

# Cryptoassets and Open Source Software: UK proposes gold-plating transposition of the EU Fifth Money Laundering Directive

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## Summary

Currently, cryptoasset exchanges and wallet providers are not generally required (depending on their business model) to identify their customers, monitor transactions or report suspicious activity. On 15 April HM Treasury (**HMT**) published a consultation<sup>1</sup> on the UK transposition of the EU Fifth Money Laundering Directive (**MLD5**). MLD5 requires firms offering fiat-to-crypto exchange and custodian wallet services to fulfil customer due diligence (**CDD**) obligations, assess the money laundering and terrorist financing (**AML/CTF**) risks they face, and report any suspicious activity. As trailed in last October's UK Cryptoassets Taskforce final report<sup>2</sup>, HMT's consultation asks stakeholders whether these MLD5 cryptoasset-specific amendments to the EU Fourth Money Laundering Directive should be gold-plated.

## Open-source software publication: gold-plating of MLD5 activities in the UK

HMT consults on whether the following activities should additionally be brought within the scope of MLD5:

- crypto-to-crypto exchange service providers
- peer-to-peer crypto-to-crypto and crypto-to-fiat exchange service providers
- crypto-fiat ATMs
- issuance and distribution of new cryptoassets via Initial Coin Offerings (**ICOs**)
- the publication of open-source software of any type.

1 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/795670/20190415\\_Consultation\\_on\\_the\\_Transposition\\_of\\_5MLD\\_\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/795670/20190415_Consultation_on_the_Transposition_of_5MLD__web.pdf)

2 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/752070/cryptoassets\\_taskforce\\_final\\_report\\_final\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf)

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HMT's proposal to bring this last activity within scope could result in a considerable amount of negative feedback. It is not clear how requiring the activity of publishing open-source software to become subject to CDD requirements would work in practice, or when the users of that software (or integrated versions of it) would become customers for this purpose, or would be entering into a business relationship with the publishers of different versions, or how these relationships could be easily tracked. Its impracticability could disincentivise the publication and use of open-source software, a facility whose many advantages are recognised globally.

## **Tokens vs “virtual currencies”: cryptoassets gap analysis: MLD5 vs UK Cryptoassets Taskforce**

HMT seeks views on whether the MLD5 definition of “virtual currencies” encompasses all three types of cryptoassets identified by the UK Taskforce last year – comprising exchange tokens, security tokens and utility tokens – or whether this definition may need to be broadened. The paper also asks if any types of virtual currency or cryptoasset would fall within scope of the MLD5 definition but outside the Taskforce's three categories. A further 2019 consultation is trailed, which will consider the UK regulatory perimeter in relation to security tokens and utility tokens, and ask how exchange tokens and relevant service providers could be regulated beyond the AML/CTF purposes outlined in this paper.

### **Privacy coins**

HMT also consults on whether the UK should consider addressing any risks posed by privacy coins and how CDD obligations should apply in this area. Privacy coins offer users complete anonymity, as compared with exchange tokens such as Bitcoin which are only pseudonymous in nature. Since an essential element of privacy coins is to mask data about their users as well as the amount traded and held in wallets, regulators in some jurisdictions impose restrictions on the trading of privacy coins on exchanges.

### **What does this mean for market participants?**

The deadline for responses to the consultation is 10 June this year, and MLD5 must be transposed into national law by 10 January 2020. HMT notes that this timeline, together with that of the Financial Action Task Force, whose updated international standards now oblige its members to regulate “virtual assets and virtual asset service providers”, means that its proposed comprehensive approach aligns with emerging global standards in this area. The consultation proposes that the FCA should be asked to supervise cryptoasset exchanges and custodian wallet providers in fulfilling their AML/CTF obligations, as well as becoming the UK registering authority for cryptoasset firms. HMT is also consulting on whether to address the potential cross-border risk of regulatory arbitrage by requiring firms based outside the UK to comply with these regulations when providing cryptoasset services to UK consumers.

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