

Officially on the Road to Crypto-Asset Regulation

By Seshree Govender, Senior Associate at Webber Wentzel

The recently published Crypto Asset Policy Paper lays out the types of crypto asset service providers that will be subjected to regulatory oversight and how they will be supervised

On 11 June 2021, the Inter-governmental Fintech Working Group (IFWG) published its long-awaited Crypto Asset Policy Paper. It shows the IFWG is officially moving towards regulating crypto-asset services in South Africa and bringing an end to the long-standing "user-beware" crypto asset regulatory position established in 2014.

The South African crypto asset industry will now begin the process of transitioning from its current unregulated landscape to an environment subject to the regulatory purview of the Financial Sector Conduct Authority (FSCA), the South African Reserve Bank (SARB) and the Financial Intelligence Centre (FIC).

The current landscape of crypto asset regulation in South Africa

The South African policy position on crypto asset/currency regulation was first set out in the 2014 position paper on Virtual Currencies issued by the SARB as part of a joint initiative between the SARB, National Treasury, the Financial Services Board, SARS and the FIC. Due to the global lack of regulation and supervision of cryptocurrency at the time, the 2014 policy position did not subject crypto assets to any regulatory oversight. Thus anyone who participated in the crypto asset industry did so at their own risk.

While the South African crypto asset industry has significantly changed and grown since 2014, the regulatory position did not. Due to the prevailing application of the 2014 position, the industry currently operates in a largely unregulated space, governed predominantly by the contractual relationships concluded between its participants.

The road to regulation - unpacking the Crypto Asset Policy Paper

The core purpose of the impending crypto asset regulatory framework is not to regulate the nature of crypto assets or dictate the development of the underlying technology, but to subject the providers of crypto asset-related services to regulatory supervision and oversight. The transition of the South African crypto asset industry to the impending regulatory framework will be driven by two important questions: (i) who is a crypto-asset service provider ("**CASP**"); and how will CASPs be supervised?

Who is a CASP?

The impending crypto asset regulatory environment will only be applicable to crypto asset-related activities that fall within the parameters of a "crypto asset service" as specifically

contemplated in the Crypto Asset Policy Paper. Crypto asset-related activities which do not fall within the ambit of "crypto asset services" will continue to operate in an unregulated environment until determined otherwise by the relevant regulators. The Crypto Asset Policy Paper sets out the types of CASPs that will be subject to regulation. These include trading platforms, intermediaries involved in the buying and selling of crypto assets, the providers of custodial wallets, and the providers of investment funds or derivative options underpinned by crypto assets. However, providers of services such as non-custodial wallets and crypto asset mining will not be subject to regulation.

How will CASPs be supervised?

Entities that are regarded as CASPs will be subject to licensing requirements as well as compliance and reporting obligations under any or all of the following existing regulatory regimes:

- Anti-money laundering regulations (FICA) under the oversight of the Financial Intelligence Centre;
- Exchange control regulations under the oversight of the South African Reserve Bank (financial surveillance department); and
- Financial services regulations under the oversight of the Financial Sector Conduct Authority

A phased approach to regulation

The Crypto Asset Policy Paper constitutes a mandate given by the IFWG to the relevant South African regulators to take the necessary regulatory steps to implement the 25 recommendations set out in the policy paper. A number of recommendations will be implemented with the enactment of the Conduct of Financial Institutions Bill (the impending legislative reform of market conduct regulation in the South African financial services sector). However, certain recommendations are already being implemented, with the following proposed regulatory developments having commenced in 2020:

The proposed amendment to the Financial Centre Intelligence Act (FICA) in terms of which CASPs will be included in the list of accountable institutions, subjecting CASPs to the full weight of FICA regulatory obligations and non-compliance penalties. This will require CASPs to develop and implement a Risk Management and Compliance Programme detailing how they will conduct customer due diligences (KYC), monitor and report transactions and manage their particular anti-money laundering risk exposure.

The draft declaration of crypto assets as a financial product under the Financial Advisory and Intermediary Services Act (FAIS Act): CASPs providing advice on or intermediary

services for the purchase or sale of crypto assets will be regarded as rendering financial services. CASPs will thus need to register as financial service providers (FSPs) in terms of the FAIS Act. The Crypto Asset Policy Paper states that the declaration of crypto assets as financial products is necessary to enable the FSCA to impose urgent consumer protection regulatory measures over CASPs. Subjecting CASPs to the "treating customers fairly" requirements of the FAIS Act is a necessary development to protect consumers against the rampant proliferation of crypto-asset scams. However, subjecting crypto-asset services providers to the same fit and proper requirements and compliance obligations as incumbent FSPs may impose unduly onerous regulatory requirements upon CASPs.

Now the long-awaited roadmap to crypto asset regulation in South Africa has been laid out, current market players in the crypto asset industry should begin developing and implementing appropriate strategies to regularise their business models in line with the impending regulatory framework. They should also actively participate in the stakeholder engagements and commentary processes that will follow the promulgation of the necessary amendments to legislation in order to give effect to the Crypto Asset Policy Paper's recommendations.