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It cannot be disputed that globalizing forces have improved the speed and effectiveness with which money changes hands around the world. From more efficient wire transfers to real-time currency conversions, technological advances have kept up with the needs of a busy global marketplace, offering no shortage of tools for individuals, corporations, and governments to direct funds from point A to point B. Although most exchanges of financial instruments are lawful, there remains a worrisome percentage of improper transactions facilitated by terrorist networks, organized crime conglomerates, and wealthy interests seeking to avoid tax burdens imposed by their home nations. The United Nations Office on Drugs and Crimes estimates that the total amount of illegal money laundered (i.e., concealed by transfers involving foreign banks or legitimate businesses) in any given year is 2-5% of global GDP, or 2 trillion USD (UNODC, 2019). Certainly the global economy is well served by an interconnected and efficient system for exchanging capital across borders, but the system has also become extremely complex, incorporating banking and non-bank interests that are equally equipped to issue money transfers. The diversity and scope of these financial intermediaries has made it more challenging for regulatory agencies to implement anti-money laundering (AML) policies and procedures capable of thwarting improper transactions.

In recent years, the most disconcerting threat to AML initiatives worldwide has become the rise of virtual currencies. Defined as “a digital representation of value that is neither issued by a central bank or a public authority, nor necessarily attached to a fiat (conventional) currency, but is accepted by natural or legal persons as a means of payment and can be transferred, stored or traded electronically," virtual currencies have become synonymous with the democratization of global finance (Bajpai, 2019). The most notable virtual currencies are cryptocurrencies, digital assets that use encrypted algorithms for creating, transferring, and securing media of exchange. Virtual currencies are being created all the time, as these instruments do not require much more than a sufficiently powerful laptop for triggering the algorithms required for perpetual issuance (Ibid., 2019; Frankel, 2018). In fact, according to Investing.com, there are currently 2,644 registered virtual currencies comprising nearly $275 billion in market capitalization alone (Investing.com, 2019). Moreover, Bitcoin and Ethereum – the two most popular cryptocurrencies in the market today – constitute 190 billion in market capitalization by themselves, a figure greater than the market capitalization of Goldman Sachs and Morgan Stanley combined (Ibid., 2019; Statista, 2019). In short, these financial instruments are becoming a force to be reckoned with in the global marketplace, yet they remain woefully unregulated even though recent reports suggest they have also been used to facilitate illicit money transfers (Kaminska, 2019).

As one of the three most important regulatory regimes in the world (alongside the United States and China), the European Union (EU) has a vested interest in confronting any emergent threats to its governance (The New York Times, 2018). However, coordinating new initiatives among its 28 member states can be a challenging proposition, especially when faced with something as intentionally diffuse and swiftly evolving as money laundering networks supported by nascent technology. Nonetheless, the EU's steadily-expanding mandate as the vanguard for advancing intra-European interests means that its approach to tackling this issue carries tremendous weight; after all, EU initiatives impact over 500 million people within its borders as well as those who interact with the bloc by other means (European Union, 2019). This paper aims to assess the EU's focus on virtual currency regulation as part of its general AML policy, starting with the European Banking Authority's landmark opinion paper on virtual currencies and moving to the European Parliament and Council of the European Union's 5th Anti-Money Laundering Directive, the primary mechanism placing virtual currencies squarely within its sights.

I. Unpacking the European Union's Focus on Virtual Currencies

On 4 July 2014, less than two years before the infamous "Panama Papers" leak served as a reminder of the strength of money laundering networks around the world, the European Banking Authority (EBA) published a lengthy opinion paper on virtual currencies. In light of the sector's relatively meager oversight and intentional evasion of centralized authority (including by governments), the growing proliferation of virtual currencies prompted the EBA to issue a public warning alerting consumers and relevant institutions of their risk (EBA, 2013). As part of its lengthy report, the EBA cited 70 risks related to virtual currencies, with their potential use in money laundering schemes constituting a primary concern (Ibid., 2013).

Perhaps the most worrisome part of the report is that the very thing which makes virtual currencies so compelling – i.e., that they can be created by anyone at any time – also renders virtual currencies immensely difficult to monitor and track. As the EBA notes:

> "A VC scheme can be created, and then its function subsequently changed, by anyone, and in the case of decentralized schemes, such as Bitcoins, by anyone with a sufficient share of computational power; that payer and payee can remain anonymous; that VC schemes do not respect jurisdictional boundaries and may therefore undermine financial sanctions and seizure of assets; and … market participants

lack sound corporate governance arrangements" (Ibid., 2013).

It was not until late 2013 that the EBA began to more actively monitor intra-EU virtual currency transactions, citing "a growing number of virtual currency schemes being launched, an increasing number of merchants, and a rising number of individuals using virtual currencies, [with] Bitcoins in particular" (Ibid., 2013).

Upon further analysis, the EBA identifies five areas in which the growth of virtual currencies presents a significant money laundering risk. The issue areas include:

1) Criminals who are able to launder criminal proceeds because they can deposit and transfer virtual currencies anonymously (deemed a high priority risk because of the lack of personal identification in virtual currency exchanges and the absence of intermediary oversight);
2) Criminals who are able to launder their proceeds because they can deposit and transfer virtual currencies globally, rapidly and irrevocably (deemed a high-priority risk because virtual currency schemes are not confined to jurisdictional borders, are hard to interpret, and are generally irreversible once executed);
3) Criminals or terrorists who use virtual currency remittance systems and accounts for financing purposes (deemed a high priority risk for the same reasons provided under risk #2);
4) Criminals or terrorists who disguise the origins of criminal proceeds, undermining the ability of enforcement authorities to obtain evidence and recover criminal assets (deemed a high-priority risk for the same reasons provided under risk #2); and
5) Market participants who are controlled by criminals, terrorists or related organizations (deemed a high-priority risk for the same reasons provided under risk #2) (Ibid., 2013).

A recurring set of themes emerge when assessing the money laundering risks highlighted in the EBA's report. First, anonymity presents the greatest challenge to any robust regulatory regime aimed at countering potential abuses within the virtual currency marketplace. Whereas illicit bank transfers or offshore accounts necessarily create a paper trail that can be retrieved and assessed by investigators, virtual currency transactions can be effectuated without a trace. Second, virtual currencies are now being used disguised as more common exchanges that muddle the ability to decipher whether the transaction in question is going to a legitimate entity or is instead an illicit transaction. For example, according to Jana Kasperkevic of Minnesota Public Radio's *Marketplace* blog, immigrants sent 445 billion USD in remittances back to their home countries in 2016 (Kasperkevic, 2017). If even a fraction of those transactions are now being co-opted by money laundering networks to evade detection, it poses a major problem for regulatory agencies seeking to differentiate between an already complex web of common transactions. Finally, even though there is a growing awareness of the risks of virtual currencies, there remains a veil surrounding who the primary virtual currency players are and how their goals may fuel money laundering activities (Newman, 2017). Virtual currency holders and creators are just as liable to use their holdings in order to transfer and store ill-gotten gains as they are to view them as part of a diversified and legally permissible investment portfolio, but tracking these individuals and intentions is nearly impossible unless they make themselves known. The unholy trinity of anonymity, mainstream mimicry, and muddled intent present a challenge unlike any other for contemporary regulatory agencies.

Although the EBA report offers a robust rendering of what virtual currencies are, how they work, and the danger they pose if left unchecked, most geographies have been slow to develop and adopt vigorous virtual currency regulation at the level of national AML policies. Per a breakdown of current cryptocurrency regulations around the world as provided by CNBC in March 2018, it seems that political figures in major countries agree that virtual currencies should be regulated, but it is also clear that many countries still have yet to define what virtual currencies are and whether they may be deemed legal tender (among other peripheral issues) (Rooney, 2018). Such debates underscore the lack of political wherewithal necessary at this time to grasp all of the implications of a virtual currency sector that shows no signs of slowing down. Fortunately, the EBA recognized the shortcomings of its own analysis and called for the EU to take action in formulating a consistent regulatory response. The EBA's report concludes:

> "With regard to national supervisory authorities, the aim of the Opinion is to build a common supervisory culture and practice across the European Union, and ensure there are uniform procedures and consistent approaches throughout. These form part of the EBA's regulatory response by seeking to put in place appropriate supervisory (and, in the long term, regulatory) practices in relation to virtual currencies, insofar as this falls within the competence of national authorities. Given that the regulatory environment for VCs is undeveloped, an EBA Opinion is an appropriate tool on which guidelines or recommendations could be built at a later stage, should a more comprehensive regime be developed in European Union law" (EBA, 2013).

It would take another four years for the EU to begin mobilizing behind an appropriate regulatory response to the EBA's report, but that response eventually came in the form of the European Commission's (EC) first ever Supranational Risk Assessment Report. Released in June

2017, the 20-page report (and its corresponding 300-page annex) touches on every possible money laundering-related risk to the EU along with associated terrorism financing schemes. Given the comprehensive nature Supranational Risk Assessment Report, it is unsurprising that one of its key portions highlights issues with virtual currency regulation. Echoing the EBA's report with even more specificity, the EC explicitly noted that the most substantial Anti-Money Laundering Directive (AMLD) issued by the EU remained an inadequate platform for combating virtual currency manipulation (European Commission, 2017). According to the EC, the biggest issue facing regulators is the difficulty of tracking virtual currency transactions and users: "[Virtual currency] risk levels differ compared to cash transactions because they require more sophisticated planning, cover lower volumes of transactions and may be subject to a certain level of monitoring. However, their anonymity features place an intrinsic limitation on identification and monitoring possibilities" (Ibid., 2017).

Most importantly, the EC's report attempted to quantify the extent to which virtual currencies were implicated in the contemporary European financial marketplace. Per the Annex of the EC's risk assessment, estimates were provided regarding key figures such as the number of virtual currency users in the EU, the number of exchange platforms, and virtual currency market capitalization (using 2014-2015 estimates):

Total VC wallets worldwide	13 million (Q4 2015)[10] – 7.4 million in Q4 2014
VC wallets in the EU	About 3 million
VC users worldwide[11]	From 1 to 4 million
VC users in the EU	About 500.000
VC miners worldwide	100.000[12]
VC miners in the EU	10.000 (estimate)
VC software wallet providers worldwide	> 500 (estimate)
VC custodians worldwide	> 100(estimate)
VC custodians in the EU	> 20 (estimate)
Exchange platforms worldwide	> 100
Exchange platforms in the EU	> 28
ATMs worldwide[13]	571
ATMs in the EU	> 100
Daily VC transactions	> 125.000 (bitcoin only - for 2015)
Merchants accepting bitcoins	110.000 (Q4 2015) – 80.000 in Q4 2014
Market capitalisation of VCs	EUR7 billion

The preliminary figures alone highlight the shortcomings of any attempt to regulate and monitor virtual currencies. Per Investing.com's most recent figures, there is enough to suggest that the calculations provided by the EC just two years ago dramatically understate the proliferation of virtual currencies not just in the EU, but worldwide (Investing.com, 2019). Given the EU's importance to the global economy, its sheer size, and the notable money laundering issues that faced more traditional financial institutions in recent years, it is unlikely that only 7 billion EUR of virtual currency market capitalization exists in the EU. Furthermore, if one examines the figures provided for virtual currency wallets worldwide, with wallets serving as a third-party storage mechanism for holding and administrating virtual currency accounts, the mere presumption that virtual currency wallet totals doubled within one year is far more emblematic of the scale with which these technologies continue to grow. The EC's report can be faulted for inadvertently yet dramatically underselling the potential danger of virtual currencies in Europe; nonetheless, its subsequent recommendation calling for greater virtual currency regulation was instrumental in pushing the entire transnational bloc to take more active steps in regulating the virtual currency sector.

Although it took four years and an extensive EC report for the EU to act upon the EBA's prescient assessment, such a response finally emerged. The EU's fourth AMLD did not reflect any of the concerns raised by the EBA, but after receiving the EC's recommendation and facing vocal exhortations from European financial regulators and policy officials (such as International Monetary Fund (IMF) chief Christine Lagarde and EC Vice-President Valdis Dombrovskis) who had become more aware of virtual currencies over time, the fifth iteration was bound to represent an important first step in managing virtual currency growth as a unified European front (Lagarde, 2018; Dombrovskis, 2018).

II. Key Takeaways from the EU's 5th Anti-Money Laundering Directive

On 19 June 2018, the European Parliament and Council of the European Union published its 5th Anti-Money Laundering Directive (AMLD), continuing the EU's tradition of issuing periodic updates to the preexisting money laundering regulatory framework. Directives represent the second tier of EU regulatory policies, as they present certain outcomes that need to be achieved across the bloc while granting each member state some freedom in determining how to translate these initiatives into national laws with binding force (USDA Mission to the European Union, 2019). Upon first glance, the directive seems to be most focused on addressing the remediation of "Panama Papers"-related oversight failures, such as calling for a more rigorous assessment of legal entities for use in potential money laundering activities (EUR-Lex, 2018). However, the most important set of long-term provisions suggested expanding the scope of the AMLD to include:

1) Virtual currency exchange platforms and similar entities as subject to EU regulations and oversight (much like investment banks and other major financial institutions);
2) A request for member states to create central databases "comprised of virtual currency users' identities and wallet addresses, as well as self-declaration forms submitted by virtual currency users" in order to better assess who is using these services; and
3) The incorporation of key terms and regulatory definitions into the EU's AML legislation. (Deloitte, 2018).

The clearest command of the 5th AMLD (or 5AMLD as it is more commonly known within the regulatory sphere) is the need for greater collaboration both within the EU and across its partner entities (such as the United Nations, Interpol, and Europol) to tackle the "convergence between organized crime and terrorism." (EUR-Lex, 2018). With an eye to the increasing frequency of terrorist attacks in major European cities, this is not a surprising consideration (European Parliament, 2018). As a result, 5AMLD aims to incorporate broader coverage of financial technologies such as (but not limited to) virtual currencies as part of a more holistic AML regulatory policy. 5AMLD states:

> "Providers engaged in exchange services between virtual currencies and fiat currencies (that is to say coins and banknotes that are designated as legal tender and electronic money, of a country, accepted as a medium of exchange in the issuing country) as well as custodian wallet providers are under no Union obligation to identify suspicious activity. Therefore, terrorist groups may be able to transfer money into the Union financial system or within virtual currency networks by concealing transfers or by benefiting from a certain degree of anonymity on those platforms.
> It is therefore essential to extend the scope of [the previous AMLD] so as to include providers engaged in exchange services between virtual currencies and fiat currencies as well as custodian wallet providers.
> For the purposes of anti-money laundering and countering the financing of terrorism (AML/CFT), competent authorities should be able, through obliged entities, to monitor the use of virtual currencies" (EUR-Lex, 2018).

By including such explicit AML-related language with respect to virtual currencies, the EU offered as clear an indication as possible that it recognized the need for a more robust approach to addressing money laundering concerns implicated by virtual currencies. Moreover, the language of the directive goes on to empower "competent authorities" serving in a supervisory capacity to meet the aims of 5AMLD by sharing confidential information without the fear of "legal uncertainty which may stem from a lack of explicit provisions in this field" (Ibid., 2018).

One notable tension in 5AMLD's language is that it seeks to strike a balance between calling for more transparency in all forms of financial regulation and aiming to protect the privacy of individuals implicated in these new provisions against the backdrop of "fundamental rights." In an extremely telling passage, the European Parliament and Council take great pains to couch its regulations in data privacy considerations, noting, "a fair balance should be sought in particular between the general public interest in the prevention of money laundering and terrorist financing and the data subjects' fundamental rights. The set of data to be made available to the public should be limited, clearly and exhaustively defined, and should be of a general nature, so as to minimize the potential prejudice to the beneficial owners. At the same time, information made accessible to the public should not significantly differ from the data currently collected" (Ibid., 2018). With a particular focus on virtual currencies, it cannot be denied that part of their appeal is the somewhat democratic nature of their use and expansion. Virtual currencies do not require opening a formal bank account with a local branch of a non-descript traditional financial institution, and virtual currencies' instant accessibility for anyone with a computer and the ability to process such transactions has opened up a new way to access and transfer capital. Perhaps implicitly, this language seeks to balance the need for regulation with the desire to remain true to the general cause of freedom and individual rights that undergird the entire European experiment.

With that said, the 5AMLD outlines broad strokes for member states to incorporate into their national laws by 2020, and such freedom suggests that there will be some variance in member state regulation as each national government determines the approach to implementation that works best. Given the general nature of the European Parliament and Council's recommendations, it remains to be seen how potent member states' responses to the need for virtual currency regulation will be when compared to confronting more pressing and wide-ranging issues with traditional financial institutions. Consider that in the last twelve months alone, the EU has been roiled by controversies stemming from malfeasant banks and individuals involved in elaborate money laundering activities. Some of the most widely publicized stories include Danske Bank's issues with money laundering in its Estonian branches, ABLV Bank's assistance with laundering illicit funds into North Korea, and the implication of a senior European Central Bank official in multiple money laundering schemes (Deslandes et al., 2018; Milne and Binham, 2018; Piovano, 2018). The clear challenges in managing financial actors that are already highly regulated and extremely attentive to money laundering issues demonstrates the uphill battle EU member states face in developing and implementing the requisite platforms for competently overseeing a fragmented and clandestine virtual currency market.

After five years of research and analysis into the virtual currency market, the EU implemented its 5th AMLD representing yet another milestone in collaboration among EU institutions. There is reason to be optimistic about the future of virtual currency regulation in Europe, but this directive simply represents a foundational step in creating the necessary platform for engaging with a complicated and diffuse financial services sphere. It should be noted that with the release of the 6th AMLD in late October 2018, the EU has doubled down on its commitment to stop money laundering activities in the form of virtual currencies, bolstering its approach with provisions that call for tougher punishments and criminal sanctions for bad actors (Deloitte, 2019). With the power to impose punitive measures on individuals and institutions found engaging in these illicit activities, the next step is creating measures that recognize the challenges of regular oversight yet attempt to deter as much malfeasance as possible. Crucially, 5AMLD prioritizes efforts that bring virtual currency transactions into the light by calling for registration and other forms of minimizing the anonymity these platforms currently enjoy. Moving forward, the success or failure of this directive will hinge on curtailing the next tier of challenges that such a project presents.

III. Notable Shortcomings and Assessing the Future of Virtual Currency Regulation

Money laundering regulations have been a mainstay of the global financial system for decades, particularly as reduced barriers to cross-border trade and rapid technological advancements increase market access for sophisticated parties wishing to access new markets. Although most financial transactions are lawful and legitimate, reflecting socially desirable activities such as investments in companies, risk mitigation efforts, or personal wealth management, there are also clandestine efforts to transfer funds into illicit activities. The IMF eloquently summarizes why money laundering is so problematic in a globalized economy, noting:

> "Money laundering and the financing of terrorism are financial Crimes with economic effects. Money laundering requires an underlying, primary, profit-making crime (such as corruption, drug trafficking, market manipulation, fraud, tax evasion), along with the intent to conceal the proceeds of the crime or to further the criminal enterprise. These activities generate financial flows that involve the diversion of resources away from economically and socially-productive uses—and these diversions can have negative impacts on the financial sector and external stability

> of member states. They also have a corrosive, corrupting effect on society and the economic system as a whole" (IMF, 2019).

The IMF's reflection on money laundering and its pernicious effects also alludes to the dangers of money laundering if left unchecked within democratic states. In an article for *Project Syndicate*, Oxford-based scholar Ngaire Woods highlighted the issues with increasing income inequality in developed countries and noted how scandals like the "Panama Papers" leak undermined trust in democratic institutions (Woods, 2016). Her concerns are well-founded: if it is believed that certain (often well-heeled) interests are improperly taking advantage of a system that everyone is expected to follow, then resentment will unsurprisingly mount among those members of society who will never be able to attain the sort of wealth and access that might embolden certain parties to flout the established order in the first place. One of the most notable takeaways of the EU's increasing body of research on virtual currencies is that not many people possess them relative to the size of the market, but it also creates a long-term risk that virtual currencies will become viewed not as a democratic platform, but as a tool for the elite to funnel funds into less than savory activities at their discretion. One economist claimed that cryptocurrencies in particular are "a toy for a very narrow segment of investors," suggesting that concerns about their impact on the real economy are unfounded (Zhao, 2017). Yet it is for that reason that virtual currencies should give observers pause, as public opinion could easily turn against them if they are beset by scandals implicating the stability of the global financial system as a whole.

This brief examination of virtual currencies and the risks of unfettered money laundering schemes on democratic stability is just one potential shortcoming of the current AML regime within the EU. As has been repeatedly asserted, 5AMLD outlines the contours of a potentially powerful virtual currency regulation platform that can serve as an example for other countries to follow (especially in the absence of coherent cross-border coordination regarding virtual currency management). However, there are several challenges that become evident as one moves from high-level policy advisory to grassroots implementation, including the following considerations:

1) There remains a high risk of coordination problems with other influential governance regimes, particularly the United States (which has steadily looked inward as reflected by the current president's governing mandate) and China (where the EC's risk assessment suggests most virtual currency mining in the world is currently taking place) (EC, 2017). The EU recognizes that most virtual currency activity happens outside the EU, but as the connective tissue between several key economic markets, this is unlikely to remain true over time. As a result, the EU must enlist support from similarly impacted actors if it hopes to cover all of the potential transactions that may pass through its borders.
2) EU member states must individually determine the best way to incorporate the broad aims of 5AMLD into national law, but this may result in a wide range of differing policies that "converge" for the purposes of EU regulation. As a result, such discrepancies in national policy may reveal gaps in certain countries' AML infrastructure that may render them more vulnerable than others to virtual currency laundering schemes.
3) Few individuals use virtual currencies relative to the size of the market, and it can be assumed that most of the market capitalization is tied up in a handful of stakes that, if exposed, would make the early iteration of this regulatory regime much easier to

execute. With that said, the process of uncovering these parties (especially if they do not want to be known) is far easier to envisage on paper than in reality.

4) It may be the case that couching virtual currency regulation in terrorism concerns is the best way to elicit buy-in from key stakeholders, but it also severely underestimates the problem that money laundering through virtual currencies presents. Just as with the "Panama Papers" scandal, it is more likely than not that wealthy interests seeking to take advantage of a lax regime will be far better positioned to use virtual currencies in illicit ways than terrorist networks (at least at this stage of virtual currencies' growth and evolution). For that reason, the same protections recommended in order to shield the financial system from offshore accounts, shell companies, and other entities likely to be leveraged by elites must also be incorporated into a sound and forward-thinking virtual currency regulation scheme.
5) Perhaps the greatest challenge will be creating strong mechanisms for sifting through virtual currency transactions and differentiating innocuous transfers from illicit ones. With the rise of virtual currency transactions for everything from currency conversion to remittances, it will be harder to tell whether a transaction is permissible or illegal, and this monitoring process will require a higher level of sophistication than what currently exists for more traditional financial instruments.
6) 5AMLD also demonstrates the challenges of defining what exactly should be covered under "virtual currencies" for the purposes of comprehensive regulation, and although the directive aims to cover "all the potential uses of virtual currencies," a sound policy must pinpoint those uses that move the needle in terms of potential money

laundering schemes and tackle those products first before moving to more fringe services.

The above considerations may raise healthy skepticism about the future of virtual currency regulation in the near-term, but the EU has nonetheless offered an important foundation for issuing protections against threats posed by a rapidly-growing and extremely unpredictable virtual currency marketplace. As the European Parliament and Council prudently assert in 5AMLD, it will be crucial to balance the need for regulation and protecting users' privacy and freedom to transact in the process, and it is this consideration that reflects the EU's overarching emphasis on democratic growth. But as stories regarding failed money laundering schemes with virtual currencies increase, public scrutiny regarding virtual currency use will increase in turn, and the early policymaking efforts of EU member states to build in platforms that can combat illicit money transfers will speak favorably on behalf of the EU's effort to establish accountability at a time when faith in democratic institutions is as lackluster as ever (Khatri, 2019; Partz, 2019).

As the G20 and other multilateral institutions begin to prioritize virtual currency regulation, the outlook for regulating these poorly understood financial instruments should remain positive. Given the EU's proactive regulatory shifts in this domain, and its outsized stake in managing potential risks within the marketplace, it is likely that Europe and European institutions will lead the charge in shaping virtual currency regulation regimes for years to come (Canepa, 2018).