

What are KYC and AML, and Why Do They Matter in Crypto?

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Financial service providers such as crypto exchanges and trading platforms face significant pressure to fight illicit activities related to transfers of fiat currencies and digital assets. Enter Know Your Customer (KYC) and Anti-Money Laundering (AML). KYC and AML are regulatory requirements that safeguard customers' information and funds within exchanges, wallets, and service providers.

What is Know Your Customer (KYC)?

When users create an account on any exchange, they need to complete KYC verification. It allows the platform to verify the customer's identity by collecting necessary information like official identification or bank statements.

Following KYC regulations is a proactive measure. Financial service providers take customers' details beforehand to make sure the person is legitimate. Institutions do not allow customers to make financial transactions without meeting KYC requirements. Even if they enable users to create an account without KYC, they do not get full access to all the functions and benefits of the platform.

- Users have to provide their identity documents to complete KYC. Examples of the documents required to complete KYC include a government ID, passport, or driver's license.

Benefits of KYC

Apart from customer identity verification, KYC combats fraudulent practices within the system, which provides several additional benefits:

1. By establishing customers' identity and financial history, lenders can assess their risks, which leads to responsible lending and risk assessment.
2. KYC fights identity theft and other financial frauds
3. As KYC is a proactive measure, it minimizes the risk of money laundering.
4. It increases the trust, security, and accountability of financial service providers.

What is Anti-Money-Laundering (AML)?

AML is a set of regulations designed to prevent the movement and laundering of illegal funds. AML measures target terrorist financing, tax fraud, and international smuggling.

AML is closely associated with the Financial Action Task Force (FATF) to encourage international cooperation. AML regulations differ from country to country, but there is currently a global effort to align the standards.

With the progressive technological developments in the financial sector, methods to launder illegal money have also evolved. The AML software



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recognizes patterns of suspicious behavior to prevent transfer of money for illicit practices such as terrorism.

The system alerts when there is a large transfer of money, repeated inflows of funds into an account, and cross-checks against users on watchlists. AML practices are required for both cryptocurrencies and fiat money transfers. All fund transfers are constantly monitored and subjected to AML & KYC conditions.

How does AML work?

There are three stages of AML regulations:

1. Suspicious money transfers like large inflows and outflows are automatically reported with the help of AML measures. Inconsistent behavior in withdrawals and deposits of money are also monitored.
2. During an investigation, suspicious customers are not allowed to make any financial transactions. The investigator will continue to make a Suspicious Activity Report (SAR)
3. If there is any evidence of illegal activity, it is supplied to the relevant officials. Based on the report, bad actors are liable for appropriate action and the funds will be transferred to the original accounts if they are found stolen.

What is the difference between AML and KYC?

KYC measures are a part of the wider AML measures, and are essential for customer's identity verification. Customers need to submit their personal information and documents to verify their identity. Customers are expected to be accountable for their financial transactions with the help of the KYC procedure.

On the other hand, AML measures help authorities to detect illegal activities. KYC is a proactive precaution before customers are involved in any illegal financial transactions. On the other hand, AML practices are reactive in nature. They suspect unauthorized and illicit activities after the transactions take place.

Why do we need KYC & AML for cryptocurrencies?

The cryptocurrency space is pseudonymous in nature, and is thus more prone to laundering illegal money and tax evasion. Cryptocurrency regulation ensures that taxes are paid in time and the reputation of the crypto industry improves.

Though KYC and AML require time and effort, these measures benefit legitimate crypto users For example:

- If crypto funds are stolen or removed, no admin can help the victims because blockchain transactions are irreversible. KYC and AML help minimize this risk.
- Cryptocurrency offers anonymity or pseudonymity. Customers don't need



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to share their personal details to create a crypto wallet and start trading cryptocurrencies.

- Crypto regulation and taxation are uncertain in most countries. Criminals leverage this opportunity as tax authorities are struggling to bring efficient tax regulations into the crypto space.

Regulation of Cryptocurrency exchanges

Because of the vast compliance pressure on the crypto industry, standard crypto exchanges like Binance have become more vigilant and cautious.

Frequent transaction monitoring and enhanced due diligence are important tools to fight money laundering schemes in the crypto industry.

However, many cryptocurrency enthusiasts value anonymity and decentralization. For many users, regulations and identity verification seem contrary to the crypto ecosystem.

Final Thoughts

While regulating measures take time and effort, they are essential to keep the funds safe. Though it isn't possible to get rid of illegal activities, implementing regulations certainly helps. KYC compliance and AML measures allow customers to trade cryptocurrency with more confidence, security, and trust.

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