REPRINT

DIGITAL ASSETS: AML AND SANCTIONS COMPLIANCE BEST PRACTICES

REPRINTED FROM:
RISK & COMPLIANCE MAGAZINE
JUL-SEP 2024 ISSUE

www.riskandcompliancemagazine.com

Visit the website to request
a free copy of the full e-magazine

Published by Financier Worldwide Ltd
riskandcompliance@financierworldwide.com

MINI-ROUNDTABLE

DIGITAL ASSETS: AML AND SANCTIONS COMPLIANCE BEST PRACTICES

PANEL EXPERTS

Daniel Burget
Director, Forensics, Compliance
BDO USA, P.C.
T: +1 (801) 456 5113
E: dburget@bdo.com

Daniel Burget has extensive financial fraud knowledge and experience gained over a 26-year career in federal law enforcement where he served as a special agent with the criminal investigation division of the Internal Revenue Service (IRS-CI). He has conducted and led numerous complex financial investigations involving tax fraud, investment fraud, bank fraud, money laundering, Bank Secrecy Act violations, terrorism financing, Foreign Corrupt Practices Act (FCPA) violations, and related financial crimes. He also has expertise in digital forensics in cyber enabled and cryptocurrency related financial crimes from serving as a leader of IRS-CI's Electronic Crimes Program.

Jacob Bach
Experienced Manager, Forensics, Monitorships & Investigations
BDO USA, P.C.
T: +1 (815) 975 7765
E: jbach@bdo.com

Jacob Bach is a forensics professional with over 10 years of experience in financial investigations, law enforcement, financial regulation and compliance programme consulting. Through this work, he has obtained extensive experience conducting interviews, performing digital asset tracing and blockchain forensics, preparing forensic analysis of financial activities, and presenting concise and understandable reports of completed work. As a forensic accountant with the Federal Bureau of Investigation in the Chicago field office, he conducted thorough investigations on cases including embezzlement, money laundering, counter-terrorism, organised crime, and multiple cases including cryptocurrency transactions.

R&C: Could you provide an overview of the increasing prevalence of digital assets, including cryptocurrencies, across the world's financial markets?

Bach: The prevalence and desire for cryptocurrencies in global financial markets continue to ascend, as seen by the introduction of Bitcoin exchange-traded funds (ETFs) and the rise of stablecoins. Bitcoin ETFs – funds that track the price of Bitcoin and are traded on traditional exchanges – represent a significant bridge between conventional investment mechanisms and the burgeoning world of cryptocurrencies. This development improves accessibility for a broader range of investors and signals a growing acceptance of cryptocurrencies within the institutional frameworks of global financial markets. Stablecoins, which are cryptocurrencies designed to minimise volatility by being pegged to a stable asset like the US dollar, offer a more predictable avenue for transactions in the crypto space. Their growing adoption underscores the financial market's receptiveness to leveraging blockchain technology for more reliable and easily tradeable digital currencies in everyday transactions.

R&C: What are some of the common anti-money laundering (AML) and sanctions-related challenges associated with digital assets?

> **"We are experiencing a 'global arms race' as the continuous growth and innovation of digital assets introduce new ways they can be used to facilitate money laundering and sanctions evasion."**
>
> *Daniel Burget, BDO USA, P.C.*

Burget: Digital assets present challenges and opportunities for anti-money laundering (AML) and sanctions compliance efforts due to their underlying blockchain technology. The challenge comes from the pseudonymity, easy access, decentralisation and speed at which cryptocurrency transactions can occur globally, providing bad actors with added means to obscure the source, nature and ownership of assets to launder illicit funds and evade sanctions. On the other hand, publicly accessible and generally immutable blockchain data allows financial institutions (FIs) and investigators to perform due diligence on assets and trace the flow of transactions in a way that is not possible with fiat currency. Within this opportunity comes the added challenge of understanding and employing continually evolving blockchain analytical tools and techniques. To perform accurate due diligence on digital assets and trace transactions across multiple blockchains and types of cryptocurrencies, it is essential to remain up to date on the use of blockchain mixers, privacy-enhanced protocols and illicit exchanges.

R&C: What steps are government authorities, such as the US Department of Justice (DOJ) and the Securities and Exchange Commission (SEC), taking to regulate digital assets? How would you characterise recent enforcement action?

Bach: The US Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) are intensifying their regulatory enforcement on digital assets, signalling a firm stance toward the oversight of exchanges and investment holders within the cryptocurrency space. The SEC has formed a dedicated team of 60 digital asset enforcement professionals, the largest contingent of crypto enforcement professionals globally. Recent enforcement actions by the SEC testifies to this heightened regulatory vigilance. For example, the SEC recently charged a brokerage firm offering securities through its crypto lending product to the public without registering them, bypassing essential disclosure requirements designed to protect investors. The increased enforcement by the SEC and the DOJ is a sign of how cryptocurrency regulation is evolving, as well as the government's resolve to establish a more secure and regulated environment for digital asset transactions.

R&C: What best practices should firms follow when implementing and improving an AML and sanctions programme to capture digital assets? What advice would you offer on establishing strong customer identification and due diligence procedures?

Burget: FIs must continually reassess their direct and indirect risk exposure related to digital assets. Accordingly, they must employ new and robust tools and procedures to screen and analyse all relevant data when onboarding and performing due diligence on customers. This includes performing blockchain analytics, using advanced tools to layer public-source and proprietary intelligence attribution data onto the blockchain data to analyse the origins and potential risks associated with customer assets. Adequate technical analysis for due diligence requires more than blockchain data. It should include geolocation of IP addresses and screening of physical addresses, which is sometimes overlooked in the implementation of screening systems, to ensure compliance with sanctions restrictions. It is also critical to commit to adequate staffing, training and funding for compliance programmes to include the advanced technology needed for the complexity of customer screening involving digital assets.

R&C: How important are automated screening and monitoring tools to an AML and sanctions compliance framework? What innovations are you seeing in this area?

Burget: Automated customer due diligence, sanctions screening and transaction monitoring tools are essential for an effective AML and sanctions compliance programme. This is particularly true for customers and accounts linked to digital assets, due to the volume and complexity of the available blockchain data that should be exploited for intelligence gathering and analysis. Automated tools that integrate blockchain analysis and intelligence data require specialised staffing and training for effective utilisation, which should be factored into compliance programme resource requirements. Some innovations recently seen with blockchain analysis tools used for customer due diligence and screening and transaction monitoring include data added from more blockchains for a wider array of cryptocurrencies or tokens. Greater depth of attribution intelligence data layered onto blockchain data, the ability to trace transactions across different blockchains, and the implementation of artificial intelligence and machine learning techniques are other improvements that provide better insight into complex transaction flows and more probing for enhanced risk analysis.

> **"Stablecoins, which are cryptocurrencies designed to minimise volatility by being pegged to a stable asset like the US dollar, offer a more predictable avenue for transactions in the crypto space."**
>
> *Jacob Bach,*
> *BDO USA, P.C.*

R&C: Looking ahead, do you expect to see an increasing risk of digital assets being used to facilitate money laundering

and circumvent sanctions? How is the regulatory landscape surrounding digital assets likely to evolve in the months and years ahead?

Burget: We are experiencing a 'global arms race' as the continuous growth and innovation of digital assets introduce new ways they can be used to facilitate money laundering and sanctions evasion. Examples include decentralised finance (DeFi) services, privacy-enhancing blockchains and mixing services. Technological advancement of blockchain analysis and intelligence tools is also available to FIs and law enforcement agencies. Regulators now expect FIs to employ these advanced tools and methods to perform customer due diligence and monitor for suspicious activity. The EU is phasing in more inclusive requirements for cryptoasset service providers under the Markets in Crypto-Assets regulatory framework, requiring compliance with the EU AML Directives. This provides for greater harmonisation of AML and sanctions requirements globally. This is needed because digital assets exist without boundaries. R&C