

# CRYPTO ASSET SECONDARY SERVICE PROVIDERS: LICENSING AND CUSTODY REQUIREMENTS

SUBMISSION TO THE TREASURY

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June 2022

## EXECUTIVE SUMMARY

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1. ANZ thanks the Treasury (**Treasury**) for the opportunity to comment on the *Crypto asset secondary service providers: Licensing and custody requirements consultation paper* (**Consultation Paper**).
2. Distributed ledger technology (**DLT**) and cryptography present transformative opportunities for market and supply chain efficiency including in financial services. Investment in crypto assets can also present certain risks to retail consumers. We support a regulatory regime that appropriately protects consumers and that provides clear guard rails for developing innovative crypto assets. As Treasury considers a suitable regulatory regime, we believe that the nation's policy should continue to balance consumer protection and financial stability with the facilitation of efficient financial markets.
3. Competitive neutrality is rightly recognised as a cornerstone of fair, efficient regulation that maximises the protection of consumers and ensures that competition is based on sound fundamentals, not regulatory arbitrage. Accordingly, it should be a core principle for any regulatory reform in this complex and rapidly changing area.
4. While crypto assets may present challenges for the application and enforcement of existing financial system regulation and economy wide regulation, the risks they present are not new. Existing conduct and disclosure regulation is designed to address 'product safety' and market participant conduct. Prudential regulation seeks to address systemic instability. Adapting existing regulation to address crypto assets appropriately may be the most efficient and effective path forward.
5. With these general principles in mind, we would recommend that Treasury completes its digital asset token mapping exercise *before* introducing new or revised regulation to deal with crypto assets. This analysis should inform any adaptation of existing regulatory regimes and any new regulation. We consider this to be the most efficient path to delivering predictable, 'fit for purpose, technology neutral and risk-focussed' regulation.<sup>1</sup>
6. To assist Treasury to achieve its policy objectives, we have made some observations on selected questions set out in the Consultation Paper. These comments are made within the context of our overall support for a strengthened regulatory regime which is fit for the digital economy. Our key points from these responses are summarised below.

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<sup>1</sup> Consultation Paper, p. 6

- **Token mapping will underpin appropriate crypto regulation**

We strongly support Treasury’s digital asset token mapping exercise to determine how to characterise and regulate various assets. This analysis is essential to understanding how existing law and regulation applies to crypto assets and to informing appropriate regulatory reform. Consequently, it’s essential to supporting responsible crypto innovation.

We recommend that this exercise includes a review of asset types against existing and proposed financial system regulation to determine (1) whether they’re already captured and (2) whether they will or should be captured. This should be a holistic review, considering the regulation of financial services and markets, credit, payment systems and financial stability and any proposed changes to those regimes.

Where particular crypto assets are determined to be outside the regulatory perimeter, this process can inform an assessment of whether it’s appropriate to bring them in through legislative amendment.

We encourage the use of technology neutral, functional definitions to bring assets within existing financial system regulatory regimes.

- **Bring crypto financial products within the Corporations Act**

To the extent that Treasury perceives a need to regulate certain crypto assets expediently, it may be appropriate to bring crypto assets that replicate the functions of a financial product, but which don’t strictly meet the existing definition, within the regulatory perimeter of the *Corporations Act 2001* (**Corporations Act**). This could more rapidly introduce consumer protections for those crypto assets through which a person makes a financial investment, manages financial risk or makes a non-cash payment.

We therefore encourage the first phase of token mapping to assess the appropriate application of the Corporations Act, particularly the definition of financial product, to different crypto assets. This analysis should promptly establish whether the financial product definition continues to be fit for purpose and can guide any necessary reform.

- **Implement technology neutral, functional regulation**

We support the Consultation Paper’s two foundational principles for the regulation of crypto assets, namely (1) that ‘products and services should be regulated according to

the risks they present' and (2) that any regulation should be technology neutral.<sup>2</sup> Consequently, our preference would be that crypto assets are not regulated as a single class of assets. Applying regulation based on the use of cryptography across a varied and expanding range of products and services will not deliver risk-focussed and technology neutral regulation. It would result in the same regulation being applied to tokenised footy cards as to digital currencies.

As described above, the token mapping exercise may establish that crypto assets that replicate the functions of financial products but don't strictly meet the definition should be regulated under existing financial services regulation. It may also establish that even with the broadening of the financial services regulation, there remains a case for another licensing regime for non-financial crypto assets.

7. We look forward to the next steps in Treasury's review and would welcome the opportunity to discuss the points in this submission if this would be useful.

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<sup>2</sup> Consultation Paper, p. 12

# RESPONSES TO SELECTED QUESTIONS

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## Proposed definitions

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### Questions responded to:

3. **Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments.**
  4. **Do you agree with the proposal that one definition for crypto assets be developed to apply across all Australian regulatory frameworks?**
  5. **Should CASSPrs who provide services for all types of crypto assets be included in the licencing regime, or should specific types of crypto assets be carved out (e.g. NFTs)?**
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### Some issues with the proposed definition

8. The Consultation Paper calls for predictable, technology neutral and risk-focussed regulation of crypto assets.<sup>3</sup> It states the characteristics of the underlying asset should dictate the regulatory approach rather than the use of a particular technology or 'tokenisation' of the asset.<sup>4</sup> We support this view. As such, we would be inclined against the proposed regulation of service providers on the basis that they deal with 'crypto assets'.
9. The unifying feature of 'crypto assets' is a *specific* technology, namely cryptography. To be a 'crypto asset', according to the proposed definition, ownership must be 'either determined or otherwise substantially affected by a cryptographic proof.'<sup>5</sup> This type of definition would capture a broad range of use cases for cryptography, without reference to the degree of risk that they may pose to consumers.
10. Equally, the proposed definition of 'crypto asset' may capture much more than intended. Two examples are described below.
  - It may capture an online banking deposit account. The online account could be a 'digital representation of value or contractual rights that can be transferred or stored electronically.' Banks use cryptographic proof to authenticate customers for the purpose of accessing their online accounts and to validate electronic transactions on a centralised ledger. This use of cryptography could be considered to 'otherwise substantially affect ownership' of the value held within the online banking deposit account.<sup>6</sup>

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<sup>3</sup> Consultation Paper, p. 6

<sup>4</sup> Consultation Paper, p. 12 - 13

<sup>5</sup> Consultation Paper, p. 10

<sup>6</sup> While the proposed licensing regime applies only to entities providing retail consumers with access to crypto assets which are *not* financial products (and therefore wouldn't capture an online banking deposit account), the use of the term 'crypto assets' across all regulatory frameworks would require detailed review to ensure that such regulation continues to operate as intended.

- It could capture a bearer bond that is encrypted and emailed between parties. The proposed definition of a crypto asset secondary service provider includes any person who, as a business, transfers crypto assets on behalf of another person.<sup>7</sup> Without further clarification, this could include the provider of encrypted email services.
11. Further, use of the definition of 'crypto asset' across *all* regulatory frameworks may capture a much broader set of assets than intended. This may require piecemeal exclusions to be introduced in other regulatory frameworks adding to regulatory complexity. For example, replacing the definition of 'digital currency' in the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML&CTF Act)* would significantly broaden the scope of the AML&CTF Act.<sup>8</sup>
  12. The proposed definition may also not capture certain crypto assets. It requires 'a digital representation of value or contractual rights'. This may not capture 'zero utility crypto assets that provide no promises, rights or other use case than the ability to transfer them via a network'.<sup>9</sup> Such assets may not have any underlying connection with, or represent, 'value' (such as a fiat currency). While they may have a secondary market value, it's possible this could drop to zero. It's unclear how a zero value crypto asset would fall within the proposed definition. Consumers would likely expect that a *specific* crypto asset regulatory regime applies to *all* crypto assets.
  13. Lastly, we note that classifying crypto assets as financial or non-financial products has been identified as a particular regulatory gap.<sup>10</sup> Applying a parallel licensing regime by reference to a technology specific 'crypto asset' definition will not clarify the scope of crypto assets captured by existing financial system regulation including under the Corporations Act, prudential regulation, credit law and payments regulation.

#### **An alternative to defining 'crypto assets'**

14. As outlined above, we believe completing the token mapping exercise is the first step to delivering predictable, 'fit for purpose, technology neutral and risk-focussed' regulation of crypto assets. Below we have set out some suggestions concerning how the completed analysis might be used to design an appropriate regulatory regime for crypto assets.

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<sup>7</sup> Consultation Paper, p. 10

<sup>8</sup> Section 5 of the AML&CTF Act defines 'digital currency'.

<sup>9</sup> Consultation Paper, p. 23

<sup>10</sup> Consultation Paper, p. 8

15. Rather than hinging regulation on the use of a particular technology, regulation could be applied based on the underlying characteristic or *function* of the particular 'crypto asset'. This technology neutral approach has various advantages including:

- **"Same risk, same rules"**

Functions that present similar risks would be regulated similarly. Existing 'off chain' regulatory regimes could be modified to clearly capture equivalent 'on chain' functions. For example, the Corporations Act definition of 'financial product' could be revised to clearly capture crypto assets that have similar functions and risks to financial products but which, currently, don't strictly meet the definition.<sup>11</sup>

Where a crypto asset tokenises an otherwise unregulated asset, the crypto asset shouldn't be regulated merely because a particular technology has been used to tokenise it. Equally, crypto assets that function like financial products shouldn't be subject to lighter touch regulation because they use cryptography.

This approach aligns with the Consultation Paper's call for regulation of products and services according to the risks they present.<sup>12</sup>

- **Minimise regulatory duplication**

Adopting a functional approach to crypto assets could avoid the need for a parallel crypto asset secondary service provider (**CASSPr**) licensing regime. It would also be consistent with the Government's approach to the review of the payments system regulatory architecture. The functional definition of payments currently being developed may also capture certain crypto assets.

16. Using this approach, we would not, *prima facie*, expect non-fungible tokens (**NFTs**) to be considered financial products. For example, digitally native NFTs that don't link to real world assets (such as digital collectibles like the Australian Open's commemorative day passes, in-game assets like skins or weapons and artwork or music) would not be captured. Similarly, NFTs that link to real-world assets like diamonds, real estate or artwork would not be regulated as financial products.

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<sup>11</sup> The Consultation Paper claims that (1) the *trustless* nature of crypto assets and (2) the relative lack of information asymmetry between buyers and sellers of crypto assets results in different potential risks to buyers even where they may be used in similar ways. It concludes this justifies regulating crypto assets and financial products differently (p. 13). We question this analysis. While a crypto asset *may* do what it is programmed to, the Consultation Paper implicitly assumes that a typical retail buyer is capable of assessing whether a crypto asset is programmed in accordance with its white paper. Similarly, it assumes that a typical retail buyer is, in practice, capable of accessing *theoretically* visible information on open blockchains.

<sup>12</sup> Consultation Paper, p. 12

17. We recognise that there is risk for consumers trading NFTs but this may be better handled by consumer law or the common law of property and trusts, rather than the financial services regime.<sup>13</sup>

## Crypto assets covered by the proposed licensing regime

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### Question responded to:

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

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### Regulation of issuers

18. Where a functionally equivalent product based on a crypto asset is brought within the regulatory perimeter, it may make sense that the issuer of the product is also brought within the regulatory perimeter. The advantages of capturing issuers align to the advantages of technology neutral regulation, namely “same risk, same rules” and minimising regulatory duplication.
19. Issuers of financial products are regulated under the Corporations Act. This includes disclosure obligations concerning the issue or regulated sale of a financial product to a retail client. These obligations already apply to issuers of crypto assets that are financial products.<sup>14</sup> It seems logical to also apply them to crypto assets that replicate the function – and therefore likely the risks – of financial products but don’t strictly fall within the existing financial product definition. This would support consistent, risk-focussed, consumer protection and a level playing field for issuers of functionally similar products.
20. We recognise regulation may need adjustment to accommodate the challenge of ‘absent’ crypto asset issuers. The European Parliament’s proposed Markets in Crypto-assets regulation captures issuers and may provide some guidance.<sup>15</sup>

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<sup>13</sup> We note a recent New Zealand case (*Ruscoe v Cryptopia Ltd (in Liquidation)* [2020] NZHC 728) held that digital assets are a form of property at common law that are capable of being held on trust. The digital currency exchange at the centre of the case was found to be a custodian and trustee of the relevant digital assets. The UK Jurisdiction Taskforce [Legal Statement on Cryptoassets and Smart Contracts](#) also concluded that crypto assets can be property. Accordingly, common law and statutory rules applicable to property may also apply to crypto assets. For example, rules concerning bankruptcy and insolvency, succession, theft and breach of trust.

<sup>14</sup> [ASIC INFO 225](#)

<sup>15</sup> [Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive \(EU\) 2019/1937](#)



## Alternative options

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### Question responded to:

- 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?**
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### Bring crypto financial products within the Corporations Act

21. We support a granular token mapping exercise to determine which crypto assets are, or should be, captured by financial system regulation as described in the response to question 29 below. This exercise should include an assessment of crypto assets against financial services and markets, payments, prudential and credit regulation.
22. We recognise that, while essential, this broader review may take time. With an increasing number of retail consumers acquiring crypto assets, it would be appropriate to expedite aspects of the token mapping exercise to inform near term regulatory reform.
23. It would seem appropriate that the Corporations Act applies equally to crypto assets that replicate the functions of a financial product even if they don't strictly meet the financial product definition. As an existing, well understood regime, the Corporations Act is well placed to efficiently address existing risks to consumers, including custody requirements. We therefore encourage Treasury to first focus the token mapping exercise on assessing which crypto assets are, or should be, captured as a 'financial product' under the Corporations Act. This will inform an assessment as to the adequacy of the existing financial product definition and any required amendment.<sup>16</sup>
24. Crypto currency may be an example of a crypto asset that should be regulated as a financial product. Where crypto currency is an accepted retail payment method in Australia it could be regarded as a non-cash payment facility regulated under the Corporations Act. ASIC has, however, noted that "[j]ust because a crypto-asset is in the form of value that is used to complete a transaction does not necessarily mean that the crypto-asset is, or involves, an NCP facility."<sup>17</sup> ASIC has indicated it doesn't consider a digital currency to be a non-cash payment facility because a currency holder has no right to make payments using the currency or to redeem it for cash.<sup>18</sup>

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<sup>16</sup> We note any revision to the definition of financial product in the Corporations Act will need to be replicated in the *Australian Securities and Investments Commission Act 2001 (ASIC Act)*.

<sup>17</sup> [ASIC INFO 225](#)

<sup>18</sup> ASIC, *Senate inquiry into digital currency – Submission by the Australian Securities and Investments Commission, December 2014*, p. 12

25. Where crypto currencies replicate many of the functions of a non-cash payment facility, it appears appropriate to regulate it as such. This would involve regulating the crypto currencies' issuers. ASIC notes that digital currencies do not have an identifiable issuer as no centralised authority is responsible to currency holders.<sup>19</sup> We recognise that these obligations would need to be tailored to achieve the appropriate outcomes for crypto assets as noted in the Consultation Paper.<sup>20</sup>
26. The ASX has suggested that the following 'digital financial products' could be brought within the Corporations Act:
- *"digital assets that are or are held out to be "cryptocurrencies";*
  - *digital assets that are used to raise funds from investors to invest in any form of collective endeavour (eg through an "initial coin offering" (ICO) or an initial exchange offering (IEO)); or*
  - *digital assets that are used for any other financial purpose (such as making a financial investment, managing financial risk or making non-cash payments)."*<sup>21</sup>

This could form a starting point for assessing which crypto assets are, or should be, captured as a 'financial product' under the Corporations Act as part of the first phase of token mapping.

27. This approach is preferable to defining all crypto assets as financial products under section 764A of the Corporations Act and empowering the Government to 'carve out' certain crypto assets that don't warrant such regulation because of their risk profile. The Consultation Paper notes that the time taken to exclude certain crypto assets from the financial services regime may impede innovation.<sup>22</sup> A functional approach to the review of 'financial product' would result in the same rules being applied to the same risks, minimising the need to subsequently exclude certain crypto assets from the regime.

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<sup>19</sup> ASIC, *Senate inquiry into digital currency – Submission by the Australian Securities and Investments Commission, December 2014*, p. 11

<sup>20</sup> Consultation Paper, p. 18

<sup>21</sup> ASX, *Australia as a Technology and Financial Centre Submission 65 – Supplementary Submission*, August 2021, p. 1-2

<sup>22</sup> Consultation Paper, p. 18

## Early views sought on token mapping – specifying classes of crypto assets

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### Question responded to:

- 29. Do you have any views on how the non-exhaustive list of crypto asset categories describe ought to be classified as (1) crypto assets, (2) financial products or (3) other product services or asset type? Please provide your reasons.**
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### Token mapping will underpin appropriate crypto regulation

28. The token mapping exercise will be invaluable in assessing the functions and characteristics of different crypto asset classes. A *granular* assessment of each asset type would most accurately inform the appropriate regulatory treatment of crypto assets including under existing financial system regulation (including payments, prudential and credit regulation).<sup>23</sup> The *actual* function and underlying characteristics of the crypto asset type should form the basis of this assessment, rather than the issuer's labelling and characterisation.
29. As described above, the first phase of the token mapping exercise could support a comprehensive review of existing definitions within the Corporations Act including to determine whether the definition of financial product continues to be fit for purpose.
30. In addition to financial services and markets regulation under the Corporations Act and the ASIC Act, the token mapping exercise will also need to consider the proper application of financial system regulation more broadly to crypto assets. This should include:
- **Payment systems regulation**

The assessment should have regard to proposed reforms arising from the Government's payments system review including the expansion of the definition of a payment system in the *Payment Systems (Regulation) Act 1998* and the new, functionally based, payments licensing framework.<sup>24</sup>
  - **Prudential regulation**

The assessment should consider proper application of the *Banking Act 1959* and the *Australian Prudential Regulation Authority Act 1998* to different crypto assets. It should also consider APRA's policy roadmap indicating APRA's plan to consider approaches to the prudential regulation of payment stable coins, noting they bear similarities with stored-value facilities. It has set out an initial view on potential prudential risks for

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<sup>23</sup> As a bank, our focus is on the application of financial system regulation to crypto assets. We recognise that common law and other regulation can also apply.

<sup>24</sup> Australian Government, [Payments system review – From system to ecosystem](#), June 2021

crypto asset activities for APRA regulated industries. This includes lending activities linked with crypto assets.<sup>25</sup>

- **Credit law**

The token mapping exercise should also consider how credit law (including the *National Consumer Credit Protection Act 2009*, the *National Credit Code* and the Corporations Act) applies to lending involving crypto assets.

31. We note that there may be different sub-groups within crypto asset classes (as with many financial products) and suggest a detailed analysis of example assets against the broader financial system regulatory regime.
32. If particular *technology-specific* risks are identified, these could be addressed in regulation. An example may be that financial safety is a focus of concern because crypto assets carry risks associated with private key custody. Accordingly, it may be appropriate to prescribe standards or qualities for this service.
33. Given the pace of change in this sector, we recommend that the token mapping is reviewed on a regular basis to address new asset classes and technologies. Regularly surveying the adequacy of the regulatory perimeter would help to identify emerging regulatory gaps that should be addressed. In turn, this would support entities seeking to innovate responsibly.

**ENDS**

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<sup>25</sup> APRA, [Letter to All APRA-Regulated Entities, Crypto-Assets: Risk Management Expectations and Policy Roadmap](#), 21 April 2022