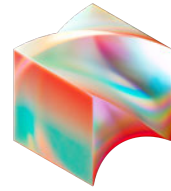


By Email: crypto@treasury.gov.au

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BLOCK

Treasury Consultation on Crypto asset secondary service providers: Licensing and custody requirements

Dear Director,

We welcome the opportunity to provide a submission to Treasury's Consultation on Crypto asset secondary service providers ("CASSPrs"). We look forward to working with Treasury and wider Industry to develop a regulatory framework that protects consumers, provides certainty and fosters innovation. Australia is widely respected for its strong financial services regulatory regime and a well considered regime for crypto assets will position Australia as a leader and innovator.

We also recognise the progress that has been made within Australia on crypto asset regulation, including this consultation and the work of the Select Committee on Australia as a Technology and Financial Centre. However, as noted within the Consultation Paper, a number of regulatory gaps exist. Any regulation must be fit-for-purpose; made with a view of its impact on the wider crypto industry, as well the wider financial system; and adopt a coherent and holistic framework.

We have endeavoured to give our best responses to the below questions in the context of the Consultation Paper's focus on secondary service providers. However, it would be useful to understand whether Treasury intends to run additional consultations on primary issuers (including of stablecoins), crypto 'deposit-takers', payment services providers and providers of financial advice, and decentralised finance ("DeFi") providers in the future. Many of the below questions, particularly those on policy objectives, should be considered with a view to regulation of the entire crypto asset ecosystem.

About Block

Block, Inc ("Block") (formerly Square, Inc) is a financial services company that was founded in 2009 to expand economic access for individuals and businesses underserved by the existing financial system. Since that time, we have provided tools to millions of entrepreneurs and individuals that have helped them run their small businesses, manage their finances, and grow in the economy. In January 2022, Block

acquired Afterpay and is listed on both the NYSE and ASX. Block does not currently offer crypto-related products in Australia (as it does in other jurisdictions through the ability to buy, sell and transfer bitcoin on Cash App), but we are continuing to invest globally in the health of bitcoin's ecosystem from a product, leadership, innovation, and legal perspective.

We believe crypto assets, specifically bitcoin, are an instrument of economic empowerment, providing a way for anyone to participate in a global monetary system. Of all the cryptocurrencies, we believe bitcoin is best placed to serve this goal because it is global, truly decentralised, deflationary and secure. Across our ecosystem we are investing in technologies that lower the barriers to entry, reduce the cost and improve the utility of bitcoin. In line with this belief, Block has launched TBD to build an open source platform that enables developers to build products and services on decentralised technologies. Block is also a founding member of the Cryptocurrency Open Patent Alliance, a non-profit that encourages the adoption and advancement of cryptocurrency technologies and the removal of patents as threats to growth and innovation. Cash App (developed by Block) allows customers to buy, sell and transfer bitcoin, similar to how they manage their fiat money. In 2022, Cash App integrated the Lightning Network, enabling users in the US to send bitcoin to any compatible Lightning wallet, anywhere in the world – instantly and for free.

Background

Crypto assets, like bitcoin, offer a global, decentralised, secure and open ecosystem that can help lower the barriers, costs and complexity of access to financial markets and provide significant benefits to small business customers and consumers.

The popularity of crypto assets has seen significant growth in recent years. In a survey conducted by Block, 94% of Australians said they were familiar with at least one cryptocurrency.¹ Interest in purchasing crypto assets is also growing with 32% of Australians likely to purchase bitcoin in the next 12 months.² Australians expect crypto to have a significant impact on the payment system in the future with 65% of respondents believing businesses will accept bitcoin for everyday transactions by 2025.³ However, some Australians have voiced concerns about crypto assets, with 30% of respondents saying they had chosen not to buy bitcoin because of its uncertain regulatory outlook.⁴

¹ Block Wakefield Bitcoin Survey (2022)

² Block Wakefield Bitcoin Survey (2022)

³ Block Wakefield Bitcoin Survey (2022)

⁴ Block Wakefield Bitcoin Survey (2022)

The adoption of an effective regulatory regime that provides both confidence and protection for consumers, as well as clarity and space to innovate for businesses, will allow Australia to leverage global demand and become a leader in blockchain technology.

Responses to Consultation Paper's Questions

1. Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'?

Business models and industry structure in the crypto assets industry are evolving rapidly. We would like to see an alternate definition proposed that has regard to the many different types of players in the crypto services ecosystem. The proposed CASSPr definition and the distinctions implied between types of providers in the crypto asset ecosystem appear based on a particular view of how certain services are currently provided, rather than an agnostic consideration of the different functions within the crypto asset industry. Terminology should flow from the regime's policy and regulatory objectives by being technology neutral and outcomes-focused.

2. Are there alternative terms which would better capture the functions and entities outlined above?

The objective of using the CASSPr definition appears to be the differentiation of primary issuance and secondary crypto activities (excluding DeFi activities). However, the inclusion of the term 'secondary service provider' might be understood to mean a non-consumer facing function, which is potentially misleading given the proposals clearly cover consumer-facing exchanges and services. It's also unclear whether the term CASSPr is intended to be limited to centralised exchanges or extended to cover other crypto services such as wallet services and non-consumer facing services. Consideration could be given to broadening the definition similar to the EU's Markets in Crypto-assets Regulation "MiCA", which uses Crypto-Asset Service Provider ("CASP"). Ultimately, terminology should flow from clearly defined policy objectives and prioritise outcomes-focused and principles-based governance over to-the-letter interpretation.

3. Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments.

Yes, although going forward the appropriateness of the definition will be dependent on the makeup of the regulation itself.

4. Do you agree with the proposal that one definition for crypto assets be developed to apply across all Australian regulatory frameworks?

Yes.

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)?

Yes. Any regulations that apply to CASSPrs should apply across the entirety of the wider crypto asset class. However, regulation must be outcomes-focused and apply based on the way a product is used or offered by CASSPrs (and the risks that poses), not the way the product was designed to be used by issuers (unless those two purposes are the same). For example, an entity providing a consumer access to a one-time NFT purchase (where the consumer stores that NFT in their own wallet) that cannot be used for speculative trading or earning a return should be treated differently to a CASSPr that operates an exchange or provides trading and funding services for that same NFT.

6. Do you see these policy objectives as appropriate?

We agree that it is appropriate to focus on minimising risk to consumers, having an appropriate AML/CTF regime and providing regulator certainty. However, protecting and incentivising innovation must also be a priority of any crypto asset focused regulatory regime. Crypto assets and associated blockchain technologies offer an opportunity for Australia to benefit from significant economic and social rewards through the support of this nascent but fast-scaling industry. Fit-for-purpose regulation that fosters innovation will see Australia take a leading position on the world stage as a destination for crypto-related investment and technological advancement.

7. Are there policy objectives that should be expanded on, or others that should be included?

Recognising regulatory objectives

The Consultation Paper outlined the Government's regulatory objectives as:⁵

- ensuring that regulation is fit for purpose, technology neutral and risk-focussed;

⁵ <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>

- creating a predictable, light touch, consistent and simple legal framework;
- avoiding undue restrictions;
- recognising the unique nature of crypto assets; and
- harnessing the power of the private sector.

These regulatory objectives should be recognised as policy objectives for the creation of a regulatory framework that provides confidence, protection and clarity for businesses and consumers.

Development of Australia as a global financial hub

As mentioned in our response to Question 6, fostering innovation and technological advancement must be an objective of a crypto asset regulatory regime. Australia should be aiming to turn any regulatory regime into a competitive advantage, attracting global talent and investment in an innovative and responsible environment.

Additionally, regulation must be technologically neutral. For example, regulation should not preference one type of blockchain technology over another. Strength of product and technological innovation should be the main market consideration that determines the overall success of any crypto-based technology, not regulation.

Jurisdictions across the globe are competing to capture the jobs and economic activity now being generated by crypto assets. For Australia to remain competitive its Government must embed this objective as part of any regulatory regime. As an example, Singapore's central bank and key financial regulator, The Monetary Authority of Singapore ("MAS"), has the explicit mission 'to develop Singapore as an international financial centre'.⁶ This objective has helped drive focus of the organisation's approach to promoting innovation and Singapore's advancement as a global financial hub. MAS's initial efforts created significant goodwill, attention and investment internationally. In taking lessons from Singapore, Australia must commit to implementing clear, consistent and reasonable regulation to position itself as a hub for crypto asset investment and innovation.

Alignment with payments ecosystem

Crypto assets have historically been associated with a means of storing value. However, they may increasingly be used to conduct everyday payments. New

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<https://cacj-ajp.org/singapore/legal-system/introduction/administrative-and-regulatory-bodies/monetary-authority-of-singapore/#:~:text=The%20Monetary%20Authority%20of%20Singapore,sound%20and%20progressive%20financial%20centre.>

innovations such as the Bitcoin Lightning Network allow for seamless real-time retail transactions at low-cost and negligible counterparty risk.⁷ This is not just limited to crypto-to-crypto transactions, but also transactions between crypto and traditional fiat currencies, both locally and internationally.

It is critical that any crypto assets regulatory regime is consistent and interoperable with Australia's broader payments ecosystem. An increasing proportion of Australian consumers and businesses will choose to pay and receive payments in crypto assets. They should receive similar protections and benefits associated with the existing payments regulatory framework. In the UK, the finance ministry, HM Treasury - recognising that crypto assets have the capacity to become a common means of payment - has undertaken to bring specific crypto asset services within the electronic money and payment services regulatory regimes, where they are used for those purposes.⁸ This approach is worthy of further exploration in an Australian context.

Promisingly, now is the ideal time to ensure that crypto assets can best be incorporated into the payments regulatory architecture. Treasury is in the process of consulting on the broader payments reforms following the release of the Transforming Australian Payments System Paper in 2021.⁹ It is critical that crypto asset policy is embedded in and consistent with any proposed reforms to the payments ecosystem. This could be achieved by undertaking a financial services White Paper process that incorporates both work undertaken on the traditional payments network, consumer lending and crypto assets more broadly.

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

Yes, subject to separately clarifying the regulatory framework for crypto asset issuers, crypto deposit-takers, providers of payment services and other entities involved in providing crypto assets services to consumers that are not covered in the scope of this proposal.

Additionally, we note that although the paper has excluded primary issuers and decentralised finance platforms and protocols from its scope, it would be helpful to clarify explicitly why they are not in scope. This would provide additional clarity in defining the purposes of this regulatory effort.

⁷ <https://lightning.network/>

⁸

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/106616/6/O-S_Stablecoins_consultation_response.pdf

⁹ https://treasury.gov.au/sites/default/files/2021-12/p2021-231824_1.pdf

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?

Yes, the requirement should be specific to activities relating to subsets of crypto assets. Regulation of CASSPrs should be fit-for-purpose and outcomes-focused. The key test of whether regulation applies should be based on what services CASSPrs are offering and the risks these services can pose, regardless of what crypto asset is included in that service. This approach is most appropriate as it can adapt to the multi-faceted nature of crypto assets (and the range of services CASSPrs can provide relating to those assets) and future-proof the regulation against any emergent and novel services.

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)?

A key outcome of the Select Committee on Australia as a Technology and Financial Centre's Inquiry was the recognition of a need for certainty and clarity in relation to crypto assets.¹⁰ The Consultation Paper highlights this, stating '*Industry has reported difficulty in determining whether the financial products and services regime or the consumer law regime applies to their products.*'¹¹

Resolving the uncertainty around 'what makes something a financial product' in the context of crypto assets is a prerequisite to the establishment of an effective crypto asset licensing regime. Without having clarity on this topic, any proposed regime is undermined as service providers are unable to determine which regulations apply to them - and in the case of a new CASSPr licensing regime, are potentially subject to multiple licensing regimes.

Additionally, this issue needs to be considered not just in the context of crypto-only service providers who are faced with a novel regime, but how any new regulatory regime would impact traditional financial service providers who also offer crypto asset services.

11. Are the proposed obligations appropriate? Are there any others that ought to apply?

¹⁰

https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Financial_Technology_and_Regulatory_Technology/AusTechFinCentre/Final_report

¹¹ <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>

The general nature of the proposed obligations are largely appropriate. However, the details of the requirements should not be specified in legislation but should be left to the regulator to determine based on industry consultation. This will allow appropriate requirements to evolve with industry developments.

In the case of markets and exchanges for crypto assets, consideration should be given to the relevance of requirements applied to traditional markets, such as price transparency and reporting, fair execution, prohibitions on front-running or selling customer order data, and self-dealing. Inadequate controls in these areas have contributed to lack of customer trust in recent cases.

The licensing regime should take into account that some crypto asset providers may also be AFSL holders with respect to financial products provided to consumers, in some cases via the same platform. It would be inefficient for providers and confusing for consumers to establish two parallel compliance and licensing regimes. We would recommend that AFSL holders be able to offer crypto asset services under their existing AFSL (subject to an appropriate additional authority being granted).

12. Should there be a ban on CASSPrs airdropping crypto assets through the services they provide?

We have no objection to CASSPrs airdropping crypto assets, provided that this kind of activity is properly covered by appropriate consumer protection regulations. Consideration could be given to whether consumers should be required to opt in to receive airdrops.

It would also be useful to clearly define an Airdrop. The wider crypto community uses this term to describe the delivery of both expected (e.g. in return for undertaking a small service like sharing a social media post; winning a prize draw; or using a specific application) and unexpected crypto assets delivered into wallets.

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)?

Rules relating to crypto assets that are determined to be financial products should remain consistent with the longstanding personal financial advice regime. In addition, the regulatory framework should also allow licensed financial advisors to

provide advice on investments in crypto assets. For crypto assets that are non-financial products, but are being marketed as an investment, consideration should be given to whether any restrictions around general and personal advice are appropriate.

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

N/A

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?

Although bringing all crypto assets into the financial product regulatory regime would set useful standards across the industry, there are crypto products (and services associated with crypto products) that clearly do not operate - and are not intended to operate - as financial products. A blanket approach that involves bringing all crypto assets into the financial product regulatory regime would unnecessarily burden non-financial product businesses and risk stifling innovation within the industry.

What is more appropriate, as discussed in our response to Question 10, is to provide guidelines to stakeholders within the crypto asset ecosystem as to 'what makes something a financial product'. This would provide the clarity required for services providers to discern whether or not they fall within the existing financial services regime. Subsequent to that exercise, a new regulatory regime could provide requirements and obligations for crypto service providers not covered by the existing financial services regulations, or introduce specific provisions that aim to regulate the risk and challenges specifically posed by crypto assets.

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

N/A

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?

N/A

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.

N/A

19. Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets?

Further research and consultation is needed to develop appropriate requirements for crypto asset custody providers and other service providers that hold customer assets, that are applicable across business models and technologies. Merely adopting the same model as is used for securities or other financial assets may not be appropriate.

In particular, the concept of 'custody' in the context of crypto assets is evolving and the subject of significant legal uncertainty. The status of customer assets held by a crypto dealer or exchange in bankruptcy has not been tested in Australia, and legislation to clarify this issue should be considered. Further, some service providers may also allow rehypothecation or pledging of customer assets. In such cases, it should be clear to the customer how their assets are being safeguarded, and that appropriate risk controls are in place.

20. Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above?

Self custody (in both hosted and unhosted crypto wallets) is a key feature of the crypto asset ecosystem with unhosted wallets often considered the safest way for consumers to safeguard assets. Any regulation must remain technology-neutral and account for the nuances in different custody and self-custody options available to consumers and businesses, as well as the exclusions that may be necessary to continue to allow consumers to safeguard their own assets.

Consideration could be given to requirements around multi-signature security and authentication controls, which enhance security and minimise the risk of single points of failure.

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?

No, we do not believe domestic location requirements need to be mandated for custody purposes. Use of specialised offshore third-party custodians is a common practice and consideration should be given to how the requirements and obligations of any regime will interact with international third-party custody arrangements.

22. Are the principles detailed above sufficient to appropriately safekeep client crypto assets?

See response to Question 19.

23. Should further standards be prescribed? If so, please provide details

See response to Question 19.

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

N/A

25. Is an industry self-regulatory model appropriate for custodians of crypto assets in Australia?

Self-regulatory models can play a useful role in helping to lift industry standards and promote consumer confidence. The appropriateness and success of any self-regulatory model does, however, depend on a range of factors, including:

- Having an industry that is not too diverse: too much diversity (of business models, of products and services) can make it very difficult to achieve agreement on the specific self-regulatory standards that should be put in place;
- Having an industry that provides products or services that do not create the risk of substantial consumer detriment (because of how the products and services are designed); and
- Having an industry that provides products or services that are well-understood by consumers.

In the case of the Buy Now Pay Later (BNPL) industry, a successful self-regulatory model has been established. In response to recommendation 9 of the 2019 Senate inquiry into credit and hardship, BNPL businesses developed a BNPL Code of Practice after extensive consultation with consumer advocates, regulators and industry members. This BNPL Code is now administered by the Australian Finance

and Industry Association.¹² The BNPL Code is also supported by broader financial services regulations applied to Buy Now Pay Later services including ASIC's Design and Distribution Obligations and Product Intervention Powers.

The BNPL Code has strengthened consumer protections by requiring members to (among other things):

- provide hardship assistance for consumers which mirrors the standards required for traditional credit products; and
- prevent consumers from making additional BNPL purchases when they are behind on repayments – a feature that is not required of credit products under existing regulations.

Following the commencement of the BNPL Code on 1 March 2021, a subsequent Senate inquiry has endorsed the BNPL industry's efforts to develop a fit-for-purpose self-regulatory response.

Although the BNPL industry is one example of a successful self-regulatory model, the crypto asset industry may not lend itself to the same type of approach due to the inherent factors noted above.

26. Are there clear examples that demonstrate the appropriateness, or lack thereof, a self-regulatory regime?

See response to Question 25.

27. Is there a failure with the current self-regulatory model being used by industry, and could this be improved?

See response to Question 25.

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

N/A

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.

¹² <https://afia.asn.au/AFIA-Buy-Now-Pay-Later-Code-of-Practice>

There may be limited benefits to a rigid token mapping process. The financial services regulatory treatment should depend more on how the tokens are distributed to, accessed and used by consumers; that is, whether they are used and marketed as a means of investing, insurance, credit, payment, etc.

A token-mapping exercise must have regard for the multifaceted nature of crypto assets. One crypto asset can be used for multiple purposes depending on the service provider. For example, Axie Infinity Tokens (which are earned as rewards when playing the Axie Infinity video game) are available to be used as in-game currency used to purchase NFTs; can be staked for rewards; and afford holders a governance vote on the decisions of the Axie Infinity Community Treasury.¹³ Additionally, these tokens are traded on centralised and decentralised exchanges. As such, token mapping must have regard for the changing and evolving nature of the crypto assets and therefore avoid being too definitional. Rigid definitions will likely hinder evolution of the crypto asset ecosystem going forward, and potentially undermine the policy principles of a CASSPr licensing regime.

As part of the proposed token mapping consultation later this year, Industry will likely require guidelines as to what kinds of services might result in the associated crypto products being defined as financial products in the context of that service (having regard for the fact that crypto assets should be treated differently based on their actual use, rather than their original purpose).

30. Are there any other descriptions of crypto assets that we should consider as part of the classification exercise? Please provide descriptions and examples.

N/A

31. Are there other examples of crypto asset that are financial products?

As mentioned above, regulation must be outcomes-focused and have regard for the way in which crypto assets are used and offered by CASSPrs in determining their status as a financial product, rather than the intention of the issuer when issuing the asset.

32. Are there any crypto assets that ought to be banned in Australia? If so which ones?

N/A

¹³ <https://axieinfinity.com/>

Thank you for the opportunity to respond to the consultation on this important issue. Please do not hesitate to contact us if you require further input or clarification.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'D. Kassabgi', written in a cursive style.

Damian Kassabgi

Head of International Public Policy

Block, Inc

