Blockchain Australia

PROMOTING BLOCKCHAIN INNOVATION IN AUSTRALIA

Blockchain Australia – Submission to Senate Select Committee on Australia as a Finance and Technology Centre

23 July 2021

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1 Blockchain Australia

This submission is made by Blockchain Australia, in collaboration with its members and industry stakeholders.

Blockchain Australia is Australia's peak industry network for businesses implementing or evaluating blockchain or distributed ledger technology. Collectively, Blockchain Australia members and the industries they service advance the adoption of blockchain technology in Australia. The members and industry partners work together to advocate for appropriate regulatory and policy settings.

Blockchain Australia consulted widely across membership and non-membership segments, conducted one on one interviews, and hosted a Digital Currency Exchange Forum to elicit responses from the community.

The preparation of this submission, including case studies and policy recommendations, was supported by a Working Group of digital asset exchanges and brokers in Australia. The Working Group members are four exchange platforms: BTC Markets, Independent Reserve, Luno and Swyftx; and Caleb & Brown, a brokerage service. Together these five entities employ 219 staff directly in Australia, and have a combined average trading volume greater than $100 million per day.

In the preparation of this submission, Blockchain Australia was also assisted by Genesis Block, Australia's leading advisors on digital assets and regulation. We thank the team for their assistance and their advice.

2 Executive Summary

The challenge of regulatory reform in the cryptocurrency and digital asset sector is not our inability to navigate a path forward, it lies instead in our willingness to establish better pathways of coordination and collaboration.

Other countries have recognised the opportunity presented by these technologies and are working to ensure that government policies can support their growth. They have actively engaged with the sector and have implemented policy settings that encourage investment and innovation. We can take the benefit of the learnings of others in forging a uniquely Australian path through what is viewed internationally as a sound, mature regulatory framework.

These technologies have the ability to change how we think about many aspects of our lives, from banking to gaming through to art and even governance itself. A new economy, based around these digital assets, is beginning to emerge and policy makers have an opportunity to turn Australia into a global leader in this nascent sector.

But this is not a race to a "regulatory bottom". Indeed, the opposite applies. More progressive jurisdictions have realised that old policy settings and regulations are not fit-for-purpose. They were developed without these new technologies in mind, they are often not technology neutral in their outcomes, and they are often decades old.

The role of good regulation is to support business, encourage innovation and ensure that consumers are protected. Regulation should not be so burdensome that it becomes unwieldy and expensive to comply with. Well designed regulation should solve these problems with as little friction as possible. We should not attempt to fit these new square pegs into our existing regulatory round holes.

Blockchain Australia's overarching recommendation is to implement a coordinated and graduated approach to ensuring that a fit-for-purpose regulatory framework is developed that facilitates innovation and competition while enhancing consumer outcomes. We outline a series of recommendations on the path towards achieving this objective.

These recommendations should not be considered sequential, rather, they should be actioned in parallel. Linear approaches will produce suboptimal outcomes, as will a siloed approach.

The first step is to provide businesses operating in the current regulatory vacuum a safe harbour. This means providing assurance to existing businesses that no regulatory action will be taken where the law is unclear, and no retrospective action will be taken once new policies have been determined. A safe harbour will give businesses greater immediate certainty while the next policy challenges are tackled. A safe harbour will be a critical sign of support showing Australia is committed to giving the process necessary time and consideration while we support those who have started the process already.

We know that a long-term regulatory framework that is fit-for-purpose will take time, as policymakers seek to properly understand the issues and develop a considered solution. But this does not mean that there is no work that needs to be done in the short term. Regulators can provide greater guidance in areas such as custody, debanking, taxation and AML/CTF. They will benefit both industry and enhance consumer protections by doing so. We also recommend that regulators increase their resourcing and undertake greater engagement with the industry through the establishment of an regulator-industry working group.

While we have highlighted a number of areas that will require legislative changes, including token classification and licensing, this list is not exhaustive. Increased engagement, including through our recommended working group, will provide a good foundation to expand upon this work. The message this will send to the world is that we are open for business and welcome both talent and inbound investment.

This is Blockchain Australia's third submission to this Inquiry. In seeking to keep this submission focused on the question of how to enhance regulatory certainty for crypto-asset service providers while also protecting their clientele, we have chosen not to include commentary or analysis on many other related issues that could have been addressed here in detail - such as CBDCs, ETFs, stablecoins, and other fintech and technology issues. This decision reflects our view, that a phased and graduated approach to building out a holistic regulatory framework is the overarching priority for the industry at this time, particularly with the accompaniment of a safe harbour.

It is not too late for Australia to seize the unique opportunity presented to us, to become a global leader in blockchain innovation.

We thank the Committee for taking the time to consider our submission.

Steve Vallas
CEO, Blockchain Australia

3 Recommendations

Overarching Recommendation:

That Australia implement a coordinated and graduated approach to the regulation of crypto-assets. Focussed on providing greater certainty to consumers and businesses, while working to develop a fit-for-purpose framework. Facilitating an environment conducive to innovation and competition in crypto-assets. This involves:

a) implementing immediate safe harbour provisions;
b) greater regulatory guidance and engagement in the short-term; and
c) a long term, fit-for-purpose legislative framework.

The First Step: Ensuring a Safe Harbour

1. That the government and relevant regulators should provide crypto-asset providers a safe harbour until such a time that they introduce guidance or legislation. Any legislation should contain an appropriate transition period and not apply retrospectively.

Recommendations for Greater Guidance and Engagement

2. That a cross-industry and regulatory working group be established to facilitate greater communication between the crypto-asset industry and the regulators. The first exercise to be undertaken by the group should be a token mapping exercise, examining the work done in overseas jurisdictions.
3. Regulatory resourcing, in particular at ASIC, that is dedicated to crypto-assets should be increased to assist with the timely implementation of the recommendations made in this submission. This could be through a combination of increased government funding or changes to the ASIC levies.
4. ASIC update RG133 to explicitly state that licensed custody providers can provide crypto-asset custodial services.
5. That AUSTRAC accelerates engagement with the industry on the consideration, application and implementation of the travel rule and to ensure that there is a sufficient consultation and transition period.
6. That the banking and competition regulators, APRA, the RBA and the ACCC, follow the lead of the United States in ensuring that there is an appropriate, transparent and communicated risk-weighted approach to providing banking services to businesses and individuals in the crypto ecosystem.

7. That the ATO consider and issue practical tax guidance that is consistent with how end users interact with the crypto ecosystem while a more comprehensive review of the tax system (in line with recommendation 5 of the Digital Law Association) is undertaken.

Recommendations for Legislative Change

8. That a comprehensive token mapping exercise be undertaken, including examining the work done on token classification in overseas jurisdictions, as the first step in a broader, fit-for-purpose regulatory framework.
9. A new licensing regime, modelled off the AFSL framework, should be developed so that entities that wish to provide general or personal financial advice in relation to crypto-assets as part of their business model can be authorised. A safe harbour and transition period should be provided.
10. That a full review of the markets licence framework is conducted and amendments implemented to ensure that the licensing regime accounts for the unique nature of crypto-assets.

4 Introduction

Blockchain Australia commends the work that has been undertaken by the Senate Select Committee on Australia as a Technology and Financial Centre (the **Committee**) to date. We recognise the important focus of the Committee in the third issues paper of 18 March 2021 on the opportunities and risks for Australia in the digital asset and cryptocurrency sector.

This submission builds upon Blockchain Australia's previous submissions to the Committee in response to the second issues paper dated 30 December 2020 and 4 March 2021 respectively.

Blockchain Australia acknowledges the challenging nature of the reforms sought in this submission. Jurisdictions globally, many of which are referenced in this submission have committed to a path of consultative, resource heavy assessment and review of the sector. They have done so, only as a result of having formed a view that this sector warrants such initiatives.

This submission will focus on issues relating to the regulation of digital assets and cryptocurrencies (referred to collectively in this submission as crypto-assets) and crypto-asset service providers, issues relating to debanking of Australian fintechs, instances of corporate law which are holding back investment in crypto-assets in Australia.

The Committee recognised in the second interim report that regulatory uncertainty remains an issue that is inhibiting the widespread uptake of blockchain and distributed ledger technology. This submission reiterates Blockchain Australia's position that a clear regulatory framework is required. In particular:

- A co-ordinated and accelerated whole of government consultation agenda that includes, but is not limited to the suite of regulatory bodies impacted by the deployment of blockchain technologies.
- A clearer framework will enhance outcomes for both consumers and businesses, by setting standards for access and asset protection, and providing clarity to industry;
- The regulatory framework must be sufficiently flexible to allow Australian entrepreneurs to innovate in ways that are currently unknown, given the pace of technological development in blockchain; and
- The regulatory framework must be grounded in the reality of how businesses and consumers interact with blockchain technology.

A regulatory regime that enhances outcomes for consumers and for businesses

A fit for purpose regulatory regime must prioritise and enhance consumer protections.

Bad actors, nefarious activity, money laundering and terrorism finance concerns are well ventilated in the sector. As an industry we do not seek to shy away from this discussion. Rather, and contrary to the oft repeated unregulated "wild west" narrative, the blockchain and cryptocurrency industry is almost uniformly demanding greater regulatory framework clarity.

Blockchain Australia is, with the assistance of regulators, proactively seeking out information about the "scams" impacting the development of confidence in the industry.

Our understanding is that the vast majority of scams are not committed by or for the benefit of those who seek to grow the industry. Rather, the conflated and deliberate misuse of language by the perpetrators of scams preys on misunderstandings, a lack of knowledge and uncertainty.

Likewise, a clear regulatory framework within which business can operate will reduce regulatory uncertainty. This would allow businesses to develop innovative products and plan for the long term with the confidence that their products will not contravene laws that are yet to be introduced. It would allow for new business models to be developed which otherwise might not have been possible without a clear regulatory framework.

A clear regulatory framework brings symbiotic benefits to both consumers and businesses.

The antecedents for the establishment of jurisdictional leadership in the blockchain and cryptocurrency sector are well underway.

Globally there is a race to regulate crypto-assets as countries seek to attract new business, investment and talent. While overregulation, or regulation that is not fit-for-purpose, can introduce unnecessary friction and costs, regulatory uncertainty also results in significant costs from lost opportunities as well as high levels of expenditure on legal and compliance advice.

As an industry we recognise the balance of a reform agenda is and should be skewed to providing consumer protections whilst creating sufficient certainty to encourage innovation.

A regulatory regime that is principles-based and future-proof

A framework should be principles-based and not overly prescriptive or burdensome, to ensure that the framework remains appropriate as the technology evolves.

There is a material risk that the implementation and enforcement of regulation may appear to be technology-neutral on paper, but in practice, has the effect of discouraging the use of blockchain.

In our experience, the consideration of the cryptocurrency sector settings are not neutral.

As at the time of this submission the stated position of the Digital Transformation Agency on the subject of Blockchain remains as follows:

> *"...We recommend agencies who are considering technical solutions focus on addressing the needs of the users and exploring solutions to meet that need, rather than primarily on a particular technology..."*[1]

We posit that the characterisation in this context of blockchain and cryptocurrency as a narrowly defined technology solution has acted as an impediment to the consideration and development of the Government and regulator narrative.

Education is lacking, considered and consistent industry consultation has been largely absent notwithstanding recent efforts on the part of regulators to redress these shortcomings.

In order for the regulatory approach to be both principles-based and effective into the future, policy makers and regulators will need to liaise closely with industry to understand the technology, its developments and the activities and services growing around it.

This consultation must occur across departments, concurrently and with active industry engagement which Blockchain Australia is able to facilitate. The primary repositories of knowledge with respect to this technology reside in the developer and development communities incubating these technology initiatives.

A regulatory regime that is fit-for-purpose and supported by evidence

Blockchain Australia notes the desire of the Committee to understand the size and scope of the economic opportunity to Australian consumers and businesses from Australia growing into a stronger technology and finance centre.

A yawning gap exists in the collection of data that adequately captures the breadth and depth of the industry. This gap is evident across government and industry in Australia.

On 23 February 2021 ASIC invited parties to tender on:

> *"Australian and global crypto market landscape and data as relevant to ASIC's regulatory remit"*
>
> Including a request for information with respect to:

[1] *Blockchain*, Digital Transformation Agency (n.d.), https://www.dta.gov.au/help-and-advice/technology/blockchain.

"We need an Australian and global crypto market landscape that identifies and quantifies the information below as relevant to ASIC's regulatory remit. Where relevant please provide comparative analysis with similar financial products, services and markets:

1. The size, composition and any other metrics about the top ten crypto assets and the crypto market including a relevant comparison to similar financial products and markets e.g. equities, derivatives, FX;

2. Significant service providers and market participants including relevant metrics about the top ten service providers in each of the following categories: issuers of crypto assets, wallet and custody service providers, advisers or other intermediary service providers, miners and transaction processors, crypto exchanges and trading platforms, payment and merchant service providers, crypto credit, crypto repo market, crypto managed funds;

3. Relevant metrics for significant DeFi projects including the size, turnover, extent of consumer participation, the nature of participants, regional distribution of consumers, extent of decentralisation;

4. Rate of growth in adoption of crypto assets;

5. Profile of crypto investors including quantification of the number of investors in various crypto assets, average exposure, proportion of investors assets in crypto and other similar metrics;

6. Consumer loses (sic) to date (from scams or failed businesses) and any other quantifiable consumer harms from accessing crypto assets;

7. Two or three critical risks and threats that crypto assets and related services (including DeFi Projects) may pose to the Australian and/or global financial system, and how to monitor those;

8. Appetite from high net-worth, institutional and retail investors;

9. The companies that are adopting crypto assets as a store of value;

10. Current trends and future projections for crypto assets, the market and providers, including metrics for measurement; and

11. Opportunities available in the crypto asset market in Australia.

Blockchain Australia was invited by ASIC to meet with the successful tenderer on the aforementioned works. We look forward to working with ASIC and the tenderer to ensure that the works are a qualitative and quantitative representation of the cryptocurrency landscape.

We are currently undertaking further research to measure the size and scale of the existing ecosystem and future opportunities and would be pleased to provide a supplementary submission with this information.

5 Comparison of International Jurisdictions

A global opportunity in plain sight.

The assessments of the international regulatory landscape that follow reflect a more active commitment to establish fertile ground for innovation and investment within jurisdictions that face similar challenges in the development of their regulatory landscapes.

The national approaches, summarised below, are a clear reflection that nations view the development of crypto-asset ecosystems as sovereign opportunities.

5.1 Singapore

- ➢ Singapore has enjoyed an early-mover advantage by introducing a regulatory framework designed for crypto-assets under the Payments Services Act.
- ➢ Existing businesses were provided with a 6 or 12 month transition period to apply for a licence, depending on the nature of the business. Many businesses are still waiting on their approved licence.

Overview

Singapore's financial regulatory body, the Monetary Authority of Singapore (**MAS**), has actively taken steps to regulate crypto-asset businesses. It has taken steps to support and facilitate crypto-assets in Singapore through a flexible regulatory posture including through supporting consumer and industry confidence through establishing a licensing regime. However, Singapore's regime has not been without problems, primarily as a result of its strict implementation of that FATF travel rule.

Regulatory framework

The Payments Services Act (**PSA**) was introduced in January 2020 and not only regulates cryptocurrency payments and exchanges but also traditional payments services. Described by the MAS as a "forward looking and flexible framework", it consolidated and updated multiple pieces of legislation which were drafted in an era before FinTech and were no longer fit-for-purpose.

The PSA provides a framework to obtain a licence to operate a payment services business in Singapore. It defines a "payment service" as:

a) an account issuance service;
b) a domestic money transfer service;
c) a cross-border money transfer service;
d) a merchant acquisition service;

e) a e-money issuance service;
f) a digital payment token service; or
g) a money changing service;

The PSA defines a Digital Payment Token (**DPT**) as a digital representation of value that is expressed as a unit, not denominated in any currency and is not pegged by its issuer to any currency; is or is intended to be a medium of exchange accepted by the public as payment, and can be transferred, stored or traded electronically.

Under this definition, cryptocurrencies including Bitcoin, Ether, Litecoin and Ripple would be considered as a DPT. In a separate consultation, MAS has sought views on whether or not the definition of e-money and DPTs remains appropriate in the view of stablecoins.[2] This is because some stablecoins may be backed by a basket of underlying assets such as cash or government bonds rather than directly pegged.

Crypto-asset businesses are now required to perform an assessment in relation to their tokens to determine if the token constitutes a capital market product, in which case the Securities and Futures Act applies, or if they constitute a DPT under the PSA. With the commencement of the PSA, exchanges will be required to have a payments licence if they provide a digital payment token service.This includes facilitating the exchange of digital payment tokens. Therefore if a DCE processes either fiat currency or a currency that satisfies the definition of a DPT it must now be licensed.

The PSA also contains requirements on the safeguarding of money, however, these measures do not apply to DPT service providers. Given the nature of the industry, these measures may not always be appropriate.

The Singapore Experience

When the PSA regime was announced by MAS, it was welcomed by those in the community, including many Australian based exchanges. Singapore has attracted a number of global players either setting up offices or moving their headquarters.[3] This is partially attributed to the regulatory environment in Singapore.

However, there have been challenges with the implementation of licensing requirements to ensure compliance with the FATF travel rule. At the time of implementation, there was a lack

[2] *Consultation on the Payment Services Act 2019 - Scope of E-money and Digital Payment Tokens, Monetary Authority of Singapore* (Dec. 23, 2019), https://www.mas.gov.sg/publications/consultations/2019/consultation-on-the-payment-services-act-2019---scope-of-e-money-and-digital-payment-tokens.

[3] *Crypto groups shelter in Singapore as global regulators crack down*, Mercedes Ruehl (Jul. 8, 2021), https://www.ft.com/content/f74d4e60-93b5-46ef-8b3f-71754cbc8a26.

of commercial solutions to comply with the travel rule and it is still difficult for an exchange to comply at a scale in a commercially viable manner.

Recognising the likely lengthy application process, the MAS offered an exemption to applicants who applied before a cutoff date. This allowed applicants to continue to operate in Singapore under an exemption while waiting for their licence to be granted or rejected. However, the transitional period proved to be too short, relative to the ability of MAS to implement the regime.

AML

MAS also issued guidance on Anti-Money Laundering/Counter-Terrorism Financing (**AML/CTF**) guidelines for DPT service providers to require the implementation of robust controls to detect money laundering and terrorism financing. DPT service providers have to implement measures as part of their internal AML/CTF policies such as:

a) customer due diligence by verifying identities and businesses;
b) monitoring customer transactions for signs of money laundering and terrorism financing;
c) screening of customers against relevant international sanctions listed by the United Nations; and
d) maintaining detailed records of customers activities and put in place a process to report suspicious transactions to MAS.

These requirements are aligned with the Financial Action Task Force (**FATF**) guidance for virtual assets and virtual asset service providers (**VASPs**). Among these guidelines is the "travel rule". This information would cover the sender and recipient's name, geographical address and account details. In Singapore, the travel rule extends to all transactions with additional information being required for transfer over SGD1500. Singapore's clearly defined application of the FATF guidelines are a contrast to the more ambiguous language of the EU (see below).

Derivatives

Following the introduction of the PSA, MAS further clarified its approach to derivative contracts on payment tokens. As of 18 May 2020, MAS now regulates derivative contracts that are traded on approved exchanges that reference payment tokens as their underlying asset. Non-approved exchanges (including DPT service providers) would not be regulated at this stage. MAS noted that regulation of derivative products would imply confidence in a highly volatile product and lead to a wider offering to retail investors. MAS' approach introduced new measures aimed at discouraging retail investors from trading payment token derivatives including tailored risk warnings and restrictions on advertising.

This means that exchanges that offer crypto derivatives will not be regulated for those crypto derivative products even if they are licensed under the PSA. Furthermore, overseas exchanges that offered crypto derivatives to Singapore residents would also be unregulated.

5.2 European Union

- ➢ The European Union (**EU**) is currently in the process of implementing a cohesive and Union-wide regulatory framework.
- ➢ It's key features will include an extensive list of crypto-asset product categories (28 asset types), a broader definition of a crypto-asset service provider, and a whitepaper obligation for token issuers.
- ➢ This new framework will be introduced with a transitional period of 18 months.

Overview

The EU is proposing a new regulatory framework (called Markets in Crypto-assets or MiCA) to harmonise its approach to crypto-assets across the Union. Prior to this, the primary focus of EU regulation has been on ensuring compliance with AML directives as well as providing guidance on whether some crypto-assets are considered securities or financial instruments. As a result, many member states developed their own regulations. MiCA is designed to ensure that there is a consistent approach.

Securities

At an EU level, crypto-assets may be regulated as financial instruments under the Markets in Financial Instruments Directive 2 (**MiFID II**) if certain criteria are met. This provides an EU framework and harmonised regulation for investment services of the member states of the European Economic Area. It provides a legal framework for securities markets, investment intermediaries, and trading venues. The European Securities and Markets Authority (**ESMA**), released advice in January 2019 to determine if crypto-assets fell under the relevant obligations of MiFID II. However, MiFID II was designed and implemented in 2008, prior to the emergence of crypto-assets and therefore the guidance is constrained by the requirements of the existing framework.

The ESMA advice considers whether a crypto-asset will be a financial instrument be it a transferable security, a collective investment undertaking or a derivative contract.

Three criteria must be met for a crypto-asset to be a transferable security:

1. The crypto-asset must belong to a class of securities
2. The crypto-asset must not be a payment instrument
3. The class of securities must be capable of being negotiated on the capital markets.

It is the third criteria that is often unclear as the use of the term "capable of being traded" can be interpreted broadly to mean technically feasible even if there is no market for it. Likewise, "capital markets" is a broad term and could possibly include online exchanges.

A collective investment undertaking is where capital is pooled together for the purpose of generating a return for the collective group where the investors have no control over the undertaking. A token that allows investors to contribute towards a venture which generates a return that is paid back to token holders could be considered a unit in a collective investment undertaking.

Once a determination is made that a crypto-asset is a financial instrument, any entity that provides an investment service or activity must be authorised. ESMA views that any platforms that trade crypto-assets that are financial instruments are likely to require authorisation and comply with the MiFID II requirements including capital, corporate governance, transparency and reporting.

Derivatives

A crypto-asset derivative is considered a financial instrument if the relevant underlying crypto-asset falls within one of the categories outlined in MiFID II, including securities, currencies, commodities or an index. A derivative with an underlying security-token would be considered a financial instrument.

AML

The Fifth Anti-Money Laundering Directive (**5AMLD**) came into effect in January 2020 and is mostly aligned with the FATF guidelines on AML/CTF though is not as comprehensive. It requires, among other things, that custodian wallet providers and crypto-to-fiat exchanges keep a record of customer activity and conduct KYC and AML checks. However, crypto-to-crypto exchanges are exempt from 5AMLD compliance. The 5AMLD requires that records are kept and that data is provided to financial regulators upon request.

Proposed regulatory framework

While not yet legislated, the European Commission (**EC**) has proposed a new legislative framework for crypto-assets called the Markets in Crypto-assets (**MiCA**). MiCA was developed as part of the EC's Digital Finance package which sought to ensure that the EU remained competitive in the financial sector but also balanced financial stability and consumer protection.

The MiCA proposal is designed to regulate currently out of scope crypto-assets and their service providers in the EU and to provide a single licensing regime across all member states by 2024. It proposes a legal framework for assets, markets and service providers that are not

currently regulated on an EU level. It will also affect any firm seeking to do business in the EU even if the business is based outside of the EU.

MiCA proposes to introduce 28 new crypto-asset related definitions. Some of the key definitions are:

- crypto-asset: a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology.
- asset-referenced token: a type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such assets.
- utility token: type of crypto-asset which is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token
- electronic money token (e-money token): a type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender.
- crypto-asset service provider: any person whose occupation or business is the provision of one or more crypto-asset services to third parties on a professional basis.

MiCA defines a crypto-asset service as any of the services and activities listed below relating to any crypto-asset:

a) the custody and administration of crypto-assets on behalf of third parties;
b) the operation of a trading platform for crypto-assets;
c) the exchange of crypto-assets for fiat currency that is legal tender;
d) the exchange of crypto-assets for other crypto-assets;
e) the execution of orders for crypto-assets on behalf of third parties;
f) placing of crypto-assets;
g) the reception and transmission of orders for crypto-assets on behalf of third parties;
h) providing advice on crypto-assets.

Furthermore, MiCA provides a definition for crypto-asset service provider (CASP) which is broader than the definition of virtual asset service provider (VASP) that is used by FATF. This is to ensure that the definition captures most crypto companies as well to ensure that it will capture markets that may not exist yet.

Issuers of crypto-assets captured by MiCA will be required to publish a whitepaper which must contain the core information on the characteristics, rights and obligations, and underlying technology and project. This must be shared with authorities 20 days before publication, although it is not subject to approval. Once the whitepaper has been published, it may be then marketed throughout the European Economic Area. In some circumstances, a whitepaper does not need to be published, for example where the issuance is for a small amount or is targeted at specific investors.

MiCA has an extensive focus on "stablecoins" in line with the recent FCA consultation however takes a differing approach. While the EC recognises that the current market for stablecoins is modest, it recognises the regulatory challenges that stablecoins such as Diem (formerly Libra) could pose. Under MiCA, stablecoins would be considered either an asset-referenced token or an e-money token, depending on their underlying assets.

Finally, MiCA will also provide a mechanism for crypto-asset service providers to be authorised which will then be valid across the European Union (known as passporting). This means that any CASP will only need to seek authorisation under MiCA through the relevant authority of the member state where they have their registered office and this will provide them the authority to operate across the EU. CASPs will also be subject to various additional requirements depending on their size and the associated risk. These additional requirements may relate to various requirements including prudential requirements, governance, staff training, and insurance.

Under the proposed framework, regulators would be required to provide a decision on each completed application with 3 months of receipt of the application. The resources for this would be on a user-pays basis with a levy imposed on the sector.

It is intended that these regulations will also apply to non-EU CASPs seeking to market to EU clients. This framework will not only affect entities registered within the EU but will have global implications for all businesses that seek to do business with the EU. MiCA proposes additional requirements for non-EU CASPs including the need for a legal entity in an EU country and a licence. Depending on the activity that is being undertaken, additional licensing may also be needed.

Transitional arrangements

MiCA's safe harbour provisions provide an 18 month transitional period for the industry.

Article 123 of the MiCA proposal introduces protection for crypto-asset providers who are already engaged in crypto-assets on the date the proposal is passed into law. This protection will extend for eighteen months from the passing of the law or until the entity is licensed under MiCA or a corollary member-state's licensing regime. Entities who are part of this transitional period are also able to apply for a simplified procedure for authorisation, between the date that the law passes and eighteen months from that same date.

The streamlined applications available for grandfathered entities are an example of proper safe harbour provisions. That is, not only are existing entities protected from immediate enforcement of newly proposed laws, but so too are these entities prioritised and further

protected in the application process.[4] Member states are required to import MiCA into their own local legislative regimes by at most twelve months from the passing of the proposal into law.

State-level regulatory regimes

With respect to pre-MiCA regulatory approaches, we observe that some countries within Europe have been particularly successful in attracting entrepreneurs and investors, including attracting Australian talent. This includes smaller states like Malta but also extends to larger economies such as Germany. The following sections of the submission go into further detail on two particularly relevant case studies - Germany and Switzerland.

5.3 Germany

- ➢ Germany's strengths are its clear custody regulations, its licensing regime, and favourable tax treatment - gains on crypto-assets that are held long-term are completely exempt from taxes.
- ➢ A number of high-growth Australian start-ups have relocated to Berlin following the legislative reforms and regulatory guidance issued by German regulators.

Licensing

The most relevant legislation implemented to cover crypto-assets, the Act on the Implementation of the Amendment Directive to the Fourth EU Money Laundering Directive (Gesetz zur Umsetzung der Änderungsrichtlinie zur Vierten EU-Geldwäscherichtlinie, "the Act") alters the existing licensing requirements under the German Banking Act ("KWG").[5] As such, the Act defines a new category of financial instruments and introduces a new licensing requirement for custody services. The Act was introduced on 1 January 2020.

Crypto-assets and intermediaries are regulated and licensed under the Act, the KWG, and related legislation, and must register with the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, "BaFin") for licensure.[6] The legislation brings digital assets in line with the treatment of other financial instruments first by designating crypto-assets as financial instruments and secondly by providing for a new licensing structure and requirement for crypto custody services. The approach to definitional determinations in

[4] *Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937*, European Commission (Sep. 24, 2020), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020PC0593.
[5] *New regulatory regime for crypto assets in Germany*, Norton Rose Fulbright (Mar. 2020), https://www.nortonrosefulbright.com/en/knowledge/publications/5ee1e37e/new-regulatory-regime-for-crypto-assets-in-germany.
[6] *New regulatory regime for crypto assets in Germany*, Norton Rose Fulbright (Mar. 2020), https://www.nortonrosefulbright.com/en/knowledge/publications/5ee1e37e/new-regulatory-regime-for-crypto-assets-in-germany.

the legislation has been relatively uncertain and unclear. A broad definition has been provided, stating that crypto-assets are: digital representations of value; not issued or guaranteed by a central bank or public authority; do not possess the legal status of currency; are accepted as means of exchange or payment, or otherwise serve investment purposes; can be transferred, stored, and traded electronically.

It is currently unclear whether pure utility tokens will be regulated by BaFin or whether they will be exempt from regulation. This uncertainty is seen more broadly across the regulatory framework: German legislators intend to further reform the civil law regime surrounding and interfacing with crypto-assets and, therefore, it can be expected that further changes are impending.

Custody

Perhaps the largest changes introduced through Germany's licensing regime has been the focus on custody business models. Under the new regime, custody businesses are defined as operating in the custody, administration, and safeguarding of crypto-assets or of private keys. If any of these activities are performed, the crypto custody business will be required to seek licensing *specifically* as a Crypto Custody Business, above and beyond the other existing requirements related to crypto-assets as regulated by BaFin. Note, however, that entities who act *only* as custodian wallet providers will be subject to reduced requirements from the KWG: while licensing and registration is still mandatory, certain reporting obligations and provisions on remuneration are exempted.

Tax

Crypto-assets and related activities are currently taxed under the German Tax Acts. However, unlike other assets which are treated as "property" under the German Tax Acts, crypto-assets are treated as "other assets", meaning that tax liability attaches through the "private sale" or disposal of a crypto-asset. For crypto-assets that have been held for more than one year, any gains realised in relation to the assets are *completely* tax-exempt. For short-term crypto-asset gains, standard German income tax liability applies. For staked crypto-assets, the one year tax-free exemption is extended to a minimum period of ten years.[7]

Transitional arrangements

Following the passage of legislation in January 2020, the Act was implemented with a transitional period that expired at the end of November 2020. However, interested entities were required to have registered their interest with BaFin by the end of March 2020.[8]

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[7] *Germany Crypto Tax Guide*, Koinly (May 18, 2021), https://koinly.io/guides/crypto-tax-germany/

[8] Michael Jünemann & Johannes Wirtz, *German crypto market: what you need to know about the crypto depository service*, Bird & Bird (Jan. 2020), https://www.twobirds.com/en/news/articles/2020/germany/german-crypto-market-what-you-need-to-know-about-the-crypto-depository-service.

5.4 Switzerland

- Switzerland is known to be one of the friendliest jurisdictions for crypto-asset entrepreneurs, particularly in the canton of Zug, also known as 'Crypto Valley'
- Switzerland's attractiveness is due to a combination of their early and clear guidance to token issuers, and the willingness of their key regulator FINMA to engage meaningfully with crypto-entrepreneurs seeking to enter the regime..

Licensing

Licensing of crypto-asset intermediaries is conditional on the amount of funds with which the particular entity engages. For entities dealing with funds of up to 1 million CHF, licensing requirements with the Swiss Financial Market Supervisory Authority ("FINMA") are unlikely to apply.[9] For all other crypto-asset intermediaries, entities must register for licensure with FINMA in order to operate as a registered entity within the country. The Blockchain Act was implemented to further clarify the government's position towards crypto-assets. Of central importance are the introduced requirements to comply with local ICO guidelines, and with AML/CTF. Note that, while this regulatory landscape appears relatively straightforward and minimally burdensome at the time being, there is some degree of regulatory uncertainty arising from two factors. The first is that Swiss cantons (akin to states or provinces) independently implement their own either more restrictive or more progressive crypto-asset policies. The second is the fact that the Swiss Department of Finance is actively considering the implementation of nation-wide blanket crypto-asset regulations, which would presumably replace the existing regulatory framework.[10]

Custody

In line with the progressive and open approach taken elsewhere in the regime, Swiss policy towards custody essentially permits all crypto-related custody activities subject to an entity being licensed with FINMA.

Tax

As a preliminary matter, the Swiss Federal Tax Administration ("SFTA") treats crypto-assets as assets. In virtue of this definitional determination, crypto-assets are subject to standard Swiss wealth, income, and capital gains taxes. That is to say, presently, there is no dedicated tax policy contemplating the tax liability relating to crypto-assets; rather, the existing framework has been extended to apply to crypto-assets. Where a crypto-asset is found to be taxable as a form of personal capital gains, these gains arising from a private wealth asset are *entirely*

[9] Note, though, that these entities are required instead to inform consumers that their operations are not subject to protections that would extend to FINMA-supervised firms.
[10] *Cryptocurrency Law and Regulations in Switzerland*, Comply Advantage, https://complyadvantage.com/knowledgebase/crypto-regulations/cryptocurrency-regulations-switzerland/.

exempt from income tax.[11] Where sufficient regularity and volume is present, the trading will be treated as "regular trading", meaning that the private wealth capital gains exemption cannot be applied. Instead, where regular trading or business-scale trading is observed, corporate tax rates apply, often between 12-18%.[12] Where existing holdings are subject to wealth taxes, the SFTA issues year-end valuations for the most commonly used crypto-assets and taxpayers must use these values when declaring their crypto-asset holdings.

Transitional arrangements

Currently, no specific safe harbour, grace period, or transitional periods apply in existing Swiss crypto-related legislation. However, rather than being emblematic of a particularly rigid and strict regime, the lack of these provisions points to the fact that the crypto regulatory landscape in Switzerland is relatively mature compared to many other jurisdictions.

5.5 United Kingdom

- ➢ The United Kingdom has sought to define what activities are and aren't regulated through a token classification framework.
- ➢ Further consultation has been undertaken on promoting crypto-assets and the regulatory approach to stablecoins.
- ➢ A registration process was introduced for AML/CTF but the deadline has been extended twice from 9 January 2021 to 30 March 2022.

Overview

In the United Kingdom, the Financial Conduct Authority (**FCA**) operates within a "regulatory perimeter", this perimeter determines what the FCA can and can't regulate.[13] The perimeter is defined, in the main, by Parliament through primary and secondary legislation. While the FCA is constrained when considering activity outside the perimeter, it does have some limited powers. The ability to change the perimeter is the responsibility of HM Treasury.

To examine the opportunities and challenges posed by crypto-assets, the UK established a joint Cryptoassets Taskforce in 2018, which comprised representatives of the Bank of England, the FCA, HM Treasury (**HMT**) and is also attended by the Payment Systems Regulator.

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[11] Daniel Spitz, *Cryptocurrency: tax treatment in Switzerland*, RSM (Jun. 2, 2021), https://www.rsm.global/switzerland/en/news/cryptocurrency-tax-treatment-switzerland.
[12] *Cryptocurrency license in Switzerland*, Private Finance International Services, https://prifinance.com/en/cryptocurrency-license/switzerland/. *See also Authorisation – gaining entry to the financial market*, FINMA, https://www.finma.ch/en/finma-public/authorised-institutions-individuals-and-products/.
[13] *The work of the Financial Conduct Authority: the perimeter of regulation*, UK Parliament (Aug. 2, 2019), https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/2594/259403.htm.

Regulatory framework

In 2019, the FCA published its *Guidance on cryptoassets* which outlined a broad token classification regime and gave an overview as to how and whether each fits within the existing regulations (i.e. within the regulatory perimeter):

- e-money tokens have to meet the definition of electronic money in the Electronic Money Regulations 2011 – these are digital payment instruments that store value, can be redeemed at par value at any time and offer holders a direct claim on the issuer;
- security tokens have characteristics similar to specified investments like a share or debt instrument. These could also be tokenised forms of traditional securities;
- unregulated tokens are those which are neither e-money or security tokens and include:
    - utility tokens: tokens used to buy a service or access a DLT platform; and
    - exchange tokens: tokens that are primarily used as a means of exchange (which captures many of the widely known crypto-assets such as Bitcoin, Ether and Ripple).

As the name would imply, unregulated tokens do not fall within the current regulatory perimeter and therefore are not subject to FCA regulation. E-money and security tokens do fall within the regulatory perimeter and are therefore subject to the existing legislation.

Derivatives

On 6 October 2020, the FCA published rules which banned the sale to retail consumers of derivatives and exchange traded notes that reference unregulated transferable crypto-assets. Unregulated transferable crypto-assets generally fall in line with the UK's token classification regime and are those tokens which are not specified investments in legislation or are considered e-money.

AML

The UK is required to follow the EU's 5th Anti-Money Laundering Directive (**5AMLD**) as a result of the directive (outlined above) commencing prior to the Brexit deadline. These powers were introduced in January 2020 and require UK crypto-asset businesses to register with the FCA to comply with the Money Laundering Regulations (**MLR**).

While this registration process relates only to AML/CFT compliance, the FCA has taken a very robust approach to the application process, requiring material similar in nature to that required of firms seeking authorisation. As a result, and in light of resource constraints at the FCA, only a very small number of firms have been registered and a significant backlog remains. Given that businesses that fail to register are prohibited from providing crypto-asset services from the UK, the FCA has been forced to implement a temporary register and twice extend the relevant time periods.

The UK Experience

When the UK's registration process was opened in January 2020, crypto-asset businesses were required to register to continue their operations. Temporary registrations were provided so that businesses could continue to operate until 9 January 2021. This deadline has now been extended twice – to 9 July 2021 and subsequently 30 March 2022.

At the time of writing, over 200 applications had been received by the FCA with only 6 having been approved.

Crypto UK, Blockchain Australia's UK equivalent, has also stated that they are concerned with the delays in the FCA registration process. In a letter to the Chancellor of the Exchequer, CryptoUK expressed concern that the "perceived high levels of risk the FCA have publicly stated for crypto asset firms has resulted in an extremely high bar for all businesses to achieve." and that the FCA was attempting to "assess applicants against a higher standard more closely aligned to an full electronic money institution authorisation."[14] It also raised concerns of limited responses and resourcing from the regulator stating that "most of our members have received limited, and in many cases, no response at all from the FCA since submitting their applications." Additionally, "It is understood…that the Cryptoasset Authorisation Team is generally understaffed."

Proposed regulatory framework

The 2020 Budget announced two measures designed to make the UK more attractive as a FinTech investment destination:

1. Consulting to bring certain crypto-assets into the scope of financial promotions regulation; and
2. Consulting on the broader regulatory approach to crypto-assets including new challenges from stablecoins.

Financial promotions

Consultation on bringing crypto-assets into the scope of financial promotions closed on 25 October 2020. The consultation proposed to extend the regulatory perimeter of the financial promotions regime in order to enhance consumer protections while the government continues to consider the broader regulatory regime. The financial promotions regime is designed to ensure that consumers are provided with clear and accurate information that enables them to make decisions which are appropriate for their circumstances. This includes ensuring that communications are fair, clear and not misleading.

[14] *Crypto UK send open letter to the Chancellor*, Crypto UK (Mar. 15, 2021), https://cryptouk.io/2021/03/15/crypto-uk-send-open-letter-to-the-chancellor/.

The consultation proposed to bring unregulated tokens within the regulatory perimeter of the financial promotions regime (e-money and security tokens are already captured under the regime). This will be done though a new definition of "qualifying cryptoasset" which is defined as:

> *any cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and which –*
>
> *a) is fungible;*
> *b) is transferable or confers transferable rights, or is promoted as being transferable or as conferring transferable rights;*
> *c) is not any other controlled investment as described in this Part;*
> *d) is not electronic money within the meaning given in the Electronic Money Regulations 2011; and*
> e) *is not currency issued by a central bank or other public authority.*

The FCA specifically calls out that tokens must be fungible and transferable which excludes non-fungible tokens (NFTs) such as digital collectibles or crypto-assets that might operate within a closed system such as a loyalty points scheme.

Regulatory Approach to Cryptoassets and Stablecoins

The second consultation, *UK regulatory approach to cryptoassets and stablecoins* recognises that most crypto assets fall outside of the regulatory perimeter and focuses on establishing a sound regulatory environment for stablecoins, which the government believes represent the most risk and opportunity. In the consultation paper, HM Treasury (HMT) outlines three objectives for guiding regulation:

Consultation on the second limb of work to consider the broader regulatory approach to crypto-assets, including from stablecoins, closed on 21 March 2021. In the consultation paper, HMT outlines three objectives for guiding regulation:

1. Protecting financial stability and market integrity
2. Delivering robust consumer protections
3. Promoting competition, innovation and supporting UK competitiveness.

This is backed by three principles:

1. Maintaining the current division of UK regulatory responsibilities as far as possible and applying the principle of "same risk, same regulatory outcome"
2. Ensuring the approach is proportionate, focussed on where risks and opportunities are most urgent or acute.
3. Ensuring the approach is agile, able to reflect international discussions and aligned to the future government approach to financial services and payments regulation.

The proposed regulatory approach would establish a framework of objectives and to define the scope of the regulatory perimeter through legislation. In turn, the regulators would then develop specific requirements such as issuing roles or codes of practice. This is designed to ensure that the regime can keep pace as new businesses emerge as well as being responsive to changes in international regulatory standards.

Under the changes, it is not intended that exchange tokens such as Bitcoin or Ether would be brought into the regulatory perimeter. The FCA's research suggests that consumers understand that such assets are purchased for the purposes of investment, and that there is a high consumer awareness of the particular risks of crypto-assets. Therefore it is more appropriate that these crypto-assets be subject to the financial promotion regime outlined above.

However, the consultation recognises the growing importance of stablecoins and their role in retail and cross-border payments. It is proposed that the government introduce a regulatory regime for stablecoins by creating a "stable token" definition and in the longer term, consider the case for bringing a broader set of crypto-assets ecosystem into the authorisation regime.

5.6 United States

- The United States has a broad range of regulations both at the federal and state level with some states such as Wyoming implementing their own crypto-asset specific legislation.
- There is generally broader acceptance by US banks for individuals and businesses that deal with crypto-assets.
- One proposal being considered in the US is a 3-year safe harbour proposal to provide time for crypto-asset based projects to prove that they are not a security.

Overview

Regulation of crypto-assets in the United States is a split across a patchwork of state and federal regulators. At the federal level, agencies involved include the Securities and Exchange Commission (**SEC**), the Commodities and Futures Trading Commission (**CFTC**), the Federal Trade Commission (**FTC**), the Treasury, and the Financial Crimes Enforcement Network (**FinCEN**). State legislatures also have enacted various items of legislation that deal with crypto-assets.

This patchwork has made formalising a standard regulatory approach difficult. For example, the SEC considers crypto-assets as securities, the CFTC considers them a commodity, while the IRS considers them as closer to property for the purposes of taxation. Unlike the UK, there is no formal joint working group which brings together the multiple regulators nor is there yet a plan to develop a longer-term regulatory roadmap. However, a number of progressive actions have been taken at federal and state levels to facilitate the growth of the industry in the US,

including the provision of licences for 'crypto banks', guidance on stablecoins, and guidance on the debanking problem.

Securities

Cryptocurrencies are generally only regulated in the US as a security if their attributes are considered to be a security. Similarly, a crypto-asset service provider is only likely to be regulated at a state level if it provides money transmission services as a money service business. Like Canada, the US has a test (the Howey test) which determines when a security is an "investment contract":

a) an investment of money;
b) in a common enterprise;
c) with a reasonable expectation of profits;
d) to be derived from the entrepreneurial or managerial efforts of others.

Crypto-assets which constitute a security are regulated by the SEC. It is a matter of substance over form if a crypto-asset is considered to be a security and some tokens may change in their nature over time if they no longer meet the Howey test. For example, the SEC has determined Bitcoin and Ether are not securities because their characteristics do not meet the test. However, if a crypto-asset is deemed to be a security, then it must be registered with the SEC, or only be offered to accredited investors who are typically high-net worth individuals or those individuals with a high level of annual income. In addition to federal laws, individual states may have their own specific laws.

AML

While exchanges are not prohibited in the US, if they come under the definition of a Money Services Business (**MSB**) then they must register with FinCEN, implement an AML/CTF and sanctions program, maintain records and submit these to the regulator. The US is also generally seen as more progressed than other jurisdictions when it comes to implementing the FATF guidelines such as the travel rule. In part, this is because the travel rule is based on the Bank Secrecy Act (**BSA**) and FinCEN has been applying the BSA requirements for the crypto-asset industry for some time. FinCEN has not been afraid to take action against exchanges for breaches of the BSA rules.

In addition to these federal requirements, exchanges are also considered a money transmitter in most states and subject to each state's own Money Transmitter License (**MTL**) requirements. This can prove problematic, as while there is some overlap, each state will have different requirements to acquire a licence.

FinCEN has also issued a proposal which extends the regulatory requirements to "unhosted wallets" or "other covered wallets" (such as wallets held at foreign financial institutions not

subject to the BSA). If a customer makes or receives a transaction where the counterpart is using one of these types of wallets, the VASP will be obliged to:

1) Verify the identity of the customer, and record the name and physical address of their counterparties for transactions over $3000.
2) File currency transaction reports where a customer undertakes aggregate transactions of $10000 or greater in a 24 hour period, including the name and physical address of transaction counterparties.

This proposal appears to go above and beyond the intent of the FATF's travel rule which is designed to apply to two regulated financial institutions and not to individuals. The proposal has raised a number of concerns amongst stakeholders including technical implementation issues, greater frictions in the transaction process and philosophical concerns over how much information the government may access about end users.

Derivatives

Crypto-asset derivatives that make reference to the price of a crypto asset that constitutes a commodity are subject to regulation by the CFTC. While exchanges including the Chicago Board of Options Exchange and the Chicago Mercantile Exchange offer futures linked to the price of Bitcoin, many derivative exchanges do not operate in the US or offer US customers limited functionality. The CFTC has taken action previously against exchanges that have operated an unregistered derivatives trading platform.

Wyoming

Meanwhile, various US states have taken differing approaches to the regulation of crypto-assets. Wyoming, which is seen as one of the more progressive states, has passed numerous bills which are seen as some of the most crypto-friendly in the US. The new laws allow for the establishment of Special Purpose Depository Institutions (**SPDI**) that allows cryptocurrency companies to create financial institutions that resemble traditional custodian banks but with special conditions imposed such as being required to hold enough liquid assets to cover 100 per cent of all deposits, not being able to offer loans, and requiring sufficient funds to cover three years of operating expenses.

In addition, SPDI's are not required to obtain Federal Deposit Insurance Corporation (**FDIC**) insurance. FDIC insurance provides deposit insurance, designed to protect bank depositors from a bank's inability to pay debts or "bank runs". FDIC insurance only covers US dollars up to a certain amount but does not protect other assets such as stocks or cryptocurrencies. This requirement can hinder crypto-asset companies from accessing banking services. Wyoming's SPDI framework instead requires that banks hold significant reserves with the option to obtain FDIC insurance should it cover cryptocurrencies in the future. At the time of writing, two institutions have received an SPDI charter.

In addition to the SPDI charter, Wyoming also enacted legislation to establish a Financial Technology Sandbox to allow companies to test innovations with flexible regulatory oversight. Cryptocurrencies are also considered as property under the new Digital Assets Act and clarifies that the Uniform Commercial Code (a set of consumer law protections) applies to cryptocurrencies.

New York

In June 2015, New York introduced its virtual currency legislation. Under the "BitLicense" regulation, the New York Department of Financial Services can grant a virtual currency licence to those that are engaged in a "Virtual Currency Business Activity". A BitLicense is required for anyone that wishes to carry out a Virtual Currency Business Activity within the state of New York or with parties that reside within New York.

A Virtual Currency Business Activity is defined as:

1. receiving Virtual Currency for transmission or transmitting Virtual Currency;
2. storing, holding, or maintaining custody or control of Virtual Currency on behalf of others;
3. buying and selling Virtual Currency as a customer business;
4. performing exchange services as a customer business; or
5. controlling, administering, or issuing a Virtual Currency.

A BitLicense does not exclude a crypto-asset business from other federal requirements such as FinCEN registration, but it does impose additional conditions such as capital requirements, recording keeping, custody, cyber security and dispute resolution.

Other Developments

Where US banks had previously been hesitant to provide banking services to businesses that deal in crypto-assets, this appears to be turning and new business models are developing. On 23 June 2021, payments company NCR and digital asset management firm NYDIG announced that 650 community banks will be able to offer cryptocurrency trading to their customers directly through applications built by NCR by relying on NYDIG's custody service.[15]

5.7 Malaysia

➢ Malaysia initially implemented a crypto-asset regulatory regime, expanding on its existing financial market laws, but has since wound back some of its support.

[15] *Financial Institutions Can Now Provide Consumers Easy Access to Bitcoin via Fiserv and NYDIG*, NYDIG (Jun. 23, 2021), https://nydig.com/about-nydig/news-press-releases/financial-institutions-can-now-provide-consumers-easy-access-to-bitcoin-via-fiserv-and-nydig/.

Licensing

Malaysia has opted to amend its existing securities laws to include within their scope digital currencies and digital tokens. The Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 ("POS Order") came into effect on 15 January 2019, rendering any blockchain based digital currencies and digital tokens which are *not* issued or guaranteed by any government body or central bank as securities, subject to approval and regulation by the Securities Commission Malaysia. The POS Order further establishes digital assets as regulated securities under the purview of the Securities Commission. These guidelines and regulatory provisions allow companies to, *inter alia*, raise funds through token offerings and allows approved and registered digital asset exchanges to operate in the country. These permissions are premised upon compliance with AML/CTF mandates and restrictions on the entity's geographical presence within Malaysia. Specifically, to be properly registered and regulated by the Securities Commission, the entity must be a Malaysian corporation with its main business operations in Malaysia.[16]

Custody

There are no further regulations that specifically clarify the regulatory stance towards custody. Rather, whatever regulations exist must be inferred and drawn from the POS Order and other existing laws pertaining to digital assets in Malaysia. As such, it appears as though a custody service *could* be registered and able to operate following approval by the Securities Commission, and that this entity will then be subject to regulations contained in the Guidelines on Recognized Markets 2019.[17] These regulations are as follows:

1. The exchange operator must "ensure there are orderly, clear and efficient clearing and settlement arrangements".
2. Clearing and settlement arrangements "must include prior or upfront deposit of monies and Digital Assets" with the exchange operator "before entering into a transaction" on the digital asset exchange.
3. "[C]lear and certain final settlement" must be provided either intra-day or in real time.[18]

Tax

In line with other countries, Malaysia appears to determine tax liability related to crypto-assets based on the frequency of the trading activity. As a preliminary matter, the Inland Revenue Board ("LHDN") has specified that investors who actively trade are required to declare their

[16] *Malaysia*, Freeman Law, https://freemanlaw.com/malaysia-and-cryptocurrency/.
[17] *Guidelines on Recognized Markets*, SC-GL/5-2015(R3-2019), Securities Commission Malaysia (May 17, 2019), https://www.sc.com.my/api/documentms/download.ashx?id=eb8f1b04-d744-4f9a-a6b6-ff8f6fee8701.
[18] *Id*.

gains for income tax purposes.[19] That said, the LHDN has simultaneously expressed its inability to concretely determine tax liability under existing legislation. Rather, the LHDN has suggested that it will approach each situation of crypto-related tax liability on a case-by-case basis. Strangely, the advice directly from the LHDN is that transactions that resemble capital gains, that are unplanned or unsystematic, will be treated as tax-free income. Systematic, active, and repeated trading will, on the other hand, be liable for income tax.[20]

Transitional arrangements

When the POS Order was introduced together with the Guidelines on Recognized Markets in January 2019, a "transitional period" was initially implemented while the transition from unregulated industry to regulated industry was conducted.[21] However, at this point in time, the Securities Commission has taken the firm stance that all entities "which have not been approved by the SC, *including those which have previously been operating under the transitional period*, are required to cease all activities immediately and return all monies and assets collected from investors".[22] As such, there is no consideration of safe harbour intended to protect entities who were operating prior to the introduction of regulatory measures. Disqualified entities include Binance and eToro, amongst others.[23]

5.8 Canada

- ➢ Canada's key strengths are its first mover advantage in having approved a Bitcoin ETF, and it's early mover advantage in having issued guidance for crypto-asset trading platforms (CTPs).
- ➢ Canada's guidance also indicates a two-year transitional period for the industry.

[19] Alex Cheong, *Active Cryptocurrency Traders Are Required To Declare Their Gains For Income Tax*, RinggitPlus (Jan. 6, 2021), https://ringgitplus.com/en/blog/income-tax/active-cryptocurrency-traders-are-required-to-declare-their-gains-for-income-tax.html.
[20] Afiq Aziz, *Active cryptocurrency traders not spared from LHDN*, Malaysian Reserve (Jan. 5, 2021), https://themalaysianreserve.com/2021/01/05/active-cryptocurrency-traders-not-spared-from-lhdn/.
[21] *List of Registered Digital Asset Exchanges*, Securities Commission Malaysia (May 5, 2021), https://www.sc.com.my/regulation/guidelines/recognizedmarkets/list-of-registered-digital-asset-exchanges.
[22] *Id*.
[23] *Investor Alert List*, Securities Commission Malaysia, https://www.sc.com.my/regulation/enforcement/investor-alerts/sc-investor-alerts/investor-alert-list. This list explains that Binance has been disqualified for "[o]perating a recognized market without authorisation from the SC," while eToro has been disqualified for "[c]arrying out capital market activities of dealing in securities and derivatives without a licence" and "operating a recognized market without authorisation from the SC".

Overview

Canadian regulation of crypto-assets has primarily focused on AML/CTF requirements and classification of crypto-assets deemed securities. Canada was the first country to approve regulation of cryptocurrencies under their AML legislation and now recognises exchanges and payments processors as Money Services Businesses (**MSB**) that need to be registered with the Financial Transactions and Reports Analysis Centre of Canada. Canada was also the first country to approve a Bitcoin exchange traded fund. However, Canadian regulators lag in other areas such as providing guidance around the tax treatment of crypto-assets and associated activities.

Securities

In Canada, securities laws are enacted on a provincial and territorial basis rather than federally. Instead, the Canadian Securities Administrators (**CSA**), an umbrella organisation that represents the provincial and territorial securities administrators, aims to coordinate and harmonise regulation of Canadian capital markets.

The definition of what constitutes a security is broadly defined in Canadian legislation and covers a wide range of categories including an "investment contract". The test for what is considered an investment contract was established by the Supreme Court of Canada and must satisfy each of the following elements:

a) there must be an investment of money;
b) with an intention or expectation of profit;
c) in a common enterprise; and
d) the success or failure of which is significantly affected by the efforts of those other than the investor.

Where elements of this test are not satisfied, regulators in Canada consider the policy objectives and purpose of the securities legislation in making a final determination – that is whether the public are protected through sufficient disclosure. This has been reinforced by the view of the Supreme Court of Canada that the test is substance rather than form in determining whether a contract or transaction is an investment contract.

This has implications for tokens or contracts that do not necessarily represent shares or equity in an entity. For these offerings, the CSA has affirmed that they will consider substance over form and that some coins or tokens, while marketed as software products, may instead be considered securities because of the investment contract test.

Exchanges and platforms

In order to address the features and risks of crypto-asset trading platforms (**CTPs**) that are not directly addressed by the existing framework, the Investment Industry Regulatory Organisation

of Canada (**IIROC**) together with the CSA have issued guidance regarding CTPs which clarifies how these platforms fit into the existing regulatory framework. The guidance provides clarity as to when securities legislation may or may not apply to crypto-asset trading platforms.

The rationale for guidance rather than legislation is to ensure that the guidance is flexible in order to foster innovation while also meeting the regulatory mandate to promote investor protection and ensure fair and efficient capital markets. The guidance applies to "marketplace platforms" such as exchanges that trade tokens as well as "dealer platforms" such as where there may be an over-the-counter (**OTC**) arrangement.

The approach for dealer platforms is:

a) For dealer platforms that distribute or trade security tokens or enter into crypto contracts exclusively on a prospectus exempt basis and do not offer margin or leverage, they may register as exempt market dealers or restricted dealers.
b) For dealer platforms that offer margin or leverage for security tokens, or services to retail investors in either security tokens or crypto contracts, they are generally expected to be registered as investment dealers and become members of the IIROC.

The approach for marketplace platforms is that:

a) Marketplace platforms may be required to register as investment dealers and become members of the IIROC if they conduct activities similar to those performed by dealer platforms or take custody of client assets.
b) Marketplace platforms that offer security tokens or crypto contracts may also require prospectus exemptions to facilitate the distribution or trade in tokens and crypto contracts.

Transitional arrangements

The guidelines also set out a transition period to facilitate the development of CTPs while also ensuring that they work within a regulatory environment. The CSA aims to be flexible by offering a time-limited restricted registration or exemptions while working towards longer term registration and membership of the IIROC. This interim period is generally expected to be two years.

It is likely that most exchanges that want to operate in Canada, including those that are based overseas, will have to apply and be licensed to work in Canada. The regulators have encouraged platforms to engage and discuss how their specific business models may fit into the existing regime.

Derivatives

The CSA specifically calls out that derivative products that provide exposure to crypto-assets are also subject to Canadian jurisdiction and securities legislation and flags that further work will be done on examining the regulatory framework that applies to OTC derivatives.

Other developments

Canada's flexible approach has played a part in Canadian regulators approving the world's first Bitcoin exchange traded fund (**ETF**) on 18 February 2021. The Ontario Securities Commission approved the listing which will allow retail investors access to Bitcoin through the Toronto Stock Exchange. Importantly, this ETF invests directly in settled Bitcoin rather than Bitcoin derivatives or futures. There are now a total of 25 ETFs and closed end funds that track bitcoin or crypto-assets listed on the Toronto Stock Exchange.[24]

Conversely, this flexible approach also highlights the difficulties in producing clear definitions and applying the traditional securities rules to crypto-assets and VASPs.

[24] *Bitcoin & Crypto Funds*, TMX Money (Jul. 20, 2021), https://money.tmx.com/en/stock-list/CRYPTO_FUNDS_LIST.

6 The Regulatory Opportunity

Recent developments across the globe, highlighted in the activities described above, have brought into sharp focus that Australia is lagging behind international jurisdictions in the development of a fit-for-purpose crypto-asset framework.

Australia has previously taken a proactive role in the regulation of crypto-assets, including implementing a robust AML/CTF framework for cryptocurrency exchanges. But our early mover advantages have now degraded. Australian policymakers and regulators have not established collaborative outward facing industry engagement opportunities that focus on reforms. As a result industry has not been provided the confidence to consider, review, implement and invest in projects.

Jurisdictional arbitrage, the search for greater regulatory clarity, will result in loss of talent at scale. Australian start-ups have moved, or are considering moving, to countries such as Singapore, Germany or the UK as these jurisdictions are being seen as more supportive of crypto-assets and blockchain. The key distinction to be noted here is that they are *more* supportive, they have not provided total certainty nor are they yet able to. This is not an insurmountable gap.

Blockchain Australia notes the evidence received by the Committee in the second phase of the Inquiry on the regulation of crypto-assets, and commends the recommendations made in the second interim report on blockchain and smart contracts. This is important work that requires an investment of effort from government and industry. However, more will be required to position Australia as a leader globally.

By its nature, it is work that cannot be rushed as standards and implementations are built out. The parameters of such work can be considered a fluid construct.

We note that, while there is significant merit to understanding overseas jurisdictions, any potential regulatory model should be unique to Australia to reflect our specific context while balancing the need for regulatory harmonisation. By looking at overseas jurisdictions, we can ensure that Australia selects the positive aspects from each country while taking on board any lessons learned. As such, Blockchain Australia proposes a number of recommendations based on overseas experiences.

Australia's short term reluctance to drive uptake nationally presents us with an unexpected opportunity to benefit from those internationally, who have considered or are considering pathways that are in keeping with an Australian lens.

6.1 Australia's Regulatory Regime

The current regulatory approach to crypto-assets in Australia is based on a range of enforcement activities that cut across multiple regulatory functions of government: notably the Australian Transaction Reports and Analysis Centre's (**AUSTRAC**) enforcement of anti-money laundering laws; the Australian Tax Office's (**ATO**) enforcement of tax; and the Australian Securities and Investments Commission's (**ASIC**) enforcement of the *Corporations Act 2001* (including the powers that have been conferred to ASIC by the Australian Competition and Consumer Commission (**ACCC**) in relation to tokens under consumer law). Other regulators that may play a role in crypto-assets include, but are not limited to: Australian Prudential Regulation Authority (**APRA**) and the Reserve Bank of Australia (**RBA**) (for payments, including CBDCs), Industry Innovation and Science Australia (the *Venture Capital Act 2002*) and the Office of the Australian Information Commissioner (**OAIC**) for data privacy. Given the broad range of laws and regulators to contend with, having clear guidance is of utmost importance to the sector.

Regrettably, a key ongoing challenge facing the industry in Australia to date has been that, because regulator guidance has often been either absent, ambiguous or out of alignment with the practical realities of the underlying technology, the crypto-asset sector in Australia has found that the costs as a result of this uncertainty are excessively high. Lawyers are often unable to give clarity and assurance on new services, and the subsequent dilemma facing businesses has been to either continue building at home or relocate overseas where the focus can be weighted towards managing growth rather than managing regulatory risks.

Information exchange at a national level is required to develop sovereign understanding and capability. It is clear that siloed regulatory assessments cannot keep pace with technology development that has resources disproportionately deployed offshore.

Blockchain Australia's view is that a genuinely collaborative approach between the government, public sector and private sector, facilitated by legal and technology experts in the field, will be paramount to ensuring that Australia can find its way through to a more practical and appropriate framework. With this collaborative approach, the resulting framework will be responsible for the rapid pace of development underway in the industry and will help Australia to capitalise on the opportunity available – providing an opportunity to bolster consumer choice, consumer protection, and to drive greater efficiency and productivity in financial markets.

To achieve this, Blockchain Australia suggests the following overarching recommendation:

That Australia take a co-ordinated and graduated approach to the regulation of crypto-assets, to provide greater certainty to consumers and businesses, while working to develop a fit-for-purpose framewoark that will facilitate an environment conducive to innovation and competition in crypto-assets. This involves:

a) implementing immediate safe harbour provisions;
b) greater regulatory guidance and engagement; and
c) a long term, fit-for-purpose legislative framework.

7 The First Step: Ensuring a Safe Harbour

There can be no short term forward movement in the sector without safe harbour guidance for business. Failure to provide transitional arrangements creates far greater risk in the flight of capital and a greatly reduced prospect of inbound investment being attracted into Australia.

Given the complexities that public and private institutions are grappling with in relation to crypto-assets, it is important that reforms are developed and implemented carefully. However, regulatory uncertainty must be tackled with a sense of urgency, to retain and develop jobs and growth in the Australian crypto-asset economy. To resolve these conflicting goals, the precedent that has been established by like minded jurisdictions has been to allow a regulatory 'safe harbour' or other transitional arrangement. Blockchain Australia strongly encourages this approach in Australia. Our companies cannot afford to wait years for regulatory clarity, and Australian consumers require confidence that they are able to access the products and services they desire at home, via legally regulated and compliant professionals, rather than by seeking out risky services in unregulated locations.

International precedents for crypto-asset transition periods and safe harbour

To date, transitional arrangements have been implemented in three likeminded jurisdictions that have developed crypto-asset regulatory framework: the United Kingdom (**UK**), Canada and Singapore.

The UK's transitional period was originally set for 6 months, but was extended twice, and when it does expire (in March 2022) it will have been in place for over 2 years in total. Canada's transitional period was set at two years. Singapore's transition period was only in place for 6-12 months (depending on the type of entity) and is widely regarded to have been too short in hindsight, especially considering the bottleneck of licence applications that continues to persist.

The European Union (**EU**) is proposing that its soon-to-be-implemented framework will have an 18 month transition period. In the United States (**US**), Securities and Exchange (SEC) Commission Hester Pierce is proposing a three year exemption or safe harbour from securities laws (subject to certain requirements) during which time businesses can either demonstrate that they sit outside of securities laws or, if they cannot, eventually require that they become compliant with federal laws.[25]

Given the uncertainty around how financial services law currently applies, ASIC could provide greater regulatory certainty by establishing a safe harbour mechanism that would ensure that crypto-asset businesses, subject to certain conditions, are provided assurance that they will

[25] *Token Safe Harbor Proposal 2.0*, Hester Peirce (Apr. 13, 2021), https://www.sec.gov/news/public-statement/peirce-statement-token-safe-harbor-proposal-2.0

not be in breach of the laws that it administers and that ASIC will not take retrospective enforcement action.

Based on these international experiences, a safe harbour or transitional period of 2-3 years is required to ensure that industry is sufficiently prepared to transition towards a compliant and regulated framework. A well-designed safe harbour provides regulators and businesses with the time to transition the industry towards developing and implementing a fit-for-purpose regulatory regime. Ensuring that any regulatory regime has an appropriate transition period means that businesses can be compliant from day one. A 2-3 year period will be more practical for industry and regulators than a shorter period of, for example, 12 months.

Recommendation 1: That the government and relevant regulators should provide crypto-asset providers a safe harbour until such a time that they introduce guidance or legislation. Any legislation should contain an appropriate transition period and not apply retrospectively.

8 The Path Forward: A Coordinated and Graduated Australian Approach

A safe harbour is a critical first step in providing clarity to crypto-asset businesses. Planning for which should commence immediately. Concurrently, Blockchain Australia recommends a coordinated and graduated approach to ultimately develop a fit-for-purpose legislative framework consisting of two categories: regulatory guidance and engagement that can be implemented quickly to provide an initial level of guidance and support, and long term legislative changes.

This coordinated and graduated approach recognises the importance of taking a considered and consultative approach with industry to co-design the regulatory framework while taking steps to implement "quick wins" through greater guidance and engagement. These quick wins, if properly implemented, would enhance consumer outcomes and provide increased certainty for investors and businesses.

An important lesson from overseas jurisdictions is to ensure that the regulators determine that there is a sufficiently long transition period and that they are appropriately resourced to implement any changes. The Singaporean and UK experiences show the delays and uncertainty that is created if regulators are not appropriately resourced to implement broad policy changes.

8.1 Guidance and Engagement

It is our experience that the appetite of industry to engage actively with regulators is very strong. It is also our experience that engagement can be improved by advance signalling of areas of regulatory interest or concern.

The "stateless" nature of much of the subject matter, and the cross regulatory implications of discussions, have in part meant that accountability for outcomes does not clearly enough reside within departmental remits. This problem is solved in large part by the coming together of industry and government to discuss the implications of development. In so doing, identifying unique or shared responsibilities for consideration.

Blockchain Australia urges policymakers and regulators to work with us and other industry participants to implement these recommendations and to achieve better outcomes for all parties involved.

For example, we note the recent work undertaken by ASIC in *CP343 – Crypto-assets as underlying assets for ETPs and other investment products* (**CP343**). While we welcome the engagement by ASIC in issuing this paper, we would urge ASIC to engage as early as possible with industry on future regulatory guidance and to outline a roadmap of proposed regulatory activity. This will ensure that ASIC and the industry can respond to regulatory challenges in a cohesive and efficient manner.

8.1.1 Regulatory Engagement

The formation of an industry and regulator working group will be a cornerstone of effective collaboration in the sector. We propose the rapid deployment of a working group that truncates the set up and priority setting of the group. We make this suggestion with the understanding that time and resource constraints will likely be raised against such a proposal. However, in light of the complexity of the task at hand the acceleration of the constitution of the group will afford an opportunity to avoid ceding time unnecessarily.

We would anticipate that such a working group could comprise, at a minimum, representatives from the Council of Financial Regulators (**CFR**) agencies,[26] Home Affairs and AUSTRAC, the ATO and other government agencies as required. Industry participants would consist of a cross section of subject matter experts. This could be modelled after other bodies such as the Product Modernisation Working Group. Blockchain Australia would welcome a meeting with these agencies to discuss how such a group could be established.

Overseas jurisdictions that have made considerable regulatory progress have often done so because of a collaborative effort between industry and government. The establishment of a formal mechanism comprising the relevant government agencies and a panel of industry participants would provide advantages to both sides.

Government agencies would be able to communicate with industry any potential changes in policy and would be able to leverage the expertise of the industry participants in developing any new regulations. Industry would be able to communicate with government the newest trends and developments that they are seeing and communicate to government technical challenges faced by industry. Many businesses that operate in Australia also have an international presence and can bring this experience to the table.

Recommendation 2: That a cross-industry and regulatory working group be established to facilitate greater communication between the crypto-asset industry and the regulators. The first exercise to be undertaken by the group should be a token mapping exercise, examining the work done in overseas jurisdictions.

[26] The Council of Financial Regulators is composed of the ASIC, APRA, the RBA and Treasury.

8.1.2 Regulatory Resourcing

Blockchain Australia submits it is inescapable that regulatory capability enhancement will require dedicated resourcing.

The UK and Singaporean experience has shown that their respective regulators have been overwhelmed by applications for registration and the UK has extended the deadline for registration multiple times. Predictably this has not provided businesses with certainty around regulatory decisions.

The MiCA framework sets out a 3 month timeframe for the assessment and authorisation of applications with a levy on the sector to pay for the appropriate resourcing. Blockchain Australia understands that current response times from ASIC significantly exceed 3 months in traditionally regulated sectors with a quarter of AFSL applications undetermined after 5 months and 11 per cent undetermined after 8 months.[27] This would only be exacerbated by the complex nature of crypto-assets when applying the existing regulatory framework.

To ensure that the regulators are able to be proactive and have the necessary expertise and skills to engage with industry, Blockchain Australia recommends that regulatory capabilities be increased, in particular within ASIC as a key regulator, prior to the implementation of any new policies.

Recommendation 3: Regulatory resourcing, particularly within ASIC, that is dedicated to crypto-assets should be increased to assist with the timely implementation of the recommendations made in this submission. This could be through a combination of increased government funding or changes to the ASIC levies.

8.1.3 Custody

In traditional finance, one of the primary roles of a custodian is to safely hold an investor's assets. They may hold assets in electronic form (such as a share register) or physical form (such as gold in a vault) and charge investors a fee for this service. Custodians agree with investors that they will temporarily hold these assets for safe keeping and return them upon request.

Custodians of digital assets perform similar functions to traditional custodians but operate through different methods. Crypto-assets are secured through the use of cryptographic keys. For a transaction to be executed, the correct private key must be matched with the public key. This means that whoever controls the private key effectively has control over that asset. Given

[27] *ASIC service charter results: 2019-20*, ASIC (n.d.), https://asic.gov.au/about-asic/what-we-do/how-we-operate/performance-and-review/asic-service-charter/asic-service-charter-results-2019-20/.

the irreversible nature of public blockchain transactions, it is important that this private key is held securely.

Currently, there are a number of options for digital custody. Users may wish to hold their private keys themselves, such as through a hardware device or a software solution (self-custody). Alternatively, users may wish to give control of the management of the private key to a crypto-asset business and manage their assets through an online wallet. For those users who wish for greater separation from their private keys but do not want the additional burden of maintaining self-custody, they may engage a third party custodian. Third party custodian solutions can often provide specialised services including physically secured infrastructure (such as bunkers where hardware devices containing private keys are held) and insurance. It can be costly for retail users to engage a third party custodian so these are typically only used by institutional investors.

It is common industry practice, although not mandatory, for crypto-asset businesses to use third party custodians to secure the private keys of their end users. By providing an additional layer of separation, users have greater protection against hacks and malicious actors. For example, use of third party custodians would make it impossible for employees to make copies of private keys and steal customer assets as was the case of an ex-Cryptopia employee in New Zealand.[28] The death of the CEO of Canadian exchange QuadrigaCX[29] who was the only person who could access millions of dollars of customer funds also highlighted the risks where private keys are inappropriately stored.

ASIC recognises the importance of custodial obligations. *Regulatory Guide 133 – Funds management and custodial services* (**RG133**) outlines the obligations that apply to responsible entities and licensed custodial service providers for holding assets and sets out minimum standards for asset holders. However, RG133 does not discuss custody of crypto-assets. We are not aware of any reasons why custody of crypto-assets would breach any other regulations or obligations and an explicit statement would provide reassurance to those offering custodial services in Australia that there are no regulatory impediments to doing so. We note that ASIC appears to understand the unique circumstance of ensuring that crypto-assets are appropriately custodied as flagged in their consultation on CP343.

[28] *Ex-Cryptopia Employee Pleads Guilty to Stealing $170K in Crypto*, Sebastian Sinclair (Jul. 5, 2021), https://www.coindesk.com/cryptopia-former-employee-stolen-funds-private-key-usb.
[29] *A Crypto Exchange CEO Dies—With the Only Key to $137 Million*, Gregory Barber (May 2, 2019), https://www.wired.com/story/crypto-exchange-ceo-dies-holding-only-key/.

Blockchain Australia is not aware of any jurisdiction that requires entities that operate in that country to use an on-shore custodian. However, there is an opportunity for Australia to develop a digital asset custody industry. Wyoming has started to build a new economy around crypto-asset custody and greater reassurance from ASIC could encourage new business models in Australia and bring new participants to the market.

Recommendation 4: ASIC update RG133 to explicitly state that licensed custody providers can provide crypto-asset custodial services.

8.1.4 FATF Travel Rule

Blockchain Australia commends the engagement of AUSTRAC with industry. Including their participation in sector led forums, events and Digital Currency Exchange updates. Much of the discussion with the regulator has involved updates in relation to FATF guidance and reciprocal information sharing.

Blockchain Australia has communicated its broad support to AUSTRAC of the important objectives that are outlined in the FATF guidelines on VASPs, including the travel rule initiative. AUSTRAC has been measured in its engagement and has signaled its intention to consult widely with the industry with respect to the travel rule consideration and implementation. We look forward to this consultation process being realised.

However, as can be seen from other countries, a strict and inflexible interpretation of the FATF guidelines without the appropriate transition periods to allow industry to make the required changes has proven challenging.

Unlike traditional banks who rely on the SWIFT messaging network to exchange information, FATF has taken a technology-neutral approach and has not prescribed that a particular technology or standard be used to facilitate the transfer of information between VASPs. As a result, whilst there are emergent technology solutions to implement the travel rule, widespread adoption and user testing at scale remains limited. It also remains a challenge to ensure that there is standardisation and interoperability between exchanges.

The complexity of the technology challenge is exacerbated by the differences between jurisdictions in how they have sought to, or seek to implement the travel rule. The US has taken a strict approach and is considering obligations that go beyond the FATF guidance. Singapore's implementation is also relatively strict whereas the EU and the UK's implementation of the 5AMLD has been more flexible. Recent pronouncements by the EU seek to broaden definitions. The implications of these changes, in the context of divergent regulatory approaches, create further uncertainty and place many VASPs at a disadvantage to others.

FATF's first 12 month review notes the challenges in implementing the travel rule and that it is "not aware yet that there are sufficient holistic technological solutions for global travel rule implementation that have been established and widely adopted".[30] In their second 12 month review, they note that adoption of the travel rule remains poor and that "FATF members should implement the travel rule into their domestic legislation as soon as possible, including consideration of a staged approach to implementation as appropriate"[31] to avoid VASPs engaging in jurisdictional arbitrage.

Blockchain Australia is actively involved in both local and international industry discussions concerning the implementation of the travel rule The wide ranging consultative participation includes membership of The International Digital Asset Exchange Association (IDAXA) whose primary purpose is representing: the global interests of Industry, Trade Associations and VASPs.

We share the views of IDAXA, communicated in their submission to the Committee:

> *"IDAXA is of the view that retrofitting the last industrial era regulatory thinking and policy onto the 21 st century digital world and its new and innovation solutions is not always helpful and may be a hinderance, or worse, wholly ineffective in a world where digital crime can scale as quickly if not faster than digital innovation with social purpose. IDAXA is concerned with any exclusive focus on increased regulatory arrangements responsibilities – the aim has to be a meaningful form of compliance that is focused on risk transparency for universal products that work for everybody and not purely on culpable wrongdoing, liability, and punishment. IDAXA would see such a regulatory approach having a negative impact, more serious that what seen in 2019 with FATF's first attempt as a regulatory approach to VASPs."*

The robustness of Australia's AML/CTF regime, mandatory AUSTRAC registration of Digital Currency Exchanges coupled with the willingness of the industry to work through the challenges posed by the implementation of the travel rule leave us well placed to assist in the regulatory assessment of a fit for purpose implementation, conditions and timetabling.

Industry participants have well founded concerns that the implementation of the travel rule will place unnecessarily burdensome cost pressures on business. We caution of the real risk

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[30] *12-month Review Of The Revised FATF Standards On Virtual Assets And Virtual Asset Service Providers*, FATF (Jun. 2020), https://www.fatf-gafi.org/media/fatf/documents/recommendations/12-Month-Review-Revised-FATF-Standards-Virtual-Assets-VASPS.pdf.

[31] *Second 12-month Review Of The Revised FATF Standards On Virtual Assets And Virtual Asset Service Providers*, FATF (Jul. 2021), https://www.fatf-gafi.org/media/fatf/documents/recommendations/Second-12-Month-Review-Revised-FATF-Standards-Virtual-Assets-VASPS.pdf

that the premature or rushed implementation of the travel rule, as seen in other jurisdictions, would be a significant competitive disadvantage and inhibit innovation.

We seek to build on our strong engagement history with AUSTRAC. Blockchain Australia seeks clarification with respect to

1. Timetabling of proposed consultation
2. Scope of consultation (terms of reference)
3. Public consultation opportunities
4. Legislative harmonisation consideration
5. Expanded (ex-AUSTRAC) regulator information sessions

An accelerated consultation timeline and industry feedback is warranted.

Recommendation 5: That AUSTRAC accelerates engagement with the industry on the consideration, application and implementation of the travel rule and to ensure that there is a sufficient consultation and transition period.

8.1.5 Ensuring Access to Banking

Blockchain Australia views banking as a right.

We acknowledge and respect the requirement of financial institutions to review the suitability of their (prospective) customers across a wide variety of assessment criteria. It is our contention that this assessment be performed not as a class, but on the merit of each applicant. An assessment made in a fulsome manner, with due regard to a process that is open to the review of information, provided by applicants in circumstances where banking services are to be revoked or denied. If the aim of withholding banking services is the reduction in risk, then it is incumbent on financial institutions to provide information that reflects risk profile assessments such that parties are afforded an opportunity to address concerns. The system can only be improved if the basis upon which debanking is appropriate, is communicated.

Access to banking services is vital for any business. Debanking and the inability for start-ups and crypto-asset based businesses to access banking services is prevalent across the industry. The Committee has previously heard of challenges faced by many organisations in this sector including limited access to banking services and outright denial to access new or existing services with little to no notice. Blockchain Australia can confirm that the issue of debanking across the industry is pervasive and endemic. It is our experience that assessments of the issue invariably describe the information reflecting the problem as anecdotal. It is important to state that the documented problem is anecdotal for the simplest of reasons. Industry participants fear the disproportionate retribution of financial institutions.

It is not clear to Blockchain Australia why Australian banks continue to take an extremely risk averse approach to providing banking services to crypto-asset businesses or even businesses that are tangentially related to the industry. Evidence from Chainalysis research shows that criminal activity accounts for only 0.34 per cent of cryptocurrency transaction volume globally.[32]

Blockchain Australia's members are often given little or no information as to why they have been debanked or denied banking services. Blockchain Australia has heard of debanking not only being experienced by Digital Currency Exchanges (**DCEs**) but also by start-ups that are linked to the crypto-asset industry such as education platforms or advisory firms where there is no obvious AML/CTF risk.

Blockchain Australia recognises that banks must undertake a risk assessment of individual customers and make their own decisions on how to comply with Australia's AML/CTF laws. Blockchain Australia understands that some banks have cited that accounts that trade in an unregulated currency are outside of their risk appetite while others have cited a lack of experience in dealing with digital assets. This further heightens the need for a regulatory framework.

There are many other sectors that continue to be provided banking services where the risk is significantly higher – particularly those which facilitate crime through the use of cash. Treasury's Black Economy Taskforce estimated that the value of organised crime and the resultant money laundering is approximately $16 billion in Australia alone – much of which is facilitated through the use of cash.[33] This is more than the estimated value of crime facilitated by cryptocurrencies *globally* (US $10 billion).

Ensuring entities are able to access banking services also provides consumers with greater protections. It ensures that businesses that service Australians are not forced into using offshore banks which may not be subject to the same requirements and regulatory protections of Australian banks. The use of offshore or unregulated entities itself carries a significant amount of risk as highlighted by the case of Crypto Capital, a Panamanian bank that was later found to have facilitated money laundering activities.[34] Using offshore banking providers is also typically more expensive for the customer.

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[32] *Crypto Crime Summarized: Scams and Darknet Markets Dominated 2020 by Revenue, But Ransomware Is the Bigger Story*, Chainalysis (Jan. 19, 2021), https://blog.chainalysis.com/reports/2021-crypto-crime-report-intro-ransomware-scams-darknet-markets.

[33] *Black Economy Taskforce - Final Report*, The Treasury (Oct. 2017), https://treasury.gov.au/sites/default/files/2019-03/Black-Economy-Taskforce_Final-Report.pdf.

[34] *The story of Crypto Capital's dark past and its deep ties with the crypto industry*, Tim Copeland (May 2, 2019), https://decrypt.co/6824/crypto-capital-follow-up-article.

Customers may also be forced onto P2P platforms which pose significantly more risks, as some of these platforms do not conduct proper due diligence. Some of Blockchain Australia's members have had overseas experiences of this during periods where local banking services were not available, forcing large volumes of customers onto P2P platforms and subsequently suffering losses. Furthermore, where bank accounts are obtained but are subsequently closed, funds are often frozen or transactions delayed. This leads to poor customer outcomes and can damage the reputation of Australia's FinTech sector.

Debanking is not an issue that is isolated to Australia, it is a challenge faced by crypto-asset businesses in many other jurisdictions. Some jurisdictions like the United States appear to be relaxing their positions and taking a risk-weight approach to providing banking services. As evidenced by Wyoming, a crypto-asset friendly regulatory approach has even facilitated new business models.

Blockchain Australia would welcome:

- An open and ongoing dialogue with banking institutions.
- Qualitative guidance on the matters of greatest concern to banking institutions about the sector.
- Guidance from banking institutions with respect to risk matrix assessments criteria that inform or are deemed a guide for best practice.
- An opportunity to facilitate a discussion between banking institutions and the track and trace businesses such as our members Chainalysis and Elliptic.

Recommendation 6: That the banking and competition regulators, APRA, the RBA and the ACCC, follow the lead of the United States in ensuring that there is an appropriate, transparent and communicated risk-weighted approach to providing banking services to businesses and individuals in the crypto ecosystem.

8.1.6 Taxation

The Australian Taxation Office has elevated information campaigns surrounding the need for consumers to report gains/losses from participation in the cryptocurrency sector. It is our experience that education and clarity with respect to the taxation implications of cryptocurrency and digital assets is lacking for the average consumer without the assistance of professional taxation advice.

It is also our experience that fundamentals have not been well communicated to consumers who continue to seek advice in relation to their obligations with insufficient guidance or assistance from the ATO. Broadly speaking the accounting profession has not moved quickly to assess or address the burgeoning downstream implications of this asset class. This may in part be related to the lack of professional advice being provided to industry participants. The

subject matter of which address below in the section relating to the Australian Financial Service Licences.

In the short term we encourage the ATO to engage with industry to better understand the development of the technology. We also encourage the ATO to provide greater baseline guidance on the current tax treatment of digital assets and cryptocurrency. Including the capital gains tax regime implications for investors that are using smart contracts and nodes.

There is a lack of clarity as to the tax treatment of some increasingly popular uses for crypto-assets, and Australia's tax system is not suited to handle crypto-assets or decentralised finance in any practical sense. Given the complexity involved in discussions of tax, our view is that the ATO and Treasury should aim to be more collaborative in their dealings with industry so that policymakers can better understand the practicalities involved. We urge these bodies to improve their working knowledge of crypto-assets and we note and endorse Recommendation #5 from the Digital Law Association:

> *"The Australian Treasurer instruct the Board of Taxation to undertake a comprehensive review of the federal, state and territory tax systems to recommend amendments required so the tax law does not produce anomalous outcomes to the economic intention of digital transactions, and for recommendations to be made by 1 April 2022."*

In our view, the ultimate outcome of such a review, as proposed by the Digital Law Association, should be that the ATO is empowered to issue more practical tax guidance for consumers and businesses such that tax enforcement is grounded in the reality of how digital asset technology is used by its adopters.

The technology underpinning the development of the digital asset and cryptocurrency sector is borderless. The implications of this fundamental shift in the high speed delivery of data, representing tangible value, requires a root and branch review of tax policy.

Recommendation 7: That the ATO consider and issue practical tax guidance that is consistent with how end users interact with the crypto ecosystem while a more comprehensive review of the tax system (in line with recommendation 5 of the Digital Law Association) is undertaken.

8.1.7 Existing Legal Obligations

The need for and focus on consumer protection is a fundamental tenet of the proposals put forth in this submission.

Blockchain Australia notes existing legal consumer protections including the general protections under the *Competition and Consumer Act 2010* which includes those provisions

around misleading and deceptive conduct to ensure that businesses do not engage in conduct or advertising that is likely to mislead consumers.

Furthermore, the unfair contract term regime protects consumers against unfair terms in standard form consumer contracts. This is designed to ensure that terms are not one-sided to favour the business over the consumer, that there is no commercial reason why the business needs the term, and that there is no consumer loss if the term is enforced.

These existing measures, combined with Blockchain Australia's recommendations on guidance and engagement, will provide clarity and immediate uplift in consumer protections, enhance existing arrangements whilst working towards a longer term framework.

8.2 Legislative Reforms

While actions taken by regulators, the development of a safe harbour and greater engagement would provide consumers and businesses with confidence and certainty in the short to medium term, there is a need to move to a fit-for-purpose framework for the regulation of certain crypto-assets which makes it clear what is and isn't regulated. This is required for Australia to compete internationally not only with "crypto-friendly" jurisdictions but also to keep pace with our traditional peers such as the UK, the US and Canada. There is an opportunity for Australia to not only catch up with other jurisdictions but to leapfrog them and be globally considered a crypto-friendly jurisdiction.

Given the rapidly changing nature of the industry, it is important that any regulatory regime in Australia be carefully considered and developed in close consultation with the industry. In the interim, it is important that our recommendations to form a cross-industry working group, as well as to ensure that there is a safe harbour mechanism, are implemented to provide businesses and consumers with greater certainty.

Below, we outline legislative reforms which should be considered in the first instance. Given the interconnected nature of Australia's financial regulatory regime, this is a non-exhaustive list and further reforms may need to be undertaken. However, these reforms should be prioritised.

8.2.1 Token Mapping

Many overseas jurisdictions have attempted to classify crypto-assets (or token classification) for the purposes of regulatory treatment. While there have been attempts made in overseas jurisdictions to classify crypto-assets for the purposes of regulatory treatment, these approaches have been inconsistent.

Token classification has formed the basis of many overseas crypto-asset frameworks, providing definition and clarity as to those characteristics or activities that are excluded or captured by regulation.

While we should not be bound by them, there is value in understanding the approaches that have been taken by other jurisdictions. Where it is possible and logical to do so, we should consider regulatory harmonisation. In earlier parts of our submission, we have outlined the approach taken in jurisdictions such as Singapore, Switzerland, the UK and the EU. It is important that we understand these.

An understanding of the characteristics of tokens and mapping their characteristics such as the rights they confer to users, is an important first step in developing a framework that captures certain crypto-assets. Our preliminary view is that the approach taken by the FCA would be a good starting point. The FCA sets out three broad classes, being:

- e-money tokens
- security tokens
- unregulated tokens: these are neither e-money tokens nor security tokens and include:
    - utility tokens; and
    - exchange tokens

The FCA is currently considering adding another classification to capture stablecoins or tokens with similar characteristics.

We provide further explanation on the FCA classification in section 5.5.

Recommendation 8: That a comprehensive token mapping exercise be undertaken, including examining the work done on token classification in overseas jurisdictions, as the first step in a broader, fit-for-purpose regulatory framework.

8.2.2 Providing Financial Advice

A new licensing regime, modelled off the existing Australian Financial Services Licence (**AFSL**), should be introduced to allow the provision of financial advice relating to crypto-assets.

The crypto asset class has arrived. Professional advice with respect to the asset class has not, and consumer protection is being compromised as a result.

Under the existing AFSL framework, you are required to hold a licence to provide financial advice. ASIC outlines in *Regulatory Guide 244 – Giving information, general advice and scaled advice* (**RG244**) the circumstances when an entity is required to hold an AFSL. Financial product advice generally involves a qualitative judgement of the features of a product. If you are deemed to make a recommendation or statement of opinion about a financial product then you are deemed to be giving financial advice and will be required to hold an AFSL.

You do not need to hold an AFSL if you are only providing factual information. ASIC defines factual information as "information that is objectively ascertainable information, the truth or

accuracy of which cannot be reasonably questioned".[35] However, if factual information is presented in a way that could suggest or imply a recommendation about what a client should do, then it is likely to be financial advice.

Under the AFSL framework, advice can be classified as either general or personal advice. ASIC RG244 outlines the differences between the two:

1. General advice: a recommendation or opinion about a financial product that is not tailored to an individual's personal circumstances. It does not take into account factors such as: income, expenses, assets, goals or risk tolerances.
2. Personal advice: a recommendation or opinion that is tailored to an individual's circumstances and takes into account an individual's financial situation and goals. When providing personal advice, advisors are subject to additional obligations such as the duty to act in the best interests of the client.

The recent High Court judgment in *Westpac Securities Administration Ltd & Anor v Australian Securities and Investments Commission* [2021] HCA 3 also reinforces that as long as one or more of the person's objectives, financial situation or needs is considered, the advice will be personal advice.

Currently, the AFSL regime and the accompanying regulatory guide is not fit-for-purpose to practically allow for the provision of financial advice, either general or personal, in relation to crypto-assets as a financial product and this is not in the best interests of Australian consumers. It is not sufficient to be limited to providing factual information as many customers may already have existing holdings or are looking for advice on when to rebalance their portfolios, or how to exit from a particular investment.

A new licensing category, modelled off the requirements to hold an AFSL, that allows for the provision of crypto-asset financial advice would allow competent and qualified advisors to provide advice that is tailored to an individual and takes into account their circumstances and risk profile. A new category of licensing would avoid the problems that would arise by attempting to fit crypto-assets into a framework that is not suited to these assets.

As a relevant new class of assets, many retail investors are having to "go it alone" investing in crypto-assets without any fundamental understanding of the technology, or without a clear strategy. The rise of "finfluencers" on social media platforms are an in plain sight response to the void left by inaction. These social media platforms may be providing unregulated financial advice, without any compulsion to act in the best interests of their client, and some people may be paid to market a particular token in contravention of ASIC's ban on conflicted

[35] *Regulatory Guide 244: Giving information, general advice and scaled advice*, ASIC (Dec. 2012), https://asic.gov.au/media/3336151/rg244-published-25-august-2015.pdf.

remuneration. Such scams and conflicts could be avoided if consumers had access to licensed financial advisors.

Given the often volatile nature of some crypto-assets, it is important that those consumers who wish to access quality advice be able to receive sound guidance. For example, a customer may have made substantial returns and may wish to seek financial advice in respect of when it is best to sell and take profit. However, the provision of such information would fall outside the scope of factual information and be considered financial advice, which cannot be provided without a licence.

An explanation of the risks associated with these assets and what actions they should take could be considered financial advice. The provision of factual advice would not provide sufficient protection for this customer and they may seek that information elsewhere which may not be accurate.

There is an opportunity for financial advice to be provided to consumers, including:

- Explaining to customers and testing their comprehension of crypto-assets and their ability to use the technology;
- Understanding why they have sought financial advice and their longer term financial goals;
- Matching the risk tolerances of a client and the underlying crypto-asset; and
- De-risking a client who may have made previous investments and limiting any further undesired exposure to risk.

Demand for crypto-assets in Australia is increasing. A survey by comparison site Finder shows that 25 per cent of Australians either own, or plan to own, cryptocurrency by the end of 2021.[36] This figure is as high as 44 per cent among millennials. Vanguard Australia's survey of attitudes towards investment also shows that, because of the barriers to advice, many Australians rather seek the opinions of family, friends, media and social influencers.[37]

ASIC research shows that Australians want to seek out financial advice because they feel they are not qualified themselves, or have insufficient expertise.[38] Given the increasing levels of demand for crypto-assets, there is an opportunity for a new sector to develop in Australia in providing regulated financial advice in relation to crypto-assets.

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[36] *Crypto craze: 4.8 million Aussies to own cryptocurrency this year*, Taylor Blackburn (Feb. 9, 2021), https://www.finder.com.au/cryptocurrency-uptake-australia.
[37] *New Vanguard research explores Australian attitudes to investing*, Vanguard Australia (May 25, 2021), https://www.vanguardinvestments.com.au/au/portal/articles/insights/mediacentre/australian-attitudes-to-investing.jsp.
[38] *Report 627: Financial advice: What consumers really think*, (Aug. 2019), https://asic.gov.au/media/5243978/rep627-published-26-august-2019.pdf.

Rice Warner's Future of Advice report outlines some of the broader benefits to Australian consumers and the economy of having access to quality financial advice including tangible economic benefits, intangible impacts including greater confidence in decision making and broader benefits to the Australian economy.[39] Crypto-assets as an emerging asset class should not be excluded from the advice framework for the many millions of people who have made an investment in them.

Without a clear framework and safe harbour provisions as recommended by this submission, Australian consumers who wish to access expert advice will continue to be pushed to unregulated sources of information.

Recommendation 9: A new licensing regime, modelled off the AFSL framework, should be developed so that entities that wish to provide general or personal financial advice in relation to crypto-assets as part of their business model can be authorised. A safe harbour and transition period should be provided.

8.2.3 Australian Markets Licence

In Australia, a financial market is a facility through which offers to buy and sell financial products are made and accepted. In order to operate a financial market a participant must be licensed by ASIC or be exempted by the Minister. With licensing, a market operator is subject to a wide range of licence obligations such as reporting requirements and operating rules. For example, one common financial product used by investors are derivatives.

Access to a derivatives market is a key facet of a robust and mature financial services market. These are important as they allow investors to hedge their positions alongside offering other opportunities. This principle applies equally for crypto-assets and is arguably more important given the relatively higher volatility of crypto markets. This is highlighted by the size of the derivatives market compared to the spot market.

According to research from Carnegie Mellon University, over USD100 billion of crypto derivatives are traded on a daily basis during peak periods and this is growing rapidly.[40] The research estimates that, on average, the size of the crypto derivatives market is five times the trading volume of spot markets worldwide. Not only are these products an important hedge, but they represent a significant economic opportunity for any jurisdictions that are able to provide a stable regulatory environment for crypto-asset derivative exchanges to operate.

In Australia, there are existing exchanges that provide crypto-asset derivatives through a contract for difference (**CFD**) such as eToro and Plus500. A CFD is merely a contract between

[39] *Future of Advice*, Rice Warner (Aug. 6, 2020), https://www.ricewarner.com/future-of-advice/.
[40] *Cryptocurrency Derivatives Markets Are Booming, New Study Shows*, Carnegie Mellon University (Apr. 19, 2021), https://www.cmu.edu/tepper/news/stories/2021/april/cryptocurrency-derivatives.html.

a buyer and seller to exchange the value of a financial product between the time the contract opens and closes.

However, digitally native derivatives have their own unique characteristics which combine the hedging opportunities provided by derivatives such as the management of risk with the technological benefits of the blockchain including being underpinned by a smart contract. Because they are tokenised, they can also be traded between exchanges or withdrawn to a user's wallet.

Australia's regulatory framework does not take into account such products. Our traditional securities legislation has evolved over time and there is a deep understanding as to how these are structured. However, the nature of these digitally native derivatives means that they are fundamentally different in structure. For example, it is not always the case that there is a central body issuing a crypto-asset, the most famous example being Bitcoin. Many crypto-assets are also evolving in real-time, requiring regulators to keep pace. Digitally native derivatives are only just one such example.

Some impediments imposed by the current framework on an entity seeking a markets licence for digitally native derivatives include:

1. Continuous disclosure rules in respect of price sensitive announcements – these are an important consumer protection which is enshrined in legislation and the listing rules. This is possible to follow when you have one central organisation or company issuing the notices or where a centralised exchange (such as the ASX) can enter a trading halt during periods where the market may not be "informed". However, this is not the case where you have developer communities and node operators across the world all working on different blockchain projects.
2. Custody – we have already highlighted some of the difficulties of digital asset custodianship in Australia, including the lack of third party custodians that operate in Australia. Crypto-assets differ from traditional assets due to their distributed nature. Custodians will hold part control over the private keys (effectively the rights to the tokens), but there is no share certificate which acknowledges ownership. Rather it is control over the private key which confers ownership. This forces exchanges that wish to offer digitally native derivatives to take on additional risks not shared by traditional exchanges.
3. Clearing and settlement requirements – traditional securities exchanges often have clearing and settlement rules such as a T+2 timeframe and safeguards which protect both parties during this settlement time. With crypto-assets, settlement is immediate which negates the need for clearing or settlement arrangements.
4. Trading halts – under the current market integrity rules, if an asset on a derivatives market experiences a significant price movement, the exchange is required to enter a trading halt. These rules are inappropriate for digitally native derivatives where there

may be fluctuations in price over very short periods of time and other mechanisms are used to balance price movements.

Without a properly designed market licence, Australia will miss the opportunities that are afforded by some of these innovative new products. In addition, investors will not be provided the legal protections that a market operator must comply with such as acting fairly, efficiently and honestly.

Therefore local investors are forced to make a difficult choice: they must either forgo the protections afforded to them under a regulated market operator or not access new and innovative financial products or hedging mechanisms.

Recommendation 10: That a full review of the markets licence framework is conducted and amendments implemented to ensure that the licensing regime accounts for the unique nature of crypto-assets.

9 Australia as a Technology and Finance Centre

It remains difficult to fully quantify the size and scale of the potential for Australia to be a major crypto-hub. Blockchain Australia is seeking further data from our members as to the size and scale of the current ecosystem in Australia.

One resource which aims to survey the size of the crypto-asset industry globally is the Cambridge Centre for Alternative Finance's (**CCAF**) *Global Cryptoasset Benchmarking Study*. It has been conducted every two years since 2016. Over that period of time, there has been a rapid increase in not only the users of crypto-assets but also the number of people employed in the industry.

Data from the 3rd Global Cryptoasset Benchmarking Study estimates that there are a total of 101 million unique users across 191 million accounts as of Q3 2020.[41] This is up from approximately 35 million unique users in 2018. The data suggests that employment in the sector has also continued to grow – reporting a year-on-year growth of 21 per cent in 2019, down from 57 per cent in 2018. Anecdotally, there is likely to be significantly higher growth in 2020 given the market activity seen towards the latter half of 2020 and into the start of 2021.

As a region, the Asia-Pacific continues to have the larger number of high-growth enterprises (that is, enterprises that have experienced over 10 per cent growth in FTE over a three year period) and the report suggests that higher growth firms account for a larger part of employment in the industry relative to small growth firms. Many of these Asia-Pacific firms are based in Singapore, Hong Kong and China (though the number of miners and people operating in China has dropped since China's most recent crackdown on crypto mining).

We have previously highlighted that many entities are "jurisdiction shopping" or seeking regulatory arbitrage. However, the CCAF report states that "[i]n this context, the concept of 'regulatory arbitrage' slightly departs from its traditional meaning. It is understood as seeking maximum regulatory certainty and the most benign environment, rather than to exploit legal and regulatory loopholes (i.e. absence of regulation) as is often discussed in other industries." The data shows that nearly one in three companies sought regulatory approval from outside its main jurisdiction of operations.

Another approach to investigate geographic relocation of entities to amenable jurisdictions is to compare the operational headquarters to the country of incorporation. Of the surveyed entities, 22 per cent are incorporated in a different country to where their headquarters are based and 15 per cent in a different region.

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[41] *3rd Global Cryptoasset Benchmarking Study*, Cambridge Centre for Alternative Finance (Sep. 2020), https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/3rd-global-cryptoasset-benchmarking-study/

One of the top countries for entities to incorporate in is Switzerland. While we have only provided a brief overview of Switzerland in this submission, some of the largest names count Switzerland as home, including Ethereum, Cardano, Polkadot and Diem (Libra). "Crypto Valley" is a blockchain cluster spanning Liechtenstein and Switzerland which is centred around the Swiss canton of Zug. A recent survey conducted by Crypto Valley Venture Capital and PwC puts the number of companies specialising in blockchain in Crypto Valley at 960 employing nearly 5200 people.[42] The market valuation of the 50 largest companies is USD255 billion including 11 companies worth over USD1 billion.

The authors of the survey count blockchain legislation as one reason why Crypto Valley has been successful stating that "[w]ith the newly introduced Blockchain legislation, Switzerland boasts one of the world's most advanced Blockchain legislations and has thus created a strong and solid foundation for the future prosperity of Crypto Valley. In addition, the Corona pandemic has forced digitization to accelerate, which has greatly benefited blockchain technology".

Case Study: Payment Service Provider

In one instance, an Australia-based payment service provider that enables the secure conversion between fiat and digital currencies was looking to secure funding and seek to expand their operations in Australia. The company raised more than $30 million initially, mostly from overseas investors and looked to explore a public listing as part of their expansion plans. Approaching the ASX, they found that the exchange was not receptive to their business model despite having operated in Australia for some time. Subsequently they turned to overseas jurisdictions and identified the Toronto Stock Exchange as an appropriate destination as Canada's greater regulatory certainty meant that they were able to be recognised. The company listed in January 2021 and has since grown from an initial listing of $40 million to $200 million. The company found that they were able to secure more strategic investors and higher valuations listing overseas.

[42] *Record growth in Crypto Valley despite Corona*, PwC Switzerland (Mar. 4, 2021), https://www.pwc.ch/en/press/record-growth-in-crypto-valley-despite-corona.html.

Appendix A: Timeline of actions for a coordinated and graduated approach

Overarching recommendation: That Australia take a coordinated and graduated approach to the regulation of crypto-assets, to provide greater certainty to consumers and businesses, while working to develop a fit-for-purpose framework that will facilitate an environment conducive to innovation and competition in crypto-assets.

Recommendation	Timeline for completion
0 - 6 months	
That the government and relevant regulators should provide crypto-asset providers a safe harbour until such a time that they introduce guidance or legislation. Any legislation should contain an appropriate transition period and not apply retrospectively.	As soon as possible.
That a cross-industry and regulatory working group be established to facilitate greater communication between the crypto-asset industry and the regulators. The first exercise to be undertaken by the group should be a token mapping exercise, examining the work done in overseas jurisdictions.	Initial meeting within 3 months.
6-12 months	
ASIC update RG133 to explicitly state that licensed custody providers can provide crypto-asset custodial services.	ASIC to consult on updating guidance within 6 months.
That the ATO consider and issue practical tax guidance that is consistent with how end users interact with the crypto ecosystem while a more comprehensive review of the tax system (in line with recommendation 5 of the Digital Law Association) is undertaken.	ATO to consult on updating guidance within 6 months. Comprehensive tax review to report within 12 months.

12-18 months	
Regulatory resourcing, in particular at ASIC, that is dedicated to crypto-assets should be increased to assist with the timely implementation of the recommendations made in this submission. This could be through a combination of increased government funding or changes to the ASIC levies.	Resourcing to be increased gradually in preparation of the development and implementation of a regulatory regime.
That a comprehensive token mapping exercise be undertaken, including examining the work done on token classification in overseas jurisdictions, as the first step in a broader, fit-for-purpose regulatory framework.	Exercise to be completed within 12 months to allow information to be utilised in the development of a long term policy framework.
18-24 months	
A new licensing regime, modelled off the AFSL framework, should be developed so that entities that wish to provide general or personal financial advice in relation to crypto-assets as part of their business model can be authorised. A safe harbour and transition period should be provided.	A regime to be designed and legislated within 1.5-2 years (with a transition period).
That a full review of the markets licence framework is conducted and amendments implemented to ensure that the licensing regime accounts for the unique nature of crypto-assets.	A review to be completed and recommendations to be designed and legislated within 2 years (with a transition period).
Ongoing	
That AUSTRAC accelerates engagement with the industry on the consideration, application and implementation of the travel rule and to ensure that there is a sufficient consultation and transition period.	Ongoing.
That the banking and competition regulators, APRA, the RBA and the ACCC, follow the lead of the United States in ensuring that there is an appropriate, transparent and communicated	Ongoing.

risk-weighted approach to providing banking services to businesses and individuals in the crypto ecosystem.	