South Africa

Angela Itzikowitz & Ina Meiring
ENSafrica

Government attitude and definition

As a result of the growing interest and rapid innovation in the financial technology ("**fintech**") and crypto assets domain, the Intergovernmental Fintech Working Group ("**IFWG**") was established in 2016. The IFWG is comprised of members from the National Treasury, the South African Reserve Bank (the "**SARB**") (Prudential Authority), the Financial Sector Conduct Authority (the "**FSCA**") (the Market Conduct Authority), the South African Revenue Service ("**SARS**") and the Financial Intelligence Centre (the "**FIC**"). The overarching objective of the IFWG has been to develop a common understanding among regulators and policymakers of fintech developments, as well as the policy and regulatory implications (of fintech) for the financial sector and the economy as a whole.

In early 2018, a joint working group, the Crypto Assets Regulatory Working Group (the "**CARWG**") was established under the aegis of the IFWG and is represented by members of the IFWG and SARS. The mandate of the CARWG was to review the position on crypto assets and to consider the public policy concerns raised by these assets, which should inform the regulation of these assets going forward.

The need to develop a policy and regulatory response to crypto asset activities in South Africa was driven by the impact of crypto assets on the financial sector, the potential for regulatory arbitrage and the like.

In developing its policy and regulatory responses to the emergence of crypto assets in South Africa, the CARWG adopted a functional approach (rather than focusing on the specific technology applied or the entity involved) and the following use cases (and risks inherent in these cases) were identified: (i) purchasing and/or selling; (ii) payments; (iii) capital raising through initial coin offerings; (iv) crypto derivatives and funds; and (v) market provisioning. The CARWG accepts that these use cases are not watertight and that the market, as a rapidly evolving one, requires continuous assessment.

In formulating its policy, guidance from international standard-setting bodies was considered, as well as the approaches taken by numerous other jurisdictions.

From a regulatory perspective, having definitional clarity on crypto assets is crucial, as it directly influences its classification and concomitant regulatory treatment. Despite the various nomenclature used, namely "crypto tokens", "crypto assets", "digital tokens" and the like, the crypto-phenomenon is commonly based on decentralized technology such as blockchain and other distributed ledger technology.

In January 2019, the IFWG and the CARWG released a joint consultation paper titled the "*Consultation Paper on Policy Proposals for Crypto Assets*" (the "**Consultation Paper**")

for public comment. The Consultation Paper provides a background and context for the review of the position on crypto assets in South Africa, and provides a scope of the crypto activities assessed. While the Consultation Paper identified the following crypto asset specific use cases:

(i) the purchase and sale of crypto assets;

(ii) payments using crypto assets;

(iii) capital raising through initial coin offerings;

(iv) crypto derivatives and funds; and

(v) market provisioning,

it currently focuses only on the purchase and sale of crypto assets and payment using crypto assets.

The regulatory authorities in South Africa are of the view that crypto assets do not constitute "money" as per the traditional definition of the word, but acknowledge that crypto assets may perform certain functions similar to those of currencies, securities and commodities. To this end, the following definition of "crypto assets" is proposed:

> "*Crypto assets are digital representations or tokens that are accessed, verified, transacted, and traded electronically by a community of users. Crypto assets are issued electronically by decentralised entities and have no legal tender status, and consequently are not considered as electronic money either. It therefore does not have statutory compensation arrangements. Crypto assets have the ability to be used for payments (exchange of such value) and for investment purposes by crypto asset users. Crypto assets have the ability to function as a medium of exchange, and/or unit of account and/or store of value within a community of crypto asset users.*"

In defining the most appropriate regulatory approach, the South African regulatory authorities have considered whether crypto assets require completely new regulation, or whether they can be accommodated and regulated in line with existing regulation.

The attitude of the CARWG is that regulatory action should not be delayed until the most appropriate regulatory approach has become clear, and that to the extent possible, existing regulation with the relevant amendments should be adopted to accommodate this new asset class. The South African regulatory authorities have an open door policy in considering and discussing innovation and concomitant regulation with fintech players.

Cryptocurrency regulation

There is currently no fintech specific regulation for crypto assets, but crypto assets are also not prohibited.

Sales regulation

The issuing of financial products, and related services such as the purchase and sale of financial products, is regulated in terms of the various "financial sector laws", as that term is defined in the Financial Sector Regulation Act 9 of 2017 ("**FSRA**").

Some of the financial sector laws which apply to the issuing and sale of financial products and which are, or may be relevant to crypto assets are the following:

(1) Banks Act 94 of 1990 ("**Banks Act**");

(2) Financial Advisory and Intermediary Services Act 37 of 2002 ("**FAIS**");

(3) Companies Act 71 of 2008 ("**the Companies Act**").

(4) Financial Markets Act 19 of 2012 ("**FMA**"); and

(5) Collective Investment Schemes Control Act 45 of 2002 ("**CISCA**").

Most of the financial sector legislation which applies to financial products and financial services pre-dates crypto assets and other digital assets and it is therefore not surprising that none of the financial sector laws (as set out above) dealing with the issue and sale of financial products apply (at least not expressly) to crypto assets.

For example:

(1) the marketing of crypto assets, including the giving of any advice or making a recommendation as to which assets to purchase, would not currently require authorisation in terms of FAIS as these assets are not financial products within the remit of that Act (FAIS). Importantly, however, if a person gives advice regarding a financial product (as defined in FAIS) that referenced a crypto asset or in which a crypto asset was the underlying asset, then that person would possibly be required to be registered as a financial services providers in terms of FAIS; and

(2) the FMA, which regulates the provision of securities services in South Africa, does not contain any reference to crypto assets in the definition of "securities" and the Registrar of Securities Services has not prescribed crypto assets to be instruments similar to any of the securities listed in the FMA. Furthermore, the type of securities listed in the FMA all have one common feature: there is a "central issuer" against whom the holder of the securities will have a claim. A crypto asset lacks this feature, as it is not issued by any central authority or person.

Taxation

A draft Taxation Laws Amendment Bill ("**TLAB**") has been published and proposes various amendments to the Income Tax Act 58 of 1962 ("**Income Tax Act**") and the Value Added Tax Act 89 of 1991 ("**VAT Act**"), which (amongst others) seeks to clarify the existing provisions dealing with crypto assets in the South African tax law.

Under the VAT Act, it is proposed to amend section 2 to include in the description of "financial services", the issue, acquisition, collection, buying or selling or transfer of ownership of any crypto assets. As a result, if the proposal in respect of the VAT Act is accepted, all dealings in crypto assets will be exempt from VAT in terms of section 12 of the VAT Act.

Under the Income Tax Act, it is proposed that crypto assets be included in the definition of "financial instrument". Moreover, it is also proposed to amend section 20A of the Income Tax Act, to include the acquisition or disposal of any crypto assets under the ring-fencing of assessed loss provisions. If this proposal is accepted, crypto asset dealers will not be able to offset the losses incurred from dealing in crypto assets from any other trade. These losses are therefore ring-fenced to be used only against income earned from crypto asset trade.

The purpose of these proposed amendments to the tax legislation is to clarify the tax treatment of crypto assets under the tax laws. From an income tax perspective, crypto assets are to be treated as financial instruments for income tax purposes, and from a VAT perspective, the issue, acquisition, collection, buying or selling or transfer of ownership of any crypto asset is to be treated as a financial service. Until such time as these amendments are given effect to, there remains a gap in the tax treatment of crypto assets.

Money transmission laws and anti-money laundering requirements

The Financial Intelligence Centre Act 38 of 2001 ("**FICA**"), one of South Africa's anti-money laundering statutes, imposes various duties on "accountable institutions". These include the duty to: identify and verify clients; keep records; and report certain transactions to the Financial Intelligence Centre ("**FIC**").

"Accountable institutions" are listed in schedule 1 to FICA and include banks and money remitters. Importantly, the duty to report suspicious or unusual transactions is more widely cast and applies not only to accountable institutions but to all persons who carry on business in South Africa.

Going forward, crypto asset service providers (including crypto asset exchanges and entities that provide custodial services) will be obliged to register as accountable institutions in terms of FICA, and as such will be obliged to comply with anti-money laundering and counter financing of terrorism requirements in the FIC Act.

In terms of section 29 of FICA, any person (including an accountable institution) who carries on a business, or is in charge of, or manages a business, or who is employed by a business, who knows or suspects that:

(a) the business has received or is about to receive the proceeds of unlawful activities or property connected to an offence relating to the financing of terrorism;

(b) a transaction or series of transactions to which the business is a party, facilitated or is likely to facilitate the transfer of the proceeds of unlawful activity or property relating to the financing of terrorist activities; has no apparent business or lawful business; may be relevant to the investigation of tax evasion or relates generally to the financing of terrorism; or

(c) the business has been used, or is about to be used for money-laundering purposes, or the financing of terrorism,

must report within a prescribed period to the FIC.

These reporting provisions would apply to any entities doing business involving crypto assets.

The remittance of crypto assets would not currently constitute money remittance within the purview of FICA as crypto assets are not considered money.

Promotion and testing

As discussed under "*Government attitude and definition*", the IFWG and the CARWG have been tasked with engaging with regulators and policymakers, and developing key considerations and a more harmonised approach to fintech-driven innovations. The purpose of this engagement is to identify the risks and benefits of financial innovation driven by fintech, so that regulators and policymakers can develop appropriate policies and implement effective frameworks that allow for responsible innovation.

Ownership and licensing requirements

As crypto assets are decentralized, there is no central government controlling authority that claims ownership of crypto assets. Further, there are currently no restrictions on investment managers owning crypto assets for investment purposes. As a result, there are also no licensing requirements imposed on anyone holding crypto assets as an investment advisor.

The Financial Institutions (Protection of Funds) Act 28 of 2001 ("**FI Act**") imposes certain duties on persons dealing with funds of clients, and with trust property controlled by financial institutions and nominee companies. "Trust property" is defined in the FI Act to mean:

> "*[A]ny corporeal or incorporeal, movable or immovable asset invested, held, kept in safe custody, controlled, administered or alienated by any person, partnership, company or trust for, or on behalf of, another person, partnership, company or trust, and such other person, partnership, company or trust is hereinafter referred to as the principal*."

This definition is sufficiently wide to encompass money – and arguably also a crypto asset – as an incorporeal asset. If an asset manager as a financial institution holds crypto assets on behalf of clients, this may amount to holding trust property for purposes of the FI Act. The FI Act imposes duties on financial institutions which deal with trust property.

Section 2 of the FI Act provides that a financial institution which invests, holds, keeps in safe custody, controls, administers or alienates any funds of the financial institution or any trust property:

- must, with regard to such funds, observe the utmost good faith and exercise proper care and diligence;
- must, with regard to the trust property and the terms of the instrument or agreement by which the trust or agency in question has been created, observe the utmost good faith and exercise the care and diligence required of a trustee in the exercise or discharge of his or her powers and duties; and
- may not alienate, invest, pledge, hypothecate or otherwise encumber or make use of the funds or trust property, or furnish any guarantee in a manner calculated to gain, directly or indirectly, any improper advantage for any person to the prejudice of the financial institution or principal concerned.

Other duties imposed by the FI Act on financial institutions (or the directors, members, partners, officials, employees or agents of the financial institution) include:

- a requirement for all parties who take part in investment decisions to declare any direct financial interest in a company in which trust property will be invested to the board of management of the company prior to the investment being made (section 3);
- investing the trust property only in such manner as directed by agreement (with the client) or, in the absence of such an agreement, as directed by the FI Act; and
- keeping its assets separate from the trust property (which separation must be visible in its books of accounts).

The FI Act, however, does not impose a regulatory approval or registration requirement on financial institutions.

Mining

Crypto asset "mining" is not regulated in South Africa and is therefore permissible. As far as we are aware, the South African regulatory authorities are not planning to regulate mining.

Border restrictions and declaration

Exchange Control in South Africa is mainly governed by the Currency and Exchanges Act 9 of 1933 (as amended) and the Exchange Control Regulations issued under this Act. The SARB also publishes Exchange Manuals and guidelines ("**Manuals**").

Any person wishing to move funds offshore for the purposes of buying crypto assets has to make an application for exchange approval through authorised dealers in foreign exchange. "Authorised Dealers" are South African commercial and merchant banks, appointed by the Minister of Finance, to buy and sell foreign exchange, within the limits and subject to conditions prescribed by the National Treasury and the SARB. Authorised dealers act on behalf of their customers and they are not agents of the SARB.

The basic principle underlying the Exchange Control Regulations is that no exchange commitment may, in terms of the Exchange Control Regulations, be entered into by South Africans without prior approval. In certain instances, Authorised Dealers are empowered to approve applications themselves (i.e. without reference to the SARB). The Manuals contain the conditions and limits applicable to transactions in foreign exchange which may be undertaken by Authorised Dealers. For all other applications involving foreign exchange that fall outside the scope of the Manuals, the Authorised Dealer must forward such application to the Financial Surveillance Department of the SARB.

The issue of crypto asset cross-border remittance is currently being considered by the Financial Surveillance Department (which monitors exchange control) within the SARB.

Reporting requirements

The reporting requirements under FICA require certain cash transactions to be reported. However, FICA defines cash as: (a) coin and paper money of South Africa or of another country that is designated as legal tender and that circulates as, and is customarily used and accepted as, a medium of exchange in the country of issue; and (b) travellers' cheques. This definition clearly does not include crypto assets and such reporting obligations will therefore not be imposed under FICA. Other reporting obligations under FICA relate to electronic transfers of money to and from South Africa. Since it is not possible to transfer crypto assets via an electronic funds transfer, these reporting obligations will also not apply.

Estate planning and testamentary succession

Crypto assets are not regulated for purposes of estate planning and succession.

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Angela Itzikowitz
Tel: +27 11 269 7600 / Email: aitzikowitz@ensafrica.com

Professor Angela Itzikowitz is a director in ENSafrica's Banking and Finance Department and co-heads the newly established Fintech department. She specialises in banking and financial market regulation, including finance and regulatory reform, card and related electronic payment instruments, derivatives, loan agreements, collective investment schemes, insurance and Fintech. She has been recognised as a leading Fintech lawyer in a number of international publications including *Chambers* and advises banks, insurers and start-ups on the regulation of Fintech. She was recently appointed external counsel to the South African Reserve Bank's (**SARB**) Intergovernmental Fintech Working Group (**IFWG**) and the Crypto Assets Regulatory Working Group (**CAR**). In her capacity as external counsel, she is assisting with the drafting of the policy paper soon to be issued by the SARB and advising on the regulation of crypto assets. She also teaches short courses on Fintech and Blockchain at the University of Cape Town. She is the author of the Law of South Africa Banking and Financial Markets (LAWSA), has co-authored a number of books and has published numerous articles in local and foreign journals.

Angela has been recognised as a leading lawyer for a number of consecutive years by:

- *Chambers Global Guide* (Banking and Finance: Regulatory). Angela is the only South African Lawyer to be ranked Band 1 for both 2018 and 2019.
- *Who's Who Banking and FinTech* (South Africa).
- *Best Lawyers* – Banking and Finance (South Africa).

Angela is fluent in English, Afrikaans and German and speaks South Sotho and Mandarin.

Ina Meiring
Tel: +27 11 269 7600 / Email: imeiring@ensafrica.com

Ina Meiring is an executive in ENSafrica's banking and finance department. Ina is regarded as one of the top finance regulatory experts in South Africa and her clients include leading local and international financial institutions. Her experience includes advising on banking and financial services regulation and consumer law matters, including: the South African Consumer Protection Act, 2008; the National Credit Act, 2005; and the Protection of Personal Information Act, 2013. Her expertise further includes advising on corporate governance, exchange control, securitisations, payment instruments and payment methods. Ina is a member of the expert group appointed by the South African Reserve Bank for the review of the National Payment System Act, 1998. She has authored chapters on South African banking regulation for a number of legal publications, and has lectured at the University of Johannesburg and the University of South Africa.

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The MARC | Tower 1, 129 Rivonia Road, Sandton, Johannesburg 2196, South Africa
Tel: +27 11 269 7600 / URL: www.ENSafrica.com