IFWG Crypto Assets Regulatory Working Group

Press release

Crypto assets to be brought into South African regulatory purview

11 June 2021

The Intergovernmental Fintech Working Group (IFWG) has today, through the Crypto Assets Regulatory Working Group (CAR WG), published a position paper on crypto assets. The paper confirms that crypto assets will be brought into the South African regulatory purview in a phased and structured manner.

The initial South African public statement on crypto assets[1] was issued by National Treasury in 2014 as a joint initiative with the South African Reserve Bank (SARB), the Financial Services Board (now the Financial Sector Conduct Authority (FSCA)),[2] the South African Revenue Service (SARS) and the Financial Intelligence Centre (FIC).[3] The public statement warned members of the public about the risks associated with the use of crypto assets for the purpose of transacting or investing, and advised users to apply caution in this regard. The cautionary tone was directly linked to the fact that no specific legislation or regulation existed for the use of crypto assets. Therefore, at the time, no legal protection or recourse was being offered to users or investors of crypto assets. The 2014 South African national policy position, namely that crypto assets are largely unregulated in South Africa, and that parties engaging in crypto-related activities do so at their own risk and without any regulatory recourse, has been revised to bring crypto assets into the South African regulatory remit in a phased and structured manner. It is, however, reiterated that with or without regulation, crypto assets remain inherently risky and volatile, and consumers' chances of incurring financial losses through investing in crypto assets remain high.

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[1] At the time the initial statement was issued, the term 'virtual currencies' was used to refer to crypto assets.
[2] On 1 April 2018, the Financial Services Board was replaced by the FSCA as a result of the Twin Peaks reforms. The FSCA is responsible for market conduct supervision.
[3] http://www.treasury.gov.za/comm_media/press/2014/2014091801%20-%20User%20Alert%20Virtual%20currencies.pdf.

The IFWG's CAR WG position paper on crypto assets makes 25 recommendations on how to bring crypto assets into the South African regulatory remit in a phased and structured approach across three main areas:

1. **Anti-money laundering and combating the financing of terrorism (AML/CFT):** The Financial Action Task Force (FATF) has revised Recommendation 15 in respect of new technologies (available here). This revised standard now explicitly requires jurisdictions to regulate crypto assets and crypto asset service providers (CASPs) for AML/CFT purposes.
2. **Cross-border financial flows:** From an exchange control perspective, the current Exchange Control Regulations do not explicitly cater for crypto assets, with the implication that the SARB's Financial Surveillance Department (FinSurv) does not have explicit powers to require South African crypto asset trading platforms to report transactions involving crypto assets. Daily crypto asset trading values in South Africa exceeded R2 billion for the first time in January 2021, providing some anecdotal evidence that there may be significant value moving into crypto assets without FinSurv having oversight over such flows, or the requisite powers to direct market behaviour as appropriate for South Africa.
3. **Application of financial sector laws:** Given the increased retail interest in crypto assets, growing instances of consumer abuse, fraud and market misconduct have been noted both internationally and in South Africa. Recent schemes highlighted in the media further emphasise the need for the South African authorities, predominantly through the FSCA, to take action against the growing tendency for market abuse under the guise of crypto assets.

Crypto asset-related activities are likely to increase, and inaction by the South African financial regulators may potentially accelerate the creation of unregulated parallel systems. This could continue to prevent authorities from having 'line of sight' of crypto asset-related activities and developments. By gradually bringing crypto assets into the South African regulatory purview, the most pertinent and immediate risks that have been identified around AML/CFT, cross-border financial flows and consumer protection will be addressed. The South African regulators will continue to monitor developments and develop mitigating measures as new risks emerge.

It is reiterated that amending the collective South African regulatory stance on crypto assets (i.e. by agreeing that crypto assets can no longer remain outside of the regulatory remit, and by making recommendations for bringing crypto assets into the South African regulatory remit in a phased and structured manner), should not be interpreted as any type of endorsement of crypto assets (whether tacit or explicit) by the government, the South African regulators and/or individual IFWG members. Rather, the decision to formally bring crypto assets within the domestic regulatory remit was driven by a combination of (i) market developments, including strong retail interest in crypto assets and the resultant need to protect consumers to the extent possible; (ii) the growing challenge experienced by regulators to maintain line of sight of crypto asset-related activities in the absence of a regulatory framework and the associated compulsory reporting and information requirements; and (iii) relevant developments and amended requirements imposed by international standard-setting bodies such as the FATF and the Basel Committee on Banking Supervision.

The IFWG therefore reiterates the following:

- The decision to regulate crypto assets as described above does not signal or suggest the endorsement of crypto assets by the government, the South African regulators and/or individual IFWG members. Rather, the decision to regulate crypto assets aims to promote responsible innovation.
- Crypto assets remain highly volatile and inherently risky given their decentralised and disintermediated value proposition (i.e. crypto assets offer a direct, peer-to-peer transactional capability that does not require a financial intermediary, such as a bank).
- Crypto assets' decentralised nature leads to the challenge of decentralised responsibility in the event of something going wrong: because there is no central intermediary, issuer or ledger keeper, consumers essentially have no recourse to any authority or entity to address or resolve user errors (e.g. using the wrong crypto asset address, or sending Bitcoin to an Ethereum address).
- The already high inherent risks associated with crypto assets are further compounded by scam activity, with many Ponzi-type schemes using crypto assets as a lure to justify the excessive promised returns.
- Crypto asset marketing material is often strongly biased towards highlighting only the potential upside of crypto assets, with little or no consideration of the massive potential downside associated with investing in crypto assets.
- The crypto asset ecosystem is evolving at a fairly rapid pace, and developments continue to challenge the applicability of existing legislation and regulations to emerging activities. Consumers are therefore strongly urged to ensure that they fully understand the products and services they are gaining exposure to, as well as the associated risks. Consumers are also urged to ensure that they only deal with registered and regulated CASPs.

The IFWG further articulates the following six high-level principles that will continue to guide the national approach to regulating crypto assets in South Africa:

1. Principle 1: Crypto assets must be regulated appropriately.
2. Principle 2: An activities-based perspective must be maintained, and the principle of ‘same activity, same risk, same regulations’ must continue to apply and inform the regulatory approach.
3. Principle 3: Proportionate regulations that are commensurate with the risks posed must apply (i.e. a risked-based approach to crypto asset regulation must apply).
4. Principle 4: A truly collaborative and joint approach to crypto asset regulation by the IFWG must be maintained.
5. Principle 5: The dynamic development of the crypto market must continue to be proactively monitored, including maintaining knowledge on emerging international best practices (through standard-setting bodies, etc.).
6. Principle 6: Digital literacy and digital financial literacy levels must be increased amongst consumers and potential consumers of crypto assets.

The CAR WG position paper on crypto assets essentially provides a roadmap for putting in place a framework for regulating crypto assets, through the regulation of CASPs, in South Africa. It also serves to initiate the process for the individual financial sector regulators to implement the recommendations contained herein. There is, however, a need to continually refine, amend and make additions to the position paper given the evolutionary nature of the subject matter.