



27 May 2022

Director – Crypto Policy Unit  
Financial System Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [crypto@treasury.gov.au](mailto:crypto@treasury.gov.au)

### **CASSPrs: Licencing and Custody Requirements**

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on CASSPrs: Licencing and Custody Requirements Consultation Paper.

AFMA supports the Government's efforts to make sensible regulations in relation to crypto-assets to improve the protections of investors, and users, and to place the economy to take advantage of the technological innovations associated with blockchain technology. We urge continued focus on developing these regulations given the increasing investor activity in these markets and developments in regulation in other jurisdictions.

We are concerned, however, that many crypto-assets present the same or higher risks as financial products and the cryptographic structures used do not intrinsically lower or avoid risks as the consultation paper suggests. It is therefore appropriate that the risks be managed in the same way through use of the existing financial product regulatory infrastructure, but with some extensions to address the absence of known issuers in the case of some crypto-assets.

Crypto-asset providers should be free to compete with existing financial service providers, but within the common rulebook and protections they afford investors.

We do not support a lightweight licencing regime as this will shift risks onto investors and users and create an uneven playing field for the better-regulated financial products sector. We support the principle of same activity, same risk, same regulation and also technology neutrality. Regulations should be risk-based.

**Australian Financial Markets Association**

ABN 69 793 968 987

Level 25, Angel Place, 123 Pitt Street GPO Box 3655 Sydney NSW 2001

Tel: +612 9776 7993 Email: [secretariat@afma.com.au](mailto:secretariat@afma.com.au)

Over 2400 crypto coins have already failed and have little or no value<sup>1</sup>. Many crypto 'currencies' for example Bitcoin, Ether and Dogecoin do not have an underlying link to anything of conventional value such as a fiat currencies, commodities or other physical objects or commitments. Each coin holding is effectively the knowledge of a very long number that lies in a sequence of long numbers linked through cryptographic calculations of no particular import. The RBA has suggested that these types of crypto-assets 'do not have the key attributes of money'<sup>2</sup>.

Various theories exist as to why some of these crypto 'currencies' manage to maintain a non-zero value in the market. For our purposes we note merely that the lack of connection to real-world assets creates difficulties in valuation, makes a collapse to zero entirely possible and this creates elevated risks for investors and users.

The universe of crypto-assets is quite heterogeneous and flexible and appears to have a wide range of use cases from carbon credits to AML/CTF credentials to equity securities. There are some whose value is linked to the provision of services (i.e. infrastructure, oracles, etc.) to blockchain and web3 services. While, there are others that are linked to, and in some cases, backed by a wide range of real-world assets. The tokenisation for these crypto-assets make them the digital equivalent to the traditional bearer bond. For example, the crypto-asset process can create crypto-assets that reliably link to fiat currencies, sovereign treasury bonds and precious metals. These can in theory be just as stable as existing rights assigning mechanisms, however, much depends on the type and quality of connectivity the crypto-asset has to the underlying asset and operational considerations regarding capacity and security of the underlying chain used.

We agree that it makes good policy sense to preserve the benefits of crypto-asset technology and to minimise the risks to investors by utilising the existing flexible framework of the financial product legal construction. This approach can help to minimise the risks around market infrastructure for crypto-assets.

We thank you for considering our submission.

We would be pleased to provide further information or clarification as desired. Please contact me via the Secretariat.

Yours sincerely



Damian Jeffree

**Senior Director of Policy**

---

<sup>1</sup> <https://www.coinopsy.com/dead-coins/>

<sup>2</sup> <https://www.rba.gov.au/speeches/2021/sp-so-2021-11-18.html>

1. Do you agree with the use of the term Crypto-asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'?
2. Are there alternative terms which would better capture the functions and entities outlined above?

AFMA prefers CASSPr terminology to Digital Currency Exchange as it is more accurate. Treasury may wish to consider using the Crypto-asset Service Provider (CASP) definition used in the MiCA Regulation in the EU for increased international consistency.

A distinction needs to be made between different services provided by CASSPrs, as they can be significantly divergent: e.g. providing trading services vs providing custody. Attention should be given to 'same risk, same rules' to avoid weakening investor protection and avoiding regulatory arbitrage: e.g. activities which are in a non DLT context subject to certain rules (e.g. fair trading, rules on front running and insider trading) should in a DLT environment be subject to the same/similar rules. See also the point on Defi and DAOs below.

A checkback should be made with provisions in other key regulations in major markets in terms of rules applying to crypto-asset service providers, such as those in the EU MiCA Regulation (in its final stages of negotiation), taking care to avoid some of the weaknesses of these regimes (e.g. liability).

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)?

AFMA raises no objection to the proposed definition but would like legal clarity on whether it captures Bitcoin, Ether and other cryptocurrencies that do not confer contractual rights, and that may not represent 'value' in the event their value goes to zero.

AFMA suggests as it will be important to maintain a level of international consistency Australia should consider a definition in closer alignment with international developments in key international jurisdictions, such as the US, UK and EU. We suggest that the EU and UK regimes may provide greater alignment to the Australian regime versus the complexity

of the US given their split of regulatory responsibilities between the SEC and the CFTC, and the states activity in this area.

The EU in MiCA Regulation have proposed a definition as follows, which aligns to the one proposed by Treasury:

‘crypto-asset’ means a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology.

Australian policy makers should continue to look at these issues through the context of current existing domestic laws. But we note that the urgency of international developments is not reflected in Australia – reform in this space needs to be a focus for the new government.

A consistent definition across all Australian regulation is recommended e.g. across AUSTRAC, ASIC, APRA, RBA and ATO. Current experience suggests that where there are even slight nuances between definitions in different regimes it adds complexity, costs and inefficiencies, and has the potential to result in gaps.

AFMA suggests there are four main categories of crypto assets that at a minimum should be brought into the regulatory regime:

- Crypto assets that do not have link to real-world assets (like Bitcoin);
- Tokens that provide rights to securities and or interests in schemes;
- Stablecoins which nominally claim to have their value “pegged”; and
- Central bank digital currencies.

Recent issues in relation to the collapse of a stablecoin and its impact into other crypto currencies, suggest early attention be given to developing an appropriate integration into the regulatory regime for stablecoins.

With the potential for regulatory arbitrage and expectations of consistent treatment it in our view it is appropriate to capture a wide range of crypto-assets but set in place a number of review points to check if this remains appropriate. We will discuss further below why NFTs and other types of crypto-assets should not be carved out. Inclusion should be driven by the legal categorisation of the crypto-asset based on the characteristics and attributes presented.

In designing the integration of these products into the financial regulatory system alignment should be sought with developments in major jurisdictions.

*Consultation questions*

6. Do you see these policy objectives as appropriate?
7. Are there policy objectives that should be expanded on, or others that should be included?

At a high-level AFMA supports the policy objective of bringing crypto-assets and related services into the regulatory system in a way that addresses their risk profile.

AFMA recognises the difficulties in capturing the issuers of crypto-assets but we are concerned that a singular focus on the easier to capture CASSPrs may unfairly burden this group for matters best dealt with by issuers.

AFMA does not support focusing regulatory efforts in crypto solely on CASSPrs and shifting responsibilities on to CASSPrs that would be better addressed with issuers where they are available. In this regard we note that MiCA Regulation covers the responsibilities of both issuers and offerors of crypto-assets in addition to CASPs (CASSPrs equivalent).

In some cases the issuers of crypto-assets will be readily capturable, while in others efforts would likely be made to ensure issuance is done offshore.

The Government has recently commenced the Product Design and Disclosure Obligations (PDDO) for issuers of financial products. AFMA originated many of the elements of PDDO as industry standards. If crypto-assets are not subject to similar obligations this will create an uneven playing field for Australian financial product issuing firms versus firms both domestic and international issuing crypto-assets. In addition, this will create the opportunity for regulatory arbitrage.

AFMA is aware of the creation of very high risk crypto-assets used by Australian entities that recreate many elements of existing financial products but without any of the protections associated with financial products. These products create financial exposures for owners of byzantine and theoretically unknowable complexity and risk. These products would not be allowed to exist as financial products or be marketed to retail investors. At present, as long as these exposures marketed for retail investment are created with crypto technology rather than more traditional architectures there is little in the way of regulation. It would be preferable to regulate this area for the protection of investors and to implement the principle of technology neutrality.

Treasury states “The point remains that crypto-assets require an order of magnitude less trust than other assets including financial products and should thus be considered differently.”

We respectfully disagree.

Trust is equally required in crypto-asset facilitated arrangements. The requirement for trust is there to exactly the same extent but is spread over different parties including those that designed the algorithm, those that run the algorithm on servers and other parties. The reason there is staking or mining is to reward key validation providers but also to subject them to put some skin in the game to incentivise honesty.

Looking through the ‘coin’ construction of many of these crypto-assets and the nominally independence of their implementation, we see the same standard array of risks of any

financial product including theft, counterparty risk, fraud, legal risk, operational risk, geopolitical risk, liquidity risk and market risk.

**There are no risks that are inherently reduced or avoided through the use of a coin or blockchain construction/infrastructure.**

Further, in AFMA's view it is not possible to create the same financial outcomes through *any mechanism* without incurring the same risks. The question is rather how those risks are managed and assessed where transparency of information to the user is low. In the existing financial system, the risks are known, observable, acknowledged and actively managed. In the case of some crypto-assets these risks may not be as clear, and in some cases may be downplayed, but they are all still there and if not properly managed will create undesirable outcomes for investors. Lower levels of transparency mean that due diligence by users, which might be done via a PDS for financial product, is more problematic.

Treasury should seek to create a level playing field for the issuers of crypto-assets and financial products as the risks that are required to be managed are the same as the implementation mechanism does not reduce or avoid risks.

**AFMA does not support setting the bar lower for crypto-asset licences on an unwarranted view that these assets are intrinsically lower risk, particularly where evidence suggests the contrary.**

#### *Global consistency*

Australia should participate in the creation of a globally consistent approach to crypto assets and reduce the risk of multiple jurisdictions developing inconsistent treatments for the same risks.

AFMA supports international consistency with the development of regimes in key market with a view to future substituted compliance and equivalence. Similar risks should, as far as possible, be regulated in the same way.

There are some novel risks with crypto-assets and these should be addressed with an appropriately calibrated regulatory structures. Were some types of crypto-assets to become systemically important this would require greater regulatory attention.

For stablecoins, recent events have highlighted the increased risks associated with pegs based on algorithms as opposed to adequately segregated and sufficient liquid assets. We note that in Europe MiCA addresses regulatory issues of stablecoins in order to reduce any potential threat to financial stability, monetary policy transmission and monetary sovereignty.

Custodial stablecoins can also present similar risks to money market funds and this might suggest similar regulatory structures may be appropriate.

AFMA considers that the Chapter 7 structures should be sufficiently flexible to allow the degree of agility that will be required to keep pace with developments in the crypto asset space.

- |     |   |
|-----|---|
| 8.  | Do you agree with the proposed scope detailed above?  |
| 9.  | Should CASSPrs that engage with any crypto-assets be required to be licenced, or should the requirement be specific to subsets of crypto-assets? For example, how should the regime treat non-fungible token (NFT) platforms? |
| 10. | How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g. in financial services)?  |

The proposed licensing regime does not apply to decentralised platforms or protocols, including, for example, decentralised exchanges upon which transactions occur between traders without the need for a secondary service provider to provide custodial or other management services. AFMA strongly opposes this carve-out as it creates substantial risks for investors and opens the door for regulatory arbitrage (similar to the points below regarding NFTs).

The risks (including and especially for retail investors) associated with decentralised platforms, were noted in the recent BIS report on Defi<sup>3</sup>. Given these risks, no carve out is appropriate as it would leave retail investors in particular exposed.

As noted above we believe that issuers should also be regulated where they are domestic in a way that manages the risks for investors through application of the PDDO regime or in a similar way to the PDDO regime.

In some cases, crypto-assets do not have a known issuer, for example ‘Satoshi Nakamoto’ appears to be the alias of the person or persons who created Bitcoin, but there is no clarity on the identity of this person or people. That the creator has made efforts to be unknown or has moved on from the project should not mean that the risks associated with issuance should be left unaddressed as this would be to the detriment of investors.

Where issuers are out of the jurisdiction or unknown, the management of these risks should be transferred through a requirement for due diligence process to the entities that provide access to the products, these can be brokers, dealers or market operators. Clarity will be required for service providers on what this process should involve.

For efficiency, where licenced market operators have undertaken such due diligence brokers and dealers should be able to rely on this to a reasonable extent.

---

<sup>3</sup> See pages 36-42 of <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD699.pdf>

The CASSPr licences for brokers, dealers and those who operate markets should be the same as the requirements for financial market and financial market participant licences but should have an additional element as noted above to require due diligence for crypto-assets to address the same risks that would otherwise be addressed by issuers. Code auditing is not something required in traditional services but is needed here given the implications for safety and soundness and avoidance of fraud.

As in relation to financial products, the obligations on custodians should not extend to PDDO type obligations. Custodians of crypto-assets should have the same requirements as custodians of financial products, be able to negotiate liability contractually and be responsible for negligence and wilful misconduct as in traditional financial products.

CASSPrs that engage with any crypto-assets should be required to be licenced in line with existing requirements for financial products.

Non-Fungible Tokens (NFTs) are records on the blockchain that refer to digital art, intellectual property or any other asset, which could include financial instruments. In a parallel to crypto-currencies, NFTs in some cases, provide no legally enforceable claim in themselves to ownership or copyright to the referenced asset. In other cases though, they have been recognised as 'property' (UK) or 'assets' (Singapore).

Trading on NFTs is notable for extreme prices in reported trades. However, as the market is largely unregulated these may well be misleading due to wash trading and other practices that would be illegal for financial products.

The US Treasury has suggested<sup>4</sup> that NFTs are just as susceptible to money laundering risks as other art transactions and "may present new risks".

Given the AML/CTF risks and potential for misleading market practices we suggest that NFTs be included in licencing requirements. Being non-fungible should not mean those assets need to be excluded from regulation. As long as they have some sort of intrinsic value and can be negotiated in a secondary market, similar protections to financial instruments should be given to those investors. A legal categorisation of an NFT should be performed, such as for any other crypto-asset, based on the rights conferred to the purchaser.

Regulatory duplication can be minimised by utilising the existing licencing framework as much as possible for CASSPrs. Consistent with this:

- Wholesale investors should be dealt with in the same manner as they now are under Chapter 7.
- Retail advice should be consistent with the requirements for financial products (noting that reform around the advice framework is needed from the Quality of Advice Review).
- Issuers and decentralised platforms where accessible should be included and alternative risk management arrangements made where they are not.

---

<sup>4</sup> <https://home.treasury.gov/news/press-releases/jy0588>



- Existing mechanisms for customisation available under Chapter 7 should be used in relation to crypto-assets.

We note also that use of the existing regulatory structures for financial products for crypto-assets will facilitate a far more rapid development pathway. Given the rate at which this space is innovating, this opportunity for rapid deployment of a fully formed regulatory framework should be welcomed.

11.	Are the proposed obligations appropriate? Are there any others that ought to apply?
12.	Should there be a ban on CASSPrs airdropping crypto-assets through the services they provide?
13.	Should there be a ban on not providing advice which takes into account a person's personal circumstances in respect of crypto-assets available on a licensee's platform or service? That is, should the CASSPrs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto-asset)?
14.	If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

### *Obligations*

The proposed obligations are a lightweight selection of elements from the various AFSL licencing requirements. We find them unlikely to be sufficient to offer anywhere near the investor protections levels of the existing AFSL licencing regime. Gaps in coverage will risk creating issues for investors down the track.

We suggest that the level of analysis provided in the paper is inadequate to form the basis for a licencing regime. AFMA supports simplification and streamlining of the existing financial product licencing regime in preference to the creation of a parallel but inadequate licencing regime specifically for a particular technological approach to managing the same risks. Regulation should be technological neutral, this implies that contractual arrangements implemented by different technologies (including crypto) should not be given lower standards to meet.

### *Airdrops*

In relation to the suggestion on a ban on airdropping crypto-assets we suggest that this is a very granular level matter that should not be addressed out of the context of a comprehensive exploration of the information security challenges of crypto-assets. The existing financial security regime provides an appropriate framework for the consideration of technical matters such as the appropriateness of airdrops.

In this context AFMA has supported consistent information security requirements across the financial services sector in alignment with international standards such as ISO and NIST. We note that we are working with the Cyber Risk Institute to look at mapping existing APRA and ASIC requirements to the NIST framework.

The Council of Financial Regulators has indicated its support for standardisation of information security requirements across financial services. Consistent with this would be including crypto-assets under the existing arrangements.

Airdrops may well not be appropriate under this existing comprehensive framework but merely isolating this element of information security is unlikely to be sufficient to create secure custodian practices around crypto-assets.

### *Advice*

AFMA supports a comprehensive review of the framework for financial advice which has made financial advice unaffordable at a price that is a multiple of what the majority of Australian investors are prepared to pay.

The regulatory framework is in urgent need of radical reform, however, we do not support the view that this means that certain product types should be entirely exempt from the framework. Such an approach would likely create profoundly higher advice-related risks for investments in an asset class that is often already higher risk.

Crypto-assets should be included in the existing financial product advice regime, and the reform of this regime should be prioritised. Investors should be able to get independent, quality, personal advice if they seek it, where any potential conflicts of interest are appropriately managed, particularly in this new area that has a lot of retail interest. A regime for this exists, however imperfect, in the Corporations Act. There will be complexities given the complexity of many crypto assets, but if retail investors are able to access such products it is a benefit for them to be able to access appropriate advice under the existing regime.

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?
16. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

AFMA strongly supports bringing the great majority of crypto-assets into the financial product regulatory regime. This should be the default setting where they represent a means of payment or a financial investment, or, as in the case of NFTs, could be made to have this effect.

For governance or utility coins, where the underlying characteristics and attributes do not and cannot be manipulated to represent a means of payment or investment alternatives to inclusion in the financial products regime could be appropriate.

Given that the same or higher risks exist for crypto-assets as for financial products the alternative approach proposed of a potentially enforceable code of conduct would create a significant gap to the financial product regime. It would create regulatory arbitrage incentives to recreate products with a crypto implementation, and effectively discourage the use of the financial product framework. While we would agree that the financial products regulatory framework is in urgent need of simplification and streamlining we do not believe that creating a parallel weaker regime for products that produce similar outcomes that is very light touch is an appropriate response.

- |     |  |
|-----|--|
| 17. | Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia? |
| 18. | If you are a CASSPr, what do you estimate the cost and benefits of implementing this proposal would be? Please quantify monetary amounts where possible to aid the regulatory impact assessment process.   |

No. AFMA does not support this approach for the reasons outlined above.

- |     |   |
|-----|---|
| 19. | Are there any proposed obligations that are not appropriate in relation to the custody of crypto-assets?  |
| 20. | Are there any additional obligations that need to be imposed in relation to the custody of crypto-assets that are not identified above?                                       |
| 21. | There are no specific domestic location requirements for custodians. Do you think this is something that needs to be mandated? If so, what would this requirement consist of? |
| 22. | Are the principles detailed above sufficient to appropriately safekeep client crypto-assets?  |
| 23. | Should further standards be prescribed? If so, please provide details   |
| 24. | If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?   |

AFMA does not agree that the underdeveloped principles-based obligations proposed are sufficient and appropriate for crypto-asset custodians. In comparison to the requirements on financial product custodians these obligations are unlikely to offer anywhere near the same level of protection of assets for investors.

The existing requirements for financial products are comprehensive and consistent with international standards (noting closer alignment is supported by AFMA) and as such they

offer a ready-made timely way to implement an appropriate custody scheme for crypto-assets.

Consistent with our earlier comments we suggest that in line with the Council of Financial Regulators' support for consistent information security standards for the same risks across the financial system that the existing regulatory regime be used for crypto-assets.

- |     |   |
|-----|---|
| 25. | Is an industry self-regulatory model appropriate for custodians of crypto-assets in Australia?                |
| 26. | Are there clear examples that demonstrate the appropriateness, or lack thereof, a self-regulatory regime?     |
| 27. | Is there a failure with the current self-regulatory model being used by industry, and could this be improved? |
| 28. | If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?                       |

AFMA does not support the creation of an industry self-regulatory model that is inconsistent with the model used for financial products.

Investors will expect consistent treatment of similar products and a failure in crypto-asset custodian could be conflated in investors' minds with a failure in the financial product custodian regime. This could undermine investor confidence in the Australian regulatory and financial system.

- |     |   |
|-----|---|
| 29. | Do you have any views on how the non-exhaustive list of crypto-asset categories described ought to be classified as (1) crypto-assets, (2) financial products or (3) other product services or asset type? Please provide your reasons. |
| 30. | Are there any other descriptions of crypto-assets that we should consider as part of the classification exercise? Please provide descriptions and examples.   |
| 31. | Are there other examples of crypto-asset that are financial products?   |
| 32. | Are there any crypto-assets that ought to be banned in Australia? If so which ones?   |

AFMA supports the general principle that the financial products framework should apply noting that even NFTs which are nominally associated with art (although they provide no ownership or copyright transfer), have been raised as an AML/CTF risk by the US Treasury.

Similar risks of AML/CTF and fraud exist for almost any crypto-asset.

While it may be possible to carve out certain types of assets for lighter touch regulation, as the paper notes the reprogrammability of crypto-assets makes this a risky approach as any carve out could drive those with disreputable intentions to the crypto-asset type with a carve out.

ASIC has an existing product intervention power which could be applied to particular crypto-assets if necessary and justified where they are regulated within Chapter 7.