



National Australia Bank response

Treasury token mapping consultation paper

March 2023

Introduction

National Australia Bank (NAB) appreciates the opportunity to provide a submission to Treasury's consultation on token mapping.

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

Given the rapid pace at which crypto asset development continues to occur globally, we consider that Treasury should ensure that the regulatory regime(s) that will govern crypto assets in Australia, are reflective of and consistent with global trends and developments, to avoid stifling innovation or investment.

At its core, we consider that regulation governing crypto assets should:

- Incorporate definitions that are consistent with international best practice 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 from harm.

NAB continues to pursue the development of several crypto asset use cases, for the benefit of our business, corporate & institutional banking customers. Most recently, we minted our stablecoin, AUDN on the Ethereum network, and are working closely on a number of innovative use cases for the benefit of these customers.

NAB has provided responses in this document to the consultation questions that are most relevant to our crypto asset experience and skills.

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

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

NAB considers that the role of the Government in regulating the crypto ecosystem should largely resemble the role of the Government in regulating the ‘traditional’ financial system, but incorporate a lens that crypto assets are an emerging sector, and that a balance needs to be struck to ensure consumers and entities are protected, while allowing enough room for innovation and product development, where there is a significant customer benefit to be realised. Customer benefits may include: improved access to simple financial products, innovative borrowing and investment that aligns to customer needs, and lowers risk.

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

NAB is of the view that regulation targeting crypto asset service providers will help to protect consumers and investors.

As noted in paragraph [58] of the Consultation Paper, the major failures in the crypto market downturn of 2022 related to entities providing crypto asset services that had clear centralised control over user assets, without sufficient levels of transparency and segregation of duties within the entity. By appropriately regulating crypto asset service providers themselves, consumers and investors will be better protected. NAB looks forward to Treasury’s upcoming consultation relating to the licensing and custody arrangements of crypto asset service providers.

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?

NAB believes that a key policy lever to assist in combatting scams involving crypto assets is increased clarity on the consumer protection obligations of crypto asset service providers. Crypto asset service providers are the predominant gateway for consumers and investors to gain exposure to crypto assets. Increased oversight over crypto asset providers to protect consumers from scams and the introduction of obligations similar to those imposed on regulated financial institutions would be appropriate. NAB also notes that greater clarity of the obligations of crypto asset providers in relation to token listing requirements, would be of benefit.

While imposing additional obligations on crypto ecosystem intermediaries will not protect consumers from all crypto scams, it would be a significant improvement upon current safeguards.

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.

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?

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

At present, NAB does not have a position on whether explicit reference is required to the concept of ‘exclusive use or control’ for the purposes of a general definition of a crypto token and crypto network, to be included in future legislation.

NAB understands that the ‘exclusive use or control’ characteristic of crypto tokens can lead to enforcement issues when the token record is fraudulently altered. For example, when a wallet is hacked and a crypto token is transferred to a bad actor, no means of recourse would be available to a centralised entity to rectify the record.

However, a general definition of crypto tokens and crypto network and the concept of 'exclusive use or control' may be of benefit in the context of the obligations of crypto asset service providers, when providing customers and investors with access to crypto tokens.

Explaining the concept of 'exclusive use or control' to crypto consumers and investors and the risks it poses should be a positive obligation imposed on crypto asset service providers.

Q5) 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?

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

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?

It is essential that if bespoke 'crypto asset' taxonomy were implemented, that it does not conflict with existing domestic and international regulation. A lack of clear regulation globally has created an environment in which bad actors have been able to flourish. Additionally, this lack of clarity has dissuaded many regulated firms from participating.

While a standalone regulatory framework may not be necessary, additions to the existing framework will be required to provide certainty.

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. 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? 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?

Clear guidance to the market is required that where an intermediated crypto asset affords the token holder certain rights, these tokens will attract the same regulatory oversight as they would under the existing framework.

It should be made clear to the market that only entities licensed to deal in the real-world assets, can deal in those same products when they are represented as intermediated crypto assets. Reforms would not be required for the issuers of wrapped real-world assets if issuance of wrapped real-world assets was restricted to appropriately licensed entities. Appropriately licensed entities may include but not be limited to entities that are prudentially regulated and those with suitable credit ratings.

It should be noted that the ability to issue real-world assets in tokenised form may in time minimise the frictions historically associated with investment in certain asset classes and their use as eligible collateral to support further investment.

Frictions such as minimum parcel sizes govern investment in certain classes of assets. The utilisation of intermediated crypto assets and the ability to simply fractionalise, may lead to fewer controls being necessary for the distribution of intermediated crypto assets. For example, assets that have historically only been accessible to sophisticated investors may be considered more appropriate for retail investors.

Q7) It can be difficult to identify the arrangements that constitute an intermediated token system. 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? What are some other initiatives that crypto asset service providers could take to promote good consumer outcomes?

Crypto asset service providers should be required to ensure their customers are able to access information that allows them to identify arrangements underpinning crypto tokens. In our experience, full transparency surrounding the arrangements that underpin an intermediated crypto asset is not always forthcoming.

In these circumstances, crypto asset service providers should consider carefully whether it is appropriate to offer to customers intermediated crypto assets when the underpinning arrangements and rights that are conferred upon token holders is not clear. Similar to 'traditional' financial products, crypto asset service providers should be required to very clearly communicate to consumers the investment risks associated with the products they are investing in.

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

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

NAB expects that it is likely that as the intermediated crypto asset market matures and products emerge that do not closely resemble existing financial products, it may be necessary for specific definitions to be provided for these products.

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?

NAB employs a multi-blockchain strategy that includes the utilisation of public crypto networks. In certain instances, NAB believes that public crypto networks are suitable for the hosting of wrapped real world assets. In coming to this determination, NAB has been guided by its existing governance framework and processes. NAB has also looked to jurisdictions including Switzerland, the United Kingdom, the United States and Singapore to inform our stance regarding appropriate token classifications.

Ultimately, regulation should be technology agnostic so long as the technology allows for a sufficient level of control and minimisation of risk.

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?

NAB is of the view that not all products currently available within the crypto ecosystem are appropriate for all classes of investors. Therefore, the implementation of restrictions on the marketing and promotion of some products in the crypto ecosystem is suitable.

Q14) Some smart contract applications assist users to connect to automated market makers (AMM).

What are the key differences in risk between using an AMM and using the services of a crypto asset exchange?

Is there quantifiable data on consumer outcomes in trading on conventional crypto asset exchanges compared with user outcomes in trading on AMMs?

The key differences in risk between using an AMM and crypto asset exchange include:

1. Counterparty risk
Through the utilisation of an AMM, counterparty risk is minimised. However, counterparty exposure to the crypto asset exchange is replaced with smart contract risk.
2. Price volatility risk
The reliance of AMMs on algorithms to set the price of assets, theoretically makes them more susceptible to price volatility, particularly in instances of large trade volumes.
3. Liquidity risk
While liquidity risk can affect both centralised crypto asset exchanges and AMMs, arguably, AMMs are more exposed to liquidity risk as they are reliant on a relatively symmetrical pool of sellers and buyers. However, centralised exchanges can cultivate their own network of liquidity providers and market makers that may have an inherent axe.
4. Smart contract risk
AMMs rely on the operation of smart contracts. Smart contracts can be vulnerable to bad actor exploits.

NAB does not hold a view on whether AMMs could completely replace centralised market makers hence NAB would employ a hybrid model of utilising AMMs only when the products being traded had the requisite stability and depth of liquidity to warrant AMM use.