



VIRTUAL ASSETS AND VIRTUAL ASSET SERVICE PROVIDERS: REQUIREMENTS OF INTERNATIONAL AML/CFT/CPF STANDARDS

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Article history:	Abstract:
Received: June 26 th 2023 Accepted: July 26 th 2023 Published: August 28 th 2023	The development of modern trends in the use of virtual assets for money laundering and the requirements of international standards for the latest technologies are being studied. In the article, taking into account the comparative legal analysis of the FATF Recommendations and international conventions that regulate the activities of virtual asset service providers and forensic activities, the features of the national approaches of states to this activity are identified.

Keywords: Virtual assets, providers, FATF, money laundering

Emerging technologies, system products and related services are a good accelerator for innovation in the financial sector, not only improving efficiency but also expanding the scope of financial services for all segments of the population. However, these technologies help criminals and terrorists to legalize their proceeds from crime or to finance illegal activities. In 2012, the FATF approved a new version of the Standards on Combating Money Laundering, the Financing of Terrorism and the Financing of Weapons of Mass Destruction. A risk-based approach is a key element for adhering to and effectively implementing these standards. The FATF, in turn, is actively working to identify the risks that new technologies may entail.

The FATF has developed and released a number of documents such as "Virtual Currencies: Key Definitions and Potential AML/CFT Risks" in June 2014 due to the proliferation of virtual currencies and related payment mechanisms that facilitate new ways of transferring value across the network Internet; in the following 2015, the Group issued the "Guidelines for applying a risk-based approach to virtual currencies" in order to minimize the ML/TF risks that arise when using payment products and services through virtual currencies.

It is worth noting that the Guidelines, issued in 2015, emphasized such centers where many types of activities intersect, such as virtual currencies and can thus give access to the financial system. But recently, the scope of virtual assets has grown significantly and now it includes new products and services, activities, business models, various interactions, which include transactions for the exchange of one virtual asset for another.

In the past few years, virtual assets have seen an increase in the number of cryptocurrencies that have the property of increased anonymity, mixers and

mixers, which for some are new terms in the crypto world, as well as decentralized platforms and other products and services that contribute to reducing the transparency of financial transactions. There are also business models and activities such as "Initial Coin Offering" (ICO - initial coin offering). All of these new technologies entail money laundering and terrorist financing risks, including market manipulation and fraud risks. In addition, there are cases with new methods of illegal financing through schemes for hiding and layering assets by exchanging one for another virtual assets in the hope of covering their tracks in a cheap and easy way.

Taking into account emerging new products and services, as well as providers, the FATF recognizes the importance of detailed clarification regarding new technologies and providers. For example, in 2018, the FATF added two terms to its Glossary - virtual assets and virtual asset service providers, and introduced some additions to recommendation 5. The purpose of all these changes and additions is to understand how the Standards for IA and PUVA. This is important for the regulation of virtual asset service providers for all countries. The FATF standards will not only help reduce the AML/CFT risks associated with virtual assets, but also help many jurisdictions to protect their financial systems. The FATF also emphasizes that the Standards apply both when exchanging one VA for another VA, and for transactions relating to the exchange of VA for other fiat currencies and vice versa and everything related to virtual assets.

At the end of the first half of 2019, the Financial Action Group submitted an explanatory note to recommendation 15, explaining how the FATF VA and VASP requirements should be applied. In addition, the Standards apply a risk-based approach to VA transactions and VA service providers, to the regulation



and enforcement of VASPs in the area of AML/CFT, registration and licensing, including customer due diligence and reporting, on suspicious transactions and for international cooperation.

The purpose of the VA and VASP guidance is to help private sector entities that intend to engage in VAs understand and apply these standards to effectively comply with FATF requirements.

The guidance indicates how the requirements developed by the FATF may apply to activities that involve virtual assets and virtual asset service providers. It is a supplement to 15 of the New Technology Recommendation and its recent explanatory note, which mentions the definitions of "property", "funds", "income", "funds or other assets" and other "relevant value". In other words, it can be said that the guidelines contribute to the effective implementation of anti-money laundering and anti-terrorist financing measures.

The Financing Actions Group states that a number of countries are already considering measures to regulate VAs and VASPs. But it is important to understand that not all jurisdictions have effective anti-money laundering and counter-terrorist financing approaches to minimize ML/TF risks, in particular, in cases related to VA, many do not operate within one country, but between different jurisdictions. The FATF, in response to rapidly developing new technologies, calls on all countries to take urgent action to minimize the risks in the area where IA is present. While the current guidance is assisting countries in implementing the RBA on VA and VASP regulation, the FATF notes that other factors may also affect the coordination and oversight of the VASP sector in certain countries.

As required by the Financial Action Group on Money Laundering, all jurisdictions should apply anti-ML/TF measures to both financial institutions (FIs) and designated non-financial businesses and professions (DNFBPs), taking into account their specifics while complying with their obligations. The Guidance emphasizes how these recommendations will affect regulatory VAs, as well as their transactions and the VASP sector, to assist countries to effectively implement the FATF Standards.

The guidance argues that a well-designed RBA contributes to the effective operation of the AML/CFT system in the VASP sector, as well as identifying the inherent risks and risk profile of virtual asset service providers in countries, and taking into account the cross-border nature of this sector and their prevalence around the world. After considering all the principles given in the guidance on VAs and VASPs, i.e., it is important for the relevant national authorities to take into account the current situation in their jurisdictions including definitions and effective risk management,

regulatory framework and supervisory method. Again, the prevalence of activities with VA and PUVA must be taken into account.

But on the other hand, the FATF states that although virtual assets can be actively used in money laundering and terrorist financing typologies, and VA-related activities can serve as another mechanism for illegal transfer of value, it is not necessary that countries consider virtual asset service providers as a high-risk AML/CFT activity. It should also be noted that the RBA is properly used in financial institutions, and that they do not stop providing their financial services by terminating a client relationship or exclusion from the VASP area without properly assessing the risks of clients.

Those operating in the field of VA (VASP or other entities) should clearly understand the basic principles that are based in the FATF recommendations regarding VA:

a) Equal functions and achievement of set goals. The FATF says in its recommendations that the requirements are comparable and are in contact with different administrative and legal systems. These requirements state what countries are advised to do to prevent or mitigate ML/TF risks related to virtual assets, and yet they do not require the application of any strict restrictions or specific guidelines on how this result can be achieved. This takes into account the peculiarities of different legal systems of countries and the degree of flexibility. Therefore, different options can be applied under different circumstances.

b) Objectivity regarding existing and new technologies. Requirements that include VA and PUVA are used regardless of techno platforms. As mentioned above, these requirements do not indicate that certain products are used for this activity or for the provision of services. Again, on the contrary, the FATF speaks of the need to apply these requirements with some degree of flexibility, suggesting that countries adapt them to existing and emerging technologies without adding specific changes.

c) Providing equivalent terms. In all countries and in the relevant authorities, VASPs should be treated on an equal basis from the position of supervision and regulation in order to prevent different interpretations in the regulatory legal frameworks of various jurisdictions in their favor.

The FATF does not define all sectors as high risk, instead its standards define only those sectors (for example, the VASP sector) that are vulnerable to ML/TF. Here it is worth considering that different PUVA entities can define this sector as increased or decreased. Here the assessment is based on various factors (geographic, customers, products, their development, services, etc.). All of these assessments should rely on Recommendation 1 (risk-based approach) developed by



the FATF. In this way, the FATF does not hint at restricting or restricting the activity of a certain sector by harsh methods, on the contrary, it encourages countries to manage these risks through the development of a clear risk-based approach.

When determining the level of risk in the use of VAs and VASPs by users around the world to make payments and transfers, it is important to consider the degree of use. For example, virtual asset service providers that are located in one jurisdiction may provide their services to clients in another jurisdiction. Here, both jurisdictions may have different regulatory frameworks or may have different AML/CFT obligations and controls. This case warrants increased attention only in cases where the VASPs are located in jurisdictions that have weak or no AML/CFT controls. An example of such jurisdictions can be considered countries that are included in the FATF gray and black list (Iran, Syria, Pakistan, etc.).

A number of countries may ban VA and VASP activities based on NRA assessments or to achieve other national policy goals that are not covered by the FATF recommendations (for example, for consumer protection, for the safety and smooth functioning of the financial system). In this case, the standards and norms indicated in recommendation 15 will not work. However, countries should still assess their risks based on the FATF VA and VASP requirements and develop appropriate tools and rules to take action in case of non-compliance with the ban.

According to the FATF Recommendations, all countries should adopt appropriate AML/CFT requirements for financial institutions and designated non-financial professions and businesses to comply with these obligations. In October 2018, the FATF revised Recommendation 15 and added a number of additions and introduced two new definitions to the Common Vocabulary (Virtual Assets and Virtual Asset Service Providers) to clarify the application of AML/CFT requirements in the context of AA. To the FATF Glossary:

Virtual assets are a digital expression of value that can be used to carry out trade transactions and transfers in digital form, use them for payment or investment purposes. Virtual assets do not include the digital expression of fiat currencies, securities and other financial assets that are already covered by the FATF Recommendations

A VASP is any person or entity that is not covered by the FATF Recommendations and conducts one or more of the following activities or transactions for or on behalf of another person or entity:

1. Exchange of virtual assets for other fiat currencies and vice versa;
2. Exchange of some forms of virtual assets for other forms of virtual assets;

3. Transfer of virtual assets;

4. Secure storage and/or administration of virtual assets or instruments that may assist in the control of virtual assets;

5. Participation in and provision of financial services related to the offer of the issuer's asset and/or the sale of the virtual asset.

It should be taken into account that the FATF definitions include not only operations and activities for the exchange of one VA for other VA, but also the exchange of fiat currencies for virtual ones, and vice versa.

There are so-called peer-to-peer trading platforms. They are websites and serve as intermediaries between buyers and sellers of virtual assets, i.e. help find each other. A number of trading platforms are even involved in the buying and selling process. Based on the variety of legal and regulatory frameworks in different countries, if trading platforms that deal with virtual assets provide a place where sellers and buyers place their offers and orders, and then these two parties themselves will negotiate and perform transactions but only on a different site (other exchange has no connection with the previous trading platform), where transactions are carried out only between two users, then such platforms under the interpretation of the FATF may not fall within the meaning of VASP. But if these VASPs perform all or part of the transfer, exchange, or other activities in the field of virtual assets that were mentioned in subparagraphs (1-5) of the definition of VA, as well as the purchase of virtual assets from users and subsequent, if appropriate, the sale of these assets to other users, then such platforms are fully eligible for commercial VASPs.

Persons, both legal and natural, who carry out their activities by offering, issuing and trading VA, in addition to the previously listed ones, and also accepting orders for the purchase and acquisition of VA from the issuer for the purpose of reselling and distributing assets, can also be included in subparagraphs (1-3), as well as subparagraph (5) of the VASP definition. For example, (Initial Coin Offering) - Initial placement of coins, the main purpose of which is to attract investments from the outside, i.e. sponsorship funds at the beginning of some new startups or projects, if the project initiator does not have initial investments, and thus, in the process of placing coins, legal entities or individuals who actively support their issue can provide exchange and / or transfer services, and in addition this offer and the sale of issued coins.

Internet platforms that provide their services for trading in both conventional assets and virtual assets offered and/or sold through ICOs may fall under the category of exchanges or entities operating in securities



trading with VA, which may be considered "securities » in most jurisdictions. Other jurisdictions may take a different approach, which may include "payment tokens". Therefore, countries and relevant competent authorities should clearly consider this issue and apply a functional approach, based on the relevant characteristics and facts of the platform and their activities, in order to determine whether they fall under the definition of an "exchange" or other accountable entity (let's say an entity exercising its securities activities) under their national laws and under a specific definition. When making a decision, countries should take into account the activities of the entity, regardless of the technologies they use.

The FATF does not intend to regulate the activities of entities that are associated with virtual assets, the purpose of which is not to obtain financial gain (although in some cases in certain jurisdictions they may be subject to obligations regarding specific measures and sanctions). There are some kind of assets of "closed" systems that cannot be converted, exchanged, transferred or replaced by other means of value. These types of assets can be found in various airlines that provide their customers with certain kilometers flown for showing loyalty to the airline. They cannot be sold or resold on the secondary market. Revisiting the FATF definition of VAs and VASPs, it covers specific functions and activities (such as holding, managing and issuing assets, as well as exchanging and transferring them) and assets that can be substituted for other values despite carrying out an operation to exchange VA for fiat currency.

It should be noted that the FATF is not going to regulate the technologies themselves, which are based on virtual assets. The regulation covers both individuals and legal entities that use such technologies and software in the financial sector or conduct their activities with virtual assets on a commercial basis on behalf of others. This means that if a person himself creates a certain product or software related to VA solely for the sake of obtaining profit through the sale of development to others, then he cannot be a VA service provider. However, if a person is themselves a software developer and thus uses it for the purposes of transferring, exchanging and other transactions related to the VA and mentioned above, then this person falls under the category of VASP.

According to the FATF Recommendations, countries should develop a RBA to ensure that the measures taken to minimize the risks associated with money laundering and terrorist financing are consistent with the risks found in these jurisdictions. In the event that there is an increased risk in situations and activities associated with virtual assets, then countries need to take tougher measures as part of a risk-based approach. When conducting a national AML/CFT risk

assessment on virtual assets, countries should pay attention to the distinction between decentralized and centralized IAs, as this topic is still relevant today. Given the difficulty of detecting anonymous financial flows, as well as the emerging difficulties of effectively identifying clients, the VA sector and VA service providers are rated as a high risk of ML/TF, which may eventually lead to enhanced measures in specific situations.

The FATF allows jurisdictions to establish a ban on VA activities and VA service providers in accordance with a national risk assessment, as well as a regulatory regime or other policy objectives that the FATF does not specify in its documents. Such cases may include actions aimed at ensuring the security and stability of the country's economy, consumer protection. If jurisdictions do decide to impose bans on VA activities and VA providers, then countries need to consider how these bans may affect money laundering and terrorist financing risks. In any case, whether countries adopt any prohibitions or not, the development of additional measures in the field of AML/CFT is still useful for mitigating general risks. When countries prohibit activities related to VAs and VAs, risk mitigation measures in this area should include actions to identify VAs in their jurisdictions, as well as other entities that may be engaged in activities with virtual assets in an illegal manner. In addition, when such cases are discovered, countries should apply proportionate and dissuasive sanctions against VASPs and/or other reporting entities. Given the risks in jurisdictions, when VASPs and VAs are banned, countries should still develop a strategy to mitigate risks and implement geographic outreach and cross-border VA transactions around the world.

In order to implement the FATF recommendations, countries should carefully consider all terms contained in the recommendations, such as "revenue", "property", "funds", "funds or other assets" and other "relevant value", as being included in the IA. For example, these terms are used in recommendations 3 to 8, 30, 33, 35 and 38, which require countries to take appropriate measures to prevent the illegal use of LA for ML/TF/PF. Appropriate measures should also be taken against income received from activities related to virtual assets.

In order to comply with the requirements of recommendation 3, it is necessary that the offense of money laundering cover all types of property, without limitation on their value, which may be the proceeds of illegal activities, in particular from virtual assets. It should be taken into account that it is not necessary to hold a person liable for having committed a predicate offense in the process of proving that an asset is the profit from an illegal activity, and also if the profit is related to virtual assets.

Regarding the 4th recommendation:



a) property that has been given a lawful appearance;

b) income that was obtained in the process of legalization or predicate crimes (funds);

c) property that is intended to be used as FT;

d) property that is equivalent to value is also classified under virtual assets.

When it comes to confiscation and appropriate measures that apply to goods and fiat currencies, then the relevant authorities should apply actions related to the temporary freezing of property if the facts of their occurrence illegally are proven. In the future, in order to extend the terms of freezing or confiscation of property, law enforcement agencies need to obtain court decisions.

It is recommended in each country to establish authorities that are responsible for licensing and registration of VASPs. If you look closely at the third paragraph of the explanatory note to recommendation 15, then VASPs must obtain a license in order to operate or must be registered in the jurisdictions where they will introduce their activities.

If the PUVA is an individual, then it must obtain a license where it operates. Countries should take into account a number of factors when determining where to operate a VASP. This place may be where the person conducts his business, or where he actually resides or lives, and may also be the place where various documents are stored. In the event that the body failed to determine the place of the person's activities, then the main place is considered to be his place of residence.

The VASP must comply with the licensing and registration requirements set by the relevant authorities. The FATF notes that it is essential for licensing authorities to establish licensing and registration requirements for IA service providers in such a way that it is easier for relevant authorities to exercise effective oversight of IA providers.

In countries where VA service providers operate, in jurisdictions, competent authorities should take clear oversight and control measures to prevent cases in which attackers or their accomplices did not have majority ownership or were not the beneficial owners of VASPs, as well as were not in leadership positions. In order to avoid such cases, the VASP should notify the relevant authorities in the event of a change in the composition of shareholders or management.

Countries should exercise strict control in their jurisdictions over the identification of individuals or entities that operate or engage in transactions related to virtual assets without obtaining a license or registration with the relevant authorities. It is important for the competent authorities to have clear mechanisms in place to oversee the IA service provider sector. The creation of channels for the interaction of IA service

providers with the competent authorities is also encouraged. These channels can be helpful in obtaining a license or registration, as well as informing VAs of their AML/CFT responsibilities.

In order to identify or identify legal entities or individuals that operate without obtaining a license or registration with the relevant authority, countries in their jurisdictions should develop clear mechanisms that can effectively detect IA service providers without any authorization documents. One of these methods is Internet scraping. This is such a technology that makes it possible to obtain web information by extracting them from web resources. Thus, this technology can help in identifying advertisements posted on the Internet or various B2B offers posted by IA service providers without relevant documents, as well as information that is stored on the basis of financial intelligence units or information regarding reports of suspicious transactions, provided by reporting entities (banks, microfinance organizations, etc.). Among other things, such tools can help identify unlicensed entities from closed sources that store information about entities that have filed a request for a license or information about its cancellation.

It is important to note that the interaction of various departments and authorities at the national level is an important aspect in the regulation of entities in the context of licensing or registering IA service providers, since these authorities may contain the necessary information about entities that operate without permits. In this regard, it is recommended to develop and establish communication channels for the interaction of authorities in terms of the transfer of information to facilitate to one degree or another.

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