UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

Regulating Virtual Currencies in South Africa

by

Phumelela Maliza

18375732

Submitted in partial fulfilment of the requirements for the degree

Master of Laws (Banking Law)

In the Faculty of Law,

University of Pretoria

October 2019

Supervisor: Prof R Brits

Declaration

1. I understand what plagiarism is and am aware of the University's policy in this regard.
2. I declare that this thesis is my own original work. Where other people's work has been used (either from a printed source, Internet or any other source), this has been properly acknowledged and referenced in accordance with departmental requirements.
3. I have not used work previously produced by another student or any other person to hand in as my own.
4. I have not allowed, and will not allow, anyone to copy my work with the intention of passing it off as his or her own work.

Phumelela Maliza

October 2019

Summary

In late 2008, a paper titled “Bitcoin: A peer-to-peer electronic cash system” was published by Satoshi Nakomoto. This paper introduced the global community to Bitcoin and by extension, to virtual currencies. The paper details the characteristics of Bitcoin, a virtual currency, and its linked enabling technology, named Blockchain. Since then, the popularity and use of virtual currencies has drastically increased.

Virtual currencies are defined as “digital representation of value that can be digitally traded and function as a medium of exchange, a unit of account and/or a store of value but does not have legal tender status”.

Much like the broader global community, virtual currencies are not viewed as legal tender in South Africa and as such are not subject to regulatory scrutiny. However, with this increased global popularity, central banks are awakening to the need to develop regulatory frameworks to deal with virtual currencies, to ensure the stability and integrity of financial markets.

In this dissertation I will examine the current South African regulatory framework in relation to the issuing and supervision of legal tender and the broader financial services legal and regulatory framework. I will also consider international regulatory trends, in order to identify what regulatory enhancements could possibly be developed and implemented, to best regulate virtual currencies and financial technology.

Acknowledgements

Firstly, I would like to thank my parents Ntombomzi and Silumko Maliza for their unending support and encouragement throughout my life. Thank you for always wanting the best for me and daring me to always dream big. I owe my resilience to you.

To my siblings, Sanelisiwe, Sivuziwe and Junior, you hold a special place in my heart. Thank you for always being a constant in my life. And to my extended family, in particular the Jako Family, thank you for being such a source of joy and happiness.

To my family of friends, thank you for consistently motivating, inspiring and pushing me towards the finish line of this marathon. Your love, support and friendship has been invaluable.

To my supervisor, Professor Reghard Brits, thank you for your guidance. Your assistance has been instrumental towards the completion of this dissertation.

And lastly, I would like to dedicate this dissertation to my grandfather, Morris Dambile Nxati and to the memory of my late grandmother, Mzikazi Gladys Nxati.

Table of contents

Declaration i

Summary ii

Acknowledgements iii

Table of contents iv

Chapter 1: Introduction 1

Chapter 2: The history of money and of virtual currencies 4

2.1 What is money? 4

2.2 A background to virtual currencies 6

Chapter 3: The history of central banks and the role of the South African Reserve Bank 10

3.1 Introduction 10

3.2 Central banking in general 10

3.3 The South African Reserve Bank 12

3.4 The concept of legal tender 13

Chapter 4: The financial services legal and regulatory framework in South Africa 15

4.1 The South African legal and regulatory framework 15

4.2 The Banks Act 16

4.3 The Income Tax Act 17

4.4 The Financial Intelligence Centre Act 19

4.5 Exchange Control Regulations 22

4.6 Closing remarks 24

Chapter 5: Global regulatory trends in regulating virtual currencies 25

5.1 Introduction 25

5.2 Global organisations 25

5.2.1 Financial Action Task Force 25

5.2.2 European Union 27

5.3 Countries 30

5.3.1 Canada 31

5.3.2 Senegal 32

5.3.3 Singapore 33

5.3.4 United States of America 35

5.3.5 South Africa 40

Chapter 6: Initial Coin Offerings 44

Chapter 7: Conclusion 48

Bibliography 50

Literature 50

Case law 51

Legislation 51

Internet sources 52

Chapter 1:
Introduction

Virtual currencies and by extension financial technology (fintech) have become a topical subject within the global financial services sector. The popularity and use of virtual currencies have drastically increased since their inception, circa 2008. In South Africa, virtual currencies are currently not viewed as legal tender and as such are not subject to regulatory scrutiny. However, with this increased global popularity, central banks and regulators all over the world are awakening to the need to develop regulatory frameworks to deal with virtual currencies and fintech, to ensure the stability and integrity of financial markets.

There are varying definitions in relation to virtual currencies. The Financial Action Task Force defines virtual currencies as a "digital representation of value that can be digitally traded and function as a medium of exchange, a unit of account and/or a store of value, but does not have legal tender status".[1] South Africa, through the Intergovernmental Fintech Working Group (IFWG), has decided to adopt a broad definition of crypto assets that includes virtual currencies. In terms of the IFWG Consultation Paper on Crypto-Assets:[2]

> "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"[3].

Despite not being legal tender, what has become abundantly clear is that virtual currencies are becoming a "real thing" that cannot be ignored either, particularly in the financial services sector.

---

[1] Financial Action Task Force Report: *Virtual currencies key definitions and potential AML/CFT risks* (June 2014) Page 4.
[2] IFWG Consultation Paper on Policy Proposals for Crypto Assets (January 2019).
[3] IFWG Consultation paper on Policy Proposals for Crypto Assets (January 2019) Page 9.

In South Africa, legal tender is issued by the South African Reserve Bank (SARB), which is the central bank of the Republic of South Africa. The SARB was first established in 1921 in terms of a special act of Parliament, the Currency and Banking Act, 1920 (Currency and Banking Act).[4] Today, the SARB is governed by the South African Reserve Bank Act 90 of 1989 (Reserve Bank Act). The bank has various functions but key amongst these is the promotion of financial stability:

> "The primary purpose of the SARB is to achieve and maintain price stability in the interest of balanced and sustainable economic growth in South Africa. Together with other institutions, it also plays a pivotal role in promoting financial stability".[5]

When dealing with the regulation of virtual currencies, one must examine the Bank's role in issuing banknotes and coins. In terms of section 14 of the Reserve Bank Act, the Bank has the sole right to issue banknotes and coins. This sole right contained in section 14, must be read with section 17 of the Reserve Bank Act, which provides that only the Bank may issue legal tender. This legal position explains the Bank's current stance on the regulation of virtual currencies, in that virtual currencies are currently not deemed to be legal tender in South Africa.[6] However, with the proliferation of virtual currencies and the potential risk that these currencies could pose to the financial stability of the South African financial sector, it is important to examine what regulatory interventions can be initiated to deal with the use of virtual currencies and how best the Bank can respond to the potential risks associated with virtual currencies.

To this end, the SARB has taken steps to better understand the virtual currency landscape. This can be demonstrated by the work being carried out by the IFWG. The IFWG was formed by members from National Treasury, the SARB, the Financial Services Board – now the Financial Sector Conduct Authority – and the Financial Intelligence Centre at the end of 2016.[7] The broad purpose of the working group is to "provide a platform for regulators and policymakers to engage with industry, identify key considerations and develop a harmonized approach to fintech-driven innovations for the benefit of all South Africans".[8]

---

[4] South African Reserve Bank Commemorative Publication (June 2011) Page 3.
[5] South African Reserve Bank Commemorative Publication (June 2011) Page 3.
[6] South African Reserve Bank *Position Paper of Virtual Currencies* (December 2014) Page 4.
[7] Intergovernmental Fintech Working Group Report (April 2018) Page 5.
[8] Intergovernmental Fintech Working Group Report (April 2018) Page 5.

Over the past few years, we have seen these types of initiatives being instituted by governmental bodies globally, to better understand the virtual currency and broader financial technology landscape. Examples include regulatory developments in countries such as Singapore, Mexico, Germany and Canada, amongst others. With the heightened activity in this space, the question therefore is: how will regulators and financial markets respond to the proliferation of virtual currencies and financial technology?

In order to understand the concept of virtual currencies, one must firstly understand the concept and history of money. In chapter 2 of this dissertation, I will discuss the history of money as a tool to transfer value. The discussion will include an examination into the history and structure of virtual currencies. In chapter 3 of this dissertation, I will discuss the history of central banks in general and the history of the SARB as the central bank of South Africa. In addition, I will examine the structure of virtual currencies in relation to fiat money, which will also entail an exploration of the role of the central bank as the issuers of legal tender and whether the proliferation of virtual currencies will have any impact on this longstanding role.

In chapter 4, I will examine the broader financial services legal and regulatory framework in South Africa. This will entail reviewing current regulatory instruments to better understand whether any regulatory enhancements can possibly be developed to deal with virtual currencies. In chapter 5, I will consider certain global regulatory trends in regulating virtual currencies as compared to regulatory interventions in South Africa. In chapter 6, I will cover the concept of Initial Coin Offerings (ICOs) as a developing trend within the virtual currency space and lastly, in chapter 7, I will conclude by drawing conclusions on additional regulatory considerations in relation to the regulation of virtual currencies and financial technology.

Chapter 2:
The history of money and of virtual currencies

2.1 What is money?

Historically, the concept of money is intrinsically linked to the concept of bartering. Bartering is commonly known as the exchange of products or services for commodities. History demonstrates that money emerged for objective reasons and out of necessity. In order to facilitate the exchange of goods and services for bartering purposes, people have used "numerous commodities as means of exchange: tobacco in Colonial Virginia, sugar in the West Indies, salt in Abyssinia, cows in Ancient Greece, nails in Scotland, copper in Ancient Egypt, and also grains, tea, animal skins, fish hooks and so forth".[9]

The system of bartering, although widely used, had its disadvantages. Key amongst the issues with regard to bartering was the fact that in order to effectively exchange items, there needed to be a double coincidence of wants. As an example, one individual would have to want to exchange salt and another corresponding individual would have to want to trade cattle. What this meant is that both individuals would have to be ready and willing to carry out the exchange and agree on the quality and value of the goods to be traded. This obviously posed problems where there was no meeting of minds in relation to the exchange or the goods. Additionally, due to the physical nature of the type of goods being exchanged, the goods could not reliably store value – such as an instance of a cow dying during the exchange process. These disadvantages were the catalyst for the development of standardized stores of value.

The written history of money in itself can be traced back to the records of Mesopotamia during the third millennium BC.[10] However, it is in the seventh century BC when the kingdom of Lydia introduced the world's first standardized metal coins. Lydia, located in what is now known as Turkey, sat on the cusp between the Mediterranean and the Near East, and therefore commerce with foreign travellers was common.[11] The Lydian

---

[9] M Lavorschi *The Origins and Nature of Money* (2014) USV Annals of Economics and Public Administration 71-78.
[10] https://spectrum.ieee.org/at-work/innovation/a-brief-history-of-money (accessed 29 July 2018).
[11] https://spectrum.ieee.org/at-work/innovation/a-brief-history-of-money (accessed 29 July 2018).

coin was made of a gold-silver alloy called electrum. This was considered a breakthrough in that other kingdoms followed the Lydian example and "coins became ubiquitous throughout the Mediterranean, with kingdoms stamping their insignia on the coins they minted. This had a dual effect: It facilitated the flow of trade and established the authority of the state".[12] In addition, the use of coins meant that governments were quick to embrace hard currency because it facilitated the collection of taxes and the building of military forces.[13] Over the centuries, the use of money developed and evolved significantly with most countries using gold coins as a form of money. This use of the gold coin was the start of the move towards what we now know as the "Gold Standard". Defined, the gold standard is:

> "a monetary system in which (1) the value of each country's currency is defined in terms of a fixed weight of gold and (2) domestic currency is freely convertible to gold. To ensure convertibility, the amount of money issued by the central bank is strictly limited by the value of its gold reserves".[14]

The gold standard was formally adopted by the Bank of England in 1821. Due to the nature of the South Africa relationship with the United Kingdom by virtue of the Commonwealth of Nations, the pound sterling was the official currency of South Africa and as such South Africa also adopted the gold standard. The gold standard was adopted globally until it fell out of favour with most countries due to the Great Depression. Eventually, South Africa dropped the gold standard on 27 December 1932.[15] Abandonment of the gold standard meant that most countries' currencies were now not backed by gold but by their central banks. This concept is known as fiat currency. Fiat money is legal tender that is typically issued by the central bank of a particular country. This legal tender is not backed by a commodity as was the case of the gold standard, but instead the value of the legal tender is backed by the central bank.

In order to understand the concept of fiat money, one must deal with the commonly used definition of money and its characteristics. Typically, money is defined by the three broad roles it plays in an economy: firstly, as a medium of exchange to buy goods

[12] https://spectrum.ieee.org/at-work/innovation/a-brief-history-of-money (accessed 29 July 2018).
[13] https://spectrum.ieee.org/at-work/innovation/a-brief-history-of-money (accessed 29 July 2018).
[14] Banque de France, *Focus – What is the Gold Standard* (November 2010).
[15] South African Reserve Bank *History, Functions and Institutional Structure* (October 2009) Page 4.

and services; secondly, as a unit of account that ensures consistent terms in which prices are quoted and debts are recorded; and lastly, as a store of value[16] and underpinned by its central bank backing, giving it its status as legal tender.

In the South African context, fiat money is issued by the SARB. In terms of section 14 of the Reserve Bank Act, the SARB has the sole right to issue banknotes and coins. This right contained in section 14, must be read with section 17 of the Reserve Bank Act, which provides that only the SARB may issue legal tender.

2.2 A background to virtual currencies

In contrast to what is widely regarded as legal tender, one finds the relatively new phenomenon of virtual currencies broadly defined as follows:

> "Virtual currencies are decentralised peer-to-peer payment systems that are digital representations of value and can be transferred, stored and traded electronically. At their core, they are distinct from other digital payments (e.g, PayPal, Facebook credits, airline miles, etc) because they provide a means to transfer value between two parties without needing an intermediate party. They do not have legal tender status; they operate with no central authority or banks, and their issue is carried out collectively by a distributed network. While the transaction between buyer and seller is direct, the identities of the parties are encrypted and therefore no personal information is transferred. However, virtual currency transactions such as Bitcoin transactions are not fully anonymous. A transaction record of every Bitcoin and every Bitcoin user's encrypted identity is recorded on a public ledger. As a result, it is most appropriate to characterise Bitcoin and many other virtual currencies as 'pseudonymous' as opposed to anonymous. This pseudonymity, combined with its efficient and decentralised nature, makes it appealing to both consumers and criminals alike."[17]

The history of virtual currencies is closely linked to the most popular virtual currency, named Bitcoin. The history of Bitcoin can be traced back to a paper published in late 2008 by Satoshi Nakomoto, who is widely regarded as the developer of Bitcoin. In this paper, titled "Bitcoin: A peer-to-peer electronic cash system"[18], Nakomoto details the characteristics of Bitcoin and its enabling technology, Blockchain.

> "Bitcoins are created, or mined in Bitcoin parlance, through the completion of complex mathematical equations using sophisticated computers. By design, each

---

[16] S Konig *The Evolution of Money – From Commodity Money to E-Money* (2001) UNICERT IV Program Page 4.

[17] "Beyond Silk Road: Potential Risks, Threats, and Promises of Virtual Currencies", hearing before the US Senate Committee on Homeland Security and Governmental Affairs, 113th Cong (2013).

[18] S Nakomoto *Bitcoin: A Peer-to-Peer Electronic Cash System* (2008).

> new equation is more difficult to solve. This feature limits the rate at which new Bitcoins can be added and it is designed to result in a total cap of 21 million Bitcoins. There are over 13 million Bitcoins today, and it is projected that the number of new Bitcoins will be halved every four years until the maximum circulation is reached. Users install Bitcoin wallets on their computer or mobile phone, which generates a unique address and a public and private encryption key that verifies transactions".[19]

Following the Bitcoin paper of 2008, interest in virtual currencies has grown exponentially. This interest has predominately stemmed from consumers. Such popularity has made it very clear that the use of virtual currencies has a potential impact on the financial stability of the global financial markets. As such, regulators have also awakened to the concept of virtual currencies, its related technology and how best to respond to it.

In South Africa, the SARB issued a paper, titled the "Position paper on virtual currencies"[20]. In this paper, the Bank outlines its position on virtual currencies as it relates to the Bank's mandate and responsibilities. Currently, the Bank's position in relation to virtual currencies is as follows:

> "The Bank does not oversee, supervise or regulate the VC landscape, systems or intermediaries for effectiveness, soundness, integrity or robustness. Consequently, any and all activities related to the acquisition, trading or use of VCs (particularly DCVCs) are performed at the end-users sole and independent risk and have no recourse to the Bank.
>
> Given the current landscape and information currently available, the Bank contends that VCs pose no significant risk to financial stability, price stability or the National Payment System. However, end-users, whether individuals or businesses that accept VCs and businesses involved in the VCs ecosystem, are cautioned that any activities performed or undertaken with VCs are at their sole and independent risk.
>
> In line with the Banks position that regulation should follow innovation, the Bank continues monitoring developments in this regard and reserves the right to change its position should the landscape warrant regulatory intervention."[21]

In considering the composition of virtual currencies, one must not confuse virtual currencies with what we commonly known as "electronic money". Electronic money is defined as:

---

[19] J Lee *Bitcoin Basics: a Primer on Virtual Currencies* (2015) Business Law International 21-48.
[20] South African Reserve Bank *Position Paper of Virtual Currencies* (December 2014).
[21] South African Reserve Bank *Position Paper of Virtual Currencies* (December 2014) Page 12.

> "monetary value represented by a claim on the issuer. This money is stored electronically and issued on receipt of funds, is generally accepted as a means of payment by persons other than the issuer and is redeemable for physical cash or a deposit into a bank account on demand."[22]

This definition is contained in the same position paper (mentioned above) issued by the South African Reserve Bank in 2009. It is clear from this definition that electronic money is explicitly viewed as legal tender by the Bank, this being in contrast to the Bank's stance on virtual currencies.

Whilst the Bank does not consider virtual currencies as legal tender in the context of the Bank's mandate, regard must be had to the fact that although we generally believe virtual currencies to be a "currency" in common discourse, questions remain over whether these virtual currencies rather can be defined as something other than a currency, such as an asset or investment product.

To illustrate this point, one can look at the statement by the South African Revenue Service (SARS) published on the 6 April 2018. In this statement, SARS notes that:

> "The word 'currency' is not defined in the Income Tax Act, 58 of 1962 (the Tax Act). Cryptocurrencies are neither official South African tender nor widely used and accepted in South Africa as a medium of payment or exchange. As such, cryptocurrencies are not regarded by SARS as a currency for income tax purposes or Capital Gains Tax (CGT). Instead, cryptocurrencies are regarded by SARS as assets of an intangible nature. Whilst not constituting cash, cryptocurrencies can be valued to ascertain an amount received or accrued as envisaged in the definition of 'gross income' in the Income Tax Act. Following normal income tax rules, income received or accrued from cryptocurrency transactions can be taxed on revenue account under gross income. Alternatively, such gains may be regarded as capital in nature, as spelt out in the Eighth Schedule to the Tax Act for taxation under the CGT paradigm."[23]

It is clear from this text that SARS considers virtual currencies to not be a currency, but an asset of an intangible nature that is subject to tax liability on the proceeds of trades in such virtual currencies.

[22] South African Reserve Bank *Position Paper on Electronic Money* (November 2009) Page 5.
[23] http://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx (accessed on 17 April 2018).

Statements like the above and position papers issued by the SARB and SARS illustrate that regulators are consciously dealing with the advent of virtual currencies. This effort can also be traced back to the increased regulatory activity globally, with countries such as Canada passing regulations to deal with virtual currencies. In terms of a statement released by the Canadian Congress:

> "Canada allows the use of digital currencies, including cryptocurrencies. However, cryptocurrencies are not considered legal tender in Canada. Canada's tax laws and rules, including the Income Tax Act, also apply to cryptocurrency transactions. The Canada Revenue Agency has characterized cryptocurrency as a commodity and stated that the use of cryptocurrency to pay for goods or services should be treated as a barter transaction.
>
> On June 19, 2014, the Governor General of Canada gave his royal assent to Bill C-31, which includes amendments to Canada's Proceeds of Crime (Money Laundering) and Terrorist Financing Act. The new law treats virtual currencies as "money service businesses" for purposes of anti-money laundering provisions. The law is not yet in force, pending issuance of subsidiary regulations."[24]

What appears to be the case, therefore, is that our current understanding of money – specifically fiat money – is undergoing a dynamic shift. Whilst it cannot be said with any certainty that virtual currencies will ever formally be classified as legal tender in South Africa, there is certainly scope to utilize components of the aspects of virtual currencies to evolve fiat money. This shift arguably will require that regulators respond adequately and speedily to ensure the continued protection and stability of financial markets.

[24] https://www.loc.gov/law/help/cryptocurrency/canada.php (accessed 29 July 2018).

Chapter 3:
The history of central banks and the role of the South African Reserve Bank

3.1 Introduction

The history of central banks can be traced back to the incorporation of the first central bank, the Riksbank of Sweden, founded in 1668. However, the most commonly known and widely regarded as the "premier central bank"[25] is the Bank of England. The history of the Bank of England "is universally accepted as illustrating the evolution of central banking principles and technique".[26]

3.2 Central banking in general

Central banks the world over provide various functions aligned to the financial stability of economies. Although these functions may vary for each jurisdiction, there are key and generally accepted functions that central banks provide. Broadly, the objectives of central banks can be split into three parts, namely monetary policy, payment systems and financial stability objectives. This list of objectives can further be cascaded into various responsibilities that most central banks carry out.[27]

Monetary policy objectives are summarized as the role that a central bank plays in conducting monetary policy to protect price stability. This role is aimed at controlling economic fluctuations by maintaining a low and stable inflation rate:

> "Central banks conduct monetary policy by adjusting the supply of money, generally through open market operations. For instance, a central bank may purchase government debt from commercial banks and thereby increase the money supply (a technique called "monetary easing"). The purpose of open market operations is to steer short-term interest rates, which in turn influence longer-term rates and overall economic activity."[28]

---

[25] MH de Kock *Central Banking* (1939) 1.
[26] MH de Kock *Central Banking* (1939) 2.
[27] Bank for International Settlements Paper: *Roles and objectives of modern central banks* (May 2009) Page 28.
[28] https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/20/Monetary-Policy-and-Central-Banking (accessed 20 May 2018).

Another key role a central bank plays is its role in managing payment systems to ensure the exchange of value. A key component of any financial system is the ability to effectively transfer value between participants. This is typically done by way of a national payments system that "enables transacting parties to exchange value to conduct business efficiently".[29] Thirdly, and most important for the purpose of this dissertation, is the central bank's role in ensuring financial stability.

The European Central Bank defines financial stability as "a condition whereby the financial system is able to withstand shocks without giving way to cumulative processes, which impair the allocation of savings to investment opportunities and the processing of payments in the economy"[30].

The South African context is slightly different in that the SARB refers to financial stability in broader terms. The SARB details financial stability as:

> "the joint stability of the key financial institutions and the financial markets in which they operate. For financial institutions, this generally means that they are sound, i.e. that they have sufficient capital to absorb normal, (and at times abnormal) losses, and sufficient liquidity to manage operations and volatility in normal periods".[31]

It continues to set out the key concepts relating to financial stability:

> "The concept of financial stability is most often thought of in terms of avoiding financial crises or managing systemic financial risk. If systemic risk is managed well, that is, firstly by market participants through their private risk management, and secondly by the authorities through their banking supervision, market surveillance and systemic risk management, then systemic financial crises are less likely to occur, or will be more easily managed if they do.
>
> One way of defining financial stability is in terms of the requirements to achieve it. It requires a robust financial system, which may be defined as a system having the ability to prevent, predict and withstand shocks under all types of domestic and international market conditions. Financial stability can further be described as the absence of macroeconomic costs of disturbances in the system of financial exchange between households, businesses and financial-service firms. Another

---

[29] https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem(NPS)/Pages/Introduction%20and%20Overview.aspx (accessed 21 May 2018).
[30] https://www.ecb.europa.eu/ecb/tasks/stability/html/index.en.html (accessed 20 May 2018).
[31] https://www.resbank.co.za/Financial%20Stability/Pages/FinancialStability-Home.aspx (accessed 20 May 2018).

> definition used by some commentators is that financial stability is a sustained condition of stability in the financial system that ensures the efficient functioning of institutions and markets and low volatility in prices, interest rates and exchange rates. When the whole or an important part of the financial sector is at risk, the situation can be described as financially unstable.
>
> Financial instability would ultimately manifest itself through systemic risk, banking failures, intense asset-price volatility, interest and exchange rate volatility, and a collapse of market liquidity. The disruption of the payment and settlement system could be a result of these manifestations."[32]

This financial stability role, in order to avoid financial crises and to manage systemic financial risk, is key when examining the role that central banks may play towards the regulation of virtual currencies.

3.3 The South African Reserve Bank

The South African Reserve Bank (SARB) is the central bank of South Africa. The SARB was first established in 1921 in terms of a special Act of Parliament, the Currency and Banking Act 31 of 1920.[33] Currently, the Bank is governed by the South African Reserve Bank Act 90 of 1989 (the Act).

A key function of the SARB is to achieve and maintain price stability in the interest of balanced and sustainable economic growth in South Africa[34].

Broadly, the responsibilities of the SARB could be noted as follows:

> "formulating and implementing monetary policy; issuing banknotes and coin; supervising the banking sector; ensuring the effective functioning of the national payment system; managing official gold and foreign-exchange reserves; acting as banker to the government; administering the country's remaining exchange controls and acting as lender of the last resort in exceptional circumstances".[35]

These responsibilities are carried out to ensure the maintenance of price stability and financial stability within South African financial markets. As part of its mandate to ensure price and financial stability, the SARB is the sole issuer of banknotes and coins,

---

[32] https://www.resbank.co.za/Financial%20Stability/Pages/FinancialStability-Home.aspx (accessed 20 May 2018).
[33] South African Reserve Bank Commemorative Publication (June 2011) Page 3.
[34] Section 3 of the South African Reserve Bank Act 90 of 1989.
[35] Section 10 of the South African Reserve Bank Act 90 of 1989.

also known as legal tender. This function is explicitly set out in section 14 of the Act. In terms of the section:

> "The Bank shall have the sole right to issue or cause to be issued banknotes and coins in the Republic: Provided that all coins which at the commencement of the South African Reserve Bank Amendment Act, 1989, were lawfully in circulation and legal tender in the Republic, shall as such remain in circulation until they are withdrawn from circulation in accordance with the provisions of section 19, or are no longer of the current mass prescribed in Schedule 2 in respect of the denomination in question"[36].

3.4 The concept of legal tender

In terms of section 17 of the Act, legal tender is defined as:

> "(1) A tender, including a tender by the Bank itself, of a note of the Bank or of an outstanding note of another bank for which the Bank has assumed liability in terms of section 15(3) (c) of the Currency and Banking Act or in terms of any agreement entered into with another bank before or after the commencement of this Act, shall be a legal tender of payment of an amount equal to the amount specified on the note.
>
> (2) A tender, including a tender by the Bank itself, of an undefaced and unmutilated coin which is lawfully in circulation in the Republic and of current mass, shall be a legal tender of payment of money-
>
> (a) in the case of gold coins, in settlement of any amount, and the value of each gold coin so tendered shall be equal to the net amount at which the bank is prepared to purchase that gold coin on the day of such tender thereof; and
>
> (b) in the case of other coins, in settlement, per individual transaction, of a total amount not exceeding-
>
> (i) fifty rand, where coins of the denomination of one rand or higher are so tendered;
>
> (ii) five rand, where coins of denominations of ten cents up to and including fifty cents are so tendered;
>
> (iii) fifty cents, where coins of the denomination of five cents or less are so tendered, and the value of each coin so tendered shall be equal to the amount specified on that coin."[37]

The issuance of legal tender by a central bank is a key component of the bank's role within the financial economy. This issuance of legal tender by a central authority is important in that it ensures control over the volume, supply and value of such legal tender. This control has a direct impact on financial stability, which is a key component of the responsibilities of central banks the world over. More importantly, in the South

[36] Section 14(1) of the South African Reserve Bank Act 90 of 1989.
[37] Section 17 of the South African Reserve Bank Act 90 of 1989.

African context, the responsibility to protect the value of legal tender is constitutionally enshrined as detailed in section 224(1) of the Constitution.[38]

Therefore, it is vital for central banks to monitor the developments around virtual currencies and by extension the financial technology space, as these developments have the potential to have a direct and significant impact on the financial stability of the economy.

[38] Constitution of the Republic of South Africa, 1996.

Chapter 4:
The financial services legal and regulatory framework in South Africa

4.1 The South African legal and regulatory framework

Throughout the history of the financial services sector, the SARB has always played a key role within the regulatory framework, particularly around the regulation of banks within the financial services sector. However, with developments in the sector, the need to regulate other aspects of the financial services sector has given rise to various other regulators, such as the Financial Services Board.

The Financial Services Board (FSB) was established in 1990 by way of the Financial Services Board Act 97 of 1990. The primary purpose of this Act was to provide for the establishment of a board to supervise compliance with laws regulating financial institutions and the provision of financial services. The key functions of the FSB included:

> "a) supervising and enforcing compliance with laws regulating financial institutions and the provision of financial services;
> b) advise the Minister on matters concerning financial institutions and financial services, either of its own accord or at the request of the Minister; and
> c) provide, promote or otherwise support financial education, awareness and confidence regarding financial products, institutions and services".[39]

However, the regulatory framework has recently undergone significant changes in its regulatory model. To this end, South Africa has adopted a so-called "Twin Peaks" model of regulation. This new regulatory model is underpinned by the Financial Sector Regulation Act 9 of 2017 (FSRA), which came into effect on 1 April 2018, and creates the "two peaks" of this new regulatory structure by establishing the Prudential Authority (PA) and the Financial Sector Conduct Authority (FSCA). It is envisioned that the PA will deal with the prudential regulation of banks and insurance companies within the financial services sector, while the FSCA will deal with market conduct regulation throughout the financial services sector.

---

[39] Section 3 of the Financial Services Board Act 97 of 1990.

The Twin Peaks model of regulation is envisioned to address four key policy priorities – financial stability; consumer protection and market conduct; financial inclusion; and combating financial crime.[40] These policy priorities are particularly important when considering the impact that virtual currencies could potentially have on the financial services landscape.

Whilst there are recent regulatory framework developments within the financial services sector, the sector has existing pieces of legislation that have or may have an impact on the regulation of virtual currencies.

4.2 The Banks Act

The Banks Act 94 of 1990 is undoubtedly the most important piece of legislation that impacts the banking sector. The Act sets out various obligations on banks and companies intending to carry out the business of a bank.

In terms of the Banks Act, and subject to the provisions of section 18A, no person shall conduct the business of a bank unless such person is a public company and is registered as a bank in terms of the Act.[41] The Act further sets out in detail the definition of what would constitute "the business of a bank". In terms of section 1 of the Act, the business of a bank is defined as follows:

> "(a) the acceptance of deposits from the general public (including persons in the employ of the person so accepting deposits) as a regular feature of the business in question;
> (b) the soliciting of or advertising for deposits;
> (c) the utilization of money, or of the interest or other income earned on money, accepted by way of deposit as contemplated in paragraph (a) -
> (i) for the granting by any person, acting as lender in such person's own name or through the medium of a trust or a nominee, of loans to other persons;
> (ii) for investment by any person, acting as investor in such person's own name or through the medium of a trust or a nominee; or
> (iii) for the financing, wholly or to any material extent, by any person of any other business activity conducted by such person in his or her own name or through the medium of a trust or a nominee;
> (d) the obtaining, as a regular feature of the business in question of money through the sale of an asset, to any person other than a bank, subject to an

[40] National Treasury Policy Document: *A Safer Financial Sector to Serve South Africa Better* (February 2011) Page 5.
[41] Section 11 of the Banks Act 94 of 1990.

agreement in terms of which the seller undertakes to purchase from the buyer at a future date the asset so sold or any other asset; or

(e) any other activity which the Registrar has, after consultation with the Governor."[42]

One should consider this definition in the light of one of the key components of trading in virtual currencies, namely the fact that an exchange would typically have to accept legal tender to purchase virtual currencies. Indeed, the acceptance of deposits as a regular feature of the business in question is a key trigger in requiring the business to register for a banking license in terms of the Act. Looking at this definition it could be argued that the acceptance of fiat currency, by cryptocurrency exchanges, to convert into virtual currencies could be construed as accepting deposits. However, this is not the case.

The process that has been followed by virtual currency exchanges is that their function is not that of a deposit taker, but an act of accepting legal tender to purchase virtual currencies. This stance has been supported by the fact that the SARB has not required virtual currency exchanges to obtain banking licenses.

4.3 The Income Tax Act

Whilst the point of departure in discussions relating to the regulation of virtual currencies is often the role of the SARB as the issuer of legal tender, it must also be noted that there are other pieces of legislation that could potentially apply to virtual currencies, such as the Income Tax Act 58 of 1962. The South Africa Revenue Service (SARS) is the custodian of the Income Tax Act. As the custodian, SARS is responsible for tax collection within South Africa.

With regard to virtual currencies, the initial stance followed by SARS was to view virtual currencies not a currency but as an asset of an intangible nature. In terms of the Income Tax Act, an asset is defined as assets including

"(a) property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum; and

[42] Section 1 of the Banks Act 94 of 1990.

(b) a right or interest of whatever nature to or in such property".[43]

This classification is significant in that it effectively brought virtual currencies under the capital gains tax regime (or income tax).[44]

This view has since developed with the promulgation of the Taxation Laws Amendment Act 23 of 2018. In terms of this Amendment Act, cryptocurrencies have now been included under the definition of financial instruments. This means that virtual currencies will be dealt with in the same manner as financial instruments such as promissory notes, futures contracts and derivatives.[45]

In addition to this, section 20A of the Income Tax Act has also been amended to include the following words "(ix) the acquisition or disposal of any cryptocurrency''.[46] This inclusion means that the acquiring and disposal of any cryptocurrencies by an individual will be registered as a suspect trade on which any assessed losses are automatically ring-fenced. It is only where the circumstances noted in section 20A (3) of the Income Tax Act are met that the ring-fencing falls away, therefore allowing for any assessed losses to be set off against a taxpayer's income in terms of section 20 of the Act.[47]

This stance from SARS is particularly important in that it is the first distinctive action by an authority to place virtual currencies squarely within the ambit of the tax regime, which is akin to regulation.

---

[43] South African Revenue Services *ABC of Capital Gains Tax for Individuals* (February 2017) Page 1.
[44] http://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx (accessed 17 April 2018).
[45] Section 1 of the Income Tax Act, 58 of 1962.
[46] Taxation Laws Amendment Act 23 of 2018.
[47] https://www.thesait.org.za/news/450491/Two-Sides-to-Every-Bitcoin.htm (accessed on 30 June 2019).

4.4 The Financial Intelligence Centre Act

Another aspect of virtual currency regulation has been the discussions around the pseudo-anonymity of individuals involved in virtual currency transactions. The nature of virtual currency transactions is such that individuals transact on a pseudo-anonymous basis via blockchain technology:

> "[B]y design, Bitcoin addresses, which function as accounts, have no names or other customer identification attached, and the system has no central server or service provider. The Bitcoin protocol does not require or provide identification and verification of participants or generate historical records of transactions that are necessarily associated with real world identity. There is no central oversight body, and no AML software currently available to monitor and identify suspicious transaction patterns. Law enforcement cannot target one central location or entity (administrator) for investigative or asset seizure purposes (although authorities can target individual exchangers for client information that the exchanger may collect). It thus offers a level of potential anonymity impossible with traditional credit and debit cards or older online payment systems, such as PayPal".[48]

This pseudo-anonymity is pertinent within the South African context, particularly in the light of the requirements of the Financial Intelligence Centre Act 38 of 2001 (FICA) and broadly the anti-money laundering (AML) initiatives. The purpose of FICA is noted as follows:

> "To establish a Financial Intelligence Centre and a Money Laundering Advisory Council in order to combat money laundering activities and the financing of terrorist and related activities; to impose certain duties on institutions and other persons who might be used for money laundering purposes and the financing of terrorist and related activities".[49]

In order to combat money laundering activities and the financing of terrorist activities, the Financial Intelligence Centre (FIC) places specific obligations and duties on accountable and reporting institutions. Key amongst these requirements is the requirement to identify and verify the identity of a client. This requirement is contained in section 21(1)(a) of the Act, which states that:

> "When an accountable institution engages with a prospective client to enter into a single transaction or to establish a business relationship, the institution must, in the course of concluding that single transaction or establishing that business

[48] Financial Action Task Force Report: *Virtual currencies key definitions and potential AML/CFT risks* (June 2014) Page 9.
[49] Financial Intelligence Centre Act 38 of 2001.

> relationship and in accordance with its Risk Management and Compliance Programme -
> (a) establish and verify the identity of the client".[50]

This requirement ensures that accountable institutions that intend to enter into a business relationship or single transaction with a client, must ensure that they have established the identity of the client. This is important within the context of virtual currency trading in that, in most instances, the trader or exchange would not have verified the identity of the client, potentially allowing the client to trade under a pseudonym, which would go against the objectives of the Act and broader global requirements.

In addition, section 28 of FICA requires that accountable institutions and reporting institutions must report cash transactions above a prescribed limit. This section states that:

> "An accountable institution and a reporting institution must, within the prescribed period, report to the Centre the prescribed particulars concerning a transaction concluded with a client if in terms of the transaction an amount of cash in excess of the prescribed amount-
> (a) is paid by the accountable institution or reporting institution to the client, or to a person acting on behalf of the client, or to a person on whose behalf the client is acting; or
> (b) is received by the accountable institution or reporting institution from the client, or from a person acting on behalf of the client, or from a person on whose behalf the client is acting."[51]

The current prescribed limit in terms of FICA is R24 999.00.[52] In addition to this specific duty on accountable institutions and reporting institutions, FICA requires a person who carries on a business or is in charge of or manages a business or who is employed by a business and who knows or ought reasonably to have known or suspected that:

> "(a) the business has received or is about to receive the proceeds of unlawful activities or property which is connected to an offence relating to the financing of terrorist and related activities;
> (b) a transaction or series of transactions to which the business is a party-
> (i) facilitated or is likely to facilitate the transfer of the proceeds of unlawful activities or property which is connected to an offence relating to the financing of terrorist and related activities;

[50] Section 21(1)(a) of the Financial Intelligence Centre Act 38 of 2001.
[51] Section 28 of the Financial Intelligence Centre Act 38 of 2001.
[52] Money Laundering and Terrorist Financing Control Regulations, 2002.

(ii) has no apparent business or lawful purpose;
(iii) is conducted for the purpose of avoiding giving rise to a reporting duty under this Act;
(iv) may be relevant to the investigation of an evasion or attempted evasion of a duty to pay any tax, duty or levy imposed by legislation administered by the Commissioner for the South African Revenue Service; or
(v) relates to an offence relating to the financing of terrorist and related activities; or

(c) the business has been used or is about to be used in any way for money laundering purposes or to facilitate the commission of an offence relating to the financing of terrorist and related activities, must, within the prescribed period after the knowledge was acquired or the suspicion arose, report to the Centre the grounds for the knowledge or suspicion and the prescribed particulars concerning the transaction or series of transactions."[53]

These obligations noted above can be construed to include virtual currency transactions and exchanges. Firstly, by obliging an accountable institution to report any cash transaction above the prescribed limit, this would include the proceeds of virtual currency transactions above the limit. Secondly, there is also an obligation to report suspicious transactions that could have been carried out by way of virtual currency transactions.

This reporting obligations have recently been tested, as can be demonstrated in the most recent annual report issued by the FIC. In the report, the FIC provides details on a cyber-fraud matter that involved virtual currencies. In the matter:

> "The FIC received an alert when a person in a neighbouring jurisdiction was defrauded of a large amount of money that was transferred to a South Africa financial institution. Some funds were transferred to a virtual currency exchange and subsequently converted into a basket of virtual currencies, including Bitcoin. Some funds were irrecoverable because they were transferred to another virtual currency exchange in a foreign jurisdiction. The FIC froze the account held with the virtual currency exchange using a section 34 directive. It also provided an affidavit that led to the Asset Forfeiture Unit obtaining a preservation order from the High Court in Johannesburg".[54]

In as much as the obligation to report is explicitly set out in FICA, there remains much to do in regulating virtual currencies to meet the broader anti-money laundering requirements and the combatting of the financing of terrorist and related activities. Firstly, most virtual currency trading exchanges are not currently included in the

[53] Section 29 of the Financial Intelligence Centre Act 38 of 2001.
[54] Financial Intelligence Centre Annual Report 2017/18 (September 2018) Page 50.

definition for accountable institutions, as contained in the Act. Whilst it is true that these trading exchanges would not be required to comply with the specific requirements included in the Act, it must be noted that section 29 of FICA requires suspicious transactions to be report by any person who carries on a business or is in charge of or manages a business or who is employed by a business. Notably, this requirement is not limited to accountable institutions, which therefore means that trading exchanges could be required to report suspicious transactions. In chapter 5 of this dissertation, I will reflect on the proposed recommendations issued by the IFWG in relation to the FICA requirements and virtual currency exchanges.

4.5 Exchange Control Regulations

Another important aspect of the South African legislative and regulatory framework is that of Exchange Control Regulations[55] as determined by the SARB. The purpose of the regulations is to prevent the loss of foreign currency resources through the transfer abroad of real or financial capital assets held in the RSA, and to constitute an effective system of control over the movement into and out of the RSA of financial and real assets.[56] In terms of the regulations, South African individuals are permitted:

> "A single discretionary allowance within a limit of R1 million per calendar year is available to all South African residents who are 18 years and older, and in possession of a valid green bar-coded South African identity document or smart identity document card. This dispensation may be used for any legitimate purpose (including for investment purposes abroad as well as the sending of gift parcels in lieu of cash excluding gold and jewellery) at the discretion of the individual without any documentary evidence having to be produced to the Authorised Dealer, except for travel purposes outside the CMA, where certain prescribed documentation has to be produced."[57]

In addition to the single discretionary allowance, individuals are permitted a foreign capital allowance, which must be availed through an authorized dealer:

> "A foreign capital allowance may be availed of through an Authorised Dealer, which may be transferred to a foreign currency account with a local Authorised Dealer or invested abroad, within a limit of R10 million per calendar year per individual who is in possession of a Tax Clearance Certificate and green bar-coded

[55] Government Notice R1111 of 1 December 1961.
[56] South African Reserve Bank *Position Paper of Virtual Currencies* (December 2014) Page 11.
[57] South African Reserve Bank *Currency and Exchanges Guidelines for Individuals* (July 2018) Page 11.

> South African identity document or Smart identity document card and is 18 years and older."[58]

Furthermore, it is imperative that cross-border transactions are carried out by an authorized dealer and reported accordingly:

> "Individuals must note that the reporting of all cross-border foreign exchange transactions by an Authorised Dealer and/or ADLA to the Financial Surveillance Department is compulsory. Accordingly, individuals must provide full details pertaining to the relevant cross-border transaction as requested by the Authorised Dealer and/or ADLA concerned. The objective of the Reporting System is to ensure accurate and comprehensive reporting of all data by Authorised Dealers and ADLAs on transactions."[59]

These regulations have a direct bearing on the cross-border trading of virtual currencies, in that these trades would mostly not be carried out by an authorized dealer nor would the required reporting be carried out. However, due to the nature of virtual currencies, in that they are not viewed at legal tender by the SARB, there is no explicit requirement for trading exchanges to register as an authorized dealer and as such are not required to report cross-border trades – thereby circumventing the regulations.

The Financial Surveillance Department has issued additional guidance to traders in virtual currencies. This guidance notes that the only permissible avenue for purchasing virtual currencies from abroad is through the utilisation of the individual's single individual discretionary allowance and/or individual foreign capital allowance.[60]

In addition, the department have noted that:

> "The purchase of CAs locally and 'transfer' thereof abroad can currently not be accommodated in terms of the single discretionary allowance and/or individual foreign capital allowance. Such a transaction will be in contravention of Exchange Control Regulation 10(1)(c) which states: "No person shall, except with permission granted by the Treasury and in accordance with such conditions as the Treasury may impose - enter into any transactions whereby capital or any right to capital is directly or indirectly exported from the Republic." Although there are no regulations prohibiting residents from trading in CAs in South Africa, should a resident buy CAs

[58] South African Reserve Bank *Currency and Exchanges Guidelines for Individuals*, 2019.
[59] South African Reserve Bank *Currency and Exchanges Guidelines for Individuals*, 2019.
[60] https://www.resbank.co.za/RegulationAndSupervision/FinancialSurveillanceAndExchangeControl/FAQs/Pages/VirtualCurrenciesCryptocurrencies.aspx (accessed on 30 June 2019).

> locally and use that to externalise 'any right to capital', they will be in contravention of Exchange Control Regulation 10(1)(c)”.[61]

This stance will however not apply to the repatriation of value through virtual currencies into South Africa[62].

4.6 Closing remarks

Virtual currencies have the potential for instigating significant changes in the South African legal and regulatory framework. The fact that the development and innovation of virtual currencies have been rapid and ever evolving will require authorities to be both quick to respond and to be agile in their responses, so as to ensure continued innovation in this space. It is clear in the South African context that the current legal and regulatory framework does not sufficiently cater for the regulating of virtual currencies. Save for the Taxation Laws Amendment Act, there has been little action from regulators in this regard.

However, we must note the initiatives that are being carried out by the Intergovernmental FinTech Working Group (IFWG), which comprises of members from National Treasury, the SARB, the FSCA and the FIC. These initiatives have shown a commitment by authorities to get ahead of the curve when it comes to the regulation of virtual currencies.

[61] https://www.resbank.co.za/RegulationAndSupervision/FinancialSurveillanceAndExchangeControl/FAQs/Pages/VirtualCurrenciesCryptocurrencies.aspx (accessed on 30 June 2019).
[62] https://www.resbank.co.za/RegulationAndSupervision/FinancialSurveillanceAndExchangeControl/FAQs/Pages/VirtualCurrenciesCryptocurrencies.aspx (accessed on 30 June 2019).

Chapter 5:
Global regulatory trends in regulating virtual currencies

5.1 Introduction

The global community has had varied responses to the advent of virtual currencies. Whilst some countries and global industry bodies have embraced the technology and innovation around virtual currencies – resulting in diverse responses which has been encompassed in position papers, discussion documents, recommendations, legislation and regulation of virtual currencies – some countries have resorted to complete bans on the trade of virtual currencies.

In the case of legislative and regulatory interventions, most developments have mostly focused on the risks associated with virtual currencies, such as money laundering and terrorist financing. Other regulatory developments have centred around the possible taxation of virtual currencies and related trades or the proceeds thereof. In this chapter I will broadly examine the global regulatory interventions carried out to date, both by some global bodies and selected countries.

5.2 Global organisations

5.2.1 Financial Action Task Force

The Financial Action Task Force (FATF) has been the foremost body that has taken an active stance on the matter of virtual currencies and related risks. The FATF is an inter-governmental body established in 1989 by the ministers of its member jurisdictions.[63] The objectives of the FATF are to:

> "set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system". [64]

The FATF is therefore a "policy-making body" which works to bring about national legislative and regulatory reforms in the abovementioned areas.[65]

[63] https://www.fatf-gafi.org/about/ (accessed on 28 March 2019).
[64] https://www.fatf-gafi.org/about/ (accessed on 28 March 2019).
[65] https://www.fatf-gafi.org/about/ (accessed on 28 March 2019).

An important function of the FATF is to issue recommendations in relation to money laundering, the financing of terrorism and proliferation of weapons of mass destruction to its members.

The FATF Recommendations set out the essential measures that countries should have in place to:

> "identify the risks, and develop policies and domestic coordination; pursue money laundering, terrorist financing and the financing of proliferation; apply preventive measures for the financial sector and other designated sectors; establish powers and responsibilities for the competent authorities (e.g., investigative, law enforcement and supervisory authorities) and other institutional measures; enhance the transparency and availability of beneficial ownership information of legal persons and arrangements; and facilitate international cooperation".[66]

Member states are required to adopt and implement these recommendations and are subject to review by the FATF. It is under this function that the FATF has issued various recommendations relating to virtual currencies.

The FATF issued a 2015 guidance report titled "Guidance for a risk-based approach to virtual currencies"[67] off the back of a 2014 report titled "Virtual currencies – Key definitions and potential AML/CFT risks",[68] which dealt with key aspects of virtual currencies and the potential risks that could materialise in member states. The 2015 guidance report is envisioned to explain the application of the risk-based approach to Anti-Money Laundering (AML) and the Combating Financing of Terrorism (CFT) measures in the virtual currency context; identify the entities involved in virtual currency payment products and services (VCPPS); and clarify the application of the relevant FATF Recommendations to convertible virtual currency exchangers.[69] In addition, the guidance seeks to:

---

[66] Financial Action Task Force: *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation* (October 2018) Page 6.
[67] Financial Action Task Force Report: *Guidance for a Risk-Based Approach to Virtual Currencies* (June 2015).
[68] Financial Action Task Force Report: *Virtual currencies key definitions and potential AML/CFT risks* (June 2014).
[69] Financial Action Task Force Report: *Guidance for a Risk-Based Approach to Virtual Currencies* (June 2015) Page 3.

“(a) Show how specific FATF Recommendations should apply to convertible virtual currency exchangers in the context of VCPPS, identify AML/CFT measures that could be required, and provide examples; and

(b) Identify obstacles to applying mitigating measures rooted in VCPPS's technology and/or business models and in legacy legal frameworks”.[70]

Generally, member states are obliged to adhere to the recommendations so as to ensure financial institutions identify, assess and take effective actions to mitigate money laundering and terrorist financing risks, especially those associated with virtual currencies. Where virtual currency activities are permitted under national law, financial institutions, including virtual currency exchangers, should identify and assess the money laundering and terrorist financing risks posed by virtual currency activities and apply a risk-based approach to ensure that appropriate measures are implemented in order to prevent or mitigate these risks.[71]

This obligation on member states has been the catalyst for many countries, such as Canada, Singapore and South Africa to consider adopting measures towards the regulation of virtual currencies that will guard against money laundering and terrorist financing risks.

5.2.2 European Union

The European Union (EU) is an economic and political union that comprises of 28 member states situated in Europe. The EU is governed by the principle of representative democracy, with citizens directly represented at Union level in the European Parliament and member states represented in the European Council and the Council of the EU.[72] In October 2012, the EU released a detailed report on Virtual Currency Schemes.[73] In this report, the EU set out to define virtual currencies and specific case studies. Additionally, the Authority sought to examine the impact of virtual currencies on central banking.

[70] Financial Action Task Force Report: *Guidance for a Risk-Based Approach to Virtual Currencies* (June 2015) Page 4.
[71] Financial Action Task Force Report: *Guidance for a Risk-Based Approach to Virtual Currencies* (June 2015) Page 12.
[72] https://europa.eu/european-union/about-eu/eu-in-brief_en#from-economic-to-political-union (accessed on 29 March 2019).
[73] European Union *Report on Virtual Currency Schemes* (October 2012).

In terms of the report, the Authority arrived at the following conclusions in relation to virtual currencies:

> "- Virtual currencies do not pose a risk to price stability, provided that money creation continues to stay at a low level;
> - Tend to be inherently unstable, but cannot jeopardise financial stability owing to their limited connection with the real economy, their low volume traded and a lack of wide user acceptance;
> - Are currently not regulated and are not closely supervised or overseen by any public authority, even though participation in these schemes exposes users to credit, liquidity, operational and legal risks;
> - Could represent a challenge for public authorities, given the legal uncertainty surrounding these schemes, as they can be used by criminals, fraudsters and money launderers to perform their illegal activities;
> - Could have a negative impact on the reputation of central banks, assuming the use of such systems grows considerably and, in the event, that an incident attracts press coverage, since the public may perceive the incident as being caused, in part, by a central bank not doing its job properly;
> - Do indeed fall within central banks' responsibility as a result of characteristics shared with payment systems, which give rise to the need for at least an examination of developments and the provision of an initial assessment".[74]

Whilst this report set the path for additional investigation into virtual currencies within the EU, the most significant development occurred in 2015, where a Swedish national, Mr Hedqvist, wanted to provide exchange services for Bitcoin. He approached the Swedish Revenue Law Commission to establish whether VAT must be paid on the purchase and sale of Bitcoins. The Commission held that Bitcoin is a means of payment used in a similar way to legal means of payment and the transactions that Mr Hedqvist intended to effect consequently had to be exempt from VAT.[75] In contrast, the Swedish Tax Authority appealed against this decision. In their argument, they submitted that the transactions that Mr Hedgvist intended to carry out were not covered by the exemptions provided in the VAT Directive.[76] The matter was referred to the European Union Court of Justice for a decision.

In this matter, the court held that transactions relating to the exchange of legal tender for units of the Bitcoin virtual currency (and vice versa) constitute the 'supply of services for consideration' within the meaning of the directive.[77] What this meant was

[74] European Union *Report on Virtual Currency Schemes* (October 2012) Page 47.
[75] *Skatteverket v David Hedqvist*, ECLI:EU:C:2015:718.
[76] Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax.
[77] *Skatteverket v David Hedqvist*, ECLI:EU:C:2015:718.

that these transactions entailed an exchange of different payments and therefore there was a direct link between the service provided by Mr Hedqvist and the consideration received by him[78]. Additionally, the Court held that these transactions were exempt from VAT under the provision relating to transactions in "currencies, bank notes and coins used as legal tender".[79]

Over and above this court decision, the EU has recently released their AML Directive,[80] which includes reference to virtual currencies. In terms of the Directive, member states are required to ensure that providers of any virtual currency exchange services and custodian wallet providers, are registered.[81] The inclusion of virtual currency exchange service providers would not entirely address the issue of anonymity attached to virtual currency transactions, as a large part of the virtual currency environment will remain anonymous because users can also transact without such providers.[82]

These developments demonstrate the increased activity around the regulation of virtual currencies, especially as it relates to risks around money laundering and terrorist financing.

[78] Skatteverket v David Hedqvist, ECLI:EU:C:2015:718.
[79] Skatteverket v David Hedqvist, ECLI:EU:C:2015:718.
[80] EU Directive 2018/843 of the European Parliament and of the Council.
[81] EU Directive 2018/843 of the European Parliament and of the Council Page 36.
[82] EU Directive 2018/843 of the European Parliament and of the Council Page 3.

5.3 Countries

Regulation of virtual currencies within various jurisdictions has had a diverse approach and response. Whilst some countries have opted to ban virtual currencies, some jurisdictions have chosen to welcome the innovation and to take steps to accept the innovation within their regulatory framework. These developments across countries can often be organised over various levels as illustrated below:

Level 0	Ignoring	The government does not pay attention to the existence of crypto assets.
Level 1	Monitoring	An official body has released a statement recognising the existence of crypto assets, but no approach to dealing with crypto assets has been defined.
Level 3	Guidance	An official body has issued guidance to govern the use of crypto assets.
Level 4	Regulation	Predefined conditions exist which, once complied with, could lead to formal authorisation to provide crypto assets-related products and services.
Level 5	Ban or integration (definitive legislation)	A complete or partial prohibition or adoption of crypto assets. A ban may be implemented via different forms, including banning banks from supporting activities related to crypto assets and a complete ban on all institutions and individuals.[83]

For the purposes of this chapter, I will focus on key regulatory developments in the following countries – Canada, Senegal, Singapore and the USA. These will be compared to regulatory interventions in South Africa.

[83] J Lansky *Possible State Approaches to Cryptocurrencies* (2018) Journal of Systems Integration 19 – 31 23.

5.3.1 Canada

Canada has been one of the countries that have been at the forefront of regulating virtual currencies. Since 2013, the country has in various forms dealt with the regulation of virtual currencies. These regulatory developments have ranged from tax regulation to anti-money laundering controls.

In 2013, the Canadian Revenue Agency (CRA) issued a directive that dealt with virtual currencies. In this directive, the authority took a two-pronged approach to virtual currencies – determining that virtual currencies could either be a barter transaction or business income or as capital gains. In further detail, the Revenue Agency found that any income from transactions involving a cryptocurrency are generally treated as business income or as a capital gain, depending on the circumstances. Similarly, if earnings qualify as business income or as a capital gain, then any losses are treated as business losses or capital losses. In addition, when you use a cryptocurrency to pay for goods or services, the CRA treats it as a barter transaction for income tax purposes. A barter transaction occurs when two parties exchange goods or services and carry out that exchange without using legal currency.[84]

Subsequent developments in Canada focused on the money laundering and terrorist financing risks around the use of virtual currencies. In 2014, the Canadian Parliament amended the Proceeds of Crime (Money Laundering) and Terrorist Financing Act of 2000[85] to include virtual currencies. Broadly, the Act was adopted:

> "to implement specific measures to detect and deter money laundering and the financing of terrorist activities and to facilitate the investigation and prosecution of money laundering offences and terrorist activity financing offences, including
> (i) establishing record keeping and client identification requirements for financial services providers and other persons or entities that engage in businesses, professions or activities that are susceptible to being used for money laundering or the financing of terrorist activities, and
> (ii) requiring the reporting of suspicious financial transactions and of cross-border movements of currency and monetary instruments."[86]

[84] https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/digital-currency/cryptocurrency-guide.html (accessed on 9 April 2019).
[85] *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* [Canada], S.C. 2000, c. 17, (June 2000).
[86] Sec 3, *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* [Canada], S.C. 2000, c. 17 (June 2000).

The Amendment Act specifically includes dealing in virtual currencies, as defined by regulation, as a money services business.[87] Further, the Amendment Act enhances the client identification, record keeping and registration requirements for financial institutions and intermediaries and extends the application of the Act to persons and entities that deal in virtual currencies and foreign money services businesses.[88]

5.3.2 Senegal

Closer to home, Senegal has followed a very innovative of approach to virtual currencies. In 2016, the Banque Régionale de Marchés (BRM), which is the regional market bank of the West African Economic and Monetary Union (WAEMU), announced that it would be partnering with eCurrency Mint Limited to provide a digital currency in WAEMU. The digital currency would be named the ECFA and would be issued by the BRM. This issuance would be line with the e-money regulations of the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), the Central Bank of the WAEMU.[89]

Senegal is a member of the WAEMU. The Union comprises of seven other countries, namely Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger and Togo. The Union, through its central bank, centralizes the cash reserves of the Union, with its main responsibilities being the issuing of currency, managing monetary policy, organizing and monitoring banking activities and providing assistance to the WAMU member States.[90]

It is envisioned that the eCFA, would be a high security digital instrument that can be held in all mobile money and e-money wallets. It will secure universal liquidity, enable interoperability, and provide transparency to the entire digital ecosystem in WAEMU.[91] eCFA will run off blockchain – this being a key differentiator between the common definition of e-money and virtual currencies.

[87] Section 244.1, *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* [Canada], S.C. 2000, c. 17 (June 2000).
[88] Division 19 of Part 6, *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* [Canada], S.C. 2000, c. 17 (June 2000).
[89] https://www.ecurrency.net/static/news/201611/press_release_BRM_translated.pdf (accessed on 1 April 2019).
[90] https://www.bceao.int/en/content/presentation-bceao (accessed on the 30 March 2019).
[91] https://www.ecurrency.net/static/news/201611/press_release_BRM_translated.pdf (accessed on 1 April 2019).

The launch of this digital currency is significant in that it is backed by the WAEMU Central Bank. It could be argued that this backing by a central bank amounts to the legitimisation of virtual currencies in Senegal. And whilst the launch has occurred in Senegal, plans have been mooted to roll out the eCFA in the rest of the WAEMU.[92] This would have seen the first adoption of a unique virtual currency by an economic block.

5.3.3 Singapore

Singapore has followed an approach similar to Canada with their reaction to virtual currencies. The regulatory response from Singapore has dealt with the taxation aspects of virtual currencies and the risks around money laundering and terrorist financing. In addition to this, Singapore has issued various consultation papers dealing with virtual currency, such as the national payments framework and system.

The Inland Revenue Authority of Singapore (IRAS) issued guidance regarding the use of virtual currencies for the selling, buying and importing of goods. In this guidance, the IRAS held that virtual currencies were not considered fiat currency for Goods and Services Tax (GST) and therefore would be treated as a supply of a service which is not exempted from GST.[93]

The IRAS further goes on the deal with transactions that would be considered as a barter trade. The IRAS held the view that:

> "When you use virtual currencies to pay for goods or services, the transaction will be considered as a barter trade. There are two supplies made - one by the supplier who supplies the goods and services, and another by you who use virtual currencies to pay the supplier. GST will need to be charged on each supply if the respective supplier is GST-registered. However, if you use virtual currencies to pay a supplier belonging outside Singapore, you need not charge GST as the supply will be zero-rated"[94].

[92] https://www.jdsupra.com/legalnews/senegal-moves-toward-nationalized-83592/ (accessed on 25 April 2019).
[93] https://www.iras.gov.sg/IRASHome/GST/GST-registered-businesses/Specific-business-sectors/e-Commerce/#title5 (accessed on 10 April 2019).
[94] https://www.iras.gov.sg/IRASHome/GST/GST-registered-businesses/Specific-business-sectors/e-Commerce/#title5 (accessed on 10 April 2019).

The guidance goes on to deal with the selling of virtual currencies. In this instance, the IRAS notes that:

> "If you are a GST-registered business and you sell virtual currencies as a principal, you will have to charge GST on the sale of the virtual currencies, unless the sale is made to a person belonging outside Singapore. However, if you act as an agent for another party when selling the virtual currencies, you need to charge GST on the commission fees you receive, unless the service is supplied to a person belonging outside Singapore. Trading fees charged by a virtual currency exchange located in Singapore are subject to GST if that exchange is GST-registered"[95].

The same position applies to transactions relating to the importing of goods paid by virtual currencies.[96]

In relation to the money laundering and terrorist financing risks associated with virtual currencies, Singapore has held a view that their legislative and regulatory framework is broad enough to include trading in virtual currencies and therefore AML/CFT obligations apply to all activities carried out by of financial institutions, including trades in virtual currencies.[97] Individuals are also required under the law to report suspicious transactions, which they may come across in the course of their trade, profession, business or employment, to the Suspicious Transaction Reporting Office within the Commercial Affairs Department (CAD).[98]

Further to this, the Monetary Authority of Singapore (MAS) published a consultation paper in August 2016 seeking public views on the regulation of payment activities.[99] The scope of this consultation paper included virtual currency intermediation services. Following this consultation paper, the MAS published the consultation paper on the proposed Payment Services Bill.[100]

---

[95] https://www.iras.gov.sg/IRASHome/GST/GST-registered-businesses/Specific-business-sectors/e-Commerce/#title5 (accessed on 10 April 2019).
[96] https://www.iras.gov.sg/IRASHome/GST/GST-registered-businesses/Specific-business-sectors/e-Commerce/#title5 (accessed on 10 April 2019).
[97] https://thelawreviews.co.uk/edition/the-virtual-currency-regulation-review-edition-1/1176666/singapore (accessed on 10 April 2019).
[98] Notice Paper 984 of 2017 - Reply to Parliamentary Question on AML/CFT Enforcement on Virtual Currency Transactions, January 2018.
[99] Consultation Paper P009 *Proposed Activity-based Payments Framework and Establishment of a National Payments Council* (August 2016).
[100] Consultation Paper P021 - The Proposed Payment Services Bill, 2017.

In the consultation paper, the MAS proposes to enact new payments legislation in the form of the proposed Payment Services Bill to:

> "(a) streamline payment services under a single legislation by combining the PS(O)A and the MCRBA;
> (b) enhance the scope of regulated activities to take into account developments in payment services; and
> (c) calibrate regulations according to the risks the activities pose by adopting a modular regulatory regime".[101]

With this proposed Bill, the MAS intends to bring virtual currency services within the definition of payment services and to therefore regulate the services as such. In addition to this, the MAS will implement AML/CFT requirements on these service providers that will include the identification and verification of customer and beneficial owner, ongoing monitoring, screening for ML/TF concerns, suspicious transaction reporting and record keeping.[102]

What we are seeing in Singapore is both the regulation of virtual currencies and that the regulators are open to the constant innovation within the virtual currency space.

5.3.4 United States of America

The United States of America (USA) has followed a fragmented approach to virtual currencies. This approach is further exacerbated by the multiplicity of regulatory bodies in the financial services sector and the fragmented model of regulation in the USA. There is currently no over-arching piece of legislation that covers virtual currencies in the USA, but there have been some regulatory interventions from various regulatory bodies.

The Commodity Futures Trading Commission (CFTC) oversees the derivatives markets for to protect against various market abuses and to lower the risk of the futures and swaps markets to the economy and the public. The Commission was established as an independent agency in 1974.[103]

---

[101] Consultation Paper P021 - The Proposed Payment Services Bill, 2017 Page 3.
[102] Consultation Paper P021 - The Proposed Payment Services Bill, 2017 Page 16.
[103] https://www.cftc.gov/About/MissionResponsibilities/index.htm (accessed on 17 April).

In 2015, the CFTC heard a matter relating to contraventions of the Commodity Exchange Act[104] (CEA) by a company called Coinflip Inc. The facts of the matter are as follows:

> "During the Relevant Period, Respondents violated Sections 4c(b) and 5h(a)(l) of the Act and Commission Regulations 32.2 and 37.3(a)(l) by conducting activity related to commodity options contrary to Commission Regulations and by operating a facility for the trading or processing of swaps without being registered as a swap execution facility or designated contract market. Specifically, during the Relevant Period, Respondents operated an online facility named Derivabit, offering to connect buyers and sellers of Bitcoin option contracts".[105]

In this matter, the CFTC held that the definition of commodity contained within the CEA was wide enough to include virtual currencies such as Bitcoin. The CFTC noted that:

> "Section 1a (9) of the Act defines 'commodity' to include, among other things, 'all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in'. The definition of a 'commodity' is broad. Bitcoin and other virtual currencies are encompassed in the definition and properly defined as commodities".[106]

This decision to include virtual currencies under the definition of commodities, places virtual currencies squarely under the jurisdiction of CTFC. As such, traders that carry out virtual currency trades and services would need to be registered with the CFTC.

The USA has also seen regulatory interventions from the Financial Crimes Enforcement Network (FinCEN). The FinCEN is tasked with protecting the financial system from illicit use, combating money laundering using financial authorities and collecting, analysing, and disseminating of financial intelligence.[107]

---

[104] Commodity Exchange Act, 1936.

[105] *In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29, 2015 WL 5535736 (September 2015).

[106] *In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29, 2015 WL 5535736 (September 2015).

[107] https://www.fincen.gov/about/mission (access on the 17 April 2019).

In 2013, the FinCEN issued a guidance document on the treatment of virtual currencies within the USA. In the guidance document,[108] the FinCEN explicitly stated the following:

> "FinCEN's regulations define the term 'money transmitter' as a person that provides money transmission services, or any other person engaged in the transfer of funds. The term 'money transmission services' means the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means. The definition of a money transmitter does not differentiate between real currencies and convertible virtual currencies. Accepting and transmitting anything of value that substitutes for currency makes a person a money transmitter under the regulations implementing the BSA".

The Bank Secrecy Act[109] (BSA) places registration, reporting and report keeping obligations on entities that fall within the realm of this legislation. This inclusion then means that money transmission services for the purposes of virtual currency are required to register as a Money Service Business and are expected to comply with Anti-Money Laundering (AML) and Know-Your-Customer regulations.[110]

In addition to regulatory intervention from the FinCEN, the Internal Revenue Services (IRS) of the USA has also issued guidance on virtual currencies. In 2014, the IRS issued a guidance document that deals with virtual currencies in relation to tax matters. In terms of the guidance:

> "an individual who 'mines' virtual currency as a trade or business [is] subject to self-employment tax." The IRS states that cryptocurrencies will be classified as property for federal taxation purposes. This guidance established that general tax principles that apply to regular property transaction also apply to virtual currency transactions. Therefore, businesses that accept bitcoin and other cryptocurrencies for goods and services must pay income taxes on payments. When cryptocurrencies are used to make payments, IRS policies concerning information reporting on property transactions are applicable. Businesses that pay employee wages in bitcoin are taxable to the employee and must be reported by the employer on the Form W-2. Furthermore, payroll and federal income taxes are applicable for wages paid in cryptocurrencies. Employers that hire freelancers or independent contractors, and self-employed workers are required to file a Form 1099 to declare their income in cryptocurrency. In order to determine what value

[108] Application of FinCEN Regulations to Persons Administering, Exchanging or Using Virtual Currencies, FIN-2013-G001, (March 2013).
[109] The Bank Secrecy Act of 1970.
[110] SD Hughes *Cryptocurrency Regulations and Enforcement in The U.S.* Western State Law Review (2017).

> should be paid on bitcoin income, the IRS states that taxpayers must estimate the fair market value of the bitcoin during the time of receiving the payment."[111]

Again, this regulatory intervention brings virtual currencies squarely within the realm of legislation and regulation. What can be noted, however, is that the USA has carried out various legislative interventions in an almost siloed approach. This approach is further exacerbated by the fact that there are various states that are also delving into the regulation of virtual currencies.

In 2015 the Department of Financial Services in New York issued the "BitLicense". This license is the first comprehensive regulatory framework for firms dealing in virtual currency such as Bitcoin, and includes key consumer protection, anti-money laundering compliance, and cyber security guidelines.[112] The requirement to obtain a BitLicense applies to the following activities:

> "Virtual currency transmission; Storing, holding, or maintaining custody or control of virtual currency on behalf of others; Buying and selling virtual currency as a customer business; Performing exchange services as a customer business; and controlling, administering, or issuing a virtual currency".[113]

In California, several attempts at regulation have been carried out since 2014. The first attempt in 2014 was by way of a Bill that was targeted at dealing with virtual currencies. The Bill sought to lift the ban on virtual currencies by amending the existing law that prohibited a corporation, flexible purpose corporation, association or individual from issuing or putting in circulation, as money, anything but the lawful money of the United States.[114]

In 2017, the Virtual Currency Bill[115] was published, the Bill sought to amend the existing Money Transmission Act. The amendment dealt with the prohibition of persons from engaging in the business of money transmission in the state of California, unless the person is licensed by the Commissioner of Business Oversight

---

[111] Internal Revenue Service *Virtual Currency Guidance Notice 2014-21* (March 2014).

[112] https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1509221 (accessed on 20 April 2019).

[113] Scott D Hughes *Cryptocurrency Regulations and Enforcement in The U.S.* Western State Law Review (2017).

[114] http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201320140AB129 (accessed on 20 April 2019).

[115] Assembly Bill 1123 – The Virtual Currency Act – 2017.

or exempt from licensing under the act. In addition, the Bill extends the definition of money transmission service to include virtual currency service providers. This inclusion of virtual currencies within the definition will mean that virtual currency service providers will be required to register as a money transmission service and will be prohibited from engaging in any virtual currency business, as defined, in this state unless appropriately licensed by the Commissioner of Business Oversight.[116]

Recently, California has published enhanced regulatory measures to deal with virtual currencies. This bill would enact the Uniform Regulation of Virtual Currency Businesses Act.[117] Broadly, the Act sets out to achieve the following:

> "This bill would enact the Uniform Regulation of Virtual Currency Businesses Act. The bill would prohibit a person from engaging in virtual currency business activity, or holding itself out as such, unless licensed or registered with the Department of Business Oversight, subject to a variety of exemptions. The bill would define "virtual currency" as a digital representation of value that is used as a medium of exchange, unit of account, or store of value, and that is not legal tender, whether or not denominated in legal tender, except as specified. The bill would define "virtual currency business activity" as exchanging, transferring, or storing virtual currency or engaging in virtual currency administration, whether directly or through an agreement with a virtual currency control services vendor, among other things. The bill would prescribe requirements for licensure, which would include provisions for recognition of a license from another state. The bill would also prescribe an alternative process of registration for businesses that have an annual virtual currency business of less than a specified dollar amount, as defined. The bill would establish requirements for security, net worth, and reserves for licensed and registered businesses. Among other things, the bill would prescribe requirements for examinations of these businesses, data sharing with other states, mergers and consolidations by licensees and registrants, and disclosures to be provided to customers. The bill would grant the department specified enforcement authority over these businesses, including specified civil penalties".[118]

What we can see from the examples of legislative and regulatory interventions in the United States of America is that there is no single and consistent view. As such it would be difficult to ascertain the country's policy on virtual currencies. Whilst most regulatory bodies have been welcoming of virtual currencies, this "welcoming" has not been so consistent as to ensure that individuals and businesses that deal in virtual currencies have a single, consistent understanding of their legislative and regulatory obligations.

---

[116] Assembly Bill 1123 – The Virtual Currency Act – 2017.
[117] Assembly Bill 1489 - Uniform Regulation of Virtual Currency Businesses Act, 2019.
[118] Assembly Bill 1489 - Uniform Regulation of Virtual Currency Businesses Act, 2019.

5.3.5 South Africa

South Africa has fared relatively well in its response to regulating virtual currencies. This is demonstrated by the formation of the Intergovernmental Fintech Working Group (IFWG) circa 2016. The IFWG comprises of representatives from the Financial Intelligence Centre (FIC), the Financial Sector Conduct Authority (FSCA), the South African Reserve Bank (SARB) and National Treasury (NT).

This working group was established to examine the potential impact of fintech (including virtual currencies) in South Africa:

> "The IFWG hosted its inaugural workshop on 19 and 20 April 2018, with the objective of providing a platform for regulators and policymakers to engage with industry, identify key considerations and develop a harmonised approach to fintech-driven innovations for the benefit of all South Africans. The workshop aimed to identify risks and benefits involved in financial services innovation driven by technology, the regulatory challenges faced by fintechs in South Africa, and input on the response regulators in South Africa should take to develop appropriate policies and implement effective regulatory frameworks for specific focus areas".[119]

The key discussion areas at the workshop were the following:

1. "Private Crypto-Currencies: the session aimed to gain insight from the industry on broader crypto-currency activities such as the existing and emerging use cases, the role of crypto-currency exchanges and more specific activities relating to initial coin offerings (ICOs);
2. Financial Inclusion: the session aimed to achieve greater understanding of the existing and potential future impact of fintech on financial inclusion, as well as an understanding of risks, including consumer protection risks, regulatory challenges and possible policy or regulatory solutions. Innovations such as digital identity were also discussed;
3. Innovation Facilitation: the session aimed to identify learnings from the experience of other regulators that have implemented innovation facilitators and/or policy positions conducive to innovation facilitation as well as improved engagement between regulators, fintech providers and incumbents;
4. Regulatory and Policy Responses: the closed session aimed to provide the IFWG and its members with the opportunity to reflect on the feedback provided by workshop participants. Input received from participants was contrasted to work-in-progress on respective focus areas".[120]

[119] Intergovernmental Fintech Working Group Report (April 2018) Page 5.
[120] Intergovernmental Fintech Working Group Report (April 2018) Page 5.

The workshop revealed key a consideration towards the regulation of fintech and virtual currencies. Particularly around the issue of regulating virtual currencies, the workshop agreed that the following key issues would need to be dealt with:

1. The classification of cryptocurrencies and tokens;
2. Regulation should also be proportional to the risk;
3. Consumer and investor protection are necessary;
4. Appropriate and purposive regulation;
5. Alignment and leverage of current legal frameworks versus new regulation; and
6. The application of blockchain technology in the wider financial services market.[121]

Subsequent to this workshop, a joint working group was formed under the umbrella of the IFWG to examine South Africa's position on crypto assets. The working group is represented by the members of the IFWG and SARS. This joint working group is known as the Crypto Assets Regulatory Working Group.[122]

The working group focused on a multi-pronged problem statement, being:

1. "Crypto assets are a form of innovation that may impact the financial services sector of the country;
2. Crypto assets do not fit within the current regulatory framework;
3. Crypto assets may create conditions for regulatory arbitrage; and
4. There is a growing interest, investment and participation in crypto assets."[123]

This working group sought to examine the level of regulatory intervention required within the South African context. The working group agreed on key principles that would be considered in plotting a regulatory path. These key principles are as follows:

- "A Risk Based Approach – This would entail a balance between regulatory intervention and the potential benefits of innovation with the cryptocurrency space;
- Technology Neutral and primarily Principles Based – A principles based regulatory framework is one that focuses on principles as opposed to a rules-based framework. This approach fosters innovation in that it does not stifle businesses. In addition, a technology neutral framework is one that focuses on specific activity or function performed, as opposed to a specific entity or the type of technology used;

[121] Intergovernmental Fintech Working Group Report (April 2018) Page 15.
[122] IFWG Consultation Paper on Policy Proposals for Crypto Assets (April 2019) Page 5.
[123] IFWG Consultation Paper on Policy Proposals for Crypto Assets (April 2019) Page 6.

- Unified Regulatory Approach - This approach ensures a clear and consistent regulatory approach by all relevant South African regulatory authorities, taking cognisance of international approaches."[124]

Following this approach, the working group came up with various recommendations in relation to the regulating of cryptocurrencies. The recommendations are detailed as follows:

> "It is recommended that crypto assets remain without legal tender status and are not recognised as electronic money either. It is proposed that an appropriate regulatory framework is developed through three phases:
> Phase 1: Registration process for crypto asset service providers.
> Phase 2: Review of existing regulatory frameworks followed by new regulatory requirements or amendments to existing regulations.
> Phase 3: Assessment of regulatory actions implemented".[125]

The recommended requirement for crypto asset service providers relates to registrations with the Financial Intelligence Centre (FIC). The rationale for this is directly aimed at the money laundering and terrorist financing that exist within the virtual currency space. This is also in line with the recent amendments to the Financial Action Task Force (FATF) Recommendations. The working group has listed the crypto asset service providers that would be required to register should the recommendations be implemented:

"a. Crypto asset trading platforms (or any other entity facilitating crypto asset transactions)
   i. Provide intermediary services for the buying and selling crypto assets, including through the use of crypto asset vending machine facilities.
   ii. Trading, conversion or exchange of fiat currency or other value into crypto assets.
   iii. Trading, conversion or exchange of crypto assets into fiat currency or other value.
   iv. Trading, conversion or exchange of crypto assets into other crypto assets.

b. Crypto asset digital wallet providers (custodial wallets)
   i. Entity offering a software program with the ability to store private22 and public keys23 that are used to interact with various digital protocols that enable the user to send and receive crypto assets with the ability to monitor balances.

c. Crypto asset safe custody service providers (custodial services)
   i. Safeguarding, storing, holding or maintaining custody of crypto assets belonging to another party.

[124] IFWG Consultation Paper on Policy Proposals for Crypto Assets (April 2019) Page 24.
[125] IFWG Consultation Paper on Policy Proposals for Crypto Assets (April 2019) Page 25.

d. Crypto asset payment service providers

   i. All payment services provided when using crypto assets as a medium of exchange".[126]

Over and above the recommended registration with the FIC, the working group further recommends that crypto asset service providers should be required to comply with the AML/CFT provisions of the Financial Intelligence Centre Act[127] (FICA).[128] This requirement would mean that these providers would essentially be included in the definition of accountable and reporting institutions, as contained in FICA,[129] thereby requiring the providers to carry out certain obligations such as suspicious transaction monitoring and reporting, cash threshold reporting, customer due diligence and the application of a risk-based approach to compliance with FICA.[130]

These recommendations form the first step towards the regulation of virtual currencies in South Africa. And whilst virtual currencies remain without legal tender status and are not regarded as electronic money,[131] these recommendations go a long way to chart the path for the regulation of virtual currencies. It remains to be seen whether regulators in South Africa and globally will continue to move towards the acceptance of this innovative future.

[126] IFWG Consultation Paper on Policy Proposals for Crypto Assets (April 2019) Page 27.
[127] Financial Intelligence Centre Act 38 of 2001.
[128] IFWG Consultation Paper on Policy Proposals for Crypto Assets (2019) Page 27.
[129] Section 1, Financial Intelligence Centre Act 38 of 2001.
[130] IFWG Consultation Paper on Policy Proposals for Crypto Assets (2019) Page 28.
[131] IFWG Consultation Paper on Policy Proposals for Crypto Assets (2019) Page 25.

Chapter 6: Initial Coin Offerings

The advent of virtual currencies has brought about advanced and fast-paced innovation in the financial services industry. This innovation, primarily operated on the basis of the Blockchain technology, continues to be the catalyst for this revolution. And whilst most of this innovation has centred around virtual currencies in their simplest form, in recent times there has been increased activity in other aspects of the virtual currencies space. This shift has moved the focus on virtual currencies simply as a means of exchange, store of value and unit of account, into other developments that extend virtual currencies into the space of securities trading, typically through what is now known as Initial Coin Offerings (ICOs). ICOs are defined as:

> "the creation of digital tokens by start-up companies (i.e. young micro-SMEs) and their distribution to investors in exchange for fiat currency or, in most cases, mainstream cryptocurrencies (Bitcoin or Ether). ICOs are enabled by the use of Distributed Ledger Technologies (DLTs), such as the Blockchain, which facilitate the exchange of value without the need for a trusted central authority or intermediary (e.g. government, bank) and allow for efficiency gains driven by such dis-intermediation. Tokens are cryptographically-secured and benefit from the inherent characteristics of DLTs on which they are built such as transparency, security and immutability of the ledger given its distributed nature".[132]

Simply put, ICOs are similar to what is commonly known as an Initial Public Offering (IPO), the difference being that instead of individuals purchasing or investing in securities or shares, individuals purchase crypto coins or assets as a form of investment in a specific business venture. These investments capital raising effort would go towards the raising of capital for these new business ventures. This manner of fund raising is fraught with various fraud and customer protection risks, due to the lack of transparency of the ICO process. This is coupled with the fact that there is no set format or process to launch an ICO as would be the case with an IPO. It is to this end that many regulators have started issuing guidance in relation to ICOs, to mitigate these risks.

---

[132] Organisation for Economic Co-operation and Development (OECD) *Initial Coin Offerings (ICOs) for SME Financing* (January 2019).

In Canada, the Canadian Securities Administrators (CSA) have issued a newsletter noting that many of these cryptocurrency offerings involve sales of securities. These securities laws in Canada will apply if a person or company selling the securities is conducting business from within Canada or if there are Canadian investors.[133] In addition, the CSA compiled various requirements to be considered by potential businesses completing ICOs[134] to determine whether they fall within the definition of securities or whether they are exempt from legislation. This approach shows that regulators in Canada are following an open approach to ICOs but still noting the risks and dangers of such transactions.

In Singapore, the Monetary Authority of Singapore (MAS) has noted that offers or issues of digital tokens may be regulated by the MAS if the digital tokens are capital markets products under the Securities and Futures Act.[135] This stance by the MAS therefore requires that:

> "A person may only make an offer of digital tokens which constitute securities, securities-based derivatives contracts or units in a CIS ('Offer'), if the Offer complies with the requirements under Part XIII of the SFA15. This includes the requirements that the Offer must be made in or accompanied by a prospectus that is prepared in accordance with the SFA and is registered with MAS ('Prospectus Requirements')".[136]

Over and above the SFA requirements, offerors of ICOs would also have to comply with the MAS Notice on Prevention of Money Laundering and Countering the Financing of Terrorism.[137]

---

[133] Canadian Securities Administrators *CSA Staff Notice 46-307 Cryptocurrency Offerings* (August 2017).
[134] Canadian Securities Administrators *CSA Staff Notice 46-307 Cryptocurrency Offerings* (August 2017).
[135] Securities and Futures Act 42 of 2001.
[136] Monetary Authority of Singapore *A Guide to Digital Token Offerings* (November 2018) Page 4.
[137] Monetary Authority of Singapore *A Guide to Digital Token Offerings* (November 2018) Page 7.

These regulatory developments in relation to ICOs have certainly increased scrutiny of the fast-paced innovation within the virtual currency space. And whilst within the South African regulatory context there has been no movement in regulating ICOs, we have seen a handful of South African businesses resort to ICOs as a method of raising capital:

- "South African property investment platform ProsperiProp is one of the success stories on this list of initial coin offerings. Despite the fact that it did not reach its intended ICO target in 2017, it managed to raise an impressive $200,000. The amount raised from investors will be used to develop software that will help financial institutions to offer blockchain technology-based property investment products

- Fintech startup Wala raised $1.2 million from its initial coin offering in 2017. The South African company admitted that it considered their ICO to be a success in spite of falling well short of its $30 million target. The Dala token, as they it is named, is a new financial services utility token built on the Ethereum blockchain.

- South African-based blockchain startup, The Sun Exchange, allows anyone in the world to own or lease solar panels used to power African businesses and communities; earning them a solar powered income. With this concept in mind, the company launched an ICO that was run out of Malta, with commitments of $1.3 million received in a private presale of SunEx tokens. By the middle of October 2018, the startup raised just over $2.7 million of their $5.4 million target".[138]

What is clear from the extract above is that the capital being raised by way of ICOs is significant and as such the risks associated with transactions of this nature are too great. Currently, trading in IPOs and broadly securities trading falls under the auspices of the Financial Markets Act[139], with securities being defined as "listed and unlisted shares, depository receipts and other equivalent equities, debentures, and bonds, derivative instruments, notes and participatory interests in a collective investment scheme"[140]. It is clear that ICOs do not fall within the definition of security as defined in the Financial Markets Act, however the manner in which ICOs are operated is very much akin to IPO and securities trading.

[138] https://moguldom.com/159605/9-initial-coin-offerings-launched-in-africa/ (accessed on 2 April 2019).
[139] Financial Markets Act 19 of 2012.
[140] Section1 of the Financial Markets Act 19 of 2012.

Whilst ICOs are currently not included under the realm of the Financial Markets Act, history has shown that regulators in South Africa are very much in tune with global regulatory trends and will often reflect and implement regulatory interventions having considered what other international regulators are doing in this regard.

Chapter 7:
Conclusion

The pace of innovation and development in relation to virtual currencies has been unprecedented. In most cases, this dynamic innovation has resulted in a delayed reaction by regulators in various jurisdictions. However, we are now seeing a surge in regulatory interventions to meet these developments. These interventions will have to keep abreast of the everchanging landscape and the rapid pace of innovation in this space. Whilst we have seen varied regulatory responses globally, many countries still remain cautious of virtual currencies by implementing bans on virtual currencies and related transactions. These bans have not stifled innovation in this space, but instead it has created pockets of innovation in countries that have welcomed virtual currencies.

Since 2008, virtual currencies continue to be a major talking point in the financial services sector, both for the money laundering and terrorist financing risks they pose and for the potential benefits and innovation that they hold. In my opinion, this innovation and technology will remain a factor within the financial services sector – perhaps evolving in its usage but remaining a significant contributor to the future of financial services.

The South African regulatory framework as it stands is not readily able to include virtual currencies under the scope of its regulation. But with the recent initiatives by way of the IFWG we see that regulators are taking an active role in understanding this new innovation. These initiatives have also resulted in South African regulators taking a stance on how to regulate virtual currencies. This stance entails a risk-based approach to regulating virtual currencies – it should be technology-neutral and primarily principles-based to allow a unified regulatory approach. In my view this is the most favourable and pragmatic manner of regulating virtual currencies. This approach ensures that continued innovation and regulatory interventions can co-exist mutually.

Whilst at present regulatory recommendations in South Africa have focused on curbing the risk of money laundering and terrorist financing as it relates to virtual currencies, I submit that regulators in South Africa should start to examine the potential effect of virtual currencies and the underlying blockchain technology on the national payments system and the increasing usage of ICOs as a method of investment capital.

-o0o-

Bibliography

Literature

- Application of FinCEN Regulations to Persons Administering, Exchanging or Using Virtual Currencies, FIN-2013-G001 (2013)
- Bank for International Settlements Paper: *Roles and objectives of modern central banks* (2009)
- Banque de France, *Focus – What is the Gold Standard* (2010)
- Beyond Silk Road: Potential Risks, Threats, and Promises of Virtual Currencies, hearing before the US Senate Committee on Homeland Security and Governmental Affairs, 113th Cong (2013)
- Canadian Securities Administrators - *CSA Staff Notice 46-307 Cryptocurrency Offerings* (2017)
- Consultation Paper P009 - *Proposed Activity-based Payments Framework and Establishment of a National Payments Council* (2016)
- Consultation Paper P021 - *The Proposed Payment Services Bill* (2017)
- Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax (2006)
- De Kock MH *Central Banking* (1939)
- EU Directive 2018/843 of the European Parliament and of the Council (2018)
- European Union *Report on Virtual Currency Schemes* (2012)
- Financial Action Task Force Report: *Guidance for a Risk-Based Approach to Virtual Currencies* (2015)
- Financial Action Task Force Report: *Virtual Currencies Key definitions and Potential AML/CFT risks* (2014)
- Financial Action Task Force: *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation* (2018)
- Financial Intelligence Centre Annual Report 2017/18
- Hughes SD *Cryptocurrency Regulations and Enforcement in The U.S.* (2017) Western State Law Review
- IFWG Consultation paper *on policy proposals for crypto assets* (2019)
- Intergovernmental Fintech *Working Group Report* (2018)
- Internal Revenue Service *Virtual Currency Guidance Notice 2014-21* (2014)
- Konig S *The Evolution of Money – From Commodity Money to E-Money* (2001) UNICERT IV Program

- Lansky J *Possible State Approaches to Cryptocurrencies* (2018) *Journal of Systems Integration* 19 – 31 23
- Lavorschi M *The Origins and Nature of Money* (2014) *USV Annals of Economics and Public Administration* 71-78.
- Lee J *Bitcoin Basics: A Primer on Virtual Currencies* (2015) *Business Law International*
- Monetary Authority of Singapore *A Guide to Digital Token Offerings* (2018)
- Nakomoto S Bitcoin*: A Peer-to-Peer Electronic Cash System* (2008).
- Notice Paper 984 of 2017 - Reply to Parliamentary Question on AML/CFT enforcement on virtual currency transactions (2017)
- OECD *Initial Coin Offerings (ICOs) for SME Financing* (2019)
- South African Reserve Bank *Commemorative Publication* (2011)
- South African Reserve Bank *Currency and Exchanges Guidelines for Individuals* (2018)
- South African Reserve Bank *History, Functions and Institutional structure* (2009)
- South African Reserve Bank *Position Paper of Virtual Currencies* (2014)
- South African Revenue Services *ABC of Capital Gains Tax for Individuals* (2017)

Case law

- *In re Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan*, CFTC Docket No. 15-29, 2015 WL 5535736 (Sept. 17, 2015)
- *Skatteverket v David Hedqvist*, ECLI:EU:C:2015:718

Legislation

- Assembly Bill 1123 – The Virtual Currency Act - 2017
- Assembly Bill 1489 - Uniform Regulation of Virtual Currency Businesses Act, 2019
- Bank Secrecy Act of 1970
- Banks Act 94 of 1990
- Commodity Exchange Act, 1936
- Constitution of the Republic of South Africa, 1996
- Financial Intelligence Centre Act 38 of 2001
- Financial Sector Regulatory Act 9 of 2017.
- Financial Services Board Act 97 of 1990
- Government Notice R1111 of 1 December 1961
- Income Tax Act 58 of 1962

- Money Laundering and Terrorist Financing Control Regulations, 2002
- Proceeds of Crime (Money Laundering) and Terrorist Financing Act [Canada], S.C. 2000, c. 17, 29 June 2000
- Securities and Futures Act 42 of 2001
- South African Reserve Bank Act 90 of 1989
- Taxation Laws Amendment Act 23 of 2018

Internet sources

- https://spectrum.ieee.org/at-work/innovation/a-brief-history-of-money
- https://www.loc.gov/law/help/cryptocurrency/canada.php
- https://www.resbank.co.za/RegulationAndSupervision/NationalPaymentSystem(NPS)/Pages/Introduction%20and%20Overview.aspx
- https://www.ecb.europa.eu/ecb/tasks/stability/html/index.en.html
- https://www.resbank.co.za/Financial%20Stability/Pages/FinancialStability-Home.aspx
- https://www.businessinsider.co.za/cryptocurrency-is-now-a-financial-instrument-for-tax-purposes-after-law-change-2019-1
- https://www.businessinsider.co.za/cryptocurrency-is-now-a-financial-instrument-for-tax-purposes-after-law-change-2019-1
- http://www.fatf-gafi.org/about/
- https://europa.eu/european-union/about-eu/eu-in-brief_en#from-economic-to-political-union
- https://www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/compliance/digital-currency/cryptocurrency-guide.html
- https://www.ecurrency.net/static/news/201611/press_release_BRM_translated.pdf
- https://www.bceao.int/en/content/presentation-bceao
  https://www.ecurrency.net/static/news/201611/press_release_BRM_translated.pdf
- https://www.iras.gov.sg/IRASHome/GST/GST-registered-businesses/Specific-business-sectors/e-Commerce/#title5
- http://www.mas.gov.sg/Regulations-and-Financial-Stability/Anti-Money-Laundering-Countering-The-Financing-Of-Terrorism-And-Targeted-Financial-Sanctions/Anti-Money-Laundering-and-Countering-the-Financing-of-Terrorism/National-Policy-Statement.aspx
- https://www.cftc.gov/About/MissionResponsibilities/index.htm
- https://www.fincen.gov/about/mission

- https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1509221
- http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201320140AB129
- https://moguldom.com/159605/9-initial-coin-offerings-launched-in-africa/
- https://www.resbank.co.za/RegulationAndSupervision/FinancialSurveillanceAndExchangeControl/FAQs/Pages/VirtualCurrenciesCryptocurrencies.aspx
- https://www.thesait.org.za/news/450491/Two-Sides-to-Every-Bitcoin.htm
- http://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx
- http://www.sars.gov.za/Media/MediaReleases/Pages/6-April-2018---SARS-stance-on-the-tax-treatment-of-cryptocurrencies-.aspx
- https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/20/Monetary-Policy-and-Central-Banking