Cryptocurrency / Virtual Assets

Brief description of the industry

Virtual currency (or crypto currency) can be defined as an electronic representation of monetary value that may be issued, managed, and controlled by private issuers, developers, or the founding organisation.

Lack of regulation and regulatory oversight

Virtual currency is a type of (by principal) unregulated digital currency that is only available in electronic form. Therefore, it might experience dramatic price movements and wide swings in their valuations since the only real force behind trading is consumer sentiment, but not a central banking authority. Virtual currency held within the blockchain network that is not controlled by a centralized banking authority or any other regulatory oversight.

Use as a payment method

A method to use virtual currencies in the real world as a payment method, is to give crypto wallet holders to make purchases using the contents of their account immediately without having to actively convert their finances into fiat currency. In some other instances and depending how virtual currencies on how they're structured, crypto assets can even constitute e-money.

Risk exposures for Payment Service Providers and Financial Institutions in regard to Virtual Currency Merchants:

a. Money Laundering and Financial Crime Risks

Virtual currency vulnerable to a wide range of criminal activity and financial crimes due to its lack of regulatory oversight. Many of these risks materialize in the surrounding ecosystem, i.e. acquirers or payment firms. The anonymity, liquidity, and borderless nature of virtual currencies makes them attractive to potential money launderers. However, we would also have to note that under Directive (EU) 2018/843 (5AMLD), virtual currency and virtual currency exchanges are considered "obliged entities" and face the same AML/CFT regulations applied to financial institutions under 4MLD. Practically, this involves an obligation to perform customer due diligence (CDD) and submit suspicious activity reports (SAR) to regulatory authorities. This regulatory development is expected to reduce the heightened ML and Financial Crime risks of virtual currencies, at least in European Economic Area.

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b. Unclear Regulation

The uncertainty about whether cryptocurrencies should be regulated as a currency, commodities or securities continues globally. In regards to use of virtual currencies as a payment method, where a Payment Services provider or Financial Institution is engaged in activity by way of business that relates a virtual currency that constitutes e-money, or is involved in payment services and virtual currency is involved, they should consider whether those activities require further regulatory authorisation as an E-Money institution. Any token that is pegged to a currency, like USD or GBP, and is used for the payment of goods or services on a network could potentially meet the definition of e-money.

Merchants in the Crypto space can fall under one of the following models:

1. Exchanges – restricted
2. Mining - restricted
3. ICOs – prohibited as outside risk appetite

Additional Due Diligence and Conditions applicable to All Crypto Models:

- MCC 6051 (Quasi Cash Merchant).
- Merchant Crypto Wallet ID mandatory.
- Chainalysis Report (counterparties identification). (passed verification during onboarding)
- In the scenario where other counterparties are detected, the analyst needs to determine the services of the other counterparties. *e.g. gaming operators, forex services etc. If the merchant is within our risk appetite, after taking into consideration all the factors including full Due Diligence and checks on the counterparties (services compliant with all laws and regulations), the merchant can be provided with a separate Merchant Account for the other specific services e.g. MCC 7995 for the gambling traffic (crypto used for depositing on a gambling website).*
- Webshield Regulatory Compliance Report (passed compliance during onboarding).
- MasterCard Merchant Registration Program (MRP) registration is required – USD 500 or any other currency equivalent.
- Visa High Risk Merchant Registration (PRM) is registration is required – USD 500 or any other currency equivalent (applicable for a particular activity within the general classification).
- OCT not allowed (if exceptional approval applies – BAI Code FD (fund disbursement) applies. Visa PIF registration and approval by Visa is required for crypto merchants, prior enabling OCTs.
- Visa Direct (OCT) only applies within EU/EEA countries. PIF registration should be escalated to Compliance for guidance of additional information required.

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- AML Policy and Procedure is mandatory.
- Processing history for the last 3 months (minimum period).
- Flow of Funds – to be disclosed.
- 3D Secure MUST be applied on ALL crypto merchants as they are highly and actively targeted by fraudsters, and in accordance to PSD2.

Geographic Restrictions/BIN Blocks applicable

Following countries MUST be blocked at onboarding (list is valid at the time of writing but can change anytime)

- China
- Vietnam
- Bolivia
- Colombia
- Ecuador
- Algeria
- Bangladesh
- Indonesia
- Jordan
- Kyrgyzstan
- Morocco
- Nepal
- Saudi Arabia
- Iran
- Pakistan
- Taiwan
- Cambodia
- South Korea
- Uzbekistan

Visa Direct (OCT) only enabled on EU Countries. Any other countries should be blocked. Visa OCT requires PIF registration prior enabling OCT for Crypto Merchants.

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Scheme Requirement (Mastercard AN 1695 “Regulatory Monitoring”)

- If merchant is a licensed entity, a copy of the license must be provided and uploaded on Investigate – document centre.

- If merchant is not regulated/licensed, the merchant must provide a legal opinion addressed to Trust Payments Limited from a reputable law firm located in the jurisdiction from where the non-licensed entity is operating to confirm that Merchant does not violate local laws. This legal opinion must be uploaded on Investigate – document centre.

Certificate of Compliance

Option 1

For 500EUR one off fee or any other currency equivalent, TRUST can offer its merchant the Certificate of Compliance offered by a reputable Service Provider to operate in Europe. This fee can be waived if the Merchant provides us with a Compliance Certificate from an independent and reputable law firm situated in the operating country.

AND

For 100EUR monthly fee or any other currency equivalent, TRUST offer its merchant:

- An updated Certificate of Compliance from the Independent Third Party confirming that the merchant demonstrates “effective controls” on operating system so that they can continue processing in Europe.

Option 2

In alternative to the One-off Fee of 500EUR and Monthly Fee of 100EUR, TRUST can offer the monitoring for the effective controls and the Certificate of Compliance for a monthly fee of 195EUR or other currency equivalent.

SWIPEN has the right to amend fee by providing 2-month notice (Change Notice).

Merchant will be provided with a Certificate of Compliance issued by the Individual Third Party.

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Definition of the various model and specific requirements of acceptance

1. Exchanges Model

Under the Exchange model, for the moment, we can identify 3 broad types (others may emerge):

a) Pure Exchanges: Merchants under this category represent our preferred business model and would typically provide a service through which customers can buy crypto currency (funding part only). They may request the customer to provide his/her own crypto wallet or they may create a new wallet for them. Ideally, we should get evidence that the crypto currency was deposited in the wallet and get wallet ID. This would enable us to fight any chargebacks without relying on the merchant (covers us if merchants go bust or disappear). Depends on Omnipay being able to handle additional data elements.

This model is within our Risk Appetite unless:

1. there no evidence that the exchange is mainly being used to circumvent scheme rules by acting as a layer for the processing of illegal or prohibited transactions.
2. there is a significant volume of crypto currency movement originating or ending into illegal sites on the dark net.

This model should always pass Webshield Certificate of Compliance and Cybertonica screening and be escalated to the Head of Underwriting for acceptance.

The underwriter should always ask clarification on where the Crypto wallet is held (Merchant level or Customer level). If at Merchant level in a pooled Crypto wallet, additional collateral may be required. If customer level, we need to know if customer can also import their own wallet or need to create a new one.

b) Staged Digital Wallet (SDWO): This is an 'exchange' where a customer can buy a crypto currency which would then be immediately encashed to make a payment to a specific merchant (Closed loop). Essentially this is a replacement of the old voucher systems. This is seen by the card schemes as a way of bypassing legal or regulatory restrictions in certain industries. It can also be interpreted as transaction laundering. SDWOs also require registration with the card schemes.

This model is prohibited because of the additional Risk involved and because of the capital requirements by the Card Schemes.

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c) Traders: These are typically operated purely as a replacement of the old Binary Options or CFD (Contracts for Difference) models. With more restrictions or prohibition being made by Regulators and by ESMA on the binary & CFD models, these same operators are shifting to 'trading' in crypto currencies but always applying the same hard selling techniques.
This model might be hard to identify. Sometimes they are also licensed from Estonia. This model can be considered but carry a very high Credit & Reputational Risk.

Risk Mitigation Measures

- Rolling Reserves and Delay settlement can be "negotiated" for Pure Exchanges types of business only depending on the quality of the merchant. The better-quality exchanges will push for better terms as the above will affect their cash flow. If they are genuine business operating as an exchange, they need the funds to buy the crypto currency on behalf of their customer. Lowest we can accept which should also be doable for the exchanges is 5% for 60 days and Weekly Settlement with No Delay or Daily Settlement with 7-day delay.
- The standard conditions will apply for Traders without negotiation due to the higher risk.
- Monthly Caps will be placed on the total volume that can be processed. There will also be limits per card number.
- Merchants must provide the contracts in place with the suppliers from where crypto currencies are purchased or other documentation that provides evidence on how the crypto currencies are being sourced.
- With each transaction, merchants are to provide the wallet ID into which the crypto currencies are being deposited. This measure is more effective for exchanges that transfer the purchased crypto currencies into the card holders personal wallet.

2. Crypto Mining Model
Merchants that deploy computer server farms that are constantly mining crypto coins. They then offer a service through which customers can buy capacity on these farms. Customers receive the crypto generated through the processing capacity they have purchased.

Payments are usually made by credit/debit card for a fixed contract, typically 2-5 years but sometimes even 'lifetime' contracts. Under the lifetime contracts, mining will continue for as long as it is economically viable to do so, i.e. as long as the value generated in crypto is more than what the customer is paying.

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Payment can be made monthly or upfront for fixed term contracts. This model represents additional credit risk as the service is being provided over a long period of time, which means that the chargeback period is extended. These types of merchants are not very popular anymore as mining becomes more expensive.

All the mining models are on our Restricted List and applications will be reviewed individually.

Risk Mitigation Measures:

- Higher Rolling Reserve and higher Delay in Settlement.
- Rolling Reserve – not less than 10% (ideally more) and number of days will depend on type of mining contracts being sold by the merchant. Settlement delay needs to be proportionate to the term of the contract and the maximum liability determined by the card schemes, so may stretch to 540 days.
- Settlement – Always Weekly settlement with 15-day delay.
- Monthly Caps must be fixed together with transaction & Card Limits.

Other potential Checks:

- Endorsement from asic vendor.
- Transparent public information 'e.g. how much hash rate sold vs stock'.
- Reasonable referral programs and social network.
- Contracts demonstrate easy exist.
- Disclosure of contracts history of changes.

3. Initial Coin Offering (ICO) Model

Typically, start-ups attempting to raise money through an initial coin offering for some new project. Many times, only based on a white paper prepared by the company itself, with no external validation or audit.

Capital is typically collected via a choice or combination of the below:

- Through other crypto currencies
- Private placements
- Cards

Risk vs Return is not commensurate, there is extremely high credit & reputational risk, low volumes and low return. This model is outside of Risk Appetite.

We might open to regulated ICOs once these appear on the market.
Not aware of any country licensing ICOs at this point.

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