Commonwealth Bank

Token Mapping

Response to Treasury Consultation Paper

March 2023

1. Introduction

The Commonwealth Bank of Australia ("CBA") welcomes the opportunity to contribute its views in response to the Australian Government's 'Token Mapping' consultation paper ("Consultation Paper").

CBA was among the first Australian companies to initiate trials to explore the value of distributed ledger technology ("DLT"). In 2016, CBA piloted the use of DLT to facilitate programmable payments using a fiat-backed stablecoin. In 2018, in partnership with the World Bank, we issued the world's first blockchain-based bond. In that year we worked in partnership with Data61 to generate a proof of concept for programmable payments of 'smart money', for the National Disability Insurance Scheme. In 2019 we experimented with DLT and internet of things devices applied to global trade, and piloted a digital marketplace for the buying and selling of biodiversity credits using non fungible tokens ("NFTs"). CBA has also undertaken a crypto trading pilot that has enhanced our understanding of the risks associated with crypto assets, the different ways these risks can be mitigated and how to help consumers understand the risks of purchasing a crypto asset.

We actively collaborated with the Reserve Bank of Australia to explore potential uses and implications of a wholesale form of central bank digital currency ("CBDC") via Project Atom in 2021, and are currently participating in the RBA's general purpose CBDC with the Digital Finance Collaborative Research Centre.[1]

CBA has consistently held the view that first and foremost, the Government needs to remove the current uncertainty that exists in relation to how crypto assets are regulated. Australians continue to invest in crypto assets, but the ongoing uncertainty regarding how these assets are to be regulated is exposing retail investors to significant risks. Further, the introduction of Australian Dollar stablecoins into the retail market has the potential to create confusion for consumers and, if they grow in popularity as has happened in the USA, could create risks to the overall financial system.

We strongly support the Government's efforts to clarify the regulation of crypto assets in Australia, given how rapidly the ecosystem has evolved and the volatility characterising these markets. CBA further supports the token mapping process to be undertaken by the Government, as an essential step in understanding the crypto ecosystem and its intersection with Australia's existing regulatory frameworks. Providing policy and regulatory clarity will benefit consumers, reduce risk for industry participants and support innovation.

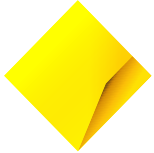
2. Need for reform

Australians remain enthusiastic participants in markets for crypto assets, even in the face of great volatility and considerable losses sustained in the last 18 months. As outlined in the Treasury consultation paper, over 1 million Australians are expected to record a tax event linked to crypto for 2022.[2] CBA data suggests this figure significantly understates the breadth of Australian crypto asset holdings, given taxable events generally only occur at the time of sale.

It has been reported that almost 30,000 Australian customers lost 'significant property' in the FTX collapse of late 2022, in addition to losses experienced by investors impacted by the collapse of Celsius in mid-2022.[3]

---

[1] "CBA joins industry pilot to explore use cases for a CBDC", Media release, CBA Newsroom, 2 March
[2] Token Mapping consultation paper, p.3
[3] J. Sier, "At least 30,000 Australians trying to claw back FTX losses", *Australian Financial Review*, 14 November 2022



As outlined in CBA's submission to Treasury's consultation on crypto asset regulation in 2022, the growth of crypto assets introduces risks to consumers and the stability of the financial system, including with respect to:

- Consumer protection - the lack of standards on product information, product disclosure or access to recourse;
- System Stability - those receiving investment funds in relation to crypto assets are not consistently held to standards governing liquidity or capital, including where service providers make claims with respect to the security of those funds, and the fact that crypto assets are increasingly used as collateral for investment in other financial markets;
- Community safety - the use of crypto currencies as a means to facilitate crimes;
- Cyber security – vulnerabilities in code have been exploited resulting in significant cyber security events.
- Confidence in the payment system - the potential increased liquidity risk as well as the impact payments in crypto assets could have on the effectiveness of monitoring and reporting around sanctions and AML/CTF laws.

The FTX collapse and a number of other recent developments have highlighted how some in the crypto eco-system have exploited gaps in existing regulatory oversight to engage in practices that negatively impact consumers, damage confidence in broader financial markets and add to systemic risk.

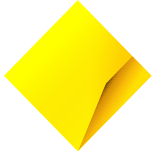
CBA's view is that the fastest and most effective way of managing these risks is that crypto assets can be regulated by Chapter 7 of the Corporations Act if they meet the relevant criteria. This will mean that retail investors that purchase crypto assets or related services that are captured by Chapter 7 will get the benefit of the existing system that has served Australia well by:

- Providing investors with adequate information to make informed investment decisions, particularly in light of the range of crypto assets and their rapid evolution;
- Allowing investors to understand their obligations and the risks involved with particular crypto assets;
- Giving investors confidence in the standard and qualifications of advisers and dealers; and
- Providing investors with appropriate avenues for redress in the event of fraud or negligence by intermediaries. [4]

We support the approach by the Bank of International Settlements that Treasury highlights regarding token mapping, specifically: identifying the key economic functions performed by crypto activities, then mapping those activities to those performed in traditional finance.

We agree with the position outlined in the Consultation Paper that it is unnecessary to map all crypto assets in order to identify a subset that are or should be treated as financial products or services. A high level taxonomy should suffice which can also leverage to similar exercises that been undertaken overseas. In this context, we welcome Treasury's objective of finalising its taxonomy in the near term, to help facilitate policy clarity on the treatment of crypto assets.

[4] CLERP 6 Paper, 28



3. *Answers to questions*

Q1) What do you think the role of Government should be in the regulation of the crypto ecosystem?

Q2) What are your views on potential safeguards for consumers and investors?

One of the roles of Government is to set the policy in relation to how the crypto ecosystem should be regulated. CBA believes that this should be a key outcome of the token mapping exercise. If after the exercise is complete, the Government was to confirm that the Chapter 7 of the Corporations Act was the regulatory regime for crypto assets this would provide much needed certainty to both the industry and regulators. Further, consumers and investors would get the benefit of the safeguards that exist in Chapter 7 which are well understood and have been effective. In addition, the Government could also confirm that existing consumer protection laws also apply to crypto assets and services that are marketed and sold to consumers.

Q3) Scams can be difficult for some consumers to identify.

a) **Are there solutions (e.g. disclosure, code auditing or other requirements) that could be applied to safeguard consumers that choose to use crypto assets?**

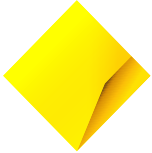
b) What policy or regulatory levers could be used to ensure crypto token exchanges do not offer scam tokens or more broadly, prevent consumers from being exposed to scams involving crypto assets?

Criminals increasingly use crypto as a means to perpetrate scams and fraud, either directly by touting false crypto investments opportunities as a way to steal money, or indirectly as a way to collect stolen proceeds from other scams.

Data from the Australian Competition and Consumer Commission's ("ACCC") Scamwatch has revealed that Australians lost over $205 million to scams between 1 January and 1 May 2022, representing a staggering 166% increase compared to the same period in the previous year. Given that only 13% of scams are reported, this number is likely greatly understated. Most losses over this period were attributed to investment scams, with $158 million lost— a 314% increase compared to the same period last year. Of these investment scams, the majority of losses involved crypto investments, with $113 million reported lost this year alone. Cryptocurrency is now by a considerable margin the most common payment method for investment scams.[5]

By regulating crypto asset service providers that are providing financial services under Chapter 7 of the Corporations Act will assist in the prevention of scams, especially investment scams. Not only will these providers have to comply with increased standards and obligations to protect investors but also help consumers to more easily identify when they are engaging with a regulated entity as opposed to a scam. It will also require these service providers to hold an Australian Financial Services Licence, be regulated by ASIC and become a member of the Australian Financial Complaints Authority.

[5] https://www.accc.gov.au/media-release/australians-are-losing-more-money-to-investment-scams



These obligations should complement any additional reforms that the Government should undertake such as payment licencing or the regulation of the overall scams ecosystem to ensure all participants comply with minimum standards to detect, deter and disrupt scams.

Q4) The concept of 'exclusive use or control' of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records.

a) How do you think the concepts could be used in a general definition of crypto token and crypto network for the purposes of future legislation?

b) What are the benefits and disadvantages of adopting this approach to define crypto tokens and crypto networks?

We are not convinced that the notion of 'exclusive use or control of public data', proposed in the Consultation Paper, is a distinguishing factor between crypto tokens and other digital records. We see examples of information on digital ledgers where only one person can alter that record – for example, records of share ownership maintained on the CHESS system. While investors can rely on intermediaries to make changes to the CHESS ledger on their behalf, investors in crypto assets also frequently rely on intermediaries to update records on DLT.

Rather than the 'exclusive use or control' concept, we believe a better approach is Treasury relying on the "principles based" concept set out in Chapter 7, which will provide clarity on how crypto assets are regulated.

Australia's functional approach to financial regulation largely gives effect to the policy adopted after the *Wallis Inquiry* that 'functionally-equivalent' products should be treated equivalently. In other words, it is technology agnostic. Specifically, under Chapter 7, to be regulated as a financial product the crypto asset must be deemed to be a financial product or be a facility, through which, or through the acquisition of which, a person makes an investment, manages a financial risk or makes a non-cash payment.
In line with the schema outlined in the Consultation paper, we identify three broad categories of crypto assets in a regulatory context:

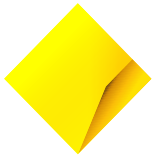
(a) Those that currently meet the definition of a financial product and therefore are regulated by the Corporations Act;

(b) Those that are not captured by the functional definition of a financial product, but are still generating risks comparable to those associated with financial products, which should be explicitly added to the list of financial products in the Corporations Act; and

(c) The remaining crypto assets, which are not financial products and should not be treated as such. These should be covered by existing general consumer laws.

One of the outcomes of the token mapping exercise that Treasury is undertaking should be to consider which categories of tokens would fall within one of these three categories or gives rise to comparable risks and to determine whether any regulatory change is necessary to deem certain crypto assets to be financial products as per (b) above.

Q5) This paper sets out some reasons for why a bespoke 'crypto asset' taxonomy may have minimal regulatory value.



a) **What are additional supporting reasons or alternative views on the value of a bespoke taxonomy?**

b) **What are your views on the creation of a standalone regulatory framework that relies on a bespoke taxonomy?**

c) **In the absence of a bespoke taxonomy, what are your views on how to provide regulatory certainty to individuals and businesses using crypto networks and crypto assets in a non-financial manner?**

CBA believes that the principles based approach set out in Chapter 7 of the Corporations Act should apply to the regulation of crypto assets as is the case in the regulation of traditional financial products and services and therefore a bespoke taxonomy codified is not necessary. Under Chapter 7, there is scope for assets to be deemed to be financial products or for products to be expressly excluded from the regime. However, this is used on an exception basis which should also apply to the treatment of crypto assets. Preparing a taxonomy to be used as part of Chapter 7 would also unnecessarily delay the clarity that is needed to properly protect consumers.

Q6) **Some intermediated crypto assets are 'backed' by existing items, goods, or assets. These crypto assets can be broadly described as 'wrapped' real world assets.**

a) **Are reforms necessary to ensure a wrapped real world asset gets the same regulatory treatment as that of the asset backing it? Why? What reforms are needed?**

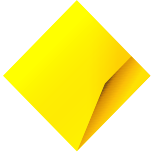
b) **Are reforms necessary to ensure issuers of wrapped real world assets can meet their obligations to redeem the relevant crypto tokens for the underlying good, product, or asset?**

Where a party issues or deals in a crypto asset that entails a right to a real world asset, the starting position should be that financial services regulation will only apply to that crypto asset if the underlying asset is a financial product or service. If a real world asset is not a financial product, then any wrapped crypto asset would be governed by general consumer law as well as any specific law that applies to that real world asset. In other words, merely representing as asset or recording ownership of an asset using DLT technology should not automatically mean it is a financial product.

There may be circumstances where there are exceptions to this principle. For example, it may be that the nature of the wrapped crypto asset means that it is a derivative as defined under Chapter 7 and therefore would be regulated under existing law.

Reforms may be necessary to the regulatory regime that governs specific real-world assets to allow for rights to be exchanged through crypto assets. For example, the exchange of a token representing a land title would need integration with existing land registry systems and adjustments to related legislation.

Stable coins are a particular subset of wrapped asset tokens that will require additional regulation, because those issuing and dealing in them may make a claim that the token is backed by fiat currency or liquid assets. In addition, stablecoins can typically only be redeemed via the issuer, meaning there is operational risk involved. The use of stablecoins has become a critical enabler of crypto asset markets, with high transaction volumes versus other crypto assets. As a result, these assets pose a greater degree of risk in terms of both consumer and business losses and financial stability. Given this, those issuing and dealing in stable coins should be covered by prudentially regulated institutions and be subject to general financial services obligations, as with any investment backed by capital.



Q7) It can be difficult to identify the arrangements that constitute an intermediated token system.

a) Should crypto asset service providers be required to ensure their users are able to access information that allows them to identify arrangements underpinning crypto tokens? How might this be achieved?

b) What are some other initiatives that crypto asset service providers could take to promote good consumer outcomes?

The starting position should be that if the crypto asset service provider is providing a financial service then it will need to comply with the obligations under Chapter 7 of the Corporations Act. We believe existing rules, provided they are consistently applied and enforced, will allow regulators to respond to the risk of misconduct.

There may be some particular services that require additional obligations but these can be dealt with on a case-by-case basis as with other financial services today.

Q8) In addition to the functional perimeter, the Corporations Act lists specific products that are financial products. The inclusion of specific financial products is intended to both: (i) provide guidance on the functional perimeter; (ii) add products that do not fall within the general financial functions.

a) Are there any kinds of intermediated crypto assets that ought to be specifically defined as financial products? Why?

b) Are there any kinds of crypto asset services that ought to be specifically defined as financial products? Why?

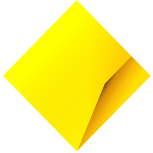
CBA believes that this should be an objective of the token mapping exercise that Treasury is undertaking. Following the approach outlined by the BIS should help inform the answers to these questions.

Q9) Some regulatory frameworks in other jurisdictions have placed restrictions on the issuance of intermediated crypto assets to specific public crypto networks. What (if any) are appropriate measures for assessing the suitability of a specific public crypto network to host wrapped real world assets?

This will depend on the nature of the real world asset. If the real world asset is a financial product, disclosure obligations will require that the risks associated with acquiring the crypto asset will need to be set out clearly along with other related investor protections.

If the real world asset and the crypto asset are not financial products, then any specific regulation that governs the real world asset may need to be adjusted to ensure consumers are adequately protected.

Q10) Intermediated crypto assets involve crypto tokens linked to intangible property or other arrangements. Should there be limits, restrictions or frictions on the investment by consumers in relation to any arrangements not covered already by the financial services framework? Why?



As referred to above, this will depend on the nature of the intangible property or arrangements. It may be that consumer protection laws or other laws relating to the specific property or arrangement are adequate. Alternatively, it may be appropriate to deem the crypto asset as a financial product.

Q11) Some jurisdictions have implemented regulatory frameworks that address the marketing and promotion of products within the crypto ecosystem (including network tokens and public smart contracts). Would a similar solution be suitable for Australia? If so, how might this be implemented?

The starting position should be that if the crypto assets or services related to the crypto ecosystem are financial products or services the marketing and promotion of these products and services will be governed under Chapter 7 of the Corporations Act like other financial products and services. As exists today, there may be a need to provide further obligations on a financial product or service given the risk to the consumer but this can be dealt with on a case-by-case basis.

If the crypto assets are not financial products, then they would be still subject to consumer protection laws such as prohibitions against misleading and deceptive conduct in relation to communications with consumers.

Q12) Smart contracts are commonly developed as 'free open source software'. They are often published and republished by entities other than their original authors.

a) What are the regulatory and policy levers available to encourage the development of smart contracts that comply with existing regulatory frameworks?

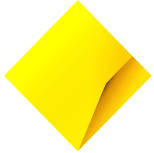
b) What are the regulatory and policy levers available to ensure smart contract applications comply with existing regulatory frameworks?

We do not see a need to specifically regulate smart contracts. If the smart contract forms a part of the provision of a financial product or service then its operation and associated risks would need to be disclosed in accordance with the Corporations Act. Alternatively, if the smart contract is not associated with a financial product or service, the offering of the product or service would be governed by consumer protection laws or other specific laws relating to the particular product or service.

4. Next steps

In line with the direction of the Consultation Paper, CBA encourages the Government to provide policy clarity, namely that Chapter 7 of the Corporations Act govern crypto assets and it will not be creating a stand-alone new regulatory regime. This will provide both ASIC and the industry the certainty to actively engage in understanding which crypto assets would be regulated as financial products and create further clarity on the purpose and the outcome of the token mapping exercise being undertaken by Treasury.

CBA does not believe that it is necessary to have definitely answered all the questions posed in the Consultation Paper before this policy intent can be articulated. In fact, if the Government does support this approach, the exercise in understanding which crypto assets are financial products or services will be an ongoing process just as it is with traditional assets today. That is, the need for the Government to understand the evolution of the uses of crypto assets and related services will not finish when the token mapping exercise is completed.



As discussed above, many crypto assets can be regulated under Chapter 7 without need of additional legislation or regulatory change. Because Chapter 7 is a principles-based regime that is agnostic to the technology used to offer a product or service, there will be many crypto assets and related serviced that fall within the definition of a financial product and services today. There may be a need to make regulatory change in the future to provide clarity on some crypto assets or services, but this does not need to happen before the policy direction is clarified.

As is highlighted in the Consultation Paper and consistent with CBA's data, Australians have and continue to purchase crypto assets and related services. These Australians are entitled to the same protections that they receive under Australian law as they get when purchasing traditional financial products and services. Chapter 7 of the Corporations Act has been effective in encouraging the development of innovative financial products and services while providing protections for retail investors. Applying this regulatory framework to investments in crypto assets will ensure that they get the benefit of a system that has served Australia well.