



NATIONAL AUSTRALIA BANK SUBMISSION

Crypto asset secondary service providers:
Licensing and custody requirements

May 2022

INTRODUCTION

National Australia Bank (**NAB**) appreciates the opportunity to provide a submission to Treasury's consultation on licensing and custody requirements for Crypto Asset Secondary Service Providers (**CASSPrs**).

NAB considers that Australia is at a pivotal moment in its crypto asset journey, as the next steps Australia takes in regulating crypto assets, will provide a clear signal to the market of our appetite to become an innovative, global crypto hub.

Given the rapid pace at which digital asset development is occurring globally, we consider that Treasury should ensure that the regulatory and licensing regimes governing these assets in Australia, are reflective of global trends and developments to avoid stifling innovation or investment.

At its core, we consider that regulation and licensing governing CASSPrs should:

- Incorporate definitions that are consistent and easy to understand;
- Be flexible and broad enough to respond to new and emerging developments; and
- Ensure that all participants in the market, whether they are wholesale or retail, are appropriately protected.

For ease of reading, there are some instances where NAB has responded to multiple consultation questions at once.

We would welcome the opportunity to discuss any aspect of this submission further.

Terminology changes

- 1. Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of ‘digital currency exchange’?**
- 2. Are there alternative terms which would better capture the functions and entities outlined above?**

In principle, NAB agrees with the use of the term CASSPr instead of ‘digital currency exchange’. We consider that the term is justifiably broad for future developments and expansion in the sector, and that it signals the collaborative manner in which Australia is approaching this sector. This is in contrast to other jurisdictions such as Singapore, where exchanges and custody providers are treated separately under different regulatory regimes.

However, NAB recommends that Treasury consider whether the term ‘digital asset’ rather than ‘crypto asset’ may be more appropriate. We recognise that both terms have their limitations. The use of the term ‘crypto’ does accurately reflect the nature of assets secured on a blockchain by a cryptographic hash function, however the term has become strongly associated with algorithmically generated crypto-currencies and these crypto-currencies are only one category of digital or ‘crypto’ assets. As the strong growth of this sector continues, the term ‘crypto asset’ has the potential to quickly become outdated and no longer fit for purpose.

In the interests of long-term regulatory certainty, Treasury may consider that the term ‘Digital Asset Secondary Service Provider’, would be more appropriate to prevent future terminology changes.

Proposed definitions

- 3. Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments.**

Currently, NAB is comfortable with the referenced definition of ‘crypto asset’, as defined by ASIC. However, in line with our views in response to Questions 1 & 2, we recommend that Treasury consider whether ‘digital asset’ may be a more appropriate term.

Regardless of the term, NAB considers that a broad definition such as ASIC’s current definition, is necessary not only to future-proof any regulatory framework, but also to ensure that Australia remains well-positioned as a nation that fosters digital asset innovation.

However, given the rapid pace of progress in this sector, NAB notes that there may be a need to review this definition in the future.

- 4. Do you agree with the proposal that one definition for crypto assets be developed to apply across all Australian regulatory frameworks?**

NAB strongly supports the proposal for a single definition to be developed to apply across all Australian regulatory frameworks. We would also propose that this definition also extends beyond the primary financial regulators of ASIC and APRA, to the RBA and ATO.

A ‘patchwork’ approach of different definitions across different regulators would make compliance unreasonably onerous for entities such as NAB, that in the future may choose to provide crypto asset products & services to their customers.

While NAB is unquestionably supportive of the introduction of a regulatory framework and associated consumer protections for crypto assets, the level of compliance measures and oversight that would need to be implemented if there were multiple definitions of ‘crypto asset’, may be a significant burden and risk the ability of companies to innovate for the benefit of the sector and their customers.

NAB also notes that a complex web of different definitions could detract from Australia's status as a market for crypto innovation, if foreign interests wishing to enter to market were to compare Australia's crypto regulatory framework with jurisdictions that have a more streamlined and consistent definition of crypto assets. The definition should also be able to be easily understood by foreign entities and investors, who may be interested in entering the Australian crypto asset sector, in order to prevent barriers to global investment.

However, NAB strongly recommends that Treasury works closely with industry to develop the definition that would apply across all regulatory frameworks, to ensure that the definition is viable and workable for industry and the regulators alike. NAB would welcome the opportunity to discuss the definition further with Treasury, at the relevant point in time.

5. Should CASSPrs who provide services for all types of crypto assets be included in the licensing regime, or should specific types of crypto assets be carved out (e.g. NFTs)?

There is an important distinction to be made between:

- financial digital assets (such as cryptocurrencies); and
- non-financial digital assets (such as non-fungible tokens).

While there is a need for regulatory certainty for each of these categories, they each present different levels of risk.

NAB considers that CASSPrs who provide services for non-financial digital assets should be regulated to a different threshold, from CASSPrs who provide services for financial digital assets. To ensure consistency and simplicity, this would ideally still fall under one, single regulatory framework, but with various levels underpinning it, to ensure that higher risk categories of assets are subject to an appropriate level of regulation. Subjecting non-financial digital assets to regulation that goes beyond what may be necessary, could stifle Australia's prosperity and potential for innovation and growth in this market.

However, NAB acknowledges that there may be a 'grey' area, where assets have characteristics of both financial and non-financial digital assets. NAB would welcome the opportunity to discuss these situations and potential treatment of these in the future, as Treasury's thinking evolves on this issue.

Proposed policy objectives

6. Do you see these policy objectives as appropriate?

NAB considers the proposed policy objectives underpinning a licensing regime for CASSPrs to be appropriate and necessary to ensure the safe growth of the crypto asset sector.

As an established financial services provider that understands the important role that we play in keeping assets safe and mitigating financial crime risks, NAB strongly supports the need for robust consumer protection and AML/CTF frameworks in the crypto asset sector.

7. Are there policy objectives that should be expanded on, or others that should be included?

Noting Treasury's comments on page 15 of the consultation paper, NAB takes this opportunity to note that clarity will be needed from Treasury regarding the extent that entities such as banks will be required to monitor transactions involving digital assets. NAB is strongly supportive of the need for robust AML/CTF governance for crypto assets, however guidance from Treasury will be needed on the extent to which banks will be required to monitor transactions where a crypto asset product or service is involved.

NAB would welcome the opportunity to discuss this matter further with Treasury, to ensure that the proposed model is viable and effective at preventing money laundering and financial crime.

NAB also notes the need for Treasury to ensure that existing legislative instruments that govern 'traditional' financial products, are reviewed and updated to accommodate digital assets and technologies. For example, financial records are generally required to be kept for 7 years before they are destroyed. However, blockchain records are inherently unable to be destroyed due to the nature of blockchain itself, which creates a need to ensure these technologies are appropriately addressed in the context of the existing legislative framework.

Licensing / interaction with existing AML/CTF regime

8. Do you agree with the proposed scope detailed above?

9. Should CASSPrs that engage with any crypto assets be required to be licenced, or should the requirement be specific to subsets of crypto assets? For example, how should the regime treat non-fungible token (NFT) platforms?

NAB is broadly comfortable with the proposed scope of the licensing regime as detailed in the consultation paper.

Further to our position in response to Question 5, NAB believes that CASSPrs that only provide access to non-financial crypto assets (such as NFTs) should be subject to a lower threshold of licensing and regulation. Consumer interactions with CASSPrs and protection of these assets are likely able to be achieved within the scope of existing property, competition and consumer laws.

This application is analogous to the licensing and regulation applicable to the provision of risk management or derivatives products today, where the licensing and regulation attaches to the financial product rather than the underlying asset (for example, insurance for artwork, or commodity futures contracts)

NAB notes that it will be necessary to review this position as the use and application of non-financial tokens evolves.

10. How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g. in financial services)?

NAB notes that ASIC is proposed to administer the proposed regime, with crypto assets that are financial products, subject to the financial services regime.

NAB strongly believes that given the rigorous levels of compliance, controls and experience that holders of an Australian Financial Services Licence are required to have, and the similarities between the proposed obligations for CASSPrs and existing AFSL obligations, that holders of an AFSL should have a 'fast-tracked' approach to obtaining a CASSPr licence. This would not be dissimilar to the current, streamlined approach taken when an existing ADI takes on a new AFSL.

There is a clear need for a separate CASSPr licence to exist, where a potential CASSPr may not hold an AFSL or Australian market licence, yet wish to operate a product or services that renders it a CASSPr. A licence such as this would ensure robust consumer protections and operating standards are upheld, where an entity may not be subject to the need to hold an AFSL or Australian market licence.

Proposed obligations on CASSPrs

11. Are the proposed obligations appropriate? Are there any others that ought to apply?

NAB considers that the proposed obligations outlined are appropriate and necessary to protect consumers.

Recent international examples have shown the significant need for ‘rogue’ operators that provide crypto asset services to be regulated, to avoid customer detriment and market concerns.

12. Should there be a ban on CASSPrs airdropping crypto assets through the services they provide?

There should not be a ban on CASSPrs airdropping crypto assets through the services they provide. Innovation should continue to be fostered and the ability for CASSPrs to airdrop crypto assets should be left open. This is important to ensure that Australia is well positioned as an innovative, global hub for developments in the crypto asset sector.

Not imposing a ban also provides Treasury, Government and regulators with the opportunity to monitor this emerging practice, and if need be, consider regulatory measures that may be required to ensure consumer safety and tax disclosure for example, without imposing an outright ban.

13. Should there be a ban on not providing advice which takes into account a person’s personal circumstances in respect of crypto assets available on a licensee’s platform or service? That is, should the CASSPrs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto asset)?

To ensure regulatory consistency and protect consumers from harm, NAB considers that the highlighted provision of advice restrictions that currently apply to financial products, should equally apply to CASSPrs in respect of crypto assets.

14. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

At present, NAB is not a CASSPr.

Alternative Option #1

15. Do you support bringing all crypto assets into the financial product regulatory regime? What benefits or drawbacks would this option present compared to other options in this paper?

As noted in response to previous consultation questions, NAB sees a clear need for balance between financial crypto products and non-financial crypto products in this proposed regulatory regime, and a need to ‘carve out’ the application of the regime to non-financial products.

While there are risks associated with non-financial crypto products, the risks are different and this should be reflected in the regulatory regime. There is a material risk of stifling Australia’s ability to innovate in the crypto product space and creating a regulatory stranglehold, should non-financial products be subject to the same levels of regulation as non-financial products.

Further, regulation that is proposed for financial products does not necessarily lend itself to easily being applied to non-financial crypto products, which could lead to confusion and an unnecessary regulatory burden.

However, in the interests of simplicity of the regulatory regime, there would be significant benefit in having the regulation for non-financial crypto products fall under the same broader regime as that for financial crypto products. Treasury may consider a tiered model to be appropriate, where a core set of regulatory requirements apply to both non-financial and financial products, with an additional 'set' or 'tier' of requirements applying to financial products.

16. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

As previously noted, NAB is not currently a CASSPr.

Alternative Option #2

17. Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia?

NAB does not support the self-regulatory option proposed here.

In a custody scenario, crypto assets are representations of value that individuals store with a provider for safekeeping. In the 'traditional' banking model, it would be unsuitable and inadequate for bank customers to only have a Code of Conduct to rely upon when dealing with their bank. While there is a Code of Conduct in the Banking Code of Practice, this is supported by the BCCC and consumers benefit from a plethora of legislative protections and regulatory protections through ASIC, APRA and the ACCC.

It would be unsuitable and inadequate for a regime to exist in the crypto landscape where individuals only have a Code of Conduct to rely upon for their protection, with potentially very limited protection from regulators or other agencies.

18. If you are a CASSPr, what do you estimate the cost and benefits of implementing this proposal would be? Please quantify monetary amounts where possible to aid the regulatory impact assessment process.

As previously noted, NAB is not currently a CASSPr.

Proposed private key obligations

19. Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets?

20. Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above?

21. There are no specific domestic location requirements for custodians. Do you think this is something that needs to be mandated? If so, what would this requirement consist of?

NAB is supportive of the proposed obligations for custodians, as we consider that these obligations are at the core of what it means to be a custodian.

We agree that it is certainly appropriate for custody providers to maintain minimum financial requirements including capital requirements, particularly in contrast to the approach taken in the United States, where custody providers generally hold low levels of capital, which would see significant consumer detriment if an adverse event were to occur.

In regard to custodians providing their services domestically, NAB considers that this would be better handled by the market, rather than through a mandate. Provided that there is a requirement for custodians to disclose whether they operate onshore or offshore, consumers should have the ability to choose whether they prefer to use an onshore or offshore custodian. With the growing emergence of DeFi, some customers are likely to prefer an offshore custodian arrangement. To continue to foster Australia's presence as an innovative crypto nation, NAB recommends that a requirement for custodians to operate domestically is not mandated.

22. Are the principles detailed above sufficient to appropriately safekeep client crypto assets?

23. Should further standards be prescribed? If so, please provide details

At this point in time, NAB considers that the principles detailed in this section are sufficient to appropriately safekeep client crypto assets.

24. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

As previously noted, NAB is not currently a CASSPr.

Alternative option – industry self-regulation

25. Is an industry self-regulatory model appropriate for custodians of crypto assets in Australia?

26. Are there clear examples that demonstrate the appropriateness, or lack thereof, a self-regulatory regime?

27. Is there a failure with the current self-regulatory model being used by industry, and could this be improved?

Similar to our response to Question 17, NAB considers that a self-regulatory model is not appropriate for custodians of crypto assets.

NAB considers that it would be imprudent for individuals that utilise custodian services to only have a Code of Conduct to rely upon for their protection, with potentially very limited protection from regulators or other agencies.

A robust regulatory framework for custodians is needed to provide regulatory certainty in this rapidly growing market, in addition to ensuring good customer outcomes and that first and foremost, customers are protected and have confidence in the market.

28. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

As previously noted, NAB is not currently a CASSPr.

Token mapping / classes of crypto assets

- 29. Do you have any views on how the non-exhaustive list of crypto asset categories described ought to be classified as (1) crypto assets, (2) financial products or (3) other product services or asset type? Please provide your reasons.**
- 30. Are there any other descriptions of crypto assets that we should consider as part of the classification exercise? Please provide descriptions and examples.**
- 31. Are there other examples of crypto asset that are financial products?**
- 32. Are there any crypto assets that ought to be banned in Australia? If so which ones?**

Given the close alignment with financial transactions, the importance in underpinning many crypto asset activities, recent developments in algorithmic stablecoins, and the future role they may fill in decentralised financial services; NAB considers stablecoins in need of special consideration.

The first category of stablecoin is a representation of an at-call deposit held with a bank and should be classified as a regulated liability of an ADI. This would be a regulated liability under APRA and subject to the same asset, liquidity and coverage requirements. We see this type of stablecoin playing a central role in the future of financial transaction settlements (e.g. FX, equity, bond, commodities and loans) and because of this a failure (such as the recent algo-stablecoin) could have systemic impact on the financial system and thus, requires a heightened level of regulation.

The second potential category of stablecoin is asset backed, with collateral held in trust, this will also need specific regulatory consideration and limitations as to the nature of who can issue these stablecoins, offer a secondary market, on-board customers and manage the underlying assets. The rights of stablecoin holders should be aligned to those of money-market holders.

These two above categories should be categorised as another type of financial product (I.e. 2-above) and a limited set of ADI's and/or other institutions be allowed to be responsible for issuing them. The proper regulation of stablecoins will have important structural impacts on the financial stability of the crypto asset sector. In addition, these two types of stablecoins represent an access point into the traditional financial system and needs to be subject to an appropriate level of financial crime monitoring and reporting.

A third category of stablecoin, and typical for small and retail-like transactions, is one designed to be similar to a "store of value facility" and regulated as those facilities are currently with appropriate reserves for the benefit of holders.

Finally, so-called 'algorithmic stablecoins' would need a totally different categorisation as a type of crypto asset (1 above) and NAB would strongly encourage that the word stablecoin is not associated with such products given the recent overseas experiences of this asset category.

As per our previous comments, we see non-financial products such as NFTs as a different category of product (3 above) potentially treated more like a commodity, but a categorisation of these assets is still important. It will for example be essential that derivatives, futures and other risk management products linked to them are regulated in a recognisable way. NAB would welcome the opportunity to discuss this further with Treasury.