

CRYPTO ASSETS GETTING THE REGULATORY TREATMENT



Crypto assets are increasingly under the spotlight as the financial services sector considers wider adoption and, while financial regulators revise their anti-money laundering and terrorist financing (AML/CFT) framework, to incorporate this technology.

The leapfrogging of crypto technology has emphasised the need for regulators to bridge the gap between

the development of regulatory frameworks and the introduction of new innovations.

According to a Statista Global Consumer Survey, South Africa is among the top countries in terms of cryptocurrency ownerships with 17.8 percent of respondents indicating they owned or used crypto assets in 2020. Furthermore, South Africa is in the top four of the 55 countries surveyed for their adoption of crypto assets like Bitcoin. There are approximately 12 different crypto asset trading platforms operating in South Africa with a market capitalisation value of approximately R6.5 billion.

South Africa's relatively high use of crypto assets increases the possibility of transaction methods being used as tools for money laundering and terrorist financing. The lack of a regulatory and legal framework, and along with it the relative anonymity in the use of crypto assets, the ease and speed of conducting cross-border transactions make crypto assets favourable for licit and illicit financial activity.

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A 2014 FATF (Financial Action Task Force) report highlighted the money laundering and terrorist financing risks associated with trading in crypto currencies. These included the potential for anonymous funding (cash funding or third-party funding through virtual exchanges that do not properly identify the funding source). They may also permit anonymous transfers if senders and recipients are not adequately identified.

In June 2019, FATF introduced amendments to its Standards placing AML/CFT requirements on virtual assets and virtual asset service providers (VASPs). FATF revised Recommendation 15 on new technologies and included new definitions “virtual asset” and “virtual asset service provider” to clarify how AML/CFT requirements apply in terms of virtual assets.

These amendments place obligations on countries to “assess and mitigate their risks associated with crypto asset activities and service providers; license or register service providers and subject them to supervision or monitoring by competent national authorities”.

While crypto assets are not currently regulated in South Africa, plans are afoot to bring the country’s AML/CFT regime in line with the FATF’s Recommendations related to the acquisition, safe custody, trading or use of crypto assets. FATF is responsible for setting international standards for combating money laundering and terrorist financing.

To that end, National Treasury and the Financial Intelligence Centre published a consultation document for public comment on proposed amendments to Schedules 1, 2 and 3 to the Financial Intelligence Centre Act, 2001 (Act 38 of 2001) (FIC Act) in June 2020.

Among the proposed amendments is to include crypto asset service providers* (CASPs) in the list of accountable institutions under Schedule 1 to the FIC Act. CASPs will be required to register with the FIC as accountable institutions and will have to fulfil AML/CFT regulatory obligations. Currently, some of the CASPs are voluntarily complying with certain AML/CFT obligations such as registration with the FIC, reporting of cash transactions exceeding R24 999.99, customer identification and verification and other requirements.

The FIC Act obligations on CASPs, as with all other businesses, irrespective of whether they are accountable institutions or not, is the reporting of suspicious and unusual transactions in terms of section 29 of the FIC Act and the prohibition in terms of section 26B to deal with UN Security Council sanctioned persons and entities.

Pieter Smit, the executive manager for Legal and Policy division at the FIC, said the implementation of a regulatory framework for the crypto asset service providers would enable the sector to operate in a safer environment by providing consumers with increased safeguards and protection mechanisms.

“The framework would not stifle innovation in crypto assets but, implement access criteria for CASPs to prohibit unscrupulous players from entering the market,” Smit said.

CASPs are defined as businesses that:

- Exchange crypto assets for fiat currencies or vice versa
- Exchange one form of crypto asset for another
- Conduct transactions that move crypto assets from one crypto asset address or account to another
- Provide facilities for the safekeeping or administration of crypto assets or instruments that enable the control of crypto assets
- Participate in or provide financial services related to issuers’ offers or sale of crypto assets.

As a result of these changes, Recommendation 16 (‘the travel rule’) requires CASPs to collect and hold information of both the originator and the beneficiary involved in a crypto asset transaction. This customer data should be shared immediately among the applicable CASPs and be made available on request to the appropriate regulatory and/or law enforcement authorities.

The FIC Act Schedule changes once signed off by the Minister of Finance, will have to be approved by Parliament before it is gazetted and enters into force, this would in part bring South Africa’s AML/CFT regime in line with the FATF Standards.

South Africa’s money laundering and terrorist financing regulatory framework on crypto assets and CASPs has already received international scrutiny during the country’s third FATF mutual evaluation at the end of 2019. The international evaluation team from the International Monetary Fund, the FATF and Eastern and Southern Africa Anti-Money Laundering Group assessed South Africa’s implementation of the AML/CFT/PF system, as well as the effectiveness of the regime.

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South Africa and Japan were the first member countries to be assessed on their implementation of the new requirements relating to crypto assets just months after the FATF introduced the amendments. South Africa has to ensure that CASPs are regulated in line with the revised FATF standards. The proposed amendments to the Schedules that would include the CASP sector as an accountable institution under the FIC Act would in part address the existing gaps in the AML/CFT regime.

South Africa's regulators have had their eyes on the CASP sector with the National Treasury, the South African Reserve Bank, the Financial Sector Conduct Authority, the South African Revenue Service and the FIC issuing a joint public statement in 2014 cautioning the public about the risks associated with the use of crypto assets for the purpose of transacting or investing.

Smit said regulators have actively engaged with innovators to build relationships that are mutually beneficial. This allows regulators to develop a deeper understanding of the industry and gain practical insights to some of the considerations in implementing revised regulatory frameworks.

The Intergovernmental Fintech Working Group (IFWG), a group of South African financial sector regulators, developed a policy position paper on this subject, which was published for comment on 14 April 2020. **(See story on the IFWG...in this newsletter)**. The purpose of this position paper was to provide specific recommendations for the development of a regulatory framework for crypto assets, including suggestions on the required regulatory changes to be implemented.

The position paper builds on a consultation paper on crypto assets that was first issued by the IFWG on 16 January 2019. The consultation paper highlighted the perceived benefits and risks of crypto asset-related activities, as well as policy proposals for a regulatory framework. Industry participants and regulatory framework stakeholders were consulted in the drafting of the document through comment submissions on the proposals in the paper.

* The FATF refers to virtual assets and virtual asset service providers, while in South Africa, the term crypto assets and crypto asset service providers is used to refer to the same.

The FATF have identified among the key risk indicators for crypto assets:

- Technological features that increase anonymity – such as the use of peer-to-peer exchanges websites, mixing or tumbling services or anonymity-enhanced cryptocurrencies
- Geographical risks – criminals can exploit countries with weak, or absent, national measures for virtual assets
- Transaction patterns – that are irregular, unusual, or uncommon which can suggest criminal activity
- Transaction size – if the amount and frequency have no logical business explanation
- Sender or recipient profiles – unusual behaviour can suggest criminal activity
- Source of funds or wealth – which can relate to criminal activity.