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Answer to the new AML regulation consultation process

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1 Summary

The Swiss Pirate Party (PPS hereafter) is strongly advocating for comprehensive regulation preventing money laundering activities. The PPS has thoroughly review the proposed revision of the anti-money laundering regulation. In the light of the outcomes of the proceeding of that review, we consider that:

- The economical cost of ineffective surveillance measures out-weights by the current damages that could be incured by hypothetical/potential threats. Thus directly threatening the economical livelihood of the operators in the cryptocurrency financial industry,
- Shifting the burden of proof onto the citizen based on hypothetical and potential cases is unacceptable,
- Over regulating a sprucing and young fintech industry can only have adverse and negative economical impacts, especially as the financial services industry needs to envision new development alternatives, and cater for job reconversion as the regulatory pressure on other sectors of the Swiss financial industry will create in the near term a severe wave of unemployment,
- The current state of the art in compliance and oversight systems in the cryptocurrencies arena provides real-time information on actual money laundering operations, without the requirement of having access to any financial intermediary monitoring system. These systems have been effectively and successfully used in several cases around the world,
- The publicity of transactions is a far greater and efficient way of addressing the overall policing of money transaction rather then attempting to view every single user of a monetic platform as potential criminals,

Based on the review hereafter, the PPS wants the following key elements amended:

- The significant raise of the thresholds to a tenfold to reflect currently envisioned yearly levels to reflect a normal use of EFT technologies,
- The abandon of the classification of money transmission transaction for any virtual currency exchange,
- The abandon of the assumptions related to cryptocurrencies, and their definition as there is no commonly accepted Terms of Reference amongst global regulators and various national and international lawmaking bodies.

These elements construe abusively the development of the emerging cryptocurrencies market and its potential strategic benefits to the Swiss financial services industry. They also further and support unsound regulation development practices which go against Swiss liberal and democratic fundaments. Several other propositions are further developed within the present document.

2 General Context

The financial industry is now entering into a deep transformation phase. With the rise of various new technologies, a strong move can be witnessed toward the disintermediation of financial services. Complex financial tools are now accessible by individuals in the same way communication tools became accessible to individuals with the rise of the Internet and mobile telephony.

A similar move toward convergence of financial services within existing services is arising. Communication or even social network platforms are integrating financial services within their infrastructure. Making the distinction between a financial exchange and a simple communication indistinguishable as lines are blurred by technologies. Fundamental changes are ahead of us. In March 2015, Facebook, a social network, allowing individuals to communicate, a right protected by its secrecy, has announced that it will integrate money transfer tools between its users. Such fluid technological frameworks will put the regulatory framework for financial services under an unbearable and impose a constant evolution.

Finally, the transformation of the financial services is also a matter of size. The new technologies do bring to the table a transformative approach whereby a one size fits all solution, whereby there is no more delineation between micro-payments and other transactions, as protocols and infrastructures are common. This implies a fundamental shift in the business model of financial service companies, where a single transaction does not bring the same value in terms of revenues.

One of these technologies known as blockchain is the ground of some important innovation and has seen the creation of more than 20 startups companies and approximately XXX jobs in the financial sector in Switzerland. The role of financial service companies is being transformed. New services are emerging. The Swiss Pirate Party embraces innovation and supports the Fintech industry, especially when increased transparancy and disintermediation are brought forth, these innovation can ensure that Switzerland can remain a place of financial innovation while having an adequate and progressive regulatory framework.

Disintermediation, convergence, micro-payments, these realities need to be taken into account in the current regulatory framework. The Swiss Pirate Party is of the opinion that this revision lacking with respect breath and depth in these area, and fails to acknowledge the real extend of the change involved with the emergence of the new technologies.

3 Preliminary remarks

In general, the Swiss Pirate Party welcomes any modernization of the legal framework, especially in order to adapt this framework to technological developments and innovation. However, the Swiss Pirate Party is very concerned that this specific revision poses a definite threat to the development of secure technologies in the realm of online financial services, stifling the development of mature solutions for the Swiss Financial Industry.

The FINMA is taking a strong stand towards the identification of each party to a transaction of any kind and any amount, thus threatening basic civil liberties of the citizens. Presumption of innocence, liberty of commerce or innovation are some of the fundamental principles that are at stake with this proposed reform.

The Swiss Pirate Party urges FINMA to review the reform in light of the following propositions.

4 Remarks concerning the proposed revision

4.1 Definition of "Virtual currencies"

The proposed revision is using the terminology "Virtual currency" without proposing a clear definition of what currencies are included in this term. At the same time, there is no international consensus of what a Virtual Currency could be.

Definition of the Federal Council: "A virtual currency is a digital representation of a value which can be traded on the Internet and although it takes on the role of money – it can be used as a means of payment for real goods and services – it is not accepted as legal tender anywhere."

Reference: http://www.news.admin.ch/NSBSubscriber/message/attachments/35355.pdf

Definition of the BitLicense New York: "Virtual currency means any type of digital unit that is used as a medium of exchange or a form of digitally stored value. Virtual Currency shall be broadly construed to include digital units of exchange that (i) have a centralized repository or administrator; (ii) are decentralized and have no centralized repository or administrator; or (iii) may be created or obtained by computing or manufacturing effort. Virtual Currency shall not be construed to include any of the following:

(1) digital units that are used solely within online gaming platforms and have no market or application outside of those gaming platforms, or can be redeemed for real-world goods, services, discounts, or purchases, but cannot be converted into, or redeemed for, Fiat Currency or Virtual Currency as defined herein; (2) digital units that can be redeemed for goods, services, discounts, or purchases with the issuer and/or other designated merchants or can be redeemed for digital units in another customer affinity or rewards program, but cannot be converted into, or redeemed for, Fiat Currency or Virtual Currency as defined herein; or (3) digital units used as part of Gift Cards;"

Reference: http://www.dfs.ny.gov/legal/regulations/revised_vc_regulation.pdf

Definition of the European Central Bank: "a virtual currency is a type of unregulated, digital money, which is issued and usually controlled by its developers, and used and accepted among the members of a specific virtual community"

Reference:

https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf

The New York bitlicense does not limit itself to "crypto-currencies". A digital currency, stored in a Digital Wallet, even if it has the same face value than a legal tender, would fall into this category.

The European Central Bank definition is limiting itself to such currencies as Bitcoin, but is not applicable in Switzerland as since the report of the Federal Council in June 2014, these types of virtual currencies are considered as regulated.

For the Federal Council, Virtual Currencies differ from e-money in that they are not based on a currency with legal tender status.

There is currently no standard definition of what virtual currencies are. The definition of virtual currencies is sometimes vague, sometime misleading.

Proposition: the term "Virtual Currency" should be removed from this revision, as it is already defined as being an asset in the Federal Council report. A document of that importance should not include terms that do not reflect a common understanding and internationally agreed definition. While the main objective of this reform is to align with FATF-GAFI recommendation, with no consensus on the definition, this term will create confusion in future international negotiations.

4.2 Virtual currencies are seen as posing a higher risk for money laundering

There are currently no known reports regarding the reality of the usage of crypto currencies in Switzerland except the initial findings by ETHZ published in the Federal Council report of 25 June 2014. The reports mentions that "from an economic perspective, Bitcoin is currently a niche phenomenon".

In one of the paragraph (2.1.1.3) of the report to this revision, to support possible misuse of virtual currencies and thus pointing a higher risk for money laundering, it is stated multiples times that : "we could imagine...", "It is theoretically conceivable..." or "We could also imagine...". No other evidence is produced than "imaginable" cases.

Usage of such rhetoric in a document as important as the report underlying the ordinance may be interpreted as evidence that is very dangerous and would create a clear statement for the Federal Tribunal that the current position of the FINMA has been taken without thorough understanding of the reality of the virtual currency market. This would pave the way for a recourse against the Ordinance.

As a political party, the PPS notices that there is, within Switzerland, an increasing number of online and physical shops but also associations that are accepting bitcoin as a mean of payment. This suggests that most virtual currencies are more and more seen as a secure and affordable payment system rather a way to exercise money-laundering activities. The fact that Bitcoin transactions are pseudonymous and fully traceable rather that anonymous, suggests that virtual transactions are not the preferred mean for money laundering activities. There have also been multiple recent high-profile cases involving individuals being successfully tracked down and prosecuted in part as a result of evidence gathered from the public nature of blockchain transactions.

Also, since the Federal Council has published its report, initial fears of members of parliament that have requested the report, have been answered by giving virtual currencies the same legal framework as any other currency. There is currently no consensus in Swiss politics that blockchain technology is posing such specific risk as money laundering. It is even more and more clear that such technology is seen as an opportunity for the financial industry to provide better and innovative services.

Proposition: With no consensus, and no demonstratable data related to the actual misuses of virtual currencies, we ask the FINMA to revert its position that virtual currencies are posing a higher risk for money laundering. Virtual currencies using blockchain technologies must be seen as a space for innovation where same rules as for "traditional" currencies should apply allowing a healthy competition. The blockchain technology enables a comprehensive public tracking of all aspects of monetary transactions with the realm of a cryptocurrency, therefore it partially alleviates the documentary require-

ments of traceability that fiat currencies.

4.3 Virtual currency exchanges are considered by default as money transmission

As a consequence of assuming that virtual currencies a posing a high risk for money laundering added with the uncertainty that a third party could be involved in a single transaction, the report proposes that any virtual currency exchange is to be considered by default as a money transmission transaction except if technically proven that it is in reality a currency exchange activity.

This proposition is a reversal of the burden of the proof which is not compatible with Switzerland fundamental law principles. The presumption of innocence must prevail regarding simple transactions.

In addition to that, qualifying virtual transactions as money transmitting transactions will bring unforeseen side effects. As we see more and more merchants accepting virtual currencies as a mean of payment, such position would force all merchants to prove systematically that a transaction is linked to a specific good or service. This would be required by merchant to avoid the qualification of its activities as money transmitting, which is a regulated activity. This would make it extremely difficult to operate in Switzerland as a merchant; we also note that other attempts at virtual currency regulation around the world, such as the BitLicense, explicitly specify that accepting virtual currency as a merchant is not a regulated activity. This would damage another fundamental law principle, the freedom of commerce.

The report also ignores other potential uses of virtual currencies. The development of digital coupons, insurance, smart contracts, e-gaming or any other activity that can benefit from a digital representation of its transactions through a virtual currency using the blockchain technology will be threatened if a simple transaction is recognized by default as a money transmission activity. We do believe it is not the intention of the FINMA to request formal identification of both parties to a smart contract, when this smart contract is exchanged through a blockchain supported virtual currency. However, the current formulation of the report is not making such distinction and thus threatening any innovation using blockchain technology even in non-monetary transactions.

By ignoring two fundamental law principles, the risk of a legal challenge in front of the Federal Tribunal should be seen as a highly probable risk, thus sending a very unsettling message about the regulation and efforts made by the Swiss financial services industry, its representative, the FINMA, as to their resolve to adequately deal and fight money laundering.

Proposition: the virtual currencies should not be treated differently than any other currency in regards with the nature of the transactions and the compliance rules applying to such transactions. The thresholds for currency exchange should apply the same way for virtual currencies. Also this threatens other non-monetary uses of virtual currencies. The PPS asks the FINMA to reverse its position.

5 Softening compliance processes regarding payment services

The PPS welcomes the position of the FINMA to reduce compliance processes regarding payment service by acknowledging the fact that more and more service are provided by non-banking regulated companies. Innovation allows indeed many companies in their early development stages to produce and market new and more efficient financial services.

However, in the introduction of the Report, due to the "by default" qualification as money transmission, virtual currencies are explicitly excluded from this paragraph, also when they are being used to develop innovative payment services.

This softening of compliance processes is conditioned by the existence of a delegation agreement with an authorized bank. With the development of the disintermediation of financial services, it appears more frequently that a bank is not needed as middle man to a financial transaction. Still, it is important that payment services supervision is delegated to a financial institution that is subject to the anti money laundering legal framework and supervision.

Finally, there is a clear limitation of such proposition to Switzerland only, excluding also other countries from the Swiss Franc monetary zone such as Liechtenstein. The modern financial industry is not evolving in closed areas. It is necessary to acknowledge that new technologies are allowing a worldwide market opening. It is clear that competition of other countries, the United States in the first place, do not see borders as a threat. The Swiss financial industry needs to be in a position where it can compete and innovate.

Proposition: New financial services are designed without necessarily having banks as a mandatory element within a transaction. Peer 2 peer systems are also used to develop innovative payment services. The expression "authorized bank" should be replaced by "authorized financial service company" to all provide these innovative payment services with a fair and healthy competition environment.

Proposition: Payment systems limited to national boundaries will quickly become an

exception as the transactions habits of the end customers are crossing more and more the borders. In order to allow payment systems to operate from Switzerland it is crucial to remove the limitation to Switzerland for softening the compliance requirement.

Proposition: Payment systems based on virtual currencies already provide more secure and innovative systems. It is important that there should be no unjustified difference between payment systems technologies. The use of virtual currencies for payment systems should not be an exclusion to the softening of compliance processes as mentioned in article 12.

6 Ultimate beneficiary owner (art 43)

Today an operating company is considered as being its own ultimate beneficiary owner (UBO). Only structures representing individuals assets and not have operational activities are to be considered as an intermediate for individuals.

The revision of the Ordinance is stating that a financial service company must inquire for the UBO identification even for an operating company. As it is clear that even if the owner of a company is known to the financial service company, it is still the operating company that is responsible and owner of the funds engaged in the transaction.

Article 43, in conjunction with the assimilation of virtual currencies exchange to money transmission, would render the development of a professional customer base from switzerland very difficult and would create a distortion in the market in regards with other countries where financial service providers can onboard professional customers much more easily.

Proposition: The existing distinction between an operating company and a structure representing assets of individuals such as a trust is currently the most appropriate. Removing such distinction will create strong administrative overhaul for operating companies to purchase and use financial services. The report should include a detailed analysis of the necessity of removing this distinction. In the case such analysis is not provided, this distinction should remain in the legal framework.

7 Lower thresholds (art 49 and 58)

Article 49 and 58 are lowering the thresholds for mandatory identification of parties from 25'000 to 15'000 in the case of a simple cash transactions. The PPS can only

point out that recent legal reforms have pushed all thresholds to lower level without any proof that such action did indeed prevent money laundering activities, this is generalizing surveillance rather then ensuring proper handling of money laundering operations.

Proposition: The report should include a detailed analysis of the necessity of lowering thresholds. In the case such analysis is not provided, the aforementioned thresholds (art 49 and 58) should remain at least untouched.