

31 May 2022

Director, Crypto Policy Unit
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Dear Director

CRYPTO ASSET SECONDARY SERVICE PROVIDERS: LICENSING AND CUSTODY REQUIREMENTS

The Australian Finance Industry Association (AFIA) appreciates the opportunity to provide a submission on the Treasury Consultation Paper on the *Crypto Asset Secondary Service Providers: Licensing and Custody Requirements* (**consultation paper**).

AFIA¹ is a leading advocate for the Australian financial services industry. We support our members to finance Australia's future. We believe that our industry can best support Australia's economy by promoting choice in and access to consumer and business finance, driving competition and innovation in financial services, and supporting greater financial, and therefore social, participation across our community.

AFIA represents over 135 providers of consumer, commercial and wholesale finance across Australia. These banks, finance companies, fleet and car rental providers, and fintechs provide traditional and more specialised finance to help businesses mobilise working capital, cashflow, and investment. They are also at the forefront of financial and technology innovation in consumer finance.

OUR SUBMISSION

The global regulatory landscape for crypto currency assets is evolving. We acknowledge the challenges governments and regulators face in attempts to keep pace with rapid innovation in this area and we recognise that as the market evolves and develops, the regulatory framework will also need to evolve and develop.

The consultation paper recognises the growing importance and need for regulatory clarity to provide certainty to market participants as well as consumer protections to increase consumer confidence, given the growing uptake and ownership of crypto assets.

¹ [Australian Finance Industry Association \(afia.asn.au\)](http://Australian Finance Industry Association (afia.asn.au))

AFIA supports the two foundational principles for the regulation of crypto assets:

1. products should be regulated according to the risk they present, and
2. regulation should be technology neutral.²

Licensing regime

The consultation paper proposes a new and separate licensing regime for crypto assets, which would be distinct from the financial services licensing regime (AFSL regime).

AFIA is broadly supportive of the introduction of a new licensing scheme for non-financial product CASSPrs. We believe that regulation should be proportionate, targeted and scalable. Therefore, the licensing regime should introduce varying obligations, depending on the types of services offered, and where appropriate, replicate in some parts the AFSL regime.

AFIA notes that similar approaches have been taken to regulation of other products, for example, relief or exemption under financial services or credit laws for certain products while maintaining the requirement for external dispute resolution and compensation arrangements, and application of other regulatory obligations, such as the design and distribution obligations and product intervention powers as well as the misleading and deceptive conduct provisions.

Additionally, we note that applying some parts of the AFSL regime without the full imposition of the existing system would recognise while there are similarities with the basic conduct and disclosure standards applicable to financial products, there will be areas where existing rules may not be appropriate and alternative technology-enabled approaches would lead to better consumer and industry outcomes. Furthermore, we consider this strikes the right balance in providing consumer protection and preserving financial stability, without imposing undue burden on an innovative and developing sector.

An important consideration is whether or not a crypto asset is defined as a financial or non-financial product – noting that crypto assets and financial products are not always mutually exclusive.

On the one hand, consumers would have more confidence and familiarity in the regulatory framework of the products they are engaging with, given the similarity with the financial products licensing regime. Providers would find it easier to build on their existing compliance systems and processes in cases where a product graduates to the financial products regime or is reclassified.

On the other hand, crypto assets may have unique characteristics that do not easily or sensibly fit in with the financial products licensing regime. For example, disclosure requirements were designed for more traditional products and would need to be updated to suit the nature of the asset and the manner in which consumers are interacting with the asset.

² For example, exchange tokens such as Bitcoin can be sent and received without relying on an intermediary, such as a bank or central bank. With regard to information asymmetry, all smart contracts and transactions are freely auditable given the technical expertise or appropriate tooling, meaning that all product information is publicly obtainable.

AFIA appreciates that the proposed licensing scheme has a lower compliance hurdle than the full financial products licensing regime. Defining crypto assets as financial products under the Corporations Act and imposing the full financial products regime would impact innovation in the sector, which is a key to its value proposition to consumers.

Therefore, we believe that the regulator, ASIC, should define what types of crypto assets should be considered financial products. This could be done with reference through a feature mapping or token mapping exercise (see below for further information).

Custody obligations

AFIA supports custody obligations as a part of the licensing regime for crypto assets. We note a key issue regarding custody is that consumers have relatively little visibility of the security of custody arrangements and thus the safety of their crypto assets. This is as much an issue for providers as for consumers, as it undermines trust in custody services. For most users of crypto assets, the technical process of managing their own custody arrangements is too cumbersome to be useful and poses the risk of permanent loss of access to one's assets through loss of a private key. Therefore, building consumer confidence in custody arrangements is important for a positive consumer outcome and to facilitate consumer uptake of crypto asset secondary services.

Token mapping

AFIA notes that the Consultation Paper is also seeking feedback on token mapping. Token mapping is intended to categorise tokens as financial or non-financial products, potentially at the level of broad token types (e.g. utility tokens, asset-backed stablecoins and algorithmic stablecoins). Our members consider that a token mapping exercise remains a crucial milestone to be reached in building a workable and comprehensive regulatory environment, which would support innovation while building consumer confidence.

However, a token mapping exercise is not without its challenges. We note that a similar exercise was conducted in the United Kingdom by the Financial Conduct Authority (FCA).³ The FCA conducted token mapping by assessing features of tokens that correspond to features of financial products. They used this method to categorise tokens as 'exchange tokens', 'utility tokens', and 'security tokens', with increasing likelihood of being regulated as financial products. This approach is less prescriptive, in that it does not explicitly categorise token types as financial or non-financial product, and so may provide the appropriate flexibility to cater to future token types. Simultaneously, it may allow for more granularity in categorisation, by differentiating within token types.

However, we believe that clarity for providers is needed on the triggers that would cause an asset to be classified as a financial product, and the process by which this would occur. Clear and easily understood principles should be laid out that guide the classification process, noting that the full range of products on the market may be too varied and changing too rapidly to be practically classified.

³ [PS19/22: Guidance on Cryptoassets \(fca.org.uk\)](#)

Providers should be appropriately informed and consulted if the asset to which their secondary service pertains is to be reclassified, for example, if the prevailing use case of the asset changes from being non-financial to financial in nature, shifting consumer expectations and imposing additional regulatory obligations.

Self-regulation

AFIA believes the crypto industry should develop and introduce a code of practice to supplement the regulatory framework. Importantly, a voluntary industry code of practice could set out the principles and operational standards for providers of crypto asset secondary services and custody services to ensure the safety of consumer assets. These could include disclosure and marketing requirements, cybersecurity practices, complaint handling and external dispute resolution obligations, compensation processes in case of asset loss, and independent auditing.

CLOSING COMMENTS

Thank you for the opportunity to provide this submission. We look forward to participating in ongoing dialogue on this issue.

Should you wish to discuss our submission or require additional information, please contact me at

[REDACTED]

Yours sincerely



Roza Lozusic
Executive Director, Policy & Strategy