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INSIGHTS AND ANALYSIS ON ECONOMICS & FINANCE

Addressing the Dark Side of the Crypto World

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Whether Bitcoin's value goes up or Bitcoin's value goes down, people around the world are asking the same question: What exactly is the potential of crypto-assets?

The technology behind these assets—including blockchain—is an exciting advancement that could help revolutionize fields beyond finance. It could, for example, power financial inclusion by providing new, low-cost payment methods to those who lack bank accounts and in the process empower millions in low-income countries.

The possible benefits have even led some central banks to consider the idea of issuing central bank digital currencies.

Before we get there, however, we should take a step back and understand the peril that comes along with the promise.

The peril of crypto-assets

The same reason crypto-assets—or what some people call crypto-currencies—are so appealing is also what makes them dangerous. These digital offerings are typically built in a decentralized way and without the need for a central bank. This gives crypto-asset transactions an element of anonymity, much like cash transactions.

The result is a potentially major new **vehicle for money laundering and the financing of terrorism.**

One recent example reveals the scope of the problem.

In July 2017, an international operation led by the United States shut down AlphaBay, the largest online criminal marketplace on the internet. For more than two years, illegal drugs, hacking tools, firearms, and toxic chemicals were sold all over the world through AlphaBay. Before the site was taken offline, more than $1 billion had been exchanged through crypto-assets.

Of course, money laundering and terrorist financing is only one dimension of the threat. Financial stability is another. The rapid growth of crypto-assets, the extreme volatility in their traded prices, and their ill-defined connections to the traditional financial world could easily create new vulnerabilities.

So, we need to develop regulatory frameworks to meet an evolving challenge. Many organizations have already started.

One positive example is the Financial Stability Board (FSB), which is looking at what new rules might be needed to meet the advancements in fintech. Another is the Financial Action Task Force (FATF)—the body that sets standards for the fight against money laundering and terrorist financing. The task force has already provided useful guidance to countries on how to deal with cryptocurrencies and other electronic assets.

The IMF is also working on these issues. Stopping money laundering and combatting terrorist financing has been part of our work for the last 20 years. Based on the standards set by FATF, we have conducted 65 assessments of countries' regulatory frameworks and provided capacity development assistance to 120 countries. Our efforts have focused on helping our member countries grapple with the specter of illicit financial flows.

But we recognize more needs to be done to get a handle on the emerging threat posed by crypto-assets and to secure a stable financial system. Where can we start?

Fighting fire with fire

We can begin by focusing on policies that **ensure financial integrity and protect consumers in the crypto world just as we have for the traditional financial sector**.

Indeed, the same innovations that power crypto-assets can also help us regulate them.

To put it another way, we can fight fire with fire.

Regulatory technology and supervisory technology can help shut criminals out of the crypto world. Already we are seeing crypto-asset exchanges in some countries that are subject to know-your-customer requirements.

These advances will take years to refine and implement. Two examples highlight the promise of this approach over the long term:

- **Distributed ledger technology (DLT)** can be used to speed up information-sharing between market participants and regulators. Those who have a shared interest in maintaining safe online transactions need to be able to communicate seamlessly. The technology that enables instant global transactions could be used to create registries of standard, verified, customer information along with digital signatures. Better use of data by governments can also help free up resources for priority needs and reduce tax evasion, including evasion related to cross-border transactions.

- **Biometrics, artificial intelligence, and cryptography** can enhance digital security and identify suspicious transactions in close to real time. This would give law enforcement a leg up in acting fast to stop illegal transactions. This is one way to help us remove the "pollution" from the crypto-assets ecosystem.

We also need to ensure that **the same rules apply** to protect consumers in both digital and non-digital transactions. The U.S. Securities and Exchange Commission and other regulators around the world now apply the same laws to some initial coin offerings (ICOs) as they do to offerings of standard securities. This helps to increase transparency and alert buyers to potential risks.

But no country can handle this challenge alone.

Indispensable international cooperation

To be truly effective, all these efforts require close international cooperation. Since crypto-assets know no borders, the framework to regulate them must be global as well.

The successful closure of AlphaBay, for example, involved the cooperation of Europol and law enforcement agencies in the United States, Thailand, the Netherlands, Lithuania, Canada, the United Kingdom, and France.

Countries will have to decide collectively that this path is worth pursuing. Promisingly, the Group of Twenty (G-20) has agreed to put crypto-assets on the agenda of its November 2018 summit in Argentina.

The IMF will play its part in this effort. With our near-universal membership and expertise, including in battling money-laundering and terrorist financing, we are uniquely situated to be a forum for helping develop answers in the evolving crypto-asset space.

What comes next for crypto

The volatility of crypto-assets has prompted an intense debate about whether they are a bubble, just another fad, or a revolution equivalent to the advent of the internet that will disrupt the financial sector and eventually replace fiat currencies.

The truth is obviously somewhere in between these extremes.

As I have said before, it would not be wise to dismiss crypto-assets; we must welcome their potential but also recognize their risks.

By working together, and leveraging technology for the public good, we can harness the potential of crypto-assets while ensuring that they never become a haven for illegal activity or a source of financial vulnerability.