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Cryptocurrencies and Money Laundering: Methodologies, Prospect and Proposed Legislation for their Prevention in Pakistan

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Abstract

The research article focuses on analysis of crypto currencies which have gained popularity in recent years, especially with the landmark triumph of Bitcoin and the utilization of these cryptocurrencies in money laundering. Like any other technology, innovation and invention the cryptocurrencies have both merits and demerits, they can either be used in positive or negative ways. The usage of digital currencies for lawful purposes is growing in tandem with technical advancements, but criminals are rising to cash this trend. This research exposition will investigate the diverse modus operandi utilized to enjoy antagonistic benefit of the digital currency for money laundering and, second, to give an outline of the legal instruments that have been established in Pakistan to counteract these actions. Without a question, cryptocurrencies are advanced financial devices, and the proper framework for their regulation is required through appropriate legislation. In this Article important legislative recommendations are also discussed in detail.

Keywords: Cryptocurrencies, Anti-money Laundering, Crypto-Legislation, Digital Assets, Pakistan

Introduction

Defining Cryptocurrency

A cryptocurrency is a computerized fund intended to work as a mode of transactions that utilizes cryptography to ensure safe transactions, confine the creation of new units, and approve fund transfers. There are several cryptocurrencies, each with its own set of regulations. see, for example, coinmarketcap.com. Different applications of virtual currencies are currently widespread, since they may be used as an investment, a deposit, a transfer, or a payment. Differences between cryptocurrencies might include things like the consensus process used, latency, and cryptographic hashing techniques. it is a decentralised cyber resource that secures transactions between users using encryption. Despite the protection that these types of cyber property provide, one should recognise that it is frequently spent to perpetrate scam and are utilised for tax avoidance, unlawful transactions, and financial transactions related to Organized Crimes (Sergio Nanez & Jarosław Kaczmarek, 2020).

A study extracting the magnitude of money laundering via cryptocurrencies found that a sample of Ethereum Network had 4681 accounts, and 2179 of them were found to be fraudulent (Farrugia, 2020). Within the 1393 Initial Coin Offerings (ICOs) investigated, 274 incidences of fraud were discovered (Hornuf, 2020). Bitcoin, on the other hand, proves itself as a trustworthy anti-money laundering tool, as only USD 10 billion of a $500 billion market is utilised in scams and other criminal operations (Two percent of the total) (Navarro Cardoso, 2019).

Faced with this scenario, the State Bank of Pakistan has intervened for the protection of users and to meet advanced payment methods. It considered the issuance and implementation of Digital Financial Services (DFS) to this purpose, and the launching of RAAST is worth mentioning.

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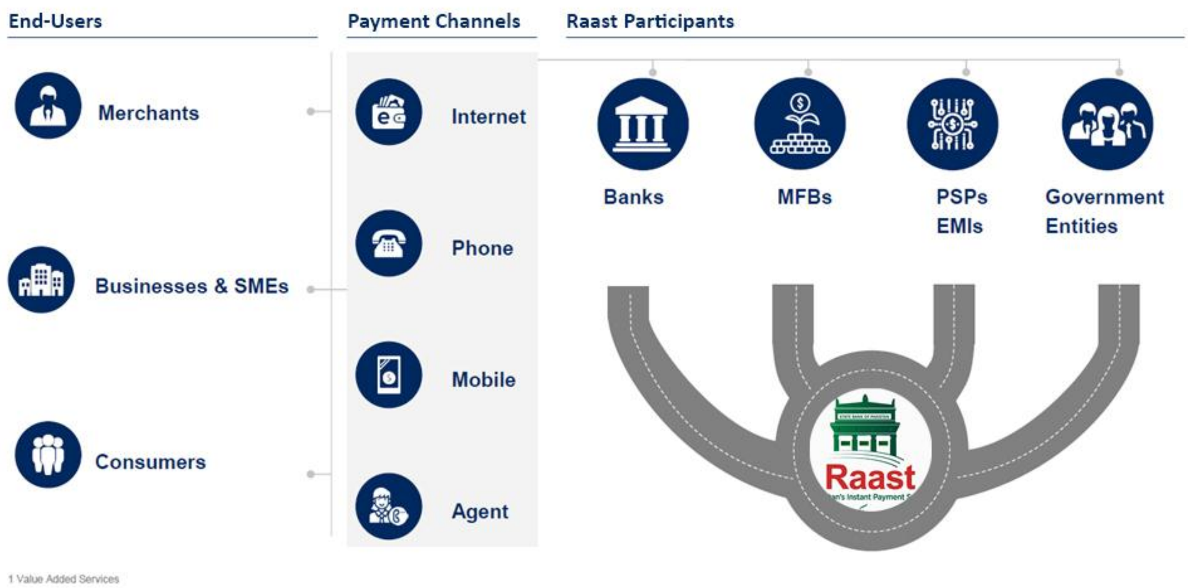


Historical Background

The history of money laundering dates back to 2000 years ago. Chinese merchants cycled money through various businesses and complex financial transactions to hide the income from government bureaucrats.

The contemporary practise of concealing illicit money is not a novel idea because if we trace the history, we can find out that in early ages the Pirates pioneering the concept through commercial ships sailing the Atlantic in the 16th and 18th centuries. Part of the pirates' loot and wealth was stowed in lairs, resulting in the creation of financial safe havens (Tondini, 2009)

However, the concept of crypto currency began in 2009, the so-called Satoshi Nakamoto, a person whose identity is still secret, created the first cryptocurrency, Bitcoin. In regular monetary affairs, there is centralization, the bank and Government oversight; in digital currencies, these elements are absent. Furthermore no strong agency or system to make control over it; instead, it operates as a larger group, with consumers, authenticating choices through a system of blocks known as blockchain, which are created by decoding mathematical algorithms (Porxas Roig and Conejero, 2018).

Research Objectives

In this article the relationship of cryptocurrency and money laundering with the perspective of Pakistan is analyzed and on the basis of findings the recommendations are suggested for legislation on the subject of crypto currencies.

Research Question

How can the facilitation of money laundering by cryptocurrencies be constrained in Pakistan?

Two step mechanisms is adopted to answer the question. First, we look at the most typical incidents of money laundering through the usage of cryptocurrency, and then we look at how Pakistani laws and regulations are now responding.

The Structure of Article is as Follows:

First, the mechanism of money laundering is elucidated with an examination of the techniques used to launder money using cryptocurrencies. Second, we look at the laws that apply to cryptocurrencies and money laundering in Pakistan. Third, we conclude the research and recommend the vital legislative recommendations.

Understanding Money Laundering

Before deliberating into the definition, legislative rules, and features of money laundering, it's vital to remember that money laundering is a key to a criminal organization's existence. They make a lot of money through illicit operations, which they must bring into the legal system. The conversion of illegal earnings into legal assets, so that their illicit origin cannot be traced back is known as money laundering (Reuter & Truman, 2004).

Money laundering is one of our society's challenges because of its economic, political, and social ramifications (Chowdhury, 2019). In defining the offense of money laundering, it provides that and also includes the following:

1. Acquiring, converting, possessing, using or transferring property, knowing or having reason to believe that such property is proceeds of crime;
2. concealing or disguising the true nature, origin, location, disposition, movement or ownership of property, knowing or having reason to believe that such property is proceeds of crime;
3. Holding or possessing on behalf of any other person any property knowing or having reason to believe that such property is proceeds of crime
4. Participating in, associating, conspiring to commit, attempting to commit, aiding, abetting, facilitating, or counselling the commission of the acts specified in clauses (a), (b) and (c).

The classified nature and confidentiality in cryptocurrency ownership, achieved through various means such as "mixers" and "exchanges," obstructs traceability and so serves as a facilitator for money laundering. Security, speed, cryptography, pseudo-anonymity, decentralization, the elimination of intermediaries, and the convenience of international transactions are the main properties of cryptocurrencies.[1]

All of these features make cryptocurrency a desirable and practical tool for money laundering.

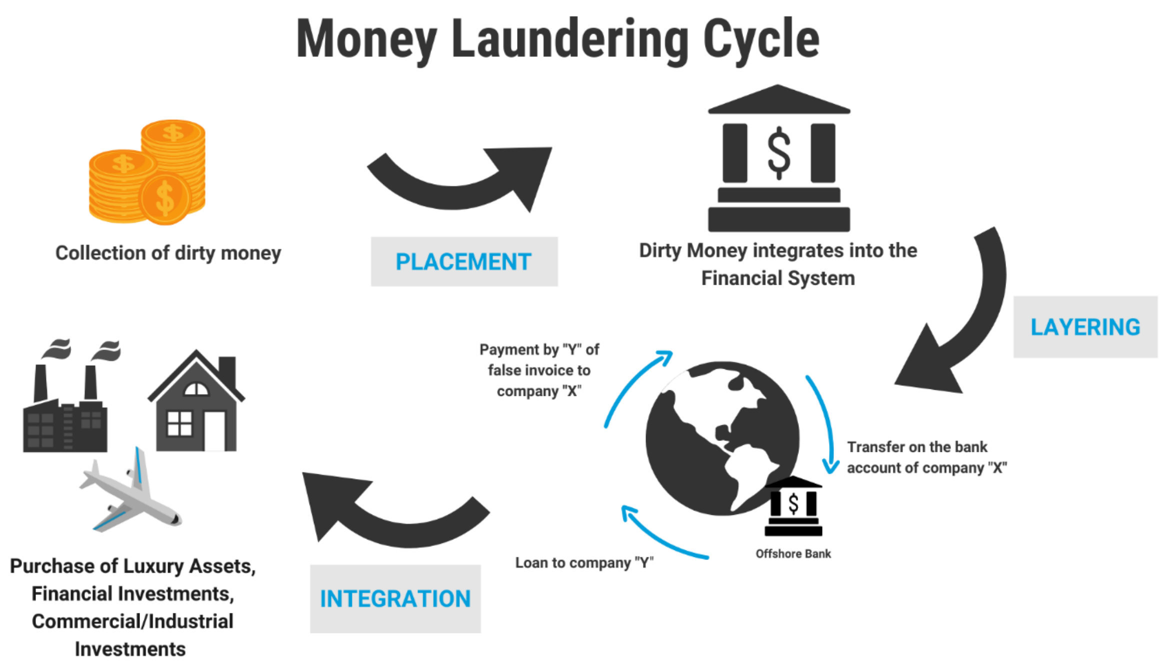
FATF (2018) characterizes money laundering as the rectification of illicit profits to camouflage their illegal origin. The war against money laundering demands a more strategic and tactical legitimate system, than other ordinary penal offences. The offence of money laundering constitutes two offences, first is the base which is criminal activity i.e. tax evasion, corruption, terror financing, drug trafficking etc. and the second is the crime of money laundering. Subsequently the FATF 2012 recommends that rather than destroying criminal organizations and prosecuting those who have committed crimes, the strategy shall focus on analyzing, obstructing, and intervening in a criminal organization's financial system to undermine it and, in some circumstances, paralyze its illegal businesses.

In money laundering exercises, legal substances are utilized as instrumental ingredients, to blend unlawful assets in with those coming from a genuine source. There are legal and financial experts that advise how to launder money, devise plans by employing proxy companies and accounts and facilitate clients with international tools to launder money. Therefore, the section 3(4) of anti money laundering act is constitutive and proscribes the participation in infraction by facilitation.

To comprehend money laundering, it's important to understand that it's a bizarre crime with numerous steps from the moment of receiving illicit criminal proceeds until it is laundered and circulated. There are many ways to launder money. Most researchers disintegrate money laundering into three stages to create it less troublesome to compare, differentiate and analyze.

These three stages are:

1. Placement: It is the introduction of illicit money into any financial system for laundering purposes.
2. Layering: It signifies the making of perplexed and sophisticated transactions and exchanges which endeavor to obscure the connection between the illicit money and the laundered one. Henceforth, through repeated transactions, the wellspring of the unlawful cash is concealed. The most incessant procedures are to transfer cash to tax havens, offshore companies, to ensure that the assets flow all through various nations, financial establishments, and accounts held by various people, legal persons and lawful substances.
3. Integration: The last stage alludes to the arrival of assets to the genuine economy. The extracted assets or funds are completely and untraceably incorporated into the economy. In this stage, when the capital has been set, defined and stratified, the assets or funds return back to the legitimate monetary circuit. The money is mixed in with other legal elements, giving it the illusion of legality.



Source: United Nations Office on Drugs and Crimes
https://www.unodc.org/unodc/en/money-laundering/overview.html

To curb money laundering and to enable Pakistan to anticipate and gauge the future risk of money laundering through crypto currencies the global observer FATF, gives an abundance of data on different unlawful exercises including the direct utilization of digital currencies in money laundering. The FATF provides recommendations to forestall coordinated crime, corruption, and terrorism, guaranteeing a collective response across globe to stifle the crime of money laundering.

The object of exercise is the advancement of a widely used prototype for combating money laundering which is the forty recommendations which implies controlling and improving national anti-money laundering frameworks through periodic evaluations, the examination of novel money laundering techniques, the establishment of international cooperation through regional and transnational organizations like U.N.O.D.C., FinTRACA etc. and the identifications of non-cooperative jurisdictions (NCTCs). In Pakistan the Central Authority to wrestle money laundering is the Financial Monitoring Unit (FMU) which has the international cooperation of more than 13 Countries including UK, China, etc.

Utilization of Cryptocurrencies in Money Laundering

The FATF recommendations and legal framework of Pakistan by taking steps such as red flag mechanism, limitations on cash transactions, digitalization of taxation, strict supervision of banking system etc. Make it onerous to launder money. In this scenario the cryptocurrencies being a decentralized asset will be the idol for criminal organizations. The risks attached with the employment of cryptocurrencies include the direct payment of criminal services, fraud and money laundering. According to the researches it is constructed that, because of secrecy, anonymity, swiftness, transnationality, and decentralization, new advances have supported crime in subject area of money laundering and tax evasion, in addition to different sorts of manoeuvre (method for remittance in drug dealing or coercion). It is obvious from these reports that digital currency forms are turning into a moderately protected strategy for lawbreakers to move illegal benefits throughout the world with a lower hazard than conventional strategies (Navarro Cardoso, 2019). The distinctive ways of employing cryptocurrencies in money laundering are displayed underneath.

Exchanges and Traders of Crypto Currencies

Exchanges and Traders facilitate the trading of digital currencies to guarantee that clients can change their cash into virtual cash as well as the other way around. This can be achieved through different payment mechanisms, for example, transfer of funds through banks, Mastercards and Visa Cards, PayPal and so on. The facilitators go about as wallets for their clients, as they store their assets and charge their respective commissions and fees from clients for their administrations.

The exchanges and traders are most convenient for money launderers due to conversion of huge cash into virtual currency, unusual & anonymous locations of exchange and traders, mutual trust due to inter-person acquaintance and bargain through internet forums. The FATF recommends that for the prevention of money laundering these exchanges and traders are to be regulated by law, enabling them to become authorized entities. As a result, money laundering protection mechanisms should be implemented immediately, and particular customer identification policies should be followed.

In-app Purchases

The most recent pattern in money laundering is the utilization of in-app purchases, which is exceptionally straightforward and shows up even in YouTube Tutorials. There are various online computer games that are utilized by criminals to launder their cash. An illustration of this malpractice is the computer game "PUBG", which permits the players to purchase unknown cash and send the same Unknown Cash to their companions and fellow players in game. Only the conversion of cash into crypto currency is strenuous, once the illegal cash is transformed into digital currency, there are various strategies to launder it and bring it into the legitimate financial framework.

Mixers

One of the most pervasive methods of money laundering by crypto currencies is the mixing of various streams of potentially identifiable cryptographic money. Mixer is basically an assistance which incorporates tumblers, blenders, or shufflers, all of these are the arrangements that permit clients to blend their virtual assets in with other clients' to secure their protection. It is the most well-known method rehearsed by money laundering service providers to guarantee that their customers can shroud the origin of the digital currencies, indeed, to erase transaction's identity.

Online Shopping

With the increasing trend of online shopping especially after the novel COVID-19 pandemic yields more businesses will accept virtual money as payment for products and services, posing a significant danger since it facilitates the conversion of money into virtual currency. Moreover, the launching of international brands and technologies in Pakistan makes the use of crypto currencies unstoppable. One example of money laundering through virtual currency is that a Software Service Provider "A" purchases a Microsoft office license via "Pay me with Bitcoin" and sells it in cash to any small enterprise in Pakistan. In this way the "A" not only converts and changes the origin of illicit money by purchasing bitcoin but also launders it by purchasing a license of Microsoft. The decentralization of bitcoin conceals the cash flow and the money is laundered accordingly. A research on the web shows sites where you can counsel the rundown of organizations that lawfully acknowledge payments with virtual cash, including those associated with entertainment, leisure time, computer games, computerized stores, gift vouchers, PCs, gadgets, and so forth. We can perceive how digital currencies, particularly Bitcoin, are progressively acknowledged as a type of payment; nonetheless, the instability of the cash and the conceivable digital assaults cause the righteous one's assume some risks when using it but for the criminal organization and money launderers it is convenient and as easy as ABC.

Prepaid Cryptocurrency Cards

The money laundering can also be carried out through converting cryptocurrencies into prepaid credit cards. These cards are recharged by virtual currencies and can be used on designated outlets. For example, BitPay prepaid debit card, Wirex crypto debit card, or prepaid Visa card.

These credit cards, preloaded with funds have every advantage, benefit, conveniences and accommodations of a standard debit card and can be utilized for online payments or merchants that acknowledge Visa or Mastercard. They can be additionally utilized for cash withdrawals through designated ATMs. The conversion of cryptocurrency into these cards is instant and accredited by the most famous coins, including BTC, ETH, LTC, and others. Contingent upon the magnitude of transaction amount, no documentation is mandatory if so, bogus documentation, or that of a third party can be sent. This makes it hard to break down the exchange, making it difficult to know the genuine proprietor of the card, and preferring the murkiness of the transactions.

In concluding the methodologies of money laundering through the cryptocurrencies, the inclusion of other proxies like Identity theft, shell companies, or tax havens can be used to make money transactions even more anonymous and opaque. This inclusion formula can be convoluted as per requirements, placing various organizations in the middle from various nations, making it difficult to know the genuine proprietor of the asset.

Legislative Framework and Proposed Recommendations

Despite the apparent security given by virtual currencies, as we discussed in the beginning, the usage of cryptocurrencies is not always lawful, we find the existence of their fraudulent use. The central bank currently does not consider cryptocurrencies to be legal tender in the country. The State Bank of Pakistan announced in a statement in 2018 that virtual currencies such as Bitcoin, Litecoin, Pakcoin, OneCoin, DasCoin, Pay Diamond or Initial Coin Offerings (ICO tokens are not legal tender, issued, or guaranteed by the Government of Pakistan. The introduction of cryptocurrencies in the financial system will violate Foreign Exchange Manual rules so SBP did not regulate any Virtual Assets Service Provider to deal in virtual currencies, coins and tokens in Pakistan. In addition to it Cryptocurrency trade is a threat to anti money laundering laws. However, regulation of cryptocurrencies still remains an issue. With the development of technology, the old payment solutions might become obsolete in future so the modern currencies such as crypto currencies, digital currencies etc. must be adopted to avoid payment hurdles in years to come. The failure of Pakistan in regulating the virtual currencies will result in scepticism regarding cryptocurrencies and will provide an opportunity for the sharp practices of scammers and fraudsters.

Pakistan did not recognize cryptocurrency nor did it legislate on this subject, however the driving force of cryptocurrencies on which the legislation in Pakistan will be based is the “Guide on Virtual Assets and Service Providers” published by FATF in 2019.

FATF frequently makes proposals, distributions, reports, and assessments to Pakistan that lead to guidelines, which, thusly, appear in public enactment. In this sense, the data of FATF distributions and reports permit us to realize which course the Pakistani virtual currency enactment will follow. The proper legislation, organization of awareness sessions, addition of “introduction to cryptocurrencies” courses in banking, financial and technology study programs will reduce the risks and dangers attached with the digital currencies. The legislation could acknowledge, regulate and legalize crypto currencies or ban them as the Cryptocurrency bill prepared by the Indian government which will embargo all cryptographic forms of money in the nation aside from a state-sponsored virtual currency.

The legislation shall also come to grips with strong price fluctuations in cryptocurrency. In this regard the guidelines for dealing with cryptocurrency proposed by the World Bank are to be followed as they depend on encounters with other computerized innovations like internet business. These guidelines will encourage the Government of Pakistan to give the new technologies space and restrict it to impose restrictive legislation before resolving initial ambiguities.

FATF guidelines disintegrate cryptocurrency dealing mechanism into two; subject and actors i.e. Virtual Assets and Virtual Asset Service Provider. In order to mitigate utilization of VA’s and VASP in money laundering, the Virtual Assets (VA’s) should contain exact data, Depositor and Beneficiary Details, and make it accessible in line with the law enforcement agencies. And all the VASPs ought to be needed to be authorized, enlisted, directed and managed by the concerned departments.

For the purpose of enforcement civil, criminal or administrative penalties can be inflicted for non-compliance. FATF regulations reflect several aspects on cryptocurrencies, which should have been transposed into the legislation for electronic transactions and are also highly recommended for legislation of cryptocurrencies. It contains the Certification Council to be known as Electronic Certification Accreditation Council to give and reestablish accreditation authentications, screen and guarantee compliance, set up and deal with the repository, do research and considers, perceive or authorize foreign certification service providers, empower consistency of guidelines and rehearses and give exhortation relating to the electronic transactions.

Currently, only the Khyber Pakhtunkhwa Assembly moved a resolution in which it is recommended to the Federal Government for legislation and regulation of cryptocurrencies. In Pakistan despite the non regularization of crypto currencies, it is estimated that over 9.0 million people, 4.1% of Pakistan’s total population, currently own cryptocurrency. This figure demands proper legislation. There is an emerging need to legislate on the issue of cryptocurrencies remembering the one for the counteraction of money laundering, which builds up the administrative structure for virtual monetary standards, setting explicit cutoff times for its launching. It is noticed that the involvement of intermediation in the crypto currencies transactions involves an incredible danger of money laundering. However, as of today, the crypto currencies have not yet been legalized and regulated in Pakistan.

Conclusion

In this article, money laundering and cryptocurrencies are analysed along with the contemporary legislation and regulations on these subjects. The genre of money laundering varies because in state regulated banking and financial systems, there is a central authority to monitor all the transactions but cryptocurrencies are decentralized. There is controversy of opinion on maintenance of complete anonymity in cryptocurrencies because an identifier associated with the wallet is required to perform transactions, this implies not having complete anonymity. However, due to the blockchain system the identifiers did not disclose personal data. "It is extremely difficult to achieve the nominal attribution of a bitcoin address or wallet, unless there have been security failures in the operations carried out"

The US Department of Justice states, "In recent years, money laundering through virtual currencies, such as Bitcoin, has become more prominent, as it allows Transnational Criminal Organizations to transfer illicit proceeds internationally and with more security than traditional cash transactions". The online shopping and payment of services attributes of cryptocurrencies make it exceptionally appealing and novel for money laundering. The cryptocurrencies serve as a paragon for money laundering due to complete anonymity of Virtual Assets, Virtual Assets Service Providers (VASPs) and transactions because Pakistan lacks the legal and regulatory framework for cryptocurrencies. What will happen if by mutual agreement, people in Pakistan directly exchange cryptocurrencies or if the illegal businesses like narcotics set the cryptocurrencies as their mode of payment at local level?

Known to these alarming threats the FATF conducts quality research and its distributions wind up being deciphered at the National level, in an enactment, which is ultimately rendered into our general set of laws. To refresh our monetary and banking framework, as per the requirements of time, it is unavoidable to counsel and study deeply the information base given by the FATF and enactment appropriately.

The identification of all prospective customers shall be established with all reasonable efforts. Before establishing any relationship with the customer in Pakistan, Virtual Currency Service Provider shall obtain, verify and record, minimum information to adopt customer due diligence (CDD) measures. The integration of CDD, International and National Banking Correspondence, reporting of suspicious transactions, record keeping and introduction of preventive and repressive systems in cryptocurrencies regulations will keep back money laundering.

The legislation in this regard should establish a Registrar of service providers for the licensing of Virtual Currencies Service Providers under the supervision of State Bank of Pakistan. The Registrar shall not only specify who must be registered but also defines rules, regulations and policies in this regard.

The most appealing element of Virtual Currencies is the secrecy of the clients or pseudo-obscurity. There is an eminent need for solid enactment on the anticipation and constraint on classified nature and absolute confidentiality of cryptographic form of money. It is indispensable that the law enforcement authorities have the vital lawful instruments and assets to battle computerized money laundering.

The conduction of training sessions, seminars and introduction courses to enable lawyers, prosecutors, judicial officers and concerned law enforcing departments to combat money laundering and other digital crimes of XXI century through crypto currencienies is highly recommended.

It is inequitable to consider that the mass of cryptographic money transactions is illicit and the legislature instead of regularizing these should cause the ban on expansion, operation and integration into traditional banking and financial systems. The use of cryptographic forms of money in illicit transactions is trivial. The cryptocurrencies are a financial marvel of the 21st century and their advancement will bring gigantic advantages to our economies by introducing low international transaction cost, enabling asset holders to drive their own assets in monetary constraint and by putting constructive restrictions on monetary authorities to overcome injudicious financial strategies.

In conclusion, I suggest that it is the commitment of law making bodies and relevant authorities in Pakistan to utilize all means to forestall, obstruct and arraign money laundering using cryptographic forms of money instead of meddling in the advancement of this new innovation. The launching of a stated backed cryptocurrency is also highly recommended.

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