

Select Committee on Finance

A guide to understanding major cryptocurrency issues & a regulatory framework

National Treasury | 25 May 2021



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Agenda

1. Setting the Scene

- a) Fintech Definition & SA Fintech Landscape
- b) IFWG Innovation Hub

2. Crypto Assets

- a) Definition and Use Cases
- b) SA Landscape Regulation
- c) SA Crypto Assets Journey

3. Annexure

- a) Tax treatment
- b) Anti-Money Laundering
- c) Financial Surveillance
- d) Domestic payments

Setting the Scene

Fintech Definition

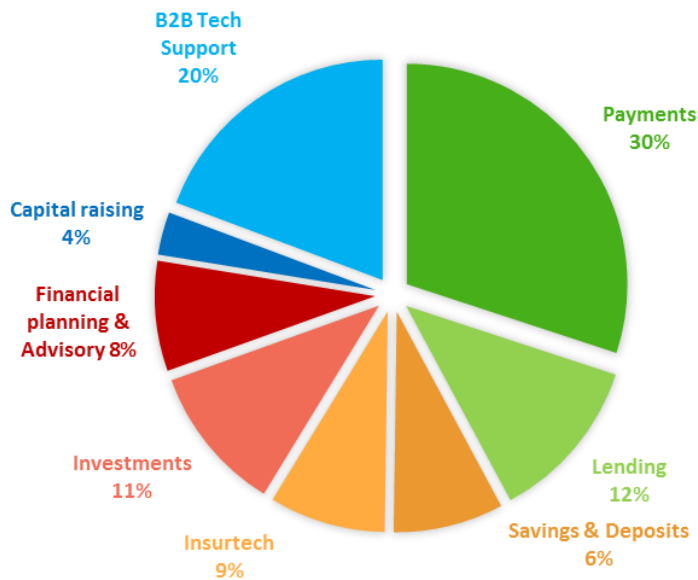
Technologically enabled financial innovation that can result in **new business models, applications, processes, products or services** with an associated material effect on financial markets & institutions and the provision of financial services

As defined fintech encompasses a wide range of innovations & there are considerable differences among them – **incl Crypto Assets**

SA Fintech Landscape

Fintech activity in SA has been on the rise. Study of the market uncovered 220 Fintechs. This number is expected to grow as technology adoption increases.

Distribution of Fintechs, by Sub-industry segment



- The results of SA Fintech sector deep dive revealed a total of **222 active operational fintech companies** in South Africa (in 2019). The fintechs identified in the study were mostly founded in the last 11 years, were not born out of the corporate structures of any incumbent financial services provider, and currently have a physical presence to serve a South African clientele.
- **Payments is the largest and most mature segment is the payments making up 30% of overall Fintech activity in SA.** This is mostly due to the large need for migrant workers in the country to send money to their countries of origin in Southern and other parts of Sub-Saharan Africa. The second largest segment is **B2B Tech (AI, Blockchain, RPA) making up 48% of fintech sector.**
- **Most fintechs in SA offer services already provided by traditional financial services, but in a cheaper and faster manner, while also looking to serve low income and underbanked customers** – whereas traditional financial services tend to focus on middle income and high net worth individuals

SOURCE: Genesis Analytics, World Bank SA Fintech Report 2019

Examples – Key Fintech Players



Lulalend



Pineapple

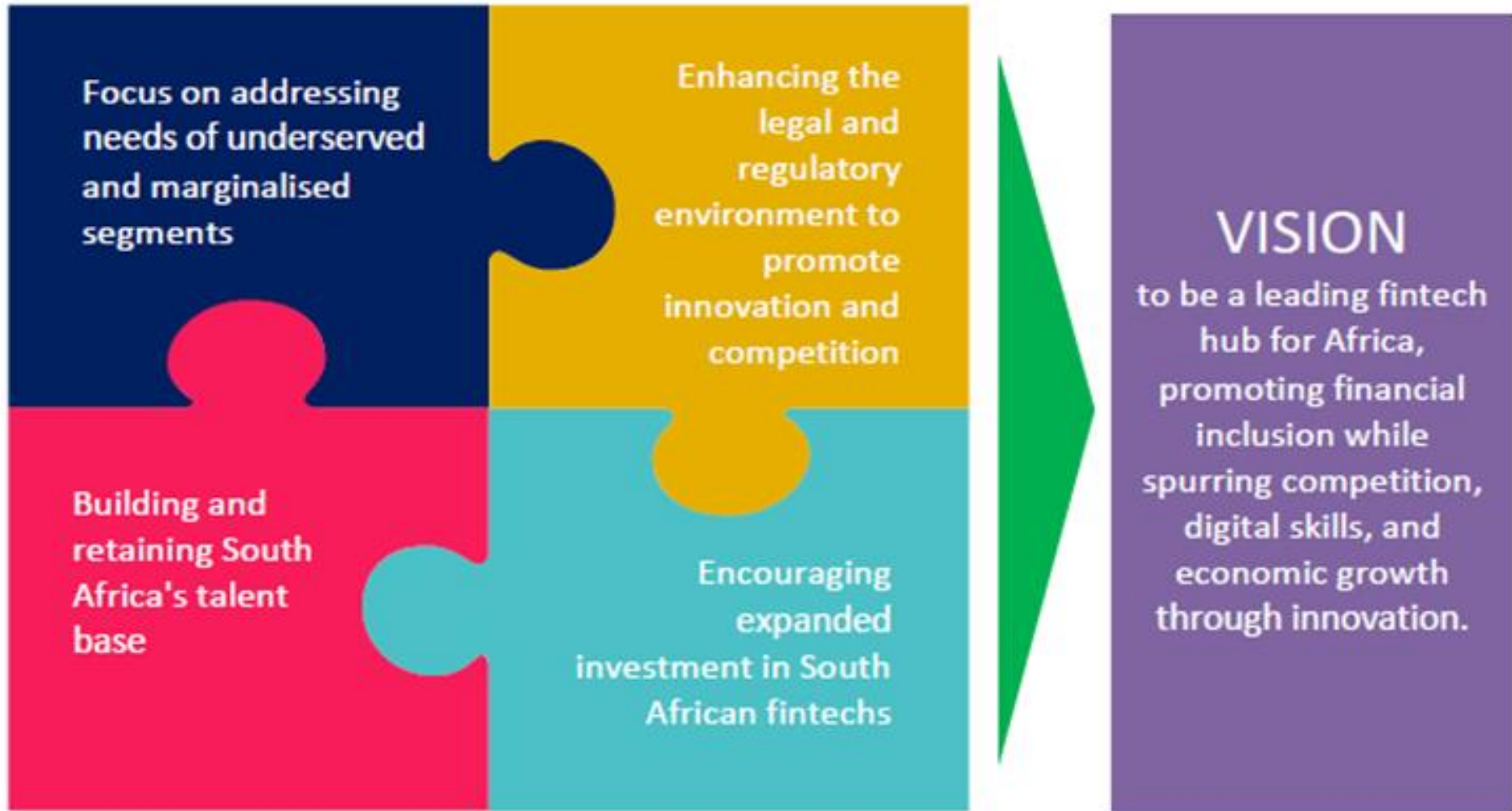


Intergovernmental Fintech Working Group

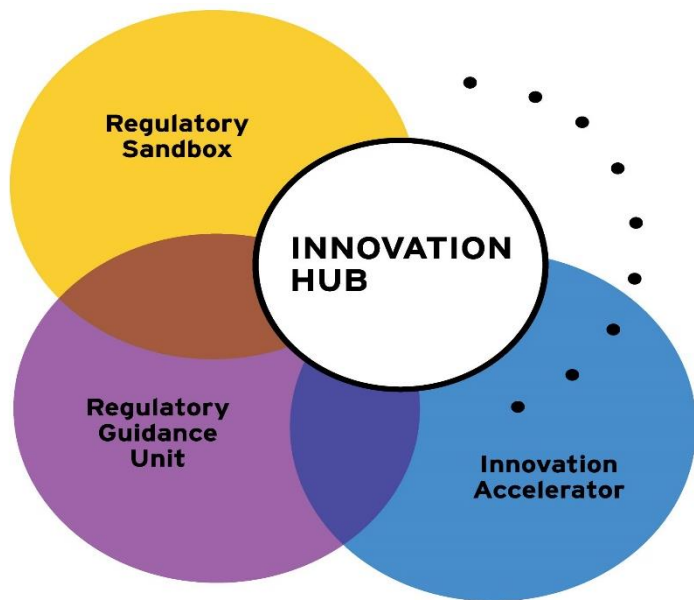
- The Intergovernmental Fintech Working Group (IFWG) **was established in 2016** between:
 - Financial Intelligence Centre (FIC)
 - Financial Sector Conduct Authority (FSCA)
 - National Treasury (NT); and
 - South African Reserve Bank (SARB).
- Has **grown since then** and now includes the National Credit Regulator (NCR) South African Revenue Services (SARS) and the Competition Commission (CC), with other members under consideration.



SA Fintech Vision



Innovation Hub: The Three Facilitators



The **Regulatory Sandbox** is a controlled environment that offers regulatory relief to test innovative products and services within predefined parameters and timeframes.

The **Regulatory Guidance Unit** provides informal, non-binding steers to entities requesting assistance and clarity in navigating any aspect of the financial services regulatory landscape.

The **Innovation Accelerator** drives both internally-oriented and market-facing innovation initiatives with the potential to deliver benefits across the regulatory and broader financial services landscape.

Innovation Accelerator: Priority Projects

There are 8 prioritized initiatives for the accelerator



Financial Markets
Innovation



Crypto Assets



Bigtech in Fintech



Regtech and Suptech



Fintech landscaping
database



Digital platforms



Non-traditional Data



Open Banking

Crypto Assets

Definition of Crypto Asset

“Digital representation of value that is not issued by a central bank, but traded, transferred or stored electronically by natural or legal persons used for the purpose of payment, investment, or other form of utility for the user”

Key Financial Activities



Investments



Capital Raising

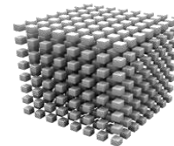


Payments



Trading

Enabling Technology



Blockchain/ Distributed
Ledger Technology

A blockchain is a decentralized, distributed, & oftentimes public, digital ledger that is used to record transactions across many computers so that the record cannot be altered retroactively



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Definition of Crypto Asset

Why 'crypto asset' & not 'cryptocurrency'?: Currency = money = legal tender = banknotes & coin issued by the SARB;

crypto assets thus far largely failed in its ambition to be a widely used payment instrument

CBDC vs Stablecoins

- **Central Bank Digital Currency (CBDC)** – A country's official currency in digital format /Digital currency issued by a central bank/Digital Banknote (*According to the BIS, 2021 - 86% of central banks actively researching the potential for CBDCs, 60% experimenting with the technology & 14% deploying pilot projects*)
- China expected to be the 1st major economy to launch CBDC, European Central Bank also considering a digital euro
- **Stablecoin:** a crypto asset designed to maintain a relatively stable value (e.g. Libra) further work required but provisionally included under crypto assets











For purposes of this presentation: crypto asset = non-government or non-central-bank-issued or backed.

Challenge - Narrowly Defining Crypto Assets

Crypto assets defy narrow definition because they:

- Perform different functions depending on their design and/or use;
- Cut across historically clearly segregated areas such as payments, investment, capital raising, securities and cross-border remittances;
- Continue to evolve & adding use cases (e.g. decentralised finance applications, non-fungible tokens, stablecoins, crypto lending/borrowing)

Top 10 Crypto Asset (coins) by Market Cap

Rank	Name	Symbol	Market Cap	Price
1	 Bitcoin	BTC	\$1,093,623,387,790	\$58,616.77
2	 Ethereum	ETH	\$209,612,160,890	\$1,821.15
3	 Cardano	ADA	\$46,372,085,534	\$1.45
4	 Binance Coin	BNB	\$42,384,959,788	\$274.28
5	 Tether	USDT	\$38,902,231,667	\$1.00
6	 Polkadot	DOT	\$33,627,280,049	\$36.51
7	 XRP	XRP	\$21,524,629,713	\$0.4741
8	 Uniswap	UNI	\$16,156,696,617	\$30.96
9	 Litecoin	LTC	\$13,685,869,361	\$205.25
10	 Chainlink	LINK	\$12,436,666,154	\$30.11

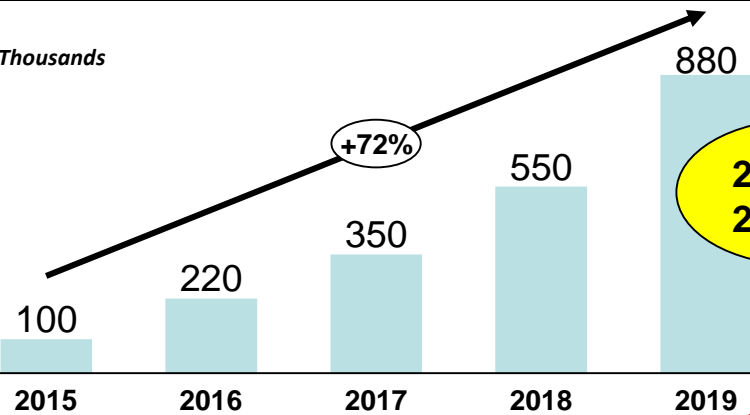
South African Crypto Assets Landscape & Regulation

Crypto Assets have grown rapidly over the years in SA

12 crypto asset trading platforms (exchanges)
(Luno, Altcoin Trader, VALR, Bitcoin.Com.)

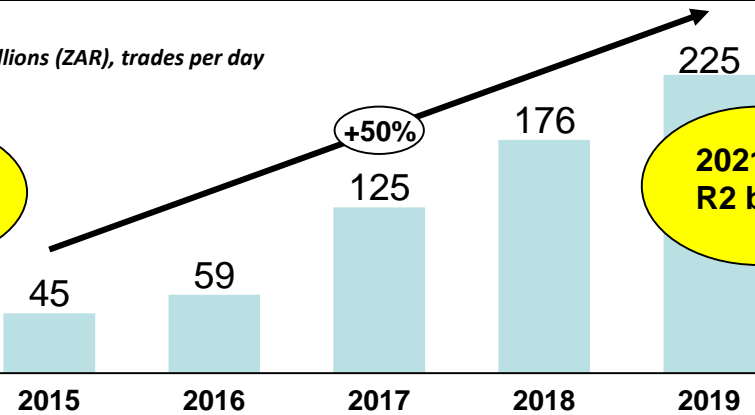
There has been significant growth in users...

**Thousands*



... and also growth in transaction volumes

**Millions (ZAR), trades per day*



Crypto Assets have become too big to ignore and pose a number **of** risks for consumers if not sufficiently regulated (licensed, supervised, and enforced)

Interesting Headlines

CRYPTOCURRENCES

South Africa's MTI was world's biggest crypto scam in 2020

By CIARAN RYAN - 16 February 2021 No Comments



Mpho Dagada
MR BITCOIN
How I became a millionaire at 21

Takealot now accepts Bitcoin

Staff Writer 18 July 2014



Facebook Twitter WhatsApp Email LinkedIn Your email address

Takealot.com has announced that customers can now use Bitcoin to shop on its site.

PayPal: Customers can now buy and sell Bitcoin

PayPal will now facilitate transactions in Bitcoin.

by Ebrahim Essa - 22-10-2020 13:05 In Crypto



Garden Route residents lose millions to cryptocurrency scam



Published by Anita Froneman on January 23, 2021

19 Sep 2017

Pick n Pay successfully trials Bitcoin as payment

fin24 Kyle Venkess, Fin24

SHARE

Cape Town - Pick n Pay, one of South Africa's largest retailers, has successfully trialed letting customers pay for groceries using the cryptocurrency Bitcoin.

Amazon backed platform to offer Bitcoin trading services in Africa

By REYNALDO - 23 November 2020

- Chipper Cash receives \$30 million funding supported by Amazon founder to expand trading services with Bitcoin.
- After completing Beta phase, BTC purchase feature is available in Chipper Cash application for all users.



Approaches to Crypto Asset Regulation

Essentially 3 approaches available in theory to the South African regulators:

- 1) **Complete ban** (not advised as it drives activities under-ground – FATF);
- 2) **Do nothing** (i.e. continue with the current stance of not having crypto asset-specific regulation – not feasible as FATF membership obliges South Africa to regulatory crypto asset service providers for AML/CFT; similar imperatives from a consumer protection perspective by the FSCA; potential for exchange control circumvention); or

3) Regulate

Bottom line – SA has no choice but to regulate Crypto Assets related activities


Jurisdictions have taken diverging approaches to CA Regulations

SA to take a facilitative, test and learn, approach to regulating crypto assets




Restrictive

China	
India	
Morocco	
Thailand	
United Arab Emirates	




Facilitative

Australia	
United Kingdom	
Singapore	
Japan	



Accommodating

Netherlands	
Switzerland	
Malta	

Country Stances on Crypto Asset regulation

- **China:** banned crypto assets - May 2021 for payments – does not recognize CA as legal tender & banking system does not accept CA or provide any services
- **India:** Banned for payments; instructed banks not to provide services to CASPs– decision challenged successfully in High Court
- **UK:** Keep an open mind but not an open door (6 Jan 2021 FCA banned the sale of all crypto assets derivatives to retail consumers in the UK)

USA - Federal Reserve Chairman – Jerome Powell (March, 2021)

“its more a speculative asset. Its essentially a substitute for gold rather than the dollar.....the public needs to understand the risks. The principal thing is there’s the volatility..... & the fact that they are not backed by anything

The Difficulty in Regulation

Domestic legal definitions

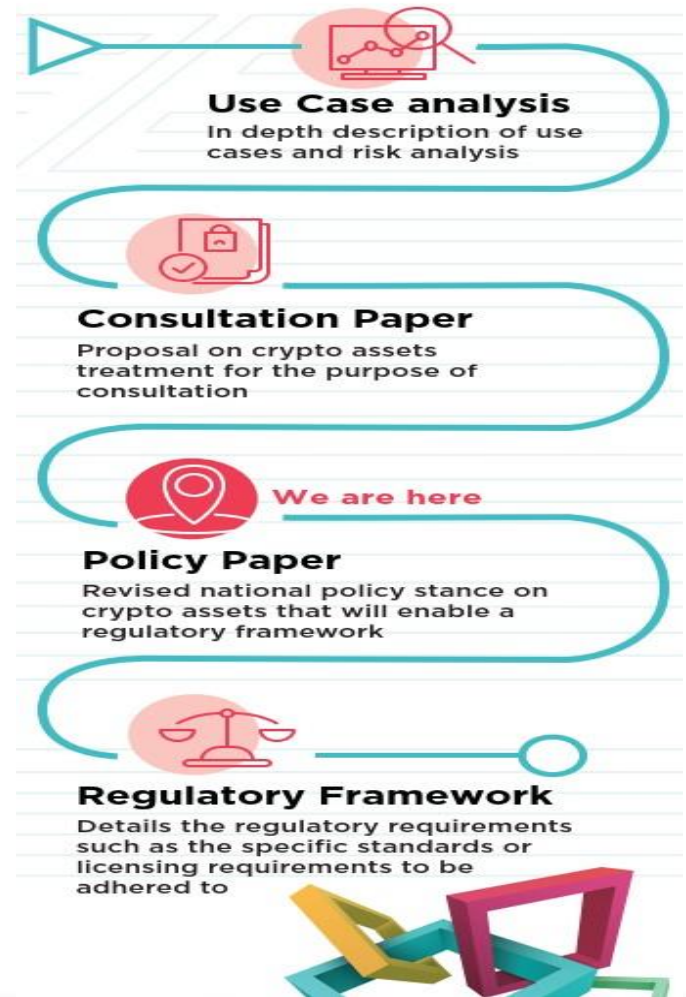
- Legal tender defined - **SARB Act**: Notes and coin issued by the SARB
- **NPS Act**: Money = Notes and coin issued by the SARB
- E-money defined in **NPS Act**: Only licensed SA banks are allowed to issue e-money
- **Banks Act**: Deposit refers to 'money', which refers - legal tender defined SARB Act
- **Exchange Control Regulations**: Foreign currency = any currency not legal tender in the Republic [but is legal tender in another country]; money = FX = legal tender [in another country]

Legacy laws & regulations: all drafted long **before emerging financial innovations** such as crypto assets were even a conception

SA Crypto Journey: A Holistic Approach To Crypto Asset Regulation

The SA crypto assets journey

The Crypto Assets Regulatory (CAR) Working Group was established in 2018 as a subcommittee of the IFWG, and it will soon publish the final crypto asset position paper under the auspices of the IFWG



The top 5 Crypto Asset use-cases in South Africa

Trading/Buy-Sell



Crypto assets used for speculative investing (for a perceived increase in future value), as a medium of exchange, or for buying then immediate on-selling (trading).

Payments



Crypto assets used to purchase goods and services by means of a peer-to-peer payment systems that enable parties to transact/ execute online or digital payments without the need for intermediation by a financial institution.

Initial Coin Offering



Initial Coin Offering (ICOs) are a means of raising capital by issuing digital tokens to the public. The issuer will use funds to finance a specific project. In exchange, the investor receives a token where they expect to receive a return on investment, voting rights, property rights, or a right to participate in the future performance.

Investment Funds



Crypto assets used as an underlying reference asset class for various investment funds including hedge funds, private equity funds, collective investment schemes, exchange-traded funds and pension funds.

Market Support



Ancillary or support services provided in respect of crypto asset activities. These activities may include services such as safe custody services for crypto assets, digital wallet provisioning for crypto assets and crypto asset mining.



Key Risks - Across the Use Cases

- Money Laundering & Terrorism Financing
- Exchange Control Circumvention
- Market Conduct and a Lack of Consumer Protection
- Cybersecurity Risks
- Price Volatility
- Environmental Risks
- Risk of Parallel, unregulated and fragmented payment systems
- The Risk of Perceived Regulatory Acceptance
- Financial Stability Risks

Specific Conduct Risks the FSCA is Monitoring Closely

Consumers not sufficiently informed on product features and risks



Complexity of products

Fraud and Cyber Crime



Failings of service providers



Maladministration



Unclear price formation and pricing practice



Excessive fees

Volatility of value resulting in loss of money



Misleading Advertising

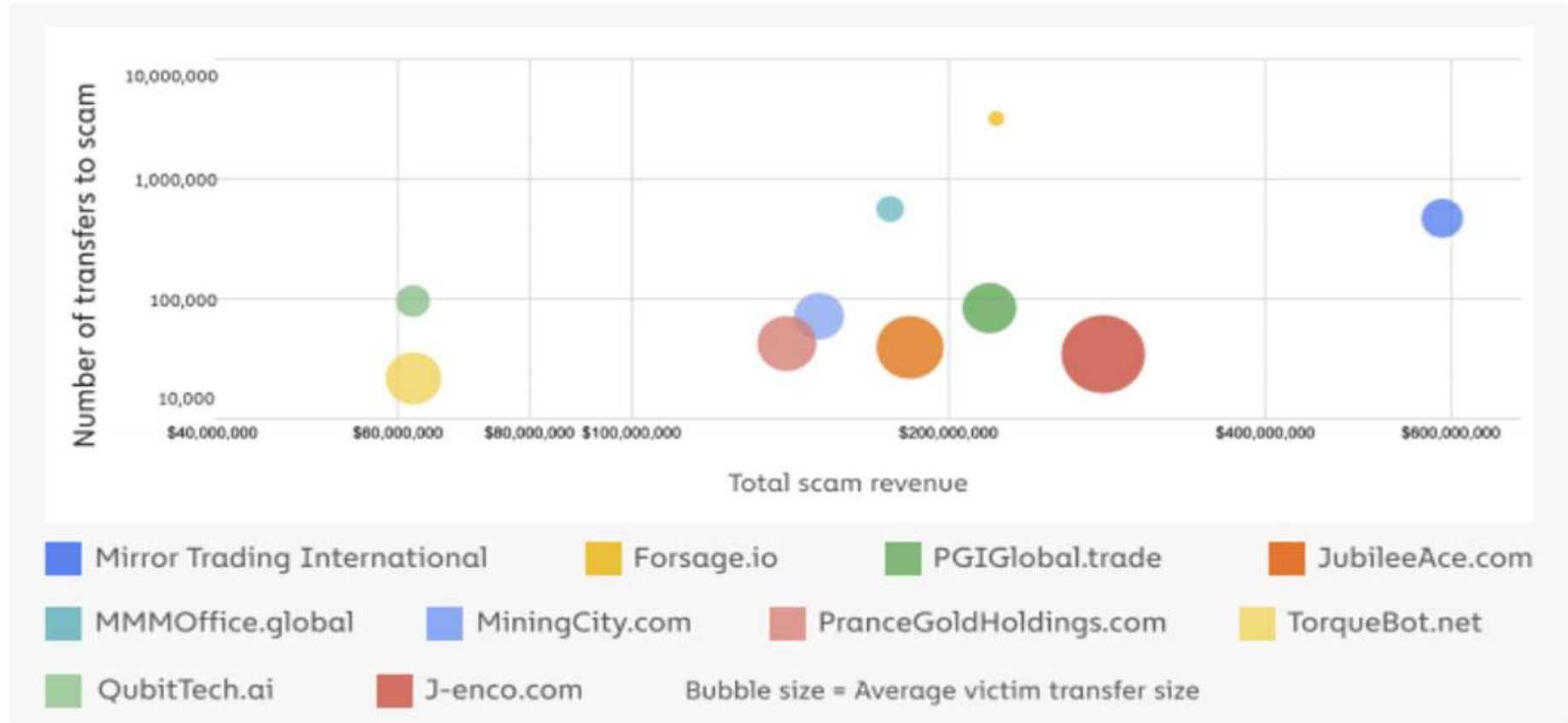


In order to mitigate the above risks, the FSCA has issued two warnings on Crypto Assets, and is currently embarking on a process to designate Crypto Assets under FAIS, to enable greater regulatory oversight



2020 Top 10 cryptocurrency investment scams

2020 Top 10 cryptocurrency investment scams



Currencies included: BTC, ETH, OMG, PAX, USDC, USDT

Key Regulatory Changes Proposed Across 3 Main Categories - 25 Recommendations

1

Implementation of AML/CFT framework

- Amendment of FIC Act (Schedule 1) - Inclusion of CASPs as Accountable Institutions (in progress)

2

Crypto assets declaration

- How most appropriately to cater for crypto assets under SA financial sector laws:
- FAIS Act
 - CoFI Bill
 - FSR Act
 - Financial Markets Act
 - NPS Act

3

Framework for monitoring cross-border financial flows

- Amendment of the Exchange Control Regulations to include crypto assets
- Amendment of the Authorised Dealer Manual
- Expansion of ADLA framework to include CASPs

NB: Retirement Funds & CISs not allowed any exposure

Some Key Considerations & Take Aways

1

The Regulation is **NOT** on the Product but on the **ACTIVITIES** of CASPs (e.g Exchanges, Wallet providers etc)

2

The decision to regulate CASPs does **NOT** suggest endorsement (tacit or explicit) of CA

3

CA remain highly volatile & inherently risky
further compounded by scam activity with many Ponzi-type schemes

4

The CA ecosystem is evolving at a very rapid pace & developments continue to challenge the applicability of existing legislation

5

CA marketing material often strongly biased towards highlighting only the potential upside of CA with no consideration of the massive potential downside

6

CA to remain **without legal tender** status & not recognised as electronic money

Principles Guiding Regulatory Approach

1. CASPs (and the activities they perform) must be regulated and regulated appropriately
2. An Activities based perspective must be maintained & principle of same activity, same risk and same regulations must continue
3. Proportionate regulations commensurate with the risks posed must apply
4. A collaborative & joint approach to the regulation of CASPs must be maintained
5. Continue to proactively monitor the dynamic developments of the crypto assets market, incl maintaining knowledge on emerging international best practices

Annexures

- 1) Tax Treatment
- 2) Financial Surveillance
- 3) Anti Money Laundering
- 4) Domestic Payments

Tax Treatment

- Existing tax laws and jurisprudence substantially provide for the taxation of crypto assets i.e. gains, profits or losses are not particularly difficult to tax from an interpretative point of view
- Some minor, mainly technical, changes to the legislation have been made to accommodate crypto assets, which include amongst others:
 - The inclusion of crypto assets as a financial instrument for income tax purposes (essentially reinforcing existing SARS interpretation that normal income tax principles apply to the taxation of crypto assets)
 - The ring fencing of assessed losses relating to crypto assets to limit the set off thereof against crypto assets income only
 - Cryptocurrency included as a financial service for purposes of section 2 of the VAT Act (the supply of financial services is VAT exempt); the result is that if a cryptocurrency is used to purchase a good or service subject to VAT, VAT is payable on the good or service but not also on the cryptocurrency used

Tax Treatment

- The main challenge posed by the advent of crypto assets lies in the detection of transactions involving crypto assets because of the anonymity aspect they confer:
 - thus crypto assets are more of a facilitator of tax evasion rather than tax avoidance
 - the problem of detection is common across government regulators in South Africa and internationally
- In this respect crypto assets share some features with cash, so techniques used in that context, such as identifying unexpected transactions, lifestyles, etc. remain applicable; in addition, regulators across the world are working to improve visibility into the crypto asset ecosystem

Anti-Money Laundering/Combating Financing of Terrorism

- **Financial Action Task Force (FATF)** - Intergovernmental body that set standards & promotes effective implementation of legal, regulatory & operational measures for combating money laundering, terrorist financing & other related threats to the integrity of the international financial system.
- Since October 2019 the revision of the FATF standard in respect of new technologies means that all jurisdictions must regulate crypto assets and crypto asset service providers for purposes of AML/CFT.
- **This obligation covers, amongst others:**
 - AML/CFT obligations such as CDD, recordkeeping etc must apply to crypto asset service providers;
 - the obligation on jurisdictions to identify, assess & understand the ML/TF risks emerging from virtual asset activities & the activities or operations of virtual asset service providers;
 - the obligation on jurisdictions to license or register virtual asset service providers & for competent authorities to take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in a VASP; and
- ensure that VASPs are subject to adequate regulation and supervision or monitoring for AML/CFT and are effectively implementing the relevant FATF Recs.

Anti-Money Laundering/Combating Financing of Terrorism

- Wire Transfers & the “Travel Rule” – **FATF Recommendation 16** -Requirements apply to all providers of such virtual asset services – includes VASPs that provide/engage in activities, such as virtual asset transfers – (that are functionally analogous to wire transfers).
- SA & Japan were the first countries to be assessed on this new standard.
- SA is in the process of being assessed by the FATF/ESAAMLG/IMF - compliance with the FATF standard.
- Among other, we are deficient & yet to comply with regulating crypto assets and CASP for AML/CFT purposes.
- During 2017 the FIC consulted with, among other, crypto asset businesses with the intention to include them under the **FIC Act, Schedule 1** as an accountable institution – this means that the FIC Act obligations such as CDD, recordkeeping, monitoring & reporting of transactions, etc. will be applicable – currently such businesses only have suspicious transaction reporting obligations and they are prohibited to deal with sanctioned individuals.
- Minister of Finance published - June 2020 draft proposals to amend Schedule 1 to the FIC Act – National Treasury & FIC are in the process of carefully assessing all comments & revising the amendments as

Financial Surveillance

- The Exchange Control Regulations prohibit transactions where capital or the right to capital is, without permission from National Treasury, directly or indirectly exported from South Africa. This includes transactions where an individual purchases crypto assets in SA and uses them to externalise 'any right to capital'.
Contravening these regulations is a criminal offence.
- As outlined in the policy paper on crypto assets, it is recommended that the Financial Surveillance Department of the South African Reserve Bank should assume the supervisory and regulatory responsibility for the monitoring of cross-border financial flows in respect of crypto assets and CASPs.
- The Financial Surveillance Department is currently involved with five use cases in the Regulatory Sandbox. The learnings will enable the Department to draft a regulatory framework on how to appoint CASPs and how crypto assets can be reported since currently, due to the nature of the assets, these transactions are currently not reportable on the FinSurv Reporting System.

Options Domestic Payments use cases

Option	Advantage	Disadvantage
Regulate crypto-assets activities/payments use cases (Enabling provision in the NPS Act)	<ul style="list-style-type: none"> Level playing fields - Allows imposition of requirements applicable to financial institutions relating to reporting, consumer protection, transparency and monitoring on crypto asset activities. 	<ul style="list-style-type: none"> Regulation could be perceived as legitimising crypto assets payments, thus incentivising creation of a parallel payment system. Lack of clear understanding of crypto assets. Growth in crypto assets payment use cases could impact financial stability and monetary policies.
Banning of use of crypto assets for payment	<ul style="list-style-type: none"> Provides legal certainty. Safety of the NPS is maintained. 	<ul style="list-style-type: none"> Stifling innovation.
Allow crypto assets with stabilisation mechanism (stablecoins) for domestic payment use cases for testing in the sandbox	<ul style="list-style-type: none"> To gain more information and understanding of the use cases. Aligned with the European draft regulation on crypto assets. 	<ul style="list-style-type: none"> Don't clearly understand all the issues involved Regulation could create unlevelled playing field May create unrealistic expectations for Fintechs.