

Pregledni rad
UDC: 323.28(4-672EU)(094);
Priljeno: 14.11.2020.
Odobreno: 21.11.2020.

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COMPARATIVE ANALYSIS OF EUROPEAN LEGISLATION OF PREVENTION TERRORISM FINANCING THROUGH CRYPTOCURRENCIES

Abstract

The terrorism financing through cryptocurrencies includes a high risk of anonymity and takes advantages of decentralized financial system, which is used for criminal activities. So, decentralized financial system and anonymity are the main problem of these ones. Every country needs to make a strong legislation of combating terrorism financing (CFT) through cryptocurrencies, if they want to prevent these ones. Comparative analysis gives the main components and characteristics of exchanges and crypto trading platforms. Countries that don't have any strong model for using cryptocurrencies need to look up to the countries that have it. Also, every country must carry out prevention, apply legislation of CFT and apply proportionate punishment for doing these activities. This article presents the analysis of legislation of CFT by Financial Action Task Force (FATF), European Union (EU) and Serbia. FATF gives recommendations for every country that wants to improve their legislation of prevention. Also, terrorists could create their own cryptocurrencies, which could be the basis of abusing cryptocurrency. The analysis shows how all countries must be cooperative when it comes to this.

Key words: *terrorism, terrorism financing, cryptocurrency, FATF, EU, Serbia.*

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INTRODUCTION

New platforms for trading cryptocurrencies and forms of financing terrorism include the anonymity of their users. The countries must make, use and improve their law to prevent criminal activities by using cryptocurrencies. In this case the main problems are decentralized financial system for trade and exchange of cryptocurrencies and anonymity of users. Also, they could be the advantage of financing terrorism.

Using platforms for trade and exchange of cryptocurrencies indicates a high risk, because it includes using the Internet and cross border for their users. Everyone could trade cryptocurrencies all over the world despite the Internet speed or their belonging to different countries. The countries must be cooperative with each other in the prevention and make strong legislation about these. It means that every country must make and improve their own step in the prevention of trading by using cryptocurrencies, and after that be cooperative with others.

The legislation of CFT in Europe involves FATF Recommendation and Guidance for money laundering and CFT, EU law and current legislation of trading cryptocurrencies in Serbia.

For safety purposes, Serbia should improve its legislation of these ones. In the future, it is expected that existing Serbian laws could be supplemented and amended.

FATF RECOMMENDATIONS

The purpose of FATF is to make standards and implementation of laws for successful prevention of terrorism financing through cryptocurrencies all over the international financial system (FATF, „Who we are“). FATF provides forty recommendations of counter measures against money laundering and CFT, but 9 are aimed at CFT.

They have been recognized and adopted by many international bodies. The countries have different legal, administrative and operational frameworks and financial systems, so they could not take identical provisions against these threats. They should adopt it and apply it according to FATF Recommendations and must coordinate it with their laws and other prevention provisions. The FATF 40 Recommendations were adopted in 2012 and have a few changes. In June 2019 the main change was the modification of Recommendation 15 and the addition of the Interpretive Note of it (FATF, „The FATF Recommendations“). The measures of these Recommendations are identifying risk and coordinating prevention measures against financing terrorism. They give suggestions to each of their members for prevention of these threats, financing systems for trading cryptocurrencies and suggestions for competent authorities who fight against these threats, respecting powers and responsibilities of competent authorities. Also, they give suggestions for enhancing the transparency and availability of information of legal persons and arrangements, improving international cooperation (Ibid).

Implementing these recommendations gives the countries possibility of softening and eliminating these threats. The countries have the goal of applying the prevention measures that are proportional to the risk of CFT through cryptocurrencies.

FATF said that suppression of financing terrorism, financing terrorism acts and financing terrorists must be in accordance with International convention for the suppression of the financing of terrorism by United Nation (1999). When it is needed, countries could apply the proportionate punishment of

doing these activities in accordance with Security Council resolution about CFT. The countries need to identify the persons who transfer money or other values without permission or registration. Accordingly, countries must apply proportional punishment for these persons (Ibid. p. 15.).

Development of new technologies includes the high risk of its abuse. The countries that apply these technologies must provide registration of virtual asset providers who need to be licensed and registered in compliance with effective systems for monitoring and ensuring compliance with the measures from the mentioned recommendations.

Recommendation 1 points out that the countries' need to identify, assess and understand the risk of money laundering and financing terrorism which comes from the activities by virtual asset providers (Ibid, chap. 2). The countries should behave in accordance with degree of terrorism financing risk, because they need to apply measures for prevention of terrorist financing. These preventions need to be proportionate to the risk of terrorism financing.

Recommendations 10 and 16 talk about prevention measures for virtual asset providers, more precisely:

1. occasional financial transactions which are performed by the virtual asset provider in the amount of \$1000;
2. virtual asset provider should give information about users of digital financial transactions and virtual assets to competent authorities;
3. The countries should provide the availability of information about freezing and banning digital financial transactions with special entities. Also, the financial institution that receives or sends transfer of virtual asset on behalf of the clients must implement these activities (Ibid, chap. 7).

Recommendation 15 points out that the countries should require virtual asset provider to be registered and licensed. If that is not possible, they have to be registered and licensed in the jurisdiction where they are established (Ibid, chap.3). FATF does not give special systems for licensing or registering. Exclusively, it expresses the need of these activities, but states that the countries

should find the systems for these ones. Also, it states that the countries could use the already existing systems that are approved to perform virtual transactions (Ibid, chap.4).

The countries have to carry out supervision of CFT measures. These recommendations show the need for the competent authorities that are not self-regulatory bodies, but they must supervise measures to identify, estimate and understand the risk of financing terrorism through cryptocurrencies. Supervisors should have authorization of withdrawal, restriction and suspension of virtual asset provider's license or registration (Ibid, chap. 5).

Recommendation 35 is about proportionate sanctions for non-compliance measures. The sanctions should apply to virtual asset providers, digital transaction service providers and other persons who do illegal digital finance transactions (Ibid, p. 71, chap. 6).

The effective CFT through cryptocurrencies is possible only with international cooperation and exchanging information of digital financial transactions. Including the above, FATF brought Recommendations 37 and 40 which include that countries should be cooperative in the area of anti money laundering (AML) and prevention of financing terrorism by using virtual asset (Ibid, chap. 8).

FATF GUIDELINES

FATF guidelines show how specific The FATF Recommendations are to convertible cryptocurrencies, their exchange for fiat currency and identification of possibility for application measures for prevention of financing terrorism through cryptocurrencies. Also, they identify obstructions for applying these measures (FATF, “Virtual currencies”, 4).

The first guideline was brought in 2002 and gives the instructions for the competent authority for CFT (Guidance for financial institutions in detecting terrorist financing, 1).

Recommendation 15 FATF gives a few Guidelines. If the virtual asset provider is the individual, he/she should be registered or licensed in the jurisdiction where he/she does these transactions. The jurisdictions could require the virtual asset providers, who do the digital financial transactions at their area, to be licensed or registered in compliance with jurisdiction’s regulations about these ones. The competent authority should launch the necessary regulations about these ones to protect the digital financial system of the threat of financing terrorism and the abuse of cryptocurrencies. The measures should include the identification of individual and legal entity which works as a virtual asset provider, but does not have appropriate license or registration. Also, they must include the proportionate sanctions (The FATF Recommendations, chap. 3).

In 2015 The United Nation gave assessment which stated that developing countries include the high risk of financing terrorism through cryptocurrencies. After that, FATF brought the guidelines which are based on the risk of different value transfer services (Guidance for a risk based approach - Money or value transfer services, pp.2-14). These guidelines are about non-banking services and they should be proportional to the risk of financing terrorism. Actually, they show how much regulations of these ones are proportional to total threat of financing terrorism through cryptocurrencies.

In the middle of 2019, FATF brought the Guidelines for Recommendations for cryptocurrencies. These ones said that the countries must understand the risk of

trading cryptocurrencies and make the competent authority which would take care about virtual asset providers and its activities. Also, they must know that some new risks are possible to arise. These risks should be considered when the competent authorities make the regulations.

The guidelines give a few principles which the virtual asset providers and other users of digital financial transactions must respect. These principles are:

1. “Functional equivalence and objectives – based approach” – The guidelines give the support to carry out the FATF Recommendations based on their purpose;
2. “Technology – neutrality and future – proofing” – The requirements should be applicable to the cryptocurrencies regardless of the type of the different technological platforms. Their goals give flexibility for using existing platforms and new platforms without checking them;
3. “Level – playing field” – All virtual asset providers should be in accordance with the countries’ regulations to avoid jurisdictional arbitrage. The countries should see the virtual asset providers equal to the other subjects who do the similar jobs (Ibid).

Other sections of these guidelines include the use of approach that is based on the risk that the virtual asset providers have. What is more, they include the ways of regulating digital financial transactions and encompassing CFT.

The fourth section of these guidelines is about subjects who are directly or indirectly included in digital financial transactions or trading cryptocurrencies. But also, it includes the assessment risks, use of the effective measures to AML and CFT and the use of measures for the customer’s identification and verification (Ibid). The summary of guidelines lists various regulations for trading cryptocurrencies in different jurisdictions. These regulations include AML and prevention of financing terrorism obligations, that refer to the monitoring the performance of digital financial transactions (Ibid).

DIRECTIVE OF THE EUROPEAN PARLAMENT

The Directive of the European Parliament (Directive EU) was brought in 2018. EU gives the regulations of prevention of abusing digital financial systems and CFT.

The all EU member states had the obligation to implement The Fifth Anti – Money Laundering Directive (AML 5) by the end of 2019. It is about the prevention of the use of the financial system for the purpose of money laundering or terrorist financing. The main EU goal for CFT through cryptocurrencies is increasing transparency of digital financial transactions in all member states.

Terrorist groups see the possibility of abusing the financial systems within EU boundaries by concealment of transmission or using the anonymity for trading cryptocurrencies. The virtual asset providers do not have the obligation to identify suspicious activities (Ibid). In order to reduce the risk, the attention should be given to The Federal Office of Justice (FOJ), which has the goal to collect the information about the relationship between the address of digital financial transactions and identity of cryptocurrencies user.

Also, The European Parliament points out that the users of cryptocurrencies could self-report their address for using digital financial transactions. This represents the contribution to CFT (Ibid).

AML 5 states that FOJ is very important for the international cooperation. The FOJ's task is to collect and analyze information in order to determine the relationship of suspicious transactions and financing terrorism through cryptocurrencies. Also, these ones include making prevention analysis of intelligence and judicial activities. The all EU members should be cooperative in the CFT when it comes to the financial investigation. They must give necessary information about monitoring illegal activities and discovering illegal network of abusing digital financial transactions and cryptocurrencies (Ibid).

EU attitude about cryptocurrencies is that they are convenient of financing terrorism because of the user anonymity, possibility of their exchange regardless

of spatial distance and their speed of transmission. The effective suppression of mentioned criminal acts is possible only by applying the prevention measures for CFT and mutual coordination of the activities among the EU members.

The Financial Stability Board (FSB) monitors and gives recommendations for the global financial system. It gives four basic regulatory bodies in the area of cryptocurrencies. Firstly, The European Commission has the responsibility for planning, preparation and proposing regulation, as well as monitoring the effectiveness of reforms of financial sector and identifying the risks of financial stability. On the other hand, The European Banking Authority – EBA monitors the forming of innovative products and services which influence the financial systems and identifies compatibility of the existing regulation with these products and services. It gives support to The European Parliament that states that the virtual asset providers are subjects to regulations. They must be covered by CFT. It gives regulation for risk reduction of cryptocurrencies and digital financial transactions (Regulation of cryptocurrency around the world). The European Insurance and Occupational Pensions Authority (EIOPA) monitors any development or changes of cryptocurrencies. The fourth legislature is The European Securities and Markets Authority (ESMA) which safeguards the stability of the EU. It sees cryptocurrencies as financial instruments with specific characters and accepts them as such (The decision of the financial stability board on common cryptocurrency rules and regulators).

In the middle of 2019, FSB brought The Report on financial stability, regulatory and governance implications in EU that shows that using decentralized financial systems would increase in importance (Decentralised financial technologies – Report on financial stability, regulatory and governance implications). This would call into question the stability of the EU financial system. The development of new technologies for digital financial transactions also contributes to the destabilization of the system, which again increases the risk of financing terrorism of cryptocurrencies.

The FSB gave analysis of these threats. Firstly, it talks about the possibility of using decentralized digital financial systems through abusing the anonymity of different criminal acts that include financing terrorism through cryptocurrencies. Secondly, it refers to the question of making CFT regulation. Also, it poses the question of sanctions due to users anonymity and inability to recover users identity. Thirdly, it talks about the cooperation of EU members and reaction of the competent authority during the observation of abusing cryptocurrencies and digital financial transactions (Ibid, p 5-6) .

SERBIAN REGULATION

Serbia does not see cryptocurrencies as a valid means of payment or of relative value. The National Bank of Serbia (NBS) issued an official opinion regulation that cryptocurrencies are mostly unregulated in Serbia. Also, there is not any regulation about individual or a company dealing with cryptocurrencies, so they are trading cryptocurrencies at their own risk. Users of cryptocurrencies in Serbia are:

1. everyone who uses the services of platforms for trading cryptocurrencies, most often for performing speculative services;
2. those who deal with mining, which means doing the mathematical algorithms for performing digital financial transactions (National bank of Serbia).

NBS states that cryptocurrencies do not threaten the digital financial systems, but trading cryptocurrencies gives a high risk of financing terrorism through cryptocurrencies. The Serbian state authority has recognized these risks and its attention is directed towards controlling and eliminating it (Ibid).

At the end of 2017 Serbian Anti Money Laundering and Financing Terrorism Act is the only act which mentions the use of virtual currency. Its implementation started in April 2018. This act includes a few obligations for persons who engage in digital financial arrangements or sale and “purchase transactions pertaining to virtual currencies, from obtaining identification details of the buyer to notifying the Serbian AML Administration regarding such transactions and similar” (Serbia in Crypto World – Where Does Serbia Rank on the Map of Crypto – Friendly Jurisdictions?).

These acts define cryptocurrencies, that is, virtual currency, as not a valid means of payment or of relative values. Also, NBS and other competent authority in the country do not accept it as a relative payment or values. The individual or a company dealing with cryptocurrencies could accept it as the means of exchange which could be used for trading, exchanging, buying, selling,

transferring or digital storing. (Law on Prevention of Money Laundering and Terrorist Financing) The same act defines the users who are cryptocurrency wallet providers as persons who are keepers of private crypto key. This key refers to the virtual values on behalf of persons who own or transfer these cryptocurrencies. (Ibid)

Also, it defines terrorism financing as “the providing or collecting of property, or an attempt to do so, with the intention of using it, or in the knowledge that it may be used, in full or in part: in order to carry out a terrorist act; by terrorist; by terrorist organizations. Terrorism financing means aiding and abetting in the provision or collection of property, regardless of whether a terrorist act was committed or whether property was used for the commission of the terrorist act” (Ibid).

Firstly, the efforts in making effective regulations for CFT were improving it through complementing and changing existing Anti Money Laundering and Financing Terrorism Act at the end of 2019. Changes include implementing EU AML 5 Directive and coordinating regulation in the area of cryptocurrency with each other. Chapter 104 gives an overview of the competent authority for supervising mentioned activities. Changes in this chapter refer to the addition of obligors, that is to say, individual or company dealing with custodial services. Also, these changes refer to limited amounts for doing the digital financial transactions (Ibid).

Implementing The EU AML 5 Directive improved the risk analysis that comes from financing terrorism through cryptocurrencies. Also, it establishes better cooperation between the countries in Europe. Accordingly, CFT must be used before, during and after doing the digital financial transactions or make business relationship (Ibid).

In the future, Serbia would coordinate its regulations of cryptocurrencies with EU regulations in this area. What is common in both Serbia and EU is that cryptocurrencies do not have the status of valid money and relative currency

in their financial system. But the difference is that trading cryptocurrencies in Serbia is not a financial transaction.

The Value Added Tax Law in Serbia states that the subject of value added tax (VAT) is considered to be “delivery of goods and providing services (hereinafter: trade of goods and services) effected by a taxpayer in the Republic with a fee, within the framework of performing an activity; the imports of goods into the Republic” (The Law On Value Added Tax). When it comes to taxing cryptocurrencies in Serbia a legislator states that the taxation applies on “all other revenues that are not taxed on other grounds or are not excluded from taxation or exempt from tax under the present Law” (Law on Personal Income Tax). So, the cryptocurrencies in Serbia are not taxed, apart from the mentioned chapter, which could be considered as an advantage for financing terrorism through cryptocurrencies.

The Serbian Strategy against Money Laundering and Terrorism Financing for the period 2020 – 2024 does not directly highlight that trading cryptocurrencies represents a risk of financing terrorism. But, indirectly it states that Serbia must coordinate its measures with FATF standards for effectively dealing with the risk of financing terrorism.

Also, this Strategy recognizes The Anti Money Laundering and Financing Terrorism Act as a main preventive law for CFT. Considering the fact that it sees users of cryptocurrencies as its obligators, they must be subjects to the measures from the Strategy (The Strategy against Money Laundering and the Financing of Terrorism 2020 – 2024). When it comes to applying CFT, the Strategy states that the competent authority must supervise work of financial institutions and individual or legal entity who is outside the financial sectors. Serbia is striving for effective regulation which is cooperative with international regulation. First efforts in this direction are seen in the implementation of FATF Recommendations about cryptocurrencies and introduction of supervision over nonprofit sector, which could be used for financing terrorism (Ibid).

The AML and CFT of Serbia have made progress when it comes to this. First of all, it could be seen in The Law on Organization and Jurisdiction of Government Authorities in Suppression of Organized Crime, Corruption And Other Severe Criminal Offences do not have any criminal act of cryptocurrencies. As we can see, the Serbian regulation of cryptocurrencies is not complete. Due to the fact that Serbia officially applied for EU membership, it is expected that it shall develop and effectively apply its regulation of cryptocurrencies.

CONCLUSION

Both, decentralized convertible virtual currencies and risks of using technology for trading, exchanging and paying with it give a possibility for their abuse for financing terrorism. Also, the speed of performing digital financial transactions along with the low cost, anonymity and geographical infinity of doing digital financial transactions give a lot of room for abuse.

Financing terrorism through cryptocurrencies must be seen as a complex appearance if CFT is to be carried out effectively. Recently, terrorists have been using new technology for doing their activities, which include terrorism financing.

It should be considered that terrorists could make their own currency, a few terrorists make a public announcement for financing terrorist's acts through cryptocurrencies. Activities like these could represent a high risk of financing terrorism. Also, the Islamic economy aims at applying God's immutable divine law which considers banking and Quran as equal, which could be convenient for abusing cryptocurrencies to achieve their goals.

The comparative analysis of European legislation of prevention terrorism financing through cryptocurrencies gives the advantage of exchanging information of terrorism financing through cryptocurrencies and implementing international standards or observation omissions for CFT through cryptocurrencies.

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**УПОРЕДНА АНАЛИЗА ЕВРОПСКОГ ЗАКОНОДАВНОГ
ОКВИРА ЗА СПРЕЧАВАЊЕ ФИНАНСИРАЊА ТЕРОРИЗМА
ПОСРЕДСТВОМ КРИПТОВАЛУТА**

Апстракт

Финансирање тероризма посредством криптовалута носи висок ниво ризика, због анонимности корисника и одсуства централизованог надзора и контроле у обављању дигиталних финансијских трансакција. У циљу спречавања ових ризика, неопходно је да свака земља успостави прецизан законодавни оквир за њихово спречавање. Анализирајући законодавне оквире других земаља уочавају се кључне компоненте оснивања и пословања платформи за трговину криптовалутама и начини уређивања ове области. Процена и смањивање ризика од финансирања тероризма кроз употребу криптовалута подразумева компаративно сагледавање методолошког оквира законодавне регулативе свих земаља, које омогућавају обављање дигиталних финансијских трансакција за размену криптовалута. Компаративна анализа регулаторних оквира земаља које су у великој мери уредиле ову област и земаља које томе теже, омогућава уочавање недостатака и смањивање ризика уз извођење закључака о ефикасним методама борбе у спречавању финансирања тероризма посредством криптовалута.

Кључне речи: криптовалуте, тероризам, финансирање тероризма, Европска Унија, Радна група за финансијску акцију.