26 August 2020

Directorate-General for Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de Spa 2
1000 Bruxelles
Belgium

Dear Sir or Madam

Action plan for a comprehensive Union policy on preventing money laundering and terrorism financing

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

On 7 May 2020, the European Commission adopted a six-point action plan for a comprehensive E.U.-wide policy on preventing money laundering and terrorism financing (the "**Action Plan**").[1] The Action Plan is aimed at harmonising, in particular, rules imposed by Member States at the national level to address money laundering risks which may have a broader impact across the E.U. To achieve that objective, the Action Plan will revise the existing E.U. anti-money laundering and terrorism financing framework by (1) adopting a single, E.U.-wide rulebook in this area; (2) creating an E.U. supervisory body; (3) improving coordination on related data analysis; and (4) improving the enforcement of EU AML/CTF rules. The European Commission has launched a public consultation to gather stakeholder views on the possible enhancements to the E.U. anti-money laundering/countering the financing of terrorism framework. The FMLC would like to draw attention to two areas.

Virtual currencies

One of the questions in section 2 (*Delivering a reinforced rulebook*) asks if there are any FinTech activities that currently pose money laundering / terrorism financing risks which are not captured by the existing E.U. framework. The FMLC has considered in detail the provisions introduced in Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the "**Fifth Money Laundering Directive**" or "**5MLD**"), which represents one of the first legislative frameworks to regulate the use of virtual currencies, targeting new actors in the financing chain: custodian wallet providers and providers of exchange services.[2] Article 1(2)(d) of 5MLD provides that

> "virtual currencies" means a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, *but is accepted by natural or legal persons as a means of exchange* and which can be transferred, stored and traded electronically[.] (Emphasis added.)

Virtual currencies must therefore be accepted as a means of exchange and be capable of being transferred, stored and traded electronically in order to fall within that definition. Moreover,

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Central Bank Digital Currencies (commonly referred to as "**CBDC**"s), virtual currencies pegged to fiat currencies and any currencies amounting to "money" at law are excluded. While it is understandable that the legislators might prima facie have wished to avoid the over-regulation of those currencies which are already regulated as money for AML purposes, excluding any exchange token which arguably has attained the "legal status of currency or money" may ultimately exclude from the purview of regulation the very actors and types of virtual currencies which are likely to be used for money laundering, namely wallet providers and exchanges dealing in cash-like virtual currencies.

The FMLC Report mentioned above highlighted the unintended and unhelpful consequences which might arise from the limited definition. These include the direct consequences of under-regulation and confusion as to the categorisation of virtual currencies and how legislative definitions apply thereof, as well as the indirect consequences of increased criminal activity and attempts by entities to remain outside the regulatory perimeter. The result of the exclusions in the definition of "virtual currencies" is that it leaves loopholes by the means of which persons or entities might be able to engage in those activities. Not only would it exclude virtual currencies like Facebook's Libra, which was to be "pegged" to a basket of sovereign fiat currencies and used as a method of payment by a number of businesses,[3] it would also render futile the attempt to regulate under 5MLD custodian wallet providers or providers of exchange services between virtual and fiat currencies.

In any future iteration of the anti-money laundering framework, the FMLC would urge the E.U. to consider clarifying—and, perhaps, broadening—the definition of "virtual currencies"

<u>The use of electronic identifiers</u>

Section 2 lists a number of provisions identified by the European Commission that could be further harmonised through a future regulation. The FMLC has previously expressed support for one of the items in the list: electronic identification and verification. Following the 2008 financial crisis, authorities and the private sector cooperated to develop the framework of a Global Legal Entity Indentifier ("**LEI**") System that will, through the issuance of unique LEIs, unambiguously identify legal entities engaged in financial transactions. For example, the use of LEIs as part of disclosure requirements for firms offering cryptoasset exchange services and custodian wallet service providers could contribute significantly to transparency in this unregulated capital market. This is especially true in the context of initial coin offerings winch are not yet typically accompanied by standardised documentation, leading to the establishment of information intermediaries. The adoption of LEIs would certainly improve the effectiveness of the anti-money laundering framework.

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

Joanna Perkins
FMLC Chief Executive

1 European Commission, Communication from the Commission on an Action Plan for a comprehensive Union policy on preventing money laundering and terrorist financing, (7 May 2020), available at: https://ec.europa.eu/finance/docs/law/200507-anti-money-laundering-terrorism-financing-action-plan_en.pdf

2 FMLC, *Report: Exchange Tokens* (23 October 2019), available at: http://fmlc.org/report-exchange-tokens-23-october-2019/

3 Libra Association, *Libra White Paper* (18 June 2019), available at: https://libra.org/en-US/white-paper/