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Dear Hema

Crypto asset secondary service providers

The Australian Banking Association (**ABA**) welcomes the opportunity to provide feedback to the consultation paper, Crypto asset secondary service providers: Licensing and custody requirements.

Banks' role in the crypto assets sector

Crypto assets ownership is increasingly mainstream in Australia. Surveys indicate that as of 2021, a quarter of Australians own or have owned crypto assets; 4 million Australians are likely to buy crypto assets over 2021-22, 33% of whom have never owned crypto assets before.¹

Banks are expecting to participate in the crypto sector in a range of roles, including to provide products and services to meet customer demand. As the crypto sector matures and consumer take up continues, other financial services industry participants may participate in the crypto assets sector now or in the future. As the lines between crypto assets and traditional finance continue to blur, a number of participants in the crypto sector may also provide financial services and payment services.

From this standpoint, the banking industry supports a clear and coherent regulatory framework for the crypto assets sector that helps to uplift standards. The crypto sector has seen significant growth in the types of services provided and consumer take-up, and there is a broad spectrum in maturity and standards in the sector as this sector continues to evolve. In this environment, prompt and appropriate regulation is crucial to 'support the continued maturing of the sector and make Australia a more attractive market for legitimate innovation, investment in and use of' crypto assets and related technology. Regulatory changes should be done concurrently with, and informed by, a phased token mapping exercise, with the initial mapping to focus on changes relevant to the proposed licensing reforms.

Key recommendations

Streamlined and coherent regulatory framework

ABA is responding to Treasury's consultation based on two key principles:

From the consumer's perspective, a crypto secondary services regulatory regime needs to meet consumers' expectations that ASIC-licensed entities would be required to comply with robust standards such as on risk management, conduct, transparency and market integrity. Consumers are also entitled to expect that the principle of 'same risk, same rules' will apply to financial and payments services, irrespective of the underlying technology used to provide the services.

¹ Australian Financial Review, Four million Aussies set to buy into crypto (8 June 2021): <https://www.afr.com/companies/financial-services/four-million-aussies-set-to-buy-into-crypto-20210608-p57z2g>; Yougov/Swyftx, Annual Australia cryptocurrency survey (August 2021): <https://swyftx.com/wp-content/uploads/2021/09/swyftxcryptocurrencysurvey.pdf>

From an industry perspective, a crypto secondary services regulatory regime should be as coherent and streamlined as possible. In particular we see benefit in a crypto regulatory framework that is streamlined and aligned with financial services, financial markets, and AML/CTF obligations, and going forward minimises duplication or gaps with payments licensing and prudential regulation. This approach would also require coordination between regulators. The involvement of financial regulators in Treasury's token mapping exercise will support this outcome.

We understand the desire for speed to market based on a clear regulatory regime. This desire is shared by current or potential participants from the finance and payments industries. Leveraging existing regulatory regimes, and their in-built flexibility, is likely to achieve this outcome more quickly than creating a new licensing regime and developing related regulatory guidance. It also helps to ensure industry participants are not subject to inconsistent and overlapping regulation for parts or all of their business.

ABA key recommendation: Based on these principles and considerations, ABA's key recommendation is to use the existing licensing regimes, particularly the Australian Financial Services Licence (AFSL), to regulate crypto secondary services where the crypto asset is functionally similar to a financial product but does not strictly meet the definition of a financial product. ABA does not support a new, stand-alone crypto asset secondary service providers (CASSPr) licensing regime.

These reforms should be undertaken concurrently with, and informed by, the first phase of token mapping.

Legal certainty beyond secondary services

The sector and government already recognise the need for legal certainty about the regulatory obligations that apply in relation to crypto asset issuance and related activities. It is important to highlight that the legal uncertainty that may currently hamper activity in this sector is not limited to the question of licensing for secondary services, but extends also to issuance, taxation and AML/CTF.

Specifically, we consider it is essential to provide greater legal certainty about when a crypto asset is a financial product, to give certainty to issuers of crypto assets and related service providers about whether their activity attracts disclosure and other conduct regulation under existing laws, or needs an AFSL.

We believe consumers will also benefit from clarity about when a crypto asset is a regulated financial product. Clarity on this question can reduce discrepancies between issuers and service providers about whether particular crypto assets, or crypto assets with particular attributes, are a financial product.

ABA key recommendation: ABA recommends that, irrespective of whether the Government proceeds with a stand alone CASSPr licence regime, the Government introduce mechanisms in the *Corporations Act 2001 (Corporations Act)* to clarify the question of when a crypto asset is a financial product and consider the regulation of crypto assets that are functionally similar to financial products. The token mapping exercise should inform this review.

Further comments and detailed recommendations are provided in the attachment.

If you have any queries, please contact me.

Yours sincerely,

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Detailed submission

Streamlined licensing

ABA reiterates banks are expecting to participate in the crypto sector in a range of roles, including to provide products and services to meet customer demand. From this standpoint, the banking industry supports a clear and coherent regulatory framework for the crypto assets sector that helps to uplift standards.

ABA strongly advocates for an approach to crypto assets regulation that:

- minimises duplication and fragmentation in relation to existing financial services licensing and proposed payments licensing, and the current AUSTRAC registration process for Digital Currency Exchanges; and
- ensures consumer protections expectations are in place and that licensees comply with robust regulatory standards.

Both will be important factors in the longer term credibility and success of a crypto regulatory framework. ABA considers this approach can best be achieved by bringing CASSPrs under the AFSL and Australian Market Licence, as applicable. This is for the following reasons:

- Speed and efficiency is important to ensuring consumer protections are in place, given a rapidly growing proportion of the Australian population are holding crypto assets – of the 4 million Australians likely to buy crypto assets over 2021-22, 33% have never owned crypto assets before. The rise of consumer investment in a largely unregulated crypto asset market and where the application of existing law has significant uncertainty creates scope for less mature or poor conduct to create consumer harm, and for financial criminals to take advantage of this interest to commit 'crypto' scams. These outcomes can reduce consumer confidence and unfairly harm the reputation of mature crypto issuers and service providers.
- We consider using existing regulatory regimes will be more efficient and enable faster speed to market for both new and existing licensees. It is likely to be more efficient to consider the case for exemptions or modifications of existing licensing obligations, rather than to develop new legislation and regulatory guidance.
- Given the blurring lines between crypto asset and traditional financial services, and between some crypto assets and payments, this approach helps to ensure participants whose activities may cross two or more sectors would not be required to hold multiple licences with duplicative but inconsistent obligations.
- This approach of adapting the AFSL and Australian Market Licence may be more consistent with the regulatory principle that functionally equivalent products should be subject to equivalent levels of regulation. Treasury has acknowledged that some types of crypto assets are financial products, and some others have similar risk profiles and underlying characteristics as financial products. Bringing CASSPrs under an adapted form of the AFSL helps to ensure consumers will have equivalent protections across financial products and functionally equivalent crypto assets that do not strictly meet the existing definition of financial product. These outcomes will reduce the scope for consumer harm regulatory arbitrage.
- Applying the Australian Market Licence regime to crypto exchange operators would also help to ensure an entity that operates a crypto exchange has broadly equivalent market integrity obligations as a licensed financial market, unless there are good reasons to apply a lower level of market and consumer protection to crypto exchange.
- Other regulatory proposals which may overlap with the uses and functions of crypto assets, including the proposed new regulatory regime for payments facilitation services and stored value facilities, are proposed to be incorporated within the AFSL regime.

It would reduce the risk of regulatory duplication and overlap if crypto assets and related secondary services are also provided for within the AFSL regime.

- Including crypto asset secondary services under the AFSL regime will enable the regulation of crypto asset secondary service providers to benefit from any improvements made to the financial services regulatory regime following the completion of the Australian Law Reform Commission's Review of the Legislative Framework for Corporations and Financial Services Regulation.

Proportionate regulation

ABA notes that the proposed scope of the CASSPr licence has some differences from the AFSL regime, and highlights that the AFSL and Australian Market Licence regimes are designed with significant flexibility. The existing regimes are principles based and designed to apply to a broad range of business models, reflecting the differing nature, scale and complexity of each business. Each regime also provides mechanisms to exempt service providers or products, or a class of persons or products, from specific obligations where appropriate.

We particularly highlight this is true of the Australian Market Licence, which has been successfully applied in a 'tiered' manner to a range of innovative trading platforms including both domestic and international markets, and not just to the traditional domestic exchanges like the ASX.² This demonstrates that the existing regime is flexible and adaptable, and could also be applied to crypto-asset exchanges in a flexible and 'tiered' manner, to take account of the differing risks inherent in different types of markets.

In addition, ABA also asks Treasury to take a more holistic view of regulatory obligations that may apply to CASSPrs: for example, in addition to financial services licensing, in what circumstances might a CASSPr be required to comply with the proposed SVF regulation in relation to stable coins, register with AUSTRAC as a reporting entity and Digital Currency Exchange provider, or hold a payments licence (if the proposed new, tiered payments licensing framework will be implemented outside of the AFSL regime).

ABA is working with Allens to undertake a more detailed analysis of regulatory proposals affecting the crypto and payments sectors, and would be pleased to share the results of this analysis with Treasury.

Key definitions and licence obligations

Irrespective of whether the Government implements a stand alone CASSPr licence regime or address crypto secondary services as part of the AFSL, legislation will need to provide clarity on key terms that define the scope of the proposed regime.

Centralised vs decentralised

Page 2 of the consultation paper states 'This consultation paper considers the regulation of centralised CASSPrs who offer crypto asset custody, storage, brokering, exchange and dealing services, or operate a market in crypto assets for retail consumers'. However page 10 of the consultation paper proposes to define a CASSPr that may be required to hold a licence as:

Any natural or legal person who, as a business, conducts one or more of the following activities or operations for or on behalf of another natural or legal person:

- i. exchange between crypto assets and fiat currencies;
- ii. exchange between one or more forms of crypto assets;
- iii. transfer of crypto assets;

² Refer ASIC Regulatory Guide RG 172, Financial markets: Domestic and overseas operators and list of licensed and exempt market operators: <https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-172-financial-markets-domestic-and-overseas-operators/>; and lists of licensed domestic and overseas markets, available at: <https://asic.gov.au/for-finance-professionals/market-infrastructure-licensees/licensed-and-exempt-market-operators/>

iv. safekeeping and/or administration of virtual assets or instruments enabling control over crypto assets; and

v. participation in and provision of financial services related to an issuer's offer and/or sale of a crypto asset.

ABA considers the definition of a CASSPr will need to distinguish between centralised service providers and decentralised organisations or entities that may provide such services. The definition should clearly define and exclude decentralised entities (noting Treasury is proposing to consult separately on an appropriate regulatory structure for decentralised autonomous organisations in the second half of 2022), distributed ledger/blockchain networks, and clarify whether the proposed licence would apply to associated infrastructure services for these organisations.

Further, this term and related key terms should also address the geographical limits of a licensing regime, such as whether the obligation to hold a licence only applies to entities that provide regulated services to 'Australian' customers or carry on business in Australia. ABA notes this question is already addressed by existing licensing regimes and associated regulatory guidance.

Retail vs wholesale

Page 2 of the consultation paper states the licence is proposed to apply to entities that provide certain secondary services for retail consumers. This proposed scope is not reflected in the proposed licensing regime as described on page 10. Consistent with the AFSL and Australian Market Licence regimes, ABA considers the licence should apply to service providers to both retail and wholesale customers. ABA also notes this question is already addressed under existing licensing regimes, with less stringent obligations applying in relation to wholesale clients where appropriate.

Define services offered

If Treasury proceeds with a stand alone CASSPr licensing regime, then to the extent different obligations will apply depending on the service offered by the service provider, ABA asks that further consultation is undertaken to clearly define the services that would be regulated under licence – thus providing legal certainty to service providers about the scope of regulation and whether they are required to be licensed to carry on a particular activity.

ABA notes this question may already be addressed under existing licensing regimes.

Single definition of crypto assets

The consultation paper proposes to adopt a single definition of crypto assets across all legislation, and refers to ASIC's definition of crypto assets as: "a digital representation of value or contractual rights". ABA asks Treasury to consider whether this definition would apply to the full range of crypto assets that the Government may seek to capture, and how it may affect various types of crypto assets:

- Not all crypto assets are 'digital representations of value or contractual rights': It is possible (and perhaps likely) that some crypto assets that should be captured by the regime will be neither a digital representation of value or of contractual rights. Many crypto assets give holders no contractual rights. While many crypto assets will have a market value if they are able to be traded, it may however not be correct to view them as 'a digital representation of value', which implies a connection to something else that provides value (such as underlying fiat currency, in the case of a stablecoin).
- Utility tokens: The characteristics and features of crypto assets vary significantly. As such, also consider how the definition may apply to tokens that have different utilities or indeed no utility.
- The term 'contractual rights' may also be too broad. For example, Lygon blockchain guarantees may be inadvertently caught under a broad definition of "digital representation of contractual rights" on a blockchain.

This proposal for a single definition, in principle, can help to avoid uncertainty as between legislative regimes. However this requires Treasury to work with industry to carefully consider the implications of the single definition under all of the regulatory frameworks to which it will apply. We also ask Treasury to consider the implications of a crypto asset definition on related concepts, such as when there is a 'transaction' as this implies a tax event, the treatment of tokens whose function or purpose may change over time, and the treatment of payment tokens under any proposed payments licensing regime.

If taxonomy mapping will be relied on in some form to provide certainty about legal treatment of certain crypto assets, the government needs to consider how the taxonomy mapping can be kept up to date, and how it can be reflected in legislation or delegated legislation. ABA will be working with members on detailed issues raised by the proposed taxonomy mapping, and would be pleased to engage further with Treasury and industry stakeholders.

On whether there is a case for excluding NFTs from the proposed licensing regime. ABA does not believe the licensing regime should provide a blanket exemption in relation to all NFTs. Not all NFTs are alike. Some NFTs may be functionally similar to financial products. Given the speed of innovation and adaptation in the sector, creating an exemption for all NFTs is likely to give rise to scope for regulatory arbitrage and disadvantage issuers of non-NFT crypto assets. Instead, NFTs should be treated in the same way as other crypto assets based on consideration of its underlying characteristics.

Other licensing and regulatory considerations

ABA raises these further questions about the proposed licensing framework for consideration:

- **Crypto assets and payments:** consider the use of crypto assets for payments for goods and services, and how these types of payments should be treated in the Treasury's payment reforms. As a starting point, ABA considers crypto wallets that facilitate crypto payments should be required to hold a payments licence (or a payments service as part of the AFSL).
- **Providing advice:** consider what obligations may be appropriate for crypto brokerages or other service providers that may provide advice to a customer about the composition of their crypto portfolio, or a mixed portfolio of crypto and traditional financial assets. ABA notes this question can be addressed under existing licensing regimes.
- **Use of crypto assets as collateral:** APRA and ASIC should provide consistent guidance to credit licensees about the use of crypto assets as collateral and risk management requirements or guidelines that may apply.
- **'True to label':** ABA agrees with the proposal that consumers should have a reasonable level of confidence that the crypto assets they invest in or buy should be true to label, however notes that CASSPrs could face difficulty complying with this requirement if there is no corresponding requirement for the issuers of crypto assets to ensure their marketing documents (such as white papers) are 'true to label'. Under existing licence regimes, general licensing obligations about providing regulated services 'honestly' and 'fairly', and prohibitions on misleading or deceptive conduct, may already require licensees to ensure the crypto assets are 'true to label'; alternately a specific licensing obligation could apply.
- **Scams:** ABA supports the proposal that CASSPrs should have an obligation to prevent scams being 'sold' on their platforms. This proposal would benefit from additional clarification in guidance on matters such as the actions that different types of service providers may be expected to take to detect and remove or prevent scams. Under existing licence regimes, general licensing obligations about providing regulated services 'honestly' and 'fairly', and prohibitions on misleading, deceptive and unconscionable conduct, may already require licensees to ensure scams are not sold on their platform; alternately a specific licensing obligation could apply.



Custody

Regardless of whether existing licencing regimes or a new, stand alone licence regime is used, banks strongly agree with the need for robust custody arrangements, and for the banking industry to be subject to appropriate requirements in relation to custody of crypto assets. This is a key consumer protection issue.

ABA asks Treasury to give further consideration to the proposal that 'The CASSPr that has the direct relationship with the consumer would be liable for the safekeeping of all crypto asset private keys in its care (whether the storage of the private keys are outsourced to a third-party custodian or not)'.

ABA supports the principle that accountability to the (retail) customer should be clear, and the retail customer should be able to seek redress from the licensed CASSPr for the custody of private key. Legislation should clarify that, while the licensee may be liable to the customer, it should be free to negotiate the allocation of liability as between itself and a third party custodian.

From this standpoint, ABA does not support legislation prescribing that the licensed CASSPr holds liability for the custody service even where the CASSPr uses a third party custodian. Legislating on liability to the consumer could also have the unintended effect of preventing a CASSPr from negotiating a commercial arrangement with a third party custodian to allocate liability between the two parties. Doing so can leave CASSPrs with an unmanageable liability given the limited market for cybersecurity insurance.

ABA also asks Treasury to consider whether, if a CASSPr uses a regulated, third party custodian, the custodian should be accountable to the retail investor for the service it provides. For example, there may be circumstances where a separate contractual relationship is established between the custodian and the consumer for the purposes of the provision of custody services, and the CASSPr provides the consumer with other services (such as exchange services) in relation to the crypto assets.

ABA provides additional comments on the proposed custody requirement:

- ABA supports giving CASSPrs flexibility to engage custodians that are global providers. This would keep the Australian crypto asset sector open and engaged with the vibrant global crypto markets and also enabling Australia-domiciled custodians to compete.
- If Treasury proceeds to introduce a stand-alone CASSPr licence, ABA queries why CASSPrs that provide custody services would not be required to have adequate human resources. Human resources and securing required expertise is an important part of a digital asset business. While many crypto assets exist on a decentralised blockchain, CASSPrs as service providers should be required to have adequate human and other resources to provide their services to consumers to the required standard.

When a crypto asset is a financial product

As stated in the overview, ABA considers it is essential to provide greater legal certainty about when a crypto asset is a financial product, to give certainty to issuers, crypto service providers and consumers.

Going back to first principles, a fundamental case for clarifying this question is that notwithstanding their legal characterisation, consumers are investing in crypto assets that are functionally similar to financial products – for example, as a form of investment and to make payments. In doing so, these consumers are being exposed to the same kinds of risk as they would be if they acquired financial products.

Uncertainty under current approach

ABA and the industry appreciates ASIC providing guidance via Info Sheet 225. However, its application to a rapidly evolving sector has provided limited clarity on the question of whether a crypto asset is a financial product. Legal uncertainty on this issue can hamper competition, innovation and can be detrimental to consistent consumer protection.

- Assessing whether a crypto asset – including all of its rights and obligations – is a financial product currently requires detailed legal analysis. Legal advice may vary or may

not provide a definitive view of whether some well known crypto assets may be a financial product.

- As a result, whether each issuer or service provider treat its activity as a regulated activity in relation to a financial product may differ – potentially substantially – from another issuer or service provider. The outcome for each entity may also differ depending on whether the entity engages with ASIC to seek clarification of its position or proceeds on the basis of legal advice. Referring to our comment about a licensing obligation to ensure crypto assets are ‘true to label’, this discrepancy can have an impact on other licensees’ compliance with their licensing obligations and the transparency of the crypto market.
- The discrepancy in outcomes can also create confusion for consumers, if their transactions in certain crypto assets appear to be afforded consumer protection under Chapter 7 of the Corporations Act from some providers, but not from others.
- In this environment, ABA advocates for a legislative mechanism – supported by a nimble and responsive regulator – that can provide the desired clarity on some of these questions.

Applying Chapter 7 to functionally similar crypto assets

ABA further advocates for the Government and regulators to consider clarifying the law to bring digital assets or crypto assets that are functionally similar with similar underlying characteristics as a financial product within Chapter 7.

Consumers are entitled to expect that crypto assets that are sold in the same way as a financial product, and/or crypto assets that have the same attributes as a financial product, would be subject to an equivalent level of regulation and therefore consumer protection. There should be compelling reasons if the existing issuer disclosure regime would not be applied to crypto issuers where the crypto assets are functionally similar to securities.

We note the ASX has proposed that the following ‘digital financial products’ could be brought within the Corporations Law:

- “digital assets that are or are held out to be “cryptocurrencies”;
- digital assets that are used to raise funds from investors to invest in any form of collective endeavour (eg through an “initial coin offering” (ICO) or an initial exchange offering (IEO)); or
- digital assets that are used for any other financial purpose (such as making a financial investment, managing financial risk or making non-cash payments).”

This or a similar approach can be used – in conjunction with token mapping – to inform amendments to the law and create a more legally certain environment for issuance and secondary services.

We note there are existing examples under the Corporations Act where the issuer of a financial product is difficult to identify. There is also existing precedent within the Corporations Act to adjust the definition of an issuer of a product, for example, each party to a foreign exchange contract is an issuer of the contract. We also draw attention to European Union’s draft Market in Crypto-Assets Regulation, which would apply to issuers of crypto-assets.

Additional issues

ABA also takes this opportunity to highlight some additional matters relating to crypto assets – a whole of government coordination is required to provide a clear regulatory environment for crypto assets and related activities.

- **Tax:** ABA notes there are uncertainties about the tax treatment of tokens and activities. ABA would welcome Government and the ATO clarifying these questions, as part of the work to adopt a single definition of crypto asset across Australian regulation.



- **AML:** while ABA agrees the AML/CTF regime is well understood, ABA suggests the current registration requirements for providers of Digital Currency Exchanges under the AML/CTF Act should be enhanced and considered as part of a whole of government approach to crypto assets.
- **Potential whole of system considerations:** If consumer investment in crypto continues to increase at scale, this could result in Australian's savings being invested in a largely unregulated asset class.
- **Token mapping:** the approach taken to token mapping will be critical to ensure crypto regulatory regimes remain up to date and flexible to respond to market developments, and provide further clarity on issues such as tax and AML/CTF. This exercise should consider the functional activity of the crypto asset, rather than (for example) its labelling or the characterisation of the token by the issuer.
 - ABA is doing further detailed work on the approach to token mapping and regulatory implications, and welcomes the opportunity to work with Treasury and other stakeholders on policy considerations raised by token mapping. A token mapping exercise has the potential to provide significant benefits to the industry if it provides certainty about the regulatory treatment that will apply to various types of crypto assets. ABA expects this to be a complex task requiring specialist technical input, and may need to be an ongoing exercise as new crypto assets are issued.