Action Plan
on addressing the Risks
emanating from the
Sectoral Risk Assessment on
Virtual Financial Assets

National Coordinating Committee on Combating
Money Laundering and Funding of Terrorism

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Acronyms used in this assessment

AML	Anti-Money Laundering
AMLU	Anti-Money Laundering Unit of the Malta Police Force
BO	Beneficial Owner
CFT	Combating the Financing of Terrorism
CFP	Combating the Financing of Proliferation
DD	Due Diligence
DLT	Distributed Ledger Technology
DNFB	Designated Non-Financial Businesses and Professions
EU	European Union
FATF	Financial Action Task Force
FI	Financial Institution
FIAU	Financial Intelligence Analysis Unit
FIU	Financial Intelligence Unit
FT	Financing Terrorism
IIP	Individual Investor Programme
ITAS	Innovative Technology Arrangements and Services
MBR	Malta Business Registry
MDIA	Malta Digital Innovation Authority
MFSA	Malta Financial Services Authority
MIIPA	Malta Individual Investor Programme Agency
ML	Money Laundering
MSB	Money Service Business
MLA	Mutual Legal Assistance
NCC	National Coordinating Committee on Combating Money Laundering and Terrorism Financing
NRA	National Risk Assessment
NPO	Non-Profit Organisations
PMLFTR	Prevention of Money Laundering and Funding of Terrorism Regulations (Legal Notice 180 of 2008)
PIF	Professional Investor Funds
PMLA	Prevention of Money Laundering Act (Chapter 373 of the Laws of Malta)
PQ	Personal Questionnaire
ROLP	Registrar of Legal Persons
STR	Suspicious Transaction Report
TCSP	Trust and Company Service Provider
TFS	Targeted Financial Sanctions
VFA	Virtual Financial Asset
VFAA	Virtual Financial Assets Act
VO	Voluntary Organisation

1. Introduction

According to the Financial Action Task Force (FATF)[1], while the FATF notes that some governments are considering a range of regulatory responses to VAs and to the regulation of VASPs, many jurisdictions do not yet have in place effective AML/CFT frameworks for mitigating the ML/FT risks associated with VA activities in particular, even as VA activities develop globally and VASPs increasingly operate across jurisdictions. The rapid development, increasing functionality, growing adoption, and global, cross-border nature of VAs therefore makes the urgent action by countries to mitigate the ML/FT risks presented by VA activities and VASPs a key priority of the FATF.[2]

The FATF in its Guidance Note (2019)[3] has assessed that ML/TF risks exist in relation to VAs, VA financial activities or operations, and VASPs. Accordingly, under the risk-based approach FATF guidelines indicate that countries should identify, assess, and understand the ML/FT risks emerging from this space and focus their AML/CFT efforts on potentially higher-risk VAs, covered VA activities, and VASPs. Similarly, countries should require VASPs (as well as other obliged entities that engage in VA financial activities or operations or provide VA products or services) to identify, assess, and take effective action to mitigate their ML/FT risks.

The DLT landscape is developing at a very fast pace in Malta. The past decade has seen numerous technological advancements across multiple fields, one of which has been the development of virtual financial assets and more specifically, virtual currencies. These assets have the potential to transform how people save, transact and invest. They also pose their own unique risks from an ML/FT perspective. Malta has positioned itself as a leading jurisdiction in this aspect by creating the EU's first comprehensive legislation and regulatory framework covering DLT-enabled services that offer legal and regulatory certainty in an environment that was previously unregulated. The related regulatory frameworks in Malta cover the broader scope of DLT assets. The Virtual Financial Assets Act (VFAA), the Malta Digital Innovation Authority (MDIA) Act and the Innovative Technology Arrangements and Services (ITAS) Act are the three pieces of legislation adopted by the Maltese Parliament to regulate this area of activity in 2018. This legislation has been supplemented by regulations issued by the relevant Ministers and rules issued by the MFSA, Malta's single regulator for financial services, the MDIA, which is the regulator for innovative technology arrangements and related services and the FIAU, which is Malta's primary supervisory authority for ML/FT. Malta is committed to combating all forms of ML/FT and the National Coordinating Committee on Combating Money Laundering and the Financing of Terrorism (NCC) has finalised a sectoral risk assessment aimed at further strengthening these efforts. This assessment, which was endorsed by the NCC members in December 2019, laid out the key ML/FT related threats facing Malta and provided an assessment of the vulnerability and control environment of both the country as a whole and a range of key sectors of the economy. The sectoral risk assessment on VFAs was a joint effort led by the NCC in collaboration with the relevant competent authorities.

[1] The Financial Action Task Force (FATF) is an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF Recommendations are recognised as the global anti-money laundering and counter-terrorist financing standard.

[2] FATF (2019), Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers, FATF, Paris, www.fatf-gafi.org/publications/fatfrecommendations/documents/Guidance-RBA-virtual-assets.html

[3] FATF (2019), Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers, FATF, Paris, www.fatf-gafi.org/publications/fatfrecommendations/documents/Guidance-RBA-virtual-assets.html

Given that the FATF guidelines stipulate that an assessment of risk should result in clear and practical follow-up actions, this document represents the targeted action plan to mitigate the identified risks within this sectoral risk assessment. The NCC has consulted with all the relevant competent authorities for the finalization of this action plan, namely with the Financial Investigations and Analysis Unit (FIAU), the Malta Financial Services Authority (MFSA), as well as the Attorney General (AG), the Malta Police Force (MPF), the Malta Gaming Authority (MGA), the Asset Recovery Bureau (ARB), the Sanctions Monitoring Board (SMB), and the Customs Department.

It is to be noted that this document is to be presented together with a document outlining the key results of the sectoral risk assessment in which more detail is provided on the approach and methodology taken in assessing risks related to the VFAs. Accordingly, this document presents only a brief section on the approach and the findings of the sectoral risk assessment. Prior to presenting the key actions aimed at mitigating the ML/FT risks by VFAs, this document will provide an explanation of the key definitions as found in the Maltese law and as presented in the revised FATF recommendations. How this risk assessment was conducted is briefly presented in the third section. Subsequently, the key findings of this risk assessment follow, while the final section will present the action plans aimed at mitigating such risks.

2. Definitions of key terms

Virtual Financial Assets

In October 2018, the FATF adopted changes to its Recommendations to explicitly clarify that such recommendations apply to financial activities involving virtual financial assets and added two new definitions for 'virtual asset' and for 'virtual asset service provider'. Accordingly, VFAs are defined as *'a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes. VFAs do not include digital representation of fiat currencies, securities, and other financial assets that are already covered elsewhere in the FATF Recommendations'*.

The analogous definition under Maltese law is that of a VFA provided in the Virtual Financial Assets Act ("VFA Act") – *any form of digital medium recordation that is used as a digital medium of exchange, unit of account, or store of value and that is not (a) electronic money; (b) a financial instrument; or (c) a virtual token.*

The two definitions are structured in the same manner, being made up of two limbs – one setting out the characteristics which would lead an asset to fall within this specific asset class ("Limb A"), and the other setting out a series of exclusions to the general rule set out in Limb A ("Limb B"). In so far as the first limb of the two definitions is concerned, there do not seem to be any relevant discrepancies between the two and this is mainly because:

Limb A – Presence of Certain Characteristics

- Digital Nature of the Asset Class: both the FATF as well as the VFA Act acknowledge the digital nature of the asset class being defined – the former by considering them as a 'digital representation' of value and the latter by potentially capturing as VFAs all forms of 'digital medium recordation'.

- Ability to Transfer or Trade the Asset: the FATF considers a VA as such if the asset can be 'digitally traded or transferred'. While this is not expressly set out in the local definition of what constitutes a VFA, it has to be acknowledged that an asset that can be used as a 'digital medium of exchange … or store of value' necessarily implies the ability of any such asset to be transferred or traded. In the absence of the ability to transfer the asset, it would not be possible to characterise the same as a means of exchange. The same applies with regards to the asset being a 'store of value' – it implies that it can be somehow traded for its value to be realised.
- Means of Payment: one of the functions that leads to the digital representation of value to be considered as a VA by the FATF is its ability to be used for 'payment'. The same is true of the VFA Act, when it considers any digital medium recordation that can be used as a 'means of exchange' to constitute a VFA[4].
- Act as an Investment: the other function which an asset can meet to be considered as a VA is that it can act as a means of investment. The Maltese definition may be considered to be covering this aspect through the reference to 'store of value', which implies the possibility of an increase or decrease in value as is the case with more conventional investment products. This is also borne by current trends, with VFAs being heavily invested in.

Limb B – Non - Characterisation as another Asset Class

An asset that meets the conditions referred to under the categories of Limb A, need not necessarily fall to be considered as a VA. The FATF only considers as VAs those assets which satisfy the conditions under Limb A of the definition and which cannot be otherwise characterised as a 'digital representation of fiat currencies, securities, and other financial assets'. The Maltese definition provides for a similar exclusion as an asset that would otherwise fall to be considered as '(a) electronic money; (b) a financial instrument; or (c) a virtual token would not be considered as a VFA even though all the conditions under limb A of the definition would be met.

The definition provided by the FATF and that present in Maltese legislation are very close when it comes to the exclusions considered. Electronic money is defined as 'electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions as defined in paragraph 1 of the Second Schedule and which is accepted by a natural or legal person other than the financial institution that issued the electronic money'. Electronic money is therefore a digital representation of a fiat currency which would equate it to the first exclusion considered by the FATF.

With regards to the exclusion of financial instrument under the Maltese definition, this refers to a wide category of assets set out in the Second Schedule to the Investment Services Act. On the other hand, the FATF makes reference to 'securities, and other financial assets' as being excluded from being a VA. While no definition of said terms is provided in the FATF's Glossary, the FATF does provide a list of what is considers as 'securities' in its Risk-based Approach Guidance for the Securities Sector and this would widely correspond to what is considered as a financial instrument under Maltese law.

[4] *Vide* EBA/Op/2014/08 EBA Opinion on 'Virtual Currencies' paragraph 22.

Virtual Asset Service Provider

FATF Definition - *Any natural or legal person who is not covered elsewhere under the Recommendations, and as a business conducts one or more of the following activities or operations for or on behalf of another natural or legal person: (i) exchange between virtual assets and fiat currencies; (ii) exchange between one or more forms of virtual assets; (iii) transfer of virtual assets; (iv) safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and (v) participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.*

The analogous definition under Maltese law is that of a "licence holder" as set out in the VFA Act[5]: *"licence holder" means a person who holds a licence under this Act* with the term "*licence"* being *a licence to provide a VFA service or services granted by the competent authority in terms of article 15* and the term "*VFA service"* being defined as *any service falling within the Second Schedule*[6] *when provided in relation to a DLT asset which has been determined to be a virtual financial asset.*

Whether the definition of a 'VASP' provided by the FATF covers also issuers seems to be debatable as paragraph (v) of the said definition makes reference to the 'participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset'. Thus, it only seems to capture whoever assists the issuer but not the issuer itself. However, the Commission Services make direct reference to initial coin offerors, which may include anyone who comes up with the idea of a new virtual currency and develops it, and not just those who assist in its distribution, as being a potential gap to address to ensure that all services considered under paragraph (v) by the FATF are actually covered by the European regime[7].

Thus, to the extent that the definition of 'issuer' can also be relevant, the VFA Act defines the same as *a legal person duly formed under any law for the time being in force in Malta which issues or proposes to issue virtual financial assets in or from within Malta*[8].

To determine to what extent the activities considered by the VFA Act reflect those covered by the FATF's own definition of a VASP, it is necessary to compare the two.

i. Exchange between virtual assets and fiat currencies

ii. Exchange between one or more forms of virtual assets

The interpretation given in the RBA Guidance as to what is considered to constitute an exchange service is quite wide as it is intended to cover all 'third-party services that enable their customers to buy and sell VAs in exchange for traditional fiat currency, another VA, or

[5] Issuers of VFAs are not being explicitly considered here as the FATF does not per se impose any obligations on issuers unless their activities can be characterized as one of the services falling under the definition of VASPs.

[6] For ease of reference the Second Schedule is being reproduced in Annex I hereto.

[7] Even if it were to be concluded that issuers are not covered by the definition of VASPs provided by the FATF, once these have been included within the local framework as subject persons, the jurisdictions will equally face questions as to the adequacy of the regime governing the same to mitigate the identified ML/FT risks.

[8] Whether the definition of 'VASPs' provided by the FATF covers also issuers seems to be debatable as paragraph (v) of the said definition makes reference to the 'participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset'. Thus, it only seems to capture whoever assists the issuer but not the issuer itself. However, the Commission Services make direct reference to initial coin offerors, including those who come up with the idea of a new virtual coin not just those who assist in its distribution. Given this ambiguity it was decided to include issuers as well within the purview of this comparison.

other assets or commodities' [par 37]. The said RBA Guidance provides a number of examples of what can be considered as an exchange:

- The business models can range from activities equivalent to money transmission exchanges as well as the constitution, maintenance or provision of a marketplace or facility to bring together purchasers and sellers, or for otherwise performing the functions commonly performed by a stock exchange.

The activities included in the Second Schedule to the VFA Act would essentially already cover a number of activities considered as exchanges by the FATF. This would include, for example, dealing on own account and the operation of a VFA exchange.

- Reference is also made to 'decentralised' business models and therefore a decentralised exchange should also be considered to have AML/CFT obligations. The Maltese legal framework does not make any distinction between centralised and decentralised exchanges. Thus, both forms would result in the same being captured under the VFA Act and, by implication, the PMLFTR[9].
- The document also makes reference to kiosks or ATMs as being another example of what can constitute an exchange, given that 'they provide or actively facilitate covered VA activities [i.e. VASP activities] via physical electronic terminals (the kiosks) that enable the owner/operator to actively facilitate the exchange of VAs for fiat currency or other VAs' [par 37].

ATMs are one of the aspects which the sector specific risk assessment refers to as needing further consideration given that there are various business models which may not at present fall to be captured under the Second Schedule to the Act. In addition, ATMs need to also be considered within the context of the transfer services for VFAs.

- The RBA Guidance also makes reference to other activities that can be considered as exchange services as understood by the FATF. These would include:
  a. VA escrow services, including services involving smart contract technology, that VA buyers use to send or transfer fiat currency in exchange for VAs, when the entity providing the service has custody over the funds.
  b. Brokerage services that facilitate the issuance and trading of VAs on behalf of a natural or legal person's customers.
  c. Order-book exchange services, which bring together orders from buyers and sellers, typically by enabling users to find counterparties, discover prices, and trade, potentially through the use of a matching engine that matches the buy and sell orders from users.
  d. Advanced trading services that allow users to buy portfolios of VAs and access more sophisticated trading techniques, such as trading on margin or algorithm-based trading.

Once more we are of the view that most of the services referred to by the FATF would fall to be captured under the Second Schedule to the VFA Act.

[9] It is to be noted that the possibility of having a decentralised VFA service provider licensed under the current regime is somewhat remote given that the regulatory framework has been conceived to accommodate a business model where there would be someone on whom enforcement supervisory action can be taken. However, the possible introduction of provisions to bestow legal personality on decentralised applications of the DLT may eventually reduce the distinction between the two business models and lead to the emergence of decentralised service providers.

Transactions effected by the Exchange
In terms of the RBA Guidance, the exchanges referred to by the FATF are those which facilitate the acquisition or disposal of VAs in return for traditional fiat currency, another VA, or **other assets or commodities**. It is important to highlight that the reference to 'other assets or commodities' is not found in the Glossary definition *per se* but is an addition made in the RBA Guidance. While guidance documents are not considered by the FATF to carry the same weight as its Recommendations, it is still deemed worthwhile to consider the same.

In so far as the VFA Act is concerned, it makes no explicit reference as to what kind of assets may be accepted by VFA service providers in return for VFAs. However, there are indications suggesting that a VFA service provider is only to accept FIAT currencies or VFAs[10]. This leads to the question as to whether anyone providing a service equivalent to those under the Second Schedule but who accepts assets other than FIAT currencies or VFAs in return for VFAs could be able to do so without undergoing any form of licensing process. Accepting financial instruments may already be subject to licensing under the Investment Services Act but accepting other assets as consideration for VFAs is to be given further consideration by the MFSA.

Transfer of Virtual Assets: The RBA Guidance does not consider this service separately from the other services that would fall within different limbs of the VASPs definition. It does however provide a description of what it considers to constitute a transfer service, i.e. the carrying out of a transaction on behalf of another natural or legal person resulting in the movement of a VA from one address to another. Thus, anyone whose business involves carrying out such a transfer is to be considered as a VASP. A number of services already covered by the Second Schedule to the VFA Act would fall to be considered as including the transfer of VFAs. However, there may be additional services that fall to be considered as such and it is therefore important to further explore this area. This is especially relevant when it comes to services that would fall to be considered as payment services had they to involve FIAT currencies. In particular, this has to be considered in the context of the extension of Recommendation 16 to transfers of VFAs.

Safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets: Paragraph 41 of the RBA Guidance describes these services as being 'services or business models that combine the function of safeguarding the value of a customer's VAs with the power to manage or transmit the VAs independently from the owner, under the assumption that such management and transmission will only be done according to the owner's/customer's instructions. Safekeeping and administration services include persons that have exclusive or independent control of the private key associated with VAs belonging to another person or exclusive and independent control of smart contracts to which they are not a party that involve VAs belonging to another person'.

With regards to the local legislation, two considerations need to be made:

[10] The Virtual Financial Assets Regulations impose safekeeping requirements on any licence holder holding or controlling clients' money or assets, with assets being defined as being *movable and immovable property of any kind and excludes financial instruments as defined in the Second Schedule to the Investment Services Act, whether issued in Malta or not.* However, it is only when it comes to VFAs and FIAT currencies that the said regulations and the VFA Rulebook lay down in detail what these safekeeping arrangements have to be. In addition, it is to be noted that in the case of VFA exchanges, they can only execute trades consisting in FIAT to VFAs, VFAs to FIAT and VFAs to VFAs.

- Among the services regulated by the VFA Act is the provision of custodian or nominee services, independently of whether the said service is being provided on its own or in an ancillary capacity to another VFA service provided by a third party.

- When licensed to provide other services in terms of the VFA Act, the licence will also stipulate whether the licensee can hold clients' assets or monies, be it VFAs or otherwise. When it comes to VFAs, these could either be deposited with a third party or held by the licensee itself. Where they are held by the VFA service provider, this would still be an activity covered by its licence and therefore subject to the accompanying AML/CFT obligations[11]. The same is true with regards to issuers which, though required to appoint a custodian for such assets, are actually able to use a smart contract instead, as long as the systems audit does not find anything wrong therewith.

It therefore seems that the VFA Act goes to some extent to ensure that anyone acting as custodian or nominee is somehow regulated.

Participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset

The RBA Guidance sheds some light on the nature of the services the FATF intends to capture under this sub-heading. It refers to '[n]atural or legal persons who actively facilitate the offer or issuance of and trading in VAs. Including by accepting purchase orders and funds and purchasing VAs from an issuer to resell and distribute the funds or assets' [par 42].

This would correspond to a number of services that are included within the Second Schedule to the VFA Act, including:

- Reception and Transmission of Orders
- Execution of Orders on behalf of Other Persons
- Placement of Virtual Financial Assets

In addition, it has to be remarked that under the Maltese framework even the issuing of VFAs itself is considered as "relevant financial business" and as attracting AML/CFT obligations. However, it is not every issue that attracts AML/CFT obligations on the part of the issuer but only when the said issue constitutes an offer to the public in terms of the Glossary to the VFA Rulebook. In so doing the Glossary also sets out a number of exemptions. Given that it was felt necessary to subject issuers making an offer to the public to the aforementioned requirements, it would be equally important to explain on what basis these exclusions were provided for and whether the ML/FT risk associated with these exemptions is adequately low to justify the said exclusion[12]. This has to be considered in the context of the discussions to be undertaken by the relevant authorities as to whether changes are required to the regime applicable to private placements to ensure better oversight thereof.

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[11] The Virtual Financial Assets Regulations stipulate that '[a] subject person [i.e. a VFA service provider] **may** deposit virtual financial assets held by it on behalf of its clients into an account or accounts opened with a third party', allowing for the possibility of having the licence holder itself hold the assets on behalf of the customer. On the other hand, it is quite clear that this would not be possible in the case of client monies which in terms of the said Regulations '**shall**' deposit the same with a third party institution. Chapter 3 of the VFA Rulebook does convey the impression that the assets should be deposited with a third party institution as well (see R3-3.1.5.1.2) but, unlike in the case of issuers, it does not expressly state as much.

[12] One such exemption is that allowed for offers which are not extended to more than 150 natural or legal persons. However, there is then no restriction as to the amount that can be invested through any such issue, be it per issuer or on the total amount of funds that are to be raised by the issuer.

The Exclusion of Virtual Tokens

The VFA Act defines a virtual token as '*a form of digital medium recordation whose utility, value or application is restricted solely to the acquisition of goods or services, either solely within the DLT platform [which cannot be a DLT exchange] on or in relation to which it is was issued or within a limited network of DLT platforms'*. Moreover, to the extent that the token can be converted into another DLT asset type, then the token is to be treated as the DLT asset type into which it can be converted.

The FATF does make allowance for the possible exclusion of some VAs from the ambit of its recommendations. It clearly states that it *'does not seek to capture the types of closed-loop items that are non-transferable, non-exchangeable, and non-fungible. Such items might include airline miles, credit card awards, or similar loyalty program rewards or points, which an individual cannot sell onwards in a secondary market'* [par 47].

It does therefore seem that a virtual token would meet the conditions to be considered as closed-loop and therefore allow for its exclusion from the ambit of the VFA Act. Virtual tokens are 'non-exchangeable' as they must intrinsically not allow for their conversion into other asset categories. They also seem to meet the non-transferability criterion as it should not allow for its trading outside the DLT platform on which it is to be used or a limited number of platforms associated therewith. Moreover, none of these platforms can be a DLT exchange.

The exclusion of virtual tokens from any form of regulation, be it prudential or AML/CFT related, is based on the limited network exclusion provided for under Directive (EU) 2015/2366[13] which then entails their corresponding exclusion under Directive (EU) 2015/849[14] and under Regulation (EU) 2015/847[15]. The main reason for the said exclusion is the limited use that can be made of the particular instrument as it can be only redeemed for goods or services provided through one or more specific providers. However, this reasoning behind this exclusion and the safeguards introduced to prevent any possible abuse thereof is nowhere documented.

3. Overview of the Risk Assessment

Approach taken

The approach involved four main steps:

- The first step was to assess the impact of VFAs on the threat landscape of predicate offences, both in terms of the impact of VFAs on existing predicate offences and in the context of new types of threat that have arisen due to the growing prevalence of VFAs (e.g. ransomware, ICO fraud etc.)

[13] *Vide* Article 3(k) of the said Directive.

[14] In setting out which entities are considered as financial institutions, Directive (EU) 2015/849 makes reference to the activities listed in points (2) to (12) of Annex I to Directive 2013/36/EU. Point 4 thereof refers to '[p]*ayment services as defined in Article 4(3) of Directive 2007/64/EC*. Given that Directive 2007/64/EC (and its replacement Directive (EU) 2015/2366) considers that any service that can avail itself of the limited network exclusion does not fall within its ambit, it follows that it cannot be considered as a service which attracts AML/CFT obligations in terms of Directive (EU) 2015/849.

[15] Article 2(2) of the said Regulation provides that '[t]his Regulation shall not apply to the list of services listed in points (a) to (m) and (o) of Article 3 of Directive 2007/64/EC'. The reference is here to the previous directive regulating payment services, with the limited network exclusion having been provided for under Article 3(k).

- The second step was to conduct a vulnerabilities assessment, both of the VA classes themselves, as well as of the Maltese sectors that will be utilising VFAs as part of their operations.
- The third step comprised a review of controls. The three pieces of VA related legislation were reviewed along with the proposed supervisory and enforcement framework.
- As a fourth and final step, recommended enhancement measures and key priorities for the country were outlined across several areas (e.g. governance, processes, capabilities etc.)

In this sectoral risk assessment, there was no residual vulnerability assessment (which refers to the 'remaining' vulnerability after taking into account the impact of mitigation controls that have been put into place). The reason for this is that the sector is still very young and is rapidly developing. As such, a review of control measures was conducted, and certain high-level strategic enhancements proposed. A gap analysis was presented with this risk assessment that addressed to what extent the implemented legislative framework governing VFAs, VFA issuers and VFA service providers is compliant with the revised FATF recommendations, as well as addressing the fact that the current law enforcement structure in Malta ignores the risks and challenges dealing with this matter. In order to establish a holistic picture of the landscape, the assessment incorporated a wider taxonomy of assets, including convertible virtual currencies like crypto-currencies as well as non-convertible virtual currencies and crypto-backed financial products.

The first step was to assess the 'threats' and here two types of threats were examined: existing threats that may be exacerbated by the rise of VFAs and emerging threats that will be created/enabled by the emergence of VFAs. The existing threats are predicate offences that are deemed particularly susceptible to the rise of virtual financial assets, namely:

- Illicit trafficking in narcotic drugs and psychotropic substances
- Corruption and bribery
- Fraud (incl. tax evasion)
- Robbery or theft

It is worth noting that, in contrast to money-laundering using VFAs, terrorism financing using VFAs has been limited to date. However, international cases have been reported, including allegations of ISIS funding via Bitcoin, but mainstream adoption of cryptocurrencies to fund terrorism has so far not occurred. This is likely due to several barriers:

- High volatility of cryptocurrencies
- Difficulties in converting cryptocurrencies into fiat cash for use in purchases
- Lack of sufficient technical expertise amongst terror groups
- Possibility of tracing and flagging suspicious transactions through the ledger on the most liquid / readily available of cryptocurrencies

Despite these disadvantages it is likely that terrorist groups will continue to solicit funding via cryptocurrencies and the barriers listed above are not insurmountable.

The emerging threats reflect the fact that recent years have seen an increase in the proliferation of new predicate offences specifically linked to the rise of VFAs. While the offences outlined above have been aided by the rise of VFAs, the following cybercrimes have grown in prevalence precisely because of the increased usage and acceptance of VFAs:

- Ransomware attacks (payments demanded to unlock the victim's computer are increasingly solicited in cryptocurrency)

- Hacks (typically involving the theft of large sums of virtual currency from an exchange provider)
- Market manipulation (increasingly common among virtual currencies with a low market capitalisation where a few large investors can control prices)
- Fraudulent ICOs (a phenomenon involving false promises regarding the future value of a crypto-asset before or during its launch).
- VFAs can be used to fund the manufacture, acquisition, purchase of illicit weaponry (nuclear, chemical or biological weapons) and their means of delivery.

Furthermore, the landscape of VFAs was divided into three categories for the purposes of the assessment: convertible virtual currencies, non-convertible virtual currencies and crypto-backed financial products. A vulnerability assessment was conducted to determine the level of ML/FT risk posed by each of the VA classes including the dimensions materiality of the asset class, technological suitability for crime, convenience, and existing criminal precedent.

The risk assessment concluded that Malta has a 'high' level of inherent vulnerability in terms of convertible virtual currencies. Non-convertible virtual currencies have overall a 'low' level of inherent vulnerability, and the last asset type that of crypto-backed financial products fall under the category of 'medium' level of inherent vulnerability. The next section presents the recommendations emanating from this risk assessment, where actions aimed at addressing such risks are presented in Section 5.

4. Risk Assessment

Assessment of the controls in place

Findings of the assessment indicate that Malta has taken a proactive approach to regulating and supervising this fledgling space and has released three pieces of landmark legislation to address the virtual asset and DLT space (the VFA, MDIA, and ITAS acts). The assessment examined the existing and proposed legislation and control framework for virtual financial asset issuers and service providers as well as innovative technology arrangement and service providers across four stages of classification, supervision (market entry and ongoing monitoring), preventative measures, and investigation, prosecution and recovery.

Each of the three acts predominantly covers the supervisory mandates and processes that will govern market entry controls, with less emphasis given to ongoing supervision, investigation and prosecution. From an AML/CFT perspective, the VFA Act goes well beyond 5AMLD and establishes that all VFA issuers (ICOs) and virtual asset service providers will be classified as subject persons (as defined in Malta's Prevention of Money Laundering act). The VFA Act also determines which assets should be classified as VFAs and applies certain criteria to distinguish VFAs from financial instruments (as defined in MiFID II), virtual tokens and e-money. It is to be noted that authorisations under the VFA and ITAS Acts are not mutually exclusive and a person may hold dual authorisation.

Key recommendations

In the risk assessment, the recommendations that were made, centred around the fact that various observations were noted for potential expansion to the framework which, if implemented, would see Malta progress yet further in its aim to establish itself as the world's soundest regulatory regime in which to operate a DLT business. This includes determining necessary enhancements to core processes to incorporate the new demands of the VFA space,

as well as building out clearer roles and responsibilities across the framework and training both public and private sector stakeholders to allow them to fulfil their role in the framework effectively.

Recommendations for the Competent Authorities

Specific enhancements for the public sector were grouped under broader thematic improvements which apply across the regulatory and supervisory framework.

Enhance legal and regulatory framework: Malta's legislation goes well beyond Europe's 5th AMLD but there is room to expand/clarify the scope. More specifically, it is not clear whether ATM providers, which are assessed to be highly vulnerable to ML/FT abuse, would fall under the proposed legislation. This point should be clarified in future guidelines. Miners are not currently covered by the VFA Act. In order to close this gap, the MFSA could update the VFA activity framework to include the creation of new coins via mining as a regulated activity. Privacy tokens are growing in popularity and they pose the highest level of ML/FT risk of any virtual asset. Malta should consider carrying out a feasibility assessment regarding the potential costs and benefits of an outright ban on privacy tokens.

Clarify roles and redefine organisational structure: the VFA Act and its guidelines establish clear divisions of responsibility for both private and public-sector entities across market entry elements of the framework. However, more clarity regarding governance and organisational structures could be provided for other parts of the framework. Greater accountability and clearer ownership should be applied to the MFSA, FIAU, MGA and ARB across the framework, but particularly in relation to ongoing supervision of the VFA sector. Authorities should review their governance mechanisms to ensure that they are able to respond to the ML/FT risks posed by VFAs. Greater emphasis is required on the need to revise organisational structures to account for the new demands and obligations arising from the VFA sector.

Clarify key processes and enhance where required: specific processes need to be laid out for enforcement, investigation, prosecution and recovery of VFAs. The MFSA should improve its core processes (including data and technology) going forward and will need to automate the DD process as far as possible. The authority will also need to enhance the data available for assessments. In additional to these MFSA-specific issues, other processes need to be laid out for enforcement, investigation, prosecution and recovery of VFAs (e.g. the processes of the economic crime unit and the asset recovery bureau).

Upskill stakeholders and deliver necessary data and systems enhancements: the DLT and VFA space will require new skills across competent authorities in order to ensure the risks posed are appropriately mitigated. In order to meet the new challenges presented by the space, competent authorities will not only need to train existing employees on the intricacies of the VFA and DLT ecosystem but also in many cases will need to hire new competencies. Also, in investigating potential crimes, the economic crime unit will need new capabilities and tools. The same applies to the Asset Recovery Bureau, who will need extensive training and enhanced technological capabilities to store confiscated VFAs.

Recommendations related to the revised FATF guidance

Furthermore, given that the in October 2018 the FATF adopted a series of changes to Recommendation 15, which led to the adoption of a revised Interpretative Note in June 2019 and, in an effort to better set out how the FATF expects jurisdictions to comply therewith, it also issued a revised version of its Guidance for a Risk Based Approach to VAs and VASP

("RBA Guidance"), the sectoral risk assessment proposed a series of recommended actions to ensure that the domestic framework is better aligned with the said recommendations.

- Determine to what extent, if any, VFA issuers are captured by the FATF's definition of a VASP.
- Consider whether there are any additional services that should be subjected to the current regulatory framework so as to ensure adherence with the definition of VASP provided by the FATF, and in particular with respect to services that fall to be considered as involving a transfer of VFAs. The MFSA has already expressed its intention to look further into the possible extension of the VFA Act to also cover VFA payment services.
- Ensure that the reasons justifying exclusions provided in relation to virtual tokens, private placements etc. are duly documented, bearing in mind possible regulatory changes there may be in relation to the same.
- Consider the challenges that competent authorities and other entities may face in eventually carrying out their functions in relation to this new sector. Law enforcement, prosecution and asset seizure agencies are very likely to face difficulties and in this context recommendations should be made as to any necessary legislative amendments and resources required to ensure that all competent authorities are in a position to exercise their role in as an effective manner as possible.
- Determine on what basis specific exemptions were allowed for under the current legislative and regulatory regime and document the reasons for as much.
- Ensure that the findings of the said document are, to the extent that they may be relevant thereto and allow for dissemination, communicated to the private sector in a manner that is both timely and allows them to make use of the same.
- Set out the necessary policies and procedures to bring to the attention of all competent authorities any developments in this area that may somehow influence the national AML/CFT framework, allowing all the said authorities to consider how any such development will influence their functions at law, and limit as much as possible the ability of the different authorities to take independent action.
- Guidance provided to VFA service providers and issuers be revised to ensure that it makes reference to any additional risk factors referred to in the RBA Guidance. In drafting any additional sector specific Implementing Procedures, the FIAU should ensure that it considers to what extent the sector is exposed to VFAs and, on that basis, provide guidance as to possible risk factors associated with VFAs to which the sector may be exposed to.
- Clear criteria should be set out specific to VFA service providers as to what it entails to have a foreign legal person established in Malta and also as to what is meant to have a VFA service provider offering services in or from Malta or an issuer conducting an offer in or from Malta;
- Set out as a matter of policy how on-going monitoring of the fit and properness test is to be carried out by the responsible authority;
- To the extent that a VFA issuer is determined to be included within the definition of a VASP, it may become necessary to see whether the current application of the fit and properness test is sufficient, or whether it requires further streamlining or additional changes;
- Carry out a monitoring exercise to seek data and information as to the possible incidence of entities registered in Malta carrying out VFA services not in or from Malta and, on the basis of the said conclusions, determine whether the situations requiring licensing by the MFSA need to be revised. The same is to be done with regards to issuers of VFAs;

- Ensure that the authorities have the necessary resources and tools to detect the carrying out of unlicensed or unauthorised VFA activity, and are effectively able to sanction for the same;
- Conduct a post-mortem examination of how the MFSA went about enforcing the transitory regime provided for under Article 62 of the VFA Act;
- Finalise the amendments to the VFA Act to ensure that a licence to provide a VFA service or the authorisation to carry out an offer to the public is withdrawn or suspended in the event of AML/CFT breaches or of significant AML/CFT concerns and consider what additional amendments, if any, are required with respect to the VFA Act.
- The FIAU clarifies in more detail what information may be required to be collected and held by a VFA service provider to reconstruct a transaction involving a transfer of funds;
- The authorities continue their engagement with service providers to identify possible solutions that may be used by VFA service providers to comply with the Travel Rule;
- Consider (i) whether action should be taken at the national level to introduce legislation extending the obligations under the Funds Transfer Regulation to VFA service providers as well or if this should be delayed pending action at the EU level; and (ii) what may be the implications of so doing on other regulated service providers due to possible changes to the definition of 'funds';
- It be clarified that any AML/CFT guidance relative to AML/CFT aspects within the VFA area is to be also applicable to anyone carrying out the said activity, even if exempt from licensing, to the extent that the activity is being carried out by way of business to service third parties;
- Highlight as much as possible any ML/FT high risk factors whenever VFAs are used in the context of relevant financial business or relevant activity.
- Initiate a dialogue between the MFSA, the MGA and the FIAU with respect to gaming companies that may be interested in conducting an offer of assets that may be considered either virtual tokens or VFAs, in particular in view of the Sandbox Approach launched by the MGA.
- The creation of a standing sub-committee focusing on the risks and challenges presented by VFAs may be a possible future development to consider. As discussed hereunder, the authorities that may have an interest in this area may be much wider than the spectrum of authorities that was involved in the consultation process carried out prior to the launching of the DLT and VFA legislative and regulatory framework. Through the NCC it would have been possible to carry out the said process in a more structured and focused manner when considering the ML/FT aspect.
- Maltese law does not impose any particular threshold for there to be an occasional transaction in the context of the PMLFTR. Thus, AML/CFT obligations are triggered independently of the amounts involved in, or the value of, a VFA transaction. This decision was taken on the basis that there may arise situations in a VFA-to-VFA transaction where it would not be possible to actually determine the values involved:
    - A VFA might not be listed on an exchange; and
    - Even if listed on an exchange, it is close to impossible to determine the basis on which the value of the VFA concerned is to be determined. Even if an average value is to be taken, the question will arise as to how many valuations is one to consider and whether any criteria are to be met for an exchange's valuation to be taken into consideration.

- A more thorough analysis be conducted as to whether the characterisation of any transaction carried outside of a business relationship as an occasional transaction is

justified, or if a threshold should actually be introduced, at least limitedly to transactions involving a VFA-FIAT-VFA exchange;

- Ensure that VFA transfer services are also subject to regulation in terms of licensing and supervision.
- Ensure that the Implementing Procedures – Part II addressed to the VFA sector provide the necessary guidance to subject persons as to how to comply with their obligations at law and include any additional risk factor that may be referred to in the RBA Guidance to ensure that subject persons have as much guidance as possible when it comes to assessing the risks they are exposed to when carrying out their particular activity.
- In terms of the reporting of suspicious transactions or activity, consider whether it would be sufficient to address the issue identified with respect to Regulation 15(3) of the PMLFTR by providing guidance in the Implementing Procedures – Part II to the effect that the term 'funds' is, in the context of VFAs, to be interpreted so as to also include VFAs. The Suspicious Transaction Report template form should also be examined to determine whether any changes are necessary to ensure that it adequately caters also for the VFA sector.

5. Planned Actions aimed at mitigating Risks

Actions by the FIAU and the MFSA

- The FIAU has significantly increased its staff. A re-structuring of its Compliance Section is finalised and so is a change in the supervisory strategy, all of which is supported by frequent and ongoing training and updating. The MFSA Financial Crime Compliance unit is set up and undertaking inspections, whilst the MGA in increasing its AML executives.
- The FIAU finalised a change in its risk assessment methodology, finalised the supervisory manual and is in the finalisation stage to update the enforcement process.
- Amendments to the Prevention of Money Laundering Act (PMLA) forwarded to Ministry to give the power to the FIAU to be able to publish imposed pecuniary penalties even if the said penalties have been appealed in front of the Courts (i.e. even if not yet final and due). Furthermore, the FIAU is in the near future to engage with the Office of the Attorney General to seek the possibility of revising the provisions regulating the appeals procedure.
- The FIAU already applies a risk-based supervisory model which is intended to cover all subject persons but determine the intensity of supervisory action and the resources spent to carry out any such action on the basis of the ML/FT risks presented by the particular sector and the individual subject person. VFA issuers and licence holders are also covered by this risk-based supervisory model.
- In so far as sanctions for AML/CFT breaches are concerned, it should be noted that the PMLFTR allows the FIAU a significant range of powers to impose both administrative sanctions and/or remediation actions on subject persons that are found by the Compliance Monitoring Committee ("CMC") to have breached AML/CFT obligations. Moreover, the FIAU's sanctioning policy also provides for the possible imposition of interim measures where supervisory action reveals shortcomings of such a nature and extent that awaiting a determination of the CMC would only exacerbate the situation.
- In so far as the FIAU is concerned, there is no known obstacle to exercise already existing powers of information exchange both with counterpart FIUs as well as counterpart AML/CFT supervisory authorities. It is also the FIAU's view that it would equally be in a position to exercise its postponement powers under Article 28 of the PMLA in situations or transactions involving VFAs.

- With regards to the possible suspension or withdrawal of a licence or authorisation to carry out an offer to the public on the basis of AML/CFT breaches, it should be noted that this is not something that the FIAU can do but would fall within the MFSA's remit. While it could be argued that the MFSA already has the necessary powers to do so[16], some uncertainty still persists as to whether it could be possible to rely on the current provisions to suspend or withdraw a licence due to AML/CFT breaches. To remove this uncertainty, amendments are at present being discussed to ensure that, to the extent possible, the MFSA has express powers under the VFA Act to actually withdraw or suspend a licence or authorisation in the event that either a licencee or issuer is found to have committed significant breaches of its AML/CFT obligations or even if there are significant concerns as to its actual adherence to the same. It is not clear whether even with the proposed amendments, it would be possible for the MFSA to restrict a licence or authorisation, rather than suspend or withdraw the same.
- AML/CFT breaches of a certain severity allow the MFSA to exercise its powers to issue directives as set out in Article 41 or to even use its powers to appoint a competent person under Article 42 of the VFA Act[17]. The ability to exercise the former even on the basis of AML/CFT grounds would be especially important given the possible application of Regulation 21(7) of the PMLFTR.

Proposed reforms by Authorities

In order to ensure that the sectoral risk assessment on VFAs takes a holistic approach as possible to the ML/FT risks posed by VFAs and VFA service providers, it was highlighted in the gap analysis that accompanied the risk assessment that the competent authorities should be involved more. This is especially so when one takes into account the fact that the legislative and regulatory framework was put in place prior to the carrying out of a proper risk assessment to determine the risks, advantages and resources required to effectively regulate and police this new sector. Accordingly, the following are the reforms and actions that are being proposed by the responsible entities in order to address the risks that emerge from the sectoral risk assessment on VFAs, with particular reference to issues that may present themselves with regards to investigations, asset tracing, freezing and confiscation, and prosecution.

Customs Department

Malta is in the process of transposing the requirements outlined by the new Cash Control Regulation (EU) 2018/1672, which will come into force by the 3rd June 2021. The commodities that will be added to the current obligations include commodities used as highly-liquid stores of value (gold bullion). Prepaid cards and virtual currencies are not covered by the same Regulation. EU Member States do not have the means to carry out such controls yet. The virtual currencies are covered in the 5AMLD which provides for reporting procedures to other entities but not to Customs. Regarding the controls of cross-border transportation of cash and bearer negotiable instruments, Malta's Customs Department adopt the obligations required by the EU Regulation.

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[16] One could argue that even at present there is the possibility for the MFSA to withdraw or suspend a licence or authorization to conduct a VFA offering to the public under Article 12(1)(c) and (d), as AML/CFT breaches could be considered as impacting the issuer's integrity in terms of Article 9(1)(a). Compliance with 'other relevant legal and regulatory requirements' is one of the high principles that VFA service providers have to comply with (*vide* R3-1.2.2 of Part 3 of the Virtual Financial Assets Rulebook). In the case of a VFA service provider this could constitute grounds to trigger Article 21(2)(a) of the VFA Act as a licensee cannot be said to be still a fit and proper person if there are serious concerns of an AML/CFT nature.

[17] Article 41 is exercisable whenever the MFSA 'deems it necessary' while Article 42 can be triggered whenever the said authority considers 'that sufficient circumstances exist'. The wording is therefore quite wide, allowing the exercise of said powers in multiple and different scenarios.

Asset Recovery Bureau

As such this authority is only regulated by a Subsidiary Legislation, which may be challenged when virtual assets are in play if the offence arises only under the VFA Act, Chapter 590 of the Laws of Malta and its sole Subsidiary Legislation (S.L.). Accordingly, it is being recommended that the ARB is indicated as a competent person under Chapter 590 or more precisely under the Subsidiary Legislation such that the ARB would be able to retrieve information from any subject person and/or entity and can, accordingly fulfil its function in line with S.L. 9.23. Since the ARB is regulated only by S.L. 9.23, it would be beneficial to carry out slight amendments to the VFA S.L. to include the ARB so that the ARB can request direct information from subject persons directly.

To date, the ARB got approval for the recruitment of new staff in 2020 and is carrying out a legal screening session to ascertain gaps hindering its functions. It is also in the process of installing new secure systems of communication and requesting access to central registries and has partnered with international resources for the disposal of assets. The Police are drawing up guidelines that are and soon to be finalised and published, whilst the ARB is mapping all policies and procedures for Asset Tracing and Recovery purposes. With regards to non-conviction-based confiscation, consultations at very high level are still being held. The competent authorities are compiling a way forward in this regard and will present it to the Minister concerned for approval since this requires an extensive change in legislation.

Attorney General

On the issue of the definition of the terms 'proceeds' and 'property', the AG remarked that the definitions of 'proceeds' and 'property' (including property with corresponding value) as provided by virtue of Cap. 9; Cap. 373 and Cap. 365 of the Laws of Malta are wide enough to include VAs even if VAs are not specifically mentioned in the legislation itself. This is therefore applicable when it comes to offences such as Terrorism; FT; ML; Breach of Sanctions; and crimes carrying as punishment over one-year imprisonment. Besides, the AG remarked that theoretically, given that the definition of 'proceeds' might be interpreted to include VAs, the Courts of Law may order the confiscation of corresponding value which consists of VAs. However, emphasis is being made to the word 'theoretically' since to-date in practice this was never done. To date inquiries into whether the convicted person has VAs or not are not done. In fact, AG remarked that to date it does not appear that the police and the ARB have the resources required to verify if a person accused/convicted is the owner of VAs. Moreover, policy is clearly lacking on how VAs should be dealt with and at what time it is best from VAs to be reverted or exchanged in FIAT once they are identified.

Thus, with regards to 'tracing' of VAs, AG highlighted that to date, there is a lack in the ability of the authorities in terms of being equipped with the required resources to trace VAs and associate a wallet with an ascertainable legal person or individuals. Therefore, on this regard, the authorities are to identify the resources (including training) they require not only to effectively trace VAs appertaining to a suspect but also on how to identify VAs coming from an illegitimate source.

Furthermore, in the risk assessment, when it comes to seizing, attaching, freezing and confiscation of Vas, the AG added that there is nothing in the law which clearly makes such instruments inapplicable to VAs. To the contrary given that from the AG's point of view the definition of 'property' and 'proceeds' is wide enough to include VAs, theoretically such measures are also available to VAs. Thus, AG indicated that against this background it can be

said that there are serious concerns on whether in practice such measures can be effectively used to effectively seize; attach; freeze and confiscate VAs. This for the following reasons:

- In terms of Maltese law such instruments are issued against an ascertained suspect, accused or convicted person and not against property (without having identified the owner). To date in Malta authorities are not able to attach/freeze/confiscate property if the person/legal person behind the property is unknown. With VAs, the 'suspect' is not easily and immediately ascertainable since portfolios are held in a number & letter combination code ('key') not in person's name. Identifying the person/legal person behind the portfolio, so that such measures can be utilized, can take time by the investigators in which time the VAs can be transferred and further disseminated in further portfolios. Hence authorities will not be able to act in an effective manner.
- The 'attachment order' (a provisional measure in terms of Maltese law) only attaches monies and other property (movables as VAs) in the hands of third parties. Given that when it comes to VAs (unlike monies held within a bank) there is many times no involvement of third parties it might prove difficult to effectively attach funds belonging to a suspect since at any time the suspect might, notwithstanding the court order, transfer such funds since he will retain complete control of such funds. The only safeguard there is in this regard is that if the suspect transfers any VAs he may still be found guilty of an offence in terms of law since he would have breached the relevant attachment order. This is also applicable when it comes to freezing order.
- To complicate further the above, if VAs belonging to a suspect/accused are identified, the VAs in question cannot legally be transferred to the authorities (e.g. ARB) pending proceedings with the view of safeguarding such assets, since that would be tantamount to confiscation which can only be done after there is a res judicata and a confiscation was ordered against the person in question in terms of law. Hence, in terms of Malta's Law if VAs are identified, such VAs cannot be transferred prior to final judgement and they have to be left in the control of the suspect/accused in which scenario the authorities cannot effectively ensure that such VAs are not transferred and we will be left at the whim of the accused on whether to dissipate such funds. The only consequence for the suspect or accused if he transfers such VAs pending an attachment/freezing order, is that he will be guilty of the offence of breach of freezing order.

Furthermore, with regards to mutual legal assistance, the AG remarked that this aspect has to be given its due attention and importance given the intrinsic global nature of VAs that will invariably lead to a situation whereby Malta will be receiving its fair share of requests for cooperation. In fact, the AG adds that they have already received a number of requests concerning VAs. Requests should basically concern tracing; seizing; attaching; freezing and confiscating VAs. All the aforementioned issues mentioned in the context of local scenario will hence be also applicable when it comes to money laundering requests. In fact, the AG have encountered several practical difficulties to provide effective assistance when it comes to money laundering requests dealing with VAs. Therefore, this is something that needs to be addressed.

With respect to the sharing of confiscated assets with other countries which is one of the obligations Malta has under various Conventions and Agreements, the AG believe that it is of utmost importance, that as mentioned in the preceding paragraphs, guidelines/policy on how Maltese Authorities should convert VAs in actual currencies (FIAT) are established. This might have a considerable impact in establishing the value confiscated and the value shared with the other States.

Although the regulation on VFAs mentions issues of ML/FT and other predicate offences and makes valid comments in that respect, the AG believe that it still does not address the details of the aforementioned issues. These issues are of outmost importance and they need to be addressed as soon as possible so that Law Enforcement will be in a better position to fight crime in connection with VAs.

Malta Police Force

In line with the argument raised by the AG, the MPF remarked that it is to be noted that while law enforcement authorities have all the necessary tools to obtain information from subject persons, legal provisions that are introduced for VA purposes should ensure that all the local licenced VASPs should maintain all the necessary documentations to be able to identify the natural and legal persons holding or having control of VA accounts or wallets, and all supporting documentation for each and every transaction effected, similar to that which is currently being adopted by local financial institutions. In this area, locally licenced VASPs should maintain such information as:

- Identification details of the owners of wallets, including ID/passports, at least 2-tier identification processes, supporting documentation, and full KYC documentation
- Supporting documentation for all transactions and movement of assets carried out, including IP/log data, and other such electronic evidence that one should expect to have in all financial institutions.

With regards to the ability to trace and identify wallets and transactions, the MPF remarked that the blockchain itself can offer a challenge to law enforcement authorities including the ARB, to identify wallets, and trace transactions. Such challenges include, but not limited to, the following:

- How to effectively carry out physical searches at properties;
- How to effectively analyse computer evidence is a secure environment, taking precautions with respect to tempering / allegations of tempering with such wallets;
- How to analyse the blockchain itself, to trace and identify transactions, taking into consideration tumblers, mixers and other mechanisms that might exist to hide the origin or destination of the VA; and
- How to deal with VA that are not traceable on the blockchain such as Monero.

To address these challenges, the MPF highlighted that the necessary recruitment of specialized personnel, its training, and the acquisition of specialized analytical tools need to be made. In addition, against this objective, as from 1st June 2019, the Malta Police has set up the Blockchain Analysis Unit within the Financial Crimes Investigations Department and will be acquiring the necessary tools to analyse the blockchain. However, there is scope for additional effort including training of personnel, adding additional staff to the Unit, and creating the necessary infrastructure to be able to carry out this function.

In addition, it should be noted that the legal provisions of the MPF for expeditiously identifying, tracing, temporarily freezing, seizing/confiscating that are found in various Acts ((such as the Money Laundering Act, the Criminal Code, and the Drugs Ordinance) will provide a challenge in the VA scenario. While these instruments can be very effectively used in the physical assets sphere, the same cannot be said to be possible in the VA sphere, particularly if the owner of the VA instrument is not known. Accordingly, it is being recommended that provisions for the freezing and seizing of assets in rem (where the owner is not known) should be introduced.

Furthermore, the MPF remarked that the VA will bring about a lot of other challenges that need to be taken as part of the Risk Assessment. Some of these challenges are the following:

- Presenting evidence in court, particularly with respect to transactions on the blockchain for which no VFSP is present in Malta, might prove to be a challenge. In particular, issues will arise on the validity of evidence that is found on the blockchain, explaining same to the Magistrates or Judges, without having the possibility of having a representative to validate that evidence. In this area, it is being suggested that the Judiciary should be provided with the necessary training on this.
- A number of VAs are not traceable on the blockchain. Some of these are Monero, Dash, and ZCash, and are being highly utilized for all kinds of criminal activities including money laundering, funding of terrorism, and other similar acts, at time also in conjunction with Dark Net. This is resulting to be an almost impossible task to overcome for most police / law enforcement authorities around the work and is offering an insurmountable challenge. While from a police perspective, we should continue to build up expertise on this subject, as a jurisdiction we should make sure that our licensed VFSP take the necessary precautions on this.
- Cyber Attacks are an ongoing threat to all Internet-based activities, and this is no acceptation for VFA agents, who could easily fall victims to such cyber-attacks with the consequential loss of business, reputation etc. In this regard, it is being suggested that VFSPs be regarded as Critical Information Infrastructure as per LS 460.35, in which case the Computer Security Incident Response Team (CSIRT) should also be included as a stakeholder in this process.
- The need to adopt very clear procedures with regards to the actions that need to be taken once a VA is identified as being proceeds of crime. Apart from the technical expertise and human resources required to perform such tasks, clear policies have to be devised as to what actions need to be taken and how these VA should be handled. For example, whether the wallet itself would be frozen or seized (if possible), whether the VA would have to be transferred to a Police or ARB wallet, whether to liquidate and when to liquidate, how to manage etc.
- The issue of smart contracts, whereby the MPF and other entities involved in law enforcement, do not have any knowledge, skills, expertise, and software on how to deal with smart contracts, what criminal activity these may generate or face, and how to investigate and proceed with cases, and therefore not addressing at all the requirements of the FATF recommendations;
- The area related to non-convertible virtual assets and in-gaming currencies, which is also problematic, particularly with specific sectors of the population (particularly the younger generation), who rather than investing in physical high value worth assets, or cryptocurrency itself, invest their money (possibly also proceeds of crime) in such assets as in-gaming currencies, such as World of Warcraft Gold, V-bucks in Fortnite, Secondlife's Linden Dollars, and a myriad of Diamonds, Golds, Bolts, Coins, and even Bananas. While such currencies cannot be converted directly to FIAT Currencies, whole accounts can be easily converted and sold using such platforms as Ebay to generate millions in FIAT currency. In this area, the MPF highlight that law enforcement authorities are not equipped to handle these types of assets, and few imagine the value of a PlayStation beyond its market value, and its potential to hold virtual assets of considerable values.

6. Concluding Remarks

This Action Plan apart from presenting the key results of the sectoral risk assessment on VFAs has focused on the issues that may arise as a result of the risks that were highlighted in this sectoral risk assessment. In particular, the enforcement aspect of the AML/CFT regime, the issues that may arise within this context with the regulation and promotion of VFAs and VFA-related activities, and the adequacy of the present legislative framework and resources available to authorities to effectively address these issues. Accordingly, the suggested reforms and actions by the responsible entities were presented, in particular the issues that may present themselves with regards to investigations, asset tracing, freezing and confiscation, and prosecution. The FATF guidelines specify that countries should establish the most appropriate regulatory regime, tailored to address relevant ML/FT risks. NCC as the governing body responsible for the general oversight of AML/CFT policy, will continue to work hard to ensure that actions aimed at mitigating the risks origination from the sectoral risk assessments are effectively and efficiently carried out. In addition, the NCC will continue to strive to ensure that risk assessments are continuously updated in light of the fact that this sector is ever growing and ever changing.