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FATF Travel Rule

A Brief Introduction

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Research and Insights

Macro Report



Head of Research and Insights
Erik Lie, FSA, CERA

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1. Executive Summary

Welcome to our Macro Report for FATF Travel Rule.

Key Takeaways:

- We have introduced the following:
 - Financial Action Task Force (FATF)
 - Society for Worldwide Interbank Financial Telecommunication (SWIFT)
 - AML / CFT Regulation
- We have gone through the origin of the Travel Rule:
 - Representative from the United States has been elected as the FATF President from 2018-2019, where he pushed forward US's crypto regulation around the globe
 - Hence the Crypto Travel Rule shares many similarities with the Bank Secrecy Act (BSA) from the US
- Besides the Travel Rule, the FATF Recommendation also imposes other requirements for VASPs, including but not limited to:
 - Customer Due Diligence (CDD)
 - Licensing and Registration
- We have discussed several details of the Travel Rule:
 - Definition of Virtual Asset Service Providers (VASPs)
 - The need of a common messaging standard
 - The VASP Discovery Problem
 - Ideal principles for designing the Travel Rule's solution
 - Various solutions in the market

2. Background

Ever since bitcoin was created, regulation regarding cryptocurrencies have been unclear or non-existent. In June 2019, however, FATF officially adopted an amendment to one of its 40 recommendations, covering crypto assets service providers in the regulation.

To make this report more reader friendly, instead of going into the minute details of the Travel Rule right away, we will start with some basic materials first, such as FATF, SWIFT, as well as why and how the Travel Rule was being introduced. We will then start to go into some details about what the Travel Rule is about and introduce the ongoing industry efforts to create a solution for Travel Rule compliance.

The Travel Rule can be considered as the most complex regulation that has been imposed on cryptocurrencies so far. Its impact is also far-reaching and may affect many aspects of how crypto asset service providers operate. However, we will leave the discussion of the impact of the Travel Rule for our feature article. If you are interested, please consider upgrading your card to get access to our monthly newsletter (which includes the feature article) exclusively to [Crypto.com Private](#) clients.

Let us start the journey on introducing the Travel Rule's originator: Financial Action Task Force (FATF) first.

2.1 FATF

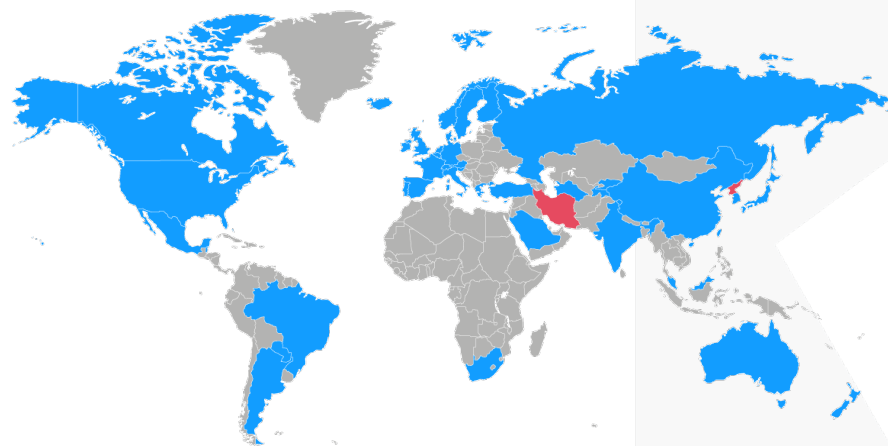
The Financial Action Task Force (FATF) is an international standard-setting body founded in 1989 on the initiative of the G7 to develop policies to combat money laundering. In 2001, its mandate was expanded to include terrorism financing.



FATF is a “policy-making body” that works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas. FATF monitors progress on implementing its recommendations through “peer reviews” (“mutual evaluations”) of member countries.

The FATF presidency rotates between the FATF’s 39 official members every one to two years.

The FATF’s 39 member countries cover almost all developed countries in the world. They are also members of the FATF-Style Regional Bodies (FSRBs) in their regions, where they usually take a leading role to assist non-member countries with implementing the Recommendations.



Source: FATF

The 39 members and graylist / blacklist countries are listed below:



Currently, only North Korea and Iran are on the FATF blacklist, meaning that they are largely excluded from international trade and money transmission.

There are also countries who are currently on the graylist, including Botswana, Yemen, Ghana, Zimbabwe, Syria, Pakistan, Mongolia and Iceland. If they are unable to improve their system within a set timeframe, they can be at risk of being demoted to the blacklist.

While FATF can influence over the 200+ countries under its jurisdiction, none of its 40 Recommendations are legally binding. The FATF Recommendations act as guidelines that member countries are expected to refer to and then expand further domestically.

2.2 SWIFT

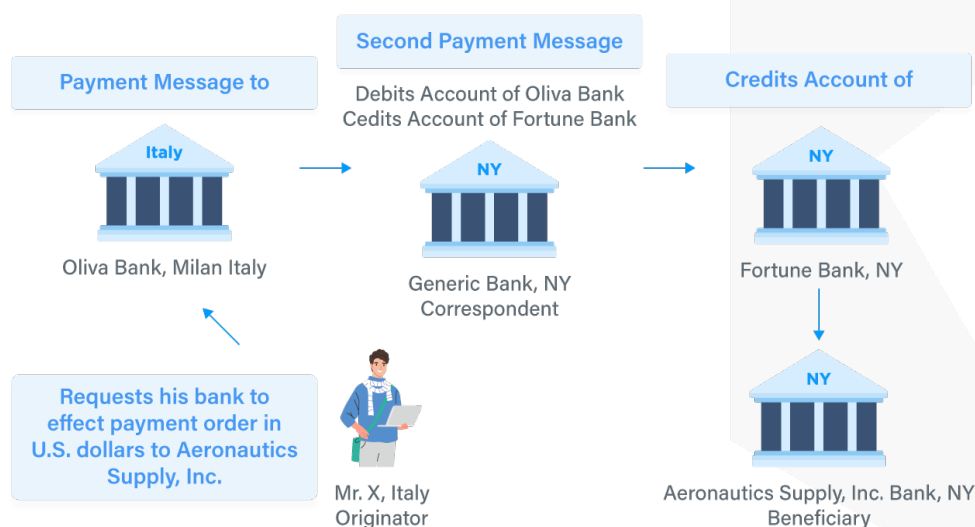
The Society for Worldwide Interbank Financial Telecommunication (SWIFT) provides a network that enables financial institutions worldwide to send and receive information about financial transactions in a secure, standardized and reliable environment.



SWIFT was founded in 1973, sponsored by 68 banks in 11 countries within Western Europe and North America due to their need for establishing global operations, and has grown rapidly since then. As of today, SWIFT links more than 11,000 financial institutions in more than 200 countries and territories, which exchange an average of over 32 million messages per day.

It is important to emphasize that SWIFT is not a bank or a clearing and settlement institution - it does not manage accounts on behalf of customers, nor does it hold funds. SWIFT does not facilitate funds transfer; instead, it sends payment orders, which must be settled by correspondent accounts that the institutions have with each other. Each financial institution, to exchange banking transactions, must have a banking relationship by either being a bank or affiliating itself with one (or more) to enjoy those particular business features.

Cross-Border Funds Transfer Involving a Correspondent Bank



Source: FinCEN

2.3 AML / CFT Regulations

Each country has its own AML / CFT regulations. However, countries tend to coordinate with each other based on the recommendations and mutual evaluation from FATF.

SWIFT plays an important role in allowing AML / CFT message to transfer between financial institutions globally, as it is the core infrastructure that provides a secure and standardized message transfer channel between them.

Some of the AML / CFT regulations per country are listed below (not exhaustive):

Country	Regulatory Bodies	Related Regulations
US	Financial Crimes Enforcement Network (FinCEN)	Bank Secrecy Act (BSA)
EU	European Banking Authority (EBA)	5 th Money Laundering Directive (5AMLD)
UK	Financial Conduct Authority (FCA)	Proceeds of Crime Act (POCA) and The Terrorism Act Money Laundering Regulation 2017 (MLR 2017)
Canada	Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)	Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA)
China	China Banking & Insurance Regulatory Commission (CBIRC)	Law of the PRC on Anti-money Laundering
Japan	Financial Service Agency (FSA)	Act on Prevention of Transfer of Criminal Proceeds (AML Act)
Australia	Australian Transaction Reports and Analysis Centre (AUSTRAC)	The Anti-Money Laundering and Counter-Terrorism Financing Act (AML / CTF Act)

3. FATF Travel Rule

In this section, we will introduce the Travel Rule in detail.

3.1 Origin

Ever since bitcoin was created, regulations regarding cryptocurrencies have been unclear or non-existent. In June 2019, however, FATF officially adopted an amendment to one of its 40 recommendations – making crypto assets service providers fall under the scope of regulation.

The FATF presidency rotates between the FATF's 39 official members every one to two years. In February 2018, Mr. Marshall Billingslea from the United States was elected as the next FATF President. His tenure started from July 2018 and ended in June 2019.



During his presidency, one of his agendas, if not the most important one, was to promote US crypto regulation around the globe.

In June 2019, FATF made a [public statement](#) on virtual assets and related providers, and an [amendment](#) on the interpretative notes for Recommendation 15.

The amendment, in short, suggested that Virtual Asset Service Providers (VASPs) are subjected to the requirements set out in Recommendations 10 to 21. In particular, the following are worth noting:

- [Recommendation 10 \(Customer Due Diligence\)](#)
- [Recommendation 14 \(Registration or licensing requirements\)](#)
- [Recommendation 16 \(Travel Rule\)](#)

The FATF also published the [Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers](#) in supplement to the amended recommendations above, which lays out further details on the recommended requirements.

Here is an excerpt from the original document:

Customer Due Diligence

Countries and obliged entities should design Customer Due Diligence (CDD) processes to meet the FATF Standards and national legal requirements. The CDD process should help VASPs (as well as other obliged entities that engage in VA activities) in assessing the ML/TF risks associated with covered VA activities or business relationships or occasional transactions above the threshold. Initial CDD comprises identifying the customer and, where applicable, the customer's beneficial owner and verifying the customer's identity on a risk basis and on the basis of reliable and independent information, data, or documentation to at least the extent required by the applicable legal or regulatory framework. The CDD process also includes understanding the purpose and intended nature of the business relationship, where relevant, and obtaining further information in higher risk situations.

Licensing or Registration

Countries should designate one or more authorities that have responsibility for licensing and/or registering VASPs.

In accordance with INR. 15 paragraph 3, at a minimum, VASPs should be required to be licensed or registered in the jurisdiction(s) where they are created.

Besides the requirements mentioned above, the most complicated requirement associated with the amendment is on Recommendation 16 (Travel Rule). We will introduce Travel Rule in the next section.

Countries who failed to abide by the FATF recommendation may be put at risk for demotion to the graylist or even the blacklist upon mutual evaluation. This in turn, will push countries to set up local regulations for monitoring VASPs, which force VASPs to stay compliant if they choose to operate in the country.

The FATF has a plenary meeting scheduled on 24/06/2020 to assess the progress of Virtual Asset Service Providers (VASPs) worldwide on enforcing the Travel Rule.

3.2 Travel Rule

So, what is the Travel Rule? In short, imagine SWIFT's interbank messaging system but for crypto. The Travel Rule requires financial institutions to share information about their customers (and the associated transactions) with each other. By doing so, they can monitor the transactions and report suspicious activities that may involve money laundering (ML) or terrorist financing (TF).

The "Travel Rule" was initially created and implemented in the US, and was called the "Bank Secrecy Act" (BSA) in the 1970s. In February 2012, FATF revised the existing Recommendation 16 (previously Recommendation VII) by including guidance to add beneficiary information in addition to originator information when sending wires, hence becoming the "Fiat Travel Rule".

When the Travel Rule was set up in 2012 for traditional banks / financial institutions, the backlash was much smaller since they already had the SWIFT system in place, both as the infrastructure and the message transfer standard (ISO 15022 / 20022). However, VASPs lack both the infrastructure and an industry-wide messaging standard. The pseudonymous nature of cryptocurrencies and new technologies / business models (e.g. DApp, DeFi) have further complicated the feasibility and scope of the Crypto Travel Rule.

According to paragraph 114 of [Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers](#), beneficiary institutions should collect and hold the following information:

- originator's name (i.e., the sending customer);
- originator's account number where such an account is used to process the transaction
- originator's physical (geographical) address, or national identity number, or customer identification number (i.e., not a transaction number) that uniquely identifies the originator to the ordering institution, or date and place of birth;
- beneficiary's name; and
- beneficiary account number where such an account is used to process the transaction.

Virtual Asset Service Providers (VASPs)

One term that has occurred frequently in this article is “Virtual Asset Service Providers,” or VASPs. The term was first introduced by FATF in October 2018, when it adopted two new Glossary definitions, “Virtual Asset” (VA) and “Virtual Asset Service Providers” (VASPs).

According to the [Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers](#), VASP is defined as:

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:

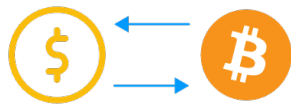
- *exchange between virtual assets and fiat currencies;*
- *exchange between one or more forms of virtual assets;*
- *transfer of virtual assets;*
- *safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and*
- *participation in and provision of financial services related to an issuer’s offer and/or sale of a virtual asset.*

Regarding the definition above, there are debates on whether peer-to-peer VASPs, for example localbitcoin or DEX (or other DeFi protocols), are in-scope or not. FATF further stated that:

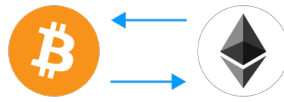
If a VA trading platform only provides a forum where buyers and sellers of VAs can post their bids and offers (with or without automatic interaction of orders), and the parties themselves trade at an outside venue (either through individual wallets or other wallets not hosted by the trading platform — i.e., an individual user-to individual user transaction), then the platform may not constitute a VASP as defined above.

In short, custodial (or centralized) crypto assets providers will very likely be defined as VASPs and subjected to the Travel Rule. However, decentralized crypto assets providers, such as DeFi, may or may not be defined as VASPs depending on its service provided and other factors.

Crypto service providers that are very likely to be defined as VASPs:



Fiat-to-Crypto
Exchange



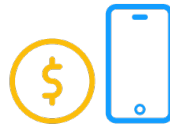
Crypto-to-Crypto
Exchange



Custodial Wallet



Token Issuers



Payment Facilitators



Bitcoin ATMs

Source: Crypto.com Research

Crypto service providers may or may not be defined as VASPs:



P2P Platforms



DApps





DeFi

Source: Crypto.com Research

3.3 Messaging Standard

As discussed, one main challenge for the Crypto Travel rule is the lack of an industry-wide messaging standard. To tackle this, a [joint working group](#) has been formed by three industry associations representing VASPs to create a messaging standard across the industry.

Name	Logo
Chamber of Digital Commerce	
Global Digital Finance	
International Digital Asset Exchange Association	

The standard, called “interVASP Messaging Standard”, or IVMS101, can act as a universal common language for communications of required originator and beneficiary information between VASPs. The first draft was released in May 2020. Proposals for the maintenance of the IVMS101 and for further standards development are currently being evaluated.

The contents of the IVMS101 data model standard comprise:

- Background and rationale;
- Scope;
- Data principles;
- Datatypes;
- Data model definition;
- Handling multiple character sets;
- Business examples.

Interested readers may access the IVMS101 [here](#).

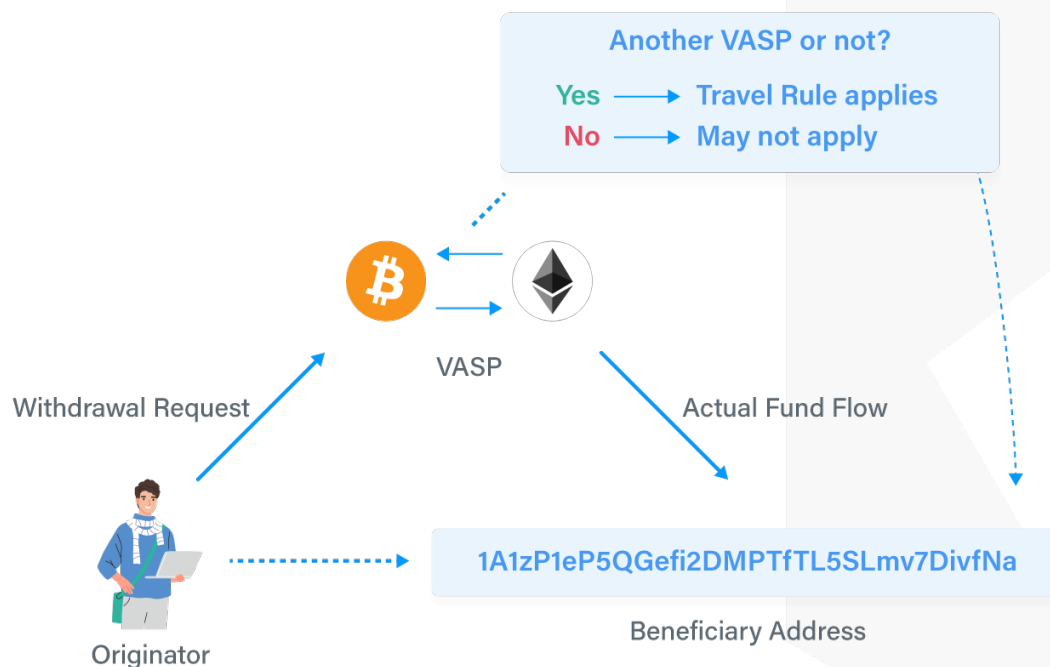
3.4 Solutions

Travel Rule can be said as the most complex regulation that has imposed on cryptocurrencies to date. It requires the construction of an infrastructure (i.e., the message transfer channel) which does not yet exist for crypto. Two more issues may further complicate the situation:

- The VASP Discovery Problem;
- Since cryptocurrencies are decentralized, creating a centralized infrastructure (like SWIFT) is undesirable.

VASP Discovery Problem

One key problem that needs to be solved for the Travel Rule is the VASP Discovery Problem. In short, the problem exists because cryptocurrencies addresses are pseudonymous, upon deposit or withdrawal, the VASP needs to identify whether the source or destination address belongs to another VASP or not.



Source: Crypto.com Research

Ideal Principles

An ideal Travel Rule solution should be able to fulfill these principles:



Secure



Fast



Permissionless



Open Source



Chain Agnostic



Cost Effective



Decentralized



Privacy Preserving



Consortium-based

Source: Crypto.com Research

Various Solutions

Many companies and organizations have begun to create and promote their solutions to VASPs who need to stay compliant. Since the Travel Rule requires a universal and homogeneous message transfer mechanism between all VASPs, it is expected that only one or a few solutions will become the dominant standard in the market.

We have no idea who may eventually win the race, but here is a list of all the solutions that currently exist in the market to our knowledge:

Name	Entity	Description
OpenVASP	Bitcoin Suisse	The protocol facilitates robust compliance for VASPs, solely based on a set of principles, regardless of jurisdiction or virtual asset, and without membership or registration with a centralized third-party.
TRISA	CipherTrace	This Travel Rule Information Sharing Architecture (TRISA) applies the trusted Public Key Infrastructure to identify and verify VASPs reliably. It is similar to the way clients and servers establish trusted communication on the web and other internet applications.
All-in-one FATF Travel Rule solution	Coinfirm	Introducing the first comprehensive solution addressing all FATF Travel Rule regulations on the market. Coinfirm's all-in-one tool enables to easily transfer, register and report all Travel Rule data, listed in FATF's guidelines.
Sygna Bridge	CoolBitX	Sygna Bridge is a simple and low-cost API messaging service that helps VASPs meet their national regulatory requirements as mandated by the FATF Rec. 16.

Name	Entity	Description
VASP Compliance Hub	KYC-Chain	The VASP Compliance Hub is a complete, self-hosted, peer-to-peer software solution that integrates directly with Crypto Exchanges (VASPs) to provide a set of services required to achieve customer identity data compliance.
TransactID	Netki	<p>Netki wants to make Travel Rule compliance easy for VASPs of all kinds – cryptocurrency exchanges, blockchains, and any distributed ledger that uses tokens.</p> <p>TransactID was created specifically to address the needs of VASPs, providing a powerful, flexible, easy-to-implement solution.</p>
Notabene	Notabene	Notabene provide compliance officers with a simple dashboard allowing them to monitor incoming and outgoing transactions and set rules for approving them automatically.
PayID	Open Payments Coalition	PayID creates a common protocol that allows for interoperability between payment networks. PayID is a free and open standard, allowing for truly organic growth where no single company can control or set the terms for joining.
Shyft Network	Shyft	Shyft Network is a data attestation layer. It combines consent channels giving users control over data and incentivize data exchange rails enabling counterparties to negotiate exchange of information.

Dedicated crypto-sleuthing firms including Elliptic and Chainalysis have been working on this as well.

4. Summary

Key Takeaways:

- We have introduced the following:
 - Financial Action Task Force (FATF)
 - Society for Worldwide Interbank Financial Telecommunication (SWIFT)
 - AML / CFT Regulation
- We have gone through the origin of the Travel Rule:
 - Representative from the United States has been elected as the FATF President from 2018-2019, where he had push forward US's crypto regulation to the globe
 - Hence the "Crypto Travel Rule" shares many similarities with the "Bank Secrecy Act" (BSA) from the US
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e. contact@crypto.com