

Short notes on:

THE REGULATORY STATUS QUO OF CRYPTOCURRENCY EXCHANGES

Introduction

The South African Cryptocurrency Market Place is currently facing scrutiny and a fair amount of uncertainty as a result of First National Bank (FNB) announcing on 20 November 2019 that they would be shutting down all bank accounts associated with cryptocurrency businesses. The decision will affect all three of the largest cryptocurrency exchanges currently in operation.¹ FNB has cited the uncertainty in the market stemming from a lack of regulation as the reason for the decision.²

The decision comes at a time where some countries continue to ban the use of cryptocurrencies, while others, such as Singapore and South Korea have begun the process of imposing stricter regulations. Without clear regulations, other South African banking institutions may be considering a similar move based on the same concerns regards a lack of regulatory guidance.

The purpose of this article will be to provide a brief overview of the current legislative framework to determine the extent and nature of the risk and liabilities associated with the existing cryptocurrency marketplace.

The Existing Financial Services Regulatory Framework

The most applicable piece of legislation is the Financial Intelligence Act 31 of 2008, as amended (FICA).³ FICA provides that any "... accountable institution may not establish a business relationship or conclude a single transaction with an anonymous client or a client with an apparent false or fictitious name." Included within this framework are Securities Exchanges as regulated Financial Market Act⁴, Banks, long terms insurers as well as gambling businesses.

A notable inclusion is the provision of financial services as per the Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS).⁵ FAIS would apply to the trading of cryptocurrency if the exchange can be seen to be provided advice regards the purchase of a financial product or

¹ <https://sacrypto.co.za/fnb-to-close-cryptocurrency-related-bank-accounts-including-big-exchanges/>

² <https://city-press.news24.com/Business/crypto-platforms-come-under-fire-20191122>

³ Financial Intelligence Act 31 of 2008

⁴ Act 19 of 2012

⁵ the Financial Advisory and Intermediary Services Act 37 of 2002

investment therein. A financial product is listed as shares in a company, debentures, money market instruments, interests in one or more collective investments schemes, foreign currency investments instruments and others.

Cryptocurrency, as a digital medium of exchange and/or unit of account and/or store of value, has no centralized regulatory recognition and thus is not legal tender. It is often described as nothing more than a digital representation of value. As such, it is clear that a cryptocurrency asset is not a financial product as defined by FAIS. FAIS includes within its sphere of influence intermediary services, but these are again limited to services related in some way to a financial product.

Cryptocurrency Exchanges are thus exempt from complying with FAIS, especially where they operate only as a crypto-to-crypto exchange. But what of the situation where the exchange accepts in fiat currency?

It is arguable that when taking in fiat currency, the exchange must, at that point, be able to comply with the requirements of whatever banking institution holds those funds on their behalf. The Banking Institution would then be able to impose compliance requirements on the particular exchange and in this way, exchanges must comply with the regulatory framework to which its banking partner must comply.

As such, excluding the above, indirect level of compliance, cryptocurrency exchanges are not included within the definitional ambit of FIC. The services they provided do not fit within the existing financial services model as the cryptocurrencies themselves are not recognized as 'things' of legal value. It is worth noting that local cryptocurrency exchanges opt into some of the requirements as detailed in the legislation, as stated above.

Protections Afforded to Cryptocurrency Customers

South African is made of various protectionists pieces of legislation as such; it is submitted that Customers would be protected as would any person using any online services. The first regulatory protections scheme would fall under the Consumer Protection Act 68 of 2008 (the CPA).⁶

⁶ The Consumer Protection act 68 of 2008

As such, those using Cryptocurrency exchanges are naturally protected by the terms of the CPA, where applicable. In terms thereof, consumers are entitled to fair, just and reasonable terms and conditions and may not suffer prejudice in the form of extortionist agreements.

In this regard it must be made clear that any transaction taking place on a cryptocurrency exchange would be subject to any written and/or oral terms and conditions. A consumer, or indeed a supplier, would be naturally protected by various common law aspects as it related to the law of contract.

It is also evident that Consumers of cryptocurrency exchanges would be afforded any protections afforded by the terms of the Protection of Personal Information Act 4 of 2013.⁷

Conclusion

The drawcard for many cryptocurrency investors and hobbyists is the concept of holding value in the form of decentralized assets free from the influence of states or financial services and banking industries. If cryptocurrency exchanges are forced in some way to comply with financial services regulations, it is arguable that the allure of cryptocurrency may fade away.

On the other hand, a trend towards regulation may very well prevent another hack similar to the Binance hack which took place earlier this year which led to an amount of \$41,000,000.00 worth of Bitcoins from been unlawfully withdrawn.⁸ Cryptocurrency is popular at the moment, but the technology and the regulation are still being developed to properly take into account the specific nuances of Cryptocurrency on the Blockchain. As such, it is wise to always trade with caution and conduct proper research and due diligence before investing significant amounts of money in any cryptocurrency exchange.⁹

Contact SchoemanLaw for all your advisory needs.

⁷ Protection of Personal Information Act 4 of 2013

⁸ <https://cointelegraph.com/news/hackers-withdraw-7-000-bitcoins-in-binance-crypto-exchange-security-breach/amp>

⁹ <https://cryptonews.com/guides/why-it-is-risky-to-leave-your-cryptocurrency-in-exchange.htm>