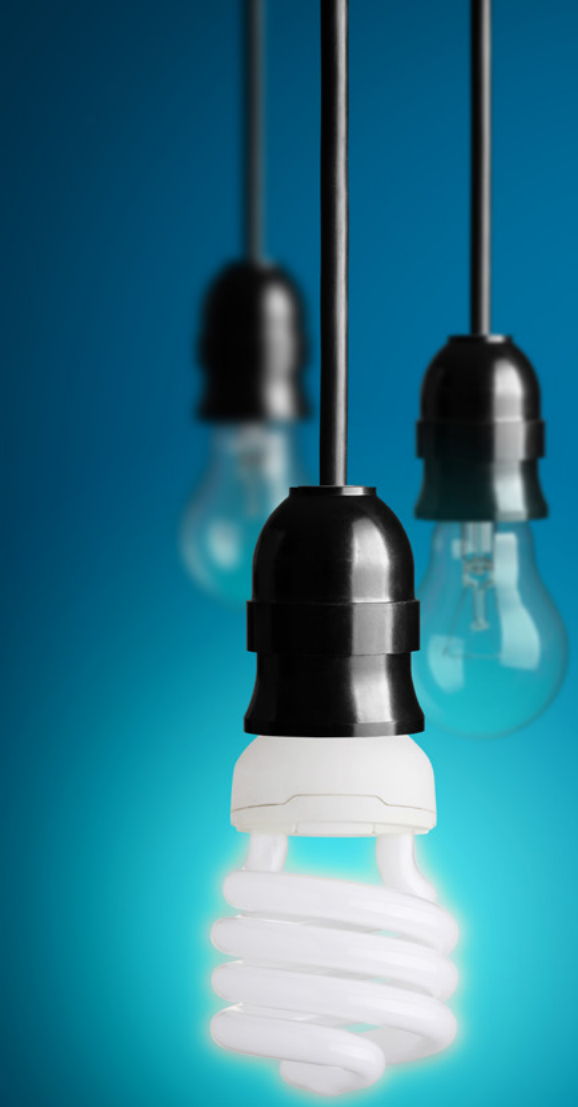

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CORPORATE & COMMERCIAL ALERT

IN THIS **ISSUE**

TOWARDS THE REGULATION OF VIRTUAL CURRENCIES?

The increasing use of crypto-currencies worldwide over the past decade or so has generated a fair bit of interest, not least of which being that of the Financial Action Task Force (FATF). This inter-governmental body comprising over thirty members (including South Africa) sets global standards (Recommendations) aimed at eradicating money laundering and the financing of terrorism (MLFT), amongst others. It does so by enjoining each member to enact legislation that tailors the Recommendations to fit its peculiar domestic circumstances, on pain of economic ostracisation by the other members.

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TOWARDS THE REGULATION OF VIRTUAL CURRENCIES?

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The next milestone was reached in June 2015, when the FATF issued a paper entitled "Guidance for a Risk-Based Approach – Virtual Currencies".

The FATF's sentiments on the rise of crypto-currencies can be characterised as ambivalent: on one hand, it welcomes the financial innovation that has been the impetus behind crypto-currencies, and that has been attended by lower costs and speedier transactions; on the other hand, it has recognised that they are ripe for abuse by perpetrators of MLFT, drug traffickers and other malfeasants, all of whom are drawn to the anonymity offered by this medium of exchange.

A working understanding was a necessary predicate to the FATF's development of effective protocols around crypto-currencies. The date June 2014 was an important one in this regard, as it marked the FATF's publication of a document entitled "*Virtual Currencies: Key Definitions and Potential AML / CFT Risks*". As its title intimates, this document articulates the conceptual framework upon which the working understanding was to be built, and it also sets out the benefits and drawbacks of crypto-currencies in very broad strokes.

Because the framework document lacked binding force, FATF members were at liberty to formulate their own views *vis-à-vis* the regulation of crypto-currencies. South Africa, along with other members, adopted a "study and monitor" approach, coupled with a cautionary warning to consumers that should they transact in crypto-currencies, they do so entirely at their own risk, and will have no recourse should they incur financial losses of any kind. This approach was enunciated in the South African Reserve Bank's (Reserve Bank) "*Position Paper on Virtual Currencies*" of December 2014 (Position Paper). It was informed by the fact that the trading volumes and values in connection with crypto-currencies have not yet achieved critical mass in South Africa, and thus do not warrant their being brought within the ambit of anti-MLFT legislation.

The next milestone was reached in June 2015, when the FATF issued a paper entitled "*Guidance for a Risk-Based Approach – Virtual Currencies*". The purpose of this paper was to illustrate how the Recommendations might be applied to different actors in the crypto-currency domain (such as governmental authorities and regulated financial institutions), and to surface some of the regulatory obstacles that might be encountered in this respect.

Recommendation 15 pertains to new technologies, and it sets out the principles in terms of which members must address

TOWARDS THE REGULATION OF VIRTUAL CURRENCIES?

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technological advancements that impinge on their MLFT risks and on their business practices. In October 2018, Recommendation 15 was amended to include a reference to "*virtual assets*" and "*virtual asset service providers*" (Service Providers). The former are defined as digital representations of value, while the latter are any persons who, *inter alia*, facilitate the exchange of crypto-currencies for currencies that enjoy the status of legal tender and *vice versa*, doing so on a commercial basis. Recommendation 15 as amended now imposes a positive obligation on members to install within their respective jurisdictions anti-MLFT measures that are proportional to the MLFT risks associated with crypto-currencies, and apply these against Service Providers. The FATF has directed its efforts to Service Providers especially because they are commonly a contact point between crypto-currencies and the formal financial system, and as such they pose the biggest MLFT risk.

The significance of the amendment to Recommendation 15 is that those FATF members who had hitherto followed the "study and monitor" approach can no longer do so. The Reserve Bank had concluded its Position Paper by expressly reserving the right to regulate crypto-currencies, thereby shifting from its initial position. In the wake of the amended Recommendation 15, this is now mandatory, as opposed to a policy choice. Precisely how our domestic anti-MLFT machinery (primarily embodied in the Financial Intelligence Centre Act, No 38 of 2001 (FICA)) will be reshaped remains to be seen. If the guidance notes promulgated under FICA in 2017 are anything to go by, South Africa's legislative response to Recommendation 15 will be the product of a multi-agency collaboration between the National Treasury, Reserve Bank, Financial Sector Conduct Authority (successor body to the Financial Services Board) and South African Revenue Service.

One way to regulate Service Providers is to subject them to the rigours of FICA by expanding the list of accountable institutions under schedule 1 thereto. There is a potential coincidence of activity between money remitters (one type of accountable institution) and Service Providers, so it may make sense to incorporate the latter into the former

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expressly. Another way is to require them to hold licences issued by a supervisory or prudential authority. However, FICA duties are not necessarily universally applicable to Service Providers. There are three key difficulties that the authorities must surmount when revising South Africa's anti-MLFT strategy in order to cater for Service Providers:

1. first, many Service Providers operate in communities that are underpinned by anonymity, which is antithetical to foundational anti-MLFT principles such as the admonition against dealing with fictitious clients, as well as the requirement to identify clients and their beneficial owners; and
2. second, the architecture of said communities is often such that it is impossible to link transactions to particular individuals (let alone ascribe responsibility to or even locate them), thus making criminal sanctions all but nugatory; and
3. third, asserting jurisdiction may be problematic where for example a Service Provider, though rendering services in South Africa, has no physical presence here. International co-operation may prove essential.

It will be interesting to see the nature and extent of the revisions to our legislative framework once the new variable, the Service Provider, is introduced into the equation, and how said revisions measure up against those of comparable jurisdictions. One sure thing amidst many uncertainties is that even once Service Providers are formally regulated, the authorities will have to keep a watchful eye on this rapidly evolving industry, adapting their strategies accordingly so as to remain FATF-compliant.

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