

Taming the Wild West

Virtual Asset Regulatory Developments

Nathan Catania

7 December 2021

Agenda

- Introduction
- Cryptoasset regulation – Timeline
- Focus – 12 month reviews
- Updated FATF guidance
- Direction of travel
- Q&A session



Who we are

Boutique policy & regulatory affairs consultancy specialising in crypto-assets.

Helping

- governments make sound policy
- regulators supervise effectively
- public authorities build capacity
- cryptoasset firms thrive and follow the rules



Your presenter



Nathan Catania

Partner



Recap

- Digital representations of value or rights
- Transferred and stored electronically
- Immutable transactions
- Pseudonymity or anonymity
- Cross-border in nature
- Reliant on cryptography
- Most use Distributed Ledger Technology (DLT)
- No central authority issuing or controlling them



What's the big deal?



Regulatory arbitrage

- ✗ NOT money
- ✗ NOT e-money (most of the time...)
- ✗ NOT a security or financial instrument (most of the time...)
- ✗ NOT always in scope of AML regulations (although this is changing)

For pure cryptocurrencies, decentralised nature makes it very difficult to impose regulatory requirements ***on the asset itself***



Regulatory arbitrage

This means...

- Difficult to track and trace, no AML requirements → used by certain groups for money laundering.
- Many VASPs acting as (poor) custodians, hacks resulting in loss of assets.
- Firms able to operate using virtual assets and cryptocurrencies without being regulated – as they are not in scope of any traditional regulations.

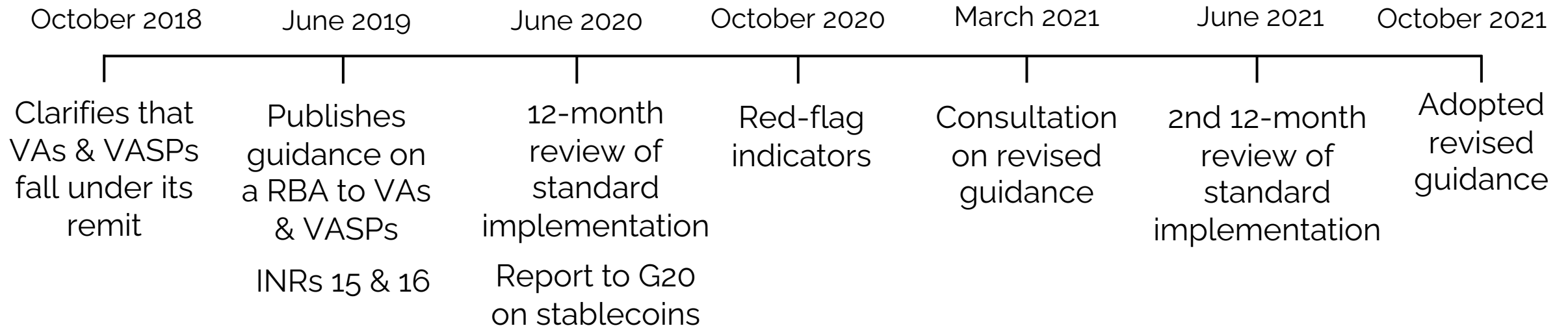




FATF



Current timeline



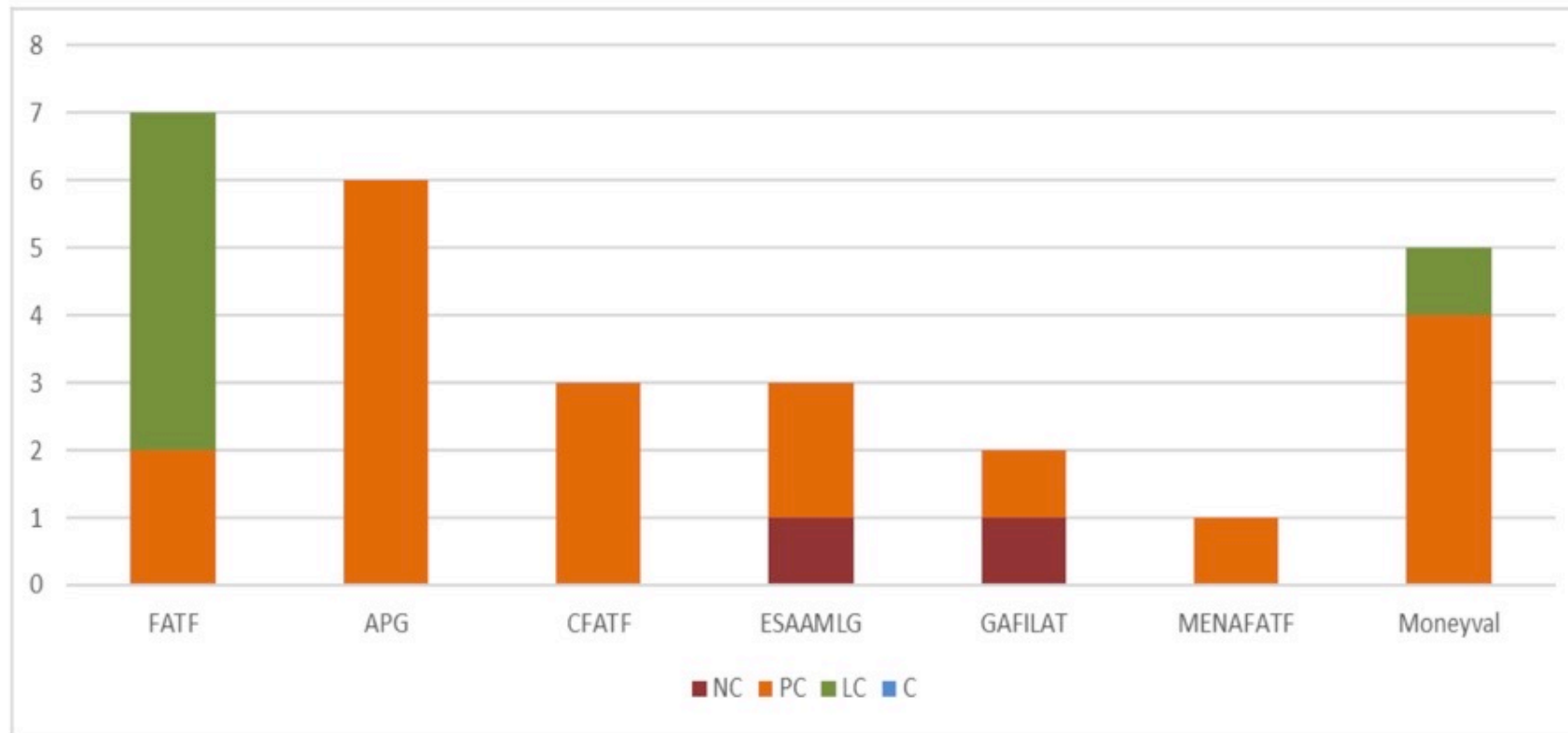
12-month reviews

- First 12-month review concluded by June 2020
- Assessed countries progress in adopting revised standards
- Second 12-month review concluded June 2021
- Clear progress by public sector – 33 to 58 jurisdictions had implemented regimes
- Still not enough!
- Particular delays in implementation of the travel rule



12-month reviews

Graph 1. R.15 assessment by FATF/FSRB region



FATF updated guidance

Key revisions:

1. VASP definition: clarification and application
2. P2P transactions: ML/TF risk mitigation
3. Travel rule: clarification
4. Stablecoins: clarification and ML/TF risk mitigation
5. Further guidance on DeFi



VAs & VASPs

All assets are either VAs or financial assets

VA: 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.

VASP: any natural or legal person not covered elsewhere in the Recommendations that conducts, as a business, one or more of the five defined activities on behalf of another natural or legal person.

Definitions to be interpreted broadly



P2P transactions: ML/TF risk mitigation

- No restrictions or monitoring, possibly higher risk
- Blockchain analytics can identify and mitigate risk
- Enhanced requirements for P2P and unhosted wallets?
- Advantages of financial inclusion and self-custody
- De-risking should only be a last resort



Travel rule: clarification

- Clarification of security standards for data transfer
- Tailored approach to counterparty VASP due diligence
- Guidance could recommend supportive measures



Stablecoins: clarification and ML/TF risk mitigation

- Clarification on how to determine which entities are VASPs
- Clarity on evaluation of stability mechanisms
- Further detail on risk mitigation around stablecoins



DeFi/decentralised services

- DApps – not VASPs, entities involved are likely to be
- Decentralised projects that don't interact with VASPs **unlikely**
- Recommendations will apply to:
 - Owners, creators, operators, others that undertake VASP activities
- Multisig participants included
- If any element of the VASP definition remains in place, you are a VASP
- Collecting fees, directly or indirectly, a large influencing factor



The future?

- Countries to continue to implement AML/CFT regimes
- Further pressure from FATF to implement standards
- Implementation of the travel rule
- VASPs to come under more regulatory pressure as focus switches to supervision
- DeFi to be brought further under the spotlight
- Consumer protection and other regulatory risks to be addressed





Questions

nathan@xreg.consulting