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MTI: An example of why crypto assets should be declared financial products

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On 7 July 2020, the Texas State Securities Board issued an emergency cease and desist order ("**Order**") against, *inter alia*, Mirror Trading International Proprietary Limited ("**MTI**") in terms of which, MTI was ordered to –

1. "*immediately cease and desist from offering for sale any security in Texas until the security is registered with the Securities Commissioner or is offered for sale pursuant to an exemption from registration under the Texas Securities Act*"[1];
2. "*immediately cease and desist from acting as a securities dealer or agent in Texas until they are registered with the Securities Commissioner or is acting pursuant to an exemption from registration under the Texas Securities Act*"[2];
3. "*immediately cease and desist from engaging in any fraud in connection with the offer for sale of any security in Texas*"[3]; and
4. "*immediately cease and desist from offering securities in Texas through an offer containing a statement that is materially misleading or otherwise likely to deceive the public*"[4].

The Order was made after the Texas State Securities Board found MTI to be conducting a number of unlawful activities, which include the following –

1. "*illegally soliciting Texans to purchase fraudulent investments in the cryptocurrency and forex trading pool*"[5];
2. "*intentionally failing to disclose Respondent Steynberg's business repute, qualifications ad experience, and this information constitutes a material fact*"[6];
3. "*intentionally failing to disclose [a number of] material facts relating to the safeguarding and protecting of bitcoin*"[7];
4. "*intentionally failing to disclose [a number of] material facts relating to the risks associated with trading foreign currencies*";[8] and
5. making "*statements [that] are materially misleading or otherwise likely to deceive the public.*"[9]

MTI's "activities" were not only noticed by the Texas State Securities Board. The Quebec Financial Market Association listed, and continues to list, MTI on its "*Warning List of Websites and companies that solicit investors illegally*"[10], and on the local front, the Financial Sector Conduct Authority ("**FSCA**") launched an investigation into MTI on 18 August 2020 on the basis that it was conducting unlicensed trading activities.[11]

So, who is MTI, and what did MTI do to capture the attention of both local and international regulators?

MTI is a private company incorporated in the Republic of South Africa ("**South Africa**") in 2019 and, whilst operating under the guise of an international multi-level marketing scheme, offered investors (both local and international) the opportunity to trade "*in derivative investments based on crypto currency (bitcoin).*"[12] MTI encouraged investors to (i) purchase Bitcoin on a cryptocurrency platform and (ii) transfer that Bitcoin to a MTI Bitcoin wallet. On receipt of the Bitcoin, MTI would "pool" all the Bitcoin it received and defer all trading decisions to a bot (or artificial intelligence) "*together with a head trader and a trading*

team".[13] MTI stated that this process was successful and investors received fantastic monthly returns on their respective investments.

In addition, and as part of its marketing strategy, MTI made a number of claims, including –

1. *Investors deposit as little as $100 and make an average of 10% per month;*
2. *Investors simply need to "[j]ust sit back and watch [their] MONEY grow;"*
3. *The investments pay "daily trade income," the daily trade income is "automatically compounded" and "compound interest is the 8th Wonder of the World;"*
4. *The investment "grows your bitcoin compounding daily earning an average of 10% per month;"*
5. *The investments have more than 200+ days straight with positive gains; and*
6. *The investments close 600 to 800 trades each day and have not lost a trade in almost a year."*[14]

MTI marketed itself as an attractive cryptocurrency investment platform for investors during 2020 and it, would appear, managed to solicit approximately 23,000 Bitcoin from an alleged 260,000 investors in just a few months.[15]

In terms of section 135(1) of the Financial Sector Regulations Act 9 of 2017 ("**FSR Act**"), the FSCA is authorised to appoint and instruct an investigator if it, *inter alia*, reasonably suspects that a person has contravened and/ or continues to contravene a financial sector law/s for which the FSCA is the responsible authority. On 26 October 2020, the FSCA executed three search and seizure warrants (issued in terms of the FSR Act) at (i) the home of Mr Johan Stenberg (MTI's chief executive officer) (ii) the home of Mrs Cheri Marks (MTI's marketing director), and (iii) MTI's offices in Stellenbosch.[16]

MTI maintains that it was not required to be in possession of an FSP license as crypto assets are not regulated by the FSCA, however the FSCA has stated that if MTI was trading in derivative instruments linked to crypto assets, the former of which fall within its authority, it would have jurisdiction over the trading activities conducted by MTI and accordingly MTI would be required to procure the relevant licenses to conduct its trading activities.[17] Notwithstanding numerous cautionary communications from local and international authorities, it appears 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 by the FSCA. On 20 November 2020, the FSCA published a draft declaration in terms of which, the FSCA intends to declare crypto assets a financial product under the Financial Advisory and Intermediary Services Act 37 of 2002 ("**Draft Declaration**"), in order to protect investors against unlicensed, unqualified and/or unscrupulous service providers. For more information on the Draft Declaration, please read our article published on 21 January 2021, titled "**Crypto Assets – a new financial product?**", which can be accessed by clicking here.

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[1] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, page 16.

[2] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, page 16.

[3] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, page 16.

[4] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, page 16.

[5] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, paragraph 11, page 3.

[6] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, Paragraph 35, Page 9.

[7] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, Paragraph 39, Page 10.

[8] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, Paragraph 40, Page 11.

[9] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, Paragraph 46, Page 13.

[10] https://lautorite.qc.ca/en/general-public/fraud-prevention/illegal-on-line-trading-platforms/warning-list-of-websites-and companies-that-solicit-investors [accessed 25 January 2021].

[11] An FSP is a "financial service provider" as defined in Section 1 of the the Financial Advisory and Intermediary Services Act 37 of 2002 ("**FAIS Act**") and/ or section 1 of the Financial Sector Regulations Act 9 of 2017 ("**FSR Act**").

[12] FSCA Press Release titled "*The FSCA's investigation on Mirror Trading International nears completion*" dated 17 December 2020, Page 2.

[13] FSCA Press Release titled "*The FSCA's investigation on Mirror Trading International nears completion*" dated 17 December 2020, Page 2.

[14] Texas State Securities Board, Order no ENF-20-CDO-1811 dated 7 July 2020, Paragraph 14, page 4.

[15] https://www.moneyweb.co.za/moneyweb-crypto/bitcoin/sa-cracks-down-on-bitcoin-after-alleged-ponzi-scheme/ [accessed 29 January 2021].

[16] FSCA Press Release titled "*FSCA conducts search operations at premises of Mirror Trading International*" dated 28 October 2020, page 1.

[17] Section 1 FSR Act and Section 1 FAIS Act.



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