DOI: https://doi.org/10.18524/2411-2054.2023.50.280276
U.D.C. 341.162

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THE LAW OF UKRAINE «ON VIRTUAL ASSETS» IN THE CONTEXT OF THE FATF STANDARDS NATIONAL IMPLEMENTATION

The article is dedicated to crypto-assets regulation both at the international level and at the national level in Ukraine. It presents a comparative analysis of the Law of Ukraine on Virtual Assets adopted in 2022 and the FATF Recommendations relating to Virtual Assets and Virtual Asset Service Providers. Even though a general congruence of these acts is shown, the publication concludes that the Law of Ukraine, pending its entry into force, is already partly outdated due to a fast development of the crypto-assets market and technologies. In this regard the 2021 FATF Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers and the 2023 EU Markets in Crypto-assets Regulation should be taken into account.

Keywords: crypto-assets, virtual assets, virtual asset service providers, FATF, the Law of Ukraine «On Virtual Assets».

Problem statement. The issues of crypto-assets legal regulation are new for national and international law. Many would say that for the moment there is no consistent international legal regulation on crypto-assets. It is really difficult to develop it due to the fact that at the national level there are many diverse approaches to their regulation: from prohibition to promotion. At the same time the crypto-assets market keeps growing and involving more economic actors[1]. Consequently, the use of existing or retrofitted regulation to crypto-assets activities proves to be ineffective. It has been shown by the effects of the so-called "crypto winter", which took place in 2022 and motivated the authorities of many jurisdictions, in particular the EU, to accelerate the elaboration of a bespoken regulation relating to different aspects of crypto-assets circulation. In this regard it should be mentioned that on 30 June 2022 the Council of the EU and the European Parliament reached a provisional agreement on the markets in crypto-assets (MiCA), finally adopted on 20 April 2023 at first reading by the European Parliament. This regulation governs issuance and provision of services related to crypto-assets and, in particular, stablecoins [1]. According to the experts, MiCA is the only legislation of its kind in the world, which paves the way for other jurisdictions. It will enter into force between mid-2024 and early 2025.

Thus, cryptoassets legal regulation keeps developing. It concerns not only the

[1]In January 2023 total crypto spot trading volume reached $1.88 trillion, available at: https://www.coingecko.com/.

national or regional level, but the international level as well, even though these developments may seem not so obvious. In this regard the Financial Action Task Force (hereinafter – FATF) recommendations are of great importance. Due to the influence that FATF exercises on the international financial system most states try to follow and implement them in a more efficient way. Ukraine is not an exception. Actually the recent Law of Ukraine "On Virtual Assets" of 17 February 2022 [2] (hereinafter – the Law) is a result of the collaboration of the Ukrainian authorities and the FATF. Notwithstanding that this law hasn't entered into force yet[2], some of its provisions can be already considered outdated given the recent developments of the relative FATF regulation. In addition, it hasn't solved all issues related to the crypto-assets market in Ukraine, which, among other things, requires a better and more detailed crypto-assets classification and analysis to elaborate their targeted legal regulation; a pilot regime implementation of distributed ledger technologies market infrastructure, etc. [3]. In this regard Ukraine should also contribute to the formation of a uniform global approach to mitigate money laundering risks associated with crypto-assets in the framework of the FATF [4, p. 6], which is to be elaborated taking into account the dynamics of their technological development and transformation.

Analysis of the latest researches and publications. Due to an innovative character of crypto-assets and a certain level of unpredictability of their legal regulation development there are not many complex scientific studies dedicated to them yet. At the same time some representatives of foreign legal doctrine have made publications concerning the issues of the FATF crypto-assets regulations. Among them are: D. Holman, B. Stettner, G. Pavlidis, R. Coelho, J. Fishman and D. Ocampo. In Ukrainian legal science one can find articles devoted to the different aspects of crypto-assets legal regime, e.g. their legal nature and other characteristics, like those of O. Bondarenko, I. Michurin, A. Ovcharenko, S. Hrytsai, etc. Meanwhile, there are only a few authors whose publications touch upon the above law and problems of its application. In this regard D. Oliynyk, T. Hudima, V. Ustymenko, R. Jabrailov, O. Chernykh should be mentioned.

Purpose statement. Taking into consideration the above suggestions, the purpose of this publication is to compare the provisions of the Law of Ukraine "On Virtual Assets" and of FATF Recommendation 15 and relative regulations in order to conclude about their congruence and to provide recommendations for the improvement of the Law.

Main part of the research paper. First of all, a brief characteristic of the FATF should be given. It is an inter-governmental body established in 1989 on the initiative of G7 by the Ministers of several jurisdictions. For the moment there are 38 members of the organ (states, organizations and territories included), the most developed and important for the world financial system. The membership of the Russian Federation was suspended on 24 February 2023. Ukraine is not a member of the FATF. Initially the mandate of the body covered only combating money laundering, mostly regarding drug trafficking. In this regard the original FATF 40 Recommendations were adopted

[2] According to Par. 1 of the Final and Transitional Provisions the law shall enter into force from the date of entry into force of the Law of Ukraine on Amendments to the Tax Code of Ukraine regarding the specifics of taxation of operations with virtual assets, but not earlier than the date of publication of this law. As of May 2023 the amendments to the Tax Code have not been adopted yet.

in 1990 as an initiative to minimize the misuse of the financial system for this purpose. In 2001 its mandate was broadened to include terrorism financing. In this connection, 9 more recommendations were elaborated. The current version of the recommendations was adopted on 15 February 2012. Interestingly enough the FATF acts are not legally binding. Being recommendations, they belong to the "soft law" mechanisms. At the same time due to the specific enforcement mechanism of the FATF states make an effort to follow them. The measures that could be taken by the body in the case of non-compliance are based on the so-called "gray" (jurisdictions under increased monitoring) and "black" (high-risk jurisdictions subject to a Call for Action) lists. Due to the fact that the FATF members play a significant role within the world financial mechanism the implications of a country listing have a very serious and almost immediate effect because its financial system is subjected to heightened scrutiny by all members. In practice it means bank payments delays, the rise of cross-border transaction costs, the downgrading of sovereign credit and business ratings by rating agencies, foreign investments decline, etc.

For the moment there are 25 states in the "graylist" and only 3 states in the "blacklist"[3]. Unfortunately, despite the effort of the Ukrainian government as of May 2023 Russia hasn't been included in the lists. Ukraine has been listed twice, in 2002 – 2004 ("blacklist") and 2010 – 2011 ("graylist"). After this sad experience our country has been aiming at avoiding the FATF sanctions. It can be supposed that the adoption of the Law of Ukraine "On Virtual Assets" is part of such endeavors. Actually it is confirmed by the official statement of the Government of Ukraine, according to which the law is based on the current standards of regulation of operations with virtual assets of the FATF [5].

So, let's consider them in more detail. As it has been already mentioned, crypto-assets regulation is provided by Recommendation 15 "New technologies". According to it, countries and financial institutions are to identify and assess the money laundering or terrorist financing risks that may arise in relation to (a) the development of new products and new business practices, including new delivery mechanisms, and (b) the application of new or developing technologies for both new and pre-existing products. In the case of financial institutions, such a risk assessment should be undertaken for the launch of new products, business practices or the use of new or developing technologies. They must take appropriate measures to manage and mitigate those risks. In this regard, countries are to ensure that virtual asset service providers are regulated for anti money laundering/counter financing terrorism purposes, and licensed or registered and subject to effective systems for monitoring and ensuring compliance with the relevant measures called for in the FATF Recommendations [6, p. 107].

In June 2019 the FATF adopted Interpretative Note to Recommendation 15 to further clarify the application of FATF requirements to virtual assets activities or operations and virtual assets service providers, including with respect to suspicious transaction reporting. The FATF also adopted a first version of the Guidance on the Application of a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers in June 2019. This Guidance was updated in October 2021.

In Interpretative Note two new glossary definitions were added, in particular, of (1)

[3] FATF, High-Risk and Other Monitored Jurisdictions, available at: https://www.fatf-gafi.org/en/publications.html

a virtual asset that is understood as a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes[4], and of (2) a virtual asset service provider, who can be any natural or legal person that conducts one or more of the following activities for or on behalf of another natural or legal person: 1) exchange between virtual assets and fiat currencies; 2) exchange between one or more forms of virtual assets; 3) transfer of virtual assets; 4) safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and 5) participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset [6, p. 109].

It is predictable that the same terms are defined in the Law as well. Actually the terminology chosen by Ukraine corresponds to the FATF approach, even though a growing tendency for different jurisdictions is to use the term "crypto-assets" [7, p. 35]. At the same time the definitions are not identical. Accordingly, virtual assets in the Law are defined as intangible goods, which are the objects of civil rights, have a value and are expressed by a set of data in electronic form (Art. 1). In this way Ukraine has tried to limit the functions that virtual assets can perform in its territory and to add their civil law characteristics. Such an approach is completely acceptable and compatible with the recommendation. Regarding virtual asset service providers in Ukraine they are limited to business entities, i.e. legal entities that conduct one or more of the following types of activities in the interests of third parties: 1) storage or administration of virtual assets or virtual asset keys; 2) exchange of virtual assets; 3) transfer of virtual assets; 4) provision of intermediary services related to virtual assets (Art. 1). So, even though such an enumeration of virtual asset services does not seem completely logically consequent (because the first 3 groups of services seem to be covered by the forth one), it can be considered corresponding to the FATF approach and even to be potentially broader and embracing more intermediary service categories.

A comprehensive definition of service providers is important for the further regulation of their activities. Paragraph 2 of Interpretative Note stresses that countries should identify, evaluate, and understand money laundering, terrorist financing and mass destruction weapons proliferation financing risks emerging from virtual asset activities. Based on it, they should apply a risk-based approach to ensure that measures to prevent or mitigate money laundering and the above financing are commensurate with the identified risks. In this regard jurisdictions should take appropriate steps to manage and mitigate the risks that they identify and, accordingly, require virtual asset service providers to identify, assess, and take effective action to mitigate them as well.

Ukraine has been trying to meet this requirement through Art. 9 of the Law where the duties of virtual asset service providers are set out. In particular, they are obliged to: 1) conduct transactions with virtual assets in good faith and at their own risk; 2) before carrying out transactions with virtual assets, familiarize themselves with the features of the systems, in which it is planned to conduct transactions; 3) when carrying out operations with virtual assets, comply with the requirements of this law, the Law of Ukraine «On Prevention and Counteraction to Legalisation (Laundering) of Criminal Proceeds, Terrorist Financing and Financing

[4] It is clarified as well that the term "virtual assets" should cover "property," "proceeds," "funds," "funds or other assets," or other "corresponding value" (Par. 1 of Interpretative Note to Recommendation 15).

of Proliferation of Weapons of Mass Destruction», the Law of Ukraine «On Currency and Currency Transactions», international treaties of Ukraine, other legal acts regulating the circulation of virtual assets. Among the above acts the Law of Ukraine «On Prevention and Counteraction to Legalisation (Laundering) of Criminal Proceeds, Terrorist Financing and Financing of Proliferation of Weapons of Mass Destruction» contains provisions for the minimization of the risks mentioned in Interpretative Note. It should be emphasized that for now the provisions of this law have not been brought into line with the new law on virtual assets yet. It concerns the notion of virtual assets, regulatory and monitoring authorities[5], etc. Thus, an effective assessment and mitigation of the risks relating to crypto-assets are based on the application of both laws acting in concert. Though relative amendments are provided for in the Law on Virtual Assets, they are pending its entry into force.

The next requirement for virtual asset service providers in Par. 3 of Interpretative Note concerns their licensing or registration. At a minimum, providers should be licensed or registered in the jurisdiction where they are created. Competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from participating or controlling activities of a provider. Countries are to reveal providers functioning without the requisite license or registration and apply appropriate sanctions.

A separate licensing or registration system is to be created with respect to natural or legal persons already licensed or registered as financial institutions within those jurisdictions, which, under such license or registration, are permitted to perform virtual assets activities and which are already subject to obligations under the FATF Recommendations (Par. 4 of Interpretative Note).

In this regard the Law fulfills the requirements of the FATF Recommendation and in Par. 1 of Art. 19 establishes that services relating to the circulation of virtual assets are provided under the condition of obtaining a prior authorization. What is more, according to Art. 21 the maintenance of the State Register of Virtual Asset Service Providers falls within the competence of the National Securities and Stock Market Commission.

In the light of Par. 5 of Interpretative Note, so as to control the activities of service providers, countries should ensure that they are supervised or monitored by a competent authority, which is to conduct a risk-based supervision or monitoring. Supervisors must have powers to impose a range of disciplinary and financial sanctions, including the power to withdraw, restrict or suspend the provider's license or registration, where applicable. In Ukraine, relative powers are assigned to the National Securities and Stock Market Commission and the National Bank of Ukraine, which can apply financial sanctions and other measures. For instance, the Commission can annul a permit in the case of more than 2 breaches per year (Par. 12 (2) of Art. 19 of the Law).

Paragraph 6 of Interpretative Note also establishes an obligation for countries to implement a range of effective, proportionate and dissuasive sanctions, whether

[5] According to the Law on Virtual Assets the competent authorities are the National Securities and Stock Market Commission (for all virtual assets, besides stablecoins) and the National Bank of Ukraine (for stablecoins), while in the Law on Money Laundering and Terrorist Financing Suppression the Ministry of Digital Transformation of Ukraine is still mentioned as a monitoring authority.

criminal, civil or administrative, available to deal with virtual asset service providers that fail to comply with the FATF rules. Unfortunately, this requirement has not been met fully by Ukraine yet.

With respect to the preventive measures established in Par. 7 of the Note, the threshold of USD/EUR 1 000 required to conduct customer due diligence verification is set out in UAH in the Law Final and Transitional Provisions that provide for amendments to the Law on Money Laundering and Terrorist Financing Suppression. But due to the devaluation of the Ukrainian currency provoked by the war for now the mentioned UAH 30 000 no longer correspond to USD/EUR 1 000. So, it seems that a more flexible approach for the threshold designation is needed.

Finally, Art. 25 of the Law in concordance with Par. 8 of Interpretative Note establishes the competence of the National Securities and Stock Market Commission to carry out international cooperation on the basis of reciprocity or on its own initiative, including the possibility of exchanging limited access information.

Conclusions. So, it can be concluded that the provisions of the Law of Ukraine on Virtual Assets adopted on 17 February 2022 are mostly consistent with FATF Recommendation 15 and the 2019 Interpretative Note to it. At the same time for the moment the provisions of the latter are already partly outdated, which the 2021 FATF Updated Guidance on Virtual Assets and Virtual Asset Service Providers confirms. In particular, it expounds and clarifies the issues of stablecoins, peer-to-peer transactions, non-fungible tokens, etc. The relevance of their regulation is confirmed by the 2023 EU act on Markets in Crypto-Assets (MiCA) as well. Meanwhile, all these aspects of the virtual assets market are only slightly touched upon in the Law of Ukraine. It is highly probable that when it enters into force, it will need even more amendments due to a fast development of the relative market and new problems arising on the background of the 2022 Russian invasion of Ukraine. For instance, the issue of donations in crypto-assets accepted by charitable organizations requires a quick legal solution [8. p. 145]. Thus, we can only hope that the Ukrainian legislator can keep up with the digital age and contribute to a future-proof economy based on the use of innovative technologies.

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Стаття надійшла 15.05.2023 р.

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ЗАКОН УКРАЇНИ «ПРО ВІРТУАЛЬНІ АКТИВИ» В КОНТЕКСТІ НАЦІОНАЛЬНОЇ ІМПЛЕМЕНТАЦІЇ СТАНДАРТІВ ГРУПИ З РОЗРОБКИ ФІНАНСОВИХ ЗАХОДІВ БОРОТЬБИ З ВІДМИВАННЯМ ГРОШЕЙ (FATF)

Резюме

Стаття присвячена правовому регулюванню обігу криптоактивів, як на міжнародному, так і на національному рівні в Україні. Вона містить порівняльний аналіз прийнятого у 2022 році Закону України «Про віртуальні активи» та Рекомендацій Групи з розробки фінансових заходів боротьби з відмиванням грошей (FATF) щодо віртуальних активів та постачальників послуг, пов'язаних з обігом віртуальних активів. Незважаючи на те, що, у цілому, продемонстровано відповідність положень Закону України зазначеним рекомендаціям, робиться висновок про те, що Закон України, який ще так і не набрав чинності,

вже є частково застарілим, що легко пояснюється швидким розвитком ринку криптоактивів і пов'язаних із ними технологій. У зв'язку з цим, українському законодавцю слід взяти до уваги Оновлену інструкцію Групи з розробки фінансових заходів боротьби з відмиванням грошей щодо застосування до віртуальних активів і постачальників послуг, пов'язаних з обігом віртуальних активів, підходу, що грунтується на оцінці ризиків, розроблену у 2021 р., та Регламент ЄС про ринки криптоактивів від 2023 р. Окремого та спеціального регулювання у законі потребують такі аспекти обігу криптоактивів, як обіг забезпечених криптоактивів (так званих стейблкойнів), безпосередні транзакції між власниками криптоактивів (так звані P2P чи peer-to-peer транзакції), обіг невзаємозамінних токенів (так званих NFT) тощо. Регламентація цих відносин, на національному рівні, не тільки дозволить вирішити проблему правової невизначеності, але й допоможе у формуванні глобального та більш конгруентного правового режиму обігу криптоактивів, який би забезпечив ефективну боротьбу із відмиванням грошей та фінансуванням тероризму під егідою FATF, а, також, надав більші гарантії криптоінвесторам.

Ключові слова: криптоактиви, віртуальні активи, постачальники послуг, пов'язаних з обігом віртуальних активів, Група з розробки фінансових заходів боротьби з відмиванням грошей (FATF), Закон України «Про віртуальні активи».