FATF

12-MONTH REVIEW OF THE REVISED FATF STANDARDS ON VIRTUAL ASSETS AND VIRTUAL ASSET SERVICE PROVIDERS

JUNE 2020

The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CFT) standard.

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Executive summary

1. The Financial Action Task Force (FATF) is the inter-governmental body which sets international standards to prevent money laundering, terrorist financing and the financing of the proliferation of weapons of mass destruction. In June 2019, the FATF finalised amendments to its global Standards to clearly place anti-money laundering and counter-terrorism financing (AML/CFT) requirements on virtual assets and virtual asset service providers (VASPs). The FATF agreed to establish a Virtual Assets Contact Group to promote implementation, identify issues and engage with the private sector to monitor progress. The FATF also agreed to undertake a 12-month review to measure the implementation of the revised Standards by jurisdictions and the private sector, as well as monitoring for any changes in the typologies, risks and the market structure of the virtual assets sector.

2. This report sets out the findings of this review. The report finds that, overall, both the public and private sectors have made progress in implementing the revised FATF Standards. 35 out of 54 reporting jurisdictions advised that they have now implemented the revised FATF Standards, with 32 of these regulating VASPs and three of these prohibiting the operation of VASPs. The other 19 jurisdictions have not yet implemented the revised Standards in their national law. While the supervision of VASPs and implementation of AML/CFT obligations by VASPs is generally nascent, there is evidence of progress. In particular, there has been progress in the development of technological solutions to enable the implementation of the 'travel rule'[1] for VASPs, even though there remain issues to be addressed by the public and private sectors.

3. At this stage in time, there is no clear need to amend the revised FATF Standards. This review has not identified any fundamental issues that would require amending the revised Standards. Nonetheless, there is still a substantial amount of work to be done. While more than half of reporting jurisdictions advised that they have introduced AML/CFT regimes for VASPs, all FATF members and its broader Global Network of nine FATF-Style Regional Bodies (FSRBs) and their respective members must implement the revised FATF Standards. The effectiveness of the revised FATF Standards is contingent on all jurisdictions implementing the revised FATF Standards and the private sector implementing their AML/CFT obligations. The feedback from the public and private sectors also indicates that there is a need for greater FATF Guidance on how to implement the revised FATF Standards. This could include tailored guidance for low-capacity jurisdictions.

4. The virtual asset sector is fast-moving and technologically dynamic, which means continued monitoring and engagement between the public and private sectors is necessary. At the same time, the one-year timeframe of this review has proved to be a relatively short time period to fully understand the impact of the revised FATF Standards and how the virtual asset market has changed. Accordingly, the FATF has agreed to continue its focus on virtual assets and undertake the following actions. The FATF will:

a) continue its enhanced monitoring of virtual assets and VASPs and undertake a second 12-month review of the implementation of the revised FATF Standards on virtual assets and VASPs by June 2021. By this time, jurisdictions

[1] The 'travel rule' is a key AML/CFT measure, which mandates that VASPs obtain, hold and exchange information about the originators and beneficiaries of virtual asset transfers.

will have had two years to transpose the revised FATF Standards on VASPs into law and the VASP sector will have had time to implement travel rule solutions globally;

b) release updated Guidance on virtual assets and VASPs;

c) continue to promote the understanding of ML/TF risks involved in transactions using virtual assets and the potential misuse of virtual assets for ML/TF purposes by publishing red flag indicators and relevant case studies by October 2020;

d) continue and enhance its engagement with the private sector, including VASPs, technology providers, technical experts and academics, through its Virtual Assets Contact Group; and

e) continue its program of work to enhance international co-operation amongst VASP supervisors.

5. As set out in this report, these actions set the FATF's forward work program on virtual assets for the coming year. These findings also support the conclusions made by the FATF in its report to the G20 on so-called stablecoins.

Introduction

6. The emergence of new technologies, products and related services over the last decade has been one of the major changes to the global financial system. These new technologies, products, and related services have the potential to spur financial innovation and efficiency and improve financial inclusion, but they also create new opportunities for criminals and terrorists to launder their proceeds or finance their illicit activities. Consistent with the risk-based approach which underpins the FATF Standards, understanding and responding to identified money laundering and terrorist financing (ML/TF) risks is at the heart of what the FATF does. The FATF is the inter-governmental body which sets the international standards to prevent money laundering, terrorist financing and the financing of the proliferation of weapons of mass destruction.

7. In June 2014, the FATF issued Virtual Currencies: Key Definitions and Potential AML/CFT Risks in response to the emergence of virtual currencies and their associated payment mechanisms. In June 2015, the FATF issued the Guidance for a Risk-Based Approach to Virtual Currencies as part of a staged approach to addressing the ML/TF risks associated with virtual currency payment products and services.

8. As the virtual asset market continued to evolve and develop, the FATF recognized the need for further clarification on the application of the FATF Standards to virtual assets and their service providers. In October 2018, the FATF adopted two new Glossary definitions – "virtual asset" and "virtual asset service provider" (VASP) – and updated Recommendation 15 (R.15). Virtual assets is the term the FATF uses to refer to crypto-assets and other digital assets. In June 2019, the FATF adopted an Interpretive Note to Recommendation 15 (INR.15) to further clarify how the FATF requirements apply in relation to virtual assets and VASPs (see **Annex A**). These changes were accompanied by a new Guidance for a Risk-Based Approach for Virtual Assets and VASPs. Finally, in October 2019 the FATF updated its Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems to reflect the revised Standards.

Changes to FATF Standards	Changes to FAF Methodology	Changes to FATF Guidance
• New definitions of 'virtual assest' and 'virtual asset service provider' • Revised R.15 • New INR.15	• New definitions of 'virtual assest' and 'virtual asset service provider' • Technical compliance - Revised R.15 • Effectiveness - Revised methodology, particularly Immediate Outcomes 3 and 4	• Release of new FATF Guidance on a Risk-Based Approach for virtual assets and VASPs

12-month review

9. When the FATF finalised the revisions to the FATF Standards in June 2019, the FATF also agreed to undertake a 12-month review of the changes, to be completed by June 2020. The FATF also agreed to establish a Virtual Assets Contact Group to promote implementation, identify issues and engage with the private sector to monitor progress. The scope of the review is as follows:

a) *Monitoring jurisdictions' implementation of the new requirements by FATF and FSRB members*. The review would consider whether jurisdictions have transposed the requirements into law and regulation, established supervisors or implemented other regulatory framework changes, and implemented licensing/registering requirements for VASPs, among other obligations under the FATF Recommendations.

b) *Monitoring VASPs' (as well as other obliged entities') progress in developing and implementing their obligations under the FATF Recommendations*, including in the context of any related technology solutions or communications protocols.

c) *Monitoring the VASP sector for any potential changes in typologies, risks and the market structure of the sector.* The review would seek to give the FATF early indications of emerging risks and typologies involving virtual assets.

10. Information on these issues has informed the analysis below on whether the revised FATF Standards, particularly R.15 and INR.15, should be adjusted, whether future updated Guidance is warranted and whether jurisdictions and the private sector are making progress in implementing the revised Standards. This review has not assessed individual jurisdiction's compliance with the revised FATF Standards.

11. The following information sources have informed the review:

a) A questionnaire surveying jurisdictions' implementation was conducted in March 2020. 38 FATF members (37 jurisdictions and 1 regional organisation) and 16 FSRB member jurisdictions responded to the questionnaire or provided updates on their progress. It should be noted that the questionnaire was a self-assessment by participating jurisdictions and is not an official FATF assessment of the level of implementation by jurisdictions.

b) Outreach to representatives from the VASP sector through meetings with the Virtual Assets Contact Group in February and April 2020. These meetings have included a select number of VASPs, industry associations and technology

providers, but cannot be taken to represent the views of the entirety of the global VASP sector.

c) The results from the completed follow-up reports using the revised FATF Standards (the United States of America[2] and Switzerland[3]).

d) The findings from the FATF's report to the G20 on so-called stablecoins.[4]

e) The findings from the FATF's ongoing work to understand the ML/TF risk environment and to review ML/TF cases involving virtual assets.

f) Desk-based research by the Secretariat into trends and market metrics involving virtual assets.

12. This report sets out the findings of this review as follows:

a) Section 1 sets out how ML/TF risks and the virtual asset market have changed since June 2019;

b) Section 2 sets out jurisdictions' progress in implementing the revised Standards;

c) Section 3 sets out the private sector's progress in implementing the revised Standards, including the development of technical solutions for the implementation of the travel rule;

d) Section 4 sets out issues identified with the revised FATF Standards and Guidance; and

e) Section 5 sets out the FATF's next steps.

2 FATF, *United States: 2nd Enhanced Follow-up Report and Technical Compliance Re-Rating*, March 2020

3 FATF, *Switzerland: 2nd Enhanced Enhanced Follow-up Report and Technical Compliance Re-Rating*, January 2020

4 FATF, *Report to G20 on so-called stablecoins*, June 2020

Section 1: ML/TF risks and the virtual asset market

13. This section sets out how the ML/TF risks and the virtual asset market has changed since June 2019. This section is based on information collected by FATF through its regular collection of virtual asset case studies, information collected through the questionnaire and desk-based research by the Secretariat.

14. As the revisions to the FATF Standards were only finalised in June 2019, it remains early to assess whether the revised Standards have resulted in changes to the typologies, ML/TF risks and the market structure of the virtual assets sector. This is not only because this is a short period of time, but because the FATF Standards are reliant on jurisdictions transposing the Standards into their national law and operationalising these laws. As set out in Section 2, some jurisdictions are still in the process of implementing the revised FATF Standards.

15. In addition, the virtual asset market is fast-moving and quickly evolving. The usage of virtual assets and VASPs is constantly changing, as products and services enter and leave the market and the sector as a whole matures. Changes in the usage of a particular virtual asset or VASP could be driven by a range of factors. These factors include consumer preferences, competition, regulation, speculation, technological development and privacy and security concerns. This makes it very difficult to directly link the revisions to the FATF Standards to any changes in the virtual asset and VASP market in the short time period. A longer time period may illuminate more concrete or obvious trends in the market or ML/TF risk profile. Nevertheless, this Section sets out the FATF's observations of trends since June 2019.

Trends in use of virtual assets for ML/TF purposes

16. The FATF has observed the following trends on the use of virtual assets for ML/TF purposes. The value of virtual assets involved in most ML/TF cases detected to date has been relatively small so far compared to cases using more traditional financial services and products, although there needs to be ongoing monitoring for any potential changes. Most detected cases involved the use of one type of virtual asset only. In cases where criminals did make use of more than one type of virtual asset, such use was primarily for the layering of illicit proceeds. While cases provided by jurisdictions typically focused on ML or on predicate offences, criminals did make use of virtual assets to evade financial sanctions and to raise funds to support terrorism. Overall, the use of virtual assets as a way of layering is the most prominent typology observed in the cases, possibly due to the ease of rapid transfer (e.g. updating public addresses and fast exchanges across borders). Professional ML networks have also appeared to start exploiting this vulnerability and use virtual assets as one of their means to launder illicit proceeds.

17. The types of offences involving virtual assets include ML, the sale of controlled substances and other illegal items (including firearms), fraud, tax evasion, sanctions evasion, computer crimes (e.g. cyberattacks resulting in thefts), child exploitation, human trafficking and TF. Among them, narcotics-related and fraud offences (e.g. investment scams and swindling, blackmail, and extortion) are the most prevalent. Jurisdictions which have incorporated virtual assets and VASPs in their domestic AML/CFT regime also noted offences related to operating unlicensed or unauthorised financial services, record keeping, and reporting requirements.

18. The main trends in the virtual asset ML/TF risk landscape since June 2019 include:

a) the use of VASPs registered or operating in jurisdictions that lack effective AML/CFT regulation, as well as the use of multiple VASPs (local and/or overseas). This makes it more challenging for competent authorities to follow the transaction trail, buying more time for criminals to move criminal proceeds.

b) the continued use of tools and methods to increase the anonymity of transactions. This includes registering Internet domain names through proxies and using DNS registrars that supress or redact the true owners of the domain names, the use of tumblers, mixers and anonymity-enhanced cryptocurrencies or privacy coins, using decentralised exchanges and applications, chain-hopping and atomic swapping exchanges (which allow the exchange of one type of virtual asset to another without going through an exchange) and dusting (which allows the transfer of tiny amounts of virtual assets to random wallets, making it more difficult to track and trace the transaction trail).

19. In response to the ongoing COVID-19 pandemic, FATF jurisdictions have also observed the increased use of virtual assets to move and conceal illicit funds. One jurisdiction reported the use of virtual assets to launder proceeds earned from selling COVID-19 medicine.[5]

Trends in virtual asset market structure

20. Looking more broadly at the virtual asset market since June 2019, global government attention has largely focused on proposed so-called "stablecoins" with potential for mass-adoption. So-called stablecoins are a type of asset that purport to maintain a stable price relative to reference assets. The proposed launch of these arrangements has brought significant attention to whether their mass-adoption would lead to a substantial increase in the number of anonymous peer-to-peer virtual asset transactions occurring via unhosted wallets. Peer-to-peer transactions, without the use of a VASP or other AML/CFT-regulated entity, are not explicitly covered by the revised FATF Standards.

21. A rapid expansion in the number and value of transactions not subject to AML/CFT controls under the revised FATF Standards would however present a material ML/TF vulnerability. Therefore, jurisdictions should assess and determine the ML/TF risks they face with virtual assets. The ML/TF risks of virtual assets are more difficult to address and mitigate once the products are launched. Their cross-border nature can present difficulties for enforcement if AML/CFT is not considered from the start. Hence, it is very important for jurisdictions to analyse and address risk in a forward-looking manner and ensure that they have all the necessary tools and authorities in place before they are needed.

22. The FATF's views on so-called stablecoins are set out in its report to the G20 and are considered further in Section 4 below.[6]

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5 FATF, *Covid-19-related Money Laundering and Terrorist Financing: Risks and Policy Response*, May 2020

6 FATF, *Report to G20 on so-called stablecoins*, June 2020

Section 2: State of implementation by the public sector

23. This section sets out jurisdictions' state of implementation of the revised FATF Standards on virtual assets and VASPs. This overview is based on the survey the FATF conducted in March 2020 of its membership and its broader Global Network. Thirty-eight FATF members (37 jurisdictions and 1 regional organisation) and 16 FSRB member jurisdictions responded. The questionnaire was a self-assessment by participating jurisdictions and is not an official FATF assessment of the level of implementation of jurisdictions.

24. The results of the questionnaire indicate that, overall, jurisdictions have made progress in implementing the revised FATF Standards (R.15/INR.15). Under the revised FATF Standards, jurisdictions may either permit and regulate VASPs or prohibit them and enforce the prohibition. Twenty-four FATF members and eight FSRB members, advised that they had introduced a regulatory regime permitting VASPs (Table 1). One FATF member and two FSRB members advised that they had prohibited VASPs.

25. Nonetheless, 19 jurisdictions, comprising 13 FATF members and 6 FSRB members, reported that they do not have a regime for VASPs yet. This gap is potentially much larger across the FATF's broader Global Network. Again, the majority of these (13) intended to regulate VASPs, two intended to prohibit VASPs and four had yet to decide. For those who had not yet implemented an AML/CFT regime for VASPs, there was a wide variation in what stage of the process they were at. At least eight of these jurisdictions reported that they were in the process of passing the necessary legislation or consulting on the design of their regime.

26. For those jurisdictions that regulate VASPs, the majority advised that they have introduced new legislation to specifically regulate VASPs. Most jurisdictions appear to have done this by adding VASPs as an obliged entity to their existing law. Several jurisdictions considered that VASPs were covered by their existing AML/CFT laws. There is a wide range of terms used to refer to VASPs, with at least eleven different terms reported (e.g., VASP, digital asset business, cryptoasset exchange provider). There does not seem to be an emerging common terminology for virtual assets and VASPs in terms of jurisdictions' legislative definitions.

Table 1. Progress in implementing VASP AML/CFT regulatory regimes

	FATF	FSRB	Total
Regulation of VASPs			
AML/CFT regime permitting VASPs is established	24	8	32
Regulations being developed / approved to regulate VASPs	9	4	13
Prohibition of VASPs			
VASPs prohibited with prohibition enforced	1	2	3
Regulations being developed / approved to prohibit VASPs	2	0	2
Yet to decide			
Approach to VASPs under consideration	2	2	4
TOTAL	38	16	54

27. For the 32 jurisdictions which advised that they have established regimes permitting VASPs, 30 have introduced either registration (18 jurisdictions) or

licencing regimes (14 jurisdictions).[7] All advised that they have included minimum option of VASPs created in their jurisdiction as required by the revised FATF Standards. Eighteen jurisdictions advised that they have extended their regime to included VASPs incorporated overseas but which offer products/services to customers in their jurisdiction and 20 jurisdictions advised that they have extended their regime to include VASPs conducting operations from their jurisdiction. This diversity in approach may present challenges in identifying which VASPs are regulated by each jurisdiction. Nineteen jurisdictions reported that they had publicly available list(s) of VASPs that they have registered or licenced.

28. Twenty-three of these jurisdictions advised that they have begun licencing / registering VASPs. The 20 jurisdictions which provided data reported that they have 1 133 registered or licenced VASPs across them. Most jurisdictions reported less than ten registered or licenced VASPs, although four reported 100 or more VASPs. Several jurisdictions noted challenges in identifying the VASPs for registration or licencing under their AML/CFT regimes.

29. For the jurisdictions that have implemented regulatory regimes permitting VASPs, they reported that they had implemented the full range of preventive measures required under the FATF Standards (Recommendations 10-21 as set our INR.15). The exception is implementation of the 'travel rule' (see Section 4). Regarding suspicious transaction reporting, 19 jurisdictions provided STR data on reports from VASPs. These 19 jurisdictions reported 134 500 STRs reported by VASPs between 2018 and March 2020. Most jurisdictions reported financial institutions, in particular banks and payment service providers, as being the main reporters of STRs about virtual assets. It is difficult to draw any other distinct trends from jurisdictions' reporting, as there is wide variation between different jurisdictions' numbers.

30. Of the 32 jurisdictions which reported that they have a regulatory regime for VASPs, 31 of these have a supervisory regime.[8] A range of different organisations have been designated as VASP supervisors, including financial services supervisors, central banks, securities regulators, tax authority and specialist VASP supervisors, and some jurisdictions have multiple supervisors. Twenty-eight of these jurisdictions advised that they have allocated supervisory staff for VASP supervision and 25 reported that they were undertaking a risk-based approach to supervision of VASPs. Fifteen jurisdictions reported that they have already conducted on- and/or off-site inspections of VASPs and eight reported that they had imposed criminal, civil and/or administrative sanctions on VASPs for non-compliance with AML/CFT obligations. This includes the cancellation, refusal of suspension of VASPs' registrations, administrative sanctions to improve VASP compliance, public warnings, civil monetary penalties and criminal sanctions.

31. Supervisors advised that they are using a wide range of information to inform their risk-based approach, including information collected through the registration or licencing process, compliance information, reporting from VASPs, information from supervisory activities and partner agencies and open source information. Several jurisdictions noted that they were using, or planning to use, 'SupTech' tools, such as blockchain analysis software. Jurisdictions also generally noted the challenges faced

7 Two jurisdictions have both a licencing and registration regime for different kinds of VASPs.

8 One FATF member (a regional organisation) does not directly supervise entities for compliance with AML/CFT regulations.

in supervising the VASP sector, where regulation is generally nascent and where VASPs generally have little experience or expertise in AML/CFT.

32. Jurisdictions noted a range of outreach activities to the VASP sector, including the dissemination of the results of risk assessments, risk indicators, red flags, advisories, typologies, guidance, training, industry consultation and events, public-private partnerships and annual reports and analysis of the VASP sector.

33. Thirty-four jurisdictions reported that they had assessed the ML/TF risks posed by virtual assets and VASPs. To conduct the risk assessments posed by virtual assets and VASPs, some jurisdictions reported they conducted such assessments through multi-agency groups. Regarding information they use for risk assessments, there are different information sources depending on jurisdictions, including FIU information (including STRs), law enforcement cases involving virtual assets, VASPs supervisory information, international co-operation requests, transactions involving virtual assists and internet information on activity of virtual assets and VASPs.

34. In terms of international co-operation, jurisdictions noted the presence of pre-existing memoranda of understanding and international co-operation frameworks that could enable co-operation in the supervision of VASPs. The FATF has a project underway to improve international co-operation amongst VASP supervisors, particularly relating to information-sharing and capability building amongst supervisors.

35. For the five jurisdictions that reported that they prohibit, or plan to prohibit VASPs, a range of tools and techniques were highlighted as ways to enforce the prohibition. This included the use of risk assessments, public information campaigns, supervisory activity and STRs from financial institutions to identify illicit virtual asset activity and the development of bespoke technological tools in order to identify illicit virtual asset activity.

36. A range of practical challenges have also been identified in implementing the revised FATF Standards where jurisdictions have requested greater Guidance. These areas are elaborated in Section 4.

Section 3: State of implementation by the private sector

37. This section sets out the state of implementation of the revised FATF Standards on virtual assets and VASPs by the VASP sector. It is based on information collected through the FATF questionnaire, the Virtual Assets Contact Group's outreach to a selection of representatives from the VASP sector and travel rule technology providers in February and April 2020 and the outcomes from the Financial Services Agency of Japan's March 2020 roundtable on the travel rule. The FATF intended to engage the broader VASP sector through its annual Private Sector Consultative Forum in May 2020, however this was delayed due to the COVID-19 pandemic. The meetings with the Contact Group only encompassed a selection of VASP representatives and technology providers, so the information collected, and the results outlined in this report, cannot be taken to represent the entirety of the global VASP sector.

Implementation of the travel rule

38. VASPs are required to implement the FATF's AML/CFT preventive measures in Recommendations 10-21 as set out in INR.15. This includes Recommendation 16 (R.16), which sets out wire transfer requirements. It is a key AML/CFT measure to ensure that originators and beneficiaries of financial transactions are identifiable and are not anonymous. VASPs and financial institutions must comply with these requirements for virtual asset transfers.[9] This is the so-called 'travel rule' and is the issue of most focus in terms of VASPs' compliance with the revised FATF Standards.

39. There are various technologies and tools available that could enable VASPs to comply with aspects of the travel rule requirements. While the FATF is technology-neutral and does not prescribe a particular technology or software, the FATF Guidance on virtual assets and VASPs published in June 2019 lists a range of technologies which may enable VASPs to comply with aspects of the travel rule requirements.[10] These tools existed when the FATF Standards were revised in June 2019. There was not, however, technological solution(s) that enabled VASPs to comply with all aspects of the travel rule in a holistic, instantaneous and secure manner.

40. The FATF has been monitoring the progress by the VASP sector in developing these solutions and complying with R.16 requirements. Based on the outreach through the Virtual Assets Contact Group with a selection of representatives of the VASP sector and travel rule technology providers, there seems to have been progress in developing technological solutions for the travel rule.

41. Firstly, there has been progress in the development of technological standards for use by different travel rule solutions. The FATF is aware of an international industry-wide initiative that has been established to set global technical standards for travel rule solutions to use. They have developed a first messaging standard which sets a common universal language for the communication of the required originator and beneficiary information between VASPs. The FATF is aware that this initiative

9 See Annex A for the full requirements.

10 These include public and private keys, Transport Layer Security/Secure Sockets Layer connections, X.509 certificates, X.509 attribute certificates and API technology.

may now be undertaking work on further messaging standards and the maintenance of this standard.

42. In addition, several different travel rule technology solutions are being developed, with some solutions being launched or being tested. Some of these solutions are being developed by VASPs to be integrated into their systems. Others are technology solutions that could be used by multiple VASPs. In line with decentralisation ethos that underpins virtual assets, there appears to be a general desire for multiple potential solutions, rather than one centralised travel rule solution. The usage of common standards will assist in ensuring different solutions are interoperable. Nonetheless, the FATF is not aware yet that that there are sufficient holistic technological solutions for global travel rule implementation that have been established and widely adopted.

43. In terms of jurisdiction implementation, there has been less implementation of travel rule requirements for VASPs than other AML/CFT requirements. From the 32 jurisdictions that have implemented AML/CFT regulatory requirements for VASPs, 15 jurisdictions advised they had introduced R.16 requirements for VASPs. Some jurisdictions noted they were enforcing R.16 requirements, but several others stated that they had faced difficulty enforcing the R.16 requirements effectively and had delayed enforcement while waiting for holistic and scalable technological solutions to be developed. Seventeen jurisdictions advised that they had not introduced R.16 requirements for VASPs, with the delay generally again attributed to the lack of adequate holistic technology solutions. Those jurisdictions who had not introduced R.16 requirements advised that they were engaging with the VASP sector to promote the development of technological solutions and identify the issues and challenges to be addressed, including through outreach of the Contact Group.

44. This delay in introducing R.16 requirements for VASPs adds to the importance of the quick development of technology solutions. Several jurisdictions noted that the travel rule represented a significant challenge to the effective implementation of the revised FATF Standards. As set out in Section 4, this review has also identified a range of issues which impact the implementation of the travel rule, which should be addressed so that there can be the effective implementation of R.16 requirements by jurisdictions in an efficient, sector-wide manner.

45. This review, however, does not consider that these are fundamental barriers to the continued development of technological solutions to implement the travel rule. As jurisdictions should fully implement AML/CFT obligations for VASPs, including the travel rule, the FATF calls upon the VASP sector to redouble its efforts towards the swift development of holistic technological solutions encompassing all aspects of the travel rule. Further outreach and engagement by the FATF with a diversified selection of VASPs should help to address these issues, develop a more comprehensive view of the remaining challenges and encourage the development of technology solutions or other means of effective compliance with the travel rule. Further clarification by FATF and national authorities on the issues identified in Section 4 and coordinated actions by national authorities should also assist.

Implementation of other AML/CFT obligations

46. Implementation of other AML/CFT obligations globally appears to be at early stages. As a relatively new sector, VASPs may not have a history of regulatory oversight and may be unfamiliar with the fundamentals of AML/CFT. This challenge

is further complicated by the rapid technological and business progress in the VASP sector, where there is a constant evolution in technology, services, business practices and firms entering and exiting the market.

47. Nonetheless, some jurisdictions have more developed AML/CFT regimes for VASPs and have imposed obligations on VASPs for a longer period of time. They reported improvements in overall compliance, with increasing awareness and attention to AML/CFT obligations, particularly among larger, established VASPs. The most common citations noted for VASPs arising from examinations included deficiencies related to internal control, independent testing, and record-keeping. These deficiencies can be related to common issues VASPs may exhibit, such as expanding operations more rapidly than their compliance function can manage, failing to implement adequate controls to mitigate risks involved with anonymity-enhanced virtual assets, reliance on manual transaction testing and not conducting appropriate levels of due diligence to understand the risk profile of customers' activity off-platform.

Section 4: Issues identified with the revised FATF Standards and Guidance

48. Jurisdictions and representatives from the VASP sector have identified a range of issues regarding the implementation of the revised FATF Standards and Guidance on virtual assets and VASPs. These issues were identified through the FATF questionnaire and the Virtual Assets Contact Group's outreach to a selection of representatives from the VASP sector.

49. The information provided does not identify any issue that requires the revised Standards to be amended at this point in time. There are numerous issues however where jurisdictions and VASPs have asked for greater and clearer FATF Guidance and sustained outreach and collaboration. This could include tailored guidance for low-capacity countries.

Definition of virtual asset and VASP

50. The amendments to the FATF Standards introduced the new terms 'virtual asset' and 'virtual asset service provider' (see **Annex A**). As jurisdictions have transposed the revised FATF Standards into their national laws, they have noted areas where there could be greater clarity in the FATF Guidance. Regarding the definition of virtual assets, there could be greater clarity about what approach jurisdictions should take if a new asset is developed that could be categorised as a traditional financial asset under the revised FATF Standards but is based on the technology associated with virtual assets. For example, this issue has particularly arisen in the context of so-called stablecoins and whether jurisdictions should be treating them as traditional financial assets / financial institutions or virtual assets / VASPs if these are regulated under two separate AML/CFT regimes.

51. Jurisdictions also saw a need for greater FATF Guidance on the scope of the activities covered by the definition of VASP. In particular, jurisdictions considered that there could be greater clarity regarding the scope of the activities of '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' and the activities covered by 'transfer of virtual assets' that are not covered by the other limbs of the definition. Ensuring consistency in the definition of VASP is important to ensure that there is a common standard applied regarding which businesses are covered as VASPs in jurisdictions. As the FATF and its Global Network conduct more mutual evaluations and follow-up reports of members, the extent to which jurisdictions are fully implementing the FATF definition of VASP will also become clearer.

Peer-to-peer transactions and private / non-custodial wallets

52. Currently, peer-to-peer transfers of virtual assets, without the use or involvement of a VASP or financial institution, are not explicitly subject to AML/CFT obligations under the revised FATF Standards. The lack of explicit coverage of peer-to-peer virtual asset transactions of this type was deliberate, as the revised FATF Standards' general focus is on placing AML/CFT obligations on intermediaries between individuals and the financial system. The lack of explicit coverage of peer-to-peer transactions via private / unhosted wallets was a source of concern for a number

of jurisdictions. Jurisdictions noted that transfers to the unregulated peer-to-peer sector could present a leak in tracing illicit flows of virtual assets.

53. However, jurisdictions did not consider that there was sufficient evidence to warrant changing the revised FATF Standards at this point at time. There was insufficient evidence demonstrating that the number and value of anonymous peer-to-peer transactions has changed enough since June 2019 to present a materially different ML/TF risk. Further research could be undertaken with the VASP sector, academics and software experts and engineers to better understand the scope of the unregulated peer-to-peer sector.

54. The launch of new virtual assets however could materially change the ML/TF risks, particularly if there is mass-adoption of a virtual asset that enables anonymous peer-to-peer transactions. There are a range of tools that are available at a national level to mitigate, to some extent, the risks posed by anonymous peer-to-peer transactions if national authorities consider the ML/TF risk to be unacceptably high. This includes banning or denying licensing of platforms if they allow unhosted wallet transfers, introducing transactional or volume limits on peer-to-peer transactions or mandating that transactions occur with the use of a VASP or financial institutions. As of yet, no common practises or consistent international approach have emerged regarding the use of these different tools. Accordingly, there should be further work undertaken on the extent to which anonymous peer-to-peer transactions via unhosted wallets is occurring, the approach jurisdictions can take to mitigate the ML/TF risks, the extent to which the revised Standards enable jurisdictions to mitigate these risks and to continue to improve international co-operation and co-ordination.

So-called stablecoins

55. A key development since the finalisation of the revisions to the FATF Standards has been the emergence of proposals for so-called stablecoins. Some proposals for so-called stablecoins have the potential to be mass-adopted on a scale not seen in pre-existing virtual assets. Depending on their design and national laws, they may be a virtual asset or traditional financial asset under the revised FATF Standards.

56. As set out in the FATF's report to the G20, the revised FATF Standards apply to so-called stablecoins and their providers either as financial institutions or VASPs.[11] Based on known models, the FATF considered that the current revised FATF Standards are sufficient to mitigate the ML/TF risks posed by so-called stablecoins at this point in time, if jurisdictions have fully implemented the revised FATF Standards.

57. Nonetheless, the FATF identified that this area must be closely monitored, as there are residual risks relating to anonymous peer-to-peer transactions via unhosted wallets, jurisdictions with weak or non-existent AML/CFT regulation and so-called stablecoins with decentralised governance. In addition, so-called stablecoins raise a range of practical challenges for jurisdictions where updated FATF Guidance would assist, including the tools, powers, skills and expertise supervisors may need to effectively regulate so-called stablecoins and situations where jurisdictions may wish to prohibit a specific so-called stablecoin proposal.

[11] FATF, *Report to G20 on so-called stablecoins*, June 2020

Identifying VASPs for registration / licencing

58. Jurisdictions have taken different approaches as to which VASPs they have covered in their AML/CFT regimes. Under the revised FATF Standards, jurisdictions must regulate VASPs created in their jurisdiction, but can chose to expand their coverage to VASPs offering services to their citizens or with operations in their jurisdiction.

59. A number of jurisdictions noted challenges in identifying the VASPs they should cover under their AML/CFT regimes. In particular, several queried what approach they should take regarding VASPs offering products and/or services to customers in their jurisdiction, but are domiciled elsewhere or have no physical presence in their jurisdiction. Jurisdictions also raised the best way to identify the appropriate 'home' supervisor(s) for VASPs, particularly if a VASP is decentralised and has no obvious 'home' jurisdiction in which it is based. These jurisdictions asked for further guidance on how to identify VASPs for registration / licencing and the responsibilities of different supervisors where a VASP is decentralised. This underscores the importance of effective international co-operation and the development of standard protocols of co-operation between VASP supervisors. It is also a challenge shared by the private sector, as set out below.

Travel rule implementation

60. A range of identified issues remain which impact the full, effective and smooth implementation of a global framework for the travel rule. These are discussed below and point generally to a need for further FATF Guidance and engagement on the travel rule. There is a strong desire from representatives from the VASP sector for continued engagement with the FATF and members as travel rule solutions develop and mature.

61. **Identifying counterparty VASPs.** In order to comply with the travel rule, VASPs must be able to identify when they are (a) transacting with another VASP (as opposed to a private wallet) and (b) whether the counterparty VASP is registered / licenced by a jurisdiction and adequately supervised for AML/CFT purposes. The best way to conduct counterparty due diligence in a timely and secure manner is a challenge.

62. One way to address this issue which has been raised by the private sector is the creation of a 'global list of VASPs'. In this approach, information on licensed and registered VASPs would be collected from each jurisdiction's list and accessed through a central database (in a centralised approach) or accessed through an API / smart contracts which connect to each jurisdiction's list (in a decentralised approach). Creation of a global list of VASPs raises a number of challenges, including how to ensure the accuracy and security of the information, who is responsible for collecting and maintaining the information (governance), who would supervise the bod(ies) responsible for collecting their information and who would have access to this information in light of potential derisking risks relating to the publication of a list of VASPs. All of these would need to be addressed before a robust solution could be developed. Further, there may be other options available to assist VASPs in identifying their counterparties.

63. **Peer-to-peer transactions via private / unhosted wallets**. Peer-to-peer transfers of virtual assets, without the use or involvement of a VASP or financial institution, are not explicitly subject to AML/CFT obligations under the revised FATF

Standards. Several VASPs have queried about what approach should be taken to their transacting with private or unhosted wallets. There is an initial issue about the extent to which a wallet can be identified as a custodial vs a non-custodial wallet. This has led some VASPs to ask for Guidance on the extent to which blockchain analytic tools can be used in complying with travel rule requirements. A second issue is then whether VASPs should be able to transact with private wallets and, if so, what kind of AML/CFT requirements need to be put in place to mitigate the risks. It should be noted that VASPs' best practice and procedures to meet AML/CFT obligations (e.g. sanctions screening) could be different from those of banks and other traditional financial institutions, given the nature of blockchain, and further clarification by FATF or national authorities could also help VASPs to meet AML/CFT obligations in a coordinated and effective manner. Some VASPs have also raised the risk that unnecessarily burdensome AML/CFT compliance obligations, including the travel rule, may incentivise greater use of peer-to-peer transactions via unhosted wallets, raising the risks and requiring further mitigation measures.

64. **Batch and post facto submission and past transfers.** Some VASPs have requested guidance on the extent to which the batched data submission of transfers of originator and beneficiary data is permissible under the revised FATF Standards. They have queried whether originator and beneficiary data could be submitted on the post facto basis (e.g. at the end of the day, or five to six business days later), instead of the immediate data submission on an individual virtual asset transfers. Some VASPs have also requested further Guidance on the extent to which beneficiary and originator data should be collected on past virtual asset transfers.

65. **Inter-operability of systems**. For implementation of the travel rule to progress smoothly globally, different solutions need to be inter-operable, with adequate controls in place to address data sharing, storage and security. This will reduce compliance costs for VASPs and limit the fragmentation of VASP markets into different systems. The development of global messaging standards is a first step in ensuring that systems can be interoperable. However, fragmentation may be driven by factors such as different rules for privacy and data protection, cyber-security or AML/CFT, such as where one jurisdiction requires "purpose of transaction" as mandatory information when another does not. Different rules and standards in different jurisdictions may impact the inter-operability of different travel rule solutions, unless sufficient flexibility is built into the messaging standards/solutions being developed to accommodate the requirements of particular jurisdictions. This highlights the importance of close co-operation with and within the private sector and amongst jurisdictions in developing their AML/CFT regimes and supervisory approaches.

66. **Sunrise issue**. At this point in time, less than half of FATF members have introduced travel rule requirements for VASPs and this gap may be larger in the FATF's broader Global Network. This means there is not yet a global framework for travel rule compliance. VASPs have raised this as a challenge as it means it is unclear what approach they should take in dealing with VASPs located in jurisdictions without the travel rule (the 'sunrise issue'). This issue will remain until all jurisdictions have introduced the requirement.

67. Some VASPs have asked for greater guidance from the FATF and supervisors on the approach they should take, particularly whether they can transact with VASPs in jurisdictions without travel rule requirements and, if so, what data can and should

be securely transmitted. Some VASPs have proposed that FATF expressly state that jurisdictions can provide an exemption for transmitting data only for such time as receiving VASPs are not licensed/registered and/or an operational travel rule system is not in place.

68. **Specific wording issues.** Several specific wording issues with the FATF Guidance regarding R.16 for VASPs were raised, including references to the Legal Entity Identifier, the term 'account number' and the address of an originator.

Section 5: Proposed next steps

69. Overall, many jurisdictions and the VASP sector have made progress in implementing the revised FATF Standards on virtual assets and VASPs. Over half the FATF membership reported that they have now incorporated the revised FATF Standards into their domestic law and there now appear to be the first technology solutions for the travel rule appearing on the market. However, challenges remain. Some jurisdictions' AML/CFT regime for VASPs are not yet operational and some have not yet established regimes. This review has not surveyed the entirety of the FATF Global Network, so the level of progress amongst non-reporting FSRB members is unknown.

70. At this stage in time, there is no clear need to amend R.15/INR.15. While there are many areas where both jurisdictions and the private sector seek further clarity, updated FATF Guidance should be pursued in the first instance. The FATF should consider future amendments to the revised Standards if this work identifies issues which updated Guidance cannot resolve. The FATF must also closely monitor the risks posed by so-called stablecoins, anonymous peer-to-peer transactions via unhosted wallets and the broader virtual asset market. If there does appear to be a significant change to the market structure or ML/TF risk profile, the FATF should consider whether amendments to the revised Standards are warranted.

71. As public and private sector implementation of the revised Standards is still ongoing, and most jurisdictions' AML/CFT regimes for VASPs are nascent, this review proposes that FATF should continue to actively monitor and support implementation of the new requirements by jurisdictions. The FATF should also continue its engagement with the VASP sector and technology providers. The FATF will also work collaboratively with other global standard-setting bodies to ensure a coordinated approach to virtual assets.

72. Therefore, this review recommends the FATF undertake the following actions focused on virtual assets and VASPs:

a) **The FATF need not amend its revised Standards on virtual assets and VASPs at this point in time, but should conduct a second 12-month review of the implementation of the revised FATF standards by June 2021 and consider whether further updates are necessary.** As the virtual asset market evolves quickly, the FATF considers that the virtual assets and VASP sector continues to warrant enhanced monitoring. A second 12-month review would provide a longer timeframe to observe changes to the virtual asset market and the impact of the revised FATF Standards. By June 2021, jurisdictions will have had two years to transpose the revised FATF Standards on VASPs into law and the VASP sector will have had time to implement travel rule solutions globally. The FATF and its Global Network will also have completed more mutual evaluation and follow-up reports, which will assess jurisdictions' compliance with the revised FATF Standards and identify any other possible challenges in implementing the Standards. The work will cover progress by the public and private sectors, consider issues such as travel rule implementation and anonymous peer-to-peer virtual asset transactions via unhosted wallets and seek to collect better market metrics on virtual assets, especially on the volume and proportion of peer-to-peer virtual asset transactions.

b) **The FATF should release updated Guidance for the public and private sectors.** This updated Guidance should address the issues outlined in this report, particularly the issues identified in Section 4, including so-called stablecoins and travel rule implementation.

c) **The FATF should continue to promote the understanding of the public and national authorities of the ML/TF risks involved in transactions using virtual assets and the potential misuse of virtual assets for ML/TF purposes.** To this end, the FATF will make available information on red flag indicators associated with virtual assets transactions to the public in October 2020.

d) **The Virtual Asset Contact Group should continue and enhance its engagement with the private sector.** The Contact Group has been a useful forum for progressing the FATF's work on virtual assets. In February 2020, it began directly liaising with a selection of VASP representatives. This has been valuable in enabling the FATF to monitor progress on travel rule implementation and build relationships with the VASP sector. These VASPs representatives have greatly appreciated this outreach and have asked for an enhanced dialogue between the FATF and the sector. This engagement should continue, particularly focusing on monitoring progress on implementation of the travel rule. The FATF should seek to engage with the broader VASP community, as well as technical experts and academics, through the FATF's Private Sector Consultative Forum and other relevant forums.

e) **The FATF should continue its program of work to enhance international co-operation amongst VASP supervisors.** An effective global response to virtual assets requires effective co-operation amongst supervisors. The FATF's Policy Development Group will consider proposals on how to enhance international co-operation amongst VASP supervisors in October 2020 and a third meeting of the VASP Supervisors' Forum will occur by November 2020.

Annex A. Recommendation 15 and its Interpretive Note and FATF Definitions

Recommendation 15 – New Technologies

73. Countries and financial institutions should identify and assess the money laundering or terrorist financing risks that may arise in relation to (a) the development of new products and new business practices, including new delivery mechanisms, and (b) the use of new or developing technologies for both new and pre-existing products. In the case of financial institutions, such a risk assessment should take place prior to the launch of the new products, business practices or the use of new or developing technologies. They should take appropriate measures to manage and mitigate those risks.

74. 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.

Interpretative Note to Recommendation 15

75. For the purposes of applying the FATF Recommendations, countries should consider virtual assets as "property," "proceeds," "funds," "funds or other assets," or other "corresponding value." Countries should apply the relevant measures under the FATF Recommendations to virtual assets and virtual asset service providers (VASPs).

76. In accordance with Recommendation 1, countries should identify, assess, and understand the money laundering and terrorist financing risks emerging from virtual asset activities and the activities or operations of VASPs. Based on that assessment, countries should apply a risk-based approach to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified. Countries should require VASPs to identify, assess, and take effective action to mitigate their money laundering and terrorist financing risks.

77. VASPs should be required to be licensed or registered. At a minimum, VASPs should be required to be licensed or registered in the jurisdiction(s) where they are created.[12] In cases where the VASP is a natural person, they should be required to be licensed or registered in the jurisdiction where their place of business is located. Jurisdictions may also require VASPs that offer products and/or services to customers in, or conduct operations from, their jurisdiction to be licensed or registered in this jurisdiction. Competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding, or being the beneficial owner of, a significant or controlling interest, or holding a management function in, a VASP. Countries should take action to identify natural or legal persons that carry out VASP activities without the requisite license or registration, and apply appropriate sanctions.

[12] References to creating a legal person include incorporation of companies or any other mechanism that is used.

78. A country need not impose a separate licensing or registration system with respect to natural or legal persons already licensed or registered as financial institutions (as defined by the FATF Recommendations) within that country, which, under such license or registration, are permitted to perform VASP activities and which are already subject to the full range of applicable obligations under the FATF Recommendations.

79. Countries should ensure that VASPs are subject to adequate regulation and supervision or monitoring for AML/CFT and are effectively implementing the relevant FATF Recommendations, to mitigate money laundering and terrorist financing risks emerging from virtual assets. VASPs should be subject to effective systems for monitoring and ensuring compliance with national AML/CFT requirements. VASPs should be supervised or monitored by a competent authority (not a SRB), which should conduct risk-based supervision or monitoring. Supervisors should have adequate powers to supervise or monitor and ensure compliance by VASPs with requirements to combat money laundering and terrorist financing including the authority to conduct inspections, compel the production of information, and impose sanctions. Supervisors should have powers to impose a range of disciplinary and financial sanctions, including the power to withdraw, restrict or suspend the VASP's license or registration, where applicable.

80. Countries should ensure that there is a range of effective, proportionate and dissuasive sanctions, whether criminal, civil or administrative, available to deal with VASPs that fail to comply with AML/CFT requirements, in line with Recommendation 35. Sanctions should be applicable not only to VASPs, but also to their directors and senior management.

81. With respect to preventive measures, the requirements set out in Recommendations 10 to 21 apply to VASPs, subject to the following qualifications:

a) R.10 – The occasional transactions designated threshold above which VASPs are required to conduct customer due diligence is USD/EUR 1 000.

b) R.16 – Countries should ensure that originating VASPs obtain and hold required and accurate originator information and required beneficiary information[13] on virtual asset transfers, submit[14] the above information to the beneficiary VASP or financial institution (if any) immediately and securely, and make it available on request to appropriate authorities. Countries should ensure that beneficiary VASPs obtain and hold required originator information and required and accurate beneficiary information on virtual asset transfers, and make it available on request to appropriate authorities. Other requirements of R.16 (including monitoring of the availability of information, and taking freezing action and prohibiting transactions with designated persons and entities) apply on the same basis as set out in R.16. The same obligations apply to financial institutions when sending or receiving virtual asset transfers on behalf of a customer.

82. Countries should rapidly, constructively, and effectively provide the widest possible range of international co-operation in relation to money laundering, predicate offences, and terrorist financing relating to virtual assets, on the basis set

[13] As defined in INR. 16, paragraph 6, or the equivalent information in a virtual asset context.

[14] The information can be submitted either directly or indirectly. It is not necessary for this information to be attached directly to virtual asset transfers.

out in Recommendations 37 to 40. In particular, supervisors of VASPs should exchange information promptly and constructively with their foreign counterparts, regardless of the supervisors' nature or status and differences in the nomenclature or status of VASPs.

FATF Glossary

A **virtual asset** is 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.

Virtual asset service provider means any natural or legal person who is not covered elsewhere under the Recommendations, and as a business conducts one or more of the following activities or operations for or on behalf of another natural or legal person:

i. exchange between virtual assets and fiat currencies;

ii. exchange between one or more forms of virtual assets;

iii. transfer[15] of virtual assets;

iv. safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and

v. participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.

[15] In this context of virtual assets, transfer means to conduct a transaction on behalf of another natural or legal person that moves a virtual asset from one virtual asset address or account to another.

References

FATF, *Covid-19-related Money Laundering and Terrorist Financing: Risks and Policy Response*, May 2020.

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FATF, *Switzerland: 2nd Enhanced Enhanced Follow-up Report and Technical Compliance Re-Rating*, January 2020

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