

Treasury consults on new crypto asset licensing regime

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AT A GLANCE:

- Treasury has released a consultation paper regarding the possible regulation of secondary service providers of crypto assets (**CSSPs**).
- The consultation paper highlights the current 'patchwork' nature of regulation of crypto assets, noting that some crypto assets may already be subject to the existing Australian Financial Services (**AFS**) or consumer law frameworks.
- The consultation paper proposes regulating CSSPs through a new licensing regime, which includes existing duties under the current AFS regime but with a bespoke set of duties and obligations tailored to the nature of, and risks posed by, CSSPs.
- The consultation paper is directed at the proposed regulation of CSSPs only. It is not directed at the regulation of primary crypto asset providers, such as product issuers.
- Financial lines insurers should familiarise themselves with the proposed new regime as it is likely to present both commercial opportunities and challenges.

CONSULTATION PAPER

On 21 March, the Treasury released a [consultation paper](#) about the regulation of secondary service providers of crypto assets (CSSPs). CSSPs allow consumers and businesses to access and use crypto assets, such as cryptocurrency exchanges.

Treasury has identified that the primary risk associated with CSSPs is the potential loss of the assets and balance via the use of the CSSP's service or platform. Treasury has specifically identified the following risks:

- operational risks, including business continuity, illiquidity and inadequate capital
- insolvency and disorderly wind down
- fraud and key personnel risks
- misleading or deceptive conduct, and
- cybersecurity.

The consultation paper is directed at the proposed regulation of CSSPs only. It is not directed at the regulation of primary crypto asset providers, such as product issuers.

CURRENT REGULATORY FRAMEWORK

The paper points out that the current regulatory framework is comprised of "*a patchwork of principles-based obligations drawn from other parts of Australian law*" and notes that there is no clear or holistic policy that directly regulates crypto assets or CSSPs.

Appendix 1 to the consultation paper includes a useful matrix of the current crypto legislation framework, as shown in the table over the page. While some crypto assets may already be subject to the existing AFS or consumer law frameworks there is currently no regulation of CSSPs apart from AML-CTF regulation of digital exchanges.

The consultation also draws attention to ASIC's Information Sheet 225 ([INFO 225](#)) regarding existing regulatory guidance on potential, and present, exposures under the *Corporations Act 2001* and *ASIC Act 2001* regarding crypto assets.

“A patchwork of principles-based obligations drawn from other parts of Australian law”

Table 1: extract from Appendix 1 (Table 1) of consultation paper

Overview of Australian crypto asset regulation					
Category	Financial product	Not a financial product	AML/CTF	Taxation	Financial Stability
Regulator/ agency	ASIC	ACCC	AUSTRAC	ATO	RBA, APRA, ASIC
Relevant legislation	<i>Corporations Act, ASIC Act</i>	Australian Consumer Law	<i>AML/CTF Act</i>	<i>Income Tax Act, Goods and Services Tax Act</i>	<i>Payments Systems (Regulation) Act, Corporations Act, Banking Act</i>
Details	<p>If the crypto asset is a financial product, it will be subject to certain obligations and requirements under the Corporations Act and ASIC Act which are designed to protect investors. This includes prohibitions on misleading and deceptive conduct or unconscionable conduct, “hawking” or pressure selling, requirements as to disclosure about the features and characteristics of financial products before sale, and, for those financial products traded on financial markets, prohibitions on market manipulation.</p>	<p>For crypto assets that are not financial products, the provisions of the Australian Consumer Law apply including prohibitions against misleading and deceptive conduct.</p> <p>Businesses may engage in conduct that involves a combination of financial and non-financial products or services. To address this potential overlap, in 2018, the ACCC delegated powers to ASIC to take action under the Australian Consumer Law relating to digital currencies and digital tokens (which includes crypto assets).</p>	<p>Digital currency exchanges are regulated by the Australian Transaction Reports and Analysis Centre (AUSTRAC) under the Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) Act for the purposes of preventing and detecting money laundering and terrorism financing.</p> <p>Digital currency exchanges must register with AUSTRAC and meet AML/CTF compliance and reporting obligations (including Know Your Customer requirements).</p>	<p>Investors in crypto assets and other market participants are subject to tax laws. Australia has not implemented crypto asset specific tax laws. If an entity is carrying on a business in relation to digital currency, or as part of their existing business, or if they are accepting digital currency as a payment in business, the entity needs to consider any GST consequences that may arise.</p> <p>Tax implications for investors flow from the underlying nature of the rights and obligations attached to the asset and the personal circumstances of the investor.</p> <p>Crypto assets will generally be capital assets, meaning there could be capital gains tax consequences.¹</p>	<p>Banks, payment systems and financial market infrastructures such as clearing and settlement facilities are subject to regulation administered by RBA, APRA and ASIC. In the event a regulated entity was to involve crypto assets in its operations (e.g. through exposure to crypto assets or the use of crypto assets in the clearing and settlement of financial products) then the relevant regulator may impose additional requirements on the regulated entity to reflect the increased level of risk.</p>

¹ For more details, see Australian Taxation Office, [Transacting with cryptocurrency](#), ATO, 2020, accessed 10 March 2022.

REGULATORY PROPOSALS

Treasury has sought feedback on two key matters – terminology and regulation.

1. Terminology

The paper seeks submissions as to whether:

- a single definition of “crypto asset” ought to be developed to apply across all Australian regulatory frameworks, and in particular whether ASIC’s definition is precise and appropriate. ASIC defines “crypto asset” as ...

a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof.

- a single definition of “crypto asset secondary service provider” ought to be developed to apply across all Australian regulatory frameworks and in particular whether the following definition proposed by the paper is appropriate:

any natural or legal person who, as a business, conducts one or more of the following activities or operations for or on behalf of another natural or legal person:

- exchange between crypto assets and fiat currencies*
- exchange between one or more forms of crypto assets*
- transfer of crypto assets*
- safekeeping and/or administration of virtual assets or instruments enabling control over crypto assets, and*
- participation in, and provision of, financial services related to an issuer’s offer and/or sale of a crypto asset.*

2. Regulation

While Treasury acknowledges some crypto assets may be subject to the existing AFS regime (under Chapter 7 of the Corporations Act), it intends to regulate the secondary service providers regarding those assets. In particular Treasury intends to regulate CSSPs that:

- provide retail consumers access to non-financial product crypto assets
- provide safekeeping, custody or storage of all crypto assets on behalf of a consumer, and
- are captured by the Financial Action Task Force’s definition of a Virtual Asset Service Provider for AML/CTF reasons.

Significantly, the paper proposes the introduction of a separate licensing regime to the AFS licensing regime for CSSPs. The regime would impose some of the obligations that apply under the AFS regime, such as obligations to act honestly, fairly and efficiently, but also some bespoke obligations including (but not limited to):

- to take reasonable steps to ensure that the crypto assets it provides access to are “true to label”, for example that a product is not falsely described as a crypto asset, or that crypto assets are not misrepresented or described in a way that is intended to mislead
- not hawking crypto assets
- to respond in a timely manner to ensure scams are not sold through their platform
- comply with AML/CTF provisions, including a breach of these provisions being grounds for a licence cancellation, and
- maintain adequate custody arrangements.

There are a series of proposed custody requirements outlined in the paper, with the paper noting that custody of client assets is a core part of the business model of most CSSPs and that the security of consumers’ private keys (similar to passwords) are of critical importance. The proposed custodial obligations include:

- holding assets on trust for the consumer
- ensuring that consumers’ assets are appropriately segregated
- maintaining minimum financial requirements, including capital requirements
- ensuring that the custodian of private keys has the requisite expertise and infrastructure
- ensuring private keys used to access the consumer’s crypto assets are generated and stored in a way that minimises the risk of loss and unauthorised access
- adopting signing approaches that minimise ‘single point of failure’ risk
- using robust cyber and physical security practices
- achieving independent verification of cybersecurity practices
- implementing processes for redress and compensation in the event that crypto assets held in custody are lost
- when a third-party custodian is used, ensuring that CSSPs have the appropriate competencies to assess the custodian’s compliance necessary requirements, and
- ensuring any third-party custodians have robust systems and practices for the receipt, validation, review, reporting and execution of instructions from the CSSP.

The alternative regulatory options posed by the paper include regulating CSSPs under the existing AFS financial services regime, or self-regulation by the crypto industry through a code of conduct that has been approved by a regulator.

IMPLICATIONS FOR INSURERS

The consultation paper raises three key issues for insurers.

First, the current regulatory environment for crypto assets is uncertain. Some crypto assets may already be subject to financial services and/or consumer protection laws, while others are not. This, in itself, presents a challenge to insurers (particularly financial lines insurers) in assessing the liability and risk framework within which its insureds are operating where those insureds are dealing with crypto assets.

Another issue is that the regulatory position is still being determined. The Commonwealth Government has recognised the need to bring some certainty to the regulatory environment within which crypto assets are bought, held and sold by starting with the application of financial services laws. The consultation paper contemplates capturing all crypto assets (whether or not they are financial products) but limiting that regulation to CSSPs. Financial lines insurers should carefully monitor these developments so they can appropriately assess the risks that arise under the proposed regulatory framework.

Finally, the consultation paper highlights the difficulties for insurers in both exploring opportunities presented by the increasing significance of crypto assets while grappling with the uncertainty posed by new risks. However, it does provide a road map of sorts that insurers can follow in assessing the commercial opportunities associated with this rapidly emerging area.

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