



**STATEMENT IN SUPPORT OF THE DRAFT
DECLARATION OF CRYPTO ASSETS AS A
FINANCIAL PRODUCT UNDER THE
FINANCIAL ADVISORY AND
INTERMEDIARY SERVICES ACT**

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1 PURPOSE OF THE STATEMENT

- 1.1 This statement relates to the publication of the draft Declaration of crypto assets as a financial product (draft Declaration) under the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002) (FAIS Act). The draft Declaration is proposed to be made in terms paragraph (h) of the definition of “financial product” as defined in section 1 of the FAIS Act.
- 1.2 The purpose of this statement is to provide –
- background to and contextualise the reason for the draft Declaration; and
 - an overview of the approach to and contents of the draft Declaration.

2 BACKGROUND

- 2.1 On 8 January 2018 the total global market value of crypto assets peaked at an estimated US\$830 billion, of which approximately 35 percent was attributed to bitcoin. This dropped to US\$210 billion by October that year. It was calculated that the price volatility of the top two crypto assets by market capitalisation over that time was between 6 and 13 times that of the euro, gold and S&P500 US equities index.¹ While the Financial Stability Board at that time concluded that there was little stability risk, the rapidly growing interest by retail investors in this market warrants close monitoring of developments by financial sector regulators and the FSCA in particular.
- 2.2 The regulation of crypto assets has been under consideration by the National Treasury (NT) and relevant authorities for a number of years. In 2004 the National Treasury (NT), as a joint initiative with the South African Reserve Bank (SARB), the Financial Services Board (now the Financial Sector Conduct Authority (FSCA)), the South African Revenue Service (SARS) and the Financial Intelligence Centre (FIC), published an initial public statement on crypto assets.² The public statement was followed by a position paper on virtual currencies that was published in 2014 by the South African Reserve Bank’s National Payment System Department (NPSD).³
- 2.3 In a significant development, the Intergovernmental Fintech Working Group (IFWG) was established in 2016, comprising members from NT, SARB, FSCA and FIC, with the National Credit Regulator (NCR) and SARS joining in 2019, in order 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. Following the establishment of the IFWG, the Crypto Assets Regulatory Working Group (CAR WG) was formed under the auspices of the IFWG.
- 2.4 The main objective of the CAR WG was to formulate a coherent and comprehensive policy stance on crypto assets, while ensuring the continued integrity and efficient functioning of financial markets, maintaining financial stability, protecting the rights and interests of customers and investors, and combating illegitimate cross-border financial flows, money laundering and terrorist financing. Following its establishment, the CAR WG published the following documents:
- a Consultation Paper on Crypto Assets in 2019;⁴ and
 - a Position Paper on Crypto Assets that was published in 2020 (Position Paper).⁵

¹ Financial Stability Board, 2018, “Crypto-asset markets: Potential channels for future financial stability implications,” <https://www.fsb.org/wp-content/uploads/P101018.pdf>

² http://www.treasury.gov.za/comm_media/press/2014/2014091801%20-%20User%20Alert%20Virtual%20currencies.pdf

³ [https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem\(NPS\)/Legal/Documents/Position%20Paper/Virtual%20Currencies%20Position%20Paper%20%20Final_02of2014.pdf](https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem(NPS)/Legal/Documents/Position%20Paper/Virtual%20Currencies%20Position%20Paper%20%20Final_02of2014.pdf)

⁴ http://www.treasury.gov.za/comm_media/press/2019/CAR%20WG%20Consultation%20paper%20on%20crypto%20assets_final.pdf

⁵ http://www.treasury.gov.za/comm_media/press/2020/20200414%20IFWG%20Position%20Paper%20on%20Crypto%20Assets.pdf

- 2.5 The Position Paper was the culmination of the CAR WG's work focussing on crypto assets. The Position Paper sets out in detail the problem statements that informed its work and recommendations and the risks related to crypto assets. The Position Paper also highlights the challenges in regulating crypto assets and, importantly, makes various policy recommendations relating to the regulation of the crypto assets environment. Various of these policy recommendations directly impact the FSCA and are under consideration. The draft Declaration, however, is intended to give effect to two particular recommendations, i.e.:
- *Recommendation 9* which provides that the specified services rendered in respect of crypto assets⁶ must be included in the definition of 'financial services' in section 3(1)(a) of the Financial Sector Regulation Act 9 of 2017 (FSR Act), and also that 'services related to the buying and selling of crypto assets must be included in the licensing activities under the Conduct of Financial Institutions (COFI) Bill.
 - *Recommendation 10* which provides that, pursuant to Recommendation 9, the FSCA should become the responsible authority for the licensing of 'services related to the buying and selling of crypto assets. Furthermore, specific conduct standards should be developed for these services.
- 2.6 It might be noted that because the Position Paper goes to great lengths in formulating the problem statements, highlighting the risks of crypto assets, and contextualising the recommendations, this Statement does not again interrogate or explore the background or reasons behind Recommendations 9 and 10, but rather just explains how the FSCA will give effect to these Recommendations.
- 2.7 The increased risk of harm to consumers purchasing/ investing in crypto assets coupled with the exponential increase in the provision and use of crypto assets in South Africa has given further urgency to the need to start regulating the selling or intermediating of crypto assets in South Africa, and giving effect to the above recommendations.⁷
- 2.8 The full extent to which consumers are exposed to crypto assets and the full breadth of crypto asset related activities being conducted in South Africa is, however, unclear as crypto assets are currently unregulated in South Africa and no regulatory data is being collected by the relevant authorities. This compounds the regulatory challenge.

3 RATIONALE, PURPOSE AND EFFECT OF DRAFT DECLARATION

- 3.1 Paragraph (h) of the definition of "financial product" as defined in section 1 of the FAIS Act provides that a financial product includes "any other product similar in nature to any financial product referred to in paragraphs (a) to (g), inclusive, declared by the FSCA by notice in the *Gazette* to be a financial product for the purposes of this Act".
- 3.2 The FSCA is of the view that crypto assets are similar in nature to some of the other financial products as defined. Different virtual assets have different features, behaviors and uses. While some behave as a commodity or a form of payment, others behave more akin to a security and/or foreign currency denominated investment instruments.

⁶ As specified in paragraph 9.1.1 of the Position Paper.

⁷ There are reportedly 12 crypto asset platform operating in South Africa as of 2019. The largest three platforms are estimated to have 800 000 registered South Africans, control 80-90 percent of the market and hold R6,5 billion assets. Whilst consumers are at risk of exposure to a poorly understood and volatile asset class, the FSCA is also observing increasing cases of fraud, misrepresentation and mis-selling (Fintech Scoping in South Africa, 2019, conducted by World Bank, Genesis Analytics and IFWG, <https://www.ifwg.co.za/reports/>).

- 3.4 It is acknowledged that crypto assets are not exactly the same as securities or foreign currency denominated investment instruments due to the digital nature of crypto assets, but material similarities exist as envisaged by the legislated intent of paragraph (h).
- 3.5 Recommendation 9 proposed that crypto assets must be designated as a financial service in terms of the FSR Act. The FSCA is, however, of the view that as an interim solution to address some of the immediate consumer risks, a similar outcome can be achieved in a more expeditious manner by declaring crypto assets as a financial product under the FAIS Act. The draft Declaration therefore proposes to declare, in terms paragraph (h) of the definition of “financial product” as defined in section 1 of the FAIS Act, crypto assets as a financial product for purposes of the FAIS Act.
- 3.6 The effect of declaring crypto assets as a financial product under the FAIS Act is that –
- any person furnishing advice or rendering intermediary services in relation to crypto assets must be authorised under the FAIS Act as a financial services provider (FSP); and
 - any person so authorised, including its representatives, must comply with the relevant FAIS requirements, e.g. the requirements of the General Code of Conduct for Authorised Financial Services Providers and Representatives, 2003 (General Code), the the Determination of Fit and Proper Requirements, 2017 (F&P Requirements), etc.
- 3.7 In the context of the broader developments surrounding crypto assets the proposed Declaration is intentionally limited in scope as to only capture advice and intermediary services in respect of crypto assets. It will not cover the full scope of potential CASP activities; this will follow the comprehensive and holistic approach set out in the Position Paper. This process however is likely to require some time as it deals with the full set of identified activities. The intention behind the Declaration is to immediately capture intermediaries that advise on or sell crypto assets to consumers so as to provide adequate protection for consumers that are advised to purchase these products. These protections should at least result in improved disclosures to customers that more effectively highlight the risks involved in investing in crypto assets and should ensure that a more robust advice process is adopted (including proper risk assessments) when intermediaries decide to advise customers to purchase crypto assets. Licensing of intermediaries is also necessary to improve the quality of data for policymakers and regulators about the crypto asset environment, and to consider whether there is a need for further regulatory interventions.
- 3.8 The FSCA views this as a critical and urgent interim step in protecting customers in the crypto assets environment as broader policy developments surrounding crypto assets progress and unfold.

4 BROADER POLICY DEVELOPMENTS

- 4.1 As explained, the Declaration will only give partial and limited effect to some of the recommendations contained in the Position Paper. Discussions and considerations regarding the regulation of the broader scope of CASP activities are ongoing through forums such as the CAR WG. The outcomes of these discussions will inform future policy interventions to be implemented across a variety of regulators and laws.
- 4.2 One specific area currently under consideration includes CASP activities in the context of exchange control regulations as this could have a knock-on effect on how CAPS activities are treated in other financial sector laws as the broader work unfolds. It must also be noted that the Declaration in no way impacts the status of crypto assets in the context of exchange control regulations. Put differently, the extent to which the exchange control regulations prohibit or regulate crypto assets will still apply notwithstanding the Declaration. The exchange control regulations must therefore be interpreted and applied separately and distinctly from

the FAIS Act framework. The same approach will also apply to specific regulations like Regulation 28 under the Pension Funds Act, 1956.

- 4.3 In addition, it is trite that many consumers are already purchasing crypto assets, and in future many new consumers will do so. Such activities are amplified by intermediaries that sell and or advise customers to purchase or invest in crypto assets. The Declaration in no way legitimises or gives credence to crypto assets, but is merely attempting to regulate intermediaries that are selling and advising customers to invest in crypto assets. It is envisaged that this will either result in customers making more informed decisions when purchasing crypto assets or potentially in a decline in intermediaries attempting to advise on and/or sell crypto assets. It will also reduce instances of fraudulent activity where players purport to be selling investments in crypto assets but are in reality absconding with customer funds.
- 4.4 Broader developments surrounding crypto assets, and in particular CASP activities, will likely be given effect through the COFI Bill which will constitute the future consolidated legal framework governing the conduct of financial institutions. The COFI Bill adopts an activity-based approach to licensing and it is probable that a variety of CASP activities will be reasonably captured under the COFI Bill as licensed activities. It is also proposed that the COFI Bill will repeal the FAIS Act, meaning that the Declaration, if made, will ultimately be collapsed into the COFI Bill framework. Put differently, the COFI Bill will as part of its activity-based approach capture advice and a variety of intermediary type services in relation to crypto assets as licensing activities.
- 4.5 It is therefore the FSCA's view that the Declaration is not pre-empting the outcome of the broader policy developments surrounding crypto assets, but rather complements such developments by facilitating gradual implementation of some of the existing proposals.

5 SCOPE OF DECLARATION

- 5.1 One particular consideration in formulating the Declaration related to setting the scope of what should be captured in the Declaration, i.e. how to define crypto assets for purposes of the Declaration.
- 5.2 In this regard, Recommendation 2 of the Position Paper recommended that CASP's should be accountable institutions in terms of the Financial Intelligence Centre Act, 2001 (FICA). It follows that crypto assets would therefore also have to be defined in the FICA framework.
- 5.3 The Financial Intelligence Centre (FIC), in conjunction with the relevant supervisory bodies listed in Schedule 2 of FIC Act,⁸ is also responsible for supervising the FICA framework. In addition, South Africa is a member of the Financial Action Task Force (FATF) and must adhere to the FATF Recommendations. In recent developments, FATF amended the FATF Recommendations to include a definition of "virtual asset" in the glossary of the FATF Recommendations.⁹
- 5.4 The FSCA is of the view that, in the aforementioned context, it is sensible to define crypto assets in the Declaration in line with the definition of virtual assets contained in the FATF Recommendations.¹⁰ As such, the definition of crypto assets in the Declaration is therefore largely based on the definition of virtual asset contained in the FATF Recommendations.

⁸ Which includes the FSCA.

⁹ <https://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

¹⁰ The FATF Recommendations defines virtual asset as follows: *A virtual asset is a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat currencies, securities and other financial assets that are already covered elsewhere in the FATF Recommendations.*

- 5.5 Notwithstanding, comment is specifically requested on the scope of the proposed definition of crypto assets. In particular, any insights into potential unintended consequences of the definitions are welcomed as this will assist the FSCA in further refining the definition and to ensure that the definition is fit for purpose.

6 CONDUCT REGULATORY FRAMEWORK FOR ADVICE AND INTERMEDIARY SERVICES IN RELATION TO CRYPTO ASSETS

- 6.1 As explained above, declaring crypto assets as a financial service means that any person that provides advice and/or intermediary services in relation to crypto assets must be licensed under the FAIS Act. It also means that such person must comply with all of the requirements under the FAIS Act.
- 6.2 In acknowledging the inherent types of risk brought about by crypto assets, and the fact that there are some differences between crypto assets and other financial products, the FSCA is in the process of considering whether the requirements contained the General Code and F&P Requirements are, in all respects, appropriate in the context of crypto assets. To the extent that specific requirements are found to be inappropriate in the context of crypto assets, a general exemption from these requirements might be issued. The FSCA is also considering to what extent it is necessary to develop a specific code of conduct in the context of crypto assets.
- 6.3 Further communication regarding the proposed framework for regulating crypto assets under the FAIS Act, whether this will entail a separate code of conduct or a combination of leveraging on existing legislation and issuing exemptions, will follow in due course.

7 TRANSITIONAL ARRANGEMENTS

- 7.1 The FSCA acknowledges the impact that the draft Declaration will have on businesses that are currently furnishing financial services in relation to crypto assets, and more specifically the fact that such business would not be able to operate legally unless they have obtained a FSP licence in terms of section 8 of the FAIS Act.
- 7.2 For this reason the draft Declaration proposes certain transitional arrangements for businesses that furnish financial services in relation to crypto assets immediately before the publication of the final Declaration. The transitional arrangements entail that such a business may continue its operations, but it must submit an application for authorisation as an FSP under section 8 of the Act within 4 months of the effective date of the final Declaration. The business will be allowed to continue its operations until its application for a licence has been granted or declined. If such business fails to submit an application within 4 months, it must cease its operations.
- 7.3 Any new business that wants to start furnishing financial services in relation to crypto assets after the effective date of the final Declaration will have to obtain an FSP licence before it can start furnishing such services.

8 WAY FORWARD AND ENQUIRIES

- 8.1 This Statement as well as the draft Declaration inviting comments is available on the FSCA's website at www.fsca.co.za.
- 8.2 Submissions on the draft Declaration must be made in writing on or before **28 January 2021** to the FSCA at FSCA.RFDStandards@fsca.co.za, using the submission template available on the FSCA's website.

- 8.3 After consideration of all submissions received on the draft Declaration, the FSCA will make a decision regarding the publication of the final Declaration in the *Government Gazette* as required in terms of paragraph (h) of the definition of a financial product in the FAIS Act.¹¹
- 8.4 For any enquiries regarding this Statement or the draft Declaration please contact the Regulatory Framework Department of the FSCA at eugene.dutoit@fsc.co.za.

¹¹ Assuming the comments received do not justify another round of public consultation or a complete reconsideration of the policy position informing the draft Declaration.