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Fintech and Anti-Money Laundering Regulation: Implementing an International Regulatory Hierarchy Premised on Financial Innovation

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FINTECH AND ANTI-MONEY LAUNDERING REGULATION: IMPLEMENTING AN INTERNATIONAL REGULATORY HIERARCHY PREMISED ON FINANCIAL INNOVATION

by: Nicholas Roide*

ABSTRACT

Innovations in financial technology (“fintech”) have rippling effects across global markets. Fintech firms utilizing virtual assets and disintermediating blockchain technology continue to rapidly grow in strength and number. As systemic risk mounts due to the inter-jurisdictional nature of fintech, anti-money laundering (“AML”) regulators must search for an international answer to maintain global financial stability and protect consumers against illicit activities. A variety of solutions have appeared within local AML regulatory frameworks. These frameworks tend to function as a hierarchy with three ordered objectives: market integrity, rule clarity, and innovation. However, frameworks often place too much emphasis on market integrity and squeeze out the financial innovation inherent in the fintech sector. This Comment argues for an international AML regulatory hierarchy that places paramount importance on the innovative nature of fintech yet still promotes market integrity.

This Comment examines the efficacy of this proposed hierarchy through the AML regulatory frameworks of several offshore financial centers (“OFCs”): Malta, Gibraltar, and Jersey. While OFCs have often been accused of light-touch regulation, they are championing a push into financial innovation with strong regulatory safeguards that maintain market integrity and guard against systemic risk. These AML regulatory frameworks provide support for the Comment’s central argument. The Comment concludes with an examination of methods by which the proposed hierarchy can be implemented. Ultimately, innovation hubs nurture regulatory learning and allow regulators to employ a conglomeration of initiatives such as regulatory sandboxes and mentorship regimes, which can be macro-produced to attain the desired hierarchical outcome.

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I. INTRODUCTION

Financial technology (“fintech”) has fundamentally changed the landscape of the financial sector in recent years. Fintech firms, ever-increasing in number, are using disintermediating blockchain technology and virtual asset transactions to attain an efficient and innovative advantage over traditional banks and investment firms.¹ Consider the following: Robinhood, a commission-free stock trading startup that lists cryptocurrencies, has a current valuation of \$40 billion.² Stripe, a company offering digital payment processing software, has announced an acquisition of Nigerian fintech company Paystack for around \$200 million to expand into the African market.³ And BlockFi, a cryptocurrency lending firm, has increased its private valuation target from \$435 million to \$3 billion.⁴ The use of blockchain technology and virtual

1. See Iris H-Y Chiu, *Fintech and Disruptive Business Models in Financial Products, Intermediation and Markets- Policy Implications for Financial Regulators*, 21 J. TECH. L. & POL’Y 55, 58–59 (2016).

2. John Detrixhe, *Robinhood Shares Are Soaring Just Like the Stocks That Trade on Robinhood*, QUARTZ (Feb. 11, 2021), <https://qz.com/1971633/robinhood-pre-ipo-secondary-shares-signal-40-billion-valuation/> [<https://perma.cc/6AGB-EWTC>].

3. Ingrid Lunden, *Stripe Acquires Nigeria’s Paystack for \$200M+ to Expand into the African Continent*, TECHCRUNCH (Oct. 15, 2020, 7:22 AM), <https://techcrunch.com/2020/10/15/stripe-acquires-nigerias-paystack-for-200m-to-expand-into-the-african-continent/> [<https://perma.cc/UY3A-R4DX>].

4. Nina Bambysheva, *BlockFi Gets a \$3 Billion Valuation with New \$350 Million Series D Funding*, FORBES (Mar. 11, 2021, 8:30 AM), <https://www.forbes.com/sites/ninabambysheva/2021/03/11/blockfi-gets-a-3-billion-valuation-with-new-350-million-series-d-funding/?sh=3e85bf8b58a5> [<https://perma.cc/A67M-SHLV>].

asset transactions as an innovative tool to establish market advantage has become both pervasive and global.

But the burgeoning wave of technology-enabled financial services also presents regulatory issues of systemic risk, consumer protection, and financial stability on a global scale.⁵ For example, the German fintech giant Wirecard, an international mobile payment and e-commerce service provider, is currently under investigation for the suspected money laundering of \$2.1 billion.⁶ A primary concern, among others outside the scope of this Comment, is that fintech firms may act outside the purview of existing anti-money laundering (“AML”) legislation and regulation.⁷ As fintech firms eliminate the need for professional intermediaries, such as banks and others in the financial sector, these firms may not be subject to the same financial reporting rules that would regularly promote market stability.⁸ However, by the same token, subjecting fintech to these stringent rules may lead to the collapse of many innovative fintech startups.⁹ The growth of innovation and disruption in fintech leaves regulatory agencies searching for an inter-jurisdictional answer to avoid global systemic risk while still maintaining market innovation.

This Comment poses three central questions: (1) *What* challenges do AML regulators face when regulating virtual asset service providers that utilize disintermediating blockchain technology, and what is the current local and international regulatory response; (2) *why* is an international AML regulatory hierarchy that fosters innovation but still maintains market integrity needed for the future of the fintech sector; and (3) *how* can this regulatory hierarchy actually be implemented? Thus, this Comment’s main purpose is to argue for the following international AML regulatory hierarchy, ordered from top to bottom: innovation, market integrity, and rule clarity. This framework is examined in the context of different AML regulatory regimes to establish innovation as the key regulatory objective in the inherently innovative fintech sector.

What are the challenges that fintech poses for AML regulatory regimes? Banks and other traditional financial institutions act as professional intermediaries, facilitating an efficient allocation of funds across the financial supply chain between two parties through information exchange, asset securitization transformation, and efficiency transfor-

5. See William Magnuson, *Financial Regulation in the Bitcoin Era*, 23 STAN. J.L., BUS. & FIN. 159, 184 (2018).

6. Jörn Poltz, *German Prosecutors Open Wirecard Money Laundering Probe*, REUTERS (July 9, 2020, 5:30 AM), <https://www.reuters.com/article/us-wirecard-accounts-probe/german-prosecutors-open-wirecard-money-laundering-probe-idUSKBN24A1EH> [<https://perma.cc/8YN9-BEUC>].

7. Yen-Te Wu, *FinTech Innovation and Anti-Money Laundering Compliance*, 12 NAT’L TAIWAN U. L. REV. 201, 207 (2017).

8. See *id.*

9. *Id.*

mation.¹⁰ Financial regulation of these intermediaries promotes financial market stability and consumer/investor protection.¹¹ By contrast, fintech firms' use of blockchain introduces disintermediation into financial transactions by bypassing existing intermediary structures.¹² In essence, blockchain technology allows connected computers in a peer-to-peer network to reach agreement over shared data.¹³ Since fintech firms often disintermediate discrete parts of the financial supply chain rather than the whole, regulators are faced with the challenge of combating systemic risk involved in myriad structural changes to existing mechanisms.¹⁴ Although the scope of fintech disintermediation is wide, this Comment narrows its focus on virtual asset transactions, blockchain technology, and their association with AML regulatory regimes.

Current local and international regulatory responses take shape in a variety of forms. Their regulatory methodology can be analyzed from a framework that has been dubbed the "innovation trilemma."¹⁵ In the context of fintech regulatory rulemaking, there are three foundational objectives: market integrity, rules simplicity, and financial innovation.¹⁶ However, under the trilemma theory, regulators are only able to achieve one or sometimes two of these three objectives.¹⁷ Most local and international AML regulatory standards mainly function with the paramount objective of preserving market integrity.¹⁸ As a result, innovation is often squeezed out.¹⁹ To combat this issue, this Comment argues for an international regulatory hierarchy that places paramount importance on innovation but guards against systemic risk.

10. See Fatjon Kaja et al., *FinTech and the Law & Economics of Disintermediation* 2 (Eur. Corp. Governance Inst., Working Paper No. 540/2020, 2020), <https://ecgi.global/working-paper/fintech-and-law-economics-disintermediation> [<https://perma.cc/T6F7-LJVS>]; see Chiu, *supra* note 1, at 83–84.

11. See JOHN ARMOUR ET AL., *PRINCIPLES OF FINANCIAL REGULATION* 16–17 (2016).

12. Chiu, *supra* note 1, at 85.

13. Peter Van Valkenburgh, *What's a Blockchain, Anyway?*, COIN CTR. (Apr. 25, 2017), <https://www.coincenter.org/education/blockchain-101/whats-a-blockchain/> [<https://perma.cc/D6CH-3D28>].

14. Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 235, 277–78 (2019).

15. *Id.* at 244.

16. *Id.*

17. *Id.*

18. See generally FIN. ACTION TASK FORCE, *INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION: THE FATF RECOMMENDATIONS*, (June 2021), <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> [<https://perma.cc/67UT-CLU4>] (listing the Financial Action Task Force's standards for preventing money laundering and terrorist financing from affecting the global financial system).

19. Asheesh Birla, *The Biden Administration Can Change the World with New Crypto Regulations*, TECHCRUNCH (Dec. 23, 2020, 12:08 PM), <https://techcrunch.com/2020/12/23/the-biden-administration-can-change-the-world-with-new-crypto-regulations/> [<https://perma.cc/2XKQ-H9JZ>].

Why is an international AML regulatory hierarchy premised on innovation so important? The fintech sector is inherently innovative. Fintech firms continue to expand the applications of blockchain technology and other financial services to compete with traditional financial institutions.²⁰ A whopping 19 companies on the 2020 Forbes list of the 50 most innovative fintech firms were newcomers.²¹ And every one of these fintech firms make using financial services more efficient, cheaper, and easier.²² Because of the sector's innovative nature, fintech firms will continually seek a regulatory space that emphasizes growth. Further, the future uses of blockchain technology—especially in emerging markets—have the capacity to revolutionize financial transactions, which in turn would further financial competition and market growth. The proposed international AML hierarchy is needed to address the inherently innovative nature of fintech and ensure future financial development.

The efficacy of the proposed hierarchy and justification for an innovative approach is examined through the lens of several established offshore financial centers (“OFCs”): Gibraltar, Malta, and Jersey. These jurisdictions are popularly known as “tax havens” and are often mischaracterized as offering “light-touch regulation.”²³ Onshore competitors often suggest that OFCs’ regulatory efforts are inadequate to safeguard against fraud, money laundering, and corruption.²⁴ However, it may be surprising to note that OFCs generally exert *the same or more* regulatory efforts than onshore competitors.²⁵ As bastions of offshore financing, OFCs have engaged in efforts to become leading hubs for blockchain technology.²⁶ These jurisdictions have recently been referred to as “blockchain havens”—a switch from their earlier “tax haven” moniker—because of their leadership in blockchain technology development.²⁷ As such, OFCs have engaged in substantive AML legislation and regulation to both entice fintech firms and maintain regulatory compliance.²⁸ Because these jurisdictions seek to spur innovation while maintaining market integrity, they provide an excel-

20. See Michael del Castillo et al., *The Forbes Fintech 50: The Most Innovative Fintech Companies in 2020*, FORBES (Feb. 12, 2020, 10:00 AM), <https://www.forbes.com/fintech/2020/#443fdcce4acd> [<https://perma.cc/PH44-CZKT>]; see Danda B. Rawat et al., *Blockchain Technology: Emerging Applications and Use Cases for Secure and Trustworthy Smart Systems*, 1 J. CYBERSECURITY & PRIV. 4, 4–5, 8–14 (2020).

21. del Castillo et al., *supra* note 20.

22. *Id.*

23. See, e.g., Omri Marian, *Blockchain Havens and the Need for Their Internationally-Coordinated Regulation*, 20 N.C. J.L. & TECH. 529, 531–32 (2019).

24. See Andrew P. Morriss & Clifford C. Henson, *Regulatory Effectiveness & Offshore Financial Centers*, 53 VA. J. INT’L L. 417, 422 (2013).

25. *Id.* at 454.

26. Marian, *supra* note 23, at 530.

27. *Id.* at 532.

28. See discussion *infra* Section III.B.

lent example to expound on the efficacy of this Comment's proposed regulatory hierarchy.

How can an international AML regulatory hierarchy premised on innovation actually be implemented? Implementation requires both a local and an international response. Some jurisdictions use stand-alone innovative initiatives that include regulatory sandboxes, mentorship programs, and fintech charters. Regulatory sandboxes cultivate a safe zone that allow fintech firms to test new innovations and proactively prevent unknown risks in emerging technologies.²⁹ And fintech-bank mentorship arrangements allow firms to take advantage of banking infrastructure to foster innovative services while partnered banks are able to gain access to new markets.³⁰ However, while these types of initiatives can spur innovation, they have a number of drawbacks and deficiencies—especially in regulatory learning between fintech firms and regulators.³¹

The use of local and international innovation hubs can provide a solution. Innovation hubs provide a point of contact for fintech firms to engage with regulators, discuss innovations, gain regulatory guidance, and recognize adjustment through collaboration.³² Stand-alone initiatives like regulatory sandboxes and mentorship regimes are just one kind of tool innovation hubs can employ to produce a well-rounded, innovative ecosystem premised on regulatory learning.³³ OFCs provide an excellent framework to observe how an innovation hub can be locally employed. And from an international standpoint, the Global Financial Innovation Network (“GFIN”), a multinational innovation hub,³⁴ is in the best position to implement the proposed international regulatory hierarchy going forward.

This Comment proceeds in four parts. In Part II, the Comment provides an overview of disintermediating fintech and the current challenges AML regulators face when creating a regime that addresses systemic danger while still fostering innovation. The Comment then examines the current local and international AML regulatory frameworks through the lens of the innovation trilemma. Current frameworks place paramount importance on systemic integrity but squeeze out innovation and ignore the cross-border ramifications of

29. Michael M. Piri, Note, *The Changing Landscapes of FinTech and RegTech: Why the United States Should Create a Federal Regulatory Sandbox*, 2 BUS. & FIN. L. REV. 233, 246 (2019).

30. Luca Enriques & Wolf-Georg Ringe, *Bank-Fintech Partnerships, Outsourcing Arrangements and the Case for a Mentorship Regime* 2–3 (Eur. Corp. Governance Inst., Working Paper No. 572/2020, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3625578 [<https://perma.cc/2QUY-TE24>].

31. See discussion *infra* Section IV.A.

32. Ross P. Buckley et al., *Building Fintech Ecosystems: Regulatory Sandboxes, Innovation Hubs and Beyond*, 61 WASH. U. J.L. & POL'Y 55, 58 (2020).

33. *Id.* at 59.

34. *About GFIN*, GLOB. FIN. INNOVATION NETWORK, <https://www.thefin.com/about> [<https://perma.cc/XB9K-HQEP>].

the fintech industry. In Part III, the Comment argues for an international AML regulatory hierarchy that places paramount importance on innovation yet still promotes systemic integrity. This hierarchy is necessary because the fintech sector is inherently innovative and its future applications promote global financial growth. The efficacy of this hierarchy is displayed through the AML regulatory regimes of three well-established OFCs: Malta, Gibraltar, and Jersey. The Comment concludes in Part IV by examining how to implement the proposed regulatory hierarchy with the use of innovation hubs locally and internationally.

II. FINTECH AND THE INTERNATIONAL ANTI-MONEY LAUNDERING REGULATORY LANDSCAPE

What challenges do AML regulators face when regulating fintech, and what is the current local and international regulatory response? This Part provides a background of the current challenges faced by regulators seeking to impose AML regulations on discrete parts of the fundamentally innovative fintech sector. The sector implicates cross-border economic interdependencies, as evidenced by the global economic consequences from the COVID pandemic.³⁵ Financial shocks reverberate across national boundaries.³⁶ Further, the sector is innovative in essence, displayed by the dramatic rise of cryptocurrencies and the utilization of fintech by developing countries in Africa and Latin America to gain a financial foothold in the advancing world.³⁷ Thus, the globalized, innovative nature of fintech underscores the need for an international AML financial regulatory framework that remedies issues domestic financial regulators cannot reach themselves.³⁸

The most prominent AML regulatory obstacles stem from fintech firms' use of blockchain technology, a process of disintermediation and decentralization that bypasses existing intermediary infrastructure to produce improved efficiency and cost reduction.³⁹ While fintech firms' use of blockchain can deliver productivity gains, this burgeoning method of financial transaction technology is also character-

35. Yesha Yadav, *Fintech and International Financial Regulation*, 53 VAND. J. TRANSNAT'L L. 1109, 1117 (2020).

36. Christine Lagarde, *A Regulatory Approach to Fintech*, STRAIGHT TALK, June 2018, at 10, <http://governance40.com/wp-content/uploads/2018/12/straight-fintech-lagarde.pdf> [<https://perma.cc/4Q54-8Z48>].

37. DOUGLAS MILLER ET AL., INT'L FIN. CORP., BLOCKCHAIN: OPPORTUNITIES FOR PRIVATE ENTERPRISES IN EMERGING MARKETS 7, (Jan. 2019) <https://www.ifc.org/wps/wcm/connect/2106d1c6-5361-41cd-86c2-f7d16c510e9f/201901-IFC-EMCompass-Blockchain-Report.pdf?MOD=AJPERES&CVID=MXyj-sA> [<https://perma.cc/LW3Z-LFLN>].

38. See Yadav, *supra* note 35, at 1118.

39. MILLER ET AL., *supra* note 37, at 14.

ized by features of diffusion, automation, and adaptation.⁴⁰ This means fintech firms utilizing blockchain are often small and entrepreneurial in nature, they rely on algorithmic operational functions, and they can easily change structure or strategy in response to external circumstances.⁴¹

In turn, AML regulators face many challenges: guarding against systemic risk, maintaining consumer protection, preserving global financial stability, and addressing issues on a multinational level with marked differences in national market structure.⁴² In addition, fintech regulators face a policy trilemma.⁴³ According to the innovation trilemma theory, regulators can only achieve two out of the following three objectives: market integrity, financial innovation, and rules simplicity.⁴⁴ As this Part notes, these three objectives form a regulatory hierarchy.

Currently, AML regulators around the globe employ this regulatory hierarchy in several different forms.⁴⁵ But most of these regulatory frameworks have a paramount objective: market integrity.⁴⁶ This makes sense; the main priority of financial regulation is to guard against challenges stated in the preceding paragraph, namely, systemic risk, consumer protection, and global financial stability.⁴⁷ But fintech firms that specialize in virtual asset transactions utilizing blockchain do not know the rules of the game they are playing.⁴⁸ AML regulation is either entirely unclear or too stringent depending on the jurisdiction. As a result, financial innovation that benefits market competition and growth is often stifled.⁴⁹ Thus, the background provided in this Part culminates into the Comment's central argument and proposal: a new hierarchy premised on innovation is needed to implement an international AML regulatory regime.

It should be helpful to note the limits of this discussion. First, "fintech" is often broadly defined as any use of technology in applica-

40. Magnuson, *supra* note 5, at 163.

41. *See id.*

42. *See generally* Schan Duff, *The New Financial Stability Regulation*, 23 STAN. J.L. BUS. & FIN. 46 (2018) (discussing financial stability, theories of financial instability, the structure of financial regulation, and the U.S. financial stability architecture); ARMOUR ET AL., *supra* note 11 (discussing the underlying principles of financial regulation).

43. Brummer & Yadav, *supra* note 14, at 242.

44. *Id.* at 244.

45. *Id.* at 282.

46. *See* Chiu, *supra* note 1, at 63 (explaining that regulators often take a cautious approach to not impede innovative competition or consumer choice).

47. *See generally* Duff, *supra* note 42 (discussing financial stability, theories of financial instability, the structure of financial regulation, and the U.S. financial stability architecture); ARMOUR ET AL., *supra* note 11 (discussing the underlying principles of financial regulation).

48. Birla, *supra* note 19.

49. *See* Lagarde, *supra* note 36, at 10.

tion to finance.⁵⁰ However, in this discussion, the term is defined more narrowly in conjunction with the use of blockchain technology. While startups specializing in financial technology have been present for many decades (e.g., the establishment of PayPal, originally Confinity, in 1998),⁵¹ the first use of blockchain technology appeared in 2009 in the form of Bitcoin, a peer-to-peer (“P2P”) cryptocurrency system created by Satoshi Nakamoto.⁵² This discussion focuses on fintech firms operating within the blockchain. Second, while blockchain technology generally underpins the function of cryptocurrencies, the technology itself has many other uses along the virtual asset value chain (P2P transfers in general, smart contracts, supply chain management, security, etc.).⁵³ Thus, while this discussion mainly focuses on virtual asset transactions, it also encompasses the other uses of blockchain technology. Finally, while regulatory efforts are widespread and varied in application, this Comment narrows its regulatory analysis to AML regulation.

A. *The Challenges of Regulating Fintech*

Financial technological innovation is increasingly disruptive and unpredictable.⁵⁴ One need only look at the rise of virtual assets as a prime example of this notion. The creation of the cryptocurrency universe began in January 2009 with Bitcoin.⁵⁵ In February 2011, Bitcoin reached parity with the United States dollar.⁵⁶ But just as a community of techno-libertarians began to view cryptocurrency as a potential alternative to fiat currency, hackers stole around \$460 million (744,408 Bitcoin) from Mt. Gox, the largest Bitcoin exchange in the world, in February 2014.⁵⁷ Despite a subsequent downturn, Bitcoin and competing cryptocurrencies managed to survive.⁵⁸ A new cryptocurrency, Ethereum, was launched in 2014 as a distributed computing platform that expanded on the current payment system framework, allowing for the creation of virtually any type of decentralized application (e.g., smart contracts).⁵⁹ As a result of the expansive growth of cryptocurrencies in such a short amount of time, local and global regulatory standard-setting authorities began to fear financing risks of money

50. See Douglas W. Arner et al., *FinTech, RegTech, and the Reconceptualization of Financial Regulation*, 37 Nw. J. INT'L L. & BUS. 373, 379 (2017).

51. Brian O'Connell, *History of PayPal: Timeline and Facts*, THE STREET (Aug. 26, 2019, 10:11 AM), <https://www.thestreet.com/technology/history-of-paypal-15062744> [<https://perma.cc/FJ6B-N6V3>].

52. MILLER ET AL., *supra* note 37, at 10.

53. *Id.* at 11.

54. Lagarde, *supra* note 36, at 9.

55. David Sharifi, *A History of Cryptocurrency*, ITBIOMETRICS, <https://itbiometrics.com/a-history-of-digital-currency/> [<https://perma.cc/T5S2-LUXJ>].

56. *Id.*

57. *Id.*

58. *Id.*

59. MILLER ET AL., *supra* note 37, at 10.

laundering and terrorism associated with virtual assets and virtual asset providers.⁶⁰ Fintech firms' use of virtual asset transactions has continued to the present where there are currently more than 2,000 tradable cryptocurrencies.⁶¹ And underlying almost all these virtual assets is blockchain technology.⁶² But just what is blockchain technology, and why is it such a hot topic for AML regulators?

Confusion over the structure, utility, and applicability of blockchain technology has persisted since its first use in 2009.⁶³ Many still associate blockchain with Bitcoin despite the technology's growth in the past few years as a means for inter-organizational cooperation and value transfer beyond cryptocurrency.⁶⁴

At its core, blockchain allows connected computers in a P2P network to register and confirm asset transactions.⁶⁵ Blockchain is a form of distributed ledger technology where transactions are recorded on a public ledger as "blocks" in a continuous chain linked to all previous blocks, reaching all the way back to the original transaction.⁶⁶ Once an asset transaction is initiated, other participating computers on the network verify and authenticate blocks on a public ledger.⁶⁷ These participating computers, termed "miners" or "nodes," are incentivized to perform authentication functions through token rewards.⁶⁸ Time-stamped records are then sequentially displayed to network parties based on their access levels.⁶⁹ Blockchain networks are either open (permission-less)—anonymous and available for anyone to join—or private (permissioned)—where different entities or individuals possess varying levels of authority to view information and conduct transactions.⁷⁰

Blockchain's primary value lies in the technology's emphasis on consensus across a distributed network of parties in the public ledger, "eliminat[ing] the need for a central authority or intermediary."⁷¹ This disintermediation—bypassing existing financial intermediary infrastructure—allows for faster and cheaper transactions.⁷²

60. See generally FIN. ACTION TASK FORCE, GUIDANCE FOR A RISK-BASED APPROACH VIRTUAL CURRENCIES (2015), <https://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf> [<https://perma.cc/XC56-6L2A>] (discussing the FATF's concerns regarding money laundering and terrorism and suggesting a framework to prevent such activities in the context of internet-based payment systems).

61. Sharifi, *supra* note 55.

62. *Id.*

63. See MILLER ET AL., *supra* note 37, at 9.

64. *Id.*

65. Magnuson, *supra* note 5, at 170; see Van Valkenburgh, *supra* note 13.

66. MILLER ET AL., *supra* note 37, at 11–12.

67. *Id.* at 11.

68. *Id.* at 11–12.

69. *Id.*

70. *Id.*

71. *Id.* at 10.

72. Lagarde, *supra* note 36, at 9.

Fintech firms that employ blockchain technology are generally characterized by three key features: diffusion, automation, and adaptation.⁷³ In terms of diffusion, actors in the fintech market are comprised of small, entrepreneurial startups rather than large companies.⁷⁴ For instance, as noted above, thousands of cryptocurrencies have been created since the advent of Bitcoin.⁷⁵ In terms of automation, fintech firms using blockchain rely on integrated algorithms of digital cryptography and distributed databases maintained by P2P networks to function.⁷⁶ And in terms of adaptation, fintech firms have shown a remarkable ability to use blockchain technology to create or adapt in response to new market conditions and other external circumstances in a short amount of time.⁷⁷ For example, with the emergence of Ethereum came the “smart contract” concept, a second-generation blockchain platform that “provid[ed] the ability to execute more complex and sophisticated tasks among parties” based on predefined contract rules embedded in code.⁷⁸ In sum, these three key features and the disintermediating quality of blockchain allow fintech firms to contend with traditional financial institutions.⁷⁹

However, these same features also represent the heart of the challenges AML regulators face in regulating fintech. First, because fintech actors utilizing blockchain technology are highly diffused and focused on discrete parts of the financial supply chain, they may be more prone to economic shocks than larger financial institutions.⁸⁰ And since blockchain technology is cross-jurisdictional by nature and virtual assets know no borders, the economic shocks that fintech firms suffer can reverberate globally.⁸¹ Second, because fintech firms rely on automation for blockchain technology, these firms are essentially tethered to the validity of the algorithm to function smoothly.⁸² While well-designed distributed ledgers could actually improve AML compliance, the anonymity associated with public blockchains can be (and has been) used for money laundering activities.⁸³ Lastly, the adaptable nature of fintech firms to changing market conditions means that these companies are “notoriously volatile.”⁸⁴ This volatility leaves AML regulators struggling to provide stability.⁸⁵

73. Magnuson, *supra* note 5, at 163.

74. *Id.* at 166.

75. Sharifi, *supra* note 55.

76. Magnuson, *supra* note 5, at 170.

77. *Id.* at 172.

78. *See id.*; MILLER ET AL., *supra* note 37, at 19.

79. Magnuson, *supra* note 5, at 163.

80. William Magnuson, *Regulating Fintech*, 71 VAND. L. REV. 1167, 1200 (2018) [hereinafter *Regulating Fintech*].

81. Lagarde, *supra* note 36.

82. *See* Magnuson, *supra* note 5, at 170.

83. MILLER ET AL., *supra* note 37, at 53.

84. Magnuson, *supra* note 5, at 174.

85. *See id.*

These challenges are especially exacerbated when AML regulators apply existing AML legislation to fintech. The disintermediating nature of fintech firms utilizing blockchain technology places firms outside the confines of existing AML legislation and regulation because their operations are not contingent on financial reporting like conventional intermediaries (like banks) in the sector.⁸⁶ Fintech firms may also operate independent of rules that regulate the general conduct of conventional banks.⁸⁷ Thus, with the rise of initial coin offerings (“ICOs”) and speculation surrounding Bitcoin, regulators have to take action to avoid the possibility of cryptocurrencies being used for illicit ends.⁸⁸ However, due to the innovative and adaptable nature of these fintech firms, severely stringent rules may lead to the collapse of those entrepreneurial companies and decrease competition in the sector.⁸⁹

In sum, AML regulators are faced with the challenge of combating systemic risk, maintaining consumer protection, and fostering innovation in a cross-jurisdictional fintech sector. Finding the right balance between risk mitigation and innovation is the key.⁹⁰ If blockchain technology is used to improve existing business processes, current legislation will probably suffice.⁹¹ However, disruptive cases arising out of the fintech blockchain ecosystem with increasingly adaptive technology and business models will require new regulation geared toward regulatory learning.⁹² Collaboration between regulators and the fintech industry itself will be incredibly important to accommodate the cross-border nature of the innovative technology.⁹³

B. *The Innovation Trilemma and the Need for a New Regulatory Hierarchy*

1. The Innovation Trilemma

Along with the regulatory challenges noted above, AML regulators must also contend with the innovative nature of the fintech sector.⁹⁴ As of the writing of this Comment, the cryptocurrency market has exceeded a \$1 trillion market cap⁹⁵—a market that did not exist just

86. Wu, *supra* note 7, at 207.

87. *Id.*

88. MILLER ET AL., *supra* note 37, at 52.

89. Wu, *supra* note 7, at 207.

90. See MILLER ET AL., *supra* note 37, at 52.

91. *Id.*

92. *Id.*

93. *Id.*

94. See Wu, *supra* note 7, at 250.

95. *Bitcoin Surges Past \$40,000 — Crypto Exceeds \$1 Trillion Market Cap*, FORBES (Jan. 9, 2021, 2:09 PM), <https://www.forbes.com/sites/cryptoconfidential/2021/01/09/bitcoin-surges-past-40000—crypto-exceeds-1-trillion-market-cap/?sh=236f2d864a3c> [https://perma.cc/GAZ3-PF6Z].

twelve years ago.⁹⁶ In recent years, fintech firms like Robinhood have allowed users to buy and sell virtual assets driven by blockchain technology, and big players like PayPal are embracing entry into this market.⁹⁷ In sub-Saharan Africa, virtual assets and blockchain have the potential to provide financial infrastructure to “previously underserved and unbanked population segments.”⁹⁸ In Latin America, distrust in local currencies has increased the adoption of cryptocurrency.⁹⁹ And in Asia, payment solution digitalization has facilitated the adoption of blockchain.¹⁰⁰ By challenging current financial institutions with decentralization and disintermediation, fintech escalates the difficulty of regulatory compliance.¹⁰¹ Thus, AML regulators are faced with a serious question: How can fintech regulation guard against financial risk but still foster innovation?

This Comment examines this question under a three-pronged theory called the “innovation trilemma,” introduced by Professors Chris Brummer and Yesha Yadav.¹⁰² The innovation trilemma is a theoretical framework for examining and understanding fintech regulation.¹⁰³ Fintech regulators face a policy trilemma among three objectives: market integrity, rules simplicity, and financial innovation.¹⁰⁴ The theory purports that fintech regulators are only able to achieve two out of these three objectives.¹⁰⁵

What do these three objectives mean? Market integrity refers to overall financial stability, protection against illegal acts, and the supervision of systematically interconnected fintech firms.¹⁰⁶ At its core, maintaining market integrity means guarding against the challenge of systemic risk.¹⁰⁷ Rules simplicity refers to regulators’ aim to create rules that are comprehensible and easy to apply, while financial innovation refers to regulators’ interest in advancing technologies that raise capital, diversify risk, and improve market operation.¹⁰⁸ Brummer and Yadav exemplify this trilemma through historical U.S. regulatory examples: the 1920s New Deal Era, the 1990s

96. See Sharifi, *supra* note 55.

97. Brady Dale, *Bitcoin Trading Fees on PayPal, Robinhood, Cash App and Coinbase: What to Know*, COINDESK, <https://www.coindesk.com/bitcoin-trading-fees-on-paypal-robinhood-cash-app-and-coinbase-what-to-know> (Nov. 30, 2020, 1:30 PM) [<https://perma.cc/3XK9-HFML>].

98. MILLER ET AL., *supra* note 37, at 40.

99. *Id.*

100. *Id.* at 42.

101. Wu, *supra* note 7, at 250.

102. Brummer & Yadav, *supra* note 14, at 244.

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.* at 244–45.

107. See discussion *supra* Section II.A.

108. Brummer & Yadav, *supra* note 14, at 246–47.

Gramm–Leach–Bliley Act, and the Dodd–Frank Act following the 2008 financial crisis.¹⁰⁹

It is important to note that while the innovation trilemma is a theoretical framework, it is taken as true in this Comment’s discussion. In fact, its efficacy may be bolstered by the examples of AML regulation given throughout this Comment. Further, for the purposes of this Comment, the three trilemma objectives are referred to as “market integrity,” “rules clarity,” and “innovation,” though their meanings from the preceding paragraph remain unchanged.

2. The Current AML Regulatory Landscape: Local and International Examples

The three objectives of market integrity, rules clarity, and innovation form an AML regulatory hierarchy. The trade-offs between these three objectives take shape as AML regulators favor certain objectives over others. As it currently stands in developed countries, AML regulatory bodies tend to place the objective of market integrity on top of the hierarchy.¹¹⁰ The same notion rings true for the Financial Action Task Force (“FATF”)—the most prominent international AML regulatory body.¹¹¹ By contrast, developing countries in regions such as Africa and Latin America have little to no AML regulatory framework and are thus susceptible to systemic risk.¹¹² The following regulatory frameworks serve as examples along this hierarchical spectrum. They highlight the need for an international AML regulatory framework that places paramount importance on innovation while maintaining market integrity.

In the United States, the Bank Secrecy Act of 1970 (“BSA”) serves as the principal legislation on AML issues, comprised of certain requirements such as currency transaction reports, reports on the sale of monetary instruments, and customer identification programs.¹¹³ The Financial Crimes Enforcement Network (“FinCEN”), devoted to safeguarding the financial system from money laundering issues,¹¹⁴ administers the BSA and requires reporting of suspicious transactions,

109. *See id.* at 249.

110. *See* Yadav, *supra* note 35, at 1121–23.

111. *See Who We Are*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/about/whoweaare/> [<https://perma.cc/9MP5-TP5L>].

112. *See* Ian Allison, *Where FATF Crypto Compliance Gets Interesting: Africa*, COINDESK, <https://www.coindesk.com/where-fatf-crypto-compliance-gets-interesting-africa> (Aug. 24, 2021, 6:46 PM) [<https://perma.cc/EGC6-XW9B>]; *see* MILLER ET AL., *supra* note 37, at 40.

113. Bank Secrecy Act of 1970, Pub. L. No. 91-508, 84 Stat. 1114 (codified as amended in 12 U.S.C. § 1829(b), 12 U.S.C. § 1951–59, and in scattered sections of 31 U.S.C.); *see* Wu, *supra* note 7, at 223–24, 227–29.

114. *What We Do*, FINCEN, <https://www.fincen.gov/what-we-do> [<https://perma.cc/37WT-A599>].

cash transactions over \$10,000, and other illicit activities.¹¹⁵ Fintech firms specializing in virtual asset transactions and blockchain technology are subject to this AML regulatory framework.¹¹⁶ The framework essentially incorporates virtual assets into the already existing BSA legislation.¹¹⁷

From a hierarchical standpoint, BSA legislation and FinCEN regulators place paramount importance on market integrity. However, when viewed through the trilemma framework, this leads to a lack of rules clarity and innovation. Most recently, FinCEN has proposed new regulations that make it easier for the government to track virtual asset transactions, requiring fintech firms to keep records of transactions over \$3,000 for personal wallets and report cumulative transactions over \$10,000 in a day.¹¹⁸ For comparison, under the BSA, traditional intermediary banks are only required to flag cash withdrawals exceeding \$10,000, not transactions that occur within the banking network itself.¹¹⁹ Further, the United States has no uniform definition of “cryptocurrency.”¹²⁰ Thus, the combination of (1) a lack of a directly applicable framework and (2) proposed regulations solely focused on maintaining market integrity leads to a lack of clarity in rulemaking and a squeeze on financial innovation.¹²¹ As a result, fintech firms may be pushed toward jurisdictions where regulations are clear and innovation is fostered.¹²²

On a similar note, the U.K. AML regulatory framework focuses on market integrity but provides more clarity to fintech firms. The United Kingdom recently implemented the Money Laundering and Terrorist Financing (Amendment) Regulations 2019, expanding an already existing framework of preventative measures based on FATF recommendations.¹²³ These regulations define “cryptoassets” as “a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can

115. *What is the BSA Data?*, FINCEN, <https://www.fincen.gov/what-bsa-data> [<https://perma.cc/U2BH-4P28>].

116. *See* Wu, *supra* note 7, at 233.

117. *See id.* at 223–29.

118. Leigh Cuen, *Bitcoin Advocates Revolt Against the Trump Administration's Frantic Crypto Regulations*, TECHCRUNCH (Jan. 8, 2021, 9:47 AM), <https://techcrunch.com/2021/01/08/bitcoin-advocates-revolt-against-the-trump-administrations-frantic-crypto-regulations/> [<https://perma.cc/Z8SE-AZ4D>]; *see* Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets, 85 Fed. Reg. 83,840 (Dec. 23, 2020) (to be codified at 31 C.F.R. pts. 1010, 1020, 1022).

119. Cuen, *supra* note 118.

120. Josias N. Dewey, *USA*, in BLOCKCHAIN & CRYPTOCURRENCY REGULATION 384, 385 (Josias N. Dewey ed., 3d ed. 2021).

121. Birla, *supra* note 19.

122. *Id.*

123. Money Laundering and Terrorist Financing (Amendment) Regulations 2019, SI 2019/1511 (Eng.).

be transferred, stored, or traded electronically.”¹²⁴ Further, the U.K. Financial Conduct Authority (“FCA”) assumed complete oversight of virtual-asset fintech firms as of January 10, 2020, requiring that firms register with the FCA for monitoring and enhanced due diligence.¹²⁵ While the U.K. AML regulatory framework emphasizes clarity, the hierarchy of the framework is still markedly similar to that of the United States—market integrity is the most important objective. But the objective of innovation is not completely absent. In 2018, the FCA established the Innovation Division and implemented several initiatives: a regulatory sandbox, the GFIN, and an Innovation Hub.¹²⁶ However, the burden on fintech firms becomes extremely heavy with stringent regulations that prompt small, entrepreneurial firms to undertake extreme customer monitoring.¹²⁷ Maintaining market integrity requires AML regulators to make these types of trade-offs, which is especially evident when viewed through the lens of the trilemma. Thus, the objective of innovation is still deficient within the U.K. AML regulatory hierarchy.

Briefly moving from local to international platforms, the FATF sets AML recommendations and standards to prevent money laundering and other illicit activities.¹²⁸ There are more than 200 FATF member countries and 40 AML standards that are continually updated to address new risks, such as the regulation of virtual assets.¹²⁹ Member countries are peer reviewed on the AML standards through mutual evaluations to assess implementation levels and technical compliance.¹³⁰ From a hierarchical standpoint, the FATF standards primarily focus on market integrity. However, the high number of standards may reduce clarity; member countries are subject to a very large-scale assessment. Further, the standards are grouped into categories such as “money laundering and confiscation,” “terrorist financing and financing of proliferation,” “preventive measures,” “international coopera-

124. Money Laundering and Terrorist Financing (Amendment) Regulations 2019, SI 2019/1511, § 14A(3) (Eng.).

125. *Money Laundering Regulations*, FIN. CONDUCT AUTH., <https://www.fca.org.uk/firms/financial-crime/money-laundering-regulations> (July 26, 2021) [<https://perma.cc/ZCZ9-S9XH>].

126. Stuart Davis et al., *United Kingdom, in BLOCKCHAIN & CRYPTOCURRENCY REGULATION* 369, 379 (Josias N. Dewey, 3d ed., 2021).

127. Will Heasman, *FCA’s New AML Regime – UK’s Crypto Market Will Have to Adapt in 2020*, COINTELEGRAPH (Jan. 21, 2020), <https://cointelegraph.com/news/fcas-new-aml-regime-uks-crypto-market-will-have-to-adapt-in-2020> [<https://perma.cc/2QFP-83XJ>].

128. *Who We Are*, *supra* note 111.

129. FIN. ACTION TASK FORCE, INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION 10–30 (2021), <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf> [<https://perma.cc/NQF4-75KD>].

130. See FIN. ACTION TASK FORCE, *Consolidated Assessment Ratings*, (Oct. 2020) [hereinafter *Consolidated Assessment Ratings*] <http://www.fatf-gafi.org/media/fatf/documents/4th-Round-Ratings.pdf> [<https://perma.cc/KBW2-GXKG>].

tion,” etc.¹³¹ No category is specifically geared toward the growth of innovation. As a result, and viewed from the hierarchy, the FATF places paramount importance on market integrity, but this also produces deficiencies in clarity and promotion of financial innovation. Local jurisdictions that are subject to FATF monitoring are left to implement their own innovative vehicles.

From a different local viewpoint, there are some jurisdictions that give little credence to the objectives of market integrity and clarity. For example, in Africa, P2P payments using digital currencies are becoming an alternative to local fiat currencies.¹³² Senegal announced plans for a cryptocurrency under the West African Economic and Monetary Union, and South Africa’s central bank gives virtual-asset fintech firms and consumers “relative ‘carte blanche’ to conduct cryptocurrency transactions.”¹³³ In Latin America, smaller economies are adopting cryptocurrency and other blockchain financial products.¹³⁴ In Argentina and Brazil, Ripio—a cryptocurrency company—has a Bitcoin financial services suite that allows P2P virtual asset transfers for both unbanked and underbanked populations.¹³⁵ From a hierarchical standpoint, the regulators in these regions place the objective of innovation at the top of the hierarchy with little regard for market integrity or rules clarity. While this system reaches previously underserved and unbanked populations in developing countries, the AML regulatory control is “weak or non-existent.”¹³⁶

The differences in these local and international frameworks seem to beg a specific question: What is the correct hierarchy to reach fintech AML regulatory equilibrium? On one hand, local, developed jurisdictions like the United States and the United Kingdom or international bodies like the FATF have stringent AML regulations that promote market integrity but leave deficiencies in financial innovation and market competition. On the other hand, jurisdictions within developing regions like Africa and Latin America are inviting fintech innovation to build their local technological ecosystems but are prone to financial market shocks because of weak or non-existent AML regulations. Moreover, the biggest problem is that the regulatory consequences in these jurisdictions are not mutually exclusive. Transfers of capital, especially electronic fund transfers involving virtual assets, are extremely mobile and implicate strong cross-border financial ramifications.¹³⁷ As mentioned in the previous discussion of the challenges fintech regulators face, modern markets are unavoidably global.¹³⁸

131. *Id.*

132. MILLER ET AL., *supra* note 37, at 38.

133. *Id.* at 39.

134. *Id.* at 40.

135. *Id.*

136. Allison, *supra* note 112.

137. See Yadav, *supra* note 35, at 1117.

138. *Id.* at 1118.

Therefore, the cross-jurisdictional challenges and the innovative nature of fintech warrant several solutions. First, the need for an *international* AML regulatory framework is apparent. Second, the hierarchy of this international regulatory framework needs to place paramount importance on the innovative nature of the sector while still maintaining market integrity to guard against the challenges of regulating fintech. The next Part examines this proposed hierarchy.

III. PROPOSAL: A NEW INTERNATIONAL ANTI-MONEY LAUNDERING REGULATORY HIERARCHY PREMISED ON INNOVATION

Why is an international regulatory hierarchy premised on financial innovation so important? This Part argues that the proposed AML hierarchy is needed because (1) the fintech sector is inherently innovative, meaning firms will continually seek an avenue for growth despite stringent regulations; and (2) the future uses of blockchain technology will revolutionize financial transactions and allow emerging/developing markets to gain a global foothold. Further, this Part promotes the efficacy of the proposed AML hierarchy through an examination of OFC regulatory frameworks, which have fostered fintech innovation by creating innovative regulatory ecosystems.

A. *Why Emphasize Innovation?*

The fintech sector is inherently innovative. The exponential rise in financial applications of blockchain technology in the recent decade prove this point.¹³⁹ Because fintech firms possess this innovative nature, they necessarily need room for growth. This can cause a regulatory “race to the bottom” where local regulators promote lower and lower standards of AML fintech regulation to invite fintech firms to their jurisdiction.¹⁴⁰ This is a result of insufficient international coordination and aggressive competition between regulators to entice innovative businesses.¹⁴¹ Thus, the proposed international regulatory hierarchy is needed to instead promote a “race to the top,” where regulators compete to adopt better-designed and more efficient regulations premised on multinational regulatory learning.¹⁴²

As noted previously, blockchain technology is still often associated with Bitcoin and other cryptocurrencies.¹⁴³ However, innovative uses of blockchain have increased exponentially since distributed ledger technology was first introduced.¹⁴⁴ Some have even heralded blockchain as one of the greatest inventions in human history, follow-

139. See Rawat et al., *supra* note 20, at 8–14.

140. Brummer & Yadav, *supra* note 14, at 296.

141. *Id.* at 301.

142. See *Regulating Fintech*, *supra* note 80, at 1223.

143. See MILLER ET AL., *supra* note 37, at 9.

144. See Rawat et al., *supra* note 20, at 8–14.

ing the footsteps of inventions such as the printing press, electricity, radio, and the Internet.¹⁴⁵ That notion is certainly up for debate. But the point is that the applications of blockchain are undeniable, consisting of the following: financial transactions, cryptocurrency, global payments, insurance processing, “Internet of things,” systems management, cybersecurity, intellectual property, identity management, and other uses in scenarios involving transaction management in a P2P system.¹⁴⁶ An examination of these specific applications would require a large-scale discussion outside the scope of this Comment. But suffice it to say the applications of blockchain technology exemplify the inherently innovative nature of the fintech sector.

Further, the impact blockchain technology can have on emerging markets cannot be overstated. When blockchain is utilized for financial services, emerging marketplaces can be “‘bootstrapped’ to function without the use of traditional ‘trusted parties’ and thereby result in significantly lower networking costs for participants.”¹⁴⁷ Fintech firms employing blockchain initiatives in emerging market economies can expand the value chain of financial services to target inefficiencies and reach largely underserved customer segments.¹⁴⁸ Examples of fintech firms operating in this manner include BitPesa in Kenya, Remit.ug in Uganda, BitSpark in Hong Kong, Coinsensure in India, and Rebit in the Philippines.¹⁴⁹ However, these developing jurisdictions need proper governance and a strong regulatory framework to provide stability and allow innovation to flourish.¹⁵⁰ Cross-jurisdictional regulatory harmonization is a mechanism that ensures that these emerging markets properly engage and collaborate with fintech firms utilizing blockchain technology.¹⁵¹ Thus, the need for this Comment’s proposed international regulatory hierarchy is evident to avoid systemic risk in these emerging markets while still allowing for fintech innovation that advances the financial economy.

The combination of an inherently innovative fintech sector and the undeniable applications of further developments in fintech innovation leads to the conclusion that the key objective for regulating the industry is fostering innovation. A regulatory hierarchy premised on innovation is a necessity.

145. See Gareth Jenkinson, *Crypto and Blockchain—Following in the Footsteps of Man’s Greatest Inventions?*, COINTELEGRAPH (July 14, 2018), <https://cointelegraph.com/news/crypto-and-blockchain-following-in-the-footsteps-of-man-s-greatest-inventions> [https://perma.cc/JZN5-7HR3].

146. Rawat et al., *supra* note 20, at 8–14.

147. MILLER ET AL., *supra* note 37, at 16.

148. *Id.* at 18.

149. *Id.*

150. *Id.* at 51.

151. See *id.* at 53.

B. *Examining the Efficacy of the Hierarchy: Offshore Financial Centers*

OFCs provide an excellent example to examine the efficacy of the proposed hierarchy. OFCs are popularly known as “tax havens” that offer “light-touch regulation,” “where bank secrecy and tax relief are essential commodities.”¹⁵² And recently, these jurisdictions have become leaders in blockchain technology development and have earned a new moniker: “blockchain havens.”¹⁵³ This supposition of light-touch regulation may be true by some accounts; lower transaction costs in a small number of these jurisdictions allow for effective AML regulatory competition.¹⁵⁴ However, it may be surprising to note that well-established OFCs have a level of AML regulatory effectiveness either on par with or close to the effectiveness of onshore jurisdictions.¹⁵⁵ As members of the FATF, OFCs are subject to AML regulation assessment and compliance ratings through one of nine FATF-style regional bodies.¹⁵⁶ The most recent FATF assessment rated Malta, an OFC located in the Mediterranean between Sicily and Tunisia, as “compliant” or “largely compliant” in 31 out of 40 AML recommendations.¹⁵⁷ By comparison, the FATF rated the United States as “compliant” or “largely compliant” in 31 out of its 40 recommendations in its most recent AML assessment.¹⁵⁸ Both jurisdictions are equally compliant with AML measures promoting market integrity. Thus, to say that these OFCs offer light-touch AML regulation disregards the objective compliance meters espoused by the FATF. This examination reviews the regulatory frameworks of three well-established OFCs: Malta, Gibraltar, and Jersey. Each of these OFCs invite financial innovation while still guarding against systemic risk.

Malta is a large OFC that specializes in “corporate and transaction banking and fund management.”¹⁵⁹ Malta recently positioned itself as a fintech-friendly jurisdiction by introducing a regulatory regime for virtual asset transactions in 2018, namely, the Virtual Financial Assets Act 2018 (“VFA Act”).¹⁶⁰ The VFA Act defines the term “virtual financial asset” and regulates the issuance of ICOs, blockchain technol-

152. Marian, *supra* note 23, at 531–32.

153. *Id.* at 532.

154. See Morriss & Henson, *supra* note 24, at 426–27.

155. *Id.* at 427–28.

156. See *Consolidated Assessment Ratings*, *supra* note 130.

157. MONEYVAL, ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING MEASURES MALTA 17 (2019), <https://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/Moneyval-Mutual-Evaluation-Report-Malta-2019.pdf> [<https://perma.cc/6RHP-EV9L>].

158. FIN. ACTION TASK FORCE, ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING MEASURES UNITED STATES, 8 (2020), <https://www.fatf-gafi.org/media/fatf/documents/reports/fur/Follow-Up-Report-United-States-March-2020.pdf> [<https://perma.cc/M9L4-BDRS>].

159. MONEYVAL, *supra* note 157, at 9.

160. *Id.* at 101.

ogy assets, and licensing related to virtual asset transactions.¹⁶¹ The Act serves as the primary Maltese AML legislative framework to guard against systemic risk, regulated by the Malta Financial Services Authority.¹⁶² And as previously noted, Malta was rated “compliant” or “largely compliant” with 31 out of 40 of the FATF AML recommendations.¹⁶³

Moreover, Malta also instituted the Malta Digital Innovation Authority Act (“MDIA Act”) and the Innovative Technology Arrangements and Services Act (the “ITAS Act”). The MDIA Act establishes an agency to promote principles “relating to technology innovation, including distributed or decentralized technology.”¹⁶⁴ The ITAS Act regulates innovative technology arrangements and virtual asset service providers, which are then overseen by the MDIA.¹⁶⁵ In sum, Malta has affirmatively created legislation and regulation to ensure innovation growth in the fintech sector, with special focus on defined uses of blockchain technology and virtual asset transactions. From a hierarchical standpoint, fostering innovation is the paramount regulatory objective. Additionally, the VFA Act still promotes systemic integrity through a stringent AML regulatory framework. When asked why Malta instituted these acts, the Digital Economy Parliamentary Secretary Silvio Schembri stated, “We want an eco-system that encourages operators to move here,” and the legislation and regulation “provide the necessary legal certainty to allow this industry to flourish.”¹⁶⁶

These movements toward financial innovation are not exclusive to the OFC of Malta. Like Malta, Gibraltar is a self-governed British OFC situated south of Spain at the tip of the Iberian Peninsula.¹⁶⁷ The OFC has been rated as “compliant” or “largely compliant” with 30 out of 40 FATF AML recommendations in its last mutual evaluation report.¹⁶⁸ In terms of direct AML legislation, Gibraltar instituted the Proceeds of Crime Act in 2015, which transposed the European Union Anti-Money Laundering Directive into the national law of Gibraltar.¹⁶⁹ This brought virtual asset transactions within existing AML leg-

161. See Virtual Financial Assets Act, 2018 (Act No. XXX) (Malta).

162. *Id.*

163. MONEYVAL, *supra* note 157, at 17.

164. Malta Digital Innovation Authority Act, 2018 (Act No. XXXI) (Malta).

165. See Innovative Technology Arrangements and Services Act, 2018 (Act No. XXXIII) (Malta).

166. Ivan Martin, *Malta Digital Innovation Authority Unveiled*, TIMES OF MALTA (Feb. 16, 2018), <https://timesofmalta.com/articles/view/malta-digital-innovation-authority-unveiled.670847> [<https://perma.cc/GZ6W-RMVU>].

167. MONEYVAL, BRITISH OVERSEAS TERRITORY OF GIBRALTAR FIFTH ROUND MUTUAL EVALUATION REPORT 17 (2019) [hereinafter GIBRALTAR REPORT], <https://www.fatf-gafi.org/media/fatf/documents/reports/mer-fsrb/Moneyval-Mutual-Evaluation-Report-Gibraltar.pdf> [<https://perma.cc/P6Q2-658C>].

168. *Id.* at 15.

169. See Proceeds of Crime Act, 2015 (Act No. 2015-22) (Gib.).

isolation regarding financial issues, such as customer identity verification and risk assessment.¹⁷⁰

Gibraltar has had a regulated blockchain providers' sector since 2017 with a dedicated blockchain authorization team.¹⁷¹ The government introduced the Financial Services (Distributed Ledger Technology Providers) Regulations 2017, which was repealed and replaced in 2019 by the Financial Services Act to form a more comprehensive regulatory framework.¹⁷² The Financial Services Act requires fintech firms engaging in blockchain activity to apply for a license from the Gibraltar Financial Services Commission ("GFSC").¹⁷³ Further, the Gibraltar Blockchain Exchange was established in 2018 as an official GFSC-licensed virtual asset exchange.¹⁷⁴ The GFSC's movement toward blockchain regulation "positions Gibraltar as a jurisdiction which facilitates innovation" with a "flexible, adaptive approach."¹⁷⁵ The GFSC even established an "Innovate and Create Team" that provides regulatory support to new or non-regulated businesses.¹⁷⁶ While Gibraltar's regulatory framework may not emphasize innovation to the same extent as Malta's, innovation is still exhibited as the paramount hierarchical regulatory objective. Moreover, regulators in Gibraltar remain focused on risk governance and mitigation through stringent, yet flexible, AML blockchain and virtual asset regulation.

Malta and Gibraltar serve as examples of jurisdictions that use direct legislation and regulation to promote financial innovation. The last OFC examined in this review, Jersey, serves as an example of a jurisdiction that promotes innovation through a more principled approach. In fact, there are no specific regulations in Jersey that directly apply to virtual assets.¹⁷⁷ However, Jersey regulators and government-backed economic development agencies promote an innovative, open

170. Clare Feikert-Ahalt, *Gibraltar*, in REGULATORY APPROACHES TO CRYPTOASSETS IN SELECTED JURISDICTIONS 98, 105, (L. Libr. of Cong. ed., 2019) 105, <https://tile.loc.gov/storage-services/service/l1/lglrd/2019668148/2019668148.pdf> [<https://perma.cc/9K66-S25P>]

171. GIBALTAR REPORT, *supra* note 167, at 120.

172. See Financial Services (Distributed Ledger Technology Providers) Regulations, 2017 (LN. 2017/204) (Gib.), *repealed by* Financial Services Act, 2019 (Act No. 2019-26) (Gib.).

173. *Id.*

174. Feikert-Ahalt, *supra* note 170.

175. *Distributed Ledger Technology Regulatory Framework (DLT Framework)*, GIB. FIN. SERVS. COMM'N, <https://www.fsc.gi/dlt> [<https://perma.cc/ESM2-U2WU>].

176. *Innovate and Create Team*, GIB. FIN. SERVS. COMM'N, <https://www.fsc.gi/FSC/innovate> [<https://perma.cc/93MR-Q88H>].

177. Clare Feikert-Ahalt, *Jersey*, in REGULATORY APPROACHES TO CRYPTOASSETS IN SELECTED JURISDICTIONS 143, 143-44 (L. Libr. of Cong. ed. 2019) [hereinafter *Regulatory Approaches to Cryptoassets: Jersey*], <https://www.tile.loc.gov/storage-services/service/l1/lglrd/2019668148/2019668148.pdf> [<https://perma.cc/9K66-S25P>].

attitude to fintech, which in turn has spurred innovative policies, examined in depth below.¹⁷⁸

The OFC of Jersey, part of the Channel Islands, is a self-governed British Crown Dependency off the coast of France.¹⁷⁹ Jersey is one of the most well-established OFCs in the world, with “a mature and sophisticated AML/CFT regime.”¹⁸⁰ It was rated “compliant” or “largely compliant” with 39 out of 40 FATF recommendations in its last mutual evaluation report,¹⁸¹ the highest score among all jurisdictions assessed in that same evaluation cycle.¹⁸² The OFC has applied its existing legislative framework to virtual asset transactions.¹⁸³ So while Jersey does not have specific regulations that apply to virtual assets and ICOs, certain types of these financial vehicles may be subject to the existing regulatory regime.¹⁸⁴ Further, Jersey has defined “virtual currency” in amendments to the Proceeds of Crime Act, enabling these assets to be subject to AML laws and regulated by the Jersey Financial Services Commission (“JFSC”).¹⁸⁵

Along with its comprehensive AML regulatory regime, Jersey has numerous organizations that promote innovation in the financial sector, following “a purposeful strategy of transparency, innovation and quality.”¹⁸⁶ Digital Jersey, “an economic development agency and industry association,” develops strategies to help establish Jersey as a leading base for digital innovation.¹⁸⁷ Digital Jersey has partnered with the government and agency organizations including the Government of Jersey, the JFSC, and Jersey Finance.¹⁸⁸ Jersey Finance, an organization “funded by members of the local finance industry and the Government of Jersey,” focuses on five pillars in the fintech sector: fintech innovation, regulation technology (“RegTech”),

178. See CHRISTOPHER GRIFFIN ET AL., *JERSEY BLOCKCHAIN AND CRYPTOCURRENCY REGULATION 2020*, (Carey Olsen ed., 2d ed. 2020) https://www.careyolsen.com/sites/default/files/CO_JSJ_Blockchain-and-Cryptocurrency-Regulation-2020-2nd-Edition.pdf [<https://perma.cc/9Y3G-GK9U>]. See generally *Fintech and Regtech*, DIGIT. JERSEY, <https://www.digital.je/initiatives/fintech-regtech/> [<https://perma.cc/V3FJ-YSQM>] (explaining that Jersey’s regulatory approach to fintech creates a “compelling environment” for fintech companies).

179. *Facts About Jersey*, GOV’T OF JERSEY, <https://www.gov.je/Leisure/Jersey/Pages/Profile.aspx> [<https://perma.cc/A976-7N79>].

180. MONEYVAL, *REPORT ON FOURTH ASSESSMENT VISIT OF JERSEY 277* (2015), <https://rm.coe.int/report-on-fourth-assessment-visit-anti-money-laundering-and-combating-/1680716452> [<https://perma.cc/AJ72-A3KG>].

181. *Id.* at 260–68.

182. *MONEYVAL Report 2016*, JERSEY FIN. (May 31, 2016), <https://www.jerseyfinance.je/our-work/moneyval-report-2016/> [<https://perma.cc/M28G-RQEA>].

183. See *Regulatory Approaches to Cryptoassets: Jersey*, *supra* note 177, at 144.

184. *Id.*

185. See *Proceeds of Crime (Miscellaneous Amendments) (Jersey) Regulations 2016*, R&O.63/2016 (Jersey).

186. *MONEYVAL Report 2016*, *supra* note 182.

187. *About Digital Jersey*, DIGIT. JERSEY, <https://www.digital.je/about/> [<https://perma.cc/P72G-AN6G>].

188. *Fintech and Regtech*, *supra* note 178.

wealthtech, cryptocurrency and blockchain technology, and cybersecurity.¹⁸⁹ Jersey's government has advanced a "balanced approach towards fintech regulation" in coordination with the JFSC, which ensures market integrity "while giving innovative businesses a pragmatic space in which to test new products."¹⁹⁰ In sum, the numerous organizations throughout Jersey have a central policy objective to foster innovation in the fintech industry. From a hierarchical standpoint, the regulatory objective of innovation is paramount, yet the strong AML regulations of Jersey still promote systemic integrity.

The three OFCs of Malta, Gibraltar, and Jersey highlight the efficacy of this Comment's proposed regulatory hierarchy. These regulatory frameworks do not necessarily serve as direct models for an international framework. It would be a difficult task to directly transpose these exact frameworks on a multinational level given global differences in national market structure. Rather, these frameworks provide clear examples of how *local* AML regulation geared towards the objective of innovation and the creation of innovation hubs is extremely effective for growth in the fintech sector. Further, these OFC frameworks highlight the various ways of placing the objective of innovation in a paramount position. Local legislation and regulation can directly govern blockchain and virtual asset transactions, similar to the frameworks of Malta and Gibraltar. Alternatively, and perhaps more likely, regulatory policy and principle geared towards innovation can promote the growth of blockchain and virtual asset transactions, similar to the regulatory framework in Jersey. Under either circumstance, the point remains the same: a regulatory hierarchy with the paramount objective of innovation is needed to govern the inherently innovative fintech sector.

IV. IMPLEMENTATION OF THE PROPOSED REGULATORY HIERARCHY

It will be helpful to recap the questions this Comment has answered thus far. First, *what* is fintech, the challenges associated with AML regulation of fintech, and the current regulatory landscape? Second, *why* is an international regulatory hierarchy premised on financial innovation so important, and how has this hierarchy been effective in a number of OFCs? This Part now turns to a more pertinent question: *How* can the proposed regulatory hierarchy be internationally implemented?

Several implementations have taken shape in the form of regulatory sandboxes, fintech charters, appointed representative regimes, and mentorship programs. Application of these strategies can be macro-produced in an international regulatory environment to foster innova-

189. *Id.*

190. *Id.*

tion and attain the desired hierarchical outcome. However, some of the current regulatory sandboxes are employed locally and may emphasize narrowly tailored industry innovation at the loss of true regulatory education.¹⁹¹ And mentorship regimes are also local in nature and currently represent only an ideological arrangement.¹⁹² Thus, a more concrete implementation is warranted.

Future developments must be both local and multinational for implementation of the proposed international AML regulatory hierarchy. The GFIN, an initiative “committed to advancing financial integrity” through innovation in financial services, has over 40 national financial sector regulatory members.¹⁹³ This nascent international fintech organization is in the best position as a global innovation hub to enable further efforts that place more emphasis on regulatory reporting geared towards innovation. Moreover, the innovation hubs created by OFCs are a lesson for local regulators across the globe. Partnerships between governmental and innovative agency organizations will improve AML regulatory transparency, quality, and innovation. We are currently at a developmental crossroads between regulatory complacency and a proactive approach that takes the innovative nature of the fintech sector into account. Positive developments toward the proposed regulatory hierarchy must be fostered to enable adequate financial development.

A. Regulatory Sandboxes and Stand-Alone Implementations

Regulatory sandboxes are safe spaces for fintech firms to test new innovations without the fear of strict regulation.¹⁹⁴ Specifically, the goal is to relax existing regulations in a controlled setting, which allows experimentation with new business models or technology.¹⁹⁵ This regulatory environment simultaneously fosters innovation and mitigates risk in financial technology.¹⁹⁶ Thus, the regulatory sandbox fits the proposed hierarchy; innovation is the paramount objective, yet market integrity is still intact and systemic risk is mitigated.

Several jurisdictions have already employed regulatory sandboxes. The U.K. FCA created the first regulatory sandbox in 2016.¹⁹⁷ A

191. Matthew J. Razzano, *An Unsafe Sandbox: Fintech Innovation at the Expense of Consumer Protection?*, 2019 U. ILL. L. REV. ONLINE 132, 138 (2019).

192. See Enriques & Ringe, *supra* note 30, at 22–28.

193. *Our Members*, GLOB. FIN. INNOVATION NETWORK, <https://www.thefin.com/members> [<https://perma.cc/6W46-6P2G>]; *About GFIN*, *supra* note 34.

194. Piri, *supra* note 29, at 246.

195. JORGE GABRIEL JIMÉNEZ & MARGARET HAGAN, *A REGULATORY SANDBOX FOR THE INDUSTRY OF LAW* (Thomson Reuters ed., 2019), <https://www-cdn.law.stanford.edu/wp-content/uploads/2019/04/Regulatory-Sandbox-for-the-Industry-of-Law.pdf> [<https://perma.cc/JJ2Z-9SXS>].

196. Piri, *supra* note 29, at 246.

197. Latham & Watkins, *World-First Regulatory Sandbox Open for Play in the UK*, CLIENT ALERT COMMENT. (May 9, 2016), <https://www.lw.com/thoughtLeadership/LW-world-first-regulatory-sandbox-open-for-play-in-UK> [<https://perma.cc/P8EZ->

fintech firm in the FCA sandbox goes through four steps: application, authorization, testing, and exit.¹⁹⁸ These steps allow for regulatory engagement and business development, empowering fintech firms to fine-tune their business models.¹⁹⁹ Regulatory sandboxes allow entrepreneurial fintech firms to innovate and prepare for financial regulation by equalizing opportunities between incumbents and start-ups.²⁰⁰

Many jurisdictions employ sandboxes at a small, local level. In the United States, the states of Arizona, Utah, and Wyoming all have active fintech regulatory sandboxes, with Florida close behind.²⁰¹ At the U.S. federal level, the Consumer Financial Protection Bureau has launched several programs and initiatives like the Trial Disclosure Sandbox, the Compliance Assistance Sandbox, streamlined no-action letter policies, and the American Consumer Financial Innovation Network.²⁰² Further, the Monetary Authority of Singapore has also launched a regulatory sandbox with recent graduates such as the capital markets blockchain platform iSTOX.²⁰³

And on a global scale, the U.K. FCA formed GFIN with an early priority for the development of cross-border testing through a pilot “global sandbox” initiative.²⁰⁴ After screening 44 applications, GFIN announced that it would be working with eight fintech firms for cross-border trials in April 2019.²⁰⁵ Based on that experience of collaboration and regulatory learning, GFIN is now committed to developing the cross-border testing framework in a post-pilot phase.²⁰⁶ A regulatory sandbox indicates a regulator’s inclination to foster innovation, provides a tangible boost to innovation and competition, and allows regulators to communicate with fintech firms in an open environment before systemic risk materializes.²⁰⁷

GSER]; DAVID STRACHAN ET AL., *A JOURNEY THROUGH THE FCA REGULATORY SANDBOX* (Deloitte ed., 2018), <https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fca-regulatory-sandbox-project-innovate-finance-journey.pdf> [<https://perma.cc/N63T-HJAW>].

198. *Id.*

199. *Id.*

200. *Id.*

201. *Can Regulators Foster Financial Innovation and Preserve Consumer Protections?*, PEW CHARITABLE TRS. (Sep. 10, 2020), <https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2020/09/can-regulators-foster-financial-innovation-and-preserve-consumer-protections> [<https://perma.cc/B7BN-JD59>].

202. *Id.*

203. Paul Muir, *Singapore Firm Graduates from Regulatory Sandbox*, ASIA TIMES (Feb. 4, 2020), <https://asiatimes.com/2020/02/singapore-firm-graduates-from-regulatory-sandbox/> [<https://perma.cc/P559-8N4J>].

204. GLOB. FIN. INNOVATION NETWORK, *CROSS-BORDER TESTING: LESSONS LEARNED 2* (2020), <https://static1.squarespace.com/static/5db7cdf53d173c0e010e8f68/t/5e1ef8c3c7a87d3abb5c7bc6/1579088083585/> [<https://perma.cc/E73C-S2JN>].

205. *Id.*

206. *Id.*

207. Buckley et al., *supra* note 32, at 71–77.

However, regulatory sandboxes also have several drawbacks. The use of sandboxes on a stand-alone basis is not the most effective method to promote a regulatory culture geared toward innovation.²⁰⁸ On a local level, jurisdictions employing regulatory sandbox programs are very selective with tight entry conditions that limit fintech start-up entry.²⁰⁹ Sandbox programs are also relatively short (e.g. six months in the U.K. FCA program), which may be an insufficient amount of time for firms to adapt to new regulatory regimes.²¹⁰ Further, while sandboxes allow regulators to learn from fintech firms and build long-lasting policies, the selective nature of sandbox programs along with the disparate nature of fintech services could result in significant regulatory learning inconsistencies.²¹¹ Thus, national and multinational regulatory sandboxes are only one piece of a complex regulatory puzzle.

Governments have proposed other initiatives to promote fintech innovation. Some jurisdictions have utilized the concept of a fintech charter, which gives fintech firms a national bank license tailored to their needs.²¹² For example, the U.S. Office of the Comptroller of the Currency first utilized fintech charters in 2018 to cover a variety of fintech firms.²¹³ However, fintech charters like these have encountered significant legal impediments,²¹⁴ and many different types of licenses may produce “regulatory arbitrage” by creating different legal standards for similar types of fintech activities.²¹⁵ The U.K. FCA has toyed with another type of initiative: appointed representative regimes, which allow some fintech firms to perform regulated activities acting as appointed representatives for a principal, directly authorized firm.²¹⁶ However, a recent review of these principal firms found that most had under-developed governance protocols, “including a lack of effective risk frameworks, internal controls and resources.”²¹⁷

The FCA has proposed a complementary scheme—the fintech mentorship program—to deal with perceived limitations of regulatory

208. *Id.* at 83.

209. *Id.* at 59.

210. Enriques & Ringe, *supra* note 30, at 18.

211. See Razzano, *supra* note 191, at 138–39.

212. Enriques & Ringe, *supra* note 30, at 19.

213. Lucas Siegmund, *A Fintech Charter by Another Name*, REGUL. REV. (Nov. 30, 2020), <https://www.theregview.org/2020/11/30/siegmund-fintech-charter-another-name/#:~:text=the%20fintech%20charter%20gives%20fintechs,burdensome%20web%20of%20state%20regulations> [<https://perma.cc/7C96-D69T>].

214. *See id.*

215. Enriques & Ringe, *supra* note 30, at 20.

216. *Appointed Representatives and Principals*, FIN. CONDUCT AUTH. (Oct. 23, 2019), <https://www.fca.org.uk/firms/appointed-representatives-principals> [<https://perma.cc/43NX-J8MS>].

217. *Review of Principal Firms in the Investment Management Sector*, FIN. CONDUCT AUTH. (May 20, 2019), <https://www.fca.org.uk/publications/multi-firm-reviews/review-principal-firms-investment-management-sector> [<https://perma.cc/8YWW-445Q>].

sandboxes, fintech charters, and appointed representative regimes.²¹⁸ A mentorship program allows fintech startups to enter the market by making regulatory licenses part of a partnership agreement between market incumbents and fintech firms.²¹⁹ The advantage of this mentorship program is twofold. The fintech firm is allowed to innovate and is within the supervisory scrutiny of the incumbent.²²⁰ Innovation is fostered while systemic risk is mitigated. However, the mentorship program idea is entirely theoretical at this point, and the implementation of the program as a stand-alone solution implicates the jurisdictional difficulties associated with differences in national market structure.²²¹

Regulatory sandboxes and other innovative initiatives each have their drawbacks as stand-alone solutions to implement this Comment's proposed hierarchy. However, these initiatives do not need to be mutually exclusive. Rather, they can all be parts of one uniform whole with an innovative regulatory purpose. An entire fintech ecosystem premised on innovation is needed to truly implement the proposed hierarchy. Luckily, we already have effective examples of innovative fintech ecosystems in the context of OFCs.

B. *Future Local Developments and International Implementation*

Implementation of the proposed hierarchy requires both a local and an international response, with the latter flowing from the former. And both require the use of innovation hubs—a scheme allowing a point of contact for regulated and unregulated fintech firms to engage with regulators and attain direction on the regulatory conformity of various financial products.²²² From a local perspective, efforts from “blockchain haven” OFCs and a conglomeration of the stand-alone efforts mentioned above provide examples of how a local jurisdiction could implement an innovative culture and, in turn, exact the proposed AML regulatory hierarchy. And from an international perspective, GFIN is in the best position to act as a multinational innovation hub and platform for implementation of the proposed AML hierarchy with further efforts geared toward regulatory learning.

An innovation hub differs from stand-alone innovative strategies because it essentially acts as a “portal”—fintech firms can access regulators to discuss innovations, gain guidance navigating regulatory requirements, and seek adjustments in regulation through firm-

218. Enriques & Ringe, *supra* note 30, at 22.

219. *Id.*

220. *Id.* at 23.

221. *See id.* at 27.

222. EUR. SEC. & MKTS. AUTHS., FINTECH: REGULATORY SANDBOXES AND INNOVATION HUBS 7 (2018), https://www.esma.europa.eu/sites/default/files/library/jc_2018_74_joint_report_on_regulatory_sandboxes_and_innovation_hubs.pdf [<https://perma.cc/7AHQ-T632>].

regulator coordination.²²³ Innovation hubs do the real work of promoting and facilitating jurisdictional fintech innovation while stand-alone initiatives, like regulatory sandboxes, are just one tool in the hub's repertoire to attract fintech market attention.²²⁴ The jurisdictions that have been the most successful in innovative efforts have implemented some form of innovation hub, as exemplified by "blockchain haven" OFCs.²²⁵ Jersey's innovation hub is the best example of an easily employable framework because the OFC has managed to promote innovation without specific regulations that apply to virtual assets.²²⁶ Rather, innovative organizations like Digital Jersey have partnered with the local Jersey government to develop strategies that promote innovative regulatory policy.²²⁷ The local government's culture of innovation, competition, and regulatory learning thus spurs the use of initiatives like regulatory sandboxes, fintech charters, etc. to create an innovative ecosystem.

Transposition of this innovation hub framework to the current U.S. regulatory framework should be helpful to elucidate the point of local implementation of the proposed hierarchy. As previously stated, some states have taken efforts to implement a regulatory sandbox, and the U.S. government has launched several initiatives, such as the American Consumer Financial Innovation Network, to promote fintech innovation.²²⁸ A number of U.S. regulatory agencies have also joined GFIN.²²⁹ While these are steps in the right direction, more is needed to genuinely foster innovation. These initiatives send a message of openness to the fintech market, but the facilitation of local regulatory learning is lacking.²³⁰ The United States needs to make regulatory staff available to interact with the fintech industry, assist with guidance to fintech startups navigating regulations, and issue dispensation of regulatory requirements.²³¹ Affirmative partnerships between regulatory agencies and organizations promoting fintech innovation—such as the partnerships in Jersey—are needed to create a true innovation hub. Only then can regulatory agencies truly learn how to accurately mitigate systemic risk and foster the inherently innovative fintech sector. And the same notion goes for any other local jurisdic-

223. See Buckley et al., *supra* note 32, at 58–59.

224. *Id.* at 59.

225. See discussion *supra* Section III.B.

226. See *Regulatory Approaches to Cryptoassets: Jersey*, *supra* note 177, at 143–48 (discussing the lack of specificity of existing regulations as they apply to virtual assets).

227. See discussion *supra* Section III.B.

228. See discussion *supra* Section IV.A.

229. Press Release, SEC, U.S. Financial Regulatory Agencies Join the Global Financial Innovation Network (Oct. 24, 2019), <https://www.sec.gov/news/press-release/2019-221> [<https://perma.cc/M6DV-V3XX>].

230. See Buckley et al., *supra* note 32, at 78.

231. See *id.* at 59.

tion. An innovation hub centered on regulatory learning is the necessary step towards truly innovative legal and regulatory action.

On an international level, GFIN is in the best position as a multinational innovation hub to implement the proposed hierarchy moving forward. GFIN “was created to provide a more efficient way for innovative firms to interact with regulators” through cooperation between financial service regulators working on innovative topics.²³² Along with its cross-border “global sandbox” program, it also has special units dedicated to supervisory technology (“SupTech”), RegTech, and a Regulatory Reporting Special Unit.²³³ The Regulatory Reporting Special Unit has an objective to “share knowledge and learnings to inform regulatory reporting approaches” and “plan future regulatory collaborations.”²³⁴ Jurisdictions that participate in GFIN would be given the tools to navigate AML regulation by learning about compliance and relevant legal frameworks, which would in turn spur innovation. What’s more, GFIN has noted that the next steps include formalizing cross-border testing, creating cross-jurisdictional tests for supervisory technologies that facilitate firm compliance, and supporting emerging regulatory markets with their approach to fintech innovation.²³⁵

While GFIN is barely two years old, this movement towards regulatory learning in an international innovation hub will help regulators develop cross-jurisdictional approaches to fintech innovation. And both developed and developing jurisdictions can also learn from each other to advance fintech regulation and innovation. For example, jurisdictions in Africa and Latin America would benefit greatly from regulatory cooperation with the United States, the United Kingdom, or an OFC.²³⁶ Further efforts by local regulators to support GFIN and similar innovative initiatives will result in implementation of the proposed hierarchy, which will promote consistency, transparency, and cooperation.²³⁷

Fintech innovation is not going away any time soon. We are at a juncture between regulatory complacency and a proactive approach that takes the innovative nature of the fintech sector into account. The promotion of innovation hubs locally and internationally—an imple-

232. *About GFIN*, *supra* note 34.

233. GLOB. FIN. INNOVATION NETWORK, REGTECH & SUPTECH WORKSTREAM UPDATE 4 (2021), https://static1.squarespace.com/static/5db7cdf53d173c0e010e8f68/t/601d7c09cbd7bc3255b685bf/1612545036876/GFIN_RegTech_SupTech_Workstream_Update+++Final.pdf [<https://perma.cc/42TS-7NWB>].

234. *Id.*

235. GLOB. FIN. INNOVATION NETWORK, GFIN – ONE YEAR ON 11 (2019), <https://static1.squarespace.com/static/5db7cdf53d173c0e010e8f68/t/5dbfaaca6b4e151deddc42ae/1572842207667/GFIN-One-year-on-FINAL-20190612+%28CLEAN+VERSION%29.pdf> [<https://perma.cc/CGY2-VAKM>].

236. *See* discussion *supra* Sections II.B.2, III.B.

237. *See* EUR. SEC. & MKTS. AUTH., *supra* note 222, at 5.

mentation of this Comment's proposed AML regulatory hierarchy—is needed to create a pro-innovation ecosystem geared towards future fintech development.

V. CONCLUSION

Fintech is altering the landscape of the financial market. Virtual asset transaction providers and blockchain technology provide a dis-intermediating, decentralized alternative to the traditional bank intermediary. Fintech firms utilizing blockchain are characterized by several features: they are often entrepreneurial in nature; they rely on algorithmic functions; and they can easily adapt in response to external circumstances. And these features present several challenges to regulators: guarding against systemic risk, protecting consumers, and maintaining global financial stability. Further, the negative consequences of these challenges run across borders into jurisdictions with different national market structures. AML regulators need an international solution to deal with an international problem.

The innovation trilemma provides a backdrop to understanding these AML regulations. Regulators are only able to achieve two out of three objectives: market integrity, rules simplicity/clarity, and fostering innovation. These three objectives form a regulatory hierarchy. Current local regulatory frameworks tend to place paramount focus on market integrity and squeeze out innovation. There needs to be an international AML regulatory hierarchy that is premised on innovation yet still provides global market integrity. Risk is at the heart of any financial innovation. Technological progress in the financial industry must be allowed to proceed with proactive safeguards for unanticipated consequences because the fintech sector is inherently innovative. And in the long run, capital markets will function better and underserved populations can gain access to those markets.

International implementation of the Comment's proposed AML regulatory hierarchy requires both a local and global response. Innovation hubs represent the most feasible avenue for implementation. Locally, partnerships between innovative organizations and local governments can promote a policy of innovation. And the innovation hub can employ initiatives such as regulatory sandboxes, fintech charters, appointed representative regimes, and mentorship programs to promote regulatory learning. Globally, GFIN is in the best position to act as an international innovation hub to promote regulatory learning on an inter-jurisdictional level. As fintech innovation continues to grow at a rapid pace, implementation of the proposed hierarchy premised on innovation is imperative for global financial growth and competition.

