



Director – Crypto Policy Unit
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

27 May 2022

Zip Co Limited
Level 14, 10 Spring St
Sydney NSW 2000

Crypto asset secondary service providers: Licensing and custody requirements

Dear Director,

Thank you for the opportunity to submit to the Crypto Policy Unit on the consultation paper: **Crypto asset secondary service providers: Licensing and custody requirements.**

Zip background

Zip Co was founded in Australia in 2013 and now operates in 14 markets, with approximately 11.4 million customers and just over 86,000 merchant relationships. We offer fairer, more transparent, and more cost-effective forms of unsecured credit. Our sector and company have grown quickly in response to a strong consumer transition away from traditional forms of credit - which are often opaque and expensive - to those Zip and our sector provides.

Zip strongly supports high-quality regulation that mitigates potential risks to consumers, enables merchants to grow effectively, and encourages financial technology firms like ours to innovate and invest to the long-term benefit of consumers. Our customers are embracing new technologies and financial services and Zip is excited to be participating in the development and provision of these new and emerging services.

Zip's interest in Crypto Currencies & Digital Assets

Zip research shows our customers have a strong interest in crypto currencies and digital assets. To this end, we are now exploring ways to provide access via our App for customers to buy, sell and hold a limited range of well-known crypto currencies. To be clear: Zip is not proposing to provide customers with credit to buy crypto currencies. Zip is also acutely mindful that any crypto offering must

include a mechanism that goes beyond disclosure and which educates consumers about the volatility and risks of crypto currencies.

Zip's Approach to Crypto Asset Regulation

Strong and durable regulatory frameworks have several key attributes:

1. Clear objectives;
2. Seek to achieve objectives in a 'least cost' way, with the least adverse impact on market competition, property rights, and individual choice and responsibility;
3. Flexibility to allow regulators to adapt their approaches to the attitudes and needs of different regulated parties, and to allow those parties to adopt efficient and innovative approaches to meet their regulatory obligations;
4. Processes that produce predictable and consistent outcomes for regulated parties across time and place;
5. Proportionality, fairness and equity in the way they treat regulated parties;
6. Consistency with relevant international standards and practices to maximise the benefits from trade and cross-border flows of people, capital and ideas;
7. Strong alignment with existing requirements in related or supporting regulatory systems, without gaps, overlaps, and inconsistent or duplicative requirements;
8. Conformation with established and constitutional principles and supportive of compliance with Australia's international obligations;
9. Legal obligations and regulator expectations are set out in ways that are easy to access, easy to navigate, and clear and easy to understand;
10. Scope to evolve in response to changing circumstances or new information on the regulatory system's performance.

It is very important for the Treasury to take time to carefully design how the new regime will interact with existing legal obligations and the extent to which a new licensing regime will overlap with the AFS licensing regime, potentially resulting in duplicate regulation or inconsistent treatment for service providers (those with and without an AFS licence).

Proposed terminology and definitions

1. Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'?

CASSPr is a substantially broader definition than Digital Currency exchange. It includes custodians, brokers and new DeFI organisations.

The danger in a single classification and consequent singular regulation is that regulation needs to reflect the different types of risk within secondary services.

Not all risk is the same and can vary significantly, for example, the differences between a broker and custodian.

This is already mirrored in existing Australian Financial Services Licence (AFSL) legislation with subsets of licensing applied based on the nature of the risk and business activities. Examples include licence frameworks that can cover providing advice, custody, issuing products and dealing in products either in all or in separate parts.

Unless regulation reflects these differences the term is too broad to be able to effectively develop a single regulatory framework and does not meet the objective of ensuring regulation is fit for purpose, technology neutral and risk-focussed.

Current Treasury proposal is for a graduation of services under a single licence similar to an AFSL under the financial services regime. Details of this graduation of the proposed obligations are unclear and the details of this will be critical to the regulatory effectiveness of this definition.

2. Are there alternative terms which would better capture the functions and entities outlined above?

Yes, by component. For example Asset Managers, Brokers, Trading infrastructure, Custodians and DeFi.

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

The consultation paper proposes that a single definition of 'crypto assets' applies across all Australian regulatory frameworks. This definition would thus replace the existing definitions 'digital currency' under both anti-money laundering/counter-terrorism financing legislation and GST law (which both contain differing definitions), and operate in a much broader way.

Definitional consistency is an important attribute of a strong and effective regulatory regime, however we would highlight how quickly the crypto-asset ecosystem is moving, and hence the difficulty of designing a definition with adequate foresight to be able to capture all future developments (including some that may be designed specifically to sit outside a point-in-time definition).

We also question whether the proposed definition would adequately capture all types of crypto assets that are intended to be captured by the regulatory regimes.

Example 1: Many crypto assets are neither a '*representation of value*' (as they are not linked to any underlying asset and do not have a fixed dollar value), nor as a representation of '*contractual rights*' (as digital assets may provide no contractual rights against a counterparty).

Example 2: If a blockchain asset had only partial representation of value or functionality had limited contractual rights - would it be caught entirely under the definition?

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

Yes, we agree that one definition for crypto assets would be useful across all regulatory frameworks.

Proposed principles, scope and policy objectives of the new regime

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)?

All CASSPrs should be covered by a consistent licensing regime. The licensing obligations need to reflect the risks of each CASSPr and their operating model including crypto assets supported.

CASSPrs may directly hold assets which belong to customers or be supported by other CASSPrs who act as crypto asset custodians. Existing marketplaces for goods are already subject to the Australian Consumer Law and the key risk to be managed is one of custody and misuse of customer crypto / funds.

Crypto assets that display the following risks should be covered under the legislation:

- Operational risks including business continuity, illiquidity and inadequate capital;
- Insolvency and disorderly wind down;
- Fraud and key personnel risks;
- Misleading or deceptive conduct; and
- Cybersecurity

Using NFT's as an example:

	NFT Producer	NFT Marketplace	NFT Custodian
Operational Risks	No - once minted NFT is a tradeable artefact	Yes	Yes
Insolvency Risks	No - NFT and its value are not subject to insolvency of producer	Yes	Yes
Fraud/ Key Personnel Risks	No - Once minted NFT, there is no further obligation by producer	Yes	Yes
Misleading & Deceptive Conduct	Yes - but only in the case of copyright that falls under existing legislation	Yes	Yes
Cybersecurity	No	Yes	Yes

Any crypto asset that acts as a financial product should fall under the existing AFSL regime.

To achieve this, the token mapping exercise to be completed by the end of 2022 is required to identify the risks of the crypto asset on a technology agnostic basis.

From that risk assessment, it should be clear whether a trust basis is established or asymmetric information is present in the crypto asset and, as a result, fall under the definition of a financial product

We agree with the statement that the tokenisation of the asset in general does not automatically dictate the regulatory treatment of an asset.

However we require legislative clarity around which crypto assets are also financial products. For example, while it is clear that derivatives of crypto-assets are financial products, other products such as stablecoins and Central Bank Digital Currencies (CBDCs) are in a grey area. It would be very useful for a regulator to provide published lists of features of concern, or identify specific tokens or products which the regulator considers to be financial products.

Multiple regulatory frameworks must be designed to be harmonious and avoid legislative arbitrage or unexpected costs or outcomes.

6. Do you see these policy objectives as appropriate?

Yes, we see the policy objectives as appropriate. Success criteria for these development of regulatory frameworks is outlined in Zip's approach to regulation in our introduction.

We are mindful that if too great a burden is placed on CASSPrs, then Australian consumers will be forced to look offshore in their dealings with crypto and that will lead to a lower level of protection.

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

Core objectives that should be included are:

- *Policy needs to be able to be feasibly implemented.* Examples include:
 - Requiring professional indemnity insurance to hold a licence. However, professional indemnity insurance in the commercial market may not be available, meaning no market participants qualify. Alternative solutions need to be available here.
 - High levels of capital adequacy for custody will substantially increase barriers to entry. Increased barriers to entry will reduce the innovation of crypto assets and send Australian users to offshore providers. This is in part due to an incumbent technology bias, as new crypto assets are created on technology not available outside existing external custody providers such as Bitgo, Fireblocks or Copper.io. This results in many CASSPr's establishing their own custody arrangements until external custody is available. Consequent friction costs will restrict availability with AU CASSPrs whilst globalisation of crypto assets means consumer risk will still exist via simple and available access to services outside the Australian jurisdiction.
- *Policy needs to have transitional arrangements.* As seen in Singapore and the UK, a new licensing regime will need to deal with a spike of applications - time to process this application flow can be extensive, requiring the need to have transitional arrangements in place for a seamless consumer transition as well as funding of an educated resource within the public service to process the applications.

See Zip's approach to regulation regarding strong and durable regulatory regimes.

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

Yes, the scope will provide well-needed regulatory clarity.

Additionally, Zip is supportive of efforts to minimise regulatory duplication and agrees that if the underlying asset is a financial product then CASSPr needs to comply with the financial service regime.

In consideration of the scope, while decentralised protocols and platforms are excluded, the regulatory framework also needs to account for CASSPr and their dealings with decentralised protocols and platforms.

For example, if the underlying platform is not a crypto asset but a service, does it fall within the framework?

A specific example would be a CASSPr using Aave or Compound to obtain a yield of return by either borrowing crypto assets from their customers or acting upon instructions from customers. Is this arranging for a customer to access a financial product or not?

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?

We support licensing obligations to provide regulatory clarity for all participants.

Specific crypto assets need to be easily identified, especially how they might fall into existing legislation. Any proposed legislative carve outs will also need to consider the future evolution of crypto assets.

We support a level playing field for licensing obligations for all CASSPrs, similar to the financial services regime.

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)?

The best way to minimise duplication is clarity of what falls within each regime and the circumstances when they are subject to other regimes. Regulatory framework needs to consider ongoing support for innovation across regimes and to avoid regulatory arbitrage.

ASIC INFO 225 provides limited guidance to whether a crypto asset is a financial product, as it is extremely high level.

This could be supported by a single agency accountable for licensing with the requisite focus, skills, capacity and capability to assess licences based on underlying crypto assets.

As no agency currently exists with this capability as a core competency, this capability build is required to be in scope of implementation of regulatory framework.

Additionally the expansion and application of agency interventionist powers need to also avoid slowing or impeding innovation whilst this capability is being built.

Proposed obligations on crypto asset secondary service providers

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

Zip supports the proposal for a single licence type to apply to those CASSPrs who facilitate the buying and selling of crypto where clear graduation of services apply. The graduation of these obligations need to support innovation such that they are fair and efficiently compared to other licensing regimes.

In particular the following obligations will need to be graduate:

(2) maintain adequate technological, and financial resources to provide services and manage risks, including complying with custody standards proposed;

(5) maintain minimum financial requirements including capital requirements; and

(13) maintain adequate custody arrangements as proposed.

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

Zip does not support the banning of crypto airdrops.

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)?

Provision of financial advice should fall under the existing Financial Services Regime. If a crypto asset is a financial product it should fall under the existing Financial Services Regime.

Personal financial advice on non-financial products should still fall within Financial Services regime and licensing obligations. It should be noted that there are substantial barriers to this including the availability of adviser insurance for people advising on crypto assets.

General or product advice provided by CASSPrs should fall under CASSPr regime with similar obligations to that under an AFSL.

Consumers or wholesale/sophisticated investors should not be forced to take advice. Personal financial advice should not be mandatory for provision of crypto assets.

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

Given the lack of detail on financial adequacy requirements, it is not possible to estimate the cost of implementing this proposal.

If regulation imposes significant costs for CASSPrs, the policy approach must be informed by recognition of the ease with which Australians already access offshore providers and the need to provide greater protection for consumers here by making products available and affordable in Australia.

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?

Without outlining flexibility available, bringing all crypto assets into a financial product regulatory regime could lead to over-regulation that won't cater for the characteristics of each crypto asset or CASSPr facilitating services. Crypto-assets are for the most part simply digital property, not financial products.

Under current market conditions there is no practical way for CASSPrs to comply with the financial services regime, particularly when commercial services such as insurance are not available.

Should the regulatory regime bring all crypto assets under it, it needs to be able to accurately and effectively delineate between various types of products and services provided.

We see the following Benefits and Drawbacks for crypto assets being included in the financial product regulatory regime:

Benefits:

- A single approach for all crypto assets would create immediate regulatory clarity for any crypto asset; and
- Established process for licence application and assessment.

Drawbacks:

- Financial services regime is not fit for purpose for crypto assets and in particular their rapid evolution and innovation;
- A financial product classification could be overly onerous for consumers and certain crypto assets which may partially fit the definition of a financial product; and
- Agency capacity to manage inflow of applications is insufficient for orderly market transition. For example, ASIC services levels 70% of applications processed in 150 days.

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

Given the lack of detail on financial adequacy requirements it is not possible to estimate the cost of implementing this proposal.

However, Zip already has both AFSL (ZipMoney Securities Limited ABN 17 082 380 023 Australian Financial Services Licence 222040) and an ACL (ZipMoney Payments Pty Ltd ABN 58 164 440 993, Australian Credit Licence Number 441878) so is familiar with existing obligations.

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?

Zip has participated in both effective self regulatory codes for Buy Now, Pay Later (BNPL) and Australia Online Small Business Lending (AOSBL).

Zip supports the adoption of this approach as an alternative to the proposed licensing regime. The benefits of industry-lead regulation in sectors that are evolving rapidly are well understood. The Buy Now, Pay Later Code of Practice in Australia is a good example of a successful program of industry-led regulation.

Zip supports the enforceability of any such code of conduct by a Code Compliance Committee along with an external dispute resolution body, as per the BNPL Code of Practice. The BNPL Code is managed through the Australian Financial Industry Association (AFIA).

The principles outlined in the codes above are appropriate for adoption in Australia.

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.

It's not possible to estimate the cost of implementing this proposal, given the lack of detail at this stage.

Proposed custody obligations to safeguard private keys

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

In general, Zip supports the principle-based obligations for CASSPrs who maintain custody.

What is not clear is:

- The level of additional operational obligation for CASSPrs where a third-party custodian is used;
- The level of capital and financial adequacy required; and
- The independent audit requirements to ensure the obligations are met.

Consideration is needed on the implications of higher custody costs including:

- Creating inappropriate barriers to entry for new projects and innovation. For example, new crypto assets on new technology will require CASSPrs to hold funds in custody to meet minimum NTA custody requirements. High costs may preclude development and distribution of crypto assets;
- Higher custody costs are expected to be passed through to consumers and as a result incentivise retail consumers to self custody and expose them to higher associated risks including loss of keys and loss of device; and
- Asset valuations of crypto assets are volatile - an exposure regime calculating minimum financial requirements for custody based on dollar value of assets under management will be difficult to operationally manage and monitor.

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

N/A

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?

Given the selection of available custody providers and the early stage of this industry, Zip would not have a domestic location requirement for custody of assets. Separately, given the international and borderless dynamics of cryptocurrency it is an unnecessary constraint for such a requirement.

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

Yes, the principles are sufficient to cover the risks. The main challenges are the availability of supporting mechanisms (like insurance) or level of capital adequacy for custody of non-financial assets.

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

Not at this stage. What needs to be clear for customers of CASSPrs is liability for breaches or hacks of security for underlying custody arrangements.

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

It's not possible to estimate the cost of implementing this proposal, given the lack of detail at this stage.

However the minimum capital adequacy requirements for custody of financial products under RGG 166 is \$10m AUD.

Insurance costs will also be substantial due to the lack of coverage available in both public and private markets.

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

Zip supports an industry self-regulatory approach as an alternative to the proposed licensing regime. The benefits of industry-led regulation in sectors that are evolving rapidly are well understood. The Buy Now, Pay Later Code of Practice in Australia is a good example of a successful program of industry-led regulation.

Zip supports the enforceability of any such code of conduct by a Code Compliance Committee along with an external dispute resolution body, as per the BNPL Code of Practice. The BNPL Code is managed through the Australian Financial Industry Association (AFIA).

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

The Buy Now, Pay Later Code of Practice in Australia is a good example of a successful program of industry-led regulation.

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

It is not a question of failure. There is no industry-wide common standard for this emerging sector. The baseline needs to be established before being improved.

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

It's not possible to estimate the cost of implementing this proposal, given the lack of detail at this stage.

Early views on Token Mapping

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.

Crypto assets need to be clearly defined as its own asset type. Given the evolution of crypto assets it should be recognised that both crypto assets and financial services products will not be mutually exclusive.

It should also be in scope of the token mapping exercise to define the underlying risks and as such, when an asset is both a crypto asset and financial service product.

If a crypto asset is also a financial product, the interplay between regulations needs to also be considered to meet the policy objectives as outlined in our introduction.

30. Are there any other descriptions of crypto assets that we should consider as part of the classification exercise? Please provide descriptions and examples.

No, the existing definitions are adequately covered in the proposal.

31. Are there other examples of crypto assets that are financial products?

Liquidity pool tokens for example Uniswap LP tokens, sushiswap, balancer or curve if operated by a centralised party, would likely be financial products.

32. Are there any crypto assets that ought to be banned in Australia? If so, which ones?

There are two crypto assets that should be considered and assessed very carefully for regulation:

- Privacy Coins - facilitates potential breaches to AML/CTF obligations;
- Initial Coin Offerings (ICO's) that are issued and promoted by individuals or organisations who fail to meet fit & proper tests - likely to be prone to scams.

Conclusion

Zip supports the development of crypto asset regulation including licensing and custody requirements and is happy to engage further on this submission.

A handwritten signature in black ink that reads "Simon Keast". The signature is written in a cursive style and is placed on a light grey rectangular background.

Simon Keast
Senior Director, Financial Services
Zip.co