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FEEDBACK AND COMMENTS ON THE TOKEN MAPPING CONSULTATION PAPER

We thank Treasury for the opportunity to comment on this token mapping exercise. We view this paper as the first step toward the establishment of a sound and progressive regulatory framework that will protect consumers, address financial stability risks, and promote innovation.

Chainalysis is a blockchain data platform that provides data, software, services and research to government agencies, exchanges, financial institutions, and insurance and cybersecurity companies in over 70 countries. Our corporate mission is to build trust in blockchains. Our data powers investigation, compliance, and market intelligence software that has been used to solve some of the world's most high-profile criminal cases and grow consumer access to digital assets safely.

At Chainalysis, we also leverage our data platform to conduct research into the digital asset ecosystem. We publish several reports, including our annual Geography of Cryptocurrency Report, which measures digital asset adoption across the globe, and our annual Crypto Crime Report, which describes annual trends in cryptocurrency crime. Our response to this paper incorporates insight derived through this research.

Section I of our response offers general remarks on the regulatory approach to digital assets. Section II provides specific remarks on selected questions raised in the paper. Section III concludes. We remain at Treasury's disposal to discuss our views, including any consultation questions not specifically addressed in this response, as well as our research.



I. GENERAL REMARKS

We encourage the government to build on the opportunity to be a leader in the digital economy. Australia has laid down its goal of revitalising its science and technology capacity, and digital asset innovation can be an anchor of that vision. We are heartened by Treasury's recognition that a vibrant digital asset ecosystem can create opportunities for businesses and consumers, creating jobs and fostering innovation.

This economic vision calls for well-designed regulatory settings. Analysis conducted by Ernst & Young suggests that in 2021, digital asset related economic activity contributed an estimated \$2.1 billion to the Australian economy and accounted for 11,600 jobs. It is projected that this contribution could grow to over \$68 billion and 205,000 jobs by 2030. However, achieving this vision will require well-calibrated and internationally competitive tax and regulatory settings.¹

Consumers would also best served by a clear and "right-sized" regime that encourages digital asset firms to operate onshore, where they can be properly supervised and their clients protected. Today, digital asset activity in Australia is significant, with over US\$100 billion in cryptocurrency received in Australia from June 2021 to June 2022.² It is vital to ensure that there are adequate safeguards for consumers transacting in this space. However, digital asset businesses are highly mobile, and can be easily accessed by Australian consumers even if they operate offshore and do not actively market into Australia.³ The goal should therefore be a regulatory and supervisory regime that encourages digital asset firms to operate onshore, where they can be properly supervised and their clients protected.

In tandem with developing the regulatory approach to digital assets, we encourage Treasury to build up Australia's financial supervisory and data capabilities in this fast-moving space. Digital asset activity is occurring on new rails and in new venues outside the perimeter of traditional financial market surveillance frameworks. As supervisors develop new monitoring arrangements to stay on top of market conduct, microprudential and macroprudential risk, we encourage them to draw on the range of regulatory technology tools in the market. Blockchain analytics companies like Chainalysis survey and glean insights from transactions settled on the blockchain, while off-chain analytics

¹ Source: [Cryptocurrency and the distributed digital economy in Australia](#), commissioned by Mawson Inc and conducted by Ernst & Young, 2021.

² See Chainalysis' [Geography of Cryptocurrency Report 2022](#).

³ The ease with which consumers can access global digital asset services is illustrated by the case of China, which placed 10th on Chainalysis' 2022 crypto adoption index (see Chainalysis' Geography of Cryptocurrency Report 2022) despite measures that policymakers have taken to curtail digital asset activity within the country.



companies offer trading insights into digital asset firms' order books, and can alert on typologies related to market manipulation. These datasets can be combined with off-chain data from other sources, including regulatory reporting, to better understand risks and contagion channels.

Finally, we encourage open dialogue and partnership with industry. Globally, the digital asset industry has been taking steps to raise standards and build confidence in the sector. Industry associations such as GBBC Digital Finance seek to advocate and accelerate the adoption of best practices for digital assets, including through the establishment of a code of conduct. Similarly, the Crypto Market Integrity Coalition is a group of digital asset players who have taken a pledge to cultivate a fair digital asset marketplace, to combat market abuse and manipulation, and promote public and regulatory confidence. Continued supervisory engagement with industry players and associations can help to raise the bar within the sector, facilitate broader understanding of regulatory objectives, and aid in the identification of emerging risks and development of appropriate policy solutions.

II. RESPONSES TO CONSULTATION QUESTIONS

Below, we respond to a subset of question raised within the consultation paper. We are happy to engage further on these responses, as well as any other consultation questions that we have not specifically addressed.

Question 2

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

The optimal outcome for consumers and investors is a vibrant and resilient digital asset ecosystem with which consumers can interact with confidence. This means:

- **Developing a robust and proportionate regulatory framework.** As mentioned above, we believe consumers would be best served by an outcome-focused regulatory framework that fosters resilience and encourages digital asset businesses to operate onshore. This means looking beyond consumer protection to consider market integrity, efficiency and transparency, as well as prudential and financial stability risks.
- **Tackling illicit activity to create a safer digital asset environment for consumers.** In 2022, global illicit cryptocurrency transaction volumes rose for the second consecutive year, hitting an all-time high of US\$20.6 billion.⁴ Key drivers of this volume include transactions with sanctioned entities, scams (which we discuss below), stolen funds, and darknet markets. We encourage Treasury and relevant authorities to continue efforts to curb such activity.
- **Educating and empowering consumers.** We encourage Treasury and relevant authorities to step up efforts to help consumers understand blockchain technology and digital assets. One example of such initiatives is the Thai Securities and Exchange Commission's Crypto Academy, an e-learning platform launched earlier this year delivering educational content and a self-assessment to help consumers gauge their readiness to transact in digital assets.⁵ Collaborations with private sector would also be particularly useful here. Chainalysis, for example, has launched a free and public digital asset academy to teach consumers about digital assets, in addition to a regular series of blogs and podcasts on topical issues that could be of industry and consumer interest.⁶

⁴ [Chainalysis 2023 Crypto Crime Report](#).

⁵ Source: [Thailand Securities and Exchange Commission](#).

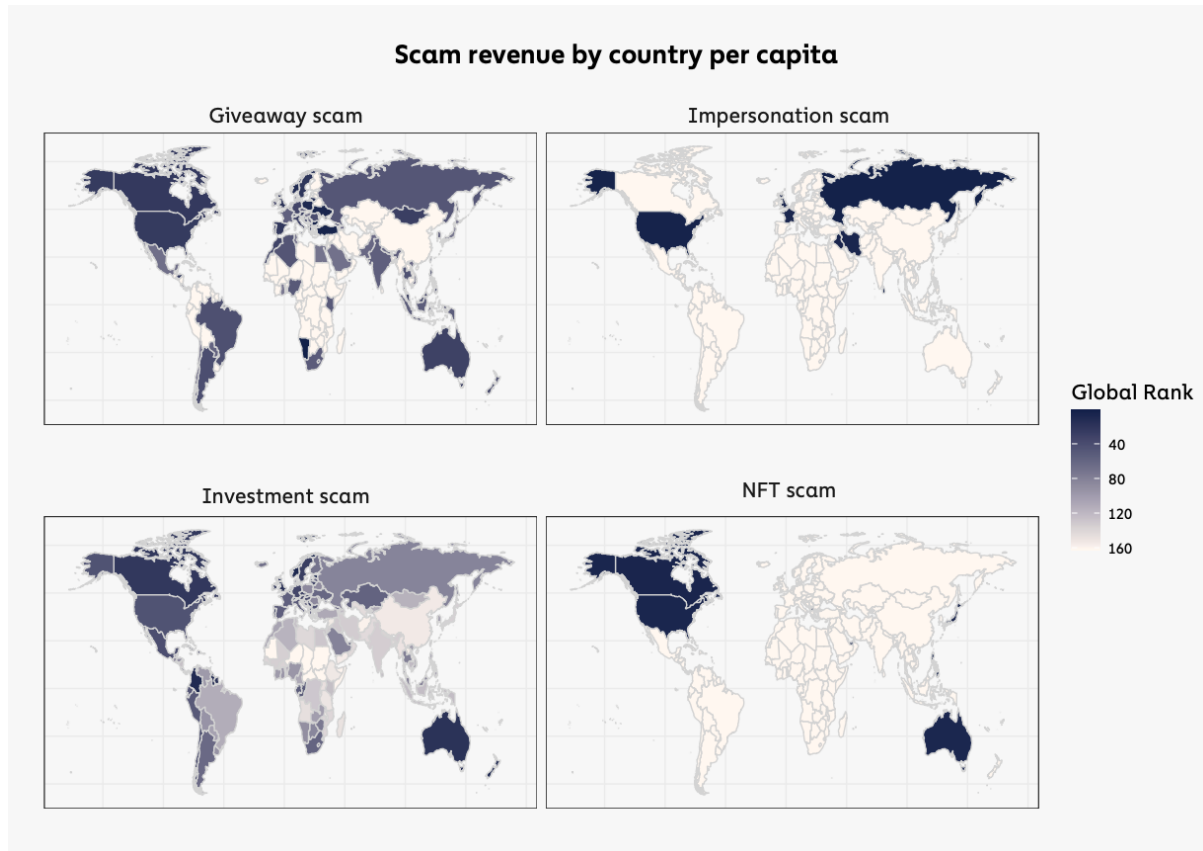
⁶ [Chainalysis Academy](#).

Question 3

Scams can be difficult for some consumers to identify.

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

Scams are a clear consumer protection priority for Australia. In 2022, Chainalysis estimates that global cryptocurrency-based scam revenue totaled about US\$5.9 billion. This is a lower bound estimate, which will be revised upward as more scams are identified, but still places scams as the largest form of cryptocurrency-based crime in 2022. Blockchain analysis paints a picture of how different countries were affected by different types of scams – we can see this on the chart below, which quantifies the amount different types of scams have taken from victims in different countries on a per capita basis. Notably, Australia was among those hard-hit by investment scams (the largest type of scam by revenue), coming in 18th on a per capita basis.



Source: Chainalysis Crypto Crime Report 2023

Scam activity continues to evolve, with new types of scams becoming prominent. For example, through 2022 we saw an large number of pump-and-dump schemes, in which a new token is launched and its price artificially inflated, before the scheme orchestrators sell off their tokens, leaving investors holding the bag. Chainalysis analysed 40,521 tokens⁷ launched in 2022 and found that about 24% saw a steep price decline in the first week indicative of pump-and-dump activity.⁸ Buyers not believed to be associated with the tokens' creators spent a total of US\$4.6 billion worth of cryptocurrency acquiring some of the 9,902 suspected pump and dump tokens we identified. Using on-chain data, we found that 445 individuals or groups accounted for 24% of the 9,902 suspected pump and dump tokens launched in 2022.

Given the difficulty in detecting scams ex ante and the speed with which they can propagate, combating them requires a broad-based approach that goes beyond regulatory levers. Regulatory safeguards, such as code audits and requiring tokens to be evaluated before they are listed for trading, can help ensure a baseline of due diligence but are by no means a silver bullet, particularly given the difficulty in detecting scams ex ante. Combating scams requires a broad-based approach including:

- **Encouraging the development of solutions and initiatives to identify, share information on and raise public awareness of potential scams.** For instance, Token Sniffer is a service that scores new tokens on a scale of zero to 100 based on their trustworthiness, and docks points for any scam-like characteristics. Public-private partnerships and industry-wide collaborations are also good channels for knowledge sharing.
- **Ensuring adequate funding, resources and training for government and law enforcement agencies charged with investigating scams and other market misconduct in digital assets.** Enforcement is a means of deterrence. A unique feature of cryptocurrency-based crime is that the transparency provided by public ledgers makes transaction tracing much easier than in other forms of value transfer. Using blockchain analysis tools, government agencies can trace cryptocurrency flows to identify their origination and cashout points, to potentially seize illicit gains and stop illicit actors exploiting consumers.

⁷ Over 1.1 million tokens were launched on the Ethereum and BNB blockchains in 2022. However, the vast majority got virtually no traction, as measured by the frequency of swapping happening on decentralized exchanges. Since we want to focus on projects that had an impact on the digital asset ecosystem, Chainalysis opted to analyse only tokens that achieved a minimum of ten swaps and four consecutive days of trading in the week following their launch. 40,521 tokens met these criteria.

⁸ Specifically, these tokens had a drastic price decline of 90% or more in the first week of trading, which could suggest the token's originators and earliest holders dumped the token extremely quickly. See the 2023 Crypto Crime Report for more details.

- **Understanding and disrupting the networks and infrastructure behind individual scams.**
A focus on detection and enforcement against individual scams should not overshadow efforts to target the enabling networks behind them. Chainalysis' 2023 Crypto Crime Report demonstrated how on-chain data can be used to identify interconnections within the scam ecosystem – for instance, where a single scam network may be responsible for multiple scams, or where multiple scam operators may be using the same nested service (e.g. at an exchange) to launder funds. By identifying nodes within the scam ecosystem, enforcement authorities can more effectively target criminal activity.

Question 5

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?

While we appreciate the rationale behind a high-level taxonomy, we encourage Treasury to consider how to ensure international consistency and regulatory clarity within this framework. Given that the digital asset ecosystem is in constant flux, we understand the rationale behind a flexible, high-level taxonomy that breaks down the universe of digital assets into four product types based on the distinction between intermediated and public token systems. However, we encourage Treasury to consider how the following operational considerations can be addressed:

- **International consistency.** While there is not yet a single international taxonomy, there is an emerging consensus around the classification of certain types of digital assets, such as fiat-backed stablecoins, central bank digital currencies, security tokens and non-fungible tokens. Various national authorities and international organisations have incorporated these concepts into their regulatory or analytical frameworks. Given the global nature of digital asset activity, an Australian taxonomy that does not map easily to international counterparts will create operational challenges downstream, such as in gauging cross-border regulatory consistency, and facilitating cross-border cooperation.

- **Efficiency and clarity.** In our view, the value of a taxonomy is not merely to conceptually segment and describe different types of digital assets, but to provide an efficient way to think about functions, risks, and hence the appropriate regulatory treatment of different types of assets – even if it is not perfect in all cases and requires periodic revision. The high-level taxonomy laid out by Treasury appears somewhat broad for this purpose, leaving licensing and regulatory obligations for each business model to be assessed on a case-by-case basis.

The assessment of digital asset business models against financial product definitions may not always be straightforward. We encourage Treasury and relevant authorities to build up over time a bank of guidance, including precedents and examples, to provide more clarity on where and when regulatory requirements are triggered. By way of example, this is consistent with the approach planned by the Korean Financial Services Commission in respect of security tokens. Regulatory sandboxes and safe harbour provisions could also be useful to allow digital asset businesses to develop while they are being assessed against the financial product definitions.

While we support the principle of regulatory consistency, there are certain important benefits that can be gained from a standalone regulatory framework for digital assets. Where a token system performs a similar economic function as a conventional financial product, it may not necessarily do so in the same way with the same risk profile. Rules can be calibrated differently to achieve substantively similar, or improved, levels of consumer protection and market integrity. A dedicated regulatory framework, as is being established in the EU and is under deliberation in the UK, Singapore and Hong Kong, offers a more streamlined way of doing this.

If digital asset activity is to be regulated under the existing financial services framework, Treasury should consider how existing requirements should be adapted for the digital asset context.

- **Certain requirements may not be practical for players in this space.** For example, a common challenge has been flagged is professional indemnity insurance under the AFSL regime, which is not easily available to digital asset businesses.
- **There may be areas in which desired regulatory outcomes can or should be achieved through different types of requirements.** The information that is available to government agencies due to the transparency of public ledgers offers a unique opportunity to think differently about regulatory and reporting requirements in this space. For instance, it may not be necessary to require the same level or type of regulatory reporting in all cases because of the ease of availability of certain on-chain data. Another example is the use of blockchain analytics to support customer due diligence and transaction monitoring.

- **Equally, there may be areas in which digital assets pose different or higher risks, which need to be addressed specifically.** One such area could be cyber and operational risk, such as operational vulnerabilities associated with smart contracts and oracles.

Even under the existing framework, there will be a need for new authorisations or licence types. For instance, custody of traditional financial products and digital assets are quite different propositions and a new regulatory regime may be appropriate for the latter. In this regard, we look forward to the upcoming Treasury consultations on licensing and custody of crypto asset service providers.

Question 12

Smart contracts are commonly developed as ‘free open-source software’. They are often published and republished by entities other than their original authors.

- c. What are the regulatory and policy levers available to encourage the development of smart contracts that comply with existing regulatory frameworks?
- d. What are the regulatory and policy levers available to ensure smart contract applications comply with existing regulatory frameworks?

We do not see a strong case for regulating smart contracts, which are merely code that can be developed to execute different functions. It is not apparent what “existing regulatory frameworks” are referred to here, with which smart contracts should comply. However, given that other types of code are not currently regulated, it is difficult to see a strong case for regulating open-source smart contracts, or how such regulation would be enforceable.

Regulation of smart contract *applications* is relevant only to the extent that these applications are used in the conduct of a regulated activity. Where this is the case, existing regulatory frameworks would apply. For instance, a regulated entity would be responsible for the operational and business resilience of the services it provides, including any aspect automated through the use of smart contracts.

III. CONCLUSION

We thank Treasury again for the opportunity to comment on this important exercise. We look forward to engaging with Treasury and other relevant agencies on future regulatory proposals, including the planned consultations on custody and regulation.