regimes to detect, prevent, and penalize money laundering. Historically, these requirements were only mandated for traditional financial institutions. With the approval of the new Interpretive Note to Recommendation 15, however, the FATF will now require member countries to bring VAs and VASPs within the scope of their AML legal and regulatory regimes.

What VAs and VASPs Are Impacted by the FATF's Guidance?

The FATF defines VAs as "a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat currencies, securities, and other financial assets that are already covered elsewhere in the FATF Recommendations." VAs include cryptocurrencies such as Bitcoin and the new "Libra" cryptocurrency being issued by Facebook.

The FATF defines VASPs as any person or business who "as a business" conducts one or more of the following activities:

- Exchange between virtual assets and fiat currencies.
- Exchange between one or more forms of virtual assets.
- Transfer of virtual assets.
- Safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets.
- Participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.

The FATF acknowledges the "wide range" of VA services and business models and indicated that member countries should consider the specific activities engaged in and whether those activities include a level of "custody" or "control" of a VA or the active facilitation of business involving a VA for a customer.

The precise scope of VASPs under individual member country laws remains to be seen, but it is clear that the FATF intends to reach the majority of businesses engaged services related to initial coin offerings (ICOs), cryptocurrency wallets, and cryptocurrency exchanges.

What Actions Will Member Countries Be Required to Take to Implement the FATF's Guidance?

The FATF is requiring member countries to engage in a risk-based assessment of money laundering risks associated with VAs and VASPs and to take steps to mitigate those risks. Each member country is expected to have:

- Licensing and registration requirements for VASPs.
- Governmental supervision and monitoring for AML risks associated with VASPs and AML program implementation by VASPs.
- Customer due diligence (CDD) and enhanced due diligence (EDD) requirements for VASPs.
- Measures to ensure that beneficial ownership information of VASPs is available.
- Coordination between regulators and law enforcement overseeing VASPs and information received from them.
- Mechanisms that engage international cooperation to prevent cross-border financial crime involving VASPs.

These elements of a national legal and regulatory framework to manage AML risk are well-recognized for traditional financial institutions, but the FATF's guidance goes into significant detail on how these elements should be tailored for the unique nature of VASPs.

How Will the FATF's Guidance Impact Cryptocurrency Exchanges and Other VASPs?

VASPs operating in the U.S. and other countries with mature AML legal and regulatory regimes, such as Japan and Australia, are unlikely to feel significant impact from the FATF's action. As the FATF indicated in its guidance, the U.S. already has a "comprehensive and technology-neutral regulatory and supervisory framework in place." There are inarguably substantial gaps in the U.S. regulatory regime and many unanswered questions about precisely how the U.S. government expects VASPs to comply with existing AML regulations that are antiquated and fit poorly with emerging FinTech companies' businesses. Regrettably, the FATF's guidance does little to fill these gaps, and the U.S. regulators have given no indication of an intention to provide more guidance in the wake of the FATF action.

As for VASPs operating in countries with less-developed AML regimes, the impact of the FATF's guidance will not be immediate but will ultimately be significant. As FATF member countries work to implement the requirements from the new guidance, VASPs throughout the world will face a new world of regulatory requirements and money laundering enforcement risks. For those VASPs that have not yet begun conducting due diligence and developing AML programs, the FATF's guidance makes it clear that the time has come to begin that process.

Why Has the FATF Issued This Guidance Now?

Financial regulators throughout the world have long recognized the money laundering risks associated with VAs. Although countries such as the U.S. have taken steps to increase oversight of VASPs, the FATF's actions represent the first major step toward a global effort to combat money laundering utilizing VAs. As U.S. Secretary of the Treasury Steven Mnuchin explained in discussing the FATF's guidance, U.S. regulators believe that the world "must work together to ensure that virtual assets are no longer a safe haven for illicit actors to end-run around established AML/CFT safeguards." Mnuchin may well be right in saying that the FATF's actions mark a global movement to ensure that VASPs "do not operate in the dark shadows."

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