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THE VIRTUAL ASSETS ECOSYSTEM IN EL SALVADOR:

Strengthening Financial Integrity and Transparency

Executive Summary



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By Global Financial Integrity and the
Cyrus R. Vance Center for International Justice

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Executive Summary

This executive summary reflects the main findings of the report, *The Virtual Assets Ecosystem in El Salvador: Strengthening Financial Integrity and Transparency* by Global Financial Integrity (GFI) and the Cyrus R. Vance Center for International Justice (Vance Center).

The report examines the development of the virtual asset (VA) ecosystem in El Salvador, first from a legal and regulatory perspective and second from anti-money laundering (AML) and countering the financing of terrorism (CFT) perspective. The report highlights the progress made by El Salvador and the remaining challenges that need to be addressed through an objective and technical analysis of these issues. Moreover, the report aims to help El Salvador in harnessing the benefits of technological and financial innovation while mitigating potential risks.

Introduction

Two years after El Salvador became the first country to accept Bitcoin as legal tender, GFI and the Vance Center published the report, *The Virtual Assets Ecosystem in El Salvador: Strengthening Financial Integrity and Transparency*. This report analyzes potential financial crime risks and red flag indicators related to VAs, offering recommendations to mitigate these risks in keeping with international standards and best practices. Additionally, the report provides information for policymakers and other key stakeholders to make informed decisions when regulating VAs.

In simple terms, this report analyzes two key aspects. First, it looks at the regulatory framework that El Salvador has established with regards to the use of Bitcoin and other cryptocurrencies. Second, it analyzes financial crime risks related to money laundering and terrorism financing in the VA ecosystem and presents recommendations in line with international standards from the Financial Action Task Force (FATF).

Legal and Regulatory Framework

El Salvador has established a regulatory framework that includes the Bitcoin Law, the Digital Assets Issuance Law,¹ and the Innovation and Manufacture of Technologies Promotion Law. These laws aim to provide a supportive environment for individuals and businesses engaging in transactions involving VAs while fostering innovation and technology manufacturing. However, due to the dynamic nature of the subject matter and the ongoing efforts to standardize these frameworks internationally, the report identifies areas that still require regulation.

After a comparative analysis of international best practices, the report identifies areas that require additional attention including cybersecurity, consumer protection, personal data protection, and financial education.

While El Salvador has made significant strides through the Virtual Asset Provider Registry and the Bitcoin Service Provider Registry, in addition to laws concerning Anti-Money Laundering and Anti-Corruption, a number of factors limit the effectiveness of their implementation, the report notes.

In conclusion, El Salvador has made significant progress, but additional efforts are still needed to reduce the risk of fraud, corruption, money laundering, and terrorism financing.

AML/CFT Considerations

To understand the financial crime risks posed by VAs in El Salvador, this report identified the most common underlying, or “predicate”, crimes. According to GFI’s research for this report, the most common predicate offenses for money laundering in El Salvador include migrant smuggling, extortion, contraband, drug trafficking, and misuse of public funds (“*peculado*”). It should be noted that

¹ El Salvador’s legislation uses the term “digital assets.” Other international sources use the term “virtual assets.” For the purposes of this report, the terms can be used interchangeably.

these predicate offenses are not specific or unique to VAs, but are simply the most common predicate offenses for money laundering in the country. In this context, the report analyzes the vulnerabilities and specific risks posed by VAs in the context of each of these underlying crimes.

Internationally, many crimes associated with VAs, drug trafficking, and gangs in recent years have involved the use of crypto ATMs. The report emphasizes the need for robust supervision of these VA ATMs to prevent similar issues from arising in El Salvador.

In addition to the risks identified by underlying crimes, this report analyzes financial crime risks associated with specific operational features of crypto implementation in El Salvador. One of the most concerning risks identified in this report is the minimum requirements imposed on legal entities to open accounts with Chivo Wallet, especially compared to the requirements for legal entities to open accounts with other financial institutions. This creates a significant risk that front or shell companies could abuse the Chivo Wallet.

Government Transparency Aspects

El Salvador has taken various steps to implement the Bitcoin Law, including creation of the Bitcoin Trust and investments by the government in Bitcoin. The report reviewed information available from official sources and analyzed previous studies conducted by national and international institutions, and found that transparency in these procedures has been very limited.

For example, a civil society report regarding Chapter II (“Prevention”) and Chapter V (“Asset Recovery”) of the United Nations Convention Against Corruption in El Salvador found that despite legal mechanisms for individuals to access public information, the Law on Access to Public Information has not been meaningfully implemented and the Institute for Access to Public Information, part of the Executive Branch, has limited access to information itself. Moreover, the report states that “El Salvador does not have a coordinated public or governmental policy focused on preventing corruption.”²

Additionally, responses from governmental authorities raise concerns regarding transparency and access to information. For example, information requested by stakeholders regarding government purchases of Bitcoin, and amounts paid in commissions, was declared by government agencies to be nonexistent. Likewise, information regarding the total value of government purchases or investments in Bitcoin is not publicly or formally available, except for what President Nayib Bukele has published on social media. In this regard, the report recommends that the Central Bank of El Salvador (BCR) add information on public investments in Bitcoin to the Balance of Payments, helping to ensure official, publicly available information on this topic.

2 UNCAC Coalition, New Civil Society Report on El Salvador: Reinstating Independence of Public Institutions and the Judiciary & Reversing Recent Trends of Restricting Civic Space Urgently Needed to Combat Corruption, February 1, 2023, available at <https://uncac-coalition.org/uncacparallereportelsalvador/>.

General Recommendations

The report concludes with a series of recommendations to help El Salvador maximize the benefits associated with financial innovation while minimizing the risks. These recommendations address legal and regulatory matters, operative aspects, and educational needs, as follows:

Legal and Regulatory Recommendations

1. Policymakers in El Salvador should urgently adopt reforms strengthening AML/CFT as well as ensuring robust oversight over VAs. These reforms are particularly important in light of El Salvador's upcoming Mutual Evaluation.
2. The Government of El Salvador, and specifically the BCR and National Commission on Digital Assets, should engage with the legal and business community in developing regulations and technical standards according to need and practice for the Bitcoin Law and Digital Assets Issuance Law, following international best practices.
3. All relevant government agencies should respect and guarantee transparency and access to public information.
4. The Superintendence of the Financial System (SSF) and the BCR, the oversight bodies responsible for the registration of crypto companies in El Salvador, should require information on the management structure of these companies, including their beneficial owners. The SSF and BCR should not allow the registration of any company whose managers, shareholders or beneficial owners have been previously convicted of fraud, money laundering, or terrorism financing. This is standard for the establishment of most financial institutions, such as banks.
5. Any new legislation that is being considered should allow space for consultation with the expert legal community and private sector.

Operative Recommendations

6. The BCR should incorporate information on government Bitcoin investments and assets in the Balance of Payments as part of transparency and accountability measures.
7. The Government of El Salvador should form an inter-agency commission comprised of the Financial Intelligence Unit (FIU), the SSF, the *Oficina de Inclusión y Educación Financiera*, *Oficina Nacional del Bitcoin*, and other relevant stakeholders to discuss and establish the criteria for a legal person to open an account at Chivo Wallet and at a bank, seeking a balance between financial inclusion and security and ensuring greater alignment between Chivo requirements and traditional financial sector requirements.
8. The Chivo Wallet should no longer permit the use of expired identification documents to register or use the wallet.
9. Given El Salvador's long standing issues with gangs, Chivo Wallet compliance staff should compare Chivo user lists to known gang member lists in an effort to prevent criminal groups from using the wallet.
10. Chivo ATMS should implement lower transaction thresholds and additional monitoring for ATMs located in geographic regions that present heightened security risks.

Educational Recommendations

11. Considering that financial institutions and other obligated entities submit suspicious transaction reports (STRs) for crypto transactions, the FIU of El Salvador and other government authorities should provide education and training opportunities to the financial sector and other obligated entities regarding identification of red flag indicators in crypto transactions. This will help to ensure that STRs contain relevant information and reflect an informed understanding of the risks.
12. The government should create programs to develop the capacity of public officials from the three branches of government and other autonomous institutions to understand VAs.
13. Considering the upcoming electoral period, training should be provided to electoral authorities, political parties, elections monitoring organizations, civil society, and citizens as a whole regarding appropriate use of VAs in campaign financing.