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Comments on Banco de Portugal's Public Consultation no. 5/2020

About the registration of entities carrying out operations with virtual assets

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Executive Summary

Banco de Portugal's Public Consultation no. 5/2020, announced on October 27th, 2020, puts forth a draft notice for a "regulatory project regarding the registration of entities engaged in activities with virtual assets". This consultation paper derives from Portugal's delayed transposition of the EU's Directive (EU) 2018/843, also known as AMLD5, aimed at preventing money laundering (ML) and terrorist financing (TF).

We believe the Directive's understanding of cryptoassets is reasonable and sensible and their ML/TF implications are adequate. However, the overreaching scope of the proposed sectoral regulation for Portugal far exceeds the European requirements, following instead the Financial Action Task Force's Recommendation 15. However, we believe the current proposal does not address key guidance later offered by the Financial Action Task Force, thus negatively impacting the technological development of blockchain and cryptoasset technology in our country.

While other European countries have inflicted severe self-damage to their ability to be attractive to this industry, Portugal should take this opportunity to create a favourable framework that meets all the essential requirements while preventing jurisdictional arbitrage. One should be particularly mindful of detrimental and excessive red tape when regulating a nascent industry; and the promising Portuguese startup ecosystem, of which one of the most innovative sectors is that of cryptoassets and blockchain technology, warrants clear and efficient guidance.

Otherwise, the inappropriate implementation of the proposed framework can (continue to) crowd out talent and capital to EU countries with better-defined regimes.

Therefore, we recommend a review of the current policy to circumvent what happened in the Netherlands and Germany, and what's currently happening in the UK.

1. Introduction and context

1.1. What is AMLD5 and how does it deal with virtual assets?

The EU Directive 2018/843, commonly known as the Fifth Anti-Money Laundering Directive, or AMLD5, amended the existing EU regulation regarding anti-money laundering and counter terrorist financing (AML/CTF). Published in June 2018, it directed EU countries to transpose it into national legislation by January 2020.

Among other updates - meant to match the international standards set by the Financial Action Task Force (FATF), a global AML/CTF watchdog - this Directive was the first to consider cryptoassets¹. It specifies that “providers engaged in *exchange services between virtual currencies and fiat currencies* as well as *custodian wallet providers*” are now “obliged entities”² which should be “monitored by competent authorities” and subject to registration in each country they operate in; in Portugal’s case, with Banco de Portugal (BdP), which was tasked with defining the details of the registration process.

Whereas exchange services have a straightforward definition - noting here that neither crypto-to-crypto exchanges nor decentralised exchanges fall within the scope of the definition, at least according to an interpretation by the European Central Bank³ - custodian wallet providers refer to “services that safeguard private cryptographic keys on behalf of its customers, to hold, store and transfer virtual currencies”.

On the other hand, virtual currencies (VCs) are defined as “a *digital representation of value* that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency and does not possess a legal status of currency or money, but is accepted by natural or legal persons as a *means of exchange* and which can be *transferred, stored and traded electronically*”⁴.

¹ In this paper, cryptoassets are used interchangeably with virtual assets, as per FATF’s expansive definition under [Public Consultation since late March 2021](#).

² Obligated entities are those which should face the same AML/CTF requirements imposed on financial institutions, e.g. customer due diligence (CDD) and know your customer (KYC) checks, as well as suspicious activity reporting (SAR).

³ See [Crypto-Assets: Implications for financial stability, monetary policy, and market infrastructures](#)

⁴ It clarified that VCs “should not be confused with electronic money nor with in-games currencies”.

1.2. Consequences of different AMLD5 transpositions

As of February 2020, eight member states had not yet transposed this Directive, including Portugal, and were sent letters of formal notice by the European Commission urging them to implement this regulation urgently.

By August 2020, Portugal's parliament unanimously approved the transposition of AMLD5 without a transitional regime or a grace period, something formally asked by the local cryptoasset community within the consultation period⁵. Other member states, such as Spain, Germany, and the Netherlands, adopted a transitional regime or equivalent grandfathering mechanism, a normal procedure when such regulations are put in place.

The Dutch case is particularly relevant, as it initially proposed the most stringent regime for crypto companies, requiring a license instead of straightforward registration. However, the Dutch Council of State⁶ advised against it on the grounds it would be incompatible with AMLD5, so the legislation was reviewed. Meanwhile, the final result is a de facto licensing scheme, with prohibitive fees ranging from €2.5k to €150k per year.

Germany also adopted steep licensing requirements⁷, defining all cryptoassets as financial instruments and subjecting them to the same regulations. Both countries followed a framework advanced by the Markets in Financial Instruments Directive, which had been designed for established financial institutions, requiring entities to disclose business plans and additional business processes unrelated to AML/CTF; among other demands⁸ not called for by AMLD5⁹.

Naturally, such measures had negative consequences for those countries' startups. The world's largest cryptoasset options exchange left the Netherlands¹⁰ and several local start-ups couldn't cope with the high registration fees¹¹ as well as other compliance costs¹².

⁵ See [Letter to the Parliament, July 20th, 2020](#)

⁶ See [License requirement for crypto-service providers off the table in the Netherlands](#)

⁷ See [EU Members Adopt Tougher Crypto Rules Than AML Directive Requires](#)

⁸ See [Dutch registration regime for crypto service providers](#)

⁹ Before, only Japan required crypto providers to submit business plans in their registration process.

¹⁰ To be fair, [Deribit](#) left for Panama, which is [working](#) with FATF to strengthen its AML regime.

¹¹ See [Dutch government killing Post-a-Coin, my crypto startup](#)

¹² See [Mining Pool Simplecoin and Interactive Faucet Chopcoin Shut Down Due to EU Regulations](#)

And, in Germany, only big banks and mature scale-ups were interested in applying for the license¹³, with the application costing €10,750 even if the authorisation was denied.

Conversely, France adopted the recommended registration procedure, while creating an optional licensing regime for cryptoasset providers other than fiat-to-crypto exchanges and custodian services. And Estonia managed to implement a licensing system that's seen as friendly - and, at a third of Germany's cost, much more affordable - while strictly complying with all AMLD5 conditions. In other words, it's clear that a country can meet FATF's guidance while still implementing favourable registration regimes.

Lastly, while the UK didn't initially consider a transitional period, the FCA, the local regulator, announced in December a "temporary registration regime" so that crypto businesses could continue to operate given the delays in assessing the 200 registration requests received¹⁴. According to CryptoUK, a digital assets trade association, the situation hasn't improved¹⁵ as of this March.

1.3. Portugal's transposition of AMLD5

The Portuguese Parliament counted with Banco de Portugal's assistance in improving the originally proposed transposition of AMLD5 into national law¹⁶. Initially, the draft suggested a straightforward translation of the Directive, which was then changed into the more restrictive interpretation of FATF's recommendation to license all virtual asset service providers - a matter which we further detail in the following chapter.

Following the approval of AMLD5's transposition to Portuguese law on August 31st, Banco de Portugal published their public consultation on October 27th¹⁷, delineating the registration requirements that entities dealing with virtual currencies must abide by.

In brief, two key issues warranted our attention: 1) these rules define virtual assets in the same way virtual currencies are defined in AMLD5, which is controversial given the

¹³ See [Digital securities in Germany: How will the new crypto license impact the market?](#)

¹⁴ See [UK regulator announces 'temporary registration regime'](#)

¹⁵ See [Crypto UK Send Open Letter To The Chancellor](#)

¹⁶ See [Banco de Portugal's Opinion on Proposed Law 16/XVI/1º\(GOV\)](#)

¹⁷ See [Banco de Portugal's Public Consultation 5/2020](#)

different ML/TF risks associated with each category, but also within each category, e.g. privacy coins and stablecoins vs. utility tokens and DeFi; and 2) the proposal clarifies that all entities dealing with virtual currencies must suspend all their crypto-related activities until they are registered with Banco de Portugal - a process which can take 6 months.

Furthermore, given Banco de Portugal's recommendations to the Parliament, the activities that require registration go far beyond the original scope detailed in AMLD5, partly following the definition offered by FATF's 2018 revision to Recommendation 15¹⁸:

- A.** Exchange between virtual assets and fiat currencies on behalf of a client¹⁹;
- B.** Exchange between one or more forms of virtual assets on behalf of a client;
- C.** Transfers of virtual assets on behalf of a client;
- D.** Custody or custody and administration of virtual assets on behalf of a client.

Of those categories, only the first and the last are within the purview of AMLD5²⁰, whose scope was also defended by the European Central Bank, as referenced in section 1.1.

Lastly, the proposal clarifies the information that such entities must submit to Banco de Portugal before resuming or initiating the above-mentioned services. As shown ahead, this is an excessively exhaustive request, which wasn't recommended by the FATF:

- 1.** General information about the entity, including:
 - a.** Articles of association;
 - b.** Company's registration certificate;
 - c.** Company's criminal record certificate;
 - d.** Company's criminal record history, or lack thereof.
- 2.** Specific information about the entity, including:
 - a.** Beneficial owners and respective proof of ownership;
 - b.** Minority interests and respective proof of ownership;

¹⁸ See [FATF's Guidance For A Risk-based Approach To Virtual Assets And VASPs, June 2019](#)

¹⁹ Note this also includes cryptoasset ATMs and centralised P2P marketplaces

²⁰ See [Law 58/2020](#), Article 5 amending Law 83/2017 Article 2 (1)(mm)

- c. Management and board and their respective documentation, including criminal record relevant for AML/CTF and CVs or other documents attesting competence relevant for AML/CTF.
3. Exhaustive business plan, including:
 - a. Organisational charts, governance details, human resource map, technical architecture, three-year financial planning broken down by each of the four crypto-related activities mentioned above, customer relationship analysis, geographical expansion, virtual assets being offered, wallet configuration, exchange order types, payment methods, and short-term and medium-term growth plans.
4. AML/CTF risk matrix and analysis, broken down by:
 - a. Activities, clients, business areas, distribution channels, geographical scope, and global risk.
5. Internal rules and manuals for AML/CTF mitigation, with a:
 - a. A detailed specification of the various pages of the manuals where all the different ML/TF policies and procedures are located.
6. Overview of the IT systems, detailing:
 - a. The capacity to filter customers and transactions, including who supplies them and who operates them;
 - b. An overview of AML/CTF ongoing monitoring activities.
7. Source of funds for the entity's equity.

All-in-all, it's clear Banco de Portugal acted with best intentions, extending the scope of AMLD5's transposition to prepare Portugal for future assessments, and to anticipate eventual updates in future Directives that integrate FATF's latest guidance. However, given that AMLD6 came into effect last December and didn't change any of the cryptoasset definitions mentioned above, we believe these good intentions can backfire and are detrimental to the Portuguese ecosystem, and therefore deserve reconsideration.

2. Recommendations and proposals

2.1. Analysis of the proposed registration process

We believe Banco de Portugal's regulatory proposal doesn't fully take into consideration the latest FATF virtual assets guidance in place²¹, clarified in 2019 with its Interpretive Note to Recommendation 15²², which had already been revised in 2018 to expand the definition of VASPs beyond "gateways to and from (i.e. the on and off-ramps to) the traditional regulated financial system".

Our perspective was made even clearer following FATF's recent public consultation to further update their virtual assets guidance, announced this March 19th²³. Even though this update is extremely stringent - and also problematic, albeit for other reasons not relevant to this paper given that it's focused instead on non-custodial intermediaries, i.e. it will impact practically all decentralised finance protocols, a matter which we'll first address directly with FATF together with other organisations focused on cryptoasset policy issues - their new draft confirms the recommendations hereby suggested.

In brief, the understanding that Portugal can perfectly comply with all the AML/TF guidance imposed by FATF so that it can still be favourably evaluated in the next assessment due this 2021, while still implementing a process that's favourable to the development of the promising blockchain and cryptoasset technology.

To begin with, in FATF's latest Mutual Evaluation of Portugal, conducted in 2017²⁴, it is reported that Banco de Portugal concluded that there's a "lack of a risk-based approach culture" in the traditional financial sector, whereas in other sectors such a culture is practically absent, with a rule-based approach being "primarily followed".

²¹ See [FATF's Guidance For A Risk-based Approach To Virtual Assets And VASPs, June 2019](#)

²² See [FATF's Public Statement – Mitigating Risks from Virtual Assets](#)

²³ See [Public consultation on FATF draft guidance on a risk-based approach to virtual assets and virtual asset service providers](#)

²⁴ See [FATF's Mutual Evaluation of Portugal, 2017](#)

We recognise this risk-based approach must be followed by each virtual assets service provider (VASP), as described in Law 58/2020 which follows FATF's 2018 definition. But we contend the current registration process not only inhibits such an approach, because it demands the same registration process of different categories of VASPs, but also impairs the work of the competent authorities, which should also "conduct risk-based supervision or monitoring", and hurts the goal of developing "prevention or mitigation measures that are *commensurate with the ML/TF risks that countries and the relevant obliged entities identify*".

This is further supported by FATF's recent report on Virtual Assets Red Flag Indicators²⁵, which mostly concerns exchange services between virtual currencies and fiat currencies. That's the key category as defined in AMLD5, which doesn't cover the remaining activities that VASPs can engage in. This is reinforced by the policies of the Financial Crimes Enforcement Network (FinCEN), the US AML watchdog, which has more narrowly interpreted FATF's guidance. And it steers away from the vague definitions surrounding the activity of transferring virtual assets on behalf of a client, e.g. a store that helps customers transfer virtual assets without any bridge to fiat currency, or even a mining pool - which is not regarded as a VASP, but that needs to transfer the proceeds of the rewards it eventually wins back to its participant members²⁶.

Moreover, the only tangential reference that FATF makes regarding the burdensome requests required by BdP for the national registration process, e.g. the detailed business and activity plans, first appears in paragraph 31 of the cited guidance²⁷. But it concerns understanding whether specific centralised or decentralised VASP business models "introduces or exacerbates specific risks", as well as any parameters or measures in place that may potentially lower the provider's exposure to risk".

Those are further contextualised in paragraph 148 as being the kind of requests which typically fall under the scope of prudential regulation for banks, not AML/CTF

²⁵ See [FATF's Virtual Assets Red Flag Indicators of Money Laundering and Terrorist Financing](#)

²⁶ See Coin Center's [The upcoming FATF interpretive note is not doomsday for cryptocurrency](#)

²⁷ See [FATF's Guidance For A Risk-based Approach To Virtual Assets And VASPs, June 2019](#)

regulation, clarifying that such specific information can be more easily obtained if a VASP is also a traditional financial institution subject to such sectoral supervision.

Instead, throughout paragraphs 36 to 41, FATF provides examples of several business models and later invites regulators to analyse whether a company's services include one of the activities that would make said company a VASP. This is easily achieved through any company's website or prospectus, not requiring combing through a detailed business plan - an outdated process that has evolved into more product and customer-centred pieces of analysis that don't provide the exhaustive business information once shared in more financially-focused plans.

Supplementally, FATF "requires supervisors to allocate and prioritize more supervisory resources to areas of higher ML/TF risk". As the ineffective situation in the UK we described earlier shows, supervisors have gone overboard regarding the requirements of AMLD5, assigning equal risk to a diverse group of VASPs which would justify a different class of information requirements, be it for registration purposes, be it for ongoing monitoring. In other words, Portugal shouldn't put in the same bag mixers and tumblers with decentralised open innovation or talent platforms²⁸.

Hopefully, Finland's example, which FATF describes as having only "basic fit and proper checks, requirements for handling customer funds, and simple rules regarding marketing", may cast some northern lights for a more effective AML/CTF paradigm.

Lastly, FATF recommends that "an effective risk-based approach will reflect the nature, diversity, and maturity of a country's VASP sector". With the current requirements on the table the nascent Portuguese cryptoasset ecosystem is at risk of being dealt a death blow. After all, the *level-playing field* principle is not protected by the current registration proposal - as it creates unfair conditions for new enterprises dealing with blockchain technology and cryptoassets to "spur financial innovation and efficiency and improve financial inclusion", as well as to compete with established players²⁹.

²⁸ These are real examples of innovative Portuguese startups which are now subject to an excessively onerous registration process even though their AML risk is negligent.

²⁹ From mature crypto scale-ups, to big banks and other intermediaries.

2.2. Recommendations and proposals

Backed by the analysis presented in the previous section, and to complement the proposals reiterated in the next section, we would like to provide the following recommendations to Banco de Portugal, with the goal of contributing to a more efficient AML/CTF regulatory framework regarding virtual asset service providers:

- 1)** Conducting a global risk analysis of the virtual assets sector and benchmark the AML/CTF programs of other countries concerning VASPs, jointly with local industry stakeholders, to guide the different levels of information requests and help anticipate the impact of newer technologies in what AML/CTF is concerned;
 - a)** This is supported by paragraph 60 and 156 of the updated guidance³⁰;
 - b)** This was very well done by Luxembourg, last December³¹
- 2)** Simplifying the risk assessment questionnaire for VASPs, which could be comprised of a straightforward digital form that collects key elements with different correlations to AML/CTF risk, e.g. a) beneficial owners, b) assets on platform or assets under custody, “including the types of services, products, or transactions involved”, c) the number of employees; d) geographies served, and e) whether the VASP operates entirely online or in person;
 - a)** This is supported by paragraphs 153 a) and 154 of the updated guidance.
- 3)** Moving the bulk of the information demands into ad-hoc requests, applicable whenever Banco de Portugal deems the risk of a particular VASP to be relevant for further inquiry and analysis;
 - a)** This is supported by paragraph 153 c) of the updated guidance.
- 4)** Creating a whistleblowing line to incentivise the submission of information related to AML/CTF non-compliance situations;
 - a)** This is supported by paragraph 153 b) of the updated guidance.

³⁰ See [FATF's Guidance For A Risk-based Approach To Virtual Assets And VASPs, June 2019](#)

³¹ See [Luxembourg's Ministry of Justice - ML/TF Vertical Risk Assessment: VASPs](#)

In addition to the above recommendations, it's important to highlight previous comments from the Portuguese cryptoasset community³² on BdP's Public Consultation 5/2020. We support the below proposals and ask BdP to provide an update about them.

- 5) Portugal should adopt a transitional regime, grandfathering businesses already operating in the space before the legislation was approved;
 - a) As the community justified, this was previously granted for other categories of obliged entities, so the enforced suspension for VASPs that was currently enforced is unwarranted and unfair.
- 6) The regulator should review the proportionality of the information requests it asks of a heterogeneous group of VASPs within the context of AML/CTF;
 - a) This is because the same is being asked regardless of the company's size or risk, which is against the spirit of AMLD5, and contrary to FATF's recommendations, as extended in our analysis;
 - i) Additionally, we note BdP declared it only intends to request information that is either available to the obliged entities or that is strictly relevant to the AML/CTF compliance duties;
 - ii) But this availability criterion isn't clear, as exemplified earlier about information request 2.5, i.e. the detailed activities and business plan³³, but other requests for data also aren't clear.
- 7) The inclusion, in Law 58/2020, of transfers of virtual assets between wallets on behalf of other clients should be reviewed;
 - a) Because for those transfers to happen there must be an associated custodial service, which is already in scope. Otherwise, mining businesses, which are not necessarily VASPs, would be considered so.

³² See [APBC - Resposta à Consulta Pública do Banco de Portugal n.º 5/2020](#)

³³ See [Banco de Portugal's Public Consultation 5/2020](#)

3. Final observations

We would like to invite Banco de Portugal to connect with the cryptoasset community in our country, not only concerning this Public Consultation, but also regarding MiCA, the current EU proposal for a Regulation on “Markets in Cryptoassets”, and regarding FATF’s new public consultation about their virtual assets guidance³⁴.

As for MiCA, such regulation will be directly applicable to member states, contrary to what happens with directives. So it can be anticipated that the European Central Bank will assume a stronger role in cryptoasset supervision, and Banco de Portugal’s stance can help the Portuguese cryptoasset community voice their perspective on the matter.

As for the new draft of FATF’s virtual assets guidance, proposed this March, Banco de Portugal can also improve the chances that our comments are heard.

In the end, it’s clear that financial innovation is positively rocking our world and we can’t just fall asleep in our cradles. After all, “the value of virtual assets involved in most ML/TF cases detected to date has been relatively small so far compared to cases using more traditional financial services and product”³⁵, and the latest crypto innovations promise to upend the existing financial sector’s stranglehold on asset management.

We believe Portugal is at a crossroads in history where blockchain technology and cryptoassets are radically impacting our competitiveness in the global digital economy.

Our actions over the next months will dictate the future of the coming generations, compelling us to ensure we clear the path for ideas whose time has come. We owe it to our country to thoughtfully consider the optimal path. We must ensure the right balance between risk-based supervision and innovation, without stifling emergent technologies that are at the forefront of the new digital economy. Other EU member states have been able to strike that balance and there is no reason Portugal cannot do so too.

³⁴ Note that this new guidance, as currently drafted, would consider certain private citizens as VASPs, would force VASPs to move from KYC to know your customer counterparty (KYCC), and would, contrary to the previous updates, be hostile towards the development of blockchain technology and cryptoassets.

³⁵ See [FATF, 12-month Review Of The Revised FATF Standards On Virtual Assets, 2020](#)