EBA-Op-2016-14

11 August 2016

Opinion of the European Banking Authority on the EU Commission's proposal to bring Virtual Currencies into the scope of Directive (EU) 2015/849 (4AMLD)

Introduction

1. In July 2014, the EBA published its *Opinion on Virtual Currencies*.[1] The Opinion was addressed to the EU Council, Parliament and Commission, in fulfillment of the EBA's mandate in Article 9 of its founding Regulation for the EBA to "monitor new and existing financial activities", "[…] adopt guidelines and recommendations with a view to promoting the safety and soundness of markets and convergence of regulatory practice" and "achieve a coordinated approach to the regulatory and supervisory treatment of new or innovative financial activities and provide advice […] to present to the European Parliament, the Council and the Commission".[2]

2. In its 2014 Opinion, the EBA identified the potential benefits and risks associated with Virtual Currencies (VC), including risks to consumers and to regulators' objectives on fighting money laundering, financial crime and terrorist financing. The EBA concluded at the time that the risks could be mitigated, and the potential benefits harnessed, through a comprehensive regulatory regime specific to virtual currencies.

3. Recognising that the creation of such a regime would take considerable time, the EBA also recommended a number of immediate measures that could be taken in the short-term and that were designed to mitigate the greatest and most urgent risks. These included a recommendation to national authorities to discourage regulated financial institutions to buy,

[1] See http://www.eba.europa.eu/-/eba-proposes-potential-regulatory-regime-for-virtual-currencies-but-also-advises-that-financial-institutions-should-not-buy-hold-or-sell-them-whilst-n

[2] See http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32010R1093&from=EN

hold or sell virtual currencies, thus creating a wall between the regulated financial services sector and the VC sector. Importantly, they also included a recommendation to EU legislators to bring market participants at the direct interface between conventional 'fiat' currencies and virtual currencies, such as virtual currency exchanges, within the scope of the EU anti-money laundering and countering the financing of terrorism (AML/CFT) Directive, which was being amended at the time.

4. Following the completion of the negotiations concerning the new directive in the following year, the directive (by then issued as Directive (EU) 2015/849, or '4AMLD', and hereafter referred to as "the Directive") did eventually not include a reference to virtual currency exchanges.

5. However, prompted by the terrorist attacks in France in 2015, the Commission published an *Action Plan to strengthen the fight against the financing of terrorism* on 2 February 2016.[3] As part of this, the Commission proposed to re-open particular aspects of the Directive, in order to address vulnerabilities in Europe's fight against terrorist finance, including in relation to the anonymity associated with the purchase and use of virtual currencies.

6. The Commission subsequently published, on 5 July 2016, its proposals for amendments to the Directive. These included proposals to bring custodian wallet providers (CWPs) and virtual currency exchange platforms (VCEPs) within the scope of the Directive as obliged entities. As a result, if adopted, these amendments would require VCEPs and CWPs to have in place policies and procedures to detect, prevent and report money laundering and terrorist financing.[4] In addition, the Commission proposes to subject these entities to registration or licensing requirements, and to subject those that own, or hold a management function in, these entities to fit and proper testing.

7. The Commission published these proposals in response to the EU Council's conclusions of February 2016 on the fight against the financing of terrorism, which underlined the importance of achieving rapid progress on legislative actions, including in the field of virtual currencies, and which called on the Commission to submit targeted amendments to EU law.[5] The EBA also takes note of the parallel resolution and report published by the European Parliament (EP) in May 2016, in which the EP proposed *inter alia* that the Commission develop recommendations for any legislation needed to regulate the virtual currencies sector.[6]

8. The EBA welcomes the Commission's proposal to bring CWPs and VCEPs within the scope of the Directive, as this will be an important step to mitigate some of the financial crime risks arising from the use of virtual currencies. However, in order for these amendments to reduce

[3] See http://europa.eu/rapid/press-release_IP-16-202_en.htm

[4] See http://europa.eu/rapid/press-release_IP-16-2380_en.htm

[5] See http://www.consilium.europa.eu/en/press/press-releases/2016/02/12-conclusions-terrorism-financing/

[6] See http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A8-2016-0168+0+DOC+XML+V0//EN

the risk of virtual currencies being abused for money laundering or terrorist financing purposes, the Commission and co-legislators should ensure that competent authorities have the appropriate tools at their disposal to ensure the effective supervision of CWPs' and VCEPs' compliance with their AML/CFT obligations. Given the transnational nature of virtual currencies, it is equally important that Member States and competent authorities approach the new AML/CFT regime for VCEPs and CWPs consistently across the EU, which is in line with one of the statutory objectives of the EBA.

9. To that end, the EBA has decided to publish a second, shorter Opinion, which responds specifically to the Commission's proposal and sets out seven proposals that the EU Commission and co-legislators should take into account when finalising the amendments to the Directive.

Legal basis

10. The EBA's competence to deliver this Opinion is based on Article 34(1), Article 56, and Article 9(2) of Regulation (EU) No 1093/2010 (henceforth referred to as 'the EBA Regulation'), as AML/CFT relate to the EBA's area of competence. In addition, in publishing the Opinion, the EBA is fulfilling its mandate in Article 9 of the EBA Regulation to "monitor new and existing financial activities", to "adopt guidelines and recommendations with a view to promoting the safety and soundness of markets and convergence of regulatory practice", and to "achieve a coordinated approach to the regulatory and supervisory treatment of new or innovative financial activities and provide advice [..] to present to the European Parliament, the Council and the Commission".[7]

11. In accordance with Article 14(5) of the Rules of Procedure of the EBA Board of Supervisors, the Board of Supervisors has adopted this Opinion.[8]

Proposals

12. The proposals outlined below address issues related to the unclear transposition deadlines of the amendments; the limited suitability of the revised Payment Services Directive; the public (mis-)perception of the legal status of the new entities; the need for the amendments to facilitate the cooperation between national competent authorities; the lack of specification of fit and proper tests of the new entities; and the unclear scope of the registration and licensing regime.

A. The transposition deadline of amendments to Directive (EU) 2015/849 should be set in a way that facilitates the adoption of a consistent approach to the AML/CFT supervision of CWPs and VCEPs across Member States

[7] See http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32010R1093&from=EN

[8] Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 27 November 2014 (EBA/DC/2011/01 Rev4).

13. Member States currently have a legal obligation to transpose the Directive by 26 June 2017. The EBA understands that Member States have committed to transposing the Directive earlier, by December 2016. The Commission appears now to be proposing in this amendment to bring forward the legal transposition deadline of the Directive itself, from 26 June 2017 to 1 January 2017 and also to require Member States to have transposed the amendments to the Directive by the same deadline, i.e. 1 January 2017.

14. However, the proposed amendments come at a time when most Member States are still consulting on changes to their national legal and regulatory framework, which risks exacerbating the already considerable legal uncertainty for both national authorities and obliged entities (including credit and other financial institutions, and creates significant resource pressure, as Member States and competent authorities will be required to create and implement a licensing and registration regime as well as decide on a supervisory approach for entities that have so far been outside of the Directive. CWPs and VCEPS, too, would be required in a very short time frame of less than six months to implement policies and procedures to be compliant with the Directive as transposed by Member States.

15. The EBA is therefore of the view that sufficient time should be given to Member States, competent authorities, VCEPs and CWPs to transpose and implement the amendments, taking into account that the AML/CFT regime for VCEPs and CWPs does not yet exist. To that end, the EBA proposes to align the transposition deadline for these new amendments with the currently applicable transposition deadline, i.e. 26 June 2017, at the very earliest.

B. Virtual currency transactions should for now remain outside of the scope of PSD2

16. The EBA notes that the co-legislators had called on the Commission to consider bringing Virtual Currency transaction into the scope of Directives in the financial sector, such as the revised Payment Services Directive (Directive (EU) 2015/2366, hereafter referred to as PSD2). The EBA agrees with the Commission's decision not to do so for now and to limit the scope of the proposed amendments, in view of the required urgency.

17. The EBA's views are based on its previous assessment, as conveyed in the EBA Opinion in July 2014, that suggests that, while some of the provisions of the PSD2 could potentially be suitable to address specific risks arising from virtual currencies, VCs incur additional, technology-specific risks that makes them distinct from conventional fiat currencies that are in the scope of PSD2. So-called '51% attacks', for example, is one such risk, which describes a scenario in which a pool of miners attains 51% of the computational power with which units of a particular VC scheme are mined, which in turn allows that pool to block transactions. The risk of a 51% attack is technologically not hypothetical: in the specific case of Bitcoin, there have been occasions where mining pools have temporarily attained 51% of the computational power, although this has not so far resulted in attacks occurring. Further legal and business model analysis would therefore be required before bringing VC schemes, or some of the entities, into the scope of PSD2.

18. Moreover, the denomination of "currency" that has been associated with this particular innovation suggests an analogy with existing fiat currencies that is, on close scrutiny, not warranted.

19. PSD2 is therefore currently not suitable for mitigating all the risks arising from VC transactions. Instead, a separate regulatory regime, or more far-reaching amendments to PSD2, would be required, the elements of which the EBA had proposed in its Opinion of July 2014. Such a regulatory regime, or such amendments to PSD2, would require several years to develop, consult, finalise and transpose, and is therefore not an option, given the short time frame within which the Commission was asked to develop its proposals. It may therefore be advisable for the Commission and co-legislators to initiate as soon as possible the comprehensive analysis that is needed for assessing which, if any, regulatory regime would be most suitable for VC transactions.

C. The status of VCEPs and CWPs should be clarified

20. The proposed amendments are limited to subjecting VCEPs and CWPs to the provisions in the Directive. While this is an important step to mitigate the ML/TF risk arising from VCs, most other risks to consumers, firms and market confidence that the EBA had identified in its 2014 Opinion remain unaddressed. This includes risks arising from fraudulent or failed transactions; insolvency; and the so-called 51% attacks mentioned above.

21. However, there is a risk that consumers and business partners of VCEPs and CWPs may not be aware that the imposition of requirements on VCEPs and CWPs for AML/CFT purposes does not include or imply consumer protection or prudential safeguards, including capital requirements, calculation of own funds, safeguarding requirements, separation of client accounts, and the extensive authorisation liability.

22. The lack of awareness of the meaning of the amendments may be further exacerbated by VCEPs and CWPs deliberately or unintentionally describing themselves as "regulated" or "authorised", thereby implying that respective regulatory safeguards are in place that actually are not. The risk of misrepresentation is not hypothetical but has already materialised in jurisdictions where the same legal entity carries out VC transactions also carries out regulated payment services under the existing Payment Services Directive, which has therefore been authorised by the national authority, but which also carries out unregulated VC transactions, represents themselves as being authorised and/or regulated for carrying out the latter. This also creates concomitant reputational risks for competent authorities, which may inaccurately be perceived to have failed in communicating that these safeguards are not in place.

23. The co-legislators should therefore consider taking steps that address how such misperception and misrepresentation can be avoided. In the long run, of course, this could be achieved by subjecting VC to a comprehensive framework. In the meantime, however, the co-legislators may want to assess the merits of one of the other recommendations the EBA had published in 2014, which was for a legal entity that carries out regulated activities not to

be allowed also to carry out VC transactions, and should also consider introducing means to inform the public about what the amendments to the Directive do and do not mean.

24. With regard to the latter, the EBA welcomes the suggestion in the report of the European Parliament that "stresses the importance of consumer awareness, transparency and trust when using VCs" and that calls on the Commission to develop guidelines "with the aim of guaranteeing that correct, clear and complete information is provided […] how [VC schemes] distinguish themselves from regulated and supervised payment systems in terms of consumer protection".[9]

25. The Commission and co-legislators may want to consider asking the EBA to perform this particular task, which it could fulfil by using a combination of various powers conferred on it in the EBA regulation including

    - "to review and coordinate financial literacy and education initiatives by competent authorities" (Article 9(1)(b)";

    - "to issue warnings in the event that a financial activity poses a serious threat to the objectives of the EBA" (Article 9(3)); and

    - "to monitor new and existing financial activities […] with a view to promoting the safety and soundness of markets and convergence of regulatory practice" (Article 9(2)).

26. Related to the regulatory status, the Commission and co-legislators may also want to consider ensuring that the characterisation of CWPs and VCEPs are not only included in Article 2 on the scope of the Directive but also in Article 3 on the definitions. This is to avoid a repetition of significant supervisory confusion and regulatory arbitrage that has arisen and remains unaddressed in other Directives, such as the Electronic Money Directive, which introduced the concept of individuals distributing electronic money without providing a definition that clarifies their regulatory status and obligations.

D. The amendments should enable competent authorities easily to exchange information in relation to VCEPs and CWPs

27. The EBA notes that by the proposed amendment to the 4AMLD not designating VCEPs and CWPs as financial institutions, no passporting rights under a sectoral Directive apply. VCEPs and CWPs may therefore be required to be registered or licensed in each Member State in which they intend to provide VC-related services.

28. However, the new entities as well as the innovation itself (VC schemes such as Bitcoin, Litecoin etc.) are characterised by the international nature of the services provided. The

[9] See http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A8-2016-0168+0+DOC+XML+V0//EN , paragraph 25

transmission of VCs from one subject to another can be made utilizing the Internet and can be offered and accessed by any entity located in any part of the world.

29. This results in practical difficulties for a competent authority that imposes national registration or licensing requirements to prevent entities that are not licensed or registered in its jurisdiction from providing VC-related services in its jurisdiction. It is therefore essential that competent authorities from different Member States are able to liaise and exchange information in relation to the operation of VCEPs and CWPs on their territory.

30. The EBA notes that the exchange of information between competent authorities responsible for supervising the compliance of credit and financial institutions with their AML/CFT requirements can at times be hampered by legal obstacles that stand in the way of effective cooperation. The EBA therefore considers that the EU Commission and co-legislators should therefore introduce further amendments to section 3 of the Directive to ensure that competent authorities responsible for the AML/CFT supervision of VCEPs and CWPs have gateways in place to exchange relevant information with one another. Given that this issue is not specific to the Commission's proposal regarding VCEPs and CWPs but arises in the context of the amendments to AMLDIV more widely, the EBA will convey its views on this particular issue to the EU Commission and co-legislators under separate cover.

E. The amendments should provide more detail on how competent authorities should carry out fit and proper tests of owners and controllers of VCEPs and CWPs

31. The amendments proposed by the Commission introduce a requirement that those who hold a management function in, or are the beneficial owners of, VCEPs and CWPs are fit and proper persons.

32. However, the Directive does not specify what this test consists of. For financial institutions, the details of such fit and proper tests are set out, not in the 4AMLD Directive, but in sectoral legislation, such as the Capital Requirements Directive for credit institutions or the Payment Services Directive for payment institutions or in legal instruments of the EBA, such as the *EBA Guidelines on the assessment of the suitability of members of the management body and key function holders* (EBA GL/2012/06).

33. In the absence of such a sectoral Directive being applicable to VCEPs and CWPs, the EBA proposes that more detail should be provided to competent authorities about how to carry out fit and proper tests for these entities, to ensure consistency of approach across the EU. This is because the EU Commission, the EU Council, the EBA and other, intergovernmental organisations such as the Financial Action Task Force (FATF) have acknowledged the significant AML/CFT risks arising from VCs and because the virtual, internet-based nature of these entities gives rise to unprecedented challenges for competent authorities.

34. Several options are conceivable for how the Commission and the co-legislators could provide the required details, each of which achieves a different trade-off between the competing demands of analytical robustness and best fit on the one hand and speedy transposition on

the other. Given the time constraints, the required details would ideally be provided directly in the amendments, for example by copying the requirements from another sectoral Directive, which would ensure a speedy implementation but may not be suitable.

35. Alternatively, a mandate could be conferred on the Joint Committee of the three European Supervisory Authorities (ESAs) to provide the content of what the amendments should specify in respect of fit and proper tests. The ESAs could provide the content of such requirements, for example after receiving a request for technical advice, which the EU Commission and co-legislators could then use in the Directive.

F. The amendments to the Directive should clarify the scope of the proposed licensing or registration regime for VCEPs and CWPs

36. The amendments proposed by the Commission require Member States to ensure that VCEPs and CWPs are either licensed or registered. In so doing, the Directive aims to create a common legal basis for the implementation of the recommendations by the Financial Action Taskforce (FATF). In those recommendations, FATF distinguishes between a licensing regime, which is obligatory for 'core' credit and financial institutions, and a less intrusive registration regime, which applies to anyone else within the scope of the FATF Recommendations. This differentiation appears to have been mirrored in the Directive for the geographical scope of European Union.

37. However, by giving Member States a choice between a licensing or a registration regime, it is likely that different Member States will adopt very different regimes. However, in light of the international nature of VC activities, the high ML/TF risk associated with VCs and the difficulty in enforcing the local AML/CFT regime (see above), such a scenario risks undermining the aims of the Directive, and of the amendments to the Directive, to strengthen Europe's terrorist finance defences.

38. The EBA therefore considers that the EU Commission and co-legislators should take a decision whether either a licensing or a registration regime is most suitable and conducive to the aim of deterring terrorist financing across the EU or, should this not be achievable, at least provide clarity about the features that a national registration or authorisation regime should have

G. The proposed extension of national sanction powers to VEPs and CWPs should be retained

39. The EBA understands that, by extending the definition of obliged entities to VCEPs and CWPs as proposed in the amendments, sanctions under section 4 of the Directive will become applicable to VCEPs and CWPs. The EBA agrees with this approach and recommends that the co-legislators retain this approach. In order to ensure that VCEPs and CWPs comply with the requirements, national authorities should have at their disposal effective, proportionate and dissuasive sanctions for failure of these new type of entities to respect key requirement of the Directive, including the reporting of suspicious transactions.

This opinion will be published on the EBA's website.

Done at London, 11 August 2016

[signed]

Andrea Enria

Chairperson
For the Board of Supervisors