

COMPLIANCE

SOUTH AFRICA

Introduction

1. BACKGROUND

In 2016, the Intergovernmental Fintech Working Group (IFWG) was established, comprising members from NT, SARB, FSCA and FIC. The National Credit Regulator (NCR) and SARS joined the IRWG in 2019. The aim of the IFWG is to develop a common understanding among regulators and policymakers of financial technology (fintech) developments as well as the regulatory and policy implications for the financial sector and the economy.

Problem Statements

The need to develop a regulatory and policy response to crypto asset activities in South Africa is driven by the following:

Crypto assets operate within a regulatory void as no globally harmonised approach or position has been reached as yet: Regulators have not yet sufficiently addressed the phenomenon of crypto assets, and have not yet settled on a collective approach to this innovation. From conceptualisation to the definition and potential usage, it remains an area that requires further clarity for regulators.

2. Defining and classifying crypto assets

- 2.1 From a regulatory perspective, having clarity on the term 'crypto assets' is fundamental as it directly influences the term's classification and concomitant regulatory treatment. Various naming conventions have been adopted in just a few years, from 'digital tokens' and 'digital assets' to, most recently, 'crypto tokens' and 'crypto assets'
- 2.2 These tokens can be classified into three types of crypto asset tokens:
 - (i) **Exchange or payment token**
 - (ii) **Security token**
 - (iii) **Utility token**

3. Security Coin Offering (STO)

Security token: These are tokens with characteristics closely associated with security, e.g. debt, equity or derivatives, with an income-generating component and potential rights vis-à-vis the issuer, e.g. in performing governance duties, active participation and/or ownership.

4. Crypto asset funds and derivatives

- 4.1 No defined legal framework for using crypto assets: South African legislation makes provision for the regulation of most investment vehicles, including pooled investment vehicles and most types of exchange-traded funds. Given that crypto assets have not been classified as a specific asset class yet, the existing regulatory provisions do not allow investment vehicles that use crypto assets as the underlying asset

5. Principles for regulating crypto assets

- 5.1 The regulatory response by South Africa to crypto assets should be undertaken in line with the principles stipulated below:
- 5.1.1 **Adopting a risk based approach**
 - 5.1.2 **Adopting a unified regulatory approach**
 - 5.1.3 **Adopting a phased approach**
 - 5.1.4 **Being technology-neutral and primarily principles-based**
 - 5.1.5 **Being resilient and adaptive.**

6. Overall policy position for crypto assets in South Africa

- 6.1 The regulatory authorities acknowledge crypto assets as a new financial innovation and recommend accommodating it within the regulatory framework.
- 6.2 Both general and specific risks have been highlighted that are pertinent in the crypto assets environment.
- 6.3 The policy position considered existing legal and regulatory frameworks as well as regulatory developments under consideration.
- 6.4 Overall recommendations
- 6.4.1 **Recommendation 1:** It is recommended that entities providing crypto asset services be regarded as CASPs.

7.4.1.1 The following entities and activities are classified within CASP functions:

<u>Crypto asset service provider</u>	<u>Services offered</u>
Crypto asset trading platform (or any other entity facilitating or providing the mentioned services)	<ul style="list-style-type: none">● Intermediary services for the buying and selling of crypto assets
Crypto asset vending machine provider	<ul style="list-style-type: none">● Providing intermediary services for the buying and selling of crypto assets
Crypto asset token issuer	These are CASPs conducting token issuances, including: <ul style="list-style-type: none">● ICOs;● the issuance of stablecoins● the issuance of global stablecoins; and● the participation in, and provision of, financial services related to an issuer's offer or sale of crypto assets.

Crypto asset fund or derivative service provider	These are entities offering investment funds
Crypto asset digital wallet provider (custodial wallet)	These entities offer a software program with the ability to store private and public keys that are used to interact with various digital protocols which enable the user to send and receive crypto assets, with the additional ability to monitor balances and execute control over the customers' crypto assets.
Crypto asset safe custody service provider (custodial service)	These entities safeguard, store, hold or maintain custody of crypto assets belonging to another party.

- 6.4.2 **Recommendation 2:** It is recommended that Schedule 1 to the FIC Act be amended by adding CASPs to the list of accountable institutions.
- 6.4.3 **Recommendation 3:** The FIC should assume the supervisory role and duties to ensure compliance by those CASP business entities that would become accountable institutions with the requirements of the FIC Act.
- 6.4.4 **Recommendation 4:** The CAR WG should continue monitoring crypto assets and should define the specific focus of a crypto assets monitoring programme, including the following aspects:
- (i) **monitoring the overall market capitalisation of crypto assets**
 - (ii) **monitoring the number and client base of crypto asset trading platforms**
 - (iii) **monitoring the crypto asset payment service providers and the number of merchants;**
 - (iv) **monitoring the volume of crypto assets**
 - (v) **monitoring the cross-border flows of crypto asset transactions.**
- 6.4.5 **Recommendation 5:** It is recommended that crypto assets remain without legal tender status and not be recognised as electronic money.
- 6.4.6 **Recommendation 6:** The Prudential Authority should consider the appropriate supervisory and regulatory approach for the treatment of crypto assets.
- 6.4.7 **Recommendation 7:** The CAR WG recommends that NT's Tax Policy Unit, alongside SARS.

7. Policy position and recommendation for each crypto asset use case

- 7.1 The buying and/or selling of crypto assets by consumers and legal persons
- 7.2 Payments using crypto assets
- 7.2.1 Policy position
- 8.2.1.1 The ability to make payments using crypto assets is currently not provided

for under the existing regulatory frameworks.

7.2.2 Recommendations

8.2.2.1 **Recommendation 8:** The NPS Act is in the process of being reviewed.

7.3 Initial coin offerings

7.3.1 Policy position

8.3.1.1 **The use of ICOs as a means of raising capital is accommodated within the regulatory framework for start-up firms to raise capital. A regulatory framework would ensure that this alternative means of raising capital takes place within a defined framework.**

7.3.2 Recommendations

8.3.2.1 **Recommendation 9: The CAR WG recommends that the regulation of ICO issuers must be aligned, as far as possible, to the regulation of issuers of securities or 'over-the-counter' financial instruments. It is therefore recommended that security token offerings be subjected to regulation under the securities legislation, as per the Financial Markets Act 19 of 2012.**

7.4 Crypto asset market support services

7.4.1 Policy position

8.4.1.1 A CASP that provides specific services, such as safe custody services or digital wallet provisioning services, is included within the scope of regulatory obligations specified below.

7.4.2 Recommendations

8.4.2.1 **Recommendation 1:** CASPs that provide safe custody and digital wallet services (custodial wallets only) should be required to adhere to AML/CFT requirements and should become accountable institutions, as referred to in the proposed amendment to Schedule 1 to the FIC Act. Also refer to Recommendation 1-3 above.

8. Conclusion and the way forward

- 8.1 This position paper sets out the recommendations for a revised policy and regulatory position on crypto asset activities.
- 8.2 The position paper is a joint initiative by the IFWG and the CAR WG.
- 8.3 The position paper is published by all the regulatory authorities, which includes NT in its role as policymaker.
- 8.4 Stakeholders and interested parties are invited to forward their comments on this position paper to the IFWG at the email address: innovation@ifwg.co.za.