Research Article

Cryptocurrencies and Money Laundering

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Abstract

Financial transactions involving cryptocurrencies have seen significant growth in recent years. Individuals and companies are using cryptocurrencies as a medium of exchange. This unstoppable process has brought opportunities for the cost-effective performance of financial transactions, but at the same time challenges for law enforcement institutions. A significant portion of cryptocurrency transactions are conducted outside the conventional banking financial system. Such transactions are difficult for law enforcement authorities to trace. There is a high possibility that cryptocurrencies will be used by money launderers to hide their identity and launder their proceeds of crime. Offshore Financial Centers, which apply a high degree of anonymity, are widely using cryptocurrencies. Countries and international institutions should take coordinated action to tackle money laundering in the field of virtual currencies as it is very difficult for one country, alone, to fight the phenomenon of money laundering in the world of cryptocurrencies. The study focuses on the difficulties faced by financial institutions and law enforcement authorities in tracking cryptocurrency transactions in the context of prevention of money laundering, seen from the Albanian perspective.

Keywords: Cryptocurrency, AML/CTF, Know Your Customer, Beneficiary Owner, Offshore Financial Centers.

1. Introduction

In an international business, investment, financing, and money management decisions are complicated by the fact that countries have different currencies, different tax regimes, different regulations concerning the flow of capital across their borders, different norms regarding the financing of business activities, different levels of economic and political risk, and so on (Hill, Hult 2019). Cryptocurrencies can be used to transfer capital across borders at faster and cheaper rate. A cryptocurrency is a digital or virtual currency secured by cryptography, which makes it nearly impossible to counterfeit or double-spend. Most cryptocurrencies exist on decentralized networks

using blockchain technology - a distributed ledger enforced by a disparate network of computers (Investopedia, 2024). Today, cryptocurrency is a thriving sector in many areas of the world and it is one of the most convenient ways to do business and also offers the greatest degree of flexibility (Relinconsultants, 2022).
Although cryptocurrencies have facilitated various financial transactions, mainly capital transfers, they present an increased risk in terms of Anti Money Laundering and Terrorist Financing AML/CTF. A significant part of these transfers is carried out outside the conventional financial system and is therefore outside the control radius of the law enforcement authorities. The large fluctuation in the value of cryptocurrencies, mainly bitcoin, represents a good opportunity to launder the proceeds of crime. Recently bitcoin had a significant appreciation that makes it possible for money launderers to avoid first and second layers of money laundering and integrate their criminal funds into the financial system or the real economy of the country. Identifying beneficial owners of corporations or individuals with criminal records becomes complex because transactions involving cryptocurrencies can be difficult to trace at their inception. Offshore Financial Centers, due to the anonymity they provide, further obscure the identity of beneficial owners using cryptocurrencies.
The paper is organized as follows. Section II shows the methodology of reserch. Section III analyzes the relationship between cryptocurrencies and money laundering. The conection between Offshore Financial Centers and Criptocurrencies is discussed in Section IV. Section VI summarizes the key conclusions and implications of the paper.

2. Methodology

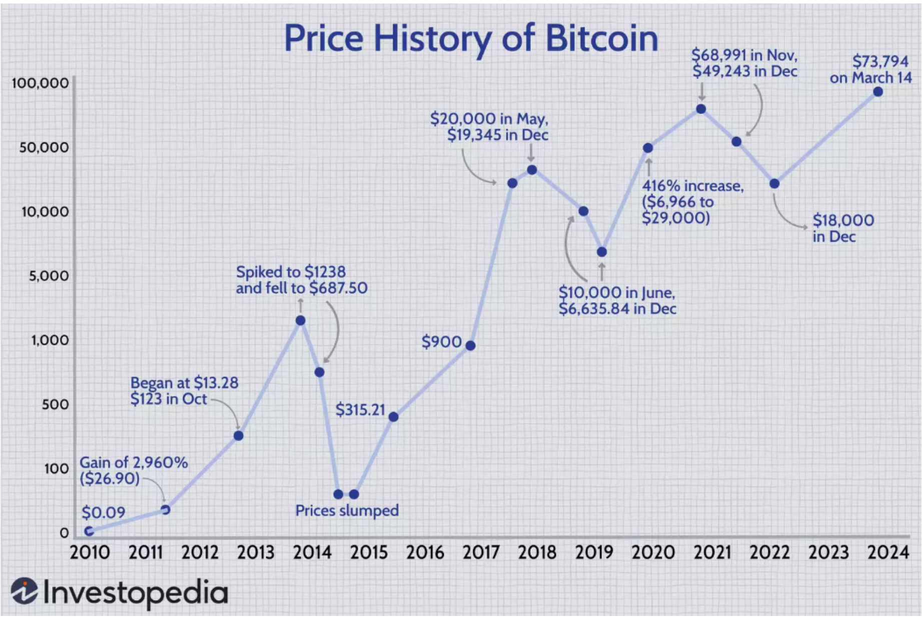
For the realization of this study, has been used the extensive contemporary literature on cripto currencies and AML/CTF. The primary data is derrived mainly from the review of the legal and regulatory framework related to “The Prevention of Money Laundering”, “Law For Technology-Based Financial Markets of Distributed Records” and “The Law For The Register of Beneficial Owners”. The most up-to-date sources of information such as the internet and electronic libraries have also been used. A significant part of the data was obtained through the use of Internet Resources such as the official website of “Yahoo Finance”, “Investopedia” etc.
In the study, a wide range of secondary sources were used in the form of academic literature, reports of important international organizations or publications. A special help was the reports of the Albanian responsible authority on AML/CTF - GDPML and the supervisory authority, the Bank of Albania, as well as the reports of international institutions such as FATF, IMF, World Bank, Europian Union etc.

3. The connection between Cryptocurrencies and Money Laundering

Cryptocurrencies have brought a new window in the field of money laundering. The possibility of hiding the identity of individuals with a criminal background increases because part of the financial transactions, mainly in their initial phase, can be carried out outside the conventional banking system.

According to lateast FATF report, without proper regulation, virtual assets also risk becoming a safe haven for the financial transactions of criminals and terrorists FATF (2024). World bank pointed out that the attractiveness of cryptocurrencies will be tested once governments extend their financial oversight to cryptocurrencies in their efforts to fight money laundering, tax evasion, and illicit transactions (World Bank, 2018). The Bank of Albania is also concerned about the anonymity that ensures cryptocurrency transactions. Bitcoin's competitive advantage as a means of payment and anonymity favor the expectations of economic agents (individuals) that the market for this means will be liquid (BoA, 2019).

According to some studies, illicit addresses sent nearly $23.8 billion worth of cryptocurrency in 2022, a 68.0% increase over 2021 (Chainalysis 2024). Cryptocurrencies, especially bitcoin, have seen significant fluctuations in recent years. From graph below, one can see that bitcoin has undergone several rallies and crashes since it became available (Investopedia, 2024).



Cryptocurrencies are anonymous at their point of creation therefore the placement stage of the money laundering process is often absent. Due to rapid increases in exchange rates, with some cryptocurrencies showing 10,000% growth, it is very easy to justify unexpected wealth through cryptocurrencies (UN, 2024).

Suppose that someone bought a certain number of bitcoins without leaving a trace in the conventional banking system in the middle of year 2014 when prices slumped to less than USD 100.00 per coin. Now let's assume that the customer appears in a

Currency Exchange Office or directly in a Banking Financial Institution in November 2020 or March 2024 where the price of bitcoin reached over USD 68,000.00 and USD 73,000.00 respectively. Of course, the customer must fill out the Know Your Customer "KYC" form and would argue that the source of income is from the purchase of bitcoins when the price was very cheap and this is not illegal. This is a very good way to avoid the first two layers of money laundering, namely placement and layering and integrate the cash in the banking system, which is the last stage of money laundering.
Albanian legislation has recently been updated regarding virtual currencies. The Law No.9917, May 19, 2008 "On the Prevention of Money Laundering and Financing of Terrorism" AML/CTF, in its definition, included Virtual assets and Virtual asset service provider in the amendments of years 2019 (Law No. 33 / 2019, dated 17.6.2019), 2021 (Law no.120 / 2021, dated 2.12.2021) and 2023 (Law 62/2023, dated 21.7.2023). The new amendments to the law stipulate that "Virtual asset" is a digital representation of a value that can be stored, traded or transferred in digital form, and which may be used for payment or investment purposes or as a means of exchange, including but not limited to crypto currencies. This definition does not include digital representations of fiat currencies officially issued or guaranteed by central banks or a public authority, securities and other financial assets provided for in the current legislation. "Virtual asset service provider" means any natural or legal person who performs, for or on behalf of another natural or legal person, one or more of the following activities: i. exchange between virtual assets and fiat currencies; ii. exchange between virtual assets and assets of any kind worth over 1 000 000 (one million) Lek; iii. exchange between one or more forms of virtual assets; iv. transfer of virtual assets; v. safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets.
The new Law No. 66/2020 "For Technology-Based Financial Markets of Distributed Records" stipulates that: With the exception of innovative service providers, any license holder, any issuer of digital tokens, as well as any other person who provides services related to digital tokens, is considered a provider of virtual means services, in accordance with the legislation in force for the prevention of money laundering and terrorist financing and must comply with any obligations. License holder, any issuer of digital tokens must: d) implement any obligation derived from the law "On the prevention of money laundering and financing of terrorism" for the service providers of virtual tools (Article 16). However, it is very difficult to trace crypto transactions that are not performed through license holders or any issuer of digital tokens, prior to 2020.
The client can argue that the legal changes were decreed later and in 2014 (when the initial Bitcoins were bought) there were no legal regulations on cryptocurrencies. This puts financial and non-financial institutions in a difficult position. But even more unclear is the position that the law enforcement authorities should maintain. Should this relatively large sum be seized?
Eventually, the existing legal framework does not foresee how to handle the purchase of cryptocurrencies before the amandments of law were enected, when their

price was very cheap and this fact can be exploited by money lounderers once the cripto currencies are extremley appreciated.

4. Offshore Financial Centers and Criptocurrencies

Offshore Financial Centers are usually referred to as: jurisdictions that have relatively large numbers of financial institutions engaged primarily in business with non-residents; financial systems with external assets and liabilities out of proportion to domestic financial intermediation designed to finance domestic economies; and more popularly, centers which provide some or all of the following services: low or zero taxation; moderate or light financial regulation; banking secrecy and anonymity. There are individuals and enterprises who rely on banking secrecy to avoid declaring assets and income to the relevant tax authorities. Those moving money gained from illegal transaction also seek maximum secrecy from criminal investigation (IMF Paper, 2000).

Offshore Financial Centres played an important role for hiding illegal activities, criminal identity and criminal ownership of assets right from their start. Virtual currencies such as Bitcoins and Ethereum, have shown to be used for laundering. Since the owner of bitcoins is almost not traceable, this currency might become attractive for criminals (EU, 2017). 70% or 21 out of 30 centralized cryptocurrency exchanges worldwide are incorporated or based in Offshore Financial Centers, defined as territories that seek to attract financial activities from abroad, through flexible regulations and low or zero-taxation schemes. Around 20% of Crypto Exchanges are Incorporated in Seychelles (CoinGecko, 2023). It only takes a few seconds to create an anonymous ryptocurrencies account and this is free of cost. It is only possible to use each account twice: to receive money and then transfer it elsewhere (UN, 2024).

Law No. 112/2020, For The Register of Beneficial Owners provides that “Beneficial owner”, is the individual who owns or ultimately controls the entity and/or the individual on whose behalf a transaction or activity is being carried out. It also stipulates that “Direct ownership” is the ownership held by an individual of 25% or more of the shares/equity shares or ownership interests in a reporting entity. However, politicians or lawbreakers can use offshore companies with ownership below the 25% threshold and use cryptocurrencies at the same time.

Therefore, Offshore Financial Centers can hide beneficial ownership of criptocurrency accounts and this complicates the application of Enhanced Due Diligence standards. The Law provides that “Enhanced Due Diligence” is a deeper control process, beyond the “Know Your Customer” procedures, that aims to create sufficient certainty to confirm and evaluate: a) the customer’s identity, b) to understand and test the customer’s profile, business, and its activity with respect to the services, products and transactions provided by the entity; c) to identify the important information and to assess the possible risk of money laundering/terrorism financing pursuant to the decisions aiming at providing protection against financial, regulatory or reputational risks as well as compliance with legal provisions (Law No.9917, “On AML/CTF”).

Trusts or of similar legal arrangements, which are widely used in offshore centers, complicates the efforts to obtain sufficient information concerning the beneficiary owners. Ensuring the identification of the beneficiary at the time of the payout or at the time of the exercise by the beneficiary gets more complex when cryptocurrencies are involved. In the framework of the exercise of due diligence, the entities shall find it difficult to identify the customer (permanent or occasional, natural or legal person, or legal arrangement) and verify his identity through documents, data or information received from reliable and independent sources as required by AML/CTF legal framework.
At the international and local level, there is a tendency to formalize the cryptocurrency market. President Biden is proposing e new Crypto Regulation, including Mining Tax. Any firm using computing resources, whether owned by the firm or leased from others, to mine digital assets would be subject to an excise tax equal to 30% of the costs of electricity used in digital asset mining (Yahoo finance, 2024). However, the attempt to incorporate the cryptocurrency market into the system does not shed light on previous transactions.
From what can be seen above, the problem of identifying transactions involving cryptocurrencies exceeds national borders and must be managed at an international level. Small countries, such as Albania, may find it difficult to prevent the last stage of money laundering – integration into the banking system. Institutions such as FATF, UN, World Bank, IMF, etc., should be vanguards in establishing standards to prevent the use of virtual currencies in the AML/CTF field.

5. Conclusions and implications

Cryptocurrencies have developed significantly in the last decade, revolutionizing the financial market. Crypto transfers can be done very quickly and at little cost compared to the traditional financial system. Many companies are now embracing the payment system that includes cryptocurrencies, which in addition to the role of store value, are increasingly being used as a medium of exchange. The drastic developments in the field of cryptocurrencies have also brought concerns as a significant part of the transactions are carried out outside the conventional financial system and therefore outside the range of law-enforcement authorities. Money launderers can find a golden opportunity to launder their proceeds of crime. The initial transactions of cryptocurrencies may leave no traces in the banking system and later integrate into the system. The great fluctuations of the cryptocurrency market, especially bitcoin, create perfect conditions for the final stage of money laundering - "integration", bypassing the first two stages - "placement" and "layering". Bitcoin slumped less than USD200.00 in 2014, and reached over USD73,000.00 in March 2024.
Albania, in the last two years, has decreed legal amendments to the organic law "The Prevention of Money Laundering", as well as a new law "For Technology-Based Financial Markets of Distributed Records". The virtual currency and the legal obligations of the license holder, or any issuer of digital tokens, are clearly defined. How-

ever, it remains unclear how the capital acquired by cryptocurrency holders will be treated, considering that a significant part is already carried out outside the conventional financial system. Customer due diligence measures are not implemented at all as only financial institutions and other registered entities can exercise Know Your Customer KYC policies. It remains to be seen how this mixture of transactions in the non-formal cryptocurrency market and the formalised conventional market can be handled in light of the regulatory framework. Should law enforcement authorities seize the large sums generated by the huge appreciation of cryptocurrencies in recent years? In fact, individuals may not have been involved in any criminal activity. However, identifying the initial source of income becomes very difficult.

Offshore Financial Centers are known for the anonymity of corporations and the concealment of the beneficial owner. Virtual currencies such as Bitcoins, have shown to be used for money laundering since the owner of bitcoins is almost not traceable. 70% of the centralized cryptocurrency exchanges worldwide are incorporated or based in Offshore Financial Centers that seek to attract financial activities from abroad, through flexible regulations and low or zero-taxation schemes. Law No. 112/2020, "For The Register of Beneficial Owners" stipulates that "Direct ownership" is the ownership held by an individual of 25% or more of the shares/equity shares or ownership interests in a reporting entity. Offshore Financial Centers might become attractive for criminals and currupt politicians by using offshore companies or trusts with ownership below the 25% threshold and use cryptocurrencies at the same time.

Anonymity creates an ideal environment for the involvement of cryptocurrencies in hiding the beneficial owners of corporations. Therefore, in the law "On the Register of Beneficial Owners" the threshold of identification of the beneficial owner should be removed. At the global level, international institutions such as the FATF, the UN, the World Bank, etc., must press for the removal of the anonymity of corporations registered in offshore financial centers. A more transparent and legal environment increases the attractiveness of the Albanian market for foreign direct investments because the economic ecosystem would be much more competitive and healthy.

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