

FSCA takes first steps in the regulation of crypto assets

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On 20 November 2020, the FSCA issued a draft Declaration of crypto assets as a financial product (draft Declaration) under the Financial Advisory and Intermediary Services Act, 2002 (FAIS Act).



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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, which 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*”. The FSCA has taken the view that crypto assets are similar in nature to some of the other financial products as defined under the FAIS Act, and the draft Declaration therefore proposes to declare, in terms paragraph (h) of the definition of “financial product”, crypto assets as a financial product for purposes of the FAIS Act.

Background

The draft Declaration is the result of lengthy consideration on how best to regulate crypto assets by the National Treasury, the SA Reserve Bank, the FSCA, and the Financial Intelligence Centre each in their individual capacities, and also as members of the Intergovernmental Fintech Working Group and the subsequently established Crypto Assets Regulatory Working Group, the (Car WG). In its 2019 Consultation Paper on Crypto Assets, the Car WG highlights the challenges in regulating crypto assets and also makes various policy recommendations relating to the regulation of the crypto assets environment. The draft Declaration is intended to give effect to two particular recommendations, ie:

1. Recommendation 9, which provides that the specified services rendered in respect of crypto assets must be included in the definition of ‘financial services’ in section 3(1)(a) of the Financial Sector Regulation Act, 2017, 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 Bill. 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.

2. 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', and should develop specific conduct standards for these services.

Effect of the draft Declaration

3. The effect of declaring crypto assets as a financial product under the FAIS Act is that –
 1. 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 as such, must comply with all the requirements under the FAIS Act; and
 2. any person so authorised, including its representatives, must comply with the relevant FAIS requirements, eg. the requirements of the General Code of Conduct for Authorised Financial Services Providers and Representatives, 2003 (General Code), the Determination of Fit and Proper Requirements, 2017 (F&P Requirements).
4. Once registered as a FSP, a crypto asset service provider (CASP) may in turn become subject to the requirement to register as an accountable institution in keeping with the requirements of Schedule 1 of the Financial Intelligence Centre Act, 2001. As an accountable institution, a CASP will need to comply with various anti-money laundering requirements, including the identification and verification of clients and the reporting of suspicious transactions.
5. Further communication regarding the proposed framework for regulating crypto assets under the FAIS Act, will follow. This may entail a separate code of conduct for crypto assets or a combination of leveraging on existing legislation and issuing exemptions, for example, a general exemption from the requirements contained in the General Code and F&P Requirements, to the extent that these are found to be inappropriate in the context of crypto assets.
6. Existing CASPs may continue their operations, but must submit an application for authorisation as an FSP under section 8 of the FAIS Act within four 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 four months, it must cease its operations.
7. 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.

Caveat

8. In the context of the broader developments surrounding crypto assets, the draft Declaration is intentionally limited in scope as to only capture advice and intermediary services in respect of crypto assets.

9. The draft Declaration will not cover the full scope of potential CASP activities. Broader developments surrounding crypto assets 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 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. 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.
10. The extent to which the exchange control regulations prohibit or regulate crypto assets will still apply notwithstanding the draft Declaration. South African residents must continue to ensure compliance to applicable exchange control requirements, notwithstanding any licensing of CASP activities.
11. The Declaration in no way legitimises or gives credence to crypto assets.

Call for comment

The FSCA has stated that particular consideration was given how to define crypto assets for purposes of the draft Declaration. While the draft Declaration relies on the definition of virtual asset contained as in the FATF Recommendations, the FSCA has specifically requested comment on the scope of the proposed definition of crypto assets, as well as any insights into potential unintended consequences.

Submissions on the draft Declaration must be made in writing on or before 28 January 2021 to the FSCA at FSCA.RFDStandards@fsc.co.za using the submission template available on the FSCA's website.

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