

RECONSIDERING THE DEBATE RELATING TO THE PROPOSALS FOR THE REGULATION OF CRYPTOCURRENCIES IN SOUTH AFRICA

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DECLARATION

I, 540385 (Student number, declare that this Research Report is my own unaided work. It is submitted in partial fulfillment of the requirements for the degree of Master of Laws (by Coursework and Research Report) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

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ABSTRACT

Crypto assets are a growing market and do not appear to be the fad many thought they would be when the first crypto asset, Bitcoin was create in 2008. As such, regulators and interested investors alike continue to debate the need, if any, to regulate crypto assets. However, their very nature of decentralisation creates obstacles for regulators, due to the anonymous nature of crypto assets. However, all is not lost for regulators and if the basic principles of risk management and corporate governance, can be applied perhaps there is a future for both crypto assets and fiat currencies to be regulated in one market. The South African Government has already taken steps to declare crypto assets as financial products, therefore crypto asset regulation in South Africa has taken a step towards supporting the future use and investment of this growing financial market.

I INTRODUCTION

The issue of regulating crypto assets has been a global phenomenon since the introduction of the very first crypto asset, Bitcoin by Satoshi Nakamoto in 2008.¹ Debates regarding the regulation of crypto assets have focused on the relevance and need to regulate a financial commodity which is decentralised and is not regarded as fiat currency by the majority of countries who are players within the global financial market.²

However, it is fair to say that within the last couple of years, there has been an increase in the need to seriously consider the need for the regulation of crypto assets globally. In early 2022, the stablecoin – TerraUSD (UST) collapsed, taking with it the unbacked crypto coin connected to it – Luna.³ This in turn saw many crypto asset investors experiencing huge losses due to the fact that there was no centralised protection against these losses. Moreover, this saw the crypto asset market experience dips in confidence, increasing the volatility risk associated with using crypto assets as a means of investment or as a holder of financial stability.⁴

During the last quarter of 2022, leading into the first quarter of 2023, the global financial crypto asset market saw the collapse of FTX Trading Ltd (known throughout the crypto asset market as FTX), a prominent crypto asset exchange whose Chief Operating Officer (CEO) and co-founder, Sam Bankman-Fried was charged by the U.S Securities and Exchange Commission with ‘orchestrating a scheme to defraud equity investors in FTX Trading Ltd...’⁵. These events involving crypto assets are just two of many instances where the legitimacy and stability of the crypto asset market has been called into question.

¹ Eveshnie Reddy and Vivienne Lawack ‘An Overview of the Regulatory Developments in South Africa Regarding the use of Cryptocurrencies’ (2019) 31 *South African Mercantile Law Journal* 1 at 6.

² E Reddy op cit note 1 at 3.

³ Parma Bains, Arif Ismail, Fabiana Melo and Nobuyasu Sugimoto ‘Regulating the Crypto Ecosystem: The Case of Stablecoins and Arrangements’ IMF Fintech Note 2022/008, International Monetary Fund, Washington, DC 22-3, available at <https://www.imf.org/en/Publications/fintech-notes/Issues/2022/09/26/Regulating-the-Crypto-Ecosystem-The-Case-of-Stablecoins-and-Arrangements-523724>, last accessed on 26 March 2023; BIS (Bank of International Settlements) ‘The Future Monetary System’ Chapter 3, BIS Annual Economic Report 2022, Bank of International Settlements, Basel, Switzerland 81-2, available at <https://www.bis.org/publ/arpdf/ar2022e.htm>, last accessed on 26 March 2023.

⁴ Ibid.

⁵ U.S Securities and Exchange Commission Press Release ‘SEC Charges Samuel Bankman-Fried with Defrauding Investors in Crypto Asset Trading Platform FTX’ 2022-219, available at <https://www.sec.gov/news/press-release/2022-219>, last accessed on 26 March 2023.

In attempting to answer the question of regulating crypto assets, the South African Reserve Bank (SARB) released their guidance note entitled ‘*Position Paper on Virtual Currencies*’⁶ in 2014, which was aimed at advising citizens on the use of what has commonly become known as cryptocurrencies and what the SARB has gone on to define as ‘crypto assets’⁷ in order to be consistent with the approach adopted globally.⁸

In the alert published by the National Treasury in 2014 entitled *User Alert – Monitoring of virtual currencies* - the public was warned that the use of crypto assets should be done so at the user’s own risk due to the fact that at the time of publishing the alert, there was no intention on the part of the South African government to regulate crypto assets within the financial sector, thus users would be left open to risks including but not limited to theft and the potential misuse by those who trade in or who administer crypto assets.⁹

It may be argued that regulation of a decentralised commodity is counterintuitive, an oxymoron to the exact purpose of the existence and creation of cryptocurrencies. However, the dangers of non-regulation of crypto assets and their use in criminal activities have posed the question – Should the South African regulatory authorities take the step to regulate these emerging assets now?

Since the initial SARB’s *Position Paper* in 2014,¹⁰ there has been an increase in various categories of crypto assets available which has necessitated a progressive and proactive approach to regulation both globally and in South Africa. In a first attempt to initiate regulation, the Prudential Authority released a guidance note in August 2022 encouraging banking institutions to conduct business operations with those who deal within the crypto asset market.¹¹

⁶SARB ‘Position Paper on Virtual Currencies’ (2014) 4-5, available at https://www.resbank.co.za/content/dam/sarb/what-we-do/payments-and-settlements/regulation-oversight/Virtual%20Currencies%20Position%20Paper%20%20Final_02of2014.pdf, last accessed on 21 April 2023, as cited in E Reddy and V Lawack op cit note 1 at 18.

⁷ IFWG ‘Crypto Assets Regulatory Working Group Position Paper on Crypto Assets’ (2021) at 15, available at https://www.treasury.gov.za/comm_media/press/2021/IFWG_CAR%20WG_Position%20paper%20on%20crypto%20assets_Final.pdf, last accessed on 26 March 2023.

⁸ Ibid.

⁹National Treasury ‘User Alert – Monitoring of virtual currencies’ (2014), available at https://www.treasury.gov.za/comm_media/press/2014/2014091801%20-%20user%20alert%20virtual%20currencies.pdf, last accessed on 26 March 2023.

¹⁰ SARB op cit note 6.

¹¹ SARB Prudential Authority ‘Guidance Note issued in terms of section 6(5) of the Banks Act 94 of 1990’ G10/2022, available at <https://www.resbank.co.za/content/dam/sarb/publications/prudential-authority/pa-deposit-takers/banks-guidance-notes/2022/G10-2022%20-%20Supervisory%20guidelines%20for%20matters%20related%20to%20the%20prevention%20of%20unlawful%20activities.pdf>, last accessed on 26 March 2023.

In the guidance note it was proposed that banking institutions use the existing regulations established in the Financial Intelligence Centre Act,¹² whilst awaiting regulatory reform by the South African Reserve Bank and other members of the Intergovernmental Fintech Working Group (IFWG) who would develop specific regulations for the use of crypto assets.¹³

On 19 October 2022, the Financial Sector Conduct Authority (FSCA) declared that crypto assets will be considered a financial product under the Financial Advisory and Intermediary Services Act,¹⁴ thus requiring all institutions and individuals trading in the crypto assets market to be registered as financial institutions.

This research paper aims to address the question as to whether the current South African legislative framework as it currently stands can offer guidance in regulating crypto assets. In addressing this question crypto assets will be defined, and a brief outline of how crypto assets operate will be discussed, as well as an exposition of events which have called into question the stability and financial sustainability of the crypto asset market. Furthermore, a comparative analysis of the positions in the United States of America; the European Union; Nigeria and the People's Republic of China will be made with specific reference to the FSCA's recent declaration and the issued policy document in support of this regulatory development.

An analysis of the recommendations proposed by the IFWG in its 2021 position paper will be done in light of the recommendations proposed by academic commentators and the like.

II CRYPTOCURRENCIES AND THEIR PLACE IN THE FINANCIAL MARKETS

This section will deal with the emergence of crypto assets and how they have been defined, as well as the risks associated with such assets in the absence of proper regulations.

¹² *Financial Intelligence Centre Act* 38 of 2001, hereinafter referred to as '*FICA*'.

¹³ SARB Prudential Authority op cit note 11.

¹⁴ General Notice 1350 GG 47334 of 19 October 2022, available at <https://archive.gazettes.africa/archive/za/2022/za-government-gazette-dated-2022-10-19-no-47334.pdf>, last accessed on 26 March 2023.

(a) WHAT ARE CRYPTOCURRENCIES OR CRYPTO ASSETS

In 2021 the Crypto Asset Regulatory Working Group (CAR WG) of the IFWG – a body consisting of the National Treasury, the SARB, FSCA and other national financial regulators – released an updated position paper with regard to the regulation of crypto assets within South Africa.¹⁵

In the updated position paper, South African regulators have defined crypto assets as ‘... a digital representation of value that is not issued by a central bank, ... capable of being traded, transferred or stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility; applies cryptographic techniques and uses distributed ledger technology.’¹⁶

On 19 October 2022, in the FSCA’s declaration, the above definition was officially adopted and section 1 of the Financial Advisory and Intermediary Services Act 37 of 2002,¹⁷ was amended to include the definition of crypto assets as adopted by regulators in South Africa and abroad. Furthermore, section 1 of the *FAIS Act* has been further amended to include crypto assets under the definition of a ‘financial product’.¹⁸

In order to fully understand the nature of crypto assets it is important to understand what is meant by ‘not issued by a central bank’, ‘cryptographic techniques’ and ‘the distributed ledger’ – further known as the decentralised nature of crypto assets, as set out in the definition of crypto assets above.¹⁹

(i) The decentralised nature of crypto assets

The creation of crypto assets, such as the popularly traded Bitcoin and Ether, was initially meant as competition for standard fiat currencies i.e. currencies issued by a central bank, regulated and used for the trading and purchasing of everyday commodities.²⁰ Whereas fiat currencies rely on a

¹⁵ IFWG ‘Crypto Assets Regulatory Working Group Position Paper on Crypto Assets’ (2021), available at https://www.treasury.gov.za/comm_media/press/2021/IFWG_CAR%20WG_Position%20paper%20on%20crypto%20assets_Final.pdf, last accessed on 26 March 2023.

¹⁶ Ibid at 16.

¹⁷ Hereinafter referred to as ‘*FAIS Act*’.

¹⁸ Paragraph (h) of the definition of ‘financial product’.

¹⁹ IFWG op cit note 15 at 16.

²⁰ E Reddy and V Lawack op cit note 1 at 7.

centralised banking system for their stability and everyday use, crypto assets are based on the decentralised, mathematical technology known as cryptography.²¹

The decentralised nature of crypto assets therefore means that there is no control by a central bank or government, which supports the understanding that crypto assets are free from government control and therefore a true reflection of the notion of the ‘free-market theory’.²²

In order to participate in the crypto asset system a user must use open-source software - which is software capable of development by those who become part of the development community, which allows users to communicate over what is known as a peer-to-peer network.²³ This allows for the trading of crypto assets without the need for a centralised body or middle-man and rather direct interaction between traders and users of crypto assets.²⁴ In contrast to the centralised monetary system, crypto assets are known to be ‘pseudo-anonymous’²⁵ in that the personal identity of the user always remains anonymous.²⁶ However, this sense of anonymity is foregone once there is any transfer of any crypto assets or the use of fiat currencies to purchase crypto assets,²⁷ resulting in transactions being made public.²⁸

The ability to make public all transactions on the open-source software is made capable by blockchain technology, which is a public ledger of all crypto asset transactions.²⁹ It is this public ledger which gives crypto assets their decentralised nature in that there is no central entity controlling the distribution of crypto assets.³⁰

Furthermore, the open-source software associated with the use of crypto assets allows for the cost effective and quick transferability of funds across borders, without the usual centralised regulatory rules imposed in the trading of fiat currencies.³¹

A further technological difference between crypto assets and fiat currency, is that of the blockchain. A ledger used to track all crypto asset transactions, including details pertaining to those

²¹ Deon Erasmus and Susan Bowden ‘A Critical Analysis of South African Anti-Money Laundering Legislation with regard to Cryptocurrency’ (2020) *OBITER* 309 at 312.

²² E Reddy and V Lawack op cit note 1 at 7.

²³ E Reddy and V Lawack op cit note 1 at 9.

²⁴ Ibid.

²⁵ D Erasmus and S Bowden op cit note 21 at 311.

²⁶ Ibid.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.

³⁰ Ibid.

³¹ D Erasmus and S Bowden op cite note 21 at 312; Karabo Mothokoa *Regulating Crypto-Currencies in South Africa* (unpublished LLM thesis, University of Pretoria 2017) 73 at 38.

trading in and using crypto assets. Each transaction forms a ‘chain’ within the peer-to-peer network thus forming the blockchain.³²

The link between crypto assets and fiat currencies, lies in the fact that fiat currencies may be used to purchase crypto assets through an exchange.³³ Furthermore, crypto assets may be used to purchase goods and services and stored in an online wallet which is linked directly to the specific user-owner and records all transactions on the blockchain.³⁴

(ii) Stablecoins – Offering stability or volatility

Being decentralised allows crypto assets the ability to operate without the usual red-tape of regulation associated with the centralised monetary system.³⁵ However, this can lead to higher volatility and less stability, which may detract from the possible gains offered by crypto assets.³⁶

As such there has been an emergence in what has been termed – stablecoins. Stablecoins are crypto assets which maintain or purport to maintain their value by being backed or pegged against a specific asset, such as a fiat currency like the US Dollar, or other financially backed assets.³⁷ In being backed by the US Dollar, for instance, a stablecoin is able to offer crypto asset users or those interested in crypto assets ‘stability when compared to the high volatility of unbacked crypto-assets’.³⁸

Thus, it can be understood that the stability and therefore trust placed in stablecoins is based purely on the value of the financial asset it is back by, which has been issued by a central bank or the current financial market.³⁹ Stablecoins are therefore the crypto market’s answer to dealing with the decentralised financial market’s high volatility.⁴⁰

According to the Financial Stability Board (FSB), stablecoins are commonly used for trading crypto assets with fiat currency.⁴¹ Therefore, as the use of stablecoins increases they will

³² E Reddy and V Lawack op cit note 1 at 12.

³³ E Reddy and V Lawack op cit note 1 at 13.

³⁴ E Reddy and V Lawack op cite note 1 at 12.

³⁵ E Reddy and V Lawack op cit note 1 at 3.

³⁶ NH Hamukuaya ‘The Development of Cryptocurrencies as a Payment Method in South Africa’ (2021) 24 *Potchefstroom Electronic Law Journal* 1 at 14-15.

³⁷ P Bains op cit note 3 at 10; BIS (Bank of International Settlements) op cit note 3 at 81.

³⁸ FSB (Financial Stability Board) ‘Crypto-assets and Global “Stablecoins”’, available at <https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/crypto-assets-and-global-stablecoins/>, last accessed on 26 March 2023.

³⁹ BIS (Bank of International Settlements) op cit note 3 at 81.

⁴⁰ Ibid.

⁴¹ Ibid.

‘become more interconnected with the existing financial system’⁴² therefore, eventually elevating stablecoins to the same level as fiat currency in that they will become ‘a means of payment and store of value’.⁴³

The International Monetary Fund has noted that stablecoins can potentially be used by developing economies and other emerging markets with failing or weak fiat currencies.⁴⁴ These markets and economies can use stablecoins to ‘hedge against inflation’.⁴⁵ Furthermore, in using stablecoins, which creates the impression of stability and security can potentially enable developing economies to substitute their weaker fiat currencies, thus allowing for stablecoins to enter the existing currency exchange market.⁴⁶

In order to prevent an over reliance on the value of a fiat currency, there are stablecoins which are based on algorithms.⁴⁷ These algorithms allow the stablecoin to remain balanced and thus meet the targets set by the fiat currency of financial asset it is backed by.⁴⁸ In order for algorithmic stablecoins to operate optimally, they rely on what is known as ‘smart contract-based algorithm to regulate between a pair of tokens, a stablecoin, and a balance token’.⁴⁹

However, although the name stablecoins suggest stability and less volatility, it has been noted that this is not always the case.⁵⁰ It is important to be cognisant that the future of stablecoins and the possibility of their stabilising impact on the crypto asset market for those who are sceptical and wish for clearer surety, lies in them being transparent and there being substantial assets in the reserves of the issuer.⁵¹ This however, appears to be sorely lacking in the crypto asset market as will be evidenced in the discussion surrounding recent events in the crypto asset market expounded on in section V below.

III RISKS ASSOCIATED WITH CRYPTO ASSETS

The decentralised nature of crypto assets leaves users open to a variety of risks, not very different to those found in the standard financial market. Regulators have highlighted various risks

⁴² P Bains op cite note 3 at 13.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Ibid.

⁴⁷ BIS (Bank of International Settlements) op cit note 3 at 81.

⁴⁸ Ibid.

⁴⁹ P Bains op cite note 3 at 22.

⁵⁰ Ibid.

⁵¹ Ibid

associated with crypto assets, these risks have been divided into two main categories, namely: general risks associated with crypto assets and specific risks associated with the different stages of crypto assets uses.⁵²

Regulators and academics alike have identified risks associated with crypto assets including but not limited to money laundering / financing of terrorist activities; cyber security; and the volatility of the crypto asset market.

(a) Decentralised Parallel Monetary System, High Volatility & Transparency

Crypto assets are not created or issued into the market by a central bank, but rather by private individuals with their own objectives.⁵³ Central banks ensure a monetary system with efficient monetary policies, influencing the supply of money and the respective country's fiat currency.⁵⁴

The non-regulation of crypto assets may result in a parallel and fragmented monetary system in which the demand for crypto assets will increase and thereby decreasing the demand for regulated fiat currencies. Accordingly, this negatively impacts a central bank's ability to ensure an efficient monetary system. Furthermore, by the creation of a parallel monetary system there is also the inevitability of an increase in the instability of prices.⁵⁵

As posited in an earlier section of this thesis, crypto assets are not regulated by a central authority such as a banking institution, therefore there is no guarantee of price stability.⁵⁶ Crypto assets are associated with high volatility, this means that the variance over time with regard to the price of an individual virtual coin can fluctuate quickly over time making it riskier than fiat currency markets.⁵⁷

Unlike fiat currencies, the value of crypto assets is largely determined by the perception of the public. Mothokoa noted that crypto asset exchange merchants and consumers require stability in order to truly feel confident in using crypto assets.⁵⁸ The current unpredictability and volatility of crypto assets may lead to reluctance in using these assets in future without any regulatory protection.⁵⁹

⁵² IFWG op cit note 15 at 30.

⁵³ IFWG op cite note 15 at 22.

⁵⁴ Ibid.

⁵⁵ Karabo Mothokoa op cite note 31 at 30.

⁵⁶ Ibid.

⁵⁷ Karabo Mothokoa op cit note 31 at 36.

⁵⁸ Karabo Mothokoa op cit note 31 at 37.

⁵⁹ Ibid.

It is noted that the decentralised nature of crypto assets further exacerbates the lack of transparency within the crypto asset market.⁶⁰ Those with nefarious objectives may exploit this lack of transparency and abuse consumers' trust by hiding features of the crypto assets and the inherent risks associated.⁶¹

(b) Anonymity within the crypto asset market

The Financial Action Task Force (FATF) released guidelines in 2014 for member states to consider when dealing with the existence of crypto assets within financial markets and how these member states should regulate and handle the existence of this emerging financial asset.⁶²

As stated earlier in this thesis the true of identity of a crypto asset user is unnecessary to purchase crypto assets, therefore there is always a layer of anonymity associated with crypto assets.⁶³ Anonymity creates a favourable hub for criminals who seek to hide the true intention of their operations due to the near impossibility to of being able to trace transactions to the precise individual who partook in the said illegal transaction.⁶⁴

Anonymity further leaves the users susceptible to cyber security attacks. Regulators noted that the large number of transactions completed during the Initial Coin Offering stage, can be of particular interest for criminals who will benefit from the lack of security measures in place and the irreversibility of the technology governing transactions.⁶⁵

(c) Money laundering / financing of terrorist activities

Associated with the anonymous nature of crypto asset transactions is the increased ability to conduct illegal activity such as money laundering and the financing of terrorist activities. Money laundering is the processing of illegally obtained assets and money through legitimate financial market means in order to conceal their illegal origins.⁶⁶

⁶⁰ Karabo Mothokoa op cit note 31 at 35.

⁶¹ Ibid.

⁶² FATF 'Virtual Currencies - Key Definitions and Potential AML/CFT Risks' (2014) FATF, Paris, France, available at <https://www.fatf-gafi.org/en/publications/Methodsand Trends/Virtual-currency-definitions-aml-cft-risk.html>, last accessed on 26 March 2023.

⁶³ D Erasmus and S Bowden op cit note 21 at 311.

⁶⁴ D Erasmus and S Bowden op cit note 21 at 315; Karabo Mothokoa op cit note 27 at 37.

⁶⁵ IFWG op cit note 15 at 27.

⁶⁶ Karabo Mothokoa op cit note 31 at 26.

Currently there is no specific regulation requiring that Crypto Asset Service Providers must be able to identify their customers when they purchase, trade or convert their crypto assets.⁶⁷ The lack of information surrounding the identity of customers means that customers who are involved in money laundering, terrorist financing or in the process of making illegitimate cross-border financial transactions will not be capable of being identified.⁶⁸

In the position paper released by South African regulators, it was noted that some crypto asset traders require customer identification such as the crypto exchange Luno, which requires the real identity of the customer in order for an account to be created.⁶⁹ Erasmus notes that this requirement ensures the protection of the customer's identity and assists with being able to trace and identify the criminal should there be an investigation into any illicit activities.⁷⁰

However, when regulators first published their position paper on crypto assets and all subsequent updated versions, this procedure as followed by Luno to ensure that crypto asset exchanges and wallets obtain their customers' identities and perform the usual regulatory background checks on customers, was not a regulatory requirement but rather an anti-money laundering / counter financing of terrorism (AML/CFT) measure implemented at the discretion of the crypto asset exchange.⁷¹

Though there may not be any specific AML/CFT measures established with regard to crypto assets, the FATF did provide guidelines and recommendations to member states in using existing and developing further AML/CFT measures to combat any potential risks faced by the crypto asset market.⁷² Specifically, member states should require crypto assets exchanges (also known as service providers) to be registered with regulatory authorities and thus be legally obligated to conduct the Know Your Customer policy as with all financial institutions conducting business in the financial markets.⁷³

⁶⁷ IFWG op cit note 15 at 23.

⁶⁸ Ibid; FATF 'Guidelines for a risk-based approach to virtual currencies' (2015) FATF, Paris, France at 32, available at <https://www.fatf-gafi.org/en/publications/Fatfgeneral/Guidance-rba-virtual-currencies.htm>, last accessed on 26 March 2023.

⁶⁹ D Erasmus and S Bowden op cit note 21 at 315.

⁷⁰ Ibid.

⁷¹ Ibid.

⁷² FATF op cit note 68 at 19-20; FATF 'Updated Guidance for a risk-based approach to virtual assets and virtual asset service providers' (2021) FATF, Paris, France, available at <https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Guidance-rba-virtual-assets-2021.html>, last accessed on 21 April 2023.

⁷³ D Erasmus and S Bowden op cit note 18 at 318-19.

Although, there are currently no regulatory obligations placed on the crypto asset market, in the position papers published by the *IFWG's CAR WG* it was noted that there should be specific regulatory frameworks in place for dealing with anti-money laundering / counter financing of terrorism in terms of the recommendation made by the FATF which recommends that providers of financial services relating to the issuing, offer or sale of crypto assets with regard to an Initial Coin Offering should be registered as accountable institutions for purposes of reporting nefarious activities.⁷⁴

There appears to be a fault in the armor provided by AML/CFT measures when it comes to the use of crypto assets. This can be seen in particular when one observes the use of crypto assets on what has been termed the Dark Web, a seedy corner of the Internet where no governance and illegal, criminal activity is the aim.⁷⁵

A prime example of the above can be observed in the case of Silk Road, which was an illicit 'marketplace'⁷⁶ used for criminal activity and the trading of illegal goods and services over the Internet with the use of crypto assets as payment.⁷⁷

IV CHALLENGES IN REGULATION USING AML/CFT MEASURES

Regulators have noted that there are particular challenges posed in attempting to regulate crypto assets due to their decentralised and anonymous trading nature.⁷⁸ Erasmus notes that in a perfect world the most effective regulatory approach would be to scrutinize every component in the crypto asset transaction.⁷⁹

However, due to the anonymity awarded to a crypto asset user and thus the fact that no personal information is exchanged between users either buyers or sellers, it would be impossible to regulate this phase of the crypto asset transaction.⁸⁰ Furthermore, even if regulators were able to track and trace users in a crypto asset transaction, this would be a costly exercise with little surety of success.⁸¹

⁷⁴ IFWG op cit note 15 at 25; FATF op cit note 68 at 22-3.

⁷⁵ D Erasmus and S Bowden op cit note 18 at 315.

⁷⁶ Karabo Mothokoa op cit note 31 at 27.

⁷⁷ Ibid.

⁷⁸ IFWG op cite note 15 at 28.

⁷⁹ D Erasmus and S Bowden op cit note 18 at 319.

⁸⁰ Ibid.

⁸¹ Ibid.

Some authors have posited that regulation may lie in requesting that crypto asset developers alter the current coding pattern of the asset by de-anonymising all crypto asset transactions.⁸² However, this would be impossible to guarantee and would go against the very nature of crypto assets.

Thus, it has been posited that the best way within which to regulate crypto asset using the existing AML/CFT measures available, would be to use a balanced approach.⁸³ Crypto asset exchanges should be required legally to follow AML/CFT measures and should apply the Know Your Customer policies. In doing so exchanges will be procedurally required to keep all customer information regarding their identity, as well as running background checks to confirm that the information furnished by the customer is correct.⁸⁴

In following AML/CFT measures exchanges would further be required to report on all suspicious transactions and ensure that where suspicions are raised from the outset of the exchanger-customer relationship, that the exchange does not perform any transactions for such customer.⁸⁵

V QUESTIONING EVENTS IN THE CRYPTO MARKET

As discussed earlier in this research paper, there have been numerous events which have brought into question the volatility of the crypto asset market and the ensuing fragmented nature of this decentralised financial market.

(a) Terraform Labs PTE Ltd Collapse May 2022

An event that has not assisted the case of crypto assets and the vitriol its detractors spread, is that of the collapse of TerraUSD (UST) and its associated crypto coin Luna in May 2022. TerraUSD (UST) was an algorithmic stablecoin created by Terraform Labs PTE Ltd and was backed by the UST which aimed to have a ‘one-to-one peg to the US dollar’⁸⁶ allowing for users to be able to convert their TerraUSD (UST) for \$1 worth of Luna, the same applying to the conversion of Luna to TerraUSD (UST).

⁸² Ibid.

⁸³ D Erasmus and S Bowden op cit note 18 at 320.

⁸⁴ Ibid.

⁸⁵ Ibid.

⁸⁶ BIS (Bank of International Settlements) op cit note 3 at 82.

However, in May 2022 UST made a \$2.5 billion withdrawal from Anchor, a lending platform operated on the same blockchain as TerraUSD (UST) and Luna.⁸⁷ Within the same period, UST began losing liquidity, which has been cited as a major concern surrounding stablecoins and their ability to liquidated assets within their reserves should the financial needs arise.⁸⁸

According to the U.S Securities and Exchange Commission’s Press Release (2023-32),⁸⁹ it is alleged that Terraform and its CEO, Do Hyeong Kwon misled investors with regard to the liquidity and stability of UST, and continued to make false marketing statements when promoting Luna coins.⁹⁰ As such, on 16 February 2023 Terraform Labs PTE Ltd and Do Kwon were charged with ‘orchestrating a multi-billion dollar crypto asset securities fraud involving an algorithmic stablecoin and other crypto asset securities.’⁹¹

The impact of the TerraUSD (UST) and the subsequent Luna crash was felt throughout the crypto asset market. Not only did UST’s being unpegged or unbacked by the US Dollar impact other stablecoins, such as the largest stablecoin Tether; the crash further resulted in all unbacked coins suffering major losses.⁹²

(b) The Collapse of FTX Trading Ltd

On 13 December 2022, the U.S Securities and Exchange Commission charged crypto asset trading platform (exchange) FTX and its Chief Operating Officer and co-founder, Samuel Bankman-Fried with fraud and the violation of securities laws.⁹³

It is noted that at the time of being charged, FTX was considered one of the largest crypto asset exchanges, with celebrity endorsements and a high volume of investors.⁹⁴ In its heyday, FTX

⁸⁷ Ibid.

⁸⁸ BIS (Bank of International Settlements) op cit note 3 at 8; P Bains op cit note 3 at 22.

⁸⁹ U.S Securities and Exchange Commission Press Release ‘SEC Charges Terraform and CEO Do Kwon with Defrauding Investors in Crypto Schemes.’ 2023-32, available at <https://www.sec.gov/news/press-release/2023-32>, last accessed on 26 March 2023.

⁹⁰ Ibid.

⁹¹ Ibid.

⁹² P Bains op cit note 3 at 23.

⁹³ U.S Securities and Exchange Commission Press Release ‘SEC Charges Samuel Bankman-Fried with Defrauding Investors in Crypto Asset Trading Platform FTX.’ 2022-219, available at <https://www.sec.gov/news/press-release/2022-219>, last accessed on 26 March 2023.

⁹⁴ Ibid.

was promoted as a safe crypto asset exchange platform, with ‘sophisticated, automated risk measures to protect customer assets.’⁹⁵

However, behind the scenes the exchange platform was anything but safe. It has been alleged that the funds brought into FTX were syphoned out of the exchange platform into Alameda Research LLC, Bankman-Fried’s privately owned crypto hedge fund.⁹⁶ In syphoning investor funds into Alameda Research, FTX granted the crypto hedge fund ‘virtually unlimited’⁹⁷ credit funded by FTX’s customers, and further exempted Alameda from the usual risk mitigation factors other debts were forced to abide by.⁹⁸

In providing Alameda with these exemptions (to the detriment of and without the consent of FTX investors and customers) FTX was left unprotected to Alameda’s holdings.⁹⁹ The U.S Securities and Exchange Commission has further alleged that Bankman-Fried used the funds in FTX for his personal gain and to acquire personal properties and investments, thus treating FTX as his personal financial institution.¹⁰⁰

FTX and Bankman-Fried were charged with being in contravention of the anti-fraud provisions of the *Securities Act* of 1933 and the *Securities Exchange Act* of 1934.¹⁰¹

(c) Ishan Wahi of Coinbase pleading guilty to insider trading

On 7 February 2023, Ishan Wahi (Wahi) the former product manager of Coinbase, a crypto asset exchange platform based in America, pled guilty to insider trading in what is considered the first crypto asset insider trading case.¹⁰²

In a case pursued by the United State Attorney for the Southern District of New York, Wahi pleaded guilty to using confidential information held by Coinbase to assist individuals, Nikhil Wahi and Sameer Ramani, with making profitable crypto asset trades.¹⁰³ On multiple occasions Nikhil Wahi and Sameer Ramani were privy to information regarding crypto assets

⁹⁵ Ibid.

⁹⁶ Ibid.

⁹⁷ Ibid.

⁹⁸ Ibid.

⁹⁹ Ibid.

¹⁰⁰ Ibid.

¹⁰¹ Ibid.

¹⁰² United States Attorney’s Office, Southern District of New York ‘Former Coinbase Insider Pleads Guilty In First-Ever Cryptocurrency Insider Trading Case.’, accessed from <https://www.justice.gov/usao-sdny/pr/former-coinbase-insider-pleads-guilty-first-ever-cryptocurrency-insider-trading-case>, last accessed on 26 March 2023.

¹⁰³ Ibid.

which were going to be listed on Coinbase, resulting in these individuals selling their crypto assets for substantial profits once Coinbase publicly announced these new listings.¹⁰⁴

Wahi was caught partaking in insider trading, when a twitter account operated by Sameer Romani admitted to purchasing Etheruem coins (an unbacked crypto asset) within 24 hours before Coinbase had publicly announced their listing. Through careful investigation the relationship between Wahi and Sameer Romani was established and soon the floodgates were opened.¹⁰⁵

This case has been considered by many to be the first case of insider trading in the crypto asset market,¹⁰⁶ and shows the necessity for clear regulatory rules for the operation of crypto asset exchange platforms to ensure that such instances are curtailed and consequences for such actions set out clearly for the public's knowledge.

VI REGULATORY POSITIONS TAKEN BY DIFFERENT JURISDICTIONS

Globally, governments have been tasked with the difficult decision of how to regulate crypto assets and whether or not crypto assets should be regulated at all. As such there have been differing approaches taken across foreign jurisdictions. This section will contrast the regulatory approaches taken by the United States of America; the European Union; Nigeria; and China – jurisdictions where the regulation of crypto assets has developed as a refence point for other jurisdictions, or in some cases where the use of crypto assets have in their totality been banned.

These approaches will be contracted with the recommendations made by the IFWG's CAR WG and the recent policy declaration made by the FSCA in addressing crypto asset regulation and recognition as a financial product.

(a) Crypto Asset Regulation in the United States of America

There are several regulatory bodies within the United States of America which may facilitate the regulation of crypto assets.¹⁰⁷ The Securities and Exchange Commission has stated that for purposes of the regulator's obligations, crypto assets are considered securities.¹⁰⁸ This was after the case of *Securities and Exchange Commission v Trandon T. Shavers and Bitcoin Savings and*

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

¹⁰⁶ Ibid.

¹⁰⁷ Blake Hamil 'EU Crypto Currency Regulation: Creating a Haven for Businesses or for Criminals?' (2020) 48 *Georgia Journal of International & Comparative Law* 833 at 837.

¹⁰⁸ Ibid.

Trust,¹⁰⁹ where the Securities and Exchange Commission was required to determine whether investments in Bitcoin fell within the ambit of the definition of securities¹¹⁰.

In the aforementioned matter the court developed the Howey Test which states that an investment shall constitute a security if it involves the investment of money in an enterprise for the purpose of making a profit through the efforts of a third party.¹¹¹

The Commodity Futures and Trading Commission (CFTC) released a policy document in 2017 which determined that crypto assets fall within the ambit of the definition of commodities as defined in section 1a(9)the *Commodity Exchange Act*,¹¹² - ‘all goods and services for tangible products, and all services, rights and interests for intangible products specifically contracts for future delivery which are presently or in the future dealt in.’¹¹³ The CFTC first defined crypto assets as commodities in 2015 in the case of *Coinflip, In., d/b/a Derivabit, and Francisco Riordan*.¹¹⁴

Furthermore, the Financial Crimes Enforcement Network has classified crypto asset developers and service providers as “money transmitters”¹¹⁵ for purposes of the *Bank Secrecy Act*.¹¹⁶ In this regard crypto asset developers and service providers are required to keep detailed records of their transaction similar to banks and other financial institutions,¹¹⁷ and are to further practice strict anti-money laundering and Know Your Customer protocols.¹¹⁸ It has been noted that the importance of including crypto asset developers into the definition of money transmitters, extends regulatory reach to those who mine crypto assets, as well as those offering Initial Coin Offerings for new crypto assets.¹¹⁹

¹⁰⁹ *Securities and Exchange Commission v Trandon T. Shavers and Bitcoin Savings and Trust Case No. 4: 13-CV-416 United States District Court at 2*, as cited in Lucrecia Sadhaseevan *The Regulation of Cryptocurrencies in the Context of South Africa’s Financial Sector* (unpublished LLM thesis, University of KwaZulu-Natal 2019) at 69.

¹¹⁰ *Ibid*

¹¹¹ *Ibid*.

¹¹² *Commodity Exchange Act* (ch. 545, 49 Stat. 1491).

¹¹³ Commodity Futures and Trading Commission, ‘A CFCT Primer on Virtual Currencies’ (2017) at 11, available at https://www.cftc.gov/sites/default/files/idc/groups/public/documents/file/labcftc_primercryptocurrencies100417.pdf, last accessed on 26 March 2023.

¹¹⁴ CFTC Docket No. 15-29, available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder09172015.pdf>, last accessed on 3 November 2022.

¹¹⁵ Blake Hamil op cit note 107 at 838.

¹¹⁶ *Ibid*.

¹¹⁷ *Ibid*.

¹¹⁸ *Ibid*.

¹¹⁹ *Ibid*.

(b) Crypto Asset Regulation in the European Union

Within the European Union there has been a request from member states for the European Central Bank to set guidelines for the regulation of crypto assets.¹²⁰ In this regard the European Central Bank has been reticent in defining crypto assets, choosing to instead state that for purposes of the European Central Bank crypto assets do not qualify as legal tender within the European Union.¹²¹

However, the European Union has developed their anti-money laundering regulations in the form of the Fifth Anti-Money Laundering Directive (AMLD5),¹²² to include crypto assets exchange services and wallets providers as accountable institutions which must keep detailed records of their transactions, as well as follow the Know Your Customer protocols for reporting purposes.¹²³

In incorporating crypto assets into the ambit of AML/CFT law across Europe, the AMLD5 further replaced paragraph 1 of Article 47 of the previous rendition of the directive to specifically provide for the registration of crypto asset exchanges and wallet providers by all member states.¹²⁴

Hamil argues that although there has been a movement to codify and include crypto asset exchanges and wallet providers, the lack of inclusion of crypto asset developers in the AMLD5 fails to protect member states and their citizens from criminals posing as legitimate crypto asset developers who will attempt to commit fraudulent or illicit activities.¹²⁵

(c) Crypto Asset Regulation in Nigeria

To date there is no official regulatory framework in place for the regulation and control of crypto assets in Nigeria.¹²⁶ However, it has been noted that two financial statutes in Nigeria may serve to assist with the regulation of the emerging assets.¹²⁷ In his article titled *Cryptocurrency: Towards Regulating the Unruly Enigma of Fintech in Nigeria and South Africa*,¹²⁸ Ukwueze posits that

¹²⁰ Blake Hamil op cit note 107 at 839.

¹²¹ Ibid.

¹²² Council Directive 2018/843, 2018 O.J. (L 156/43) 3 (EC), available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32018L0843>, last accessed on 26 March 2023.

¹²³ Ibid at L 156/44.

¹²⁴ Article 29 of Council Directive 2018/843, 2018 O.J. (L 156/43) 3 (EC) at L 156/67, available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32018L0843>, last accessed on 26 March 2023.

¹²⁵ Blake Hamil op cit note 107 at 840.

¹²⁶ Ukwueze FO 'Cryptocurrency: Towards Regulating the Unruly Enigma in Fintech in Nigeria and South Africa' *Potchefstroom Electronic Law Journal* 2021 (24) at 12.

¹²⁷ Ibid.

¹²⁸ Ibid.

section 2 of the *Foreign Exchange (Monitoring and Miscellaneous Provisions) Act*,¹²⁹ as well as sections 13 and 315 of the *Investments and Securities Act*,¹³⁰ could possibly assist with the regulation of crypto assets in Nigeria.¹³¹

In its approach to crypto assets, Ukwueze notes that although the Nigerian *Foreign Exchange Act* does not make particular reference to crypto assets it does make reference to transactions conducted in foreign currencies, through the usual money market instruments or “any other money market instrument”¹³² at the discretion of the Nigerian Minister of Finance.¹³³ This would therefore require the extension of existing statutes to incorporate the use of crypto assets; however, he notes that this lack of crypto asset inclusion does not prevent citizens of Nigeria from dealing in crypto assets outside of the existing foreign exchange system.¹³⁴

The initial approach to crypto assets in Nigeria has been that of scepticism due to the uncertainty with regard to consumer protection to losses and the close association of crypto assets to pyramid schemes.¹³⁵ Both the Central Bank of Nigeria and the Nigerian Securities and Exchange Commission have expressed doubts and concerns with regard to the use of crypto assets due to the links crypto assets have had to money laundering or the financing of terrorism. In 2021 the Central Bank of Nigeria issued directives to all financial institutions operating within the borders of Nigeria, to ascertain who of their clients are transacting in or with crypto assets and to have such bank accounts closed, failing to comply would result in sanctions being imposed on the financial institutions.¹³⁶

However, the Nigerian Securities and Exchange Commission appears to be more open to finding an amicable regulatory solution to the issues posed by crypto assets. In 2018 the Nigerian Securities and Exchange Commission established the Fintech Roadmap Committee in order to develop adequate strategies for dealing with the emergence of crypto assets.¹³⁷ The Fintech Roadmap Committee issued a recommendation that the Securities and Exchange Commission

¹²⁹ Cap F34 LFN 2004 as cited in Ukwueze FO op cit note 126 at 12.

¹³⁰ Act 29 of 2007 as cited in Ukwueze FO op cit note 126 at 12.

¹³¹ Ibid.

¹³² Ibid.

¹³³ Ibid.

¹³⁴ Ibid.

¹³⁵ Ukwueze FO op cit note 126 at 13.

¹³⁶ Ukwueze FO op cit note 126 at 14.

¹³⁷ Ibid.

classify crypto assets as securities and not currencies.¹³⁸ In doing to the Securities and Exchange Commission would be broadening their regulator powers.

In recent years the Securities and Exchange Commission has set up the Blockchain and Virtual Financial Assets Framework Committee to assist with the development of recommendations and guidelines for regulating crypto assets in Nigeria.¹³⁹ To date the Securities and Exchange Commission awaits the recommendations, but has released statements in which it has stated that it shall regulate crypto assets in instances where the activities constitute securities transactions.¹⁴⁰ Although this may not be regulation of crypto assets as envisaged, Ukwueze notes that this may be a step in the direction of things to come in the future for crypto asset regulation in Nigeria.¹⁴¹

(d) Crypto Asset Regulation in the People’s Republic of China

As of May 2021, the Chinese government has banned all activities involving the exchange, trading, payment or mining of crypto assets.¹⁴² The government cited the volatility of the crypto asset market and the adverse impact this volatility would have on ‘economic and financial order’. It was further submitted that crypto assets would result in the flow of Chinese capital to foreign markets in order to circumvent the monetary controls put in place by the government.¹⁴³

However, the Chinese government has recognised crypto assets as a property right during inheritance disputes, which has created some confusion with some academic commentators noting that ‘property rights “illegally” obtained in violation of the ban laws should be tainted by *ex turpi causa*.’¹⁴⁴

Of great interest is the development of the Central Bank Digital Currency, which is a crypto asset created by the Chinese Central Bank using blockchain technology in order to establish a virtual fiat currency which will result in the Chinese market being fenced in and preventing any outflows of Chinese capital to foreign jurisdictions.¹⁴⁵ Thus, the Chinese Government will be able

¹³⁸ Ibid.

¹³⁹ Ibid.

¹⁴⁰ Ukwueze FO op cit note 126 at 16.

¹⁴¹ Ibid.

¹⁴² Iris H-Y Chiu, ‘Hegemony, Self-Regulation or Responsive Regulation: International Regulation Competition in Crypto-Finance’ (2021) 24 *Currents: Journal of International Economic Law* 3 at 13.

¹⁴³ Ibid.

¹⁴⁴ Ibid.

¹⁴⁵ Ibid.

to create a controlled virtual market using the consumer trait of risk avoidance which relies on ‘home bias, familiarity with home institutions or indeed the compulsion to rely on home institutions’.¹⁴⁶

VII RECOMENDATIONS PROPOSED FOR SOUTH AFRICA

This following section specifically looks at the recommendations which were made by the IFWG’s CAR WG with regard to the regulation of crypto assets within South Africa, in comparison to the recently release *Policy Document Supporting the Declaration of a Crypto Asset as a Financial Product Under the Financial Advisory and Intermediary Services Act* as issued by the FSCA on 19 October 2022.

It is important to note that the IFWG’s CAR WG highlighted principles necessary to consider and which support the need for a regulatory framework for crypto assets and service providers alike before delving into the recommendation made.

(a) Principles in Support of Regulation

(i) Principle 1

Ensuring that a risk-based approach is implemented in order to ensure that a balance is struck between the risks posed by crypto assets and the benefits associated with the emerging market.¹⁴⁷ These risks and benefits of crypto assets must be weighed-up against the obligations placed on regulatory bodies to ensure that the integrity and stability of the financial markets are retained at all times.¹⁴⁸

(ii) Principle 2

A unified regulatory approach should be implemented to ensure consistence amongst regulatory authorities, whilst being aware of the international regulations in place for crypto assets.¹⁴⁹

¹⁴⁶ Ibid.

¹⁴⁷ IFWG op cit note 15 at 29.

¹⁴⁸ Ibid.

¹⁴⁹ Ibid.

(iii) Principle 3

It is imperative that a phased approach to regulating crypto assets is implemented in order to ensure the correct level of regulation is adopted.¹⁵⁰

(iv) Principle 4

All regulations should be technology-neutral and principles-based, which requires broader, high-level principles over prescriptive rules.¹⁵¹ In special circumstances and where necessary principles may be accompanied by detailed regulatory requirements or standards.¹⁵² Furthermore, although the technology cannot be separated from the activity which is performed, it is imperative that the regulation be applied to the activity or function as opposed to the type of technology used.¹⁵³

(v) Principle 5

All regulations should be adaptive to changes in the crypto asset environment without requiring constant amendments, which may cause unnecessary delays in the implementations of regulatory frameworks.¹⁵⁴

(b) General Regulatory Recommendations

In developing a responsive regulatory framework for the South African financial market a number of general recommendations, as well as specific recommendations for the different stages in the crypto asset market, were made by regulators in their position paper. The following are a few of the general recommendations proposed for consideration in order to establish sound regulatory reform:

(i) Recommendation 1

Entities providing crypto assets services should be defined as - Crypto Asset Service Providers (CASPs).¹⁵⁵ An example of entities which satisfy the definition of CASPs include but are not limited to: crypto asset vending machine operators; crypto asset token issuers; crypto asset fund or derivative service providers.¹⁵⁶

¹⁵⁰ Ibid.

¹⁵¹ Ibid.

¹⁵² Ibid.

¹⁵³ Ibid.

¹⁵⁴ Ibid.

¹⁵⁵ IFWG op cit note 15 at 30.

¹⁵⁶ IFWG op cit note 15 at 31-2.

In establishing the various classifications of the various types of CASPs, regulators recommended that specific institutions would be in charge of the registration and monitoring of that specific service provider, for example crypto asset vending machine operators are to register with the SARB's Financial Surveillance Department as a Crypto Asset Trading Platform and/or 'money remitter in terms of the Exchange Control Regulations';¹⁵⁷ the Financial Intelligence Centre as an Accountable Institution in terms of Schedule of the *FICA*;¹⁵⁸ and the Financial Sector Conduct Authority as a licensed crypto asset intermediary, in line with any developments in the Conduct of Financial Institutions Bill.¹⁵⁹

(ii) Recommendation 2 and Recommendation 3

In discussing the potential to regulate crypto assets, it has been recommended that *FICA* should be amended to include CASPs as in the List of Accountable Institutions under Schedule 1 of the *FICA*.¹⁶⁰ If regulators are to take-on-board this recommendation this will require that all CASPs should adhere to AML/CFT regulations and protocols.¹⁶¹

Therefore, CASPs would need to apply a risk-based approach when entering into agreement with customers and would be required to verify both the identity of the customer and all ancillary information which is obtained from the customer and necessary for the adherence of AML/CFT regulations and protocols.¹⁶² Thus, ensuring that CAPS adhere to the AML/CFT policy of Know Your Customer and ensuring that FATF Recommendation 16 with regard to money-laundering and other illegal practices related to wire transfers is abided.¹⁶³

It is noted that FATF Recommendation 16 requires that countries monitor and retain information regarding all wire transfers, such as the originator's information and that of the beneficiary, in order to detect any irregularities.¹⁶⁴ In light of the fact that crypto asset transaction are akin to wire transfers in that there is a link between the originator (purchaser of crypto assets)

¹⁵⁷ IFWG op cit note 15 at 31.

¹⁵⁸ Ibid.

¹⁵⁹ Ibid.

¹⁶⁰ IFWG op cit note 15 at 33; see Schedule 1 of the *FICA*.

¹⁶¹ IFWG op cit note 15 at 33.

¹⁶² IFWG op cit note 15 33.

¹⁶³ Ibid.

¹⁶⁴ FATF 'International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations', FATF, Paris, France (2012-2023), 17-18, available at <https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF%20Recommendations%202012.pdf.coredownload.inline.pdf>, last accessed on 29 May 2023.

and the beneficiary of the funds (CASPs), the need to ensure that FATF Recommendation 16 is upheld is of vital importance.

Furthermore, with regard to the regulatory requirements of *FICA* the Financial Intelligence Centre (FIC) would have to take on a supervisory and regulatory role to ensure that CASPs comply with the requirements of the *FICA* to qualify for the status of an Accountable Institution.¹⁶⁵ This regulatory role of the FIC with regard to CASPs will ensure that when CASPs are investigated for illicit dealings, such as money-laundering, the appropriate legal action can be taken, as well any relevant criminal sanctions imposed if required.¹⁶⁶

(iii) Recommendation 4

The IFWG's CAR WG will continue to monitor any changes in the crypto asset market and shall continue to make any necessary recommendation for the further regulation taking into consideration any changes in the crypto asset market.¹⁶⁷

(iv) Recommendation 5 and Recommendation 6

It is the strong recommendation by the IFWG, in particular the CAR WG that crypto assets remain as non-legal tender and not be equated to electronic money.¹⁶⁸ Furthermore, by not satisfying the definition of legal tender, crypto assets cannot be used for settlement obligations in financial market infrastructures.¹⁶⁹

(v) Recommendation 7 and Recommendation 8

The Prudential Authority shall be tasked with the regulation of those financial institutions with exposure to the crypto asset market.¹⁷⁰ Furthermore, public awareness and education initiatives on the benefits and potential risks associated with crypto assets should be conducted by the FSCA.¹⁷¹

(c) Special Recommendations

Over-and-above the submissions of principles in support for the regulation of crypto assets and the general regulatory recommendations put forward by the various regulatory authorities and the like,

¹⁶⁵ IFWG op cit note 15 at 34.

¹⁶⁶ Ibid.

¹⁶⁷ Ibid.

¹⁶⁸ IFWG op cit note 15 at 35.

¹⁶⁹ Ibid.

¹⁷⁰ Ibid.

¹⁷¹ Ibid.

there are further special recommendations which are essential in developing a sustainable regulatory framework for crypto assets within the South African context.

(i) Trading of crypto assets by consumers

The IFWG's CAR WG made further specific recommendations for the various stages and uses in the crypto asset market. This thesis will focus on one specific recommendation and probably the most pertinent of the specific recommendations referred to in the position paper published by the IFWG.

According to the IFWG it is recommended that in the interim the FSCA declare crypto assets as a financial product in terms of paragraph (h) of section 1(1) of the *FAIS Act*.¹⁷² This interim recommendation declaring crypto assets as a 'financial product' would grant the FSCA the necessary 'legal powers'¹⁷³ to ensure customers do not fall prey to being abused by those appearing to offer financial guidance on crypto assets.¹⁷⁴

On 19 October 2022, in line with this above recommendation the FSCA published a declaration that as of the date of publication, crypto assets will be regarded as a 'financial product' and thus able to be regulated by the FSCA in line with the *FAIS Act*. Before publication of the declaration, the FSCA requested comments from interested parties in the financial field with regard to the planned inclusion of crypto assets.¹⁷⁵

Some commentators questioned the validity of declaring a crypto asset a 'financial product' citing that crypto assets are not similar in nature to the current list of financial products catered for under the definition of a financial product in the *FAIS Act*.¹⁷⁶ Commentators suggested that crypto assets would be better suited to being declared a financial product under section 2(2) of the *Financial Sector Regulation Act 9 of 2017*.¹⁷⁷

In response to the comments received, the FSCA noted that after careful consideration, the authority found that there were similarities between financial products and crypto assets which

¹⁷² IFWG op cit note 15 at 35-6.

¹⁷³ Ibid.

¹⁷⁴ Ibid.

¹⁷⁵ FSCA 'Policy Document Supporting the Declaration of a Crypto Asset as a Financial Product under the Financial Advisory and Intermediary Services Act' (19 October 2022) at 4 at para 3.1, available at <https://www.fsca.co.za/Regulatory%20Frameworks/Temp/Policy%20Document%20supporting%20the%20Declaration%20of%20crypto%20assets%20as%20a%20financial%20product.pdf>, last accessed on 26 March 2023.

¹⁷⁶ Ibid at 5.

¹⁷⁷ Ibid; hereinafter referred to as 'the *FSR Act*'.

justify the inclusion of crypto assets in the *FAIS Act*.¹⁷⁸ Furthermore, in the view of the authority crypto assets behave in accordance with the existing understanding of financial products. In noting this point, the FSCA response was that many crypto assets act as a means of payment, or as a commodity for those consumers who choose to buy them; while other crypto assets are more prone to acting similar to securities or other investment instruments available to the public.¹⁷⁹

Similarly, crypto assets are also marketed akin to the way in which financial products are marketed to the public, at times marketing has been aimed at selling crypto assets as a substitute to existing financial products available to the public.¹⁸⁰ As such the FSCA noted that in line with the initial recommendation, long term regulation of crypto assets and services related to and rendered in respect of crypto assets, would fall within the purview of the ‘licensing activities’ of the *Conduct of Financial Institutions Bill*.¹⁸¹

The FSCA’s declaration requires further that those businesses which provide crypto asset financial services to the public must be registered as a Financial Service Provider (FSP) authorised to do so in terms of section 8 of the *FAIS Act*, or be appointed by a registered FSP to provide such services in terms of section 13 of the aforementioned legislation.¹⁸²

In accordance with the FSCA’s Policy Document, CASPs would need to register for a license to legally operate under section 8 of the *FAIS Act* between 1 June 2023 and 30 November 2023,¹⁸³ however, if by the stipulated date not application for a license has been received the CASP will have to prove that they are licensed in terms of section 7(1) of the *FAIS Act*.

CASPs should further comply with the regular fit and proper requirements which all FSPs should comply with under Chapter 2 of the *Determination of Fit and Proper Requirements for Financial Service Providers*,¹⁸⁴ as well as the *General Code of Conduct for Authorised Financial Service Providers and Representatives*, 2003.¹⁸⁵ These requirements for the registration of CAPs as FSPs is a clear alignment with the recommendations made by the FATF and further ensures that

¹⁷⁸ Ibid.

¹⁷⁹ Ibid.

¹⁸⁰ Ibid.

¹⁸¹ Ibid; IFWG op cit note 15 at 36.

¹⁸² FSCA op cit note 175 at 7.

¹⁸³ Ibid.

¹⁸⁴ Board Notice 194 of 2017 in GG No. 41321 on 15 December 2017, available at <https://www.fsca.co.za/Notices/Board%20Notice%20194%20of%202017.pdf>, last accessed on 26 March 2023.

¹⁸⁵ FSCA op cit note 175 at 8.

crypto asset users can expect to receive the same, if not similar protection as those users of ordinary financial products available on the financial markets.

In amplification of this movement towards regulation of crypto assets, on 23 January 2023, the South African Advertising Regulatory Board published their updated Codes of Advertising Practice in order to regulate the way in which crypto assets are advertised taking into consideration the FSCA's declaration that crypto assets are financial products for purposes of financial regulation.¹⁸⁶

In terms of clause 17 of the Codes of Advertising Practice,¹⁸⁷ when advertising crypto assets there must be clear wording warning the public that 'investing in crypto assets may result in the loss of capital...'¹⁸⁸. Furthermore, all advertising of crypto assets must explain all the key features of the crypto asset being advertised and must be supported by proof.¹⁸⁹ This includes but is not limited to, the returns and risks associated with the investing in the crypto asset.¹⁹⁰

Considering the recommendations made by the various authorities, it should be further recommended that the movement towards the regulation of crypto assets not stop at their declaration as a financial product and the way in which they are marketed to the public. Regulators should take stronger and more robust approaches in ensuring that once CASPs have been registered as FSPs, that regular monitoring of their dealings with the public and other online virtual entities is conducted, taking into account the issue of anonymity as outline earlier in this research report.

The monitoring of CAPs dealing could take place in the form of random inspections of records retained by the CASPs or advancements in technology which allow for the immediate reporting to regulatory bodies, to ensure that illicit dealing using the veil of anonymity are thwart before they are completed.

Furthermore, as with any other financial product on the market and those accountable institutions who trade in these products, CASPs should be held liable for any illicit dealings with sanctioned individuals and should be required to perform and conduct their business within the same regulatory ambit as that of any other FSP.

¹⁸⁶ Advertising Regulatory Board – Code of Advertising Practice, v2023.1 (incorporating v2021.1), available at <https://www.arb.org.za/assets/section-iii---specific-categories-of-advertising-v2023.2.pdf>, last accessed on 26 March 2023.

¹⁸⁷ Ibid.

¹⁸⁸ Advertising Regulatory Board – Code of Advertising Practice op cit note 186 at Clause 17.1.

¹⁸⁹ Advertising Regulatory Board – Code of Advertising Practice op cit note 186 at Clause 17.3.2, 17.3.3 and 17.3.4.

¹⁹⁰ Advertising Regulatory Board – Code of Advertising Practice op cit note 186 at Clause 17.3.3.

VIII CONCLUSION

Since the creation of the first crypto asset, Bitcoin, there has been debate as to the legitimacy, longevity and stability of the crypto asset market. This in turn has led to the fundamental question of whether these emerging financial assets should be regulated. Furthermore, if regulation is the way forward, how should crypto assets be regulated, with consideration to the way in which the crypto asset market operates and its differences to that of the standard financial markets.

Globally the process of regulating crypto assets has been slow and marred by criticism, with the recent events of the FTX scandal resulting in the quick downward spiral of the crypto asset market in 2022 and the sudden loss of value in the majority of the unbacked crypto asset, coupled with crypto asset exchanges not operating within the ambit of regulations within which financial product service providers operate; have led to the need to increase efforts to regulate crypto assets.

The FSCA's declaration that crypto assets are financial products for purposes of regulation is a move in the right direction. Although South Africa's response to the crypto asset market may be perceived as having been slow, the recent changes point to the fact that the global phenomenon is quickly catching the eyes of South African regulators who wish not to be left behind or worse deemed to be below standard in the eyes of the FATF regulators.

The FSCA's declaration will not only ensure that investors or users of crypto assets are adequately protected, as any crypto asset exchange or other financial service provider offering crypto assets as a financial product in their portfolio, will need to abide by the normal regulatory rules imposed on financial service providers when dealing in the usual financial products in existence prior to the creation of crypto assets.

This will further ensure that the creators of crypto asset blockchains, report truthfully and do not mislead investors or users of their crypto asset products, as any misleading information will leave them open to legal action by not only disgruntled investors but further by regulatory bodies.

Thus, South Africa's current approach declaring crypto assets as financial products is a step in the right direction to ensuring that crypto assets are regulated and those who choose to invest and pursue using crypto assets are adequately protected from misuse and fraud on the part of exchange platforms or creators seeking to pull the wool over investors' eyes.

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