

FINANCE & BANKING ALERT

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CRYPTO ASSETS – REGULATORS PROPOSE A ROBUST REGIME

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Which crypto assets are we dealing with?

The Regulators have chosen to focus on the economic activities that crypto assets can be utilised for, and have accordingly proposed the following definition:

"Crypto assets are digital representations or tokens that are accessed, verified, transacted, and traded electronically by a community of users. Crypto assets are issued electronically by decentralised entities and have no legal tender status, and consequently are not considered as electronic money either. It therefore does not have statutory compensation arrangements. Crypto assets have the ability to be used for payments (exchange of such value) and for investment purposes by crypto asset users. Crypto assets have the ability to function as a medium of exchange, and/or unit of account and/or store of value within a community of crypto asset users."

Which risks are the regulators concerned about?

According to the Regulators, threats that have already materialised, and which therefore require regulatory action, include:

- the lack of consumer protection;
- possible misuse related to money laundering and terrorist financing;

- escape from exchange control regulations;
- illicit financial flows and purchases; and
- tax evasion.

The majority of the Regulators' consultation paper highlights the perceived risks associated with crypto assets, including yet to materialise threats, like the potential for crypto assets to infringe on central banks' historically exclusive right to issue money and control the money supply, which may lead to the monetary policy transmission mechanism becoming less effective.

The challenges of regulating crypto assets

The Regulators rightly point out that one of the reasons that crypto assets are difficult to regulate, is because crypto assets operate on a global level, and do not fit neatly within a specific defined economic function. This means that a unified international regulatory approach is essential. Should each country impose different levels of regulations, then crypto assets will migrate towards jurisdictions that are less stringently regulated, resulting in most countries regulations being ineffective.

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How will the proposed regulations work?

Registration as a licensed crypto asset service provider

The Regulators envisage that their proposals will be implemented through the issuing of policy instruments by the appropriate regulatory body.

The first of these proposals is the registration of “crypto asset service providers” at a central point, the objective of which, according to the Regulators, is to specifically gain further insights from market participants. This registration requirement could serve as the basis for the formal authorisation and designation as a registered/licensed provider for crypto asset services operating in South Africa in the future.

Registration will be required for all entities performing the following crypto asset activities:

1. crypto asset trading platforms (or any other entity facilitating crypto asset transactions) that:
 - provide intermediary services for the buying and selling of crypto assets, including through the use of crypto asset vending machine facilities;
 - trade, convert or exchange fiat currency or other value into crypto assets;
 - trade, convert or exchange crypto assets into fiat currency or other value; and
 - trade, convert or exchange crypto assets into other crypto assets,

2. crypto asset digital wallet providers;
3. crypto asset safe custody providers (ie a platform that safeguards, stores, holds or maintains custody of crypto assets belonging to another party);
4. crypto asset payment service providers (ie all payment services provided when using crypto assets as a medium of exchange); and
5. merchants and service providers accepting payment in crypto assets.

When is registration likely to commence?

It is stated in the consultation paper that the “[t]he details of the registration process will be set out in a policy paper to be published by the SARB in 2019.” The Regulators have indicated that they expect the registration process to be implemented by the first quarter of 2019, however it is unclear at this stage when exactly SARB will publish its policy paper regarding the registration. Given where we already are in 2019, it is unlikely that the registration process will be implemented before the end of the first quarter of 2019.

What about existing financial markets laws?

On the completion of registration, the Regulators will then turn their attention to assess whether crypto asset activities will fit into existing regulatory frameworks, or whether amendments can be made to existing laws and regulations to bring the relevant activity within the supervisory ambit of the Regulators. In situations where it is impractical to amend existing regulations, new regulations will be drafted. This will likely be a lengthy process, involving the necessary (and vitally important) period for public comment.

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The Regulators have in the meantime, recommended that crypto asset service providers be required to comply with the anti-money laundering and combating the financing of terrorism provisions in the Financial Intelligence Centre Act, 2001, and regulations made thereunder (FICA).



No anonymous trading allowed

The Regulators have in the meantime, recommended that crypto asset service providers be required to comply with the anti-money laundering and combating the financing of terrorism provisions in the Financial Intelligence Centre Act, 2001, and regulations made thereunder (FICA). These provisions would require crypto asset service providers to do, among other things, the following:

1. register with the FIC, conduct due diligences of clients, perform ongoing monitoring and file reports on suspicious and unusual transactions, or cash transactions of R25,000 and above;
2. apply a risk-based approach to meet the requirements of FICA, which includes the ability to distinguish between different categories of risk and apply higher levels of due diligence to riskier clients; and

3. ensure compliance with FICA, or face remedial action, which may include administrative sanctions.

Future Monitoring Mechanisms

The Regulators have proposed to monitor:

- the overall market capitalisation of crypto asset;
- the number of merchants/retailers accepting crypto assets as payment both in South Africa and internationally; and
- the volume of crypto assets bought and sold via crypto asset vending machines.

Furthermore, the Regulators propose very careful surveillance of the crypto asset trading platforms by monitoring, amongst other things, the flow of funds from fiat into crypto and vice versa; the services offered; the trading volume of crypto assets; the number of customers; the governance mechanisms and record-keeping of transactions etc.



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There are many unanswered questions around the mechanisms of registration, possible reporting requirements and the regulation of other crypto areas.



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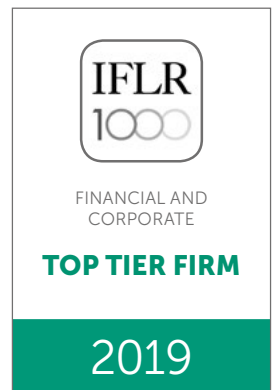
In order for such careful monitoring to take place, the Regulators (or a specific regulatory body), will either need extensive access to each of the trading platforms, or will have to impose trade reporting requirements on all crypto asset trading platforms in the future. How exactly the Regulators plan to monitor the trading platforms remains to be seen.

Imminent deadline for public comments

There are many unanswered questions around the mechanisms of registration, possible reporting requirements and the regulation of other crypto areas. Some of these issues may be clarified in the Regulators' further consultation papers, as well as SARB's registration process policy proposal.

Regarding the pressing issues arising from the current consultation paper, members of the public, and any stakeholders effected by the proposals have until 15 February 2019 to provide comments on the consultation paper (which can be accessed from both the FSCA's and SARB's website and is titled "IFWG Crypto Assets Regulatory Working Group Consultation Paper on Policy Proposals for Crypto Assets"). Comments must be submitted by email to SARBFINTECH@resbank.co.za. These comments will feed into a crypto assets policy paper that will set out the manner in which crypto assets will be managed within the regulatory framework in South Africa. As such, it is important that stakeholders voice their concerns now in order to potentially influence the inevitable outcome of the regulation of crypto assets.

Bridget King and James Peart



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