

## **RAPID RESPONSE BRIEF**

### **KNOWN KNOWNS: UNDERSTANDING STABLECOIN AML/CFT RISKS**

Recent extreme volatility in the digital assets markets, exacerbated by the collapse of at least one leading algorithmic stablecoin, Terra’s UST, along with its LUNA governance token, has placed renewed media, legislative, and regulatory attention on the digital assets industry. Despite the speed of the recent market decline and collapse of UST/LUNA, such risks posed by stablecoins based on exactly this type of scenario were widely known among informed stakeholders.

This rapid response brief contextualizes recent developments in stablecoins within the US anti-money laundering and countering the financing of terrorism (AML/CFT) framework, to assist compliance and other professionals to reinforce a risk-based approach to stablecoins.

#### **How does this relate to AML/CFT Compliance?**

- US and international policymakers and regulators have been proactive in identifying AML/CFT risks involving stablecoins over the past several years, since at least 2019.<sup>1</sup>
- The current downward market volatility in the digital assets industry, including the Terra UST and LUNA collapse, does not appear at this time to involve discrete or systemic AML/CFT control failures, but rather broader industry and macroeconomic forces.
- Nonetheless, this current market dynamic will likely spur greater legislative and regulatory scrutiny of the digital assets industry, which may have AML/CFT implications.

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<sup>1</sup> Financial Action Task Force, October 18, 2019, “Money Laundering Risks From ‘Stablecoins’ and Other Emerging Assets”, <https://www.fatf-gafi.org/publications/fatfgeneral/documents/statement-virtual-assets-global-stablecoins.html>.

## Context

### What are stablecoins?

1. No single definition of stablecoins exists. However, the White House recently defined stablecoins as “a category of cryptocurrencies with mechanisms that are aimed at maintaining a stable value, such as by pegging the value of the coin to a specific currency, asset, or pool of assets or by algorithmically controlling supply in response to changes in demand in order to stabilize value.”<sup>2</sup>
2. Recently, digital asset markets have seen an increased volume of trading between tokens using stablecoins. This may create additional AML risks as more transaction volume is occurring through stablecoins. Stablecoins may also be attractive to malign actors because of their attempted price stability and general liquidity. Recently, Securities and Exchange Commission Chair Gary Gensler went as far as to say that “Each one of the three big [stablecoins, referring to Tether, USD Coin, and Binance USD] were founded by the trading platforms to facilitate trading on those platforms and potentially avoid AML and [Know Your Customer].”<sup>3</sup>

### Recent US actions to address stablecoin AML/CFT risk

3. As part of the Treasury Department’s 2022 National Strategy for Combating Terrorist and Other Illicit Financing released on May 13, 2022, the US Government put forward a 2024 benchmark that specifically addressed stablecoins to “[ensure] that stablecoins have a proper AML/CFT framework and that there are sufficient resources to support domestic supervision.”<sup>4</sup>
4. Under the March 9, 2022 Executive Order on Ensuring Responsible Development of Digital Assets, US Government agencies, including the Treasury Department will now have 90 days to submit to the White House “additional views on illicit finance risks posed by digital assets, including... stablecoins.”<sup>5</sup>
5. In the context of an intragovernmental review of stablecoins focusing heavily on market integrity and investor protection concerns, the President’s Working Group on Financial Markets (PWG), along with the Federal Deposit Insurance Corporation and the Office of the Comptroller

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<sup>2</sup> The White House, March 9, 2022, “Executive Order on Ensuring Responsible Development of Digital Assets”, <https://www.whitehouse.gov/briefing-room/presidential-actions/2022/03/09/executive-order-on-ensuring-responsible-development-of-digital-assets/>.

<sup>3</sup> Allyson Versprille and Olga Kharif, Bloomberg, May 10, 2022, “SEC’s Gensler Says Crypto Exchanges Trading Against Client”, <https://www.bloomberg.com/news/articles/2022-05-10/sec-chief-questions-whether-crypto-exchanges-bet-against-clients>.

<sup>4</sup> U.S. Department of the Treasury, May 13, 2022, “National Strategy for Combating Terrorist and Other Illicit Financing”, <https://home.treasury.gov/system/files/136/2022-National-Strategy-for-Combating-Terrorist-and-Other-Illicit-Financing.pdf>.

<sup>5</sup> The White House, March 9, 2022, Op. Cit.

of the Currency, issued a Stablecoin Report in November 2021 that went into substantial detail about illicit finance risks from stablecoins.<sup>6</sup>

6. The PWG report identified factors influencing the magnitude of AML/CFT risks including “the application of [AML/CFT] controls, the degree to which it is adopted by the public, and the design of the stablecoin arrangement.”<sup>7</sup> The report also identified the need for effective implementation of international standards “for the regulation and supervision of service providers associated with stablecoins and other digital assets” as a “critical factor for illicit finance risk mitigation.”

### **FATF guidance on stablecoins**

7. The Financial Action Task Force (FATF), the intergovernmental AML/CFT standard setting body, published updated guidance on stablecoins in October 2021, to “provide guidance on how the FATF Standards apply to stablecoins and clarify that a range of entities involved in stablecoin arrangements could qualify as [Virtual Asset Service Providers] under the FATF Standards...”<sup>8</sup>
8. FATF did not define stablecoin, but shared clarifying language with a footnote on terminology, “The FATF considers that the term ‘stablecoin’ is not a clear legal or technical category, but is primarily a marketing term used by promoters of such coins. Because of this, the FATF uses the term ‘so-called stablecoins’ in its [2020] report to G20” and FATF’s recent use of the term stablecoins “does not represent endorsement of their claims.”<sup>9</sup>
9. FATF noted that stablecoins “share many of the same [money laundering/terrorism financing, “ML/TF”] risks as some [virtual assets, “VA”], because of their potential for anonymity, global reach and use to layer illicit funds. However, certain stablecoin projects could have greater potential for mass-adoption, which could heighten ML/TF risks.... Mass-adoption is an important ML/TF risk factor to consider, because criminals’ ability to use a VA as a means of exchange depends to a great extent on it being freely exchangeable and liquid, which mass-adoption could facilitate.”<sup>10</sup>

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<sup>6</sup> President’s Working Group on Financial Markets, et al., November 2021, “Report on Stablecoins”, [https://home.treasury.gov/system/files/136/StableCoinReport\\_Nov1\\_508.pdf](https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf).

<sup>7</sup> Ibid.

<sup>8</sup> Financial Action Task Force, October 21, 2021, “Updated Guidance for a Risk-Based Approach: Virtual Assets and Virtual Asset Service Providers”, <https://www.fatf-gafi.org/media/fatf/documents/recommendations/Updated-Guidance-VA-VASP.pdf>.

<sup>9</sup> Ibid.

<sup>10</sup> Ibid.

10. Similarly, the Financial Stability Board provides resources for regulators and supervisors to manage stablecoin risks, including involving AML/CFT.<sup>11</sup>

### **Practical Steps for Compliance**

- Ensure that AML/CFT compliance programs integrate guidance from AML/CFT regulators.
  - Review the November 2021 President’s Working Group on Financial Markets [Stablecoin Report](#)’s section on illicit finance risks.
  - Review the digital assets and virtual currency sections of the Treasury Department’s 2022 [National Strategy](#) for Combating Terrorist and Other Illicit Financing, released on May 13, 2022, and the 2021 FinCEN AML/CFT [National Priorities](#) released on June 30, 2021.
  - Review the “Stablecoins and ML/TF Risks” section of the October 21, 2021 [FATF Updated Guidance](#).
- Anticipate and adapt to stronger international coordination on stablecoin AML/CFT standards, as explained in US Government strategy documents.

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### **Disclaimer**

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<sup>11</sup> Financial Stability Board, last updated February 17, 2022, “Crypto-Assets and Global ‘Stablecoins’”, <https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/crypto-assets-and-global-stablecoins/>.

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