



April 20, 2021

Secretariat
Financial Action Task Force
FATF.Publicconsultation@fatf-gafi.org

RE: Chamber of Digital Commerce's Comments on FATF's Draft Guidance on a Risk-based Approach to Virtual Assets and Virtual Asset Service Providers

To Whom it May Concern:

The Chamber of Digital Commerce (the "Chamber") welcomes the opportunity to offer comments to the Financial Action Task Force ("FATF") regarding the draft Guidance on a Risk-based Approach to Virtual Assets and Virtual Asset Service Providers (the "Guidance").¹

A. Introduction

The Chamber is the world's largest trade association representing members in the digital asset and blockchain industry. Our mission, supported by a diverse and global membership of nearly 200 members, is to promote the acceptance and use of digital assets and distributed ledger technology ("DLT").

Through education, advocacy, and close coordination with policymakers, regulatory agencies, and industry across various jurisdictions, our goal is to develop a pro-growth legal environment that fosters innovation, job creation, and investment. We represent the world's leading innovators, operators, and investors in the digital asset and blockchain technology ecosystem, including leading edge start-ups, software companies, global IT consultancies, financial institutions, insurance companies, law firms, and investment firms. Consequently, the Chamber and its members have a significant interest in the proposed Guidance.

We support the efforts of the FATF to modernize anti-money laundering ("AML") laws to counter the financing of terrorism ("CFT") and money laundering, both critical issues. This objective is particularly important in light of the technological advancements that enable people and industries to engage in borderless commerce in new and important

¹ Financial Action Task Force ("FATF"), *Public Consultation on FATF Draft Guidance on a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers* (March 19, 2021), <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/public-consultation-guidance-vasp.html>.

ways. The Chamber supports effective regulatory action to mitigate the risks presented by emerging technologies, including virtual currencies, but believes that more work needs to be done to clarify and narrow the current version of the Guidance to create a regulatory framework that comports with long-standing principles of financial regulation, aligns with Member State rulemakings, and allows innovative uses of DLT for AML/CFT compliance.²

The Chamber understands that the Guidance will not form part of the FATF Recommendations against which Member States are formally assessed for compliance. Nonetheless, the Guidance will be an official FATF position that is intended to—and will very likely have—a significant influence on AML/CFT regulation of Member States. For that reason, the Chamber believes that the Guidance should be held to the same standards of precision and accuracy as the FATF Recommendations. The weight that the Guidance is given by the FATF during assessments should be clearly stated in the document so that Member States are informed clearly of their obligations.

In this letter, we explain our concerns with the current Guidance before offering recommendations to address those concerns. As detailed below, our key concerns are:

1. The combination of: (1) the “broad” and “expansive” interpretations of the definitions; (2) the perspective that virtual assets (“VA”) cover all virtual assets and not just those used for payments;³ and (3) the increased scope of virtual asset service providers (“VASPs”) by including persons who “facilitate” the covered activities, ultimately render the Guidance an attempt to cover all activities in the virtual asset space, not just those that would typically be viewed as money services businesses or financial intermediaries. This expansion beyond money services presents significant challenges in implementing requirements typically reserved for these services, such as customer due diligence and the travel rule. Contrary to the newly added language that “countries should therefore subject VASPs to AML/CFT requirements that are functionally equivalent to other entities when they offer similar products and services with similar risks,”⁴ the FATF proposes broader scope than what currently exists for money services businesses and non-bank financial institutions.
2. The need to focus on development of frameworks and technologies to implement the travel rule worldwide, rather than potentially derailing this progress by incorporating activities unrelated to the scope of money services that typically

² The Chamber has previously commented on earlier initiatives of the FATF regarding virtual assets and virtual asset service providers, including Interpretive Note to Recommendation 15. *See Comment of Chamber of Digital Commerce on Interpretive Note to Recommendation 15* (April 8, 2019), <https://4actl02jlq5u2o7ouq1ymaad-wpengine.netdna-ssl.com/wp-content/uploads/2019/04/Chamber-of-Digital-Commerce-FATF-Submission.pdf>.

³ Guidance at ¶ 40.

⁴ *Id.* at ¶ 22(c).

have customer due diligence and travel rule obligations, as the Guidance currently does.

3. While novel activities concerning VA may challenge policy makers in considering how to support innovation while deterring illicit activity, not all activities involving VA are appropriately covered by regulations designed for money services businesses. These additional activities, such as those involving decentralized applications (“DApps”) used in decentralized finance (“DeFi”), as well as those involving non-fungible tokens (“NFTs”) and potentially others, should be considered first, as to whether they are captured under existing principles governing money services and, if not, then; second, whether new frameworks or perspectives should be considered after gaining additional information, data, and feedback on these quickly evolving activities. Attempting to roll the entire VA space into one framework, tempered only by those activities covered under other frameworks (and even then, only if they are more restrictive), is impractical and ineffective at achieving law enforcement objectives.
4. The Guidance departs from the FATF’s stated goal to mitigate unintended consequences and negative effects of AML/CFT regulation on financial inclusion. Instead, it recommends various measures that will likely hinder financial inclusion, such as enhanced controls or outright prohibitions on peer-to-peer (“P2P”) VA transactions.

Our key recommendations are:

1. Revise the interpretation of “person” so that a person must conduct covered VA activity, and not merely facilitate it, to be a VASP.
2. Revise the interpretation of “control” to be consistent with custodial vs. non-custodial principles, so that a person must have total independent control over VA to be engaged in safekeeping and/or administration of such VA.
3. Continue to focus on risk-based implementation of the travel rule, such as encouraging implementation of national rulemakings and private-sector compliance initiatives, to completion.
4. Use an “owner/operator” test to determine which persons are VASPs in connection with current DApp and other DeFi activities (consistent with traditional AML/CFT principles) and conduct additional analysis before determining whether emerging DeFi technologies require a new test.
5. Expand engagement with stakeholders in emerging areas such as NFTs, stablecoins, and DeFi to reach a mutual understanding of the technological benefits and potential gaps in current AML regulatory frameworks, and address

these, as needed, incorporating the learnings from this collaborative engagement and associated developments.

6. Continue the FATF's commitment to financial inclusion by revising or removing interpretations that unnecessarily discourage financial inclusion.

B. Thematic Comments Regarding the Guidance's Departure from Risk-Based, Tech-Neutral Approaches to Regulation

The Chamber commends the FATF's efforts to provide further interpretive guidance for the definitions it established almost two years ago. FATF's interpretations, however, take an overly expansive view of VA-related risks, lack empirical support, are not tech-neutral, and prematurely address several emerging areas.

Expansive Interpretations of VA and VASP Press Far Beyond Financial Services

The Guidance establishes intentionally "expansive" definitions of VA and VASP that extend far beyond traditional notions of regulated financial activity into non-financial activity and businesses of and by ancillary participants, noting this broad and expansive interpretation in at least four places.⁵ In particular, the FATF is taking an expansive view of VASPs that goes beyond what is traditionally regulated as a non-bank money services business.⁶ As a result, numerous entities whose activities would ordinarily not be treated as regulated money services businesses are in fact treated as such, and thereby inappropriately subject to the FATF's customer due diligence and travel rule requirements. This approach renders an expansive regulatory framework tempered only if the entity is regulated elsewhere and then, only if such regulation is more expansive than that for VASPs.⁷

Unsupported Assumptions About VA Risk

The Guidance's overbreadth appears to result from unsupported assumptions about VA risk.⁸ For instance, the Guidance alleges that "VAs are becoming increasingly

⁵ See Guidance at ¶ 40 ("no asset should be interpreted as falling outside the FATF Standards"); ¶ 41 ("[t]he definition of VA is meant to be interpreted broadly"); ¶ 48 ("the definition of VASP should be read broadly"); ¶ 60 (the safekeeping and administration limbs of VASP definition "should also be read expansively").

⁶ For example, in the United States, a bureau of the U.S. Treasury Department (the Financial Crimes Enforcement Network ("FinCEN")) regulates those money services businesses (the presumed equivalent of a VASP) typically on the basis of providing money transmission services, which is defined as "the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds or other value that substitutes for currency to another location or person by any means." 31 CFR § 1010.100(ff)(5).

⁷ Guidance at ¶ 49.

⁸ Chainalysis found that, in 2019, criminal activity represented 2.1% of all cryptocurrency transaction volume. In 2020, the criminal share of all cryptocurrency activity fell to just 0.34%. See Chainalysis, 2021

mainstream for criminal activity more broadly,”⁹ while in fact, research from Chainalysis (a Chamber member and DLT analytics company) indicates that cryptocurrency-related crime is falling and remains a small part of the overall cryptocurrency economy.¹⁰ The FATF’s non-empirical approach results in a sweeping international standard that will be difficult to implement generally, and particularly in jurisdictions that require cost-benefit analysis for rulemakings (e.g., the United States).¹¹ In addition, the Guidance applies traditional rules to VA activity without evaluating whether DLT obviates or lessens the need for certain AML/CFT measures.¹² The FATF should conduct empirical analysis of the risks and benefits of the subject matter before outlining—on the basis of factual determinations—why additional AML/CFT measures are necessary to fill current gaps.

Tech-Focused, Not Tech-Neutral

Despite multiple assurances to the contrary, the Guidance is tech-focused rather than tech-neutral. Instead of analyzing actions and imposing a risk-based approach consistent with FATF Recommendation 1, it focuses on categories of technology to ensure particular technologies are subject to its desired definitions.¹³ The Chamber supports an approach to regulating financial activities in the digital space that is principles-based, rather than prescriptive. Prescriptive regulations are quickly outdated. They apply both too broadly, restricting the use of new risk-reducing technologies, and too narrowly, exempting by default other technologies or processes from regulation disproportionate to the risks they address or raise. This is particularly true in areas experiencing rapid innovation, such as digital finance. A principles-based approach, in

Crypto Crime Report (Jan. 19, 2021), <https://blog.chainalysis.com/reports/2021-crypto-crime-report-intro-ransomware-scams-darknet-markets>.

⁹ Guidance at ¶¶ 19.

¹⁰ At least one senior United States official at a regulatory agency has stated, “[i]t is common to hear government officials worrying about crypto’s use by criminals, even though the numbers suggest that it is used for illicit purposes less often than cash is.” Commissioner Hester M. Pierce, *Remarks at the British Blockchain Association’s Conference Success Through Synergy: Next generation Leadership for Extraordinary Times* (March 15, 2021), <https://www.sec.gov/news/speech/peirce-paper-plastic-peer-to-peer-031521>.

¹¹ See, e.g., *Comment of Chamber of Digital Commerce on FinCEN Docket Number FINCEN-2020-0020, RIN 1506-AB47* (January 4, 2021), at Section II, https://4actl02jlq5u2o7ouq1ymaad-wpengine.netdna-ssl.com/wp-content/uploads/2021/01/Chamber-of-Digital-Commerce_Comments_FINCEN-2020-0020-RIN-1506-AB47-Requirements-for-Certain-Transactions-Involving-Convertible-Virtual-Currency-or-Digital-Assets-c2.pdf.

¹² See, e.g., Guidance at ¶¶ 34-36.

¹³ Including by excluding central bank-issued digital currencies that the FATF designates as fiat currency (Guidance at ¶ 16). However, the same principles the FATF has for excluding central bank-issued digital currencies (namely that it is already regulated as fiat) should apply to large portions of the broad definition of VASP laid out by the Guidance.

turn, better serves Member States, industry participants, and users by providing clarity to all while remaining consistent with regulatory schemes worldwide.¹⁴

Premature Coverage of Emerging Areas

Further, the FATF attempts to address definitively certain areas of the industry that have only recently garnered attention and instead may be covered appropriately under the existing framework elsewhere, or may not need to be covered at all, as they may represent neither the “financial” activity nor the increased AML/CFT risk the Guidance is designed to address.¹⁵ The Chamber believes that the FATF could, instead, address these areas through continued active engagement with industry, including targeted meetings, roundtables, and other initiatives to develop a strong mutual understanding of this rapidly evolving space. Continued engagement with stakeholders should focus on functional business models and use cases, as well as what regulations have already been proposed or implemented to achieve the goals the FATF seeks through the Guidance.

C. The Definition of VASP Is Overly Broad

The definition of VASP is overly broad,¹⁶ touching nearly all if not all participants in the space in duplicative fashion while deviating from long-standing regulatory principles applied to financial services.¹⁷ While this is a comment the Chamber provided when the VASP Recommendations were being formulated, the proposed interpretations in the Guidance reinforce this overbreadth and, in some cases, worsen it.

1. Merely “Facilitating” VA Activity Should Not Implicate VASP Regulation

a. Including “Facilitation” in the Definition of Virtual Assets Departs from Long-Standing Regulatory Principles

The stated definition of VASP covers any “person” who “conducts” VA exchange, transfer, safekeeping, administration, control, or issuance services.¹⁸ In its interpretation

¹⁴ See also, Heath P. Tarbert, *Rules for Principles and Principles for Rules: Tools for Crafting Sound Financial Regulation*, HARV. BUS. L. REV. (June 15, 2020), at 8, https://www.hblr.org/wpcontent/uploads/sites/18/2020/05/Tarbert_Final_Draft_vFINAL-1.pdf.

¹⁵ See, e.g., Guidance at ¶¶ 56 (decentralized exchanges); 60 (multi-signature wallets); 72-73 (stablecoins).

¹⁶ *Id.* at ¶ 47.

¹⁷ The Chamber previously raised concerns regarding the broad definition of VASP during an earlier consultation on the definition. See Chamber April 2019 letter to the FATF, *supra* note 2 at 2-3 (explaining that the VASP definition incorrectly covers non-financial services, individuals, and businesses who accept payment in VA, and third-party service providers who provide only ancillary services to a VA platform. In addition, the inclusion of “investment” purposes unnecessarily covers far more entities as VASPs than those conducting money transmission.).

¹⁸ Guidance at ¶ 47.

of “person,” however, the FATF explains that a person need only “facilitate” such activity to come within the scope of the VASP definition,¹⁹ a significant expansion of those activities. It is commonly understood that “conducting” an activity entails a principal, active role.²⁰ By contrast, “facilitating” an activity generally involves a lesser role, *e.g.*, assisting or making the activity easier.²¹ It is a long-standing principle that someone must actually conduct money transmission services (*e.g.*, by accepting and transmitting value or operating a system that does so) to be regulated as a money transmitter.²² The FATF’s coverage of “facilitation” marks a radical and unwarranted departure from this principle, requiring an inappropriately wide range of persons to become VASPs.

For example, as interpreted in the Guidance, the first limb of the VASP definition (transfer) would cover any services that “facilitate” the transmission of a virtual asset on behalf of another person.²³ Such an interpretation captures a host of ancillary providers such as self-hosted wallet providers, internet service providers, and even venture capital firms and computer manufacturers. Similarly, a digital asset investment fund using staking services to generate additional tokens for investors (*i.e.*, by staking invested VA) may be “facilitating” the issuance of a VA, which could come within the fifth limb (issuance) of the VASP definition. Because these businesses are not providing money transmission services, they should not be regulated as VASPs.

Notwithstanding these problematic applications, the Guidance explains that “persons that solely engage[] in the operation of a VA network and [who] do not engage in or facilitate any of the activities or operations of a VASP on behalf of their customers (*e.g.*, internet service providers that offer the network infrastructure[]) . . . are not VASPs . . . individual jurisdictions however may choose to extend their AML/CFT regimes to include them as regulated entities.”²⁴ This explanation is self-contradicting: nearly all persons involved in a transaction “engage in or facilitate any of the activities or operations of a VASP” given the breadth of those terms.²⁵

It also directly contradicts the approach of at least one national AML/CFT regulator, the U.S. Treasury Department, which has specified that “suppliers of tools (communications, hardware, or software) that may be utilized in money transmission,

¹⁹ *Id.* at ¶ 50.

²⁰ See Oxford English Dictionary Online, *Conduct* (defined, as relevant here, as “To direct, manage, carry on (a transaction, process, business, institution, legal case, etc.)”), <https://www.oed.com/view/Entry/38619?rskey=1fCBp2&result=3&isAdvanced=false#eid>.

²¹ See Oxford English Dictionary Online, *Facilitate* (defined, as relevant here, as “To make (an action, process, etc.) easy or easier; to promote, help forward . . .”), <https://www.oed.com/view/Entry/67460?redirectedFrom=facilitate#eid>.

²² Under U.S. Treasury Department regulations, a “money transmitter” is a person that provides “money transmission services,” which means “the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means.” 31 CFR § 1010.100(ff).

²³ Guidance at ¶ 53.

²⁴ *Id.* at ¶ 69.

²⁵ *Id.* at ¶ 47(i-v).

like anonymizing software, are engaged in trade and not money transmission.”²⁶ This activities-based approach, focusing on whether a person takes custody over a customer’s assets, has been helpful to businesses who may be involved in the DLT industry but are not engaged as a business in money transmission.²⁷

b. Covering “Facilitation” Is Not Necessary to Address AML/CFT Risks of Decentralized Finance

The FATF’s use of the expansive “facilitation” concept appears motivated by a desire to regulate various parties involved in the emerging DeFi ecosystem as VASPs, including persons who develop and deploy DApps. DeFi presents AML/CFT challenges that the FATF and its Member States must evaluate. However, the FATF’s “facilitation” concept would indiscriminately apply VASP regulation to various DApp software providers, investors, and vendors, among other DeFi actors – those who are clearly not involved in money transmission. Examples in the Guidance demonstrate how far the new VASP definition may reach in the DApp and broader DeFi context:²⁸

- “a person that conducts business development for a DApp may be a VASP when they engage as a business in facilitating [VASP] activities . . .”
- “a party directing the creation and development of the software or platform and launching it for them to provide financial services for profit likely qualifies as a VASP . . .”
- “Launching a service as a business that offers a qualifying function, such as transfer of assets, may qualify an entity as a VASP even if that entity gives up control after launching it . . . Automating a process that has been designed to provide covered services does not relieve the controlling party of obligations.”

The parties in these examples would generally have insufficient control over the resulting operations to comply with core VASP compliance requirements such as customer due diligence or the travel rule, either because they have relinquished it or never had it in the first place. A person who “conducts business development for a DApp” (the first example above), perhaps by placing advertisements for a VASP, would generally have no technical or legal ability to compel persons using the DApp to comply with customer due diligence requirements. Moreover, because law enforcement can

²⁶ Compare with FinCEN, *Application of FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies*, FIN-2019-G001 (May 9, 2019), at 20, <https://www.fincen.gov/sites/default/files/2019-05/FinCEN%20Guidance%20CVC%20FINAL%20508.pdf>.

²⁷ In yet another example, even the Chamber itself may become a VASP. Under the Guidance, a “service that facilitates companies accepting VA as payment would . . . be a VASP.” Guidance at ¶ 70. The Chamber advocates for companies to accept VA as payment (among other things) and is not covered elsewhere by the FATF Recommendations. But the Chamber never takes custody of such companies’ VA and should not be a VASP.

²⁸ Guidance at ¶¶ 57, 68, 75.

already view blockchain transactions and assess them with blockchain analytics tools, the business development person likely is no better placed than law enforcement to monitor whether blockchain transactions conducted through the DApp are suspicious.

Nor would it be appropriate or practical to hold liable, in perpetuity, a developer for a system the developer explicitly does not control.²⁹ To illustrate, nobody would reasonably consider the MoneyGram CEO responsible for ongoing money transmitter obligations after he resigns—even if MoneyGram continues to use new products he or she developed, or if he or she retains a significant amount of MoneyGram stock. This is because personnel who depart a company typically are not held liable for activity of the company that occurs after they left it. But under the Guidance, this far-reaching result is possible. Indeed, the Chamber is unaware of any regulatory regime under which a person remains responsible for regulated activities that others conduct, just because that person had some prior role with respect to the company or technology through which the activity is conducted. If not removed from the Guidance, the “facilitation” concept poses a serious threat to innovation and development beyond the VA and VASP industry, for example, impacting the open source production model.³⁰

For those reasons, the FATF correctly acknowledges that its “facilitation” concept will bring “practical challenges to competent authorities in identifying which entities are VASPs and defining their regulatory perimeter.”³¹ The FATF outlines “a few general questions” that are intended to “help guide the answer,” but the questions are of varying relevance and therefore do not provide useful guidance. For example, a person that merely “possesses . . . data” for a service or “drove the creation” of a service should not be a VASP for the reasons explained above.³² Other questions are somewhat more relevant, such as who can “make decisions affecting operations” or who can “shut down the product or service,”³³ but they still fail to provide a complete and principled test for

²⁹ The FATF’s attempt to construe software development as a VASP activity which incurs permanent risk on the developer does not reflect modern software development, which is frequently based on open source software: Synopsys, the leading provider of auditing services for software companies, in its annual Open Source Security and Risk Analysis report for 2020, noted that open source code is widely used across nearly all industries and was incorporated into 99% of all codebases audited. In fact, open source code comprised nearly 70% of all code in those audited code bases. Synopsys, *Open Source Security and Risk Analysis Report* (2020), at 8, <https://www.synopsys.com/software-integrity/resources/analyst-reports/2020-open-source-security-risk-analysis.html>.

³⁰ See, e.g., Raina Haque, Rodrigo Seira Silva-Herzog, Brent A. Plummer & Nelson Rosario, *Blockchain Development and Fiduciary Duty*, 2.2 STAN. J. OF BLOCKCHAIN LAW & POL’Y 139 (2019) (discussing the various incentives and obligations of blockchain developers and suggesting that labeling public blockchain protocol developers as fiduciaries would be impractical and have other negative effects including potentially destroying the open source production model), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3338270.

³¹ Guidance at ¶ 77.

³² *Id.*

³³ *Id.*

addressing the core issue: whether a person has sufficient responsibility to be regulated as a VASP.

Such a test is articulated elsewhere in the Guidance, however. Specifically, the Guidance explains that “the owner/operator(s)” of a DApp “likely fall under the definition of a VASP, as they are conducting the exchange or transfer of VAs as a business on behalf of a customer.”³⁴ Financial Intelligence Units (“FIUs”) such as FinCEN have already been using this “owner/operator” test in their own guidance related to mechanical agencies ranging from automatic teller machines to DApps.³⁵ As stated in relevant FinCEN guidance, when “DApps perform money transmission, the definition of money transmitter will apply to the DApp, the owners/operators of the DApp, or both.”³⁶ The Chamber is not aware of any evidence indicating (and the Guidance points to none) that this “owner/operator” test has provided insufficient regulatory coverage for DApps.

Truly decentralized financial systems present various challenges to AML/CFT as well as other regulatory frameworks. While we appreciate the gravity of these considerations, it is not appropriate to corral every actor in this space into money services business obligations. We recommend further evaluation of this space and the organizations developing in it to determine if money transmission is an appropriate framework or perhaps some other policy, and how and to what extent blockchain analytics and other tools are available to mitigate risk and/or allow law enforcement to obtain information necessary to track and prosecute any illicit activity.

2. Ability to “Use” VA Does Not Constitute Control of VA

The definitions of “safekeeping” and “administration” are similarly expansive. The FATF explains that the general act of “provid[ing] or facilitat[ing] control of assets” would constitute safekeeping or administration, that control “should be understood as the ability to hold, trade, transfer, spend, or destroy the VA,” and that “[p]arties that can use a VA or change its disposition have control of it.”³⁷ Covering any “use” of a VA broadens “control” (and by consequence, “safekeeping” and “administration”) beyond any reasonable conception of those terms.

To begin, it implies that multiple parties may routinely “control” an asset at the same time, creating confusion as to which parties in a VA arrangement are responsible for VASP compliance.³⁸ In the case of multi-signature wallets, for example, an entity

³⁴ *Id.* at ¶ 57.

³⁵ FinCEN 2019 Guidance, *supra* note 26 at 17-18.

³⁶ *Id.*

³⁷ Guidance at ¶¶ 61-63.

³⁸ The prior version of the Guidance contained an “exclusive and independent control” concept in its interpretation of “safekeeping” and “administration” which should not have been removed. See Guidance at p. 32 (deleted text in redline). Even if this change were warranted, which it is not, it separately demonstrates the rapid and unsustainable manner in which the FATF is updating significant regulatory

holding one key in a multi-signature storage arrangement would (but should not) be a VASP merely due to the (backup) “control” it has over the virtual asset. The holding of a backup key, which is not used unilaterally and is not used to keep other parties from transacting, should be outside the scope of VASP activity. If the backup key holder were a service provider to a custodian VASP, the Guidance’s overbreadth generates ambiguity as to which compliance obligations the service provider or custodian must fulfill.

In the United States, for example, FinCEN has articulated a “custodial vs. non-custodial” approach to control that helps avoid these problems. Following that approach, “[i]f the multiple-signature wallet provider restricts its role to creating un-hosted wallets that require adding a second authorization key to the wallet owner’s private key in order to validate and complete transactions, the provider is not a money transmitter because it does not accept and transmit value.”³⁹ This test of accepting and transmitting value has been a key resource to the industry as it develops and adopts appropriate compliance programs.

3. Duplication with Other Regulatory Regimes is Unnecessary and Confusing

The FATF’s expansive definition of VASP further captures a significant number of regulated entities, which may vary from jurisdiction to jurisdiction. While the Guidance does not apply to persons “covered elsewhere under the Recommendations[,]” the FATF acknowledges the potential for overlap and encourages jurisdictions to apply the definition that provides more thorough regulatory and supervisory coverage.”⁴⁰ Given the expansive reach of the Guidance as proposed, it is unclear what, if any, other coverage would be more expansive.

For example, it appears that credit card networks could come within the VASP definition if they settle virtual assets. In the United States, these entities are already regulated as operators of credit card systems.⁴¹ Yet the proposed Guidance would require an unnecessary analysis of whether the VASP framework provides a “more thorough regulatory and supervisory coverage” than the well-established and tailored rules for operators of credit card systems. In addition, virtual asset transactions involving these businesses would already involve other obliged entities, such as banks, VASPs, and other financial institutions.

The Guidance sets forth a “conscious choice by the FATF” which “envision[s] very few VA arrangements will form and operate without a VASP involved at some stage.”⁴² In

concepts. The Chamber urges the FATF to consider the pace at which industry participants can feasibly handle compliance with its changed recommendations.

³⁹ FinCEN 2019 Guidance, *supra* note 26 at 17.

⁴⁰ Guidance at ¶ 49.

⁴¹ See U.S. Code of Federal Regulations, Title 31, Chapter X, Part 1028.

⁴² Guidance at ¶ 76.

seeking to hold numerous entities accountable in all instances across the space, as these examples show, the FATF creates a confusing and duplicative framework of regulation for VASPs. The FATF's approach is contrary to the stated intent of the most-recent sweeping AML reform in the United States, the Anti-Money Laundering Act of 2020 (the "AMLA"), which seeks to codify a more effective and efficient risk-based approach to AML/CFT compliance regimes, to streamline low-value processes and eliminate obsolete regulations, and to mitigate the effects of de-risking.⁴³ The FATF's approach is also contrary to its own stated goal of mitigating unintended consequences of its AML/CFT proposals, as discussed in more detail below.⁴⁴

Member States are continuing to develop and determine the regulatory perimeter for VA activities, which requires coordination within and between jurisdictions and incorporates extensive public consultation. The FATF's revised definition of VASP would disrupt and add confusion to these processes, not just for the private parties subject to regulation, but also for Member State regulators who implement FATF Recommendations and Guidance.

4. Applying Correspondent Banking Principles Imposes an Unwarranted Level of Compliance Burden on VASPs

While the travel rule seeks to treat all VA transfers as "wire transfers," the Guidance also suggests that correspondent banking measures should apply to all "ongoing" service provider relationships in general.⁴⁵ Correspondent banking poses unique considerations, such as relationships that provide access to the financial services system in another country. Treating all VA transactions as correspondent "banking" relationships is an unwarranted expansion of obligations in a traditional non-bank money services business sector. It also ignores a fundamental difference between VA transactions and correspondent banking transactions, in that VASPs may settle VA transactions bilaterally without one VASP needing to establish and maintain an ongoing account relationship for the other (unlike the correspondent accounts that domestic banks maintain for foreign banks in correspondent banking). Moreover, treatment as a correspondent banking relationship makes little sense when considering the expansive interpretation of the VASP definition to include those who may not have any involvement in a "wire transfer."

5. Negative Cybersecurity, Privacy, and Tax Implications Will Arise from the FATF's Broad VASP Definition

The FATF's all-inclusive "regulatory perimeter" is overly burdensome on developing stakeholders because it imposes onerous data, tracking, and custodial-like

⁴³ See Section 6002 of the Division F, H.R.6395 - U.S. National Defense Authorization Act for Fiscal Year 2021. "The purpose of [the AMLA] is to reinforce that the anti-money laundering and countering the financing of terrorism policies, procedures, and controls of financial institutions shall be risk-based."

⁴⁴ See, e.g., *infra* n. 68 and accompanying text.

⁴⁵ Guidance at ¶ 147.

requirements on actors not necessarily involved in the provision of financial services, discouraging innovation. Designation as a VASP for many entities not directly involved in financial services will have minimal (or no) regulatory benefit and instead create negative unintended consequences, such as:

- raising the cost of compliance without clearly articulating through data analysis areas of risk or benefit to law enforcement;
- creating unnecessary privacy and cybersecurity risks to end-users by forcing the collection and transmission of personal data to and from entities who would not typically be required to manage such a responsibility; and
- triggering other obligations under other global regulatory regimes.⁴⁶ Insofar as tax reporting or other obligations may be incurred by VASPs, many of the entities that would be captured in the expansive interpretation of the Guidance (e.g., vendors, service providers, and other “facilitators”) should not be subject to information reporting requirements.⁴⁷

D. The Definition of VA Goes Beyond Currencies Typically Captured by Money Services Business Regulations

In addition to “VASP,” the term “virtual asset” itself is interpreted in an overly broad fashion, as it covers any digital transferable asset that is “capable” of use for payment or investment purposes, whether financial or not financial.⁴⁸ Although the Guidance explains that the FATF “does not seek to capture the types of closed-loop items that are non-transferable, non-exchangeable, and non-fungible,” this interpretation does not reasonably limit the kinds of assets constituting VA to those typically covered as money services businesses. Rather, VA would cover a variety of non-financial assets that may be transferable due to their digital nature but often pose minimal AML/CFT risk, as the Chamber has previously explained.⁴⁹ Such uses may include fractional property interests, for example, as well as NFTs and event tickets, to name a few.

AML/CFT regulation involving a VASP, with its attendant customer due diligence and wire transfer obligations, is typically and properly limited to its function as a medium of exchange akin to a currency. For example, the United States uses the term “convertible virtual currency” to describe “a medium of exchange that operates like a currency in

⁴⁶ See, e.g., the use of FinCEN’s definition of “convertible virtual currency” by the United States Internal Revenue Service. Internal Revenue Service, “Notice 2014-21,” at 1, <https://www.irs.gov/pub/irs-drop/n-14-21.pdf>.

⁴⁷ See *supra* Section C.1.

⁴⁸ Guidance at ¶ 38b.

⁴⁹ See Chamber April 2019 letter to the FATF, *supra* note 2 at 2 (explaining the broad definition would cover a variety of non-financial assets, like game tokens).

some environments but does not have all the attributes of real currency. In particular, virtual currency does not have legal tender status in any jurisdiction.”⁵⁰

While the Guidance attempts to carve out certain non-fungible items from the scope, it states that these are only excluded when not sold “onward in a secondary market outside of the closed-loop system.”⁵¹ Blockchains and DLT enable the tokenization of a wide spectrum of items – this tokenization enables trading in a secondary market. The Guidance is expressly designed to capture all types of VA, even what it identifies as NFTs excluded from the definition, because NFTs can be traded in secondary markets. Such secondary markets may already be subject to money services business regulation (and AML/CFT obligations) if activities they conduct trigger such regulation, such as accepting and transmitting fiat or virtual currency that customers use to purchase NFTs. But the exchange or purchase of NFTs, taken alone, should not constitute VASP activity.

If the FATF is concerned with non-financial uses of VA, it should address those through a separate process using a risk-based approach tailored to the specific type of asset represented by the NFT.

E. The Guidance Incorrectly Assumes That All Peer-to-Peer Transactions Are High Risk

Throughout the Guidance, the FATF’s interpretations treat P2P transactions as inherently high risk. For example, the Guidance explains that VASPs should “consider the extent to which their customers may engage, or are involved, in P2P activity” due to their “heightened risk” potential, while offering no evidence or basis for this assertion.⁵² The Guidance then provides a “non-exhaustive list of options to mitigate the supposed risks posed by P2P transactions at a national level if the ML/TF risks are unacceptably high.”⁵³ These options range from enhanced controls on P2P activity to an outright prohibition on VASPs allowing transactions to self-hosted wallets (which could, in turn, be used for P2P transfers).⁵⁴

Regulatory control over storage of a virtual asset in a self-hosted wallet is the functional equivalent to restricting the holding of cash in one’s pocket or handbag—an invasive and overly burdensome maneuver that will have the effect of displacing, rather than

⁵⁰ FinCEN, *Application of FinCEN’s Regulations to Persons Administering, Exchanging, or Using Virtual Currencies*, FIN-2013-G001 (Mar. 18, 2013), <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf>.

⁵¹ Guidance at ¶ 70.

⁵² Guidance at ¶ 35.

⁵³ *Id.* at ¶ 91.

⁵⁴ *Id.*

extinguishing, illicit transactions. This sweeping control would be inconsistent with the regulation of fiat currency as well as current standards for regulation of virtual assets.⁵⁵

In practice, the world is rapidly moving toward comprehensive digital immersion. As a matter of individual liberty, consumers should (with only limited exceptions) be allowed to retain control and privacy over the digital bearer assets that they wish to self-custody and use, as they currently do with cash.⁵⁶ In fact, digital wallets, as with traditional wallets, can hold other unique and valuable information such as personal identification.

Indeed, the draft Guidance will result in ordinary commercial transactions being brought within the purview of AML/CFT regulations, something never intended and in conflict with the first principles on which AML/CFT regulation is founded. For example, P2P transactions can involve a merchant on one side and its customer on the other. Moreover, merchants will “facilitate” transactions in VAs under the broad scope of the new language. Most critically, merchants will sell VAs to customers that are not financial instruments. All of these examples will be ordinary commerce on the internet now that blockchain makes digital uniqueness and the transfer of digital items possible. And yet they will be regulated, without justification, imposing a much more burdensome regime than those of fiat regulations focusing on financial services intermediaries who transact in cash, a necessarily peer to peer item.

Moreover, some proposed AML/CFT measures related to P2P activity, such as requiring VASPs to file transaction reports on VA transfers to self-hosted wallets,⁵⁷ are unnecessary and overly burdensome. This is because suspicious activity reporting requirements, which already apply, should provide regulators with sufficient information regarding the transfers that pose potential AML/CFT concern. It further ignores the core benefits of the underlying technology to enable law enforcement to directly identify risk among transactions on a publicly available blockchain.

F. The FATF Should Support Efforts to Develop and Comply with the Travel Rule Before Adding New Interpretations

Considering the emerging state of the technology, national rulemaking efforts, and the diligence with which private entities worldwide are moving rapidly to comply with the

⁵⁵ See FinCEN 2019 Guidance, *supra* note 26 at 16 (“In so far as the person conducting a transaction through the unhosted wallet is doing so to purchase goods or services on the user’s own behalf, they are not a money transmitter.”).

⁵⁶ See Rodrigo Coelho, Jonathan Fishman and Denise Garcia Ocampo, *FSI Insights on policy implementation No 31*, BANK FOR INTERNATIONAL SETTLEMENTS (“BIS”) (April 2021), at 2, <https://www.bis.org/fsi/publ/insights31.pdf> (identifying jurisdictions that “consider [P2P] transactions as the equivalent of cash exchange and believe the risk they pose falls within the risk tolerance of the FATF standards and national regulation,” noting further that “[t]he availability of ledger analytic tools to track these assets also partially tempers the concern among some authorities regarding P2P transactions as it suggests transparency is achievable.”).

⁵⁷ Guidance at ¶ 91(a).

travel rule, the FATF should focus on encouraging and completing this work, rather than adding more complexity and unwarranted burdens.

In the Guidance, the FATF explains that its travel rule results from applying wire transfer requirements (from FATF Recommendation 16) in the VA context.⁵⁸ But the Guidance proceeds to impose certain requirements on VA that are more onerous than those applicable to wire transfers, without providing a rationale for the difference.⁵⁹ Such requirements include:

- the treatment of all VA transfers as “cross-border” (which will likely be duplicative and less likely to identify any new or additional risk indicators);⁶⁰
- the prohibition of “*post facto*” submission of the required information (contrary to the current version of the U.S. Travel Rule Working Group’s solution);⁶¹
- recommendations that countries “consider [self-hosted wallet transactions] as higher risk transactions that require enhanced scrutiny and limitations” without regard to thresholds, de-risking, and financial exclusion considerations;⁶² and
- the application of the requirements to transactions not just between VASPs, but between VASPs and self-hosted wallets.⁶³

The Guidance also sets forth a novel and impractical view of how the travel rule applies to VASP transactions between VASPs and self-hosted wallets.⁶⁴ In particular, the Guidance places VASPs in a bind by requiring collection and retention of counterparty information for all inbound transactions from self-hosted wallets, even those for which it receives no prior notice and has no control over the originator.⁶⁵ The VASP may be unable to collect the required information in a number of situations such as: (1) the VASP’s customer declines to provide the necessary information, (2) the VASP’s customer doesn’t know the name or physical address of the originator (which may happen in certain transactions such as token drops), or (3) VA is received from a smart contract or similar decentralized application that lacks a single identifiable owner (such as protocols jointly owned by thousands of individuals holding governance tokens). In such situations, VASPs could be penalized for non-compliance even though they have

⁵⁸ Guidance at ¶ 155.

⁵⁹ See FATF, *The FATF Recommendations*, (Oct. 2020), at 17, <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

⁶⁰ Guidance at ¶ 156; The Wolfsberg Group, *Wolfsberg Guidance on Sanctions Screening* (2019), at 8, <https://www.wolfsbergprinciples.com/sites/default/files/wb/pdfs/Wolfsberg%20Guidance%20on%20Sanctions%20Screening.pdf>.

⁶¹ Guidance at ¶ 163.

⁶² *Id.* at ¶ 179.

⁶³ *Id.* at ¶¶ 156, 179-180.

⁶⁴ *Id.* at ¶ 156.

⁶⁵ *Id.* at ¶¶ 179-180.

no control over the situation and could not reasonably be expected to have prevented such an outcome.

Practical concerns regarding travel rule compliance arise, as well, when taking into account the sunrise issue (*i.e.*, the period of time when countries and industry are coming on-line with compliance requirements and solutions, respectively). These include uneven implementation of regulations globally which will result in some VASPs having travel rule obligations when other counterparty VASPs may not. In that case, a VASP may be obligated to transfer personally identifiable information of its customers to VASPs not subject to the travel rule, compromising its customers' privacy and security.⁶⁶

More broadly, by attempting to cover DeFi, multi-signature software, stablecoins, NFTs, software providers, and others, the Guidance increases the scope of items that are rapidly evolving, even at the time of writing or when the Guidance may ultimately be adopted this summer. Consistent with the Chamber's recommendation that regulation must have an empirical basis, there is not an adequate body of information as to what regulatory gaps exist in current and proposed frameworks, if any, to address these areas. Imposing additional considerations—particularly ones that are technology-focused—will needlessly stifle innovation and become quickly outdated. Early U.K. regulations on self-propelled vehicles, for example, imposed severe and tech-focused requirements (*e.g.*, speed limits of 2 mph in towns) that “delayed advances in automobile development by decades.”⁶⁷ Instead, regulation of activities based on new technology calls for a principles-based approach to avoid unnecessarily delaying or harming advances in innovation.

Instead of issuing supplemental guidance attempting to capture every new technological innovation within just a few months (from the time of this Consultation until June), the Chamber suggests the FATF maintain a principles - and activities-based approach and encourage completion of global regulatory implementation and the development of private-sector solutions to facilitate compliance with that rule as a primary objective. This would include active monitoring and discussion of the developing ecosystem to determine whether, based on the actual risks presented, additional guidance or other considerations regarding these areas is necessary. Issuing supplemental Guidance expanding the universe of industries and products could stymie what is already a complex process.

⁶⁶ See 2021 BIS Report, *supra* note 56 at 2 (“A number of jurisdictions question whether they can reasonably impose the travel rule” until “there are technological solutions available that would make compliance less onerous, as SWIFT does for correspondent banking. Surveyed authorities also raised concerns that if these technological solutions were not commonly accepted or interoperable, compliance with the travel rule would remain burdensome.”).

⁶⁷ See William D. Eggers *et al.*, *The Future of Regulation*, DELOITTE INSIGHTS (June 2018), <https://www2.deloitte.com/us/en/insights/industry/public-sector/future-of-regulation/regulating-emerging-technology.html>.

G. Stablecoins Do Not Require Distinct Treatment Under the Guidance

Contrary to established principles, the Guidance's approach to stablecoins is not rooted in a technology-neutral and activity-based approach. Stablecoins are and should be treated as another form of virtual asset, without an independent set of AML/CFT controls unless such current controls are insufficient. As with VA generally, only those interacting with stablecoins as VASPs (or as other regulated institutions) should be regulated as such for AML/CFT purposes. The Guidance should not put forth new or supplementary, tech-focused, regulatory controls or considerations on stablecoins, let alone without a sufficient body of data as to how current initiatives and legacy regulations serve to address the FATF's concerns. Those that engage in AML/CFT regulated activities involving stablecoins should be regulated by an activity-focused, principles- and risk-based approach.

Stablecoins may resemble and may be no different than other virtual assets or other existing financial instruments constituting currencies, commodities, or securities. As such, the Chamber recommends that the term "stablecoin" should not indicate any particular type of AML/CFT regulatory treatment and, instead, questions about the structure, issuance, governance, and use of the token, among other factors, should determine whether it be treated and regulated as a currency, commodity, security, or some other financial instrument, with a clear distinction as to what are AML/CFT regulatory considerations or *prudential* purposes.

H. The Guidance Will Negatively Impact Financial Inclusion Efforts

Quite often, regulatory changes have exacerbated rather than ameliorated the problem of financial inclusion. The Chamber believes the Guidance could have a significant impact on financial inclusion that should be specifically considered and addressed before implementing additional Guidance impacting DLT and related technologies that could serve to alleviate the acute needs of the unbanked and underbanked. The FATF has itself acknowledged both its "commit[ment] to financial inclusion" and the importance of mitigating unintended and negative consequences of AML/CFT measures on financial inclusion.⁶⁸

More than 1.6 billion adults worldwide are either unbanked or underbanked and access to financial services has only become more difficult during the current COVID-19 pandemic.⁶⁹ Unfortunately, regulatory changes have all too often led to financial exclusion. The Chamber also notes that the issue of financial inclusion is closely tied to

⁶⁸ FATF, *FATF Guidance on AML/CFT measures and financial inclusion, with a supplement on customer due diligence* (November 2017), at 2, <https://www.fatf-gafi.org/publications/fatfgeneral/documents/financial-inclusion-cdd-2017.html>; FATF, *Mitigating the Unintended Consequences of the FATF Standards* (February 2021), <http://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html>.

⁶⁹ Luca Ventura, *World's Most Unbanked Countries 2021*, GLOBAL FINANCE (February 2021), <https://www.gfmag.com/global-data/economic-data/worlds-most-unbanked-countries>.

fighting illicit finance, as individuals who are excluded from the regulated financial sector are likely to turn to unregulated or offshore providers.⁷⁰

A desire for financial inclusion has long been at the center of the DLT industry and promoting equity in financial services is a core goal of many Chamber members. The Chamber is encouraged that, in the United States, Secretary Yellen seems to share this important goal. As she recently said, the “issues of diversity, inclusion and racial equity are incredibly important, particularly at this moment in history when the pandemic has taken an unbelievable and disproportionate toll on low-income workers and especially people of color.”⁷¹ The Chamber was similarly pleased to see the U.S. Congress require the U.S. Treasury Department to review “the most appropriate ways to promote financial inclusion and address the adverse consequences of financial institutions de-risking.”⁷² The FATF has in the past preferred closer public and private sector dialogue and coordination in order to mitigate de-risking of lower income financial services customers by innovative technology platforms that provided more accessible means to financial services.⁷³ While we encourage the United States and countries globally to prioritize this important issue, we worry the Guidance will have the opposite effect by reducing financial inclusion and making financial services harder to access. Too many people, particularly those from communities of color, as well as lower income and immigrant communities, lack access to basic financial services.

For example, a 2019 report from the U.S. Federal Deposit Insurance Corporation (“FDIC”) finds that 5.4% of all American households are completely unbanked, meaning that no one in the household had a checking or savings account at a bank or credit union.⁷⁴ Among Black households that number was even higher at 13.8% and among Hispanic households it was 12.2%.⁷⁵ Survey participants cited a number of factors as a reason for not having a bank account, including not having enough money to meet minimum balance requirements (48.9%), a lack of trust in banks (36.3%), a desire to retain privacy (36.0%), high account fees (34.2%), unpredictable account fees (31.3%), personal identification, credit, or former bank account problems (20.5%), banks not offering needed products and services (19.6%), inconvenient bank locations (14.1%), and inconvenient bank hours (13.0%), among others.⁷⁶

⁷⁰ Kahler *et al.*, *Global Governance to Combat Illicit Financial Flows*, COUNCIL ON FOREIGN RELATIONS (October 2018), at 6, <https://www.cfr.org/report/global-governance-combat-illicit-financial-flows>.

⁷¹ Finance Committee Questions for the Record: Hearing on the Nomination of Dr. Janet Yellen Before the S. Comm. On Fin., 117th Cong. 34 (2021) (Responses by Dr. Yellen).

⁷² National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, at § 6204.

⁷³ FATF, *Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion* (February 2013), https://www.fatf-gafi.org/media/fatf/documents/reports/AML_CFT_Measures_and_Financial_Inclusion_2013.pdf.

⁷⁴ Federal Deposit Insurance Corp., *How America Banks: Household Use of Banking and Financial Services* (2020), at 1, <https://www.fdic.gov/analysis/household-survey/2019execsum.pdf>.

⁷⁵ *Id.* at 2.

⁷⁶ *Id.* at 3.

The problem is even worse globally with an estimated 1.7 billion adults unbanked according to the World Bank.⁷⁷ Lack of access to traditional bank accounts can have a variety of negative consequences, including difficulty accessing credit, difficulty obtaining a loan, and difficulty getting paid and making payments, to name but a few.

The DLT industry has long been a leader in expanding access to financial services in the United States and around the world. Self-hosted wallets play a critical role in that expansion as they allow users to send and receive funds with just a smartphone, which in turn opens an array of additional financial services. The Chamber believes that DLT and, in particular, self-hosted wallets, can be a critical tool in expanding access to financial services and reducing poverty at home and abroad, while maintaining a public ledger of the transfers.

Indeed, DLT has the potential to solve or ameliorate many of the concerns cited by unbanked persons in the FDIC study, including high or unpredictable fees, a desire to retain privacy, lack of trust in traditional financial institutions, and inconvenient bank locations and hours. DLT improves on fiat P2P transactions by being more secure and transparent than activities undertaken in cash. The convenience of P2P interaction and the efficiencies of electronic payments are combined with new risk controls associated with pseudonymous transactions to mitigate the centralized risk of reliance on a specific financial intermediary. Self-hosted wallets put the consumer in control, enabling them to take advantage of transactions and financial services that have been denied to them in the traditional fiat context. Given the critical role that DLT and self-hosted wallets can play in promoting financial inclusion, measures that disincentivize or stigmatize use of self-hosted wallets should be avoided. For the reasons discussed throughout this letter and our prior letter, we believe the Guidance may lead to significant derisking by MSBs and banks, reducing the ability of self-hosted wallet holders to access or be involved in DLT-related financial services.

The Chamber seeks to encourage, rather than discourage, inclusive participation in the regulated financial sector. Frictionless access to inexpensive money transfer services and payment capabilities offered by convertible virtual currencies are increasingly being used by segments of both the domestic and global economy that struggle to obtain or maintain access to traditional financial services. Notably, such services are actively being pursued to support individuals and small businesses, particularly those that have been previously and historically underserved or excluded from the traditional financial marketplace, and particularly hard hit by the COVID-19 pandemic.

⁷⁷ The World Bank, *The Global Findex Database* (2017), at 35, https://globalfindex.worldbank.org/sites/globalfindex/files/chapters/2017%20Findex%20full%20report_chapter2.pdf.

I. The Guidance Seeks to Broadly Solve a Host of Issues Without Sufficient Contemplation or Input from Stakeholders

The FATF faces the difficult task of reconciling international practices and regulations with a rapidly evolving technical frontier while balancing the joint goals of financial inclusion and global financial system integrity.⁷⁸ Numerous issues raised do not have easy solutions, such as which parties (if any) should be responsible in a decentralized network and how traditional anti-money laundering principles might continue to apply in these networks. But the Guidance should not seek to cloak the entire ecosystem in regulation designed for financial services providers, particularly where the technology itself may abrogate the need for many historic regulatory controls. As the Bank for International Settlements has recognized, national authorities should be able to “make more intensive use of data and technological tools like blockchain analytics to improve the effectiveness of their supervisory frameworks.”⁷⁹

In addition to increasing financial inclusion and reducing transactional inefficiencies, DLT allows transparency into transactions across the network, providing a distinct departure from and advantage over cash transactions in regard to tracking illicit activity. The Guidance in part recognizes this transition by acknowledging the existence of DLT analytics. But the Guidance does not take into account any of DLT’s distinct advantages or attempt to determine what regulatory obligations might be lessened or modified as a result.

For example, DLT enables law enforcement and financial intelligence units to have ready access to much of the information they sought to obtain from financial institutions decades ago. Within a traditional, non-digital environment, only the financial institution itself had knowledge of transactions that exceeded certain thresholds or intersected with higher risk accounts. DLT allows law enforcement to see this information itself, in real time, without the need to ask anyone else for that information. One distinct benefit of this transparency is a fundamental reversal of the historic push-pull relationship between obliged entities and regulators, where institutions previously had to push information to regulatory bodies. Now, a suspicious transaction can be independently identified by regulators, allowing the state to subpoena additional information as necessary. This “pulling” approach significantly reduces the number of reporting requirements necessary to achieve the goals of surveillance historically met by institutions “pushing” information to regulators.

If the FATF’s goal is to ensure that financial networks are properly able to track, control, and prevent illicit activity, that goal is best served by acknowledging that DLT and decentralized finance will in some ways enhance AML/CFT compliance, and perhaps require a wholly renewed and adapted regulatory structure, not a mere revision of definitions to capture new technology. In some instances, current controls are likely

⁷⁸ See generally the FATF 2017 guidance on financial inclusion, *supra* note 68.

⁷⁹ See 2021 BIS Report, *supra* note 56 at 2.

sufficient. In other instances, where current controls are *not* sufficient, simply widening the net of those current controls will only serve to create exclusionary, reactive regulation that discourages financial inclusion and creates numerous unintended consequences.

To be clear, the Chamber believes that the FATF and Member States have properly adapted traditional AML/CFT regulatory principles to certain VA activities, and that these efforts have helped foster mainstream VA adoption by deterring bad actors and protecting good actors. But the lesson is not that VA will continue to benefit from more and more stringent regulation, as the Guidance assumes in its new attempts to address DeFi. Rather, any new regulation must be principled and tailored appropriately. At bottom, regulatory bodies must work with stakeholders to understand the implications of these technological sea changes and craft law that acknowledges the substantial ways this technology necessitates or *allows* deviation from historic approaches, rather than simply stretching current controls to find ways in which novel technology could fall under any particular regulatory scheme.

J. Recommendations

To address the concerns discussed in this letter, the Chamber recommends that the FATF:

Provide clarity on the role of the Guidance. The Guidance should be held to the same standards of precision and accuracy as the FATF Recommendations. The weight that the Guidance is given by the FATF during assessments should be clearly stated in the document so that Member States are informed clearly of their obligations.

Address non-financial uses of VA in a separate process. If the FATF is concerned with non-financial uses of VA, it should address those through a separate process using a risk-based approach tailored to the specific type of asset represented by the NFT.

Remove “facilitation” concepts from the definition of “person.” To avoid an overly broad and impractical definition of VASP, the Chamber encourages the FATF to revise its interpretation of “person” so that a person must conduct covered VA activity, and not merely facilitate it, to be a VASP. Specifically, we recommend that paragraph 50 of the Guidance be deleted and replaced with the following: “The word ‘person’ in the definition refers to the entity that conducts the service that performs the transaction.” “Facilitation” captures a host of ancillary VA service providers and users such as self-hosted wallet providers, internet service providers, and even computer manufacturers. Because these entities do not actually handle customer VA, it is inappropriate and unnecessary to impose AML/CFT requirements on them in addition to other obliged entities.

Focus on an “owner/operator” test for DApps. The FATF should use the more appropriate “owner/operator” test for DApps in revised Guidance (not “facilitation”).

Specifically, we recommend that paragraph 57 of the Guidance be deleted and replaced with the following: “A DApp itself (i.e., the software program) is not a VASP under the FATF Standards, as the Standards do not apply to underlying software or technology (see below). However, entities involved with the DApp may be VASPs under the FATF definition if they are acting as the owner/operator(s) of the DApp. In general, a person should have the unilateral right or ability to control a DApp’s operations to be considered the owner/operator of a DApp.” We also recommend deleting paragraph 77, which contains interpretative guidance in conflict with the “owner/operator” test.

Adopt a more precise, custody-focused definition of “control.” To address the definitional overbreadth of the Guidance, the Chamber strongly supports a simple custodial versus non-custodial distinction as being the correct prism through which to conduct an analysis of control, particularly as to hosted and self-hosted wallets.⁸⁰ To do this, the Chamber recommends that the FATF use the concept adopted by FinCEN, which looks to whether a person has “total independent control” over VA.⁸¹ This definition captures situations where a VA owner has given sufficient power over the VA to another person for the other person to be acting as a VASP. By incorporating this custodial/non-custodial concept of control, the FATF’s guidance would better align with long-standing approaches to money services business regulation globally.⁸²

Focus on supporting implementation of the travel rule by governments and the private sector. The Chamber believes that it is important for the FATF to prioritize completion of global regulatory implementation (as has been underway for several years) and the development of private-sector solutions to facilitate compliance with the travel rule. New and expansive interpretations regarding the travel rule change the playing field, including, for example, suggestions that Member States may expand the travel rule to include transfers between financial institutions and self-hosted wallets.⁸³ Accordingly, the Chamber recommends that no new interpretations regarding the scope of the travel rule be included in the Guidance until progress is made on current efforts to implement and comply with the travel rule, which are proceeding at a remarkable pace.

Refrain from imposing requirements on new, rapidly evolving areas that require additional analysis, understanding, and engagement. The Chamber further recommends that the FATF continue and expand engagement with stakeholders with respect to emerging DLT technologies (including stablecoins, decentralized finance, and NFTs) to determine whether and to what extent: (1) such technologies are already included in existing Recommendations, and (2) they pose sufficiently new or different AML/CFT risk to warrant specific treatment in the Guidance. These are rapidly

⁸⁰ See *Comments of Chamber of Digital Commerce to FinCEN Guidance: FIN-2019-G001* (November 26, 2019), at 3, <https://digitalchamber.org/wp-content/uploads/2019/12/Chamber-of-Digital-Commerce-Comment-Letter-to-FinCEN-Guidance1.pdf>.

⁸¹ FinCEN 2019 Guidance, *supra* note 26 at 16.

⁸² The Guidance previously included a similar concept by its description of “exclusive and independent” control of smart contracts and private keys. Guidance at p. 32 (deleted text in redline).

⁸³ *Id.* at ¶¶ 156, 179-180.

developing areas of DLT; regulation of those areas at this time may be premature, will be quickly outdated, and may frustrate or foreclose entire areas of transformative innovation unnecessarily. As such, the Chamber urges the FATF to convene discussions with public and private parties across the spectrum of DLT to achieve, where possible, mutual understanding on key issues in the Guidance. The Chamber is happy to participate in this endeavor. These discussions should not only include short updates, but back-and-forth discussion of concerns and mitigators to aid adoption and compliance.

Continue the FATF's commitment to financial inclusion. As mentioned above, the FATF sets forth a commitment to financial inclusion, yet the Guidance has the ultimate effect of recommending (at times directly) practices that will discourage, rather than encourage, financial inclusion. The Guidance should specifically explain how the FATF's commitment to financial inclusion is met by its recommendations.

* * *

We appreciate the opportunity to offer comments and would be pleased to provide further information to support the FATF's work.

Sincerely,



Amy Davine Kim
Chief Policy Officer