BANKING & FINANCE

Crypto assets – a new financial product?

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On 20 November 2020, the Financial Sector Conduct Authority ("**FSCA**") published a draft Declaration ("**Draft Declaration**") and a statement in support thereof which sets out its proposal to bring crypto assets within the ambit of the definition of "financial product" in Section 1 of the Financial Advisory and Intermediary Services Act 37 of 2002 ("**FAIS Act**")[1].

Crypto assets are currently not regulated by the FSCA in the Republic of South Africa ("**South Africa**"), however, the FSCA has identified a number of crypto asset platforms operating in South Africa which "*are estimated to have 800 000 registered South Africans, control 80 – 90 percent of the market and hold R6,5 billion assets.*[2]"

If one considers the above numbers, it would seem that South African investors are investing more frequently or more substantially (or both) into crypto assets and are doing so without the protection typically afforded to investors in South Africa. This has prompted the FSCA (through the Draft Declaration) to take steps to regulate this asset class and to offer investors protection against unlicensed, unqualified and/or unscrupulous service providers.[3]

What is a crypto asset?

The Draft Declaration defines a crypto asset as "*any digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes, but excluding digital representations of fiat currencies or securities that already fall within the definition of financial product.***[4]**"

The definition is broad enough to capture all existing crypto currencies as well as those which will be developed in the future and furthermore includes other related "digital" assets, such as stable coins and utility tokens.[5]

Whilst the Draft Declaration sets out the FSCA's intention to classify crypto assets as a financial product under the FAIS Act to provide, amongst others, greater protection to South Africans who invest in crypto assets, the FSCA is at pains to clarify that the classification of crypto assets as a financial product does not in any way legitimise the asset class and is not intended to influence how crypto assets are treated under any other South African legislation.[6]

The implications of the Draft Declaration

If crypto assets are classified as financial products, then only persons who are authorised under the FAIS Act to provide advice and/or intermediary services in respect of financial products will be permitted to market, offer and/or sell crypto assets and the same consequences for any failure to comply with the FAIS Act will be applicable to FSPs[7] who make the asset class available to investors.[8] Further, the service provider (as a licensed FSP) and its authorised representatives will be required to comply with the General Code of Conduct for Authorised Financial Service Providers and Representatives, 2003 and the Determination of Fit and Proper Requirements, 2017.[9]

Timeline for compliance

Comments on the Draft Declaration are required to be submitted to the FSCA using the FSCA's submission template which is available on its website by no later than 28 January 2021.[10]

The Declaration makes provision for transitional arrangements which at this stage, envisages a four month period within which crypto asset service providers are required to submit their applications for authorisation to act as a FSP. The transitional period will commence on the date on which the Declaration is promulgated. The Declaration furthermore makes provision for all crypto asset service providers (including those providers who have elected not to apply to become a licensed FSP) to continue to offer financial services in respect of crypto assets during the transition period.[11] Service providers considering making application to become a FSP should also be aware of the provisions relating to the sale and purchase of crypto assets as currently proposed in the Conduct of Financial Institutions Bill.[12]

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[1] The Draft Declaration dated 20 November 2020.

[2] Footnote 7 on page 3 of the "*Statement in support of the Draft Declaration of Crypto Assets as a Financial Product under the Financial Advisory and Intermediary Services Act*", issued on 20 November 2020.

[3] Paragraph 3.7 on page 4 of the "*Statement in support of the Draft Declaration of Crypto Assets as a Financial Product under the Financial Advisory and Intermediary Services Act*", issued on 20 November 2020.

[4] Paragraph 1 of the Schedule to the "*Notice of Publication – Draft Declaration of Crypto Assets as a Financial Product*", titled "Definitions", dated 20 November 2020.

[5] Article titled "*The FSCA's Draft Declaration: Closing in on Crypto Assets in South Africa*", published by Lexology on 8 December 2020.

[6] Paragraph 4.3 on page 5 of the *Statement in support of the Draft Declaration of Crypto Assets as a Financial Product under the Financial Advisory and Intermediary Services Act*", issued on 20 November 2020.

[7] An FSP is a "financial service provider" as defined in Section 1 of the FAIS Act.

[8] Paragraph 3.6 on page 4 of the "*Statement in support of the Draft Declaration of Crypto Assets as a Financial Product under the Financial Advisory and Intermediary Services Act*", issued on 20 November 2020.

[9] Paragraph 3.6 on page 4 of the "*Statement in support of the Draft Declaration of Crypto Assets as a Financial Product under the Financial Advisory and Intermediary Services Act*", issued on 20 November 2020.

[10] Page 2 of the FSCA Press Release, "*FSCA publishes a draft Declaration of crypto assets as a financial product under the Financial Advisory and Intermediary Services Act*", dated 20 November 2020.

[11] Paragraph 3 of the Schedule to the "*Notice of Publication – Draft Declaration of Crypto Assets as a Financial Product*", dated 20 November 2020.

[12] Please note that the Conduct of Financial Institutions Bill ("**COFI Bill**") may or may not repeal the FAIS Act in whole or in part. If this happens, then crypto assets are very likely to fall within the ambit of the COFI Bill (or Act as it will then be) and the principles are likely to remain unaltered.

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