European Crypto Initiative

EUCI's Position Paper on the draft Anti-money Laundering Regulation

15th February 2023

The European Crypto Initiative (*EUCI*) and its members strongly support the efforts of fighting money laundering and countering the financing of terrorism stipulated in the AML/CTF package proposed by the European Commission. We particularly welcome the adoption of a Regulation governing AML/CFT activities in the EU (*Proposal for a regulation of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing*, AMLR, the Regulation), as this would unify the EU27 approach and solve the issue of the fragmented regulatory landscape in the area of AML, lessening the impact of the so-called *regulatory arbitrage*, also observed in the crypto industry.

Furthermore, we understand the need for crypto-assets, transactions with them and the activities of crypto-asset service providers (*CASPs*) to fall within the scope of any upcoming AML regulation - a need made particularly timely with the upcoming adoption of the Markets in Crypto-Assets Regulation (*MiCA*).

Moreover, our recent involvement with the Transfer of Funds Regulation (*TFR*) negotiations has demonstrated the need to be open to discussion, especially in the context of complex issues, such as combatting money laundering and the financing of terrorism.

However, **we are concerned that the focus on the use of crypto-assets for laundering money and financing terrorism has been disproportionately high in comparison to the actual data about such occurrences**.[1] Furthermore, **we are concerned about the possible effects that some of the proposed rules might have on fundamental rights and principles, such as the right to privacy**. Therefore, the EUCI and its members would like to bring your attention to the following problematic parts:

I. The expansion of the customer due diligence obligations to also cover occasional crypto-asset transactions that amount to at least EUR 1 000 instead of the general rule that only applies for transactions over EUR 10 000.

[1] See, for example, *Crypto Crime Trends for 2022: Illicit Transaction Activity Reaches All-Time High in Value, All-Time Low in Share of All Cryptocurrency Activity,* Chainalysis, January 2022, available here: https://blog.chainalysis.com/reports/2022-crypto-crime-report-introduction/.

II. The introduction of enhanced due diligence for CASPs, involved with transactions with self-hosted wallets/addresses.

Moreover, we would also like to point your attention to other potentially problematic aspects of the draft Regulation:

III. The lack of clarity on AMLR's application and the heavy reliance on the future Anti-Money Laundering Authority (*AMLA*) for a significant part of them.

IV. The overlapping mention of CASPs as obliged entities - both as part of the umbrella term "*financial institutions*" (Article 3, (2) in relation to Article 2, (6) (fa)) and as a stand-alone term in Article 3, (3) (g).

V. The expansion of the obliged entities' list by including "*persons or platforms (other than CASPs) trading or acting as intermediaries for importing, minting, sale and purchase of unique and not fungible crypto-assets that represent ownership of a unique digital or physical asset, including works of art, real estate, digital collectables and gaming items and any other valuable*".

VI. The unnecessary mention of "Decentralised Autonomous Organisations (DAOs) and Decentralised Finance (DeFi) arrangements" that are "controlled directly or indirectly, including through smart contracts or voting protocols, by natural or legal persons" in the case where they fall within MiCA's definition of a CASP (Article 3, (11a)).

We ask you to consider the following arguments and proposed solutions to the above mentioned issues:

I. & II. Our concerns regarding Article 15 (b) - derogation on the derogation from the general rule of subjecting occasional transactions to customer due diligence only when they exceed EUR 10 000 and subjecting occasional crypto transactions when they exceed EUR 1000, as well as the newly proposed Article 30b on the issue of the specific enhanced due diligence regarding crypto-asset transactions involving a self-hosted address (previously "wallet") are that:

1. They go **against technological neutrality**, previously stated as a principle by the European Commission,[2] and instead pose a risk of overregulating a nascent industry. We understand that the rules set in *Article 15 (b) - derogation* follow the already established reporting standards by both the Financial Action Task Force (FATF) and the Council General Approach. Nevertheless, we would like to point out their **potential to add a disproportionate burden on smaller projects that would not have the resources to conduct such a large volume of customer due diligence.**

2. Moreover, they do not take into consideration the nature of the technology used and the pseudonymous nature of the data on a distributed ledger technology infrastructure that could never be truly anonymous. Therefore, any unnecessary and overburdensome personal data collection might prove **detrimental to the safety, security and privacy of the individuals while also reversing the significant work done by the EU in the past decade as a leader and an example in privacy regulation.**

3. Furthermore, it is **discriminatory** in its nature, as it provides for more burdensome access to similar services for a group of people due to their technological choice.

4. Last but not least, the proposed Article 30b **is also detrimental to legal clarity regarding the scope of the Regulation**, as the used wording changes - from "self-hosted wallets" to "self-hosted addresses" and even "anonymous wallets" in the words of the Council - bringing

[2] Technological neutrality is defined as "the freedom of individuals and organisations to choose the most appropriate and suitable technology for their needs. Products, services or regulatory frameworks taking into account the principle of technology neutrality neither impose nor discriminate in favour of the use of a particular type of technology." See, for example, *Supporting telecommunications networks and digital service infrastructures across Europe*, available here: https://eur-lex.europa.eu/EN/legal-content/summary/supporting-telecommunications-networks-and-digital-service-infrastructures-across-europe.html.

further uncertainties regarding the intended meaning of the text, as it differs from the terminology adopted with the *TFR*.

Therefore, we ask for the derogation of the general rule in Article 15 (b) - derogation, as well as Article 30b, to be removed from the draft.

III. As future legal certainty and clarity are among the most significant added values coming with the adoption of the AMLR, we are concerned by the sheer number of essential aspects within the Regulation left for further clarification by the AMLA, especially when those are in the form of *regulatory technical standards* (*RTS*). This is concerning as:

1. AMLA has **yet to be established** and might, therefore, require some technical time even to begin operating at total capacity - which has not necessarily been considered when proposing the deadline for their RTS and other opinions.

2. The topics themselves are **pretty crucial** for the timely preparation and compliance of the various obliged entities and, therefore, should not be left for such a late stage of the process - see, for example, *Article 30b (3)*, which stipulates for AMLA to create, among other things, *RTS regarding the criteria and means for the identification and verification of a "self-hosted address,"* *Article 15 (5)*, which envisions that AMLA will draft *RTS* regarding critical aspects of the Regulation's application, such as identifying *business relationships*, *linked transactions* and *occasional transactions* (including those involving crypto-assets) and *Article 7 (4)*, assigning to AMLA to draft *RTS*, related to *risk-related internal policies, controls and procedures* for obliged entities.

Therefore, we ask for more clarity on the upcoming meaning of the key terms used in the Regulation, as well as for reduced uncertainty related to the AMLA's involvement.

IV. We agree with the need for CASPs to fall within the scope of obliged entities under the AMLR. However, we see a possibility for confusion related to the inclusion of CASPs in the umbrella term *financial institutions*. This is due to the fact that:

1. The new term "*CASP*" and its broad scope are already a source of concern due to the need for further clarification and practical expertise to determine what falls within it. Therefore, we find

it potentially **detrimental if this umbrella term is wrapped up within another umbrella term** even before the industry and entities have become familiar with the meaning of CASPs and their scope.

Therefore, we ask for Article 2, (6) (fa) to be removed from the draft.

V. Our concern regarding the newly proposed Article 3, (3) (ia) is that it might have far more significant negative effects than any potential positive ones, especially as:

1. We understand and agree that the recent exclusion of unique and non-fungible tokens from MiCA does not negate the applicability of AML rules to these tokens. However, the current wording of the proposed Article 3, (3) (ia) **underscores the importance of considering the wide-ranging implications of the proposed regulations on all parties involved in the creation of tokens that do not pose high (or any) risks and do not hold high (or any) financial value.** By doing so, there is a risk of unnecessarily burdening the parties involved in creating the NFT even though the activities of uploading and minting an NFT do not directly engage with customers and therefore do not pose any money-laundering risk. Furthermore, it also goes against FATF's general exclusion of NFTs from the scope of virtual assets.[3]

Therefore, we ask for Article 3 (3) (ia) to be removed from the draft.

VI. We would also like to point out Article 3 (11a), which again scopes in CASPs, even though AMLR already covers them as a result of Article 3, (3) (g). We find this approach unnecessary, as:

1. It serves **no practical purpose** due to the same category of CASPs having already been scoped in.

2. We see a **risk of creating confusion** around the meaning of these still undefined terms, as the mention of *DAOs* and *DeFi* in the AMLR might unintentionally lead to the conclusion that there is a different understanding of their meaning for the purposes of this Regulation that differs

[3] *Virtual Assets and Virtual Asset Service Providers - Updated Guidance for a Risk-based Approach* - Financial Action Task Force (FATF), October 2021, p. 24.

from the one onthe basis of MiCA. Furthermore, the definition provided in Article 3 (11a) for both DeFi and DAOs is so broad that it risks becoming meaningless in practice.

3. Last but not least, *Article 3 (11a)* **goes against the FATF guidance** that explicitly leaves DeFi outside of the scope of virtual asset service providers (VASPs), as “the Standards do not apply to underlying software or technology.”[4]

Therefore, we ask for Article 3 (11a) to be removed from the draft.

[4] Ibid, p. 27.