

Virtual Asset Contact Group
Financial Action Task Force (FATF)
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FRANCE

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To whom it may concern,

This letter contains the Electric Coin Company's comments on the question of how the FATF and its members should assess and mitigate the risk of peer-to-peer transactions without use of a VASP.

The Electric Coin Company (ECC) is a US-based company focused on research and development of the technology that underpins virtual assets (VAs). We are best known as the team that created Zcash, although the technology we have developed can also be found in other VAs such as Ethereum.

We believe that well-informed policy-makers and regulators produce better and more effective regulation, and we recognise that virtual assets represent a paradigm shift when compared to legacy financial networks. To that end, while ECC is not a VASP, we believe that we have a responsibility to engage proactively, constructively, and cooperatively with policy-makers and regulators, acting as subject matter experts, and providing accurate and objective information and feedback to help inform and support a balanced, proportionate and risk-based approach to regulation.

We believe that the risk posed by peer-to-peer transactions is similar in nature to - but lower in magnitude than - the risk posed by cash transactions.

To the uninformed, the prospect of peer-to-peer transactions taking place without the involvement of a regulated intermediary may cause alarm. However, such transactions' characteristics echo those of cash transactions. The risks posed by cash transactions have long been recognised and appropriate, proportionate measures have been adopted to mitigate those risks, without unduly impacting consumers' ability to continue to enjoy the benefits of cash transactions.

The reason we believe that the risk posed by peer-to-peer VA transactions is lower in magnitude than that posed by cash transactions is because the utility of cash is far greater due to its near-universal acceptance, whereas VAs are far less widely-accepted as a means of payment. While adoption and acceptance of VAs is likely to grow over time, we expect that VASPs will play an important role in facilitating payment for goods and services using VAs, which will help mitigate the risks.

It is important to note that there are (currently, and for the foreseeable future) limited avenues for obtaining VAs. These are:

1. mining,
2. selling goods or services that are paid for with VAs (note that, in practise, merchants that accept payment in VAs typically use the services of a payment processor which is, itself, a VASP),
3. exchanging fiat currency for VAs using a VAS, and
4. hacking, theft, fraud or other criminal activity.

Similarly, the principal avenue for exchanging VAs for fiat currency is through VASPs.

Therefore, while it is possible to transfer ownership or control of VAs using peer-to-peer transactions, it is not currently practical to effectively launder funds using VAs without, at some point, channelling the funds through a VASP. Similarly, given the lack of widespread adoption of VAs as a payment mechanism, it is not currently practical to use VAs to fund terrorism without converting them into fiat currency, which requires using a VASP.

Therefore, the risk posed by peer-to-peer transactions must be considered in the proper context - specifically, as part of a broader system that includes well-regulated VASPs, just as the risk posed by cash transactions must be considered in the context of a broader system that includes well-regulated financial institutions.

Until FATF adopted its revised Recommendations in 2019, many jurisdictions had not made VASPs subject to AML/CFT requirements. This vulnerability allowed illicit actors to exploit the lack of controls and use VAs without facing the type and scale of AML/CFT controls that are employed by traditional financial institutions. However, as noted in FATF's 12 month review, jurisdictions have made significant progress in regulating VASPs and requiring that they put in place systems and processes to prevent and detect ML/TF. As a result, this critical vulnerability is in the process of being reduced significantly.

Most of the AML/CFT measures that are in widespread use in the traditional financial sector (e.g. customer due diligence, transaction monitoring, suspicious activity reports) are as applicable to VAs and VASPs as they are to fiat currency and traditional financial institutions. We expect that their widespread adoption by VASPs will make it increasingly difficult for illicit actors to use VAs for ML/TF.

Therefore, it seems premature, at this point, to consider introducing restrictions on peer-to-peer transactions, before the impact of the measures that are currently being adopted has become clear.

To that end, we recommend that FATF begins assessing the effectiveness of the measures that are being introduced as a result of Recommendation 15, in terms of detecting and preventing the



use of VAs for ML/TF. An appropriate way to do this would be to invite FATF member countries to submit data that addresses the following questions:

- How many attempts to conduct ML/TF using VAs were prevented by measures that were implemented as a result of the FATF Recommendations?
- How many attempts to conduct ML/TF using VAs were successful due to a VASP's failure to meet requirements that were imposed as a result of the FATF Recommendations?
- How many attempts to conduct ML/TF using VAs were successful despite a VASP's compliance with requirements that were imposed as a result of the FATF Recommendations?

We would also recommend collecting the amounts involved in each category.

As well as allowing FATF to objectively assess the effectiveness of the existing measures, this data can help guide research into both the scale and nature of the risks associated with peer-to-peer transactions. We believe that the outcome of that research will help answer the question of how those risks should be mitigated, and we expect that some of the techniques that are already employed to mitigate the risks of cash transactions will be applicable to peer-to-peer VA transactions.

Finally, we wish to sound a note of caution. We understand that there are some who advocate for placing significant restrictions on peer-to-peer transfers of VAs. We believe that doing so would negatively impact the utility of virtual assets, and deal a significant blow to the VA sector in general.

Virtual assets are an emergent technology with the potential to have huge impacts, from increasing access to financial services for more than a billion people who are marginalized and excluded from traditional financial services, to changing the way we conduct commerce by making it more efficient and frictionless. Virtual assets are built on a foundation of peer-to-peer technology, and the ability to facilitate peer-to-peer transactions underpins virtual assets' potential to catalyze change and deliver the potential benefits. It is inevitable that such change will be accompanied by risks but it is vitally important that we do not allow those risks to blind us to the potential benefits, and that we properly assess the scale of those risks before rushing to impose restrictions.

We stand ready to provide whatever help we can to the Virtual Asset Contact Group. Please feel free to reach out to me if we can help in any way.

Sincerely,

Jack Gavigan
Head of Regulatory Relations
Electric Coin Company

