

## Crypto-assets - the Law Enforcement Position

In the second article of this four-part series into crypto-assets, we explore how law enforcement currently interacts with crypto-assets and our expectations for the future.

---

<b>Submitted</b>	4 July 2018
<b>Applicable Law</b>	UK (England & Wales) , European Union
<b>Topic</b>	<a href="#">FinTech</a> <a href="#">Crime, Fraud &amp; Investigations</a>
<b>Sector Focus</b>	<a href="#">Asset Management and Investment Funds</a> <a href="#">Financial Institutions</a> <a href="#">Technology Media and Telecommunications</a>
<b>Contact</b>	<a href="#">Stephen Gentle</a> , <a href="#">Tim Harris</a> , <a href="#">Matthew Worby</a>

---

### Crypto-assets and criminal activity

As discussed in our earlier article in this series, there is a common misconception that crypto-assets are principally used as a vehicle for criminal activity.

However, as a recent report compiled by the US based think tank Centre on Sanctions and Illicit Finance (CSIF) noted, only 1% of Bitcoin transactions between 2013 and 2016 were identified as being used for the purposes of money laundering.

The CSIF specifically looked at Bitcoin exchanges. It found that of this 1% of transactions, darknet marketplaces such as Silk Road and, later, AlphaBay, were the source of almost all of these illicit bitcoins laundered through exchanges. The study also identified that exchanges based in Europe received the greatest share of illicit bitcoins, more than five times as much as North American exchanges.

The NCA's findings as part of the 2017 National Risk Assessment was consistent with the CSIF's findings. The NCA considered that crypto-assets were low risk for Anti-Money Laundering and Terrorist Financing risk but expected this risk rating to increase as the volume of transactions increases.

We also expect to see more litigation as authorities seek to disrupt flows of criminal property through crypto-assets and possible civil actions by aggrieved parties seeking to obtain restitution. The FCA are alive to this issue, in their recent "Dear CEO" letter of June 2018 they stated that "Retail customers contributing large sums to [initial coin offerings] may be at a heightened risk of falling victim to investment fraud", and confirmed that FCA guidance covering the general risks involved with investment fraud also applied to initial coin offerings.

However, recently Europol struck a slightly more cautious note in comparison to the FCA in respect of the uses of crypto-assets in financial crime. Europol reported in February 2018 when they estimated that, in fact, of the £100bn in

illicit proceeds created in Europe 3-4% are laundered through cryptocurrencies. Europol noted that this amount is growing “quite quickly”.

## Specific enforcement concerns about these criminal proceeds

What is sometimes lost in the discussion around the risk rating of crypto-assets are the specific challenges that crypto-assets can pose to law enforcement agencies. In our experience the principal concern of law enforcement, at present, is the accurate identification of criminals who are using crypto-assets, and then the effective removal of these crypto-assets from the financial ecosystem.

Identification is a problem because of the development of “tumbling” services, that allow for individuals to obfuscate their crypto-asset trail so that identification processes cannot accurately identify suspicious trading patterns, and the growth of crypto-assets that actively seek to hide the owner’s identity (such as Monero). As awareness of identity-hiding techniques grows it will become harder for law enforcement and financial institutions to tackle these issues and creates the obvious problem, if the ownership of the assets cannot be identified they cannot be effectively policed.

Removal of criminal crypto-assets is also a concern. Currently UK law enforcement agencies struggle to target criminal assets effectively and are often prevented from doing so on grounds of either jurisdiction (e.g. criminal conduct may not have occurred in the UK, or the crypto-assets are “held” in a wallet on a server outside the UK), or because laws cannot be adequately used to target this developing asset class.

Indeed, it was only as recently as November 2017 that the UK Crown Court considered the police’s ability to seize crypto-assets under the Proceeds of Crime Act 2002 (POCA). In this case an order was made under s.41 (7) POCA to transfer the crypto-assets into fiat currency (R v Teresko (Sergejs)). This was an important step in confirming the principal that enforcement agencies could seize and liquidate such assets, and that the courts will construe such powers widely.

## Next steps

As crypto-asset transaction volumes increase, we expect financial institutions and law enforcement to seek out intelligence provided by crypto-assets analysts to identify illegal activity on the crypto-assets blockchain and to provide forensically sound intelligence on any underlying criminal origin of funds.

Crypto-assets analysts are able to identify bitcoins moving from illicit sources (darknet marketplaces, profits from ransomware, and other fraudulent activities) to legitimate exchanges, using their own in-house forensic analysis tools, which combine public blockchain data with a proprietary dataset of crypto-assets addresses associated with known entities, to provide visibility as to who is transacting with whom in crypto-assets.

In such a complex, fast-moving area, we predict that public and private partnerships will be critical in identifying the ownership of criminal assets, allowing them to be seized to remove criminal property from the financial system.

Law enforcement agencies, however, can only be fully effective with governmental, and intra-governmental support. In our next article we will examine what steps are being taken globally in respect to the regulation of crypto-assets.

This document (and any information accessed through links in this document) is provided for information purposes only and does not constitute legal advice. Professional legal advice should be obtained before taking or refraining

from any action as a result of the contents of this document.

---

© Simmons & Simmons LLP 2019. All rights reserved. Registered in England & Wales Registered Number OC352713

---

elexica Limited, CityPoint, One Ropemaker Street, London EC2Y 9SS