

## ABA submission: Crypto assets token mapping

### Summary

The Australian Banking Association (ABA) welcomes the Treasury's consultation and the role that this initiative can play in developing a crypto regulatory regime in Australia.

#### Regulation of crypto assets

The Reserve Bank's retail Central Bank Digital Currency trial highlights the potential for crypto assets to benefit the economy, with a role for banks, payments, financial markets and fintechs. The crypto assets market continues to grow. An estimated 25.6% of Australians own crypto assets,<sup>1</sup> and the global cryptocurrency market rebounded to an estimated US\$1.08 trillion in early 2023.<sup>2</sup>

On the other hand, high profile failures in 2022 including FTX highlighted risks to consumers and potential systemic risks. While blockchain technology is new, the poor or illegal conduct uncovered by some of these failures (including conduct that are likely to have caused loss of customers' assets or funds) are not. The characteristics of the technology also makes crypto assets a frequently used 'off ramp' for cyber criminals and scammers to move funds offshore.

Together, these facts highlight the case for applying clear and consistent regulation to crypto assets to protect retail investors, apply oversight of financial services including advice, and maintain the transparency and integrity of financial markets. In Australia, the principle of 'same risk, same rules' apply to financial and payments services, irrespective of the underlying technology used. This approach can and should apply to blockchain technology and crypto assets as described in the next section.

Clarifying the legal regime for crypto assets can make Australia a more attractive destination for legitimate innovation, investment and use of crypto assets and related technology.

#### Applying financial services regulation

The consultation paper illustrates the complexity of the question of how tokens/systems should be classified. Given the implications of this question, the consultation paper also helps illustrate the need for a clear and logical approach that can be consistently applied by a broad range of stakeholders.

Treasury's consultation paper has focused on the question of what is a financial product. ABA agrees this is a key question that can currently create confusion or a divergence of approach. ABA's suggestion is to consider the classification of the token/system and regulatory implications as follows:

1. Legal analysis: whether the token, or the token and smart contract considered together, have the functions of a financial product. ABA queries the need to separately consider whether there is a 'facility' since the term is not intended to be restrictive.
2. If yes, consider how existing laws can apply and any questions about practical compliance: is there an entity or entities that can be subject to regulation in relation to the issuance and secondary trading of the financial product and disclosure in relation to the product.
  - a. If yes, then the token system can be subject to existing law. Currently, this may be the case for a significant majority of token systems that may be financial products.
  - b. If no, this may be a case to revise regulations so that it can apply to the relevant token system. For example, a public network can have governance mechanisms that are able to comply with financial services regulation, but the decentralised nature of the network may raise practical difficulties of identifying a licensee or regulated entity.

<sup>1</sup> Statista: <https://www.statista.com/statistics/1244739/australia-cryptocurrency-ownership/>; Gemini estimated 18% of Australians owned crypto currency in 2022.

<sup>2</sup> Coingecko: <https://www.coingecko.com/en/global-charts> (as at Saturday 4 March)

3. If the answer to (1) is no, ABA reiterates our view there is a case to consider whether tokens/smart contracts that are functionally similar to a financial product should be regulated as such.

With this approach, the role of the Government and/or regulators is to work with industry to introduce greater certainty in the analysis of whether a token system is a financial product, provide guidance on practical compliance with financial services regulatory requirements, and enforcing applicable regulatory requirements. The role of Government is also to consider the questions in 2(b) and 3 for the application of regulation.

Specifically, ABA supports clarifying expectations and regulatory obligations in relation to scams, in line with the Government's policy focus on scams prevention and response. This should include capability for 'notify and take down' and taking part in funds recovery.

To illustrate this proposed approach, see decision tree in [Appendix A](#).

## Responses to questions

### 1. What do you think the role of Government should be in the regulation of the crypto ecosystem?

The role of the Government and/or regulators is to:

- Work with industry to introduce greater certainty in the analysis of whether a token system is a financial product, and assist industry to align on more consistent practices in complying with financial services regulatory requirements. This can be done via a mechanism such as a regulatory sandbox or regulatory forum, where guidance from Government and/or regulators can be provided to the industry.
- Consider questions about the application of regulation, as set out in the summary.
- Clarify expectations or obligations in relation to scams prevention and response, in line with the Government's focus.
- Enforce the application of legislation and regulations.

### 2. What are your views on potential safeguards for consumers and investors?

For token systems that are financial products, provide practical guidance on how existing consumer protections under Chapter 7 of the *Corporations Act 2001* (Corporations Act) apply. For example, where retail investors can face information asymmetries with crypto assets, clarify how Australian Financial Services licensees may provide clear and effective disclosure, practical compliance for financial advisers and influencers, and/or how Australian Market licensees can comply with obligations to maintain fair, orderly and transparent markets that support confident and informed participation by investors. Some overseas regulators and international standard-setting bodies have published consultations or recommendations relevant to these objectives.

As set out in the summary, ABA also recommends Government consider applying appropriate regulations to crypto assets that are functionally similar to financial products so that relevant consumer protections apply.

### 3. 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?

For token systems that are financial products, clarify how existing consumer protections under Chapter 7 of the Corporations Act apply, and how industry can comply with these regulatory obligations in a way that most effectively addresses scam risks. This may mean bringing particular focus to how industry

can comply with disclosure requirements (for example, via practical guidance on how to identify key risks associated with a crypto asset and how white papers can provide clear and effective information to retail consumers about common risks associated with crypto assets) and market licensees' obligations to maintain fair, orderly and transparent markets (for example, to what extent should market operators conduct due diligence on crypto asset).

Code audit could be one way for licensees to meet their regulatory obligations, for example a way to identify the key risks that should be disclosed or for a market licensee to conduct due diligence so that scams are not sold or traded on an exchange.

Reflecting the Government's policy focus on scams, ABA also proposes that Treasury consider whether, as part of a market licensee's obligation to maintain fair, orderly and transparent markets, the exchange operator should be required to have an efficient mechanism for users and other trusted parties to notify the operator of scams and to take down scams promptly, and to take part in funds recovery since crypto platforms are used by criminals as an 'off ramp' to move funds out of the banking system and away from victims. ABA understands some crypto exchanges already work with banks on scam prevention and funds recovery.

Finally, ABA reiterates our recommendation for the Government to consider whether tokens that are functionally similar to a financial product should be subject to regulation so that consumer protections under Chapter 7 of the Corps Act apply.

5. **This paper sets out some reasons for why a bespoke 'crypto asset' taxonomy may have minimal regulatory value. What are additional supporting reasons or alternative views on the value of a bespoke taxonomy? 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?**
  - (a) **Are reforms necessary to ensure issuers of wrapped real-world assets can meet their obligations**
  - (b) **What are your views on the creation of a standalone regulatory framework that relies on a bespoke taxonomy?**

ABA does not support a stand-alone regulatory framework based on a bespoke taxonomy. Crypto assets are already being addressed under existing regulatory regimes by domestic regulators and international standard-setting bodies, see for example, BCBS publication, *Prudential treatment of cryptoasset exposures*. ABA does see value in the Government and regulators helping to promote a more consistent application of the law, including the question of whether a crypto asset is a financial product.

Treasury also asks about the case for reforms to ensure wrapped real-world assets get the same regulatory treatment as the assets backing it. ABA does not support this approach. While a token can be a digital representation of an asset, legal analysis is still required on the function performed by the token, or the token and smart contract taken together. Currently financial products may have a physical commodity as an underlying – eg, commodity ETFs. The commodity is not a financial product while the ETF is a financial product.

6. **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?**

Assisting industry to clarify which crypto assets are financial products will also help to provide certainty about which assets are not subject to regulation under Chapter 7 of the Corporations Act. This approach has been applied to provide certainty to individuals and businesses that use other assets that are not financial products. For crypto assets that are not financial products (for example, some collectible NFTs), ABA notes general consumer protections would apply.

7. **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?**

Refer to responses to questions 3 and 5 about practical guidance on clear and effective disclosure and due diligence, with particular focus on how to describe common risks associated with crypto assets, arrangements that may be more complex, and/or a consumer's rights and obligations. Greater consistency in the application of, and practical compliance with, financial services regulation can assist to promote maturity of the industry.

**8. In addition to the functional perimeter, the Corporations Act lists specific products that are financial products.**

- (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?**

In general terms, ABA considers there is a case to consider whether tokens/smart contracts that are functionally similar to a financial product should be regulated as a financial product. This can be done by considering whether specific features or arrangements are likely to make a crypto asset functionally similar.

Two additional considerations are consistency between Australian legislative regimes (such as financial services law and taxation law), and maintaining consistency with overseas and global approaches.

**9. 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?**

ABA considers the first question is who is providing a financial service or operating a market, and whether financial services or market regulation can apply to the person. If the person can meet their regulatory obligations where the crypto asset is issued to a public network, then existing regulations can apply as intended. Depending on the arrangement for a crypto asset, there may be a question of whether a public network has the governance mechanisms that can meet relevant regulatory obligations, and whether existing regulations can apply as intended to a public network.

The International Standards Organisation has published ISO/TS 23635:2022,<sup>3</sup> which sets out guidelines and best practice standards for blockchain network governance that could be applied in Australia.

**10. 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?**

ABA refers to our comment about the application of general consumer law.

**11. 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?**

ABA refers to our earlier responses about the application of financial services and market regulation, and the application of general consumer law. ABA also refers to our proposal for the Government to

<sup>3</sup> <https://www.iso.org/standard/76480.html>

consider whether crypto assets that are functionally similar to financial products should be subject to regulation under Chapter 7 of the Corporations Act.

- 12. 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?**

ABA considers existing regulations and enforcement mechanisms can already enforce the requirement for smart contracts to comply with applicable regulatory frameworks. ABA also refers to our earlier responses about the role of the Government in considering whether regulations can apply to public networks as intended and the regulation of crypto assets that are functionally similar to financial products.

As a practical matter, ABA refers to our earlier responses about the value of guidance from Government or regulators about practical compliance with applicable regulatory obligations. For example, code audit can play a role in assisting licensees to conduct due diligence on a crypto.

## Appendix A: decision tree

