



Current Status of Anti-money Laundering Measures in Virtual Currency Transaction < Based on the Virtual Currency Market in Transition >

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Introduction

The virtual currency market cooled rapidly after the collapse of bubble which occurred in early 2018. But, it still maintained a certain scale and a phenomenon has become prominent in which a virtual currency is utilized for money laundering due to its anonymity.

This report describes about a change in the money laundering measures at home and abroad as well as the trend of the virtual money since 2017.

(Though there is a proposal to change the name of a “virtual currency” to a "crypto asset" by the “Study Group on Virtual Currency Exchange” which was organized by Japan Financial Services Agency (FSA) ", the name of "virtual currency" will be used at this report.)

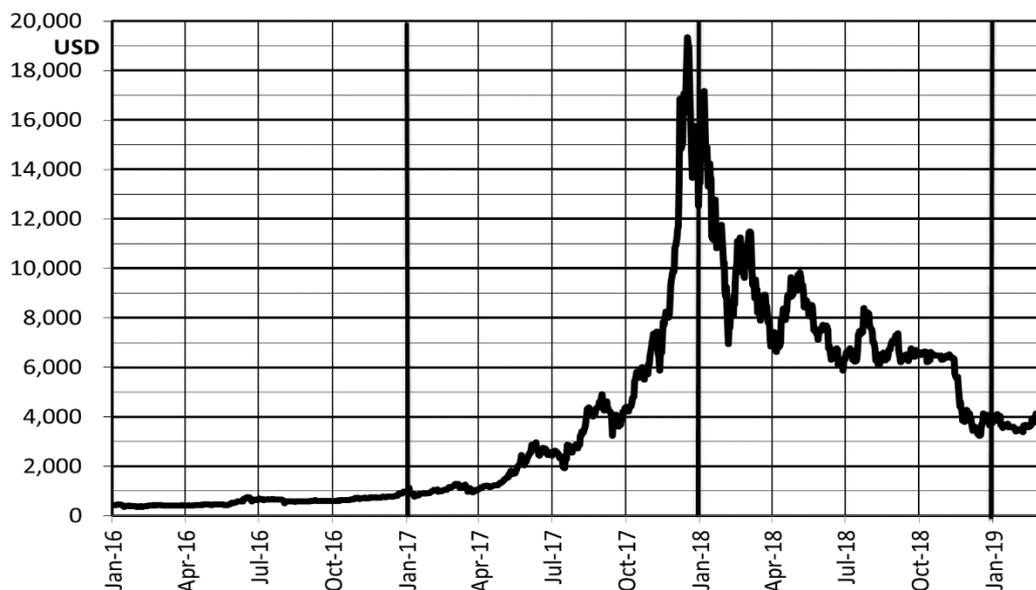
1. The Trend of the Virtual Currency Market

(1) The Aggregate Market Value Declined to 15 Trillion Yen (USD 140 Billion) from the peak 90 Trillion Yen (USD 800 Billion).

Although the recognition of a virtual currency by news media and magazines in 2017 quickly expanded the virtual currency market with much enthusiasm, it cooled rapidly in 2018. According to CoinMarketCap, one of the famous sites about virtual currency, the aggregate market value of the virtual currency expanded by 45 times (from about 2 trillion Yen (USD 18 billion) at the end of 2016 to 90 trillion Yen (USD 800 billion) in the beginning of January 2018), but it turned to decline after that and it's about 15 trillion Yen (USD 140 billion) as of March 14, 2019.

And the price of the Bitcoin, which is the most famous virtual currency and accounts for about 50 % of the whole aggregate market value, surged to a historic high (2.1 million Yen / USD 19,000) at the end of 2017 and fell rapidly to about 700 thousand Yen (USD 6,000) in June 2018. It plunged again in the middle November and was traded at around 430 thousand Yen (USD 4,000) as of March 14, 2019.

Chart 1 : Price Change of the Bitcoin (since 2016)



(Source : CryptCompare.com)

The reason for soaring price in 2017 can be explained by the continuation of worldwide credit ease. In addition, it can be explained by the greater attention to the possibility of the block chain technology worldwide, and an increased buying by individual investors for speculating purpose. Especially in Japan, the virtual currency transaction boom occurred in the background of legislation of the “Revised Settlement Act (which is also known as “Virtual Currency Act”) on April 1st, 2017, and all the media had compiled special reports about virtual currency. At a time, 70% of the transaction amount per day of a Bitcoin in the whole world was settled in Japanese Yen and the Bitcoin was priced at more than 2 million Yen (USD 18,000) at the end of 2017.

On the other hand, the reason for the slump in 2018 can be explained by the sudden reaction against overheated trading of the virtual currency whose fair price nobody knows, and the decreasing of the transaction in Japan reflecting hacking damage which occurred at Coincheck Ltd.(January) and Tech Bureau Corp. (known as Zaif) (September). Also, the split problem of Bitcoin Cash (BCH) gave a further pressure on the downside in mid-November.

The “BCH split problem” is an event which BCH was split into "Bitcoin ABC" and "Bitcoin SV" on November 15th 2018. This split was caused by the dispute on a “Miner” or a person/company who conducts a mining operation (a task of verifying the correctness of

transaction data of virtual currency and recording it on a block-chain so as not to be rewritten as different data. A reward is given to the person/company who completed the work earliest). Both “ABC” and “SV” supporters tried to link the block-chain longer in order to allow investors and others to recognize that “their side is the legitimate successor of BCH”. As a great deal of electric power for moving many high-performance computers is necessary to record transactions on the block-chain, both supporters kept competing with no regard to profitability (this competition is called "hash war"). And the miners who suffered a loss from this competition sold the Bitcoin which they had previously possessed to cover the loss.

If you lose the battle, the virtual currency of your side will not be recognized in the market and its value will drop significantly. So, both supporters are desperately carrying out the record work on the block-chain. For this reason, both supporters have been recording almost the same length of the block-chain since its split, and the match has not been settled yet.

Under these circumstances, investors who saw that both miners would continue to sell Bitcoins for the time being also sold Bitcoins, and the price fell sharply as a result of synergy and the price dropped from 900 thousand yen (USD8,000) to 400 thousand yen (USD 3,700) in a month after the split of BCH.

(2) Virtual currency Deviates from the Original Idea and Purpose

This "BCH split problem" asked the persons in concern a question, "For whom and for what reason the virtual currency exists?"

The virtual currency was proposed in a Satoshi Nakamoto's paper "Bitcoin: A Peer-to-Peer Electronic Cash System (Bitcoin: P2P Electronic Money System)" in 2008, and the operation of the Bitcoin started in January 2009. From its beginning, the Bitcoin does not have such thing as banknotes and coins, relies only on programs and systems in operation, and it is distributed as if it were a fiat currency such as the yen or the dollar.

The emergence of a virtual currency stems from the failure of a major US investment bank, and it coincides with the time when the global financial crisis occurred. Satoshi Nakamoto raised doubts about injecting a large amount of tax money into financial institution bailouts, even though it is said to have been injected for a prompt recovery of stability of the financial system and the maintenance of confidence in the local currency. And he felt that there was a problem with the current system where the government or the central bank monopolized the currency issuing authorization. And, it is said that the birth of Bitcoin was driven from his thought that it would be better to create an independent global currency.

Bitcoin was, at the beginning of the birth, traded in a small amount between nerds called “Geeks”. Afterwards, its presence gradually spread to ordinary citizens as they used Bitcoin as a safe haven to counter the deposit blockade in the Cyprus crisis and the Greek crisis, or as an

intermediation means for an unlimited exchange of renminbi (China's fiat currency) to other fiat currency that slips through China's capital restriction.

However, as mentioned above, the virtual currency was not used as a "more convenient and freely usable currency than the legal currency" which Satoshi Nakamoto originally conceived, but it flared up intensely as a "speculation commodity" with its price soaring in 2017, and then it plunged after it was recognized that it was simply a "Tool of conflict between miners".

2. ICO: Rapid Expansion and Shrinkage along with the Virtual Currency Market

(1) Attention as a New Means of Financing

The activity and stagnation of an "ICO (Initial Coin Offering)" is inseparable from the price movement of virtual currencies after 2017.

The initial motive for the creation of a virtual currency such as Bitcoin was, as mentioned above, "building a universal currency which is independent from the government and the central bank". But, a movement to try to raise funds using the technology of a virtual currency emerged in around the beginning of 2016.

ICO is a mechanism in which companies issue "Tokens (new virtual currency)" on the internet, to use the funds raised by them for new projects such as development costs. It is sometimes referred to as a "Digitized IPO" or an "IPO in a virtual currency world" because it is similar to an "Initial Public Offering (IPO)" in which a stock is listed for funding. But, an ICO and an IPO is a different instrument.

First, a period for realization of financing differs between an ICO and an IPO. In the case of an IPO companies have to go through preparatory works with the securities companies and examination by the stock exchange in addition to formulate capital policies and build internal systems based on laws and rules of the stock exchange. So, it usually takes several years to raise the funds by an IPO. On the other hand, in the case of an ICO, the issuer creates a "White Paper (document)" that describes the outline of the issuance plan of a new virtual currency, its issuance schedule, the use of funds received from investors, etc. It is possible to invite investors just by uploading the paper on the company's homepage and without receiving any special examination by the public. Therefore, it is possible to raise funds in several months from the original plan.

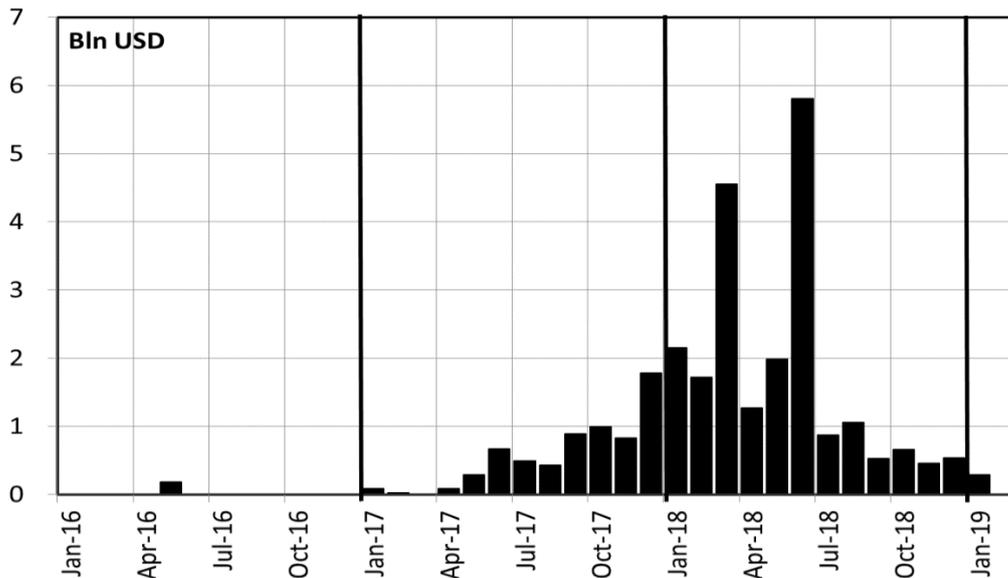
In addition, while securities companies act as intermediaries with investors in an IPO, token issuers (fund raisers) deal directly with investors in an ICO.

ICOs have increased since 2017 because they benefit both issuers and investors. First of all, from the issuer side, while the IPO costs issuers various fees such as commissions for the lead managing securities company, it is said that an ICO issuer can keep the cost low because he

raises the funds directly from investors. On the other hand, the merit on the investor side is that the application to the ICO can be made across the border relatively easily as the payment to the ICO is made in virtual currency such as Bitcoin. Also, since the public offering price of tokens is generally set low, it is thought that it would be possible for the investors to gain a profit from selling the tokens if the funded project succeeds and the token price rises.

However, there are disadvantages to the investors, too. In an ICO, investors trust the contents described in the "White Paper" and purchase tokens issued by companies with projects in progress or plans for the project. But, unlike IPO stocks, investors' right or issuers' duty is not clearly defined. That is, the investor does not have "voting rights" for the project. And, if a company which raised funds by an ICO goes bankrupt, investors do not have a right to receive the distribution of the remaining property.

Chart 2: Developments of ICO Contracts (Funded Amounts)



(Source: CoinSchedule)

(2) Under Strong Speculation, 80% of the Projects Fell under Offering Price

Along with the rising interest in virtual currencies from 2017 and an intensified mood for "buy everything", the ICO market also grew rapidly. Also, as mentioned above, the need for investors to first prepare major virtual currencies such as Bitcoin in order to apply for an ICO further stimulated demand for virtual currencies. This has created a virtuous cycle of the rising prospects of token market appreciation which further attract investors who want to gain the profit into the ICO market. However, when the virtual currency market itself cooled down, its rewinding was also fast.

Additionally, as the individuals were investing on a wave of speculative fever for virtual

currency, there were cases that investors invested in tokens without carefully examining what kind of project would be carried out with the funds raised by the ICO, or problems arose in that ICOs were used for frauds as the procurement side exploited the fact that there was no obligation to disclose the progress of the project.

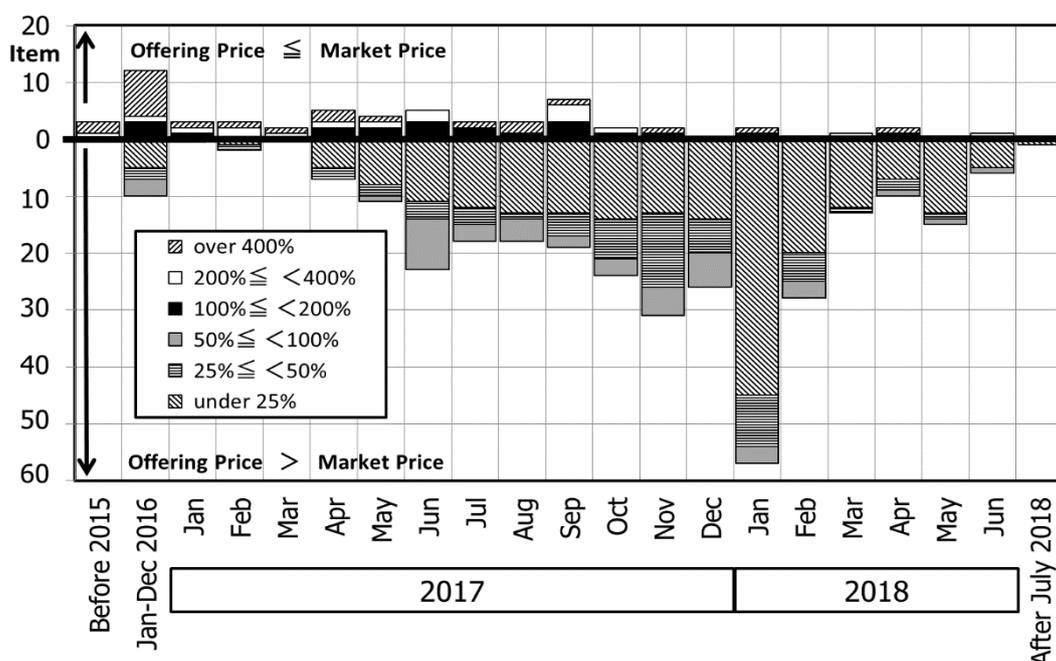
In fact, the ICO report which Ernst & Young issued on October 19, 2018 revealed that 61 projects out of 86 projects (71%) where progress could be confirmed on the website etc. had no progress at all even after raising funds.

Also, according to the data published by the research site TokenData (as of the end of February 2019), out of all 359 ICO tokens for which the trading price is available,

- 1) Only 60 projects (about 17%) had a return of 100% or more (that means the current market price is higher than the public offering price).
- 2) 254 projects (about 71%) had less than 50% return, and 121 projects (about 34%) less than 10% return.
- 3) Moreover, ICO's average return (weighted average by procurement amount) tended to decrease as the procurement date gets shorter.

Under these circumstances, ICO's investors who at first gave a pragmatic explanation that “they are buying their dreams” gradually found that most of them had become a means for companies to easily raise funds. That led to a decrease in the number of issues and the amount of procurement since the summer of 2018.

Chart 3: Return of ICO (as of end February 2019)



(Source: TokenData)

3. Changes in Measures against Money Laundering (both Overseas and Inside Japan)

(1) Due to its Confidentiality, Outflow Incidents of Virtual Currency Continue

In retrospect, the birth of the Internet in the 1990's accelerated digitization of transactions in goods and services, and the barriers to information have become ever lower. In such circumstances, it may have been a natural progress along the flow of innovation that a new idea and framework such as a virtual currency which is de-centralized and can be used worldwide, and ICOs that enabled quick and low cost funding came into existence.. However, various events that occurred after 2017 highlighted the lack of “soundness” for a sustainable development of their markets, and at the same time made people recognize that it was essential for national authorities to coordinate to promote it.

In particular, it had been pointed out that virtual currencies may be used for money laundering because of its anonymity. Money laundering is the “washing up” of funds by repeatedly sending money to financial institution accounts etc., for the purpose of disguising the source and flow of illicit funds that have resulted from illegal trade in drugs and crimes. According to a report released by Ciphertrace (the US data security company) in October 2018, the amount of money related to crime via Bitcoin reached 380,155 BTC (at current market value about USD1.3 Billion) as ascertained from January 2009 to September 2018. In addition, the total outflow due to hacking of a virtual currency (the majority of which is likely to be laundered later) amounted to about USD927 million in the first nine months of 2018, which was about 3.5 times bigger than that of 2017. And the report forecasted that the total damage in 2018 would exceed USD1 billion.

Chart 4: Major Outflow Incidents of Virtual Currencies which Occurred since 2018

Date	Victim	Country	Damage Amount	Reason of the Outflow	Name of the Virtual Currency	
Jan-18	Coincheck	Virtual Currency Exchanger	Japan	USD 530Mln	Hacking to the Exchanger	NEM(XEM)
Feb-18	BitGrail	Virtual Currency Exchanger	Italy	USD 200Mln	Hacking to the Exchanger	Nano(XRB)
May-18	Bitcoin Gold	Platform of Virtual Currency Transaction	-	Over USD 20Mln	"51% Attack" Vulnerability of the System	BTG
Jun-18	Coinrail	Virtual Currency Exchanger	Korea	Over USD 40Mln	Hacking to the Exchanger	NXPS/ATC/NPER
Jun-18	Bithumb	Virtual Currency Exchanger	Korea	USD 30Mln	Hacking to the Exchanger	BTC/ETH etc
Jun-18	Geth	Official Client Software for Ethereum	-	Over USD 20Mln	Vulnerability of the Program	ETH
Jul-18	Bancor	Virtual Currency Exchanger	Switzerland	USD 20Mln	Hacking to the Exchanger	ETH etc
Sep-18	Zaif	Virtual Currency Exchanger	Japan	USD 60Mln	Hacking to the Exchanger	BTC, MONA, BCH
Jan-19	Cryptopia	Virtual Currency Exchanger	New Zealand	USD 4Mln	Hacking to the Exchanger	ETH, CENNZ

(Edited by IIMA)

Turning to Japan, the National Police Agency's "Annual Report on the Prevention of Transfer of Crime Revenues 2017" reported that there were 669 cases of "suspicious transactions" that were reported to the Agency by virtual currency exchange companies (exchangers) from April to December 2017.

Since organized crimes have long been a threat to the international community, and the proceeds from crimes can be further used for organized crimes, countries are taking measures against money laundering to prevent organized crimes.

As an intergovernmental organization for promoting international cooperation and coordination, the Financial Action Task Force on Money Laundering (FATF) was established in 1989. At the time of establishment, its main purpose was to establish a financial system for the purpose of preventing money laundering related to drug crimes. But, since the occurrence of the terrorist attacks in the United States in September 2001, its activities expanded to include international measures to prevent fund transfers to terrorist organizations and to promote cooperation.

Chart 5: Main Activities of the FATF

1	Set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.
2	Monitors the progress of its members in implementing necessary measures. (Members:37 / Observers:3)
3	Promotes the adoption and implementation of the FATF Recommendations globally to the non-members / non-observers.
4	Identification and publication of non-cooperative countries / areas for measures against money laundering, and requests for corrective measures.

(Edited by IIMA)

As described above, a virtual currency was born in January 2009 based on the paper "*Bitcoin: A Peer-to-Peer Electronic Cash System*" published by Satoshi Nakamoto in 2008. The following two points are listed as its features.

- (i) No existence of object or cash (circulate only in the internet world).
- (ii) Public organizations such as governments and central banks do not mediate in its creation or transactions (thus it can be issued without depending on government or central bank credit).

Though both Bitcoin and cash (fiat currency) can be used for money laundering, their methods differ depending on their characteristics. For example, when cash is delivered by hand such as in personal delivery, it is difficult to track its movements, while it takes cost and time to

prepare money in advance and transport it.

On the other hand, every transaction data on Bitcoin is recorded on the block-chain including "how much of it moved from the sender address (equivalent to deposit account at a bank) to the recipient address". It is possible to grasp the flow, but the information about the owner of the address is not recorded on the block-chain. Therefore, it can be said that the virtual currencies including bitcoin are "highly anonymous". In addition, it can be said that these virtual currencies are problematic in that their cross-border movement is possible digitally in a short time and can be utilized for money laundering in a different way from cash.

(2) FATF's Past Achievements

In June 2014, the FATF published a report "*Virtual Currencies: Key Definitions and Potential AML/CFT Risks*" in which it for the first time focused on money laundering and other transactions that use virtual currency. However, the report covered only the types of virtual currencies (the difference between virtual currency and digital currency, whether it can or cannot be exchanged to fiat currency, difference between centralized type and decentralized type, etc.) and the cases of money laundering using virtual currency. Therefore, it was not clarified whether the virtual currency exchange service provider falls under the category of "financial institution" or "designated non-financial businesses and professions (DNFBPs)" to which the FATF Recommendations are applied.

Chart 6: FATF Reports on Virtual Currencies

Issued Date	Name of the Report
June 2014	Virtual Currencies : Key Definitions and Potential AML/CFT Risks
June 2015	Guidance for a Risk-Based Approach to Virtual Currencies
July 2018	FATF Report to the G20 Finance Ministers and Central Bank Governors
Oct 2018	Regulation of Virtual Assets

(Edited by IIMA)

Therefore, the FATF published a "*Guidance for a Risk-Based Approach to Virtual Currencies*" (hereinafter "*guidance*") in June of the following year and indicated the regulation policy on the virtual currency market.

In its introduction, the guidance defined the position of the virtual currency exchange service providers as "the intersection that provides gateways to the regulated financial system", and clarified that the provider is a "financial institution" subject to the FATF Recommendations. And, in order for national authorities to address the risk of abuse of virtual currency transactions such as for money laundering, clauses to be applied within the FATF Recommendations were specified.

Chart 7: Application of FATF Recommendations to Countries and Competent Authorities
/ Covered Entities (Overview)

Number	Abstract of the Article (Request Matter)	Countries / Authorities	Covered Entities
Article 1	Activate to identify, understand, assess and mitigate the money laundering and terrorist financing risks.	○	○
Article 2	Develop the national coordination mechanisms on anti-money laundering and terrorist financing. Also, cooperate among authorities.	○	
Article 10 Article 22	Undertake customer due diligence (CDD).		○
Article 11	Keep records of all transactions for a minimum of 5 years.		○
Article 14	Establish a registration or a licencing system for natural and legal persons providing virtual currency exchange services between virtual currency and fiat currencies.	○	○
Article 15	Identify and assess money laundering and terrorist financing risks relating to the development of new products, and new business practices.	○	○
Article 16	Establish the requirements for countries with respect to wire transfers (both cross-border and domestic).	○	
Article 18	Have overseas branches / subsidiaries also comply with the law concerning anti-money laundering and counter-terrorist financing of the country where headquarters are located.		○
Article 20	Report the "Suspicious Transactions".		○
Article 26	Consider amending legacy legal frameworks, as needed, to authorize effective anti-money laundering and terrorist financing regulations for decentralised virtual currency payment mechanisms.	○	
Article 35	Formulate effective, proportionate, and dissuasive sanctions.	○	
Article 40	International cooperation on money laundering and terrorist financing risks (include Article 37, 38, and 39).	○	

(Edited by IIMA)

However, unlike the "FATF Recommendations" where compliance obligations were placed on the member countries/regions, this guidance remained only as a "principle". So, the actions for each country to enact legislations on virtual currencies were generally slow.

(3) Legal Improvement in Japan Concerning Virtual Currencies

In response to the above FATF guidance, Japan established the world's first comprehensive law on virtual currencies (effective from April 1st, 2017). Specifically, the following two legal systems were developed.

First, the "Revision of Payment Services Act" (hereinafter referred to as the "Virtual Currency Act") was implemented, and the virtual currency was defined as "one of the means of settlement different from the statutory currency such as yen and dollar, electronic money, prepaid card". In addition, it introduced a preregistration system for virtual currency exchange service providers dealing with it, and it required the providers to undertake business under the supervision of the government (Financial Services Agency).

Chart 8: Main Regulations of "Virtual Currency Act"

Article2	<p>Definitions of Virtual Currency</p> <p>(5)The term "Virtual Currency" as used in this Act means any of the following:</p> <p>(i) property value (limited to that which is recorded on an electronic device or any other object by electronic means, and excluding the Japanese currency, foreign currencies, and Currency-Denominated Assets; the same applies in the following item) which can be used in relation to unspecified persons for the purpose of paying consideration for the purchase or leasing of goods or the receipt of provision of services and can also be purchased from and sold to unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system; and</p> <p>(ii) property value which can be mutually exchanged with what is set forth in the preceding item with unspecified persons acting as counterparties, and which can be transferred by means of an electronic data processing system.</p>
Article 63-2	<p>Registration of Virtual Currency Exchange Service Providers</p> <p>No person may engage in the Virtual Currency Exchange Service unless the person is registered with the Prime Minister.</p>
Article 63-10	<p>Measures for Customer Protection</p> <p>A Virtual Currency Exchange Service Provider must, pursuant to the provisions of Cabinet Office Order, provide explanation designed to prevent users from mistaking the Virtual Currency used in the business for the Japanese currency or a foreign currency, and information about fees and other terms and conditions of contracts pertaining to the Virtual Currency Exchange Service, and take other measures necessary for protecting the users of the Virtual Currency Exchange Service and ensuring the proper and secure conduct of the Virtual Currency Exchange Service.</p>
Article 63-11	<p>Management of Users' Property</p> <p>(1) A Virtual Currency Exchange Service Provider must, in connection with its Virtual Currency Exchange Service, manage the money or Virtual Currency of the users of the Virtual Currency Exchange Service separately from its own money or Virtual Currency, pursuant to the provisions of Cabinet Office Order.</p>

(Translated by the Japanese government)

Next, as countermeasures against money laundering via virtual currencies and countermeasures against terrorism, "Act on Prevention of Transfer of Criminal Proceeds"

(hereinafter referred to as "Criminal Law") was revised. And, virtual currency exchange service providers were added as "specified business operator" who should comply with the law.

Chart 9: Main Regulations for the Virtual Currency Exchange Service Providers Specified in the Revised "Criminal Law"

Article2 (2)-31	Range of specific businesses Designate the virtual currency exchange service provider as "specific business"
Article4	Clerical work requiring confirmation at the time of dealing (Personal identification matters, transaction purpose, occupation / business content, real rulers, assets and income situation, etc.) " (1) Conclude contract with contents such as continuing and repeating virtual currency transaction (opening the account contract etc.) (2) Interchange and exchange of virtual currency exceeding JPY2mln (high risk transaction) (3) Transfer virtual currency for over JPY100thd.
Article6 and Article7	Creation and preservation obligation of transaction confirmation record, transaction record, etc. (1) It is necessary to immediately create these records after confirming transactions and trading. (2) These records shall be kept for seven years from the date of termination of the contract concerning the transaction.
Article8	Duty of notification of suspicious transaction (1) Notification is required if there is a doubt that the property received on the transaction is obtained by crime (not limited to money). (2) When there is a doubt that customers are conducting money laundering related transactions.
Article11	Improvement of in-house management system (1) Implementation of education and training on confirmation at the time of trading. (2) Preparation of regulations concerning implementation of measures such as confirmation at the time of transaction. (3) Full-time auditing and general manager. (4) Measures to be determined by law, etc., to be taken in consideration of the contents of the survey.

(Translated by IIMA)

However, following the virtual money (NEM) theft incident at Coincheck Ltd. in January 2018, the FSA conducted a series of on-site inspections on virtual currency exchange service providers. And it found that many providers neither complied the currency law nor the criminal law concerning the anti-money laundering measures. In response to this finding, in August 2018, the FSA announced "Issues Relating to Money Laundering and Terrorism Financing Measures of Virtual Currency Exchange Service Providers"¹ and revealed that the problems as shown in Chart 10 were recognized.

¹ Refer to <https://www.fsa.go.jp/news/30/20180817amlcft/20180817amlcft-1.pdf>.(Japanese)

Chart 10: Insufficient or No Compliance cases of Virtual Currency Exchange Service Providers

Even if trading a large number of virtual currencies over several times, the service providers do not make confirmation at the time of transaction and judgment on necessity of notification of suspicious transactions.
The service providers provide the virtual currency exchange service without adequately implementing the transaction time confirmation based on laws and regulations. Also, they did not appropriately judged the necessity of reporting suspicious transactions.
Service providers have not established an appropriate internal control system according to various risks such as money laundering and the risk of providing terrorist financing.
Service provider have not prepared a system to verify transactions at the time of trading. And they have not been conducting business operations based on internal regulations, such as conducting training for staff.
It is stated that the judgment of the spectators who have not judged the notification of suspicious transactions has been judged again and made a notification. But, there was no person who fully understands the contents requested by the authorities despite the guidance of the authorities.

(Translated by IIMA)

After that, the virtual currency exchange service providers who received these indications have sequentially implemented measures such as establishment of rules to verify investors and consumers who opened accounts with them and sophistication of "suspicious transactions detection" function.

(4) Issues Left Untouched in the Japanese Law

As mentioned above, the establishment of the virtual currency law and amendment of the criminal law have fairly straightened the legal system, and the compliance situation is expected to be improved in the days ahead. However, even with the revisions of these two laws, it seems difficult to spread a legal net of money laundering control over all virtual currency transactions.

One of the reasons includes that, although the current criminal law (Article 4) stipulates that the obligation to verify transactions arises at the time of (i) to (iii) below, this obligation does not apply to companies / applications other than virtual currency exchange service providers.

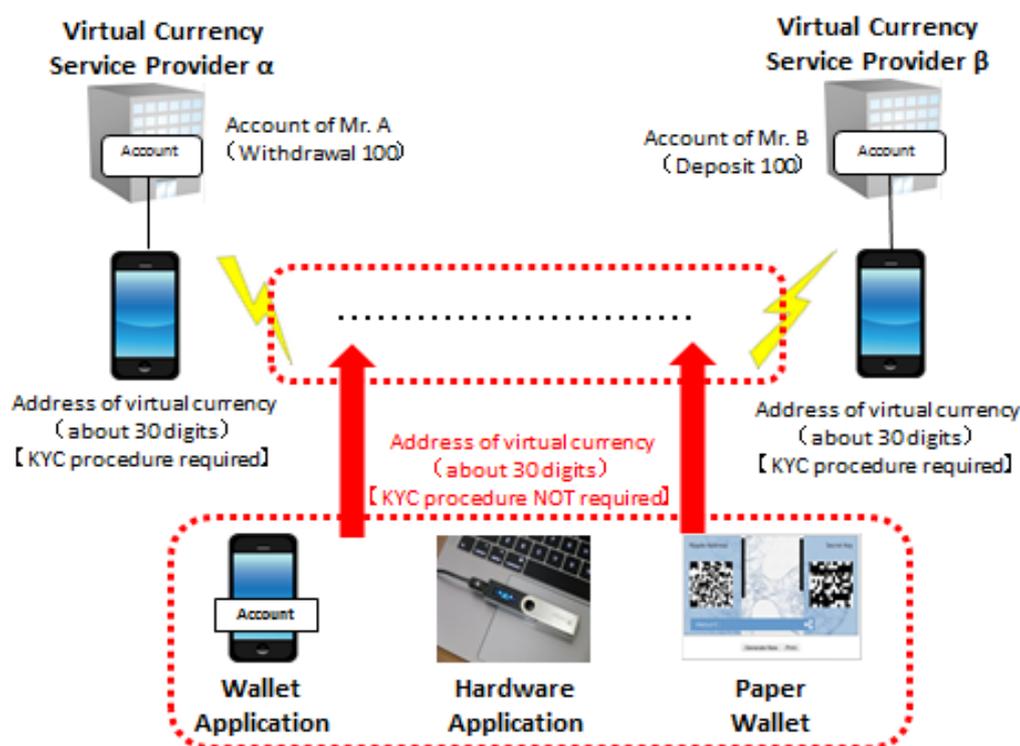
- (i) When opening an account with a virtual currency exchange agent.
- (ii) When exchanging a certain amount of "legal (fiat) currency to virtual currency" or "virtual currency to virtual currency" using the account with the service providers.
- (iii) When dispensing / depositing a certain amount of virtual currency using the account with those service providers.

Therefore, when virtual currencies are transferred through the following applications (i) to

(iii), their tracking becomes difficult.

- (i) "Wallet application": Stores virtual currencies in smartphone application.
- (ii) "Hardware Wallet": Stores virtual currencies in commercially available flash memory such as USB and hardware wallet.
- (iii) "Paper wallet": a method of transferring virtual currency information such as passwords to paper and restoring it.

Chart 11: Transactions that Use Wallet Application etc (Image Diagram)



(IIMA)

In addition, since only Japan and some other major countries have established the regulatory laws at this time, it is difficult to specify the individual / corporate name of the remitter (receiver) when virtual currencies are sent to accounts established by virtual currency exchange service providers in other countries than those noted above (or when they are received from an account opened with the providers in another country).

In fact, according to a survey report by an analytical organization "PAID Strategies"², only 32% of the surveyed major virtual currency exchange service providers and wallet providers in Europe and the United States were conducting a verification procedure.

² Refer to https://www.miteksystems.co.uk/sites/default/files/docs/Cryptocurrency_identity_Crisis_Whitepaper_web.pdf.

(5) Trends in International Virtual Currency Regulations since 2018

As the trade of virtual currencies spread widely in 2017 and risks of abusing these settlement products and services for money laundering increased, the momentum for establishing more binding international rules has also grown. Then, in 2018, as described above, a big hacking incident occurred, and the FATF and G20 worked at strengthening the regulation of virtual currency trading in response to the possibility that it would be used for criminal funds.

1) Joint statement of the "G20 Finance Minister / Central Bank Governors Meeting" in March 2018

In its joint statement of the G20 Finance Ministers and Central Bank Governors Meeting, held in Buenos Aires, Argentina³, Ministers and Governors acknowledged that "the virtual currencies (crypto assets) raise issues with respect of consumer and investor protection, market integrity, tax evasion, money laundering and terrorist financing. They lack the key attributes of sovereign currencies." And the G20 members committed to implement the FATF standards as they apply to virtual currencies, look forward to the FATF review of those standards, and called on the FATF to advance global implementation. In addition, the G20 called on international standard-setting bodies (SSBs)⁴ including the FATF to continue their monitoring of virtual currencies and their risks and asked the FSB, in consultation with other SSBs, including CPMI and IOSCO, and FATF to report in July 2018 on their work on virtual currencies.

2) July 2018 Report of the FATF

Following the above request, the FATF released the "Report to the G20 Finance Ministers and Central Bank Governors" on July 24th. It announced that there is some difference in the regulatory situation of the virtual currency in the countries surveyed (3 countries prohibited the virtual currencies, 7 countries already enforced regulations, 2 countries reported suspicious transactions, 11 countries preparing regulations). Also, as the regulatory situation is rapidly changing, it said that tackling the situation with a globally consistent regulation could rather increase risks.

Also, the FATF announced that it began in June to review its Guidance and Recommendations to determine if changes are necessary to clarify their application to virtual currencies. In particular, it said it will hold an intersessional meeting in September on how the "FATF Recommendations" apply to virtual currencies, and will consider in October detailed proposals (see (3) below) to clarify the application of its Recommendations to activities involving virtual currencies and related businesses.

³ Refer to https://g20.org/sites/default/files/media/communique_fmcbg_march_2018.pdf [#9] .

⁴ Committee on Payments and Market Infrastructures (CPMI) and the Basel Committee on Banking Supervision (BCBS) which are under the umbrella of the International Settlement Bank (BIS), and the International Organization of Securities Commissions (IOSCO).

3) FATF Report of October 2018

The FATF announced the "Regulation of Virtual Assets"⁵ after the closing of the "FATF WEEK"⁶ meeting organized in Paris from October 14th to 19th. There, it emphasized the needs for all countries to take coordinated action to prevent the use of virtual currencies for crime and terrorism, although the FATF had already issued the guidance on virtual currencies in 2015.

In addition, the definitions on "virtual currencies / assets" and "virtual currency / asset service providers" were newly added to the FATF Recommendations. Then, the FATF encouraged national authorities to ensure that the virtual currency service providers are subject to anti-money laundering / counter-terrorist financing regulations such as ongoing monitoring, record-keeping, and reporting of suspicious transactions, etc. Also, the FATF requested the national authorities to introduce licensing or registration system for virtual currency service providers⁷.

In addition, the FATF declared that they will reconsider in the next 12 months whether various regulatory matters described in the FATF regulation standards are still appropriate in view of the virtual currency development and whether it is necessary to renew them or not. And, after that, the FATF president told to some of the media, "We plan to issue additional revision instructions of the FATF regulation standards by June 2019 so that enforcement in each country will reach the level expected by the FATF."

⁵ Refer to <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/regulation-virtual-assets.html>

⁶ More than 800 staff members from 204 government agencies around the world (including the IMF, the United Nations, and the World Bank) held discussions on 140 items of agenda on anti-money laundering and counter-terrorist financing measures.

⁷ "Licensing or registration system for virtual currency service providers" was already mentioned in the "Guidance for a Risk-Based Approach to Virtual Currencies (Article #32)" (June 2015). It seems that the recent report reemphasized its importance.

Chart 12: Amendments to the FATF Regulation Standards Made in October 2018

<p>Recommendation #15: New Technologies (Add the comments described below)</p> <p>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.</p>
<p>GENERAL GLOSSARY (Add new definitions "virtual asset" and "virtual asset service provider")</p> <p>【Virtual Asset】 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.</p> <p>【Virtual Asset Service Providers】 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:</p> <ul style="list-style-type: none"> i. exchange between virtual assets and fiat currencies ii. exchange between one or more forms of virtual assets iii. transfer of virtual assets iv. safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets v. participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset

(Edited by IIMA)

4) Official Statement of the FATF in February 2019

The FATF released the "Public Statement--Mitigating Risks from Virtual Assets" after the closing of the FATF plenary meeting in Paris which was held from 20th to 22th February 2019. In the statement the FATF proposed a draft of the interpretation of virtual currency service providers (more detailed requirements for effective regulatory oversight), which will be added in the June 2019 revision of the FATF regulatory standards.

Chart 13: Official FATF Statement of February 2019

(Extraction of draft on Virtual Asset Service Providers (VASPs) (extract))

1	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).
2	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.
3	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. 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.
4	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.
5	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.
6	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.
7	Countries should rapidly, constructively, and effectively provide the widest possible range of international cooperation in relation to money laundering, predicate offences, and terrorist financing relating to virtual assets.

(Edited by IIMA)

Conclusion

As we have seen above, a money laundering measure of a virtual currency is in the direction to be strengthened steadily. The improvement of regulations is indispensable for building and maintaining sound virtual monetary markets, and is the necessary process for a virtual currency to be recognized as one kind of financial products in the long run.

However, we cannot help saying that the speed of the reinforcement is too slow. Some experts say that providing an unsubstantial or token regulation in a circumstance where there is no clarified definition on and value for virtual currencies may rather raise doubts about its effectiveness. Others see that too strong regulations may obstruct financial innovation. But, as the utilization of virtual currencies for money laundering is said to be increasing year by year, a

speedy tightening of regulation is indispensable.

Japan is G20 presidency holder in 2019. And a FATF plenary meeting (June 16th – 21st at Orlando, Florida) and a revision of FATF regulatory standards (June) are scheduled in June almost overlapping the time of the G20 summit meeting (June 28th - 29th). Japan is desired to summarize the arguments from the view point of G20 presidency holder.

On October 24th, 2018, Japan Virtual Currency Exchange Association (JVCEA) was authorized by the Japanese Financial Services Agency (FSA) as a certified fund settlement business association of the virtual currency. Also, the participants in the “Study Group on Virtual Currency Exchange”, which was organized by the FSA and held meetings occasionally from April to December 2018, discussed the sound development of virtual currency market and additional institutional measures for investor protection, and submitted proposals to the FSA on December 21st, 2018. Now, the FSA is planning to revise the laws and ordinances based on the proposals (see “Supplementary Explanation” described below).

From now on, Japan is expected to work on tightening regulations with authority and industry working hand-in-hand, and take the lead in international deliberations, since it is the country where a law about a virtual currency was established for the first time in the world.

Chart 14: Major Coming Events Relating to Virtual Currency Regulations

Date	Name of the Meeting etc.	Venue
Nov. 30th - Dec. 1st 2018	13th G20 Summit	Buenos Aires (Argentina)
Feb. 17th - 22th 2019	FATF Plenary Meetings	Paris (France)
June 8th - 9th 2019	G20 meeting of Finance Ministers and Central Governors	Fukuoka (Japan)
June 16th - 21st 2019	FATF Plenary Meetings	Orlando (USA)
June 28th - 29th 2019	14th G20 Summit	Osaka (Japan)
June, 2019 (Tentative)	Revision of the "The FATF Recommendations"?	—
Oct. 13th - 18th 2019	FATF Plenary Meetings	Paris (France)

(Source: Various reports)

< Supplementary Explanation >

On March 15, 2019, the FSA submitted a bill to the Diet that would strengthen regulations on virtual currencies. The bill will be passed by the Diet into Act which will come into force as early as June 26th, 2019.

Chart 15: Summary of Revised Act

1	Change the name in the act from "virtual currency" to "crypto asset" based on international trends.
2	Require virtual currency exchangers to manage their client's crypto assets in a reliable manner (such as cold-wallets), except for those required for the smooth execution of operations.
3	Maintain advertising and solicitation (Prohibition of false labeling and hype. Prohibition of advertising and solicitation that encourages speculation.)
4	Apply restrictions on the management of crypto assets to vendors who only manage cryptographic assets (custodians). (KYC obligations, separate management duty of customer assets, etc.)
5	A change in crypto assets handled by a virtual currency exchangers shall be notified in advance. And a system will be developed to check for problems.
6	Maintain regulations (sales and solicitation regulations, etc.) under the Financial Instruments and Exchange Act regarding the margin transaction of crypto assets.
7	Clarify that the Financial Instruments and Exchange Acts will apply to ICO (Initial Coin Offering).

(Edited by IIMA)

<End>

This is the English translation of an article the author contributed to the monthly magazine "International Finance (an April 2019 issue)" issued by The Institute of Foreign Exchange and Trade Research, with an addition of the outline of the bill to revise the Payment Services Law under the jurisdiction of the FSA which was submitted on March 15th, 2019 for consideration at the 198th Diet.

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