



CPA Australia Ltd
ABN 64 008 392 452

Level 20, 28 Freshwater Place
Southbank VIC 3006
Australia

GPO Box 2820
Melbourne VIC 3001
Australia

Phone 1300 737 373
Outside Aust +613 9606 9677
Website cpaaustralia.com.au

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

By email: crypto@treasury.gov.au

Dear Sir / Madam,

Submission on Crypto asset secondary service providers: Licensing and custody requirements

CPA Australia represents the diverse interests of more than 170,000 members working in 100 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

The creation of a proportionate regulatory framework for crypto assets and CASSPrs is a necessary step to reduce regulatory arbitrage and to ensure adequate protection of the interests of investors, businesses and the public. We believe that regulatory certainty for crypto assets that are considered financial products will benefit crypto asset investors and the industry alike.

In our view, financial services regulation is applicable to financial crypto assets but unsuitable for non-financial crypto assets. Our main concern is that the proposed definition of crypto asset, which is supposed to be applied across all Australian regulatory frameworks, does not consider the accounting definition of an asset.

We suggest the Treasury considers the following recommendations:

- Use terminology such as Virtual Asset Service Provider (VASP) used in other jurisdictions to define crypto asset service providers.
- Refer to blockchain/Distributed Ledger Technology (DLT) in the crypto asset definition.
- Consider accounting regulation in the proposed crypto asset definition.
- Ensure that investors and consumers benefit from equivalent protections as they would expect when investing in financial products.
- Include financial stability and market integrity, financial literacy and investor education, fair competition, responsibility and sustainability, and collective development of harmonised rules in the policy objectives.
- Consider a temporary ban on financial advice which takes into account an investor's personal circumstances, unless that advice is provided by financial advisers operating under an AFS license.
- Consider existing frameworks and maps to classify different crypto assets as part of the token-mapping exercise.
- Conduct the token-mapping exercise before proposing regulatory frameworks and/or licensing regimes.
- Form a task force to lead and inform further policy discussions.
- Allow crypto asset innovators and CASSPrs to participate in ASIC's Enhanced Regulatory Sandbox.

CPA Australia's perspectives on these issues are provided in the attachment to this letter.

If you have any questions about this submission, please do not hesitate to contact Dr. Jana Schmitz, Digital Economy Policy Lead at CPA Australia on jana.schmitz@cpaustralia.com.au.

Yours sincerely

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

Dr Gary Pflugrath FCPA
Executive General Manager, Policy and Advocacy

Encl.

Attachment

Proposed terminology and definitions

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

In our view, the proposed terminology appears vague and undefined.

Treasury's definition of CASSPrs includes "safekeeping and/or administration of virtual assets or instruments enabling control over crypto assets". We note that safekeeping can include a range of hosting services that vary from simple cloud hosting services to those that involve some degree of control or escrow. Private key cryptography is similarly used universally in encrypting or signing of digital data and so may not offer sufficient qualification for the definition. Further, mentioning virtual assets and crypto assets in the same sentence without distinguishing the terms may cause confusion.

Further, the terminology should be the same or very similar to that used in other jurisdictions. For instance, the [Financial Action Task Force's \(FATF\)](#) definition of Virtual Asset Service Provider (VASP) is used, amongst others, in Hong Kong and Singapore. As Treasury's proposed terminology 'CASSPrs' is almost identical to the definition of VASPs, we do not see the need for creating a new term, i.e., CASSPrs. Further, the term "secondary" seems unnecessary.

Considering the need to take a harmonised policy approach, we encourage the Treasury to consider using terminology deployed in other jurisdictions.

Recommendation 1: Use terminology such as VASP used in other jurisdictions to define crypto asset service providers.

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

VASPs, as proposed in our response to Q1.

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

With respect to crypto staking, which generates rewards in form of new tokens of the staked cryptocurrency itself, we propose including "create" in the definition of a crypto asset. Further, we note that ASIC's current definition bears the risk of being over-extended to include a digital "representation of value", in particular of usage rights, and thus akin to digital vouchers or other means to provide proof of right to gain access to products or services. To avoid the definition of crypto asset being too broad, we propose including reference to the underlying technology, i.e., blockchain and/or distributed ledger technology (DLT) in the definition.

We therefore propose the following definition of a crypto asset:

"a digital representation of value or contractual rights that can be *created*, transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by *cryptographically secured blockchain/distributed ledger technology*."

A similar approach was taken in the [European Commission's MiCA](#), which defines a crypto asset as "a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology".

Moreover, we believe that a clearer distinction is needed between crypto assets that qualify as financial products (payment or investment function) and other crypto assets that primarily serve as means to legitimise the access to certain products or services. We suggest Treasury revisits the definition of crypto asset once the token-mapping exercise was finalised (see also our response to **Q29**).

See also our response to **Q4**.

Recommendation 2: Refer to blockchain/DLT technology in the crypto asset definition.

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

In general, we support the proposal to develop one definition that applies to all relevant Australian regulatory frameworks. However, we foresee a definitional conflict arising between the proposed definition and the definition of “asset” for financial reporting purposes under the Australian Accounting Standards (AAS), which are legislative instruments and therefore part of Australian regulatory frameworks.

In AAS, an asset is defined as “a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.” If the proposal to develop one definition for crypto assets to apply across all Australian regulatory frameworks is pursued, the proposed crypto asset definition needs to be aligned with the definition of an “asset” under AAS.

Further, we recommend that Treasury and ASIC keep track of international accounting regulation developments as accounting standards and regulation have implications for tax policies. In June 2019, the IFRS Interpretations Committee (IFRIC) published an [agenda decision](#) in which it was concluded that holdings of cryptocurrencies should be accounted for under IAS 38 (Intangible Assets) unless they are held for sale in the ordinary course of business, in which case IAS 2 (Inventories) would apply.¹ The committee also noted that cryptocurrencies do not meet the definition of financial assets in IFRS 9 (Financial Instruments).

However, in its issues paper on [Preliminary recommended options on developing IFRS requirements for Crypto-Assets \(Liabilities\)](#), published in January 2022, the European Financial Reporting Advisory Group (EFRAG) recommended the IASB develop clarifying application guidance addressing a range of crypto asset (and liability) holders, issuers and valuation topics alongside scoping crypto assets [out of](#) IAS 2 and IAS 38 and [into](#) IFRS 9 or IAS 40 (Investment Property).² The IASB has not yet commented on EFRAG’s issues paper and recommendations, although it has included the topic for further consideration as part of a research project examining the broader topic of intangible assets.

The Board of Taxation is also currently undertaking a [Review of the Tax Treatment of Digital Assets and Transactions in Australia](#). The report is due by the end of 2022 and there may be findings in relation to the definition and treatment of crypto assets that are relevant to this proposal.

CPA Australia is monitoring the policy development surrounding accounting for and taxation of crypto assets closely and is available for further discussions with Treasury.

Recommendation 3: Consider accounting regulation in the proposed crypto asset definition.

¹ IFRIC agenda decisions only capture cryptocurrencies but no other crypto assets such as stablecoins and central bank digital currencies (CBDCs) and others.

² See also CPA Australia’s submission made in 2021 on [EFRAG’s Discussion Paper – Accounting for Crypto-Assets \(Liabilities\): Holder and Issuer Perspective](#) (prepared jointly with Chartered Accountants Australia and New Zealand (CA ANZ)).

5. Should CASSPrs who provide services for all types of crypto assets be included in the licensing regime, or should specific types of crypto assets be carved out (e.g., NFTs)?

In our view, CASSPrs that provide services involving crypto assets that are considered as financial products should be brought under the regulatory framework as they expose investors and markets to several risks. However, we note that several crypto assets such as gaming tokens have a dual function as they allow the owner/investor to ‘use’ the token for gaming purposes while earning financial rewards. CASSPrs offering services involving such ‘hybrid’ tokens should be captured by the scope of the regulatory regime.

Proposed principles, scope and policy objectives of the new regime

Policy objectives

6. Do you see these policy objectives as appropriate?

Whilst we agree with the proposed policy objective of “minimis[ing] the risk to consumers from the operational, custodial, and financial risks facing the use of CASSPrs”, we urge Treasury to create stronger consumer protections.

Investors and consumers should benefit from the same level of protection as they would expect when investing in regulated financial products. In the absence of sufficient regulatory oversight, CASSPrs may provide inadequate protections for sensitive financial data, custodial and other arrangements relating to customer assets and funds, or disclosures of risks associated with investments. Cybersecurity and market failures at major crypto exchanges and trading platforms have resulted in billions of dollars in losses. The new and unique uses and functions that many crypto assets can facilitate may create additional economic and financial risks (see also our response to **Q13**).

Recommendation 4: Ensure that investors and consumers benefit from equivalent protections as they would expect when investing in financial products.

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

Protect financial stability and market integrity. Crypto assets markets are fast evolving and could reach a point where they represent a systemic threat to financial stability due to their scale, structural vulnerabilities and increasing interconnectedness with the traditional financial system. Whilst episodes of price volatility have, so far, been contained within crypto asset markets and have not spilled over to financial markets, it is challenging to assess inflection points given the rapid evolution of crypto markets. Protecting the stability and integrity of the Australian financial market must be a top priority among Treasury’s policy objectives.

Improve financial literacy and investor education. There are significant risks associated with investing in or in the holding of crypto assets. Several of these risks are unlikely to be understood by retail investors. Hence, crypto assets are considered complex investment products. Therefore, it is necessary to impose additional investor protection measures and promote investor education. This responsibility should not only sit with regulators and government but also with industry, particularly CASSPrs offering services related to crypto assets that qualify as financial products.

Promoting fair competition and innovation. Australia’s policy approach must be innovation-friendly and not pose unreasonable obstacles to the development and application of new crypto assets and services. This is of particular relevance for small and medium-sized businesses including start-ups that have limited resources (financial and human) available. Government must ensure its overall regulatory approach is not more onerous than that in other jurisdictions to remain in a strong competitive position to attract blockchain and crypto investment and talent to Australia.

Encourage responsible and sustainable development of crypto assets (and service providers). The Australian government must ensure that the crypto asset ecosystem is developed, designed, and implemented in a responsible

and sustainable manner that includes privacy and security in its architecture, integrates features and controls that defend against illicit exploitation, and reduces negative climate impacts and environmental pollution, as may result from cryptocurrency mining activities.

Foster international coordination and collaboration on policy development. CASSPrs and cryptoassets in general operate on a borderless basis and therefore require international cooperation between regulators and governments. This cooperation is critical to develop harmonised standards and policies and maintain a level playing field. Differing regulation, supervision, and compliance across markets creates opportunities for arbitrage and raises risks to the stability of financial markets, and the protection of consumers, investors and businesses. Moreover, inadequate AML/CTF regulation, supervision, and enforcement by other jurisdictions challenges the ability of the Australian government to investigate illicit cryptoasset transaction flows to/from overseas, as is often the case in ransomware payments and other cybercrime-related money laundering.

Recommendation 5: Include financial stability and market integrity, financial literacy and investor education, fair competition, responsibility and sustainability, and collective development of harmonised rules in the policy objectives.

Crypto assets covered by the proposed licensing regime

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

We agree in principle.

Regarding the proposed crypto asset service providers licenses, we seek clarification on whether those licenses will be transferable (change of control) in the same way that Australian Financial Services (AFS) licenses are transferable.³

10. How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g., in financial services)?

To minimise regulatory duplication, it is essential for regulators to collaborate and collectively develop harmonised rules. The Council of Financial Regulators, and its members including ASIC, the Australian Prudential Regulation Authority (APRA), Treasury and the Reserve Bank of Australia (RBA), should coordinate the development of harmonised rules.

We also encourage that Australia's regulatory approach be consistent with that of other jurisdictions to minimise regulatory duplication across jurisdictions. To achieve this, we support continued collaboration between Australian and foreign regulators through bodies such as IOSCO, with the aim being to have a consistent approach to regulation, supervision, compliance and enforcement.

Proposed obligations on crypto asset secondary service providers

13. Should there be a ban on not providing advice which takes into account a person's personal circumstances in respect of crypto assets available on a licensee's platform or service? That is, should

³ See ASIC (2022): Change in control of AFS license, available at: [Change in control of AFS licensee | ASIC - Australian Securities and Investments Commission](#) (accessed on 9 May 2022).

the CASSPrs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto asset)?

For clarity, we are interpreting this question as “Should there be a ban on providing advice, which takes into account a person’s personal circumstances [...]”.

Recognising the quickly evolving crypto asset environment, there are likely to be situations where CASSPrs are providing a financial product deriving in some way from crypto assets. These should be regulated accordingly.

We consider that all measures to align consumer protections between licensing regimes is of paramount importance. We are aware that part of the uncertainty regarding the treatment of crypto assets as financial products means that a solution of apparent simplicity such as legislating crypto assets to be financial products overlooks the varied nature of the different types of products which exist. However, as explained above, these may not need to be defined in instances where investors are already able to access the retail investor protections required under the AFS licensing regime through other means.

Additional uncertainty arises in the current reviews underway at Treasury (Quality of Advice Review) and the Australian Law Reform Commission (Review of the Legislative Framework for Corporations and Financial Services Regulation) which are due to be finalised at the ends of 2022 and 2023 respectively. These reviews, together, could potentially produce a different model of financial advice – whether this involves financial products or otherwise – than has existed to date. A model of advice which is indifferent to whether financial products are used or not may obviate many of the inconsistencies which currently exist.

Consequently, we would recommend that a temporary ban be put in place, on advice which takes into account an investor’s personal circumstances, and where the retail investor protections presently in place for investment in financial products are not available. We recommend that this temporary ban be long enough to cover the Government’s response to recommendations made by the aforementioned reviews.

We would make an exemption to this ban for financial advisers who are operating under an AFS license, if they are not related parties of the platforms through which the crypto assets are accessed, and if all retail investor protections presently available to investors in financial products are also made available to investors in crypto asset products which may not require such protections.

Likewise, the availability of such assets through platforms also providing access to financial products (such as Investor-Directed Portfolio Services (IDPS), exchanges, administration services etc.) should allow for an exemption from such a ban to enable investors to receive equivalent protections as they would expect when investing in financial products (see also our response to Q6).

Finally, we believe that a complete ban on conflicted remuneration should accompany this ban, as well as any exemptions.

Recommendation 6: Consider a temporary ban on financial advice which takes into account an investor’s personal circumstances, unless that advice is provided by financial advisers operating under an AFS license.

Alternative option 1: Regulating CASSPrs under the financial services regime

15. Do you support bringing all crypto assets into the financial product regulatory regime? What benefits or drawbacks would this option present compared to other options in this paper?

We do not support a blanket approach to bring all crypto assets into the financial product regulatory regime.

Only crypto assets that are financial products should be brought into the scope of existing financial services regulation. The principle of “same business, same risk, same rules” need to be preserved to uphold the values of

transparency, fairness, stability, investor protection, and market integrity. Non-financial crypto assets should not be subject to established financial regulatory requirements as such regulation is not suitable for non-financial crypto assets and likely to unnecessarily hamper innovation. In our view, the token-mapping exercise should precede further (regulatory) discussions (see our response to **Q29**). A clear understanding and classification of crypto assets is essential to assess suitable (regulatory) frameworks for different crypto assets.

Alternative option 2: Self-regulation by the crypto industry

17. Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia?

We do not support a self-regulation approach in this situation.

Preliminary token mapping

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

To categorise and classify different subsets of crypto assets, we believe Treasury should utilise the framework and definitions provided in the Global Financial Markets Association (GFMA) [Approach to the Classification and Understanding of Crypto-assets](#) to build a more granular taxonomy (see Annex II). The GFMA approach has been developed by the crypto industry and could be an important tool for clarifying what types of crypto assets are intended to be included in the scope of the licensing regime and/or financial services regulation and what types of crypto assets are not.

Further, we recommend Treasury reviews token maps that have been developed by other jurisdictions. For instance, the European Commission's MiCA could be useful for Treasury's token mapping exercise.

Recommendation 7: Consider existing frameworks and maps to classify different crypto assets as part of the token-mapping exercise.

In our view, token-mapping needs to be conducted before further decisions are made about crypto asset regulation and the proposed CASSPrs licensing regime. Determining the economic and operational characteristics of different crypto asset 'subsets' and classifying them accordingly, is essential to assess regulatory requirements with which those subsets must comply.

Regulatory 'ringfencing' of crypto assets could be detrimental to innovation in the sector and could lead to future developments being focused on intentionally circumventing regulatory parameters. Regulators must strike the right balance between regulating and encouraging innovation. Over-regulation must be avoided.

Recommendation 8: Conduct the token-mapping exercise before proposing regulatory frameworks and/or licensing regimes.

The market is likely to develop significantly over the coming year(s) and we believe it is important that there is close engagement between the industry, financial advisers, investors and the regulatory community. We therefore recommend the establishment of a task force to facilitate ongoing discussions.

Recommendation 9: Form a task force to lead and inform further policy discussions.

While we appreciate Treasury's effort to complete a token-mapping exercise by the end of 2022, we believe that such an exercise should be undertaken on an ongoing basis considering the continuous development of novel crypto asset subsets and products. This long-term exercise should be supported by regulatory oversight.

To allow regulators to closely monitor and oversee the development and execution of novel crypto asset subsets and projects, we suggest that ASIC permits crypto asset developers and innovators, as well as CASSPrs, to partake in its Enhanced Regulatory Sandbox.

Recommendation 10: Allow crypto asset innovators and CASSPrs to participate in ASIC's Enhanced Regulatory Sandbox.

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

The existence of blockchains and crypto assets specifically designed to ensure secrecy over the sender, the receiver and the amount transferred, create almost risk-free ways of laundering money originating from criminal activities, or hiding the financing of terrorist organisations. Australian regulators must find ways to ban crypto assets designed to make users untraceable.