The Senate

Select Committee on Australia as a Technology and Financial Centre

Final report

October 2021

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Recommendation 12

6.84 The committee recommends that the Australian Government establish a Global Markets Incentive to replace the Offshore Banking Unit regime by the end of 2022.

Executive Summary

Overview

Following the release of the Senate Select Committee on Financial Technology and Regulatory Technology's first two interim reports, in September 2020 and April 2021, the committee has now undertaken a final phase of work as the Select Committee on Australia as a Technology and Financial Centre.

The committee has already made a range of recommendations in a variety of areas across its first two interim reports. The committee decided that for this phase of the inquiry, it would focus on several issues that had been identified to the committee as key areas affecting the competitiveness of Australia's technology, finance and digital asset industries, namely: the regulation of cryptocurrencies and digital assets; issues relating to 'de-banking' of Australian FinTechs and other companies; the policy environment for neobanks in Australia; and options to replace the Offshore Banking Unit.

Cryptocurrency and digital assets

The scale and speed with which cryptocurrencies and other digital assets have progressed in recent years has surprised governments, regulators and policy makers. With a global market now totalling in the trillions of dollars, the tremendous potential of blockchain technology and decentralised finance is becoming recognised by mainstream institutions and investors. Recent survey data shows that 25 per cent of Australians either currently or have previously held cryptocurrencies, making Australia one of the biggest adopters of cryptocurrencies on a per capita basis.

While other jurisdictions have moved forward in attempting to create regulatory frameworks that give market participants certainty and provide consumer protections, Australia has not yet introduced fit-for-purpose regulatory systems for these emerging technology sectors. This is creating uncertainty for project developers, businesses, investors and consumers. Two prominent Australian-founded digital currency exchanges (DCEs) have recently gained regulatory licenses in Singapore and the UK respectively, showing what Australia is missing out on by not developing an appropriate framework here.

Chapter 2 of this report outlines the current regulation of this sector in Australia and overseas, while Chapter 3 sets forth the many proposals put forward by submitters and witnesses on how digital assets could be properly regulated in Australia in order to promote innovation and attract investment while providing appropriate safeguards for investors and consumers.

The committee has put forward a series of eight recommendations to address these issues.

Firstly, it is clear that the current regulation of DCEs, which is generally limited only to registration with AUSTRAC, is inadequate for businesses that in some cases are dealing with asset volumes in the billions of dollars. A properly designed Market Licence for this sector will assist the sector to mature and create confidence.

Secondly, an appropriate regime for custodial and depository services for digital assets is required. Custody arrangements for digital assets present some unique risks that are not analogous to traditional assets, which must be carefully thought through in the development of appropriate requirements. Given the scale of Australia's existing industry for custody of traditional assets, there is significant scope for Australia to benefit from becoming a leader in the digital assets space.

Thirdly, a token mapping exercise is required to classify the various types of crypto-asset tokens and other digital assets being developed in the market, to ensure that the regulatory classifications for these assets are fit-for-purpose. This exercise should take account of the various approaches to classifying digital assets that have occurred in other jurisdictions in recent years.

A new Decentralised Autonomous Organisation legal structure is needed to ensure that emerging types of blockchain-based organisations can be established with clarity as to how they can operate in Australia. This approach has already been trialled in other jurisdictions, and in practical effect will operate similar to a limited liability company.

A review of the Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) regulations is required to ensure that these regulations are fit-for-purpose and do not undermine innovation. In particular, issues around the implementation of the Financial Action Task Force 'travel rule' have been raised with the committee as requiring attention.

Taxation rules for digital assets require further clarification. In particular, the rules around Capital Gains Tax (CGT) for cryptocurrency and digital assets need to be updated to ensure that new types of technology structures are appropriately accounted for, and digital asset transactions only create a CGT event when they genuinely result in a clearly definable capital gain or loss.

The opportunities associated with digital asset infrastructure were highlighted in evidence to the committee, as well as the energy intensity of cryptocurrency 'mining' practices. The committee is recommending a tax concession for digital asset miners operating in Australia who source their own renewable energy.

Finally, the committee heard about both the opportunities and risks associated with Central Bank Digital Currencies (CBDCs). The committee considers that

Treasury should conduct a policy review on the potential for a retail CBDC in Australia, to ensure these issues are continuing to be appropriately explored in the Australian context.

De-banking

The issue of de-banking is discussed in Chapter 4 of this report. The committee heard extremely concerning accounts from individuals and businesses that have experienced de-banking in Australia, particularly in the remittance, payments and the digital assets sectors.

The committee recognises that de-banking is a complex problem occurring for a number of reasons, including underdeveloped regulatory arrangements (particularly in the digital asset space), and the severe penalties associated with banks breaching their AML/CTF obligations. It is also clear that banks are often de-banking clients in these sectors without adequate consideration and without clear reasons. In addition, anticompetitive reasons for de-banking were also suggested to the committee. More must be done to ensure that the guidelines around de-banking are clear and there are avenues of recourse for those who have been treated unfairly.

Work by the ACCC in 2019 recommended that the government establish a working group to consult on the development of a scheme through which the due diligence requirements of the banks can be addressed. The Council of Financial Regulators has now established this working group. The committee has recommended that this work to establish a due diligence scheme should be finalised and implemented by June 2022.

The committee is also recommending that, order to increase certainty and transparency around de-banking, the Australian Government should develop a clear process for businesses that have been de-banked. This scheme should involve businesses that have been de-banked being able to have recourse to a complaints process through the Australian Financial Complaints Authority, to ensure that procedural fairness and natural justice are afforded.

The committee also heard that providing more direct access for businesses to payments rails, rather than having to rely on the major banks, can help address issues around de-banking. Noting that the recent Farrell payments review recommended that the RBA should develop common access requirements for payments systems, the committee has recommended that the RBA should develop common access requirements for the New Payments Platform in order to reduce the reliance of payments businesses on the major banks for the provision of banking services.

Other issues

The committee also considers several other issues in Chapter 5 of the report, before setting out its full conclusions in Chapter 6. In particular, the committee

has considered evidence on options to replace the Offshore Banking Unit, and is recommending that the Global Markets Incentive suggested by submitters should be implemented to replace the Offshore Banking Unit regime by the end of 2022.

Conclusion

Australia has significant potential to keep advancing as a technology and financial centre, if we grasp the opportunity to update our regulatory frameworks, drive innovation and enhance our competitiveness. The committee commends this report and the recommendations in it to government, and industry, to drive this agenda forward.

Chapter 1
Introduction

Referral

1.1 On 18 March 2021, the Senate agreed that the resolution of appointment of the Select Committee on Financial Technology and Regulatory Technology be amended as follows:

> The committee be called the Select Committee on Australia as a Technology and Financial Centre.
>
> The following additional matters be referred to the committee:
>
> the size and scope of the opportunity for Australian consumers and business from Australia growing into a stronger technology and finance centre;
>
> the flow-on employment and economic benefits which accrue to finance and technology centres;
>
> barriers to the uptake of new technologies in the financial sector;
>
> new opportunities for Australia as a technology and finance centre arising from the COVID-19 pandemic;
>
> benchmarking of comparable global regimes with Australia;
>
> the impact of corporate law restraining new investment in Australia;
>
> the policy environment facing neo-banks;
>
> opportunities and risks in the digital asset and cryptocurrency sector; and
>
> any related matters.
>
> That the committee present its final report on or before 30 October 2021.[1]

Conduct of this phase of the inquiry

1.2 On 19 May 2021, the committee released its third issues paper calling for submissions by 30 June 2021. The issues paper noted that in this phase of the inquiry, the committee would particularly focus on:

- the regulation of cryptocurrencies and digital assets;
- issues relating to 'debanking' of Australian FinTechs;
- the policy environment for neobanks in Australia;
- instances of corporate law holding back investment; and
- options to replace the Offshore Banking Unit.

1.3 During this phase of the inquiry the committee received 88 submissions. A list of submissions received by the committee is at Appendix 1.

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[1] *Journals of the Senate*, No. 96—18 March 2021, pp. 3365-3366.

1.4 The committee held 3 public hearings, all via videoconference: on 6 August, 27 August and 8 September. A list of witnesses who gave evidence is available at Appendix 2. Submissions and transcripts of evidence may be accessed through the committee website.

Acknowledgement

1.5 The committee would like to thank the organisations and individuals who have participated in the public hearings as well as those that made written submissions.

Structure of the report

1.6 The report consists of the following chapters:

- Chapter 2 provides an overview of digital assets markets in Australia and the regulatory framework for digital assets in Australia and overseas;
- Chapter 3 examines options for reforming the regulatory framework for digital assets in Australia;
- Chapter 4 explores the issue of de-banking for Australian FinTechs, and policy proposals to help address this issue;
- Chapter 5 details other issues raised in this phase of the committee's inquiry, focusing on the policy environment for neobanks in Australia and options to replace the Offshore Banking Unit; and
- Chapter 6 details the committee's conclusions and recommendations.

Chapter 2
Overview of digital assets markets and regulation

2.1 A primary focus of this phase of the committee's inquiry has been the regulation of digital and crypto-assets in Australia. The committee has engaged deeply with industry players, peak bodies, academics and regulators on these issues.

2.2 The evidence the committee has received on these issues is covered over two chapters. This chapter provides an overview of digital asset classes and the current market for these products in Australia and internationally. It then provides a broad summary of the existing regulatory framework for digital assets in Australia, and an overview of the frameworks in place in some other leading jurisdictions, as highlighted by submitters to the inquiry.

2.3 Chapter 3 then discusses options for reforming Australia's regulatory treatment of digital assets that were raised in evidence to the committee.

Overview of digital assets markets

2.4 The Australian Securities and Investments Commission (ASIC) uses the term 'crypto-asset' as an umbrella term to describe products that are also commonly referred to as 'digital assets', 'virtual assets' or 'digital tokens'.[1]

2.5 ASIC offered the following broad definition in its submission:

> A crypto-asset is a digital representation of value or contractual rights that can be transferred, stored or traded electronically. Crypto-assets use cryptography, distributed ledger technology or other technology to provide features such as security and pseudo-anonymity. A crypto-asset may or may not have identifiable economic features that reflect fundamental or intrinsic value.[2]

2.6 ASIC noted that crypto-assets 'are not a homogenous asset class', stating:

> The rights and features of each crypto-asset can raise different considerations for consumers, product issuers, and regulators. Crypto-assets are commonly regarded as speculative assets, with volatile prices and minimal to no regulatory oversight.[3]

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1 ASIC, *Submission 61*, p. 3.

2 ASIC, *Submission 61*, p. 19. ASIC noted that this definition is adapted from the UK HM Treasury's publication 'UK regulatory approach to cryptoassets and stablecoins: Consultation and call for evidence', published in January 2021.

3 ASIC, *Submission 61*, p. 19.

2.7 A brief overview of some common terms often discussed in the context of digital and crypto-assets are included here, as follows.

Cryptocurrency

2.8 The most well established and highly traded digital assets are cryptocurrencies. The Reserve Bank of Australia (RBA) described cryptocurrencies in the following terms in its submission:

> [Cryptocurrencies] have their own 'currency' unit and are not denominated in the currency of any sovereign issuer. The distinguishing feature of most cryptocurrencies is that they utilise DLT [Distributed Ledger Technology] and cryptography to store digital 'coin' ownership records and transactions in a digital ledger that is distributed (and synchronised) across a number of 'nodes' (or computers) rather than relying on a central party to operate the system. Bitcoin is the most prominent implementation of a decentralised cryptocurrency protocol, but thousands of variations have emerged. Cryptocurrencies have no intrinsic value, are typically not issued by any single entity and effectively rely on users' complete trust in the software protocol that controls the system.[4]

2.9 The RBA states that while the term 'cryptocurrency' may suggest these assets are a form of money, 'the consensus is that existing cryptocurrencies do not provide the key attributes of money', as they: are rarely used or accepted as a means of payment; are not used as a unit of account; and their prices can be very volatile so they are a poor store of value.[5]

2.10 Proponents of cryptocurrencies disagree with this assessment. Bitaroo, an Australian Digital Currency Exchange (DCE), submitted that Bitcoin, the world's most prominent cryptocurrency, provides users with 'better control over their own money and alternatives to traditional and often exclusive financial services'.[6] Proponents argue that cryptocurrencies can assist traditionally underserved and un-banked populations to access payment mechanisms. Several submitters noted that El Salvador has recently classified Bitcoin as legal tender, with other countries also reportedly considering this classification.[7]

Decentralised Finance

2.11 Decentralised Finance (DeFi) is an emerging and rapidly evolving area of financial technology. DeFi encompasses a range of blockchain-based business models and structures, with the main common factor being that DeFi solutions

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4 Reserve Bank of Australia (RBA), *Submission 37*, p. 3.

5 Reserve Bank of Australia (RBA), *Submission 37*, p. 3.

6 Bitaroo, *Submission 5*, p. 2.

7 See, for example: Bitaroo, *Submission 5*, p. 3; Dr Darcy W.E. Allen, Associate Professor Chris Berg, Professor Sinclair Davidson, Dr Aaron M. Lane, Dr Trent MacDonald, Dr Elizabeth Morton and Distinguished Professor Jason Potts, *Submission 67*, p. 10.

all attempt to 'provide functions analogous to, and potentially beyond, those offered by traditional financial service providers, without reliance on central intermediaries or institutions'.[8] DeFi aims 'to reconstruct and reimagine financial services on the foundations of distributed ledger technology, digital assets and smart contracts'.[9]

2.12 The Wharton Blockchain and Digital Asset Project identifies six major DeFi categories: stablecoins (discussed further below); decentralised exchanges for digital assets; credit products; derivatives, also known as synthetic financial instruments; insurance products; and asset management applications.[10]

2.13 Recent DeFi developments in Australia include the launch of a DeFi investment fund,[11] the development of cryptocurrency derivatives trading platforms which enabling cryptocurrency holders to lend their cryptocurrencies and earn a return, and the development decentralised insurance contracts which are programmed to pay out should software fail or criminals steal assets.[12]

2.14 Blockchain applications are also being used to tokenise real world assets. A recent example in the Australian context is the issuance of the Perth Mint Gold Token (PMGT), a partnership between Perth Mint and Trovio Capital Management which digitises physical gold in the form of GoldPass certificates, and makes a tokenised form of these certificates available on a public blockchain where investors, traders and institutions can buy and sell them on Digital Asset Exchanges.[13]

2.15 The World Economic Forum notes that although examples of DeFi have existed for several years, there was a sudden upsurge of activity in 2020, with the value of digital assets locked in smart contracts growing to over $13 billion:

> In one year, the value of digital assets locked in DeFi smart contracts grew by a factor of 18, from $670 million to $13 billion; the number of associated

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8 World Economic Forum, *Decentralized Finance (DeFi) Policy-Maker Toolkit White Paper*, June 2021, p. 6.

9 World Economic Forum, *Decentralized Finance (DeFi) Policy-Maker Toolkit White Paper*, June 2021, p. 6.

10 Wharton Blockchain and Digital Asset Project, *DeFi Beyond the Hype: The Emerging World of Decentralized Finance*, May 2021, p. 8.

11 See: Jessica Sier, 'What it's like to launch a $40m DeFi crypto fund', *AFR*, 5 October 2021, https://www.afr.com/technology/what-it-s-like-to-launch-a-40m-defi-crypto-fund-20210930-p58w3a (accessed 11 October).

12 Jessica Sier, 'The Sydney coder behind crypto's new $14b craze', *AFR*, 25 September 2020, https://www.afr.com/companies/financial-services/the-sydney-coder-behind-crypto-s-new-14b-craze-20200924-p55yvc (accessed 11 October 2021).

13 Trovio and The Perth Mint, 'Perth Mint Gold Token: Gold for the Blockchain Era', https://pmgt.io/ (accessed 10 October 2021).

> user wallets grew by a factor of 11, from 100,000 to 1.2 million; and the number of DeFi-related applications grew from 8 to more than 200. This growth in turn has stimulated interest from both the private and public sectors.[14]

Stablecoins

2.16 Stablecoins are a leading category of DeFi assets. According to ASIC, stablecoins are 'a form of crypto-asset that aim to maintain a stable value relative to a specified unit of account or store of value':

> Examples of these units or stores are as a national currency, commodity or other asset. Many other crypto-assets have prices determined solely by supply and demand and can be volatile. In contrast to these crypto-assets, stablecoins aim to maintain a specified price level. This makes them more attractive to hold as a means of payment or store of value.[15]

2.17 Several stablecoins that aim to have their price pegged to the US Dollar have gained prominence in recent times. There are not currently any stablecoins of significance linked to the Australian dollar.[16]

Central Bank Digital Currencies

2.18 The RBA submitted that a Central Bank Digital Currency (CBDC) represents a potential new form of digital money that would be a liability of, or a claim on, a central bank. The RBA explained further:

> This could include both retail CBDC, which would be like a digital version of cash that is essentially universally accessible, and wholesale CBDC, which would be accessible only to a more limited range of participants (but probably including some that do not currently have access to settlement accounts at central banks). Like cash and settlement account balances, the unit of account of the CBDC would be the sovereign currency (i.e. the Australian dollar), the CBDC would be convertible at par (i.e. one for one) with other forms of money, and it would likely also be specified to serve as legal tender.[17]

2.19 The RBA stated that while much research is occurring internationally on CBDCs, including by the RBA itself, only one country (the Bahamas) currently has a fully operational CBDC. The RBA noted, however, that the People's Bank of China is in an advanced stage of testing possible issuance of a retail CBDC or 'digital yuan'.[18]

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[14] World Economic Forum, *Decentralized Finance (DeFi) Policy-Maker Toolkit White Paper*, June 2021, p. 3.

[15] ASIC, *Submission 61*, pp. 6-7.

[16] Dr Anthony Richards, Head of Payments Policy Department, Reserve Bank of Australia, *Proof Committee Hansard*, 27 August 2021, p. 31.

[17] Reserve Bank of Australia, *Submission 37*, p. 2.

[18] Reserve Bank of Australia, *Submission 37*, p. 2.

Non-Fungible Tokens (NFTs)

2.20 NFTs are crypto-assets which 'may represent the original or licenced literary and artistic works of an author or authors or the unique contractual terms between parties'.[19] The most high-profile examples of NFTs are digital artworks, however NFT technology is broader than this, as explained by FinTech Australia:

> NFTs is a description of the technology used where something unique or a record of something unique, is maintained on a blockchain or distributed ledger. What an NFT is, depends on the nature of the information that is provided when an NFT is transferred and recorded. For example, NFTs underpin many blockchain use cases, such as in relation to supply chain management to track the movement of a particular good at a particular time, or records of trademarks. Other NFTs exist purely in the digital realm, such as collectors items, such as jpeg images, or rights in those images.[20]

Size and scope of digital assets markets in Australia and globally

2.21 ASIC noted that, consistent with global trends, it has seen 'significant interest in the Australian market for crypto-assets', which are 'available to Australian retail investors through local digital currency exchanges and overseas-based crypto-asset trading platforms'.[21]

Global market for digital assets

2.22 Recent estimates have put the current aggregate market value of the digital asset ecosystem globally at approximately $2.8 trillion AUD, with about 221 million users worldwide having traded a cryptocurrency or used a blockchain-based application as of June 2021, up from 66 million at the end of May 2020.[22]

2.23 DeFi is an area of the crypto-asset ecosystem experiencing remarkable growth. The World Economic Forum notes that although examples of DeFi have existed for several years, there was a sudden upsurge of activity in 2020:

> In one year, the value of digital assets locked in DeFi smart contracts grew by a factor of 18, from $670 million to $13 billion; the number of associated user wallets grew by a factor of 11, from 100,000 to 1.2 million; and the number of DeFi-related applications grew from 8 to more than 200. This

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[19] Digital Law Association, *Submission 49*, p. 12.

[20] FinTech Australia, Answers to Questions on Notice, p. 8.

[21] ASIC, *Submission 61*, p. 5.

[22] Timothy Moore, *AFR*, 'Digital assets sector 'too big to ignore': Bank of America', https://www.afr.com/companies/financial-services/digital-assets-sector-too-big-to-ignore-bank-of-america-20211005-p58x7w (accessed 5 October 2021).

growth in turn has stimulated interest from both the private and public sectors.[23]

2.24 The Digital Law Association (DLA) submitted that its members have undertaken preliminary research showing the significance of the global economic opportunities associated with various parts of the digital asset economy, summarised at Figure 2.1.

Figure 2.1 Potential scope of the digital asset economy

Asset Class	Global Opportunity
Stablecoins and financial services based on stablecoins / central bank digital currencies	Opportunity at least $2 trillion USD, based on 10% of the existing financial industry's size.
Digital assets generally	Centralised exchanges alone process $1.1 trillion USD per annum of digital asset transactions, plus other markets are evolving for customer due diligence and custodianship.
Blockchain based security tokens (natively digital assets)	Small current market at $700 million but projected to reach $8 trillion USD by 2025.
Tokenised real world assets (tangible and intangible)	Small existing market but with real estate value in the Australian market alone, already over $8 trillion AUD, has potential to grow rapidly
Non-fungible tokens	NFT market is $2 billion in Q1 2021. A much larger opportunity exists to enable the programmatic and atomic transfer of real world assets.

Source: Digital Law Association, Submission 49, p. 8.

Size of the digital asset market in Australia

2.25 The Australian Taxation Office (ATO) submitted that ATO data analysis in relation to cryptocurrencies and other digital assets 'shows a dramatic increase in trading since the beginning of 2020'. The ATO estimated that there are 'over 600,000 taxpayers that have invested in digital assets in recent years'.[24]

2.26 Finder submitted research findings from June 2021, based on a representative survey of just over 1,000 individuals, showing that 17 per cent of Australians currently own cryptocurrency, with a further 13 per cent of respondents saying they plan to buy cryptocurrency in the next 12 months.[25] Finder noted that close to a third of 'Gen Z' respondents currently own cryptocurrency, showing the strong interest among younger consumers.

2.27 Swyftyx, a Brisbane-based DCE, released findings in September 2021, based on a nationally representative survey of nearly 2,800 individuals, showing similar uptake: 17 per cent of respondents (the equivalent of 3.4 million individuals

[23] World Economic Forum, *Decentralized Finance (DeFi) Policy-Maker Toolkit White Paper*, June 2021, p. 3.

[24] ATO, *Submission 77*, p. 11.

[25] Finder, *Submission 43*, p. 6.

nationally) currently own cryptocurrency, while a further eight per cent have owned cryptocurrency in the past but do not currently.[26]

2.28 Independent Reserve, a Digital Currency Exchange operating in Australia since 2013, submitted that it 'services hundreds of thousands of Australian customers each year' and estimated that in FY20-21 total turnover on its platform alone will exceed AUD $5 billion, with total assets in custody 'in the hundreds of millions'.[27]

2.29 In addition to the value of crypto-assets themselves, the committee heard of the scale of opportunity in related areas to support this emerging industry. For example, Blockchain Australia noted that a new market to emerge from the growth of crypto-assets is businesses which provide digital asset infrastructure:

> Like physical assets which need to be securely stored, digital assets rely on an underlying infrastructure to support them. In most cases, this infrastructure is typically storage and computational power.[28]

2.30 Blockchain Australia noted that, for example, Bitcoin mining activities generated USD $1.5 billion in March 2021.[29] The committee heard of one digital asset infrastructure project being proposed in New South Wales involving upwards of $150 million worth of capital expenditure over two years.[30]

2.31 The DLA argued that, despite industry's efforts to assist in estimating the economic benefits of a digital asset policy framework in Australia, the lack of a single, consolidated and comprehensive assessment 'has meant government and policy-makers have not had an accessible resource from which to understand and prioritise policies in this area'.[31] It recommended that the Australian Government engage an independent body 'to properly and comprehensively assess the economic benefit of the opportunity within Australia of a digital asset policy framework'.[32]

Overview of digital assets regulation in Australia

2.32 Digital assets are generally not prescriptively regulated in Australia. Several regulators have a current role, or potential future role, in regulating these products. In particular:

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[26] Swyftyx, *Annual Australia Cryptocurrency Survey*, September 2021, pp. 2-3.

[27] Independent Reserve, *Submission 17*, p. 1.

[28] Blockchain Australia, *Submission 71.1*, p. 11.

[29] Blockchain Australia, *Submission 71.1*, p. 7.

[30] Mr James Manning, Chief Executive Officer, Mawson Infrastructure Group, *Proof Committee Hansard*, 6 August 2021, p. 24.

[31] Digital Law Association, *Submission 49*, p. 8.

[32] Digital Law Association, *Submission 49*, p. 8.

- Certain digital asset businesses must register with the Australian Transaction Reports and Analysis Centre (AUSTRAC) to manage potential anti-money laundering and counter-terrorism financing (AML/CTF) risks.
- Digital assets that meet the definition of 'financial product' under the *Corporations Act 2001* are subject to regulatory oversight by ASIC; companies dealing with these financial products need to hold an Australian Financial Services Licence (AFSL) or an Australian Market Licence, depending on the circumstances.
- The Australian Taxation Office (ATO) oversees the collection of tax revenue arising from digital asset businesses and transactions, and provides guidance on the circumstances in which tax accrues.

2.33 A number of other regulatory bodies may also affect businesses operating in the digital assets space, for example: the RBA has responsibility for payments policy and monitoring the development of digital assets intended for use as payment mechanisms, such as stablecoins; the Australian Competition and Consumer Commission regulates how businesses can market and sell products to consumers; and the Australian Prudential Regulation Authority (APRA) supervises Authorised Depository Institutions who provide services to digital assets businesses.

2.34 An overview is provided here of ASIC and AUSTRAC's regulatory role, as the bulk of the commentary in evidence to the committee related to these two regulators. The role of other regulators is discussed further in the remainder of this chapter and Chapter 3 where relevant.

Overview of ASIC regulation and licensing

2.35 Companies seeking to provide financial products or services (that is, operate a financial services business) need to apply to ASIC for an AFSL.[33] Companies seeking to operate a financial market in Australia (such as a stock exchange) need to apply to ASIC for a Market Licence.[34] These licences involve a range of obligations for licensees.

2.36 ASIC summarised its current regulation of digital assets as follows:

> ASIC currently regulates crypto-assets and related products and services to the extent they fall within the existing regulatory perimeter of 'financial products and services'… Crypto-assets that are not financial products and

[33] This generally includes businesses that: provide financial product advice to clients; deal in a financial product; make a market for a financial product; operate a registered scheme; provide a custodial or depository service; provide traditional trustee company services; provide a crowd funding service; provide a superannuation trustee service; or provide a claims handling and settling service. Some exemptions can apply in specific circumstances. See: ASIC, 'AFS licensees', https://asic.gov.au/for-finance-professionals/afs-licensees/ (accessed 1 October 2021).

[34] See: ASIC, 'Licensed and exempt markets', https://asic.gov.au/regulatory-resources/markets/market-structure/licensed-and-exempt-markets/ (accessed 1 October 2021).

> services are generally not regulated by ASIC. They may, however, be subject to other Australian laws—for example, the anti-money laundering and counter-terrorism financing laws regulated by AUSTRAC, consumer protection obligations regulated by the ACCC, and the taxation requirements regulated by the Australian Taxation Office (ATO).[35]

2.37 Under the current regulatory framework, the question of whether a particular crypto-asset is within or outside the financial regulatory framework 'depends on particular characteristics of the crypto-asset offering'.[36] ASIC noted that this can cause uncertainty for investors and consumers as well as issuers and distributors of these assets.[37] Further:

> Crypto-assets are not a homogenous asset class and each crypto-asset raises different considerations. As such, crypto-assets present unique challenges that can make it difficult to meet the safeguards in place to protect retail investors and Australian financial markets.[38]

2.38 ASIC does not provide advice to companies seeking to launch an Initial Coin Offering (ICO) or other digital asset offering about whether a product is likely to qualify as a regulated financial product, with the onus falling on entities to 'be prepared to justify a conclusion that their ICO does not involve a regulated financial product'.[39] Several submitters to the inquiry suggested that this regulatory uncertainty leaves many project developers unable to operate in this environment. For example, the Digital Law Association reported:

> Our member legal practitioners are reporting an increasingly frustrated cohort of otherwise law-abiding digital asset client businesses unwilling to become embroiled in regulatory test cases, but crying out for clear direction and legal processes.[40]

2.39 Most crypto-assets that are currently available to Australian retail investors (via Australian-based DCEs or overseas-based trading platforms) fall outside of ASIC's regulatory perimeter, meaning that companies offering these products do not need to hold an AFS Licence or a Market Licence. ASIC submitted that, as such:

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35 ASIC, *Submission 61*, p. 19.

36 ASIC, *Submission 61*, p. 23. These characteristics will determine whether, for example, a crypto-asset meets the statutory definition of a managed investment scheme, a security, a derivative, or a non-cash payment facility under the Corporations Act, and hence be regulated as a financial product.

37 ASIC, *Submission 61*, p. 23.

38 ASIC, *Submission 61*, p. 24.

39 ASIC, 'Information Sheet 225: Initial coin offerings and crypto-assets', https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-crypto-assets/ (accessed 12 October 2021).

40 Digital Law Association, *Submission 49*, p. 10.

> These products do not automatically benefit from all the safeguards provided under the Australian financial regulatory framework administered by ASIC, such as upfront disclosure of the risks involved, access to dispute resolution services, or access to compensation funds. The safeguards available depend on the rights and features of each individual crypto-asset. Each crypto-asset service provider or trading platform is responsible for complying with all relevant Australian laws applicable to it.[41]

2.40 ASIC stated that it was 'not aware of any retail financial products that have crypto-assets as a sole underlying asset' that have been issued under the Australian financial regulatory framework (except on an incidental basis) whether on an unlisted or quoted basis. ASIC stated that AFSL holders 'may be facilitating access to overseas funds that hold crypto-assets for wholesale or sophisticated investors'.[42]

2.41 ASIC informed the committee that, as at August 2021, it was aware of at least nine AFSL holders who were also registered by AUSTRAC as DCEs; and at least five companies that were authorised representatives of AFSL holders who were also registered by AUSTRAC as DCEs.[43]

ASIC regulatory approach and activities

2.42 ASIC noted that it has established an internal cryptocurrency working group, and stated that its general regulatory approach towards crypto-assets includes:

- engagement with legitimate crypto-asset businesses to support their compliance;
- monitoring the crypto landscape to identify emerging risks;
- identifying opportunities to disrupt scams and take enforcement action where required; and
- engaging with industry participants on practical proposals involving crypto-assets, to identify any gaps in the financial services regime to share with Treasury.[44]

Guidance on initial coin offerings and crypto-assets

2.43 ASIC has provided guidance to industry on crypto-assets and initial coin offerings (ICOs) in its *Information Sheet 225: Initial coin offerings and crypto-assets* (INFO 225), issued in 2017 and then updated in March 2019. This information

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41 ASIC, *Submission 61*, p. 23.

42 ASIC, *Submission 61*, p. 24.

43 ASIC, Answers to Questions on Notice following public hearing on 27 August 2021, p. 4. ASIC noted that its licensing registers and systems do not record details about a regulated entity's activities in relation to 'crypto-assets' or whether they are also registered as a DCE with AUSTRAC.

44 ASIC, *Submission 61*, p. 21.

sheet describes how obligations under the Corporations Act and the ASIC Act may apply to ICOs and businesses involved with crypto-assets.[45]

Consultation on Exchange Traded Products providing exposure to crypto-assets

2.44 ASIC has also recently released a consultation paper on the potential for the creation of Exchange Traded Products (ETPs) that invest in, or provide underlying exposure to, cryptocurrencies or other digital assets. ETPs include certain managed funds, exchange traded funds (ETFs) and structured products.[46] All of these products are classified as financial products and as such fall within ASIC's regulatory perimeter. ASIC noted significant industry interest in crypto-asset ETPs as the reason for its consultation process, and submitted:

> Given the unique, ever-evolving characteristics and consumer risks associated with crypto-assets, ASIC's current focus is on understanding the global developments in relation to crypto-asset ETPs such as a bitcoin ETF.
>
> We have worked with market operators and Treasury to consider the appropriateness of crypto-assets as permissible underlying assets for ETPs on Australian licensed financial markets and the appropriate minimum standards for such products.[47]

2.45 ASIC's consultation paper *Crypto-assets as underlying assets for ETPs and other investment products* (CP 343) was released in June 2021, seeking feedback on proposed good practices to meet existing legal obligations that apply to:

(a) Australian market licensees that admit such products onto their market; and
(b) issuers of crypto-asset ETPs and other investment products that provide retail investors with exposure to crypto-assets.[48]

2.46 The proposed good practices in CP 343 cover:

(a) admission and monitoring standards for products on a market, including about:
    (i) the nature of crypto-assets that are appropriate as underlying assets of ETPs;
    (ii) the reliable pricing of crypto-assets; and
    (iii) how crypto-assets should be classified with respect to underlying asset rules; and
(b) standards for issuers of ETPs and other investment products, including in relation to custody, risk management and disclosure.[49]

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45 ASIC, *Submission 61*, p. 21.

46 ASIC, *Submission 61*, p. 5.

47 ASIC, *Submission* 61, pp. 5-6.

48 ASIC, *Submission 61*, p. 6.

2.47 ASIC noted in CP343 that the only crypto-assets it considers could potentially meet the appropriate criteria to form the basis of an ETP at this point in time are Bitcoin and Ether.[50]

Regulation of consumer protection issues relating to digital assets

2.48 Some submissions highlighted consumer protection issues relating to crypto-assets. ASIC noted in its submission that scams relating to crypto-assets are an increasing problem:

> The rise in value of crypto-assets globally has seen a sharp increase in retail investor interest in crypto-assets. Further, the crypto-asset marketplace is technologically complex, online and global. These factors have resulted in a substantial increase in unscrupulous operators seeking to defraud consumers.
>
> From the beginning of 2021 to date, ASIC has received a significantly higher number of crypto-related scam reports, compared to previous years.
>
> Most reports of misconduct (complaints) lodged with ASIC that involve crypto-assets involve what appear to be outright scams. We are increasingly seeing crypto-wallets as the preferred method of funds transfers to scammers, instead of bank accounts and wire transfers.
>
> Many scams originate via either dating apps ('romance-baiting') or fake news articles. They are usually coupled with advertisements to trade in foreign exchange or contracts for difference (CFDs) with promises of high returns.
>
> Scammers often impersonate Australian financial services licensees, and/or use ASIC's logo to legitimise their operations.[51]

2.49 ASIC stated that it has taken action in response to crypto-related scams, including: publishing scam warnings; sharing information with other regulators such as AUSTRAC; writing warnings and 'reverse onus' letters to issuers of scam-like material; and issuing warnings on the risks of investing in cryptocurrencies on the Moneysmart website. It noted that a key challenge is that scams are often generated offshore, which diminishes viable intervention options.[52]

2.50 The Australian Competition and Consumer Commission (ACCC) operates the ScamWatch website, which provides information to consumers and small businesses about how to recognise, avoid and report scams. The ACCC informed the committee that between 1 January and 31 August 2021, the

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[49] ASIC, *Submission 61*, p. 6.

[50] ASIC, *Consultation Paper 343: Crypto-assets as underlying assets for ETPs and other investment products*, June 2021, p. 13.

[51] ASIC, *Submission 61*, p. 7.

[52] ASIC, *Submission 61*, pp. 7-8.

ACCC has received 3007 reports of scams involving cryptocurrency investment scams, with losses of $53.2 million.[53] It noted that cryptocurrency investment scams represent 55 per cent of all investment scam losses and 48 per cent of all investment scam reports.[54]

Role of the Australian Financial Complaints Authority

2.51 It was noted during the inquiry that the Australian Financial Complaints Authority (AFCA) currently has limited scope to resolve consumer complaints arising from cryptocurrency dealings, because AFCA is only able to consider complaints against financial firms that are members of AFCA.[55]

2.52 Any businesses offering financial or credit products under an AFSL or an Australian Credit Licence are required by law to hold AFCA membership and be subject to its complaints processes; however at present, cryptocurrency or digital asset providers are generally not required to hold AFCA membership as they are not regulated through an AFSL.[56]

2.53 AFCA noted that in recent times a small number of crypto-asset providers have become voluntary members of AFCA.[57] AFCA recommended that access to internal and external dispute resolution arrangements should be put in place for consumers accessing digital asset products, similar to those in place for other regulated financial services providers.[58]

AUSTRAC registration requirements and AML/CTF risks

2.54 Some digital asset businesses are required to register with the Australian Transaction Reports and Analysis Centre (AUSTRAC) under requirements set out in the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act).

2.55 The Department of Home Affairs (Home Affairs) and AUSTRAC stated in a joint submission that the AML/CFT Act 'provides a framework to detect and deter money laundering and terrorism financing and provide intelligence to revenue, law enforcement and national security agencies'. It applies a risk-based approach to combating financial crime, 'consistent with global best practice, as reflected in the inter-governmental Financial Action Task Force (FATF) standards'.[59]

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53 ACCC, Answers to Questions on Notice, p. 2.

54 ACCC, Answers to Questions on Notice, p. 2.

55 AFCA, *Submission 73*, p. 3.

56 AFCA, *Submission 73*, p. 3.

57 AFCA, *Submission 73*, p. 3.

58 AFCA, *Submission 73*, p. 4.

59 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 3.

2.56 The scope of the AML/CTF Act was specifically expanded in 2018 to include regulation of digital currency exchanges (DCEs).[60] Home Affairs and AUSTRAC submitted that DCEs, which exchange fiat currency for digital currency and vice versa, represent the 'onramps' and 'off-ramps' to digital currency, and 'have a significant role to play in mitigating financial crime risks'.[61] They submitted that the main money laundering and terrorism financing risks associated with digital currencies are:

- greater anonymity or, in some cases, complete anonymity, compared with traditional payment methods;
- transfers of digital currency are unconstrained by national borders and difficult to tie to any particular geographic location;
- transactions can be made on a peer-to-peer basis, generally outside the regulated financial systems; and
- different components of a digital currency system may be located in different countries and subject to varying degrees of regulatory oversight which can lead to regulatory arbitrage or the use of digital currency moving underground.[62]

2.57 Home Affairs and AUSTRAC explained the scope of the regulations that apply to DCEs as follows:

> The regulatory obligations imposed on DCEs under the AML/CTF Act are in line with guidance developed by the FATF in 2015. The Act does not regulate cryptocurrency or digital assets, just as it does not regulate fiat currency, such as the Australian dollar. However, following the 2018 amendments, businesses offering DCE services between fiat currency and digital currency (i.e. cryptocurrency), and vice versa are regulated for AML/CTF purposes only. It does not regulate transaction exchanges from digital currency to digital currency.[63]

2.58 Specific requirements for DCE providers under the AUSTRAC regulations are to:

- enrol and register their business with AUSTRAC;
- adopt and maintain an AML/CTF program to identify, mitigate and manage the ML and TF risks they may face;
- collect information and verify the identities of their customers and undertake ongoing customer due diligence;
- report suspicious matters and transactions involving physical currency that exceed $10,000 or more to AUSTRAC; and

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60 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 3.

61 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 3.

62 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 3.

63 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 3.

- keep records relating to customer identification, transactions, and their AML/CTF program and its adoption.[64]

2.59 AUSTRAC may refuse an application (thereby preventing a digital currency exchange from operating) or tailor a business' registration according to its money laundering, terrorism financing or other serious crime risk, and may suspend or cancel the registration of a DCE on similar grounds.[65] AUSTRAC noted that its remit on regulating DCEs does not extend to areas outside AUSTRAC's mandate, such as prudential, competition or consumer protection regulation.[66]

2.60 Mr Bradley, Brown National Manager, Education, Capability and Communication, AUSTRAC took the committee through the registration process for DCEs:

> AUSTRAC's registration process, which is actually stipulated through our rules, requires businesses to efficiently complete an attestation in relation to their business operations and that will include requirements around whether they had previously had any criminal record, so whether they have been charged, convicted of any offences in relation to money laundering, terrorism, financing, any other serious crimes. They are required to obtain and maintain a national police check. In our most recent engagements in the renewal of registration, now that it is after three years, we are actually asking for businesses to produce those national police certificates. We obviously also, as a financial intelligence agency, have capability to work with some of our partners to cross reference in relation to people who register with AUSTRAC. We also look at their capabilities and that includes their capability to develop and implement an anti-money-laundering counterterrorism financing program.[67]

2.61 Mr Brown indicated that they also 'look at the competency of the people who are registering with us to say that they are and do have the ability to operate businesses'. AUSTRAC's role is then ongoing oversight:

> That ongoing supervision includes for us an annual compliance report, so each business has to complete a compliance report in relation to various different aspects of their obligations under the legislation. They all have to have AML/CTF programs. They are required to identify and know their customer and to do customer due diligence, which actually requires them to do transaction monitoring of the transactions that they undertake with their customers. They have to record all that—record keeping—and they are required to submit reports to us and that includes suspicious matter reports, which many of the regulated businesses have been doing. I would suggest that it's more robust. The CEO or delegate also has the power to refuse, cancel or apply conditions in relation to registrations. In the last

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64 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 4.

65 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 4.

66 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 4.

67 *Proof Committee Hansard*, 27 August 2021, p. 33.

> year six digital currency exchanges have had one of those forms of a penalty applied to them. Additionally, we also work with law enforcement where there may well be criminal considerations in relation to activities of digital currency extremism.[68]

Number of DCEs registered with AUSTRAC

2.62 AUSTRAC informed the committee that there are 'more than 455 registered DCE providers in Australia', and that '[s]ince regulations commenced, six businesses have had their registration cancelled and three businesses have been refused registration'.[69]

International AML/CTF framework

2.63 Home Affairs and AUSTRAC submitted that in June 2019, the FATF set international standards for the AML/CTF regulation of cryptocurrency/digital asset services. These standards 'built on the 2015 guidance and require AML/CTF regulation beyond the exchange of fiat currency for cryptocurrency or vice versa' to also include regulation of:

- exchanges between one or more forms of cryptocurrency;
- transfers of cryptocurrency on behalf of customers;
- safekeeping or administration of cryptocurrency or instruments enabling control of cryptocurrency (e.g. custodial wallet providers); and
- participation in and provision of financial services related to an issuer's offer and/or sale of cryptocurrency (e.g. Initial Coin Offerings or ICOs).[70]

2.64 The submission explains further:

> Businesses providing these services are referred to globally as 'virtual asset service providers' (VASPs) and cryptocurrency or digital assets are referred to as 'virtual assets' (VAs).

2.65 The FATF also includes VASPs under the 'travel rule', which requires financial institutions to include verified information about the originator (payer) and information about the beneficiary (payee) for wire transfers and other value transfers throughout the payment chain. However, technological solutions to enable VASPs to comply with the 'travel rule' are still under development and only beginning to be rolled out globally.[71]

Ongoing regulatory work in Australia

2.66 Several initiatives were highlighted to the committee involving regulatory work on digital asset issues.

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[68] *Proof Committee Hansard*, 27 August 2021, p. 33.

[69] Department of Home Affairs and AUSTRAC, *Submission 23*, p. 4.

[70] Department of Home Affairs and AUSTRAC, *Submission 23*, p. 4.

[71] Department of Home Affairs and AUSTRAC, *Submission 23*, p. 5.

Council of Financial Regulators stablecoins working group

2.67 APRA noted that the Council of Financial Regulators (CFR) established a Distributed Ledger Technology (DLT) Working Group in December 2015, to assess regulatory risks, and any emerging financial system risks associated with distributed ledger technologies. This working group is considering developments relating to central bank digital currencies, crypto-assets and decentralised finance.[72]

2.68 In March 2021, a dedicated CFR Stablecoins Working Group was established as an offshoot of the CFR DLT working group. APRA noted:

> This decision was made in the context of international developments in order to more closely assess risks that could potentially be presented by stablecoins, including a significant global stablecoin arrangement or a domestically issued AUD-backed stablecoin.

2.69 ASIC stated that the objectives of the CFR Stablecoin Working Group are to:

- identify key types of stablecoin arrangements that could affect the Australian financial system or Australian consumers;
- assess how these arrangements would be treated under existing regulatory frameworks (including whether the requirements are appropriate and what, if any, changes to the framework should be proposed);
- develop recommendations on actions (if any) to address emerging regulatory gaps and risks related to stablecoins, for consideration by the CFR and the Australian Government; and
- provide a forum to share information and coordinate Australian contributions on international work related to stablecoins.[73]

2.70 APRA informed the committee that this working group has performed 'an initial assessment and analysis of key risks, existing significant stablecoin arrangements, international regulatory developments/proposals and the existing regulatory framework in Australia and how it could apply to stablecoin arrangements'. APRA noted that in relation to its mandate, 'the key policy issues are the threshold at which a particular stablecoin arrangement potentially raises financial safety and/or financial stability considerations, and the appropriate regulatory framework in such cases'.

2.71 APRA stated that the CFR 'has since agreed to refocus some working group activities in order to prioritise work considering regulatory arrangements across the spectrum of crypto-assets, including stablecoins', with Treasury assuming the role of Chair of the working group.[74]

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[72] APRA, Answers to written questions on notice (received 12 October 2021), p. 1.

[73] ASIC, *Submission 61*, p. 7. See also: Council of Financial Regulators, 'Quarterly Statement by the Council of Financial Regulators – June 2021', *Media Release*, 17 June 2021.

[74] APRA, Answers to written questions on notice (received 12 October 2021), pp. 1-2.

RBA work on CBDCs

2.72 The RBA commented that 'like many other advanced-economy central banks, the Bank does not consider that a policy case has yet emerged for issuing a CBDC'. However, the RBA 'is continuing to closely monitor the case for a retail CBDC and is engaging with some other central banks on possible use cases, including for cross-border payments'.[75] It stated further:

> The [RBA] has also been conducting research on the technological and policy implications of a wholesale CBDC. This work is taking place in the Bank's in-house Innovation Lab and included the development in 2019 of a limited proof-of-concept of a DLT-based interbank payment system using a tokenised form of CBDC backed by exchange settlement account (ESA) balances held at the Bank. Currently, the Bank is close to finalising a project with a number of external parties that extends the earlier proof-of-concept in a number of ways, including to incorporate tokenised financial assets. The project explores the implications of delivery-versus-payment settlement on a DLT platform as well as other programmability features of tokenised CBDC and financial assets; a report on the project will be published shortly.[76]

Establishment of a Digital Finance Cooperative Research Centre

2.73 The RBA noted that it is also participating in the newly established Digital Finance Cooperative Research Centre (CRC), which will bring together academics and more than twenty entities in the finance industry. The aim of the CRC is 'to develop and exploit the opportunities arising from the digitisation of assets so they can be traded and exchanged directly and in real-time between any individual or organisation'.[77]

International approaches to regulating digital assets

2.74 In this phase of the inquiry, the committee has examined the existing approaches and maturity of regulatory frameworks in comparable jurisdictions in order to assess where Australia currently stands and possible ways forward. A number of jurisdictions have taken steps to create a cohesive regulatory framework for digital assets in order to drive investment and enhance consumer protections.

2.75 Some submitters provided highly detailed observations about the regulatory frameworks in a number of jurisdictions.[78] For the purposes of this chapter, a broad overview is included here followed by some insights on key jurisdictions, focusing on Singapore, the United States, and the United Kingdom.

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75 RBA, *Submission 37*, p. 2.

76 RBA, *Submission 37*, pp. 2-3.

77 RBA, *Submission 37*, p. 3.

78 See, for example: Blockchain Australia, pp. 14-35.

2.76 Swyftx, an Australian Digital Currency Exchange, submitted that 'there is a commonality in general approach around the globe, at least at a high level', with regulatory regimes aiming to cover two broad areas:

(a) Banking and payment systems and access: a key aspect of this regulatory regime is to ensure that digital asset service providers comply with AML/CTF rules and to ensure the integrity of the banking and payment systems.
(b) Investment dealing and consumer protection regulation: this aspect of regulation, including the applications of securities and financial markets laws, has been defined by each jurisdiction's approach to categorizing digital assets as certain types of financial instruments in order to fit them within existing regulatory frameworks.[79]

2.77 Regulation of cryptocurrencies and digital assets continues to change rapidly across the globe. For example, China recently announced a complete ban on all crypto transactions and mining in September 2021.[80] United States' regulators have also flagged further changes to its digital assets regulation, discussed further below.

2.78 The ADC Forum provided the following table shown at Figure 2.3, comparing a range of regulatory mechanisms used in application to digital currencies across a number of jurisdictions.

[79] Swyftx, *Submission 21*, pp. 2-3.

[80] Alun John, Samuel Shen and Tom Wilson, 'China's top regulators ban crypto trading and mining, sending bitcoin tumbling', *Reuters*, 25 September 2021, https://www.reuters.com/world/china/china-central-bank-vows-crackdown-cryptocurrency-trading-2021-09-24/ (accessed 12 October 2021).

Figure 2.2 Comparative treatment of digital currencies

Country	AML/CFT	Taxation	Consumers: Advice or Warning	Intermediaries: Licensing or Registration	Financial Sector Warning or Bans	Bans on Issuance or Use
Australia	-	Clarified tax treatment	Consumer Warning	Plans on introducing new regulations	-	-
Canada	Amendment to existing regulations	Clarified tax treatment	Consumer Warning	-	-	-
China	-	-	-	-	Ban	-
France	Applying existing regulations	Clarified tax treatment	Consumer Warning	-	-	-
Japan	Plans on introducing new regulations	-	Consumer Warning	Plans on introducing new regulations	-	-
Singapore	Plans on introducing new regulations	Clarified tax treatment	Consumer Warning	-	-	-
South Africa	-	-	-	Plans on introducing new regulations	-	-
UK	Applying existing regulations	Clarified tax treatment	-	-	-	-

Source: ADC Forum, Submission 35, p. 6. Note since the publication of this table, China has announced a complete ban on cryptocurrency business and activity.

Singapore

2.79 Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou from Monash University submitted that Singapore's cryptocurrency regulatory regime 'shares many similarities with the Australian model—opting to regulate activities that fall within the purview of the financial regulator as opposed to regulating cryptocurrencies directly'.[81]

[81] Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou, *Submission 28*, p. 3.

2.80 Blockchain Australia noted that Singapore's 'financial regulatory body, the Monetary Authority of Singapore (MAS), has actively taken steps to regulate crypto-asset businesses' by working:

> …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.[82]

2.81 Blockchain Australia explained that Singapore 'has enjoyed an early-mover advantage by introducing a regulatory framework designed for crypto-assets' with the introduction of the Payments Services Act (PSA) in January 2020. The PSA has been described by the MAS as a 'forward looking and flexible framework' that 'consolidated and updated multiple pieces of legislation which were drafted in an era before FinTech and were no longer fit-for-purpose.' Blockchain Australia provided the following outline of the PSA:

> 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.

2.82 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.[83]

2.83 Under this definition, cryptocurrencies including Bitcoin, Ether, Litecoin and Ripple would be considered as a DPT. Blockchain Australia explained further:

> 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

[82] Blockchain Australia, *Submission 71,* p. 13.

[83] Blockchain Australia, *Submission 71,* p. 13.

> 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.[84]

2.84 Crypto.com praised Singapore's regulatory approach, highlighting Singapore's *Blockchain and Cryptocurrency Regulation 2021*:

> [Singapore has] been at the forefront of crypto-related technology adoption and advancement. Singapore's positive attitude to crypto is reflected in their recent Blockchain and Cryptocurrency Regulation 2021. Compared to the UK, the level of regulatory support for navigating requirements and obtaining the relevant licence has been high.[85]

2.85 Mr Scott Chamberlain, Entrepreneurial Fellow at the Australian National University's School of Law, asserted that 'Singapore is Australia's main competitor for Digital Asset Projects' and explained 'the commercialisation of all of our research projects has necessarily involved consideration of Singapore as the destination jurisdiction'.[86]

2.86 Blockchain Australia identified that there had been challenges within Singapore's system caused primarily as a result of its strict implementation of the licensing requirements to ensure compliance with the Financial Action Task Force (FATF) travel rule.[87] Applicants faced a 'lengthy application process' and 'a lack of commercial solutions to comply with the travel rule.'[88] As a result, the MAS 'offered an exemption to applicants who applied before a cutoff date' that:

> …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.[89]

2.87 Additionally, Blockchain Australia noted that 'it is still difficult for an exchange to comply at a scale in a commercially viable manner.'[90]

2.88 Australian DCE Independent Reserve recently announced on 1 October 2021 that it had received approval for a Major Payment Institution Licence in Singapore from the MAS to operate as a regulated provider for DPT Services. Independent Reserve is one of the first virtual asset service providers to obtain

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84 Blockchain Australia, *Submission 71*, p. 14.

85 Crypto.com, *Submission 55*, p. 2.

86 Mr Scott Chamberlain, *Submission 24*, p. 12.

87 Blockchain Australia, *Submission 71*, pp. 13–15.

88 Blockchain Australia, *Submission 71*, p. 15.

89 Blockchain Australia, *Submission 71*, p. 15.

90 Blockchain Australia, *Submission 71*, p. 15.

full licensure approval under the PSA in Singapore.[91] Raks Sondhi, Managing Director of Independent Reserve in Singapore, commented that gaining licence approval in Singapore had attracted investors to the company:

> Since receiving our in-principle approval, we've seen an influx of retail and institutional investors. Until that point, most had stayed on the sidelines because determining who to trust was a lot more difficult. This licence will allow Independent Reserve to accelerate its growth in Singapore and reassure investors of our integrity and safety.[92]

United States

2.89 The United States (US) has a broad range of regulations covering cryptocurrency and digital assets at the federal level, and some states have also implemented their own crypto-asset specific legislation.[93]

2.90 Blockchain Australia stated that there 'is generally broader acceptance by US banks for individuals and businesses that deal with crypto-assets'[94] and provided an overview of the current legislative approach to crypto-assets in the US:

> 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.[95]

2.91 Blockchain Australia explained how each regulator treats crypto-assets to demonstrate some of the difficulties that come from the split in regulation across federal and state regulators:

> 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 [United Kingdom], 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

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91 Independent Reserve, 'Independent Reserve gains licensure approval from the Monetary Authority of Singapore', https://blog.independentreserve.com/news/independent-reserve-gains-licensure-approval-from-the-monetary-authority-of-singapore (accessed 12 October 2021).

92 Independent Reserve, 'Independent Reserve gains licensure approval from the Monetary Authority of Singapore', https://blog.independentreserve.com/news/independent-reserve-gains-licensure-approval-from-the-monetary-authority-of-singapore (accessed 12 October 2021).

93 Blockchain Australia, *Submission 71*, p. 27.

94 Blockchain Australia, *Submission 71*, p. 27.

95 Blockchain Australia, *Submission 71*, p. 27.

> 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.[96]

2.92 Generally, cryptocurrencies in the US would be subject to securities laws if their attributes are considered to be a security. It is 'a matter of substance over form if a crypto-asset is considered to be a security' and a crypto-asset which is determined to be a security is registered and regulated by the SEC.[97]

2.93 In the US, the Howey test is used to determine when a security is an 'investment contract' and the same test is applied to crypto-assets.[98] The Howey test considers the following criteria:

> an investment of money;
>
> in a common enterprise;
>
> with a reasonable expectation of profits;
>
> to be derived from the entrepreneurial or managerial efforts of others.[99]

2.94 Blockchain Australia stated that 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.[100]

2.95 Several recent developments in the US federal regulation of digital assets are worth noting:

- The Infrastructure, Investment and Jobs Act, which passed the US Senate with Bipartisan support in August 2021 and is now before the House of Representatives, would force crypto exchanges to report transactions and other user data to the US Internal Revenue Service.[101]
- In a September 2021 interview, the incoming Chair of the SEC, Gary Gensler, flagged the development of a regulatory framework for cryptoassets, raising points including:
  - concern about the lack of disclosure obligations, and the need for the market for crypto to be brought into alignment with policy objectives such as investor protection, tax transparency, and financial stability;

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96 Blockchain Australia, *Submission 71,* pp. 27–28.

97 Blockchain Australia, *Submission 71,* p. 28.

98 Blockchain Australia, *Submission 71,* p. 28.

99 Blockchain Australia, *Submission 71,* p. 28.

100 Blockchain Australia, *Submission 71,* p. 27.

101 DLA Piper, 'Infrastructure bill passed by the Senate would impose new information reporting requirements on cryptocurrency transactions', https://www.dlapiper.com/en/us/insights/publications/2021/08/infrastructure-bill-passed-by-the-senate-would-impose-new-information-reporting-requirements/ (accessed 12 October 2021).

- a clear view that the SEC's mandate effectively encompassed regulation of cryptoassets; and
- stating that the presence of a significant unregulated market within the broader financial system was a significant risk to financial stability.[102]

Wyoming

2.96 The US state of Wyoming was raised in evidence as having an advanced legislative approach to cryptocurrency and digital assets.

2.97 Mr Scott Chamberlain submitted that 'the most comprehensive policy settings are being developed in Wyoming'.[103] He explained:

> Wyoming has deliberately and systematically set out to be a destination jurisdiction for digital assets. It laws have included:
>
> (a) Specific forms of financial institutions for digital assets;
>
> (b) Confirmation that financial custodians hold digital assets under bailment;
>
> (c) Confirming the right to keep your secret keys secret; and
>
> (d) Legal personality for DAOs [Decentralised Autonomous Organisations] and limited liability for members.[104]

2.98 Blockchain Australia agreed that Wyoming 'is seen as one of the more progressive states' and 'has passed numerous bills which are seen as some of the most crypto-friendly in the US.'[105] This includes the establishment of a new category of financial institutions called Special Purpose Depository Institutions (SPDI):

> [This] 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.[106]

2.99 Additionally, Wyoming has introduced 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

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[102] Washington Post, 'The Path Forward: Cryptocurrency with Gary Gensler', 21 September 2021, https://www.washingtonpost.com/washington-post-live/2021/09/21/path-forward-cryptocurrency-with-gary-gensler-us-securities-exchange-commission-chair/ (accessed 12 October 2021).

[103] Mr Scott Chamberlain, *Submission 24*, p. 11.

[104] Mr Scott Chamberlain, *Submission 24*, p. 11.

[105] Blockchain Australia, *Submission 71*, p. 29.

[106] Blockchain Australia, *Submission 71*, p. 29.

> the Uniform Commercial Code (a set of consumer law protections) applies to cryptocurrencies.[107]

2.100 Mr Chamberlain also stressed the importance of private key secrecy and custody and noted Wyoming's approach to ensure 'users are legally entitled to refuse to disclose their private keys.' He explained why this is important:

> Blockchain systems rely on key pair cryptography. A consequence of this technology is the digital assets are inextricably linked with the key pair. Whoever controls the private keys controls the asset. If the private keys are lost or destroyed the asset is destroyed.[108]

United Kingdom

2.101 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, and was initially set out in 2019 through a token classification regime, which set out three broad categories of tokens and gave an overview as to how and whether each fits 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).[109]

2.102 Under this classification, 'unregulated tokens' do not fall within the current regulatory perimeter and therefore are not subject to FCA regulation, while 'e-money tokens' and 'security tokens' do fall within the regulatory perimeter and are therefore subject to the existing legislation.[110]

2.103 Further consultation has been undertaken in the UK on promoting crypto-assets and the regulatory approach to stablecoins. A registration process was

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[107] Blockchain Australia, *Submission 71,* p. 30.

[108] Mr Scott Chamberlain, *Submission 24,* p. 9.

[109] Blockchain Australia, *Submission 71*, pp. 23-24.

[110] Blockchain Australia, *Submission 71*, p. 24.

also introduced for AML/CTF requirements, but the deadline for this process has been extended twice from 9 January 2021 to 30 March 2022.[111]

2.104 Several submitters spoke favourably of the UK's regulatory system. Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou argued that '[o]ne of the main concerns of the market is uncertainty in the cryptocurrency industry.'[112] They explained that 'Singapore, Canada and the UK all have not developed a regulatory regime specific to cryptocurrency,' instead 'they use existing frameworks to regulate cryptocurrency with some specific interventions due to the nature of cryptocurrency.'[113] However:

> While all three jurisdictions have adopted a broadly similar approach, the UK's approach has created a friendlier and more certain environment for private investment in the industry.[114]

2.105 Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou explained:

> UK regulators have gone a step further to clarify how existing regimes apply to cryptocurrency. In doing so, the UK has made their regulatory objectives clear, adopting a regulatory principle of 'same risk, same regulatory outcome'. Their guidance will undoubtedly help the market understand the application of regulations and ensure compliance.[115]

2.106 Conversely, Crypto.com submitted that is has 'found the level of regulatory support for navigating requirements and obtaining the relevant licence in the UK to be limited'.[116]

2.107 Australian DCE Coinjar recently received registration from the FCA in September 2021, and is now one of only 10 other registered "crypto asset firms" to receive FCA approval to operate across the UK market as a Cryptoasset Exchange Provider and Custodian Wallet Provider.[117] Asher Tan, CEO of CoinJar, commented:

> The UK is a world leader in fintech and a progressive regulator so we are very pleased to have received this recognition as part of our commitment to offering people a safe and positive experience of buying and selling digital currencies. With the establishment of the UK-Australia Fintech

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111 Blockchain Australia, *Submission 71*, p. 23.

112 Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou, *Submission 28*, p. 2.

113 Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou, *Submission 28*, p. 1.

114 Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou, *Submission 28*, p. 2.

115 Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou, *Submission 28*, p. 1.

116 Crypto.com, *Submission 55*, p. 2.

117 James Eyers and Jessica Sier, 'Crypto exchanges Independent Reserve, Coinjar win regulation offshore', *AFR*, 1 October 2021, https://www.afr.com/companies/financial-services/crypto-exchanges-independent-reserve-coinjar-win-regulation-offshore-20210930-p58w1i (accessed 12 October 2021).

bridge, we hope that a similar scheme is replicated here via ASIC and AUSTRAC, with learnings from the two-year process taken into account.[118]

[118] Australian FinTech, 'Australian cryptocurrency exchange CoinJar secures UK's FCA Approval', 30 September 2021, https://australianfintech.com.au/australian-cryptocurrency-exchange-coinjar-secures-uks-fca-approval/ (accessed 12 October 2021).

Chapter 3
Reform options for regulation of digital assets

Introduction

3.1 In the committee's second interim report, it noted the extensive evidence it received on the need for more regulatory clarity and certainty in the emerging areas of blockchain technology, digital assets and cryptocurrencies. Submissions received in this final phase of the committee's work, continued to strongly reiterate this view, noting that a clearer regulatory framework would bring benefits for both consumers and businesses.

3.2 This chapter covers the evidence received by the committee in relation to possible options for reforming the regulatory framework for digital assets in Australia. A wide range of issues were canvassed by the committee, including:

- broad arguments outlining the need for enhanced regulation of digital assets;
- enhanced clarity and regulatory relief from the Australian Securities and Investments Commission (ASIC) and other regulators within the existing framework;
- various options to bring certain types of crypto-assets within the scope of existing financial services regulation under the *Corporations Act 2001*;
- options for regulating businesses that provide custodial and depository services for digital assets and markets licensing;
- the need for clear categorisation of digital asset categories for the purposes of developing a regulatory framework;
- issues relating to the taxation of digital assets;
- new governance structures for decentralised organisations; and
- issues relating to digital asset infrastructure.

Need for better regulation of digital assets in Australia

3.3 Swyftx, a Brisbane-based cryptocurrency broker with over 100 staff employed in Australia, summarised the need for improved regulation of digital assets as follows:

> Australian consumers are demanding access to the digital asset industry – it should be the government's aim to facilitate this access under a regulatory regime that balances competing interests but recognizes that bringing digital assets inside a tailored and sensible regulatory perimeter is a far better solution than forcing consumers to operate outside of it with unregulated, foreign providers. In addition, Australia's entrepreneurs have leapt to the forefront of the global development of blockchain technology and associated crypto-asset fields, and are leaders in many areas. This technological leadership can translate into high-skilled jobs and an area for

> growth-oriented investment, if the right balance is struck by government in approaching regulation.[1]

3.4 Blockchain Australia commented on the need for Australia to enact appropriate regulatory reform in order to keep pace with other jurisdictions:

> Recent developments across the globe…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.[2]

3.5 A common theme among submitters was that greater regulatory certainty is needed from ASIC, the ATO and other regulators to enable digital assets businesses to operate effectively while providing adequate protections for consumers.

Principles to be applied when regulating digital assets

3.6 Ripple proposed three principles upon which an Australian regulatory framework for digital assets should be founded:

- The regulatory framework should be technology-agnostic, and should not explicitly or otherwise endorse any particular technology. In practical terms, this means that financial services using digital assets as a solution should not be treated differently from financial services embedding legacy architectures, and there should be parity in the treatment of all technology;
- Given the dynamic nature of digital assets, prescriptive regulation risks obsolescence. Prescriptive regulation could also have the unintended consequence of hindering innovation. Therefore, we recommend the Committee consider a principles-based regulatory framework, which will guide market participants to regulatory and policy goals, without imposing an overly prescriptive and onerous process in doing so; and

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1 Swyftx, *Submission 21*, p. 2.

2 Blockchain Australia, *Submission 71*, p. 36 (emphasis in original).

- The regulatory framework should use a risk-based approach to identify digital asset services that pose sufficient risk to warrant regulation, and where such risks are crucial to address. This is in order to build a simple, secure, and accessible digital assets ecosystem that will encourage investment into digital assets in Australia, while mitigating any potential risks.[3]

3.7 R3 advocated for an approach that ensures digital assets that are analogous to a similar asset in its traditional form should face similar regulation to the traditional product:

> Simplicity is key in designing frameworks. Layering additional regulations on top of already robust and effective frameworks would only complicate the industry and inhibit innovation with no resulting upside.
>
> With digital assets, it is important to emphasise that the regulatory regime should not create a scenario in which the same instrument in digital form is subject to heightened regulation from when it is in traditional form. Also, it is important to ensure that there is no regulatory confusion created by the development of a second and potentially overlapping regime for some assets.
>
> Therefore, we propose that the Australian government aligns digital asset regulations with requirements imposed on the same asset in its traditional form, with the principle of 'same risk, same activity, same treatment'.[4]

3.8 Swyftx commented that application of existing financial services regulations to digital asset businesses must take into account the necessity of working with third parties for these businesses to meet some requirements:

> [A]s is the case with de-banking by the traditional banking providers, consideration must be given to ensuring a level playing field for digital asset service providers. For example, any application of the existing financial services regulatory regime to digital asset businesses that would require compulsory professional indemnity insurance should take into account the current lack of availability of such insurance for digital asset service providers. That is, implementation of a regulatory regime where compliance is not possible, has the same effect as an outright ban on the activities.[5]

Immediate regulatory clarity and relief

3.9 A number of submitters and witnesses expressed the view that, even absent any other regulatory changes, ASIC should be providing further guidance as to the status of different digital asset products.

3.10 Holley Nethercote Lawyers submitted:

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[3] Ripple, *Submission 15*, pp. 8-9.

[4] R3, *Submission 13*, p. 5.

[5] Swyftx, *Submission 21*, pp. 4-5.

> Because of the breadth and depth of virtual assets and the speed of innovation, there is no clarity in Australia about whether or not most virtual assets are financial products.
>
> ASIC has released information sheet 225 which we are instructed by DCEs is inadequate. Whenever listing a new virtual asset, DCEs must decide whether to seek legal advice on that virtual asset, or whether to "risk it and list it" because of a perception that "if everyone else in Australia is listing it, it must not be a financial product." In this environment, the participants with a more conservative appetite to legal risk are at a disadvantage.
>
> ASIC has power to grant relief in some situations, and it can take no action in others. It can also provide further clarity on whether certain virtual assets are financial products. ASIC should include a frequently updated list of Top 10 virtual assets that it believes are not financial products, and Top 10 virtual assets that it believes are financial products (and if so, what type).[6]

3.11 Holley Nethercote submitted that the government should work with ASIC 'to issue relief and no-action positions' in relation to Market Licence and Australian Financial Services Licence (AFSL) obligations for digital asset businesses, with ASIC to clarify 'which activities are captured by the relief and which are not using practical examples and adopting industry language'.[7]

Need for transitional arrangements and 'safe harbour' provisions

3.12 Several submitters argued for the extension of a 'safe harbour' period while broader regulatory changes for digital assets are developed and implemented, so that existing businesses are not forced out of the industry prematurely due to regulatory uncertainty or new requirements being imposed without adequate lead time.

3.13 For example, Blockchain Australia submitted:

> 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

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6 Holley Nethercote Lawyers, *Submission 7*, p. 8.

7 Holley Nethercote Lawyers, *Submission 7*, p. 8.

> compliant professionals, rather than by seeking out risky services in unregulated locations.[8]

3.14 Blockchain Australia recommended that the government and relevant regulators 'should provide crypto-asset providers a safe harbour until such a time that they introduce guidance or legislation', and that subsequent legislation 'should contain an appropriate transition period and not apply retrospectively'.[9]

3.15 The Digital Law Association submitted:

> A Safe Harbour would better achieve the objectives of protecting consumers and financial stability and reducing systemic risks in the short term, as well as informing 'fit for purpose' appropriate and adapted laws for markets and financial services for decentralised, open and global technology infrastructure.[10]

3.16 The Digital Law Association provided a detailed model of what a safe harbour scheme could look like.[11] It submitted that such a scheme: should include threshold conditions to access, and further conditions to be met over a defined go-forward period of 2 to 3 years. It should apply to digital asset 'issuers', digital asset 'market operators' and digital asset 'scheme operators'.[12]

Market licensing for digital assets providers

3.17 Establishing a Market Licence regime for digital asset providers, or a subset of these businesses, was also raised as an option for regulatory reform.

3.18 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 company must hold an Australian Market Licence or be exempted by the Minister. ASIC has regulatory responsibility for issuing market licences and overseeing the operation of financial markets. Market licensees are subject to a range of licence obligations including reporting requirements, operating rules and key personnel requirements.[13]

3.19 ASIC's Info Sheet 225 notes that where a crypto-asset meets the legal definition of a financial product (whether it is an interest in a managed investment scheme, security, derivative or non-cash payment facility), then 'any platform that enables consumers to buy (or be issued) or sell these crypto-assets may

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8 Blockchain Australia, *Submission 71*, p. 39.

9 Blockchain Australia, *Submission 71*, pp. 39-40.

10 Digital Law Association, *Submission 49.1*, p. 6. See also: Piper Alderman, *Submission 72*, p. 10; Caleb and Brown, *Submission 75*, p. 4.

11 Digital Law Association, *Submission 49.1*, pp. 2-8.

12 Digital Law Association, *Submission 49.1*, p. 2.

13 See: ASIC, *Regulatory Guide 172: Financial markets: domestic and overseas operators*, May 2018.

involve the operation of a financial market'.[14] It states that there are currently no licensed or exempt platform operators in Australia that enable consumers to buy or sell crypto-assets that are financial products, and warns that platform operators 'must not allow financial products to be traded on their platform without having the appropriate licence as this may amount to a significant breach of the law'.[15]

3.20 Blockchain Australia recommended 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'.[16] It argued that this is necessary to enable crypto-assets such as digitally native derivatives to be accessed in Australia:

> 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.
>
> …
>
> [D]igitally 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.[17]

3.21 Blockchain Australia concluded that without a properly designed market licence, Australia will miss out on the opportunities that are afforded by some of these innovative new products, and stated:

> In addition, investors will not be provided the legal protections that a market operator must comply with such as acting fairly, efficiently and honestly.

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[14] ASIC, 'Information Sheet 225 (INFO 225): Initial coin offerings and crypto-assets', https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-crypto-assets/ (accessed 5 October 2021).

[15] ASIC, 'Information Sheet 225 (INFO 225): Initial coin offerings and crypto-assets', https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-crypto-assets/ (accessed 5 October 2021).

[16] Blockchain Australia, *Submission 71*, p. 57.

[17] Blockchain Australia, *Submission 71*, pp. 55 and 56.

> 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.[18]

Applicability of existing Market Licence regime to digital asset businesses

3.22 FinTech Australia stated that the Australian Market Licence regime 'is not currently designed for large volumes of applicants', noting that there have only been a small number of licences granted to date and the process for obtaining a Market Licence 'remains relatively bespoke depending on the nature of each business'. It argued that the application process for this licence is extremely complicated, and that it is clear that the licence obligations 'are not designed for smaller businesses, like fintechs, due to the large capital requirements and procedural and operational requirements'.[19]

3.23 FinTech Australia argued that, in its current form, adopting a market licence approach for crypto-asset businesses 'would act as an unfair barrier to entry for fintechs and stifle innovation and growth in the crypto-asset sub-sector'. It argued that instead, an obligation to attain an AFSL would be an appropriate requirement for crypto-asset businesses looking to provide crypto-assets that fall within the definition of a financial product.[20] It argued that a new category of authorisation under the AFSL framework could be created specifically to deal with crypto-asset exchanges.[21]

3.24 FinTech Australia also emphasised the need for the government to clarify how any new regime would apply retrospectively for companies that already hold a market licence.[22]

Regulation of DCEs and market licence issues

3.25 Much of the discussion around market licencing is in the context of the current minimal regulation of Digital Currency Exchanges, which are the crypto-asset businesses most analogous to the market operators required to hold Market Licences for traditional financial products.

3.26 The committee heard that the current requirement for DCEs to register with the Australian Transaction Reports and Analysis Centre (AUSTRAC) for the purposes of AML/CTF regulation amounts to a very 'light touch' regulatory approach to these businesses, and that enhanced regulation is needed.

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18 Blockchain Australia, *Submission 71*, p. 57.

19 FinTech Australia, Answers to Questions on Notice, p. 6.

20 FinTech Australia, Answers to Questions on Notice, p. 6.

21 FinTech Australia, Answers to Questions on Notice, p. 7.

22 FinTech Australia, Answers to Questions on Notice, p. 8.

3.27 For example, Mr Adrian Przelozny, CEO Independent Reserve was of the view that the current bar for registration with AUSTRAC is set too low:

> You basically need to have an AML/KYC [know-your-customer] policy, which is pretty easy to obtain. There are providers that can basically provide a prewritten AML/KYC policy that a potential exchange could just use without having to do much work on it. I don't believe there's a fee to register with AUSTRAC, but there might be. Ultimately, it's just an online form after that. I think you could probably get everything done in a couple of days with a budget of maybe $3,000 to $4,000. So I think the bar to entry is very low, which is why we've seen that quite a large number of exchanges, or companies that try to say that they're exchanges, have registered themselves with AUSTRAC. It's quite surprising. Every time we have a meeting with AUSTRAC, they give us some huge number, like 100 registered exchanges in Australia or something ridiculous like that. We know there actually aren't that many exchanges. The bar is very low and anyone can register.[23]

3.28 Mr Duncan Tebb, Head, Risk and Operations, Independent Reserve, summarised the process of registering with AUSTRAC:

> So your obligations are…to buy a policy, fill out the online form and have an ABN, and you're done, and you'll be registered for three years. At the end of three years, you have a renewal process. The renewal process is to again make a declaration that your AML/CTF policy is correct and up to date, and you will be extended.[24]

3.29 Mr James Manning, Chief Executive Officer, Mawson Infrastructure Group, was also concerned about the registration process:

> There are no standards, so you don't have a compliance obligation. If you don't have a standard to hold someone to, how do you get them to comply with it? You're relying on your counterparty to act in good faith. That leaves a lot to be desired. There's no audit obligation. As you pointed out, there's no capital adequacy obligation. There's no-one verifying this, yet some of these exchanges are holding billions of dollars of assets.[25]

3.30 Mr Bradley, Brown National Manager, Education, Capability and Communication, AUSTRAC, commented that AUSTRAC would be looking for businesses to provide more than a pre-written compliance program:

> We are certainly of the view… that you can purchase programs for a value of money. We in AUSTRAC certainly wouldn't consider a purchased AML/CTF debt program that hasn't had regard to the individual risks of the business, that it would not be up to scratch in what we are having a look at.[26]

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23 *Proof Committee Hansard*, 6 August 2021, p. 12.

24 *Proof Committee Hansard*, 6 August 2021, p. 12.

25 *Proof Committee Hansard*, 6 August 2021, p. 26.

26 *Proof Committee Hansard*, 27 August 2021, p. 33.

3.31 Swyftx Pty Ltd suggested that there is scope for the AUSTRAC registration process, and the on-going review process thereafter, 'to be enhanced and strengthened to ensure a level of confidence that registered entities have met and continue to meet the standards expected of them'. Swyftyx noted further:

> A cornerstone of many of the overseas jurisdictions' approaches has been to recognize digital asset service providers as a specific category of "money transfer"-like business and to provide for a rigorous registration process for them.[27]

3.32 Mr Paul Derham Managing Partner, Holley Nethercote Lawyers, suggested some form of licensing regime:

> Registration with AUSTRAC, as you heard previously, is really easy. It's like registering a car. A licensing regime requires the driver to have competence. We would be suggesting some type of Australian financial services licensing regime for some aspects of what we've been talking about.[28]

3.33 FinTech Australia acknowledged that under the current regulatory framework, if cryptocurrencies were to become designated as financial products, a crypto-asset exchange would then need to hold a market licence. It recommended that, if this becomes the case, additional guidance and streamlining of the application process from the government and from ASIC will be necessary to help DCEs navigate the process. It cautioned further that a balance will need to be struck to ensure that local DCEs are not forced out of the industry by larger international operators:

> [T]he government must be careful to ensure that the obligations required for an AML [Australian Market Licence] are not watered down. Doing so may allow large international players in traditional markets to threaten the market share of Australian companies and start-ups if they were able to obtain an AML. We acknowledge that while there are currently a large number of cryptocurrency exchanges in the market we predict consolidation at least in the domestic market over time. Ultimately, a balance is required to ensure fintechs can more easily apply for an AML, without reducing the necessary protections to ensure efficient and fair markets, or enabling international players to dominate domestic players.[29]

3.34 Aus Merchant expressed the view that any requirements for DCEs to hold a market licence should not make this opportunity available only for large, established businesses:

> The crypto industry in Australia is currently driven by disruptive start-ups, and regulation should not create a barrier of entry which is too high for start-ups. This is especially important as established and institutional companies enter into the crypto industry. Established businesses not only

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27 Swyftx, *Submission 21*, p. [4].

28 *Proof Committee Hansard*, 6 August 2021, p. 22.

29 FinTech Australia, Answers to Questions on Notice, p. 7.

> have a financial advantage over startups but also have existing relationships with banking and insurance providers. One example where the need for regulation to be both fit for purpose and not pose a barrier to entry is in relation to prospective market licenses for digital currency exchanges. DCE have similar functions and features to [Over The Counter] trading. Any potential introduction of market licenses for DCE should reflect the features and technology of DCE, as a market license is a large undertaking for a start-up. The regulator's approach to Buy Now Pay Later (BNPL) regulation highlights the benefits of enabling a low barrier to entry. BNPL operated in a regulatory 'grey zone' and were able to build successful and respected services.[30]

3.35 FinTech Australia commented on the need to enhance regulation of DCEs without creating a system that drives operators offshore:

> The current AML/CTF compliance and reporting obligations that apply to registrable [DCEs], businesses that exchange cryptocurrency with fiat currency, do not take into account what we would usually expect a market operator to consider in any other sort of financial market. As such, merely bolstering AML/CTF obligations is unlikely to provide adequate protections to those accessing the market, or to ensure [its] efficient operation. On the other hand, over-regulation of DCEs will lead to investors looking offshore to find friendlier jurisdictions. A careful balance must be struck in fostering a fair and proportionate regime which aligns with the principles of financial markets, protection of consumers and the flexibility of a growing data and technology enabled industry.[31]

3.36 The ASX commented that any regulation of crypto exchanges should be designed to ensure the following points are considered:

- Responsible conduct obligations;
- Key person arrangements;
- Proper segregation of participants' assets and private keys from the marketplace's own assets;
- Appropriate record keeping;
- Maintaining policies and procedures to protect a participant's assets from theft or loss;
- Due diligence on partners and participants;
- Sufficiency of resources (including financial, technological, people); and
- Independent assurance.[32]

Custodial arrangements for digital assets

3.37 There was significant discussion in evidence to the committee around the specific need to have enhanced requirements in place for businesses that provide custodial and depository services for digital assets.

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30 Aus Merchant, Answers to Questions on Notice, pp. 5-6.

31 FinTech Australia, Answers to Questions on Notice, p. 8.

32 ASX, Answers to questions on notice, p. 2.

3.38 Australia has a large and well established industry for custodial services of traditional assets, with approximately AUD $4 trillion in value held by custodial service providers.[33] Within the framework of the Corporations Act and Corporations Regulations, ASIC provides guidance as to the requirements in respect of custodial services for traditional financial assets. These are articulated in ASIC's *Regulatory Guide 133 Funds management and custodial services: Holding assets* (RG 133), which applies to certain classes of AFSL holders who hold assets on behalf of registered investment schemes or other clients. RG 133 sets out minimum standards for asset holders to ensure that they meet their obligations under their AFS licence or delegation.[34]

3.39 Blockchain Australia provided an overview of the similarities and differences between custodial arrangements for traditional and digital assets:

> 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 the irreversible nature of public blockchain transactions, it is important that this private key is held securely.[35]

3.40 Piper Alderman summarised this risks associated with custodianship of digital assets:

> A key risk to holders of digital assets, be they director holders or indirect investors is the custody risk of digital assets.
>
> The nature of blockchain technology means that, if the private keys to digital assets are compromised, those assets can be permanently lost with no prospect of recovery. To paraphrase, the saying in the digital asset world is *"not your (private) keys, not your Bitcoin"*. In the last twelve months there has been an explosion in demand for custodial services in digital assets as it appears the case that many users of digital currency exchanges are content to leave their assets "on-exchange".[36]

3.41 Blockchain Australia submitted that there are currently a number of options for digital custody:

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[33] Australian Custodial Services Association, *Submission 76*, p. 1.

[34] ASIC, *Regulatory Guide 133 Funds management and custodial services: Holding assets*, July 2018, p. 4.

[35] Blockchain Australia, *Submission 71*, pp. 43-44.

[36] Piper Alderman, *Submission 72*, p. 8.

> 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.[37]

3.42 The ASX argued that both self-custody and custody through DCEs can present particular problems and risks:

> Crypto exchanges can provide a user experience which is attractive to many Australians who wish to invest in crypto assets, including the experience of a password-based login. However, as others have noted, there are risks in these custodial arrangements for digital assets. Many of these risks are associated with the management of private keys. A parallel can be made between management of user passwords and user private keys, however, we note below an important difference.
>
> Crypto exchanges can also be vulnerable to cybersecurity risks, and there have been some prominent examples of this. In this sense they are no different to other businesses that may be subject to this risk, and investors commonly use third parties to hold assets in custody and safekeeping. However it is important that these decisions can be made in the confidence that the custodian is appropriately regulated, well capitalised, carries appropriate insurance, maintains data and operational systems in accordance with industry best practice security standards, and so on.
>
> It is also true to say that users who choose to manage their private keys directly are vulnerable to risks. If using a 'hot wallet', which remains connected to the internet, they open themselves up to some of the security risks faced by cryptocurrency exchanges, but potentially without the benefit of the systems, insurances and so on that may be maintained by a crypto exchange. If using a 'cold wallet', which is kept offline, the user risks physical theft, loss or destruction with limited avenues for recovery other than through law enforcement in appropriate cases.[38]

3.43 The ADC Forum submitted that in recent years, while fintech has grown exponentially in complexity, 'one missing component to date has been the availability of appropriate custody services for the safekeeping of digital assets'.[39] It noted that a major challenge in this area remains the lack of independent third-party digital asset custodians:

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[37] Blockchain Australia, *Submission 71*, p. 44.

[38] ASX, *Submission 65*, p. 2.

[39] ADC Forum, *Submission 35*, p. 10.

> In traditional financial services, these service providers fulfil three key functions, namely validation, security and trust. In the absence of digital asset custodians, first-party custodianship remains the main form of safeguarding clients' assets. This is a fundamental security concern given that loss of the private key relating to the assets equates to losing the ownership rights to the digital asset. A few businesses providing digital asset custodian services are now emerging.[40]

Can digital assets be appropriately custodied under existing regulations?

3.44 Piper Alderman expressed the view that digital assets can be appropriately custodied by a third party custodian under the current regulatory regime for custodied assets, if they follow the requirements of RG 133:

> For custodians that are familiar with the attributes of, and appropriately aware of how to keep private keys for digital assets safe, there is no legal barrier to those custodians satisfying the organisational structure, staffing capabilities, capacity and resources requirements and the ability for assets to be held on trust as required in the regulations.[41]

3.45 Blockchain Australia submitted that while RG133 does not discuss custody of crypto-assets, it is 'not aware of any reasons why custody of crypto-assets would breach any other regulations or obligations'. It argued that an explicit statement to this effect from ASIC 'would provide reassurance to those offering custodial services in Australia that there are no regulatory impediments to doing so', and recommended that ASIC make it plain that licensed custody providers can provide crypto-asset custodial services through an update to RG 133.[42]

3.46 The ADC Forum submitted that updates would be required in order for the existing regulatory framework to apply to digital assets:

> While the regulators do issue custodian licences, the existing regulatory framework applicable to these licences, unless appropriate updates are made, is not directly applicable to the safekeeping of digital assets. In the eventuality the regulators may wish to license entities providing custody services for digital assets, an important aspect to be considered is the cyber resilience of these service providers, i.e., their ability to limit the impact of security incidents.[43]

3.47 The Australian Custodial Services Association (ACSA) stated that a range of considerations should be taken into account in determining how to best regulate custodial services for digital assets. It submitted:

> Firstly, for context, custodians are agents for the principal investment decision maker (including superannuation fund trustees and managed

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40 ADC Forum, *Submission 35*, p. 10.

41 Piper Alderman, *Submission 72*, p. 8.

42 Blockchain Australia, *Submission 71*, p. 45.

43 ADC Forum, *Submission 35*, p. 10.

> investment scheme responsible entities). There is an extensive regulatory framework already in place governing the formulation and implementation of investment policy that is agnostic to asset type and that already specifies licensing, capability, capital and resilience requirements of appointed material service providers including custodians (all with independent audit verification and oversight by APRA/ASIC). These should equally apply to entities providing custody of digital assets.[44]

3.48 ACSA submitted that other relevant considerations should include the following:

- A broad and consistent baseline level of KYC, AML/CTF regulation should apply to crypto asset exchanges/trading platforms and custodians. Exchanges/platforms on which crypto assets trade must provide the ability to identify remitters and beneficiaries.
- Regulation should be formed within a clear principles based policy framework. The framework needs to be largely principles based (not prescriptive) given the pace of technology change and market evolution.
- Policy should guide whether the starting point should be to provide equivalent safeguards that are already in place for today's range of investment types.
- Policy formulation and regulation should recognise that many of the risks and market constructs are not new and apply to existing assets and markets. Accordingly, an entirely new framework is not required, but rather the existing framework should be adapted at the margin to accommodate unique crypto asset features.[45]

3.49 ACSA provided a range of detailed information about the differences between custodial arrangements for physical and digital assets, as well as specific considerations for the regulation of custodial services for digital assets.[46]

Options for licensing digital asset custodians

3.50 In addition to arguments that existing licensed custodians should be explicitly authorised to provide these services for digital assets under the existing regulations, some submitters and witnesses advocated for a separate or amended set of standards and licensing requirements for businesses specifically dealing with digital asset custody.

3.51 Aus Merchant submitted that digital assets have unique technological features and risks that mean current custody regulations are inadequate. It stated that the development of a tailored licence for digital asset custody 'will raise overall

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[44] Australian Custodial Services Association, *Submission 76*, p. 1.

[45] ACSA, *Submission 76*, pp. 1-2.

[46] ACSA, *Submission 76*, pp. 3-9.

regulatory standards for digital asset service providers and create further evidence of regulatory compliance to banking providers'.[47]

3.52 Independent Reserve submitted that Australia should introduce minimum standards for digital asset custody service providers, along with a licensing program for these providers.[48] It noted that 'there have been numerous examples in the past of digital asset custody providers and exchanges losing millions of dollars of customer assets':

> This has created a perception that using a professional company to house digital assets is a risky proposition. This has had the flow-on effect of making insurance for reputable custody service providers either prohibitively expensive or simply not available.[49]

3.53 Independent Reserve recommended that the Australian Government define a set of minimum standards for any company offering digital currency custodial services, covering:

- minimum net capital requirements for all custodial service providers;
- IT security arrangements;
- redundancy arrangements (to eliminate key person risk);
- segregation of customer/house assets;
- record keeping/holder entitlement;
- reconciliations/proof of ownership; and
- regular external audit of security procedures.[50]

3.54 Independent Reserve stated that minimum standards requirements and licensing would have other benefits including:

- providing confidence in the sector to support service providers (auditors, insurance companies, underwriters, consultants, etc.), leading ultimately to insurance, audit and controls assurance services to be made available at reasonable prices to the industry;
- promoting financial product innovation including the development of ASX-traded digital asset and cryptocurrency funds domiciled within Australia; and
- increasing use of audit and assurance services locally boosts the professional services industry in Australia, as well as increasing foreign investment into Australia.[51]

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47 Aus Merchant, Answers to questions on notice, p. 4.

48 Independent Reserve, *Submission 17*, p. 1.

49 Independent Reserve, *Submission 17*, p. 2.

50 Independent Reserve, *Submission 17*, p. 2.

51 Independent Reserve, *Submission 17*, p. 3.

3.55 The ADC Forum pointed to Mauritius as an example of a jurisdiction that has implemented a successful licensing regime for the custody of digital assets.[52] Under this licensing scheme introduced in 2019, parties intending to provide custody services for digital assets in Mauritius are required to obtain a Custodian Services (Digital Asset) Licence from the Mauritius Financial Services Commission. Features of this licence include the following requirements:

- Mandatory compliance with Mauritius' AML/CTF legislation;
- Requirement to maintain an authorised representative in Mauritius, conduct core business activities in Mauritius and have a governance structure that can provide effective oversight of its activities, taking into account the nature, scale and complexity of the business;
- Minimum capital requirements of at least 6 months' operating expenses, as well as adequate skills and infrastructure to maintain operations;
- The custodian should have a comprehensively documented operational risk management program, with systems tests undertaken in accordance with industry best practice quarterly, and a comprehensive third party audit undertaken annually;
- Safeguards and best practice requirements to manage the creation and management of private keys by the custodians, including cold (that is, offline) storage standards for private keys;
- Client asset segregation rules to prevent the possibility of bulk theft of client assets;
- Multi-signature authorisation for client transactions;
- Adequately secured physical infrastructure, documented processed for protecting digital assets in the result of a security breach, and documented disaster recovery plan; and
- Recordkeeping and statutory reporting obligations.[53]

3.56 Submitters noted that ASIC's recent Consultation Paper 343 (CP 343) on the use of crypto-assets as underlying assets for exchange-traded products (ETPs) and other investment products included detailed discussion around what appropriate custody requirements could be for crypto-assets underlying an ETP. Aus Merchant stated that it agreed with the standards for digital asset custody discussed by ASIC in consultation paper CP343, which are:

- specialist expertise and infrastructure for digital asset custody;

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[52] Ms Loretta Joseph, Chair, ADC Cyber Security Council, ADC Forum, *Proof Committee Hansard*, 27 August 2021, p. 22.

[53] ADC Forum, Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 7 September 2021), pp. 10-31; DTOS, 'Mauritius: Regulatory Framework for the Custody of Digital Assets', https://www.dtos-mu.com/mauritius-regulatory-framework-for-the-custody-of-digital-assets/ (accessed 11 October 2021).

- segregation of crypto assets on blockchain - unique public and private keys for each client;
- private key generation and storage in a way that minimises risk of unauthorised access;
- multi-signature or sharding based storage;
- practices for receipt, validation, review, reporting and execution of instructions; and
- robust cyber and physical security practices.[54]

3.57 Piper Alderman commented that ASIC's CP343 'demonstrates progress towards a position where custody of digital assets may be more widespread'. It commented further:

> At present we are not aware of any licensed custodian actively offering custody services for digital assets. We agree with ASIC's approach to a best practice for digital asset custody and applaud their forward thinking presentation in CP343 and setting out detailed guidance. The good practice guidance may provide certainty for licensed custodians to consider digital asset custody, at least in regards to exchange traded products.
>
> Further urgent guidance should be provided to encourage licensed custodians to offer services for asset custody outside of only ETPs, so that digital currency exchanges can reduce the risk for their clients that digital assets left "on exchange" will be at risk of theft. The major digital currency collapses in the history of digital assets may well have been prevented had custody been in place for client assets.[55]

Should licensing requirements for custodial providers be a full AFSL?

3.58 Independent Reserve noted that for 'all financial products in Australia, any business providing a custodial or depository service must hold an Australian Financial Services licence'. It stated that applying for an AFSL 'is a non-trivial matter and carries a range of responsibilities for licensees'.[56]

3.59 Independent Reserve did not consider that an AFSL should be required to provide a custodial service for digital assets and cryptocurrency, submitting that holding an AFSL 'carries many requirements that are not appropriate or relevant to the digital currency sector as it currently stands'.[57] It recommended an alternate licensing scheme, whereby businesses that want to provide a custodial service for digital assets and cryptocurrencies 'must be issued an authority/licence to do so prior to offering services to customers', with the following requirements:

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54 Aus Merchant, Answers to questions on notice, p. 4.

55 Piper Alderman, *Submission 72*, p. 8.

56 Independent Reserve, *Submission 17*, p. 3.

57 Independent Reserve, *Submission 17*, p. 3.

- minimum capital requirements (net tangible assets) of at least $5 million AUD;
- audit certificate/external assurance of custodial procedures;
- redundancy procedures;
- segregation of customer and operational funds/assets;
- annual compliance requirements for audit/external assurance; and
- a Responsible Person with adequate experience.[58]

3.60 It argued that the benefits of this arrangement would be as follows:

> Setting a high bar for the storage and security of customer assets elevates consumer protection from unscrupulous operators and businesses that do not invest adequately in security. It will also serve as an incentive to reputable operators to sufficiently invest in security and systems and to have these systems regularly tested by external firms.[59]

3.61 The Digital Law Association, which did advocate for the introduction of a new authorisation class within the AFSL regime to cater for digital assets, noted that such a change would need to deal specifically with issues relating to custody:

> [P]ractical issues such as the lack of availability of insurance or licenced digital asset custody providers will need to be considered and accounted for so that compliance with such a license is not rendered impossible. This could be achieved by, for example making clear that custody of digital assets may be provided by existing licensed custodians.[60]

3.62 Bitcoin Babe argued that in considering potential regulatory requirements for custodial service providers of digital assets, there are several types of DCEs that do not take custody of customer cryptocurrency or funds. As such, these types of services 'require recognition and leniency where custodial requirements are concerned, which should be clearly defined in any application or dealings with ASIC or other interested industry bodies'. Bitcoin Babe argued that custodianship attributes must be clearly defined in any new arrangements; for example, through clearly defining the necessary duration of a DCE's custody over a customer's funds or cryptocurrency in order for it to be considered a formal custodial agreement.[61]

Comments on overseas and local custodial providers

3.63 Piper Alderman suggested that, in order to further attract investment and retain FinTechs locally, a preference towards Australian based custody solutions for digital assets be made:

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58 Independent Reserve, *Submission 17*, p. 4.

59 Independent Reserve, *Submission 17*, p. 4.

60 Digital Law Association, *Submission 49*, p. 11.

61 Bitcoin Babe, Answers to questions on notice, p. 7.

> Australian based digital custody would have clear benefits in terms of jurisdictional risk and in making audits of systems / wallet balances and processes potentially simpler. To our knowledge, all of the recent fund products involving digital assets are using North American or European based custody providers.
>
> A signal that digital assets can be custodied under existing regulation will help catch up with other jurisdictions that are pioneering digital asset custody and financial products backed by digital assets. For example, there are 25 digital asset backed products listed on the Toronto Stock Exchange which mostly involve Bitcoin and Ether, while in the US continued applications for ETPs involving digital assets are being made.
>
> Custodians of these funds manage their digital assets using a combination of a custodian and a sub-custodian. These custodians hold the private keys to the underlying digital assets which are the assets of the fund.[62]

3.64 Independent Reserve outlined that introducing minimum standards and licensing for digital asset custody would give customers certainty that their digital assets are secure, and ensure that these assets are held within Australia rather than by overseas platforms:

> With customers having assurance that assets can be held securely by a business, it has the added benefit that Australian-owned assets are kept in Australia, by Australian businesses and customers are then protected under existing consumer protection laws. Currently the largest providers of custody services globally are not domiciled in Australia. Should customers of these offshore businesses have a dispute with the provider, the individual customer must negotiate international laws and jurisdictions to try and resolve the dispute and recover their assets. Providing a custody standard and requiring businesses to be financially viable, domiciled in Australia and adhering to minimum standards would ensure Australian assets stay in Australia and customers are afforded the range of consumer protections already in place for Australian consumers.[63]

3.65 In contrast, Aus Merchant argued that Australian DCEs should not be required to store assets in Australia, but be able to utilise custody service providers based overseas:

> [P]otential change to digital asset custody regulation may include requirements for digital assets in custody to be stored in Australia. Digital asset custody is not suitable for on shore storage. This is due to the lack of experienced digital asset custody providers with sufficient technological capabilities based in Australia. Digital asset custody is a developing area, with international companies spearheading the development of robust technology and safe services. These companies have high regulatory standards and maintain compliance in multiple jurisdictions… Requiring digital asset custody to be hosted in Australia would create difficulty to ensure high quality custody of digital assets and severely impact the ability for Australian companies to provide custody of digital assets to their

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62 Piper Alderman, *Submission 72*, p. 9.

63 Independent Reserve, *Submission 17*, pp. 2-3.

> clients. Access to private keys and transfer instructions are ultimately managed by the head of compliance, who is domiciled in Australia. This key person is subject to police checks, staff due diligence and Australian law, even if the assets are held internationally.[64]

3.66 Aus Merchant added that creating a regulatory environment supportive of digital asset custody 'could entice these international companies to establish offices in Australia'.[65]

3.67 Blockchain Australia stated that it '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'.[66]

Bringing classes of crypto-assets directly into existing Corporations regulation

3.68 Some stakeholders argued for bringing some digital assets within the scope of existing financial services regulation.

3.69 The Digital Law Association recommended 'the introduction of a new authorisation class(es) within the Australian Financial Services licence explicitly designed to cater for digital assets and digital asset businesses as financial products and services', including changes to Part 7 of the Corporations Act if this is required to facilitate this new authorisation class.[67] It stated:

> [I]t is currently unclear how to practically license and register digital asset products and services. This is because increasingly complex, new and creative methods of economic interaction, from fractionalised fundraising to yield farming, or from tethering and stable coins to wrapped non-fungible tokens (NFT), are yet to be successfully reconciled neatly to the traditional regulatory process and in particular the current Financial Product & Service classes of security, managed investment scheme, derivative or non-cash payment scheme.
>
> The flow on effects arising from the introduction by ASIC of a bespoke digital asset friendly classification category for financial products and services, would be greater certainty for those requiring market licences that need to extend to cover digital asset financial products and services, as well as positive impacts on both traditional stock exchanges and digital exchanges, where there is considerable uncertainty as to the regulatory implications of listing tokens or platform providers that are not licensed.[68]

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64 Aus Merchant, Answers to questions on notice, pp. 4-5.

65 Aus Merchant, Answers to questions on notice, pp. 4-5.

66 Blockchain Australia, *Submission 71*, p. 45.

67 Digital Law Association, *Submission 49*, p. 10.

68 Digital Law Association, *Submission 49*, p. 10.

3.70 Mr Kevin Lewis, Special Counsel, Regulatory Policy at the ASX, summarised the argument that certain classes of crypto-assets should simply be incorporated into the current regulatory framework for financial products in Chapter 7 of the Corporations Act:

> Our submission is primarily directed to what we would call cryptofinancial products, as opposed to other broader crypto-assets. We say in relation to the cryptofinancial products that we think they should probably be treated in the same manner, from a regulatory standpoint, as other financial products. Of course, we have a well-established regulatory regime for financial products in chapter 7 of the Corporations Act. We think that one mechanism for achieving a solid regulatory framework would be to rely on chapter 7 and to bring cryptofinancial products within chapter 7. There is a mechanism in the Corporations Act for doing that, and that's the passage of a regulation simply stating that cryptofinancial products are financial products for the purposes of the Corporations Act.[69]

3.71 Herbert Smith Freehills (HSF) put forward a specific proposed set of amendments to along these lines. It recommended an amendment to s764A of the Corporations Act to include 'digital asset' as a facility specifically taken to be a financial product for the purpose of Chapter 7, where 'digital asset' is defined as:

> A record that is either created, recorded and transmitted, or stored in a digital (or otherwise intangible) form by electronic magnetic or optical means (or by any other similar means) and is:
>
> (a) a digital representation of value that:
>
> (i) functions as a medium of exchange, a store of economic value, or a unit of account; and
>
> (ii) is not issued by or under the authority of a government body; and
>
> (iii) is interchangeable with money (including through the crediting of an account) and may be used as consideration for the supply of goods or services; and
>
> (iv) is generally available to members of the public without any restriction on its use as consideration; or
>
> (b) a means of exchange or digital process or crediting declared to be a digital asset by the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) and the *Australian Securities and Investment Commission Act 2001* (Cth),
>
> but does not include any right or thing that, under the Corporations Act, is taken not to be a digital asset for the purposes of this Act.[70]

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[69] *Proof Committee Hansard*, 8 September 2021, p. 24. See also: ASX, *Submission 65.1*.

[70] Herbert Smith Freehills, *Submission 60.1*, pp. 1-2.

3.72 This would be complemented by an amendment to s765A to 'exclude any digital asset that is not used to make a financial investment, manage financial risk, or make non-cash payments, by a person'.[71]

3.73 HSF submitted that as an alternative approach, the Corporations Act regulations could be used to introduce specific digital asset financial product inclusions and exclusions.[72]

3.74 HSF stated that by 'unequivocally bringing those digital assets that are used to make a financial investment, manage financial risk, or make non-cash payments' into the scope the Corporations Act, 'there will be a waterfall effect that enlivens the clear application' of the AFSL and Market Licence regimes. It argued that this will help:

- provide clear legal guardrails for compliance by good actors in industry;
- provide clear legal guardrails to underpin enforcement actions for non-compliance by bad actors in industry;
- give clear legal guardrails to market licensees; and
- create markets where retail investors are only offered regulated financial products and services.

3.75 HSF expressed the view that this reform would make Australia an attractive destination for innovative financial products and services and other digital asset businesses, as well as meeting regulatory objectives including for confident and informed decision making by consumers of financial products and services, while promoting efficiency, flexibility and innovation in the provision of these products and services. Further it would 'move large numbers of digital asset transactions and their accompanying value, that are currently not being regulated notwithstanding that they should be, back within the appropriate regulatory frameworks'.[73]

3.76 TCM Capital argued that digital assets should be regulated to provide legal certainty for investors, and that this should be achieved by applying existing legal definitions to digital assets.[74] It advocated for amending section 763B of the Corporations Act, which outlines the legal definition of when a person makes a financial investment, to broaden this definition and include investments into digital asset products.[75]

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71 Herbert Smith Freehills, *Submission 60.1*, p. 2.

72 Herbert Smith Freehills, *Submission 60.1*, p. 2.

73 Herbert Smith Freehills, *Submission 60.1*, pp. 3-4.

74 TCM Capital, *Submission 38*, p. 1.

75 TCM Capital, *Submission 38*, pp. 8-9.

Limiting DCE regulation to certain conduct obligations

3.77 Holley Nethercote Lawyers argued that established DCEs should be subject to laws relating to market misconduct and general obligations, without necessarily being subject to the full requirements of other AFSL and Market Licence holders:

> [M]arket manipulation laws don't apply where the trading does not relate to a financial product, and many virtual assets are treated as if they are not financial products.
>
> Given the nascent status of many virtual assets, DCEs are required to engage liquidity providers with large stores of the new virtual asset before listing it, so as to maintain a stable market when the virtual asset is listed. Internationally, our view is that insider trading connected with this practice is rampant. In Australia, insider trading prohibitions are tied to inside information which relates to financial products. So, they are unlikely to apply to many of the domestic coin listings.
>
> Further, licensees in multiple categories in Australia are required to comply with general obligations, such as the obligation to provide financial services "efficiently, honestly and fairly". Imposing these obligations on established DCEs would mean ASIC has jurisdiction over contraventions of the general conduct obligations… These recommendations could be achieved by the Government declaring that virtual assets are financial products. There are existing mechanisms to exempt or provide relief from certain requirements in the current regulatory framework, so that only relevant parts of the general obligations and market misconduct provisions apply to DCEs.[76]

Licensing to enabling the provision of financial advice relating to digital assets

3.78 Several submitters argued for the introduction of an Australian Financial Services financial product category that covers crypto-assets so that financial planners can provide licensed financial advice in relation to these assets.

3.79 Caleb and Brown, a Melbourne-based cryptocurrency brokerage, submitted:

> At present, while Caleb and Brown takes all measures possible to ensure consumers are protected against risks when trading cryptocurrencies, Caleb and Brown brokers are unable to lawfully provide financial advice to consumers. Due to the fact that crypto-assets are yet to be determined to be "financial products" for the purposes of ASIC's Regulatory Guides and for the Corporations Act generally, Caleb and Brown as an entity is unable to avail itself of AFS licensing and, therefore, our brokers are unable to use RGs 36 and 244 to structure both general and scaled advice to consumers. As such, despite providing our services in a manner through which clients have direct access to a knowledgeable and skilled broker, our brokers are currently unable to provide anything beyond purely factual information to clients.[77]

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[76] Holley Nethercote Lawyers, *Submission 7*, p. 9.

[77] Caleb and Brown, *Submission 75*, p. 2.

3.80 Caleb and Brown argued that this inability to provide general and scaled advice poses a risk to clients:

> While Caleb and Brown operates internal policies to ensure only tokens with sufficiently low risk profiles are available to trade, it is still possible for an inexperienced client to engage Caleb and Brown with the intention of trading based on an unreliable tip or an erroneous calculation of a crypto-asset's risk profile. In these situations, Caleb and Brown brokers have no method by which to adequately mitigate the client's risk. These brokers are unable to provide general or scaled advice that would seek to take into consideration the client's inexperience or that would attempt to re-characterize for the risk profile of the crypto-asset for the client.[78]

3.81 Blockchain Australia recommended that a new licensing regime, modelled off the existing AFSL, 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.[79] It commented:

> 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.
>
> …
>
> 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.[80]

Classifying digital assets and 'token mapping'

3.82 As digital asset technology is evolving so rapidly, a challenge for policy makers and regulators is developing an adequate understanding and articulation of the different types of digital assets available in the market, in order to determine what regulatory requirements should apply to different types of products.

3.83 Jurisdictions overseas have taken a variety of inconsistent approaches to token classification and categorisation of digital assets. 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'.[81] A number of submitters and witnesses expressed the view that Australia needs to undertake a detailed 'token mapping' exercise

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78 Caleb and Brown, *Submission 75*, p. 2.

79 Blockchain Australia, *Submission 71*, p. 55.

80 Blockchain Australia, *Submission 71*, pp. 52 and 53.

81 Blockchain Australia, *Submission 71*, p. 51.

to create a best-practice framework for characterising digital assets, taking into account the approaches being used internationally.

3.84 CPA Australia commented on the lack of standardisation in terminology across jurisdictions:

> At present, different jurisdictions adopt different terminology to describe what the Committee refers to as 'cryptocurrencies' and 'digital assets'. The Canadian government refers to Bitcoin and other cryptocurrencies as 'digital currencies'. In Europe, the term 'crypto-assets' is applied, which appears to be an umbrella term capturing cryptocurrencies, stablecoins, CBDCs, different forms of tokens (e.g. utility and security) and others, identifying each as subsets of crypto-assets. The European Commission, in Article 3 of its Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets (MiCA), distinguishes between the characteristics of those subsets or types of crypto-assets and consolidates divergent definitions and taxonomies used across different European jurisdictions.
>
> With regards to other jurisdictions, we note that several regulators propose vague, catch-all definitions. However, more clarity is needed with respect to the distinction between crypto-assets that may be characterised as financial instruments (falling under the scope of existing financial regulation) and those which would fall under the scope of other amended or new regulation. Definitions must also be 'flexible' and technology-neutral to allow for future developments.[82]

3.85 Ripple noted that there is 'no single or generally recognised definition of digital assets at present', and submitted that these assets:

> …should not be solely defined relative to a specific technology (e.g., cryptography), but, for the purposes of regulation, should instead fall under a broader heading such as "digital assets", and subsequently classified depending on the particular economic function and purpose they serve.[83]

3.86 Ripple noted that this approach is consistent with that taken by the UK and Singapore, 'which have issued classifications that do not depend on whether a business model uses distributed ledger technology or not'.[84] It recommended that Australia adopt a digital asset taxonomy consistent with such global practices in order to provide 'clarity to the legal character of digital assets in Australia'. It recommended that this taxonomy provide clear distinctions between payment tokens, utility tokens, and security tokens, as follows:

- Payments or Exchange tokens: to describe non-fiat native digital assets that are used as means of exchange and have no rights that may be enforced against any issuer;

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82 CPA Australia, *Submission 12*, p. 3.

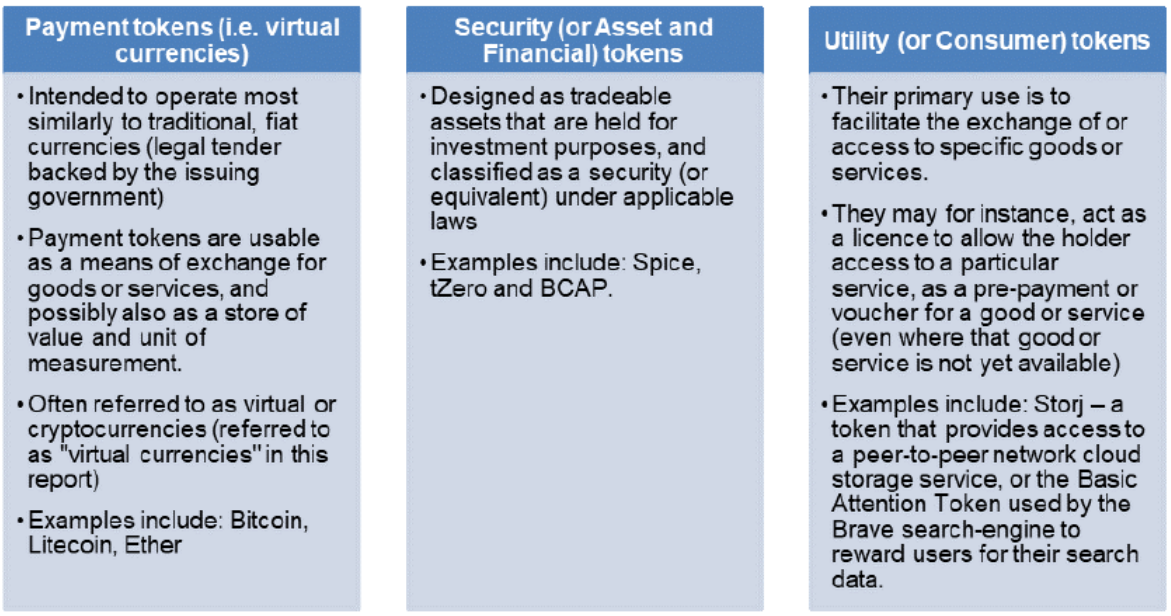
83 Ripple, *Submission 15*, p. 4.

84 Ripple, *Submission 15*, p. 4.

- Utility tokens: to describe those digital assets that create access rights for availing service or a network, usually offered through a blockchain platform; and
- Security tokens: to describe tokens that create rights mirroring those associated with traditional securities like shares, debentures, security-based derivatives, and collective investment schemes.[85]

3.87 These three categories of tokens have also been recognised by the OECD, as shown in Figure 3.1.

Figure 3.1 Common categories and types of crypto-assets (OECD)



Source: OECD, Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Policy Issues, October 2020, p. 12.

3.88 FinTech Australia argued that 'care should be taken when seeking to define crypto-assets under any regulatory or legislative framework', adding:

> In particular, where a broad approach to the definition of "crypto-asset" was taken in Singapore, this has captured a wide-range of crypto-assets within a regime which is structured for financial product and payments. In particular, the Singaporean regime does not adequately differentiate between asset classes or tokens under its regime. As such, there is concern that blockchain businesses using NFTs as part of their underlying technology are caught under this regime. Further, significant consideration should be given if existing financial products were to be caught under a new regime merely by virtue of also being a crypto-asset.
>
> Any new laws, regulations or policies should adhere to technological neutrality principles so that they do not apply based on what technology underpins a given asset, but rather has regard as to the rights given to the recipient of the asset. Separately from these unintended consequences,

[85] Ripple, *Submission 15*, pp. 6-7.

> such an approach may also entrench certain technologies, preventing the adoption of new technologies which are developed.[86]

3.89 CPA Australia recommended that the government 'establish a glossary of terms, which categorises and defines existing crypto-assets while leaving sufficient flexibility for future innovations'.[87] It argued that this glossary should differentiate crypto-assets by certain characteristics (as proposed in the European Commission's MiCA) and/or apply criteria proposed by the Bank for International Settlement (BIS). The BIS distinguishes between various types of crypto-assets by criteria including: the functionality of the crypto-asset (e.g. payment/exchange, investment, utility); underlying stabilisation mechanism (e.g. asset-backed, algorithm-based); and systematic importance (i.e. global or non-global reach).[88]

3.90 The Digital Law Association submitted that 'the most useful taxonomy of Digital Assets will be one that is developed *after* the development of new and clear authorisation classes for Digital Asset Financial Products'.[89] It explained further:

> We should not mistake what are currently commonly issued token features, (or combinations of features) to be demonstrative of the types of tokens business would like to deal in. Rather they are very often demonstrative of development undertaken to avoid regulatory oversight (e.g attempts to stay within the feature setlist often identified as a "Utility Token"). If regulatory oversight was simplified and ASIC could provide clear categories of acceptable licensed behaviour, we anticipate that token businesses would evolve their products to meet those authorisation class requirements.[90]

3.91 The Digital Law Association noted several other factors that will influence how digital assets can be classified:

- Tokens can change characterisation over time. For example, the analysis of whether a digital asset is offered or sold as a security is not necessarily static.
- There is a great deal of overlap between classification classes. Modifying a token's function (even in a small way) may move a Digital Asset from one classification category into another classification category, and/or dictate that it straddles more than one category.
- How a token should be classified and therefore regulated, is also a product of the relationship that token has with other digital assets, or its milieu of

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86 FinTech Australia, Answers to Questions on Notice, p. 8.

87 CPA Australia, *Submission 12*, p. 3.

88 CPA Australia, *Submission 12*, p. 3.

89 Digital Law Association, *Submission 49*, p. 11 (emphasis in original).

90 Digital Law Association, *Submission 49*, p. 11.

> operation. For example an NFT in isolation is its own class… if however it is wrapped or tethered to a security token, that will likely change the nature of the NFT such that it also should be a regulated token.[91]

3.92 Independent Reserve put forward the view that classification of tokens should not be a prerequisite for implementing licensing requirements for digital asset businesses in Australia:

> Token and coin classification is a complex issue that has yet to be solved in an elegant manner in any jurisdiction around the world. For example: the recent licensing developments in Singapore require a legal opinion from every participant seeking to list each token and all stable coins are treated as e-money and fall under a prohibitive section of legislation.
>
> If any near-term solution requires a comprehensive token classification mechanism to enable the digital currency and cryptocurrency sector to slot into the existing Corporations Act, then it is unlikely to happen prior to an established international standard.
>
> For this reason, it is important that the Committee focuses on what can deliver meaningful improvements to the Australian industry and consumer protection. Independent Reserve recommends that any licensing of custody services to the digital asset and cryptocurrency industry should be token neutral and allow any licensed business to offer custody for any digital asset and cryptocurrency.[92]

3.93 The Digital Law Association recommended that, as an interim measure before a more comprehensive digital asset policy framework is legislated, Treasury should 'lead the preparation and release of a multi-agency working taxonomy of Digital Assets that sets out the Australian legal and tax implications of digital asset businesses and transactions', with input from other relevant regulators.[93]

3.94 Blockchain Australia recommended that a comprehensive token mapping exercise be undertaken in Australia, including examining the work done on token classification in overseas jurisdictions, 'as the first step in a broader, fit-for-purpose regulatory framework'.[94]

Other issues relating to the AML-CTF framework

3.95 In addition to AUSTRAC registration being an insufficient form of regulation for DCEs, as mentioned above, submitters and witnesses raised several other issues in relation to the AML/CTF framework administered by AUSTRAC.

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91 Digital Law Association, *Submission 49*, p. 11.

92 Independent Reserve, *Submission 17*, p. 4.

93 Digital Law Association, *Submission 49*, p. 11. The Digital Law Association included an indicative schema that could be used as a starting point for a taxonomy of digital assets, outlining thirteen initial categories for different types of assets.

94 Blockchain Australia, p. 52.

FATF guidance and the 'travel rule'

3.96 Industry submitters were generally supportive of the way AUSTRAC has sought to engage DCEs in developing changes to its AML/CTF guidance.[95]

3.97 One are of concern relates to the potential implementation of the FATF's 'travel rule' in Australia. The 'travel rule' was released by FATF in 2019 as part of its guidance on the AML/CTF regulation of cryptocurrency/digital asset services. It requires financial institutions to include verified information about the originator (payer) and information about the beneficiary (payee) for wire transfers and other value transfers throughout the payment chain.[96] However, technological solutions to enable virtual asset service providers to comply with the 'travel rule' are still under development and only beginning to be rolled out globally.[97]

3.98 The travel rule has been implemented in domestic regulation in a number of jurisdictions since 2019 through a variety of mechanisms, but has not yet been implemented in Australia. Submitters expressed concern that if the travel rule were implemented in a strict way in Australia, this would create significant damage to the digital assets sector.

3.99 For example, Revolut Australia commented:

> The travel rule requires that the originators and beneficiaries of all transfers of digital funds must exchange identifying information. This puts a huge burden on cryptocurrency service providers which do not presently have access to detailed beneficiary information. These guidelines are likely to stifle innovation and fails to understand that blockchain analysis has the potential to be a more effective tool at preventing money laundering and terrorism financing than the manual collection of beneficiary information.[98]

3.100 Bitaroo recommended that discussion around the 'travel rule' in Australia be postponed 'until other countries discover the multiple issues around implementing it', and if Australia eventually implements the rule, it should 'elect for the lightest touch possible that FATF will allow'.[99] It submitted:

> Proposed 'Travel Rule' legislation, whereby digital asset providers would be required to share and disclose the personal details of its customers and their transactions is one example of a restrictive policy that we believe to be individuals' breach of privacy.
>
> It is regulations such as this that will only act to encumber growth in this sector.[100]

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95 See: Blockchain Australia, *Submission 71*, p. 45.

96 Department of Home Affairs, *Submission 23*, p. 5.

97 Department of Home Affairs, *Submission 23*, p. 5.

98 Revolut Australia, *Submission 44*, p. 4.

99 Bitaroo, *Submission 5*, p. 1.

100 Bitaroo, *Submission 5*, p. 3.

3.101 Blockchain Australia submitted that 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 that the premature or rushed implementation of the travel rule, as seen in other jurisdictions, would be a significant competitive disadvantage and inhibit innovation.[101]

3.102 Blockchain Australia noted that in FATF's most recent review of implementation of its guidelines, in July 2021, FATF found that 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' to avoid VASPs engaging in jurisdictional arbitrage.[102] Blockchain Australia recommended 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'.[103]

3.103 Mr Aidan O'Shaughnessy, Executive Director, Policy at the Australian Banking Association, expressed the view that the travel rule should be implemented to provide a level playing field between traditional and digital financial products:

> I think the [banking] industry's view is that the FATF standards on virtual assets—once they finalise the update of the guidance in 2021, this year—should be adopted in Australia. As part of that adoption, I think, yes, the travel rule should be adopted in Australia. I do take the point…that, in a decentralised environment, what is acceptable and works in a traditional financial system might not work in this environment. But I heard Revolut talk this morning—technology is actually solving this problem.
>
> The travel rule, in its essence, is: you must know where the money is coming from and where the money is going to. If we believe that the objective of the anti-money-laundering and counterterrorism financing legislation is to prevent money laundering, prevent terrorism financing, and we put that obligation on the traditional financial system, it is logic that we would put it onto this alternative system as well. If there is a non-level playing field, what I think might ultimately happen is that, in the digital environment, all the illegal activity will flow to that environment, because it will be less regulated and it will still have that level of anonymity.[104]

3.104 When asked whether early adoption of the travel rule may damage Australia's competitive position, Mr Daniel Mossop, Assistant Secretary, Transnational Crime Policy Branch at the Department of Home Affairs, commented:

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[101] Blockchain Australia, *Submission 71*, pp. 46-47.

[102] Blockchain Australia, *Submission 71*, p. 46.

[103] Blockchain Australia, *Submission 71*, p. 47.

[104] *Proof Committee Hansard*, 27 August 2021, p. 25.

> I think there is certainly merit in that argument. I think it depends on the way that it is implemented. A technological solution that takes a lot of the leg work out of that would be a game changer in the way that it was able to be rolled out worldwide. I think that would be quite a different story. We are not at the point where, globally, there is such a technological solution. Before that's the case, I think in every opportunity that you have to look at that you have to consider the impacts we would have and whether there was too much of a detriment to industry in terms of rolling out a solution based on the technology that's available at the moment.
>
> We also have other regulatory options, including a policy principles period while technology comes up to scratch. [105]

3.105 When asked whether options could include amendments to the AML/CTF legislation and regulations, Mr Mossop stated:

> Changing [the regulations], delaying the implementation or having a different approach to how AUSTRAC regulates, whether it's through guidance—there are a myriad of options that you might look at, but I think from Australia's perspective we'd be looking for a solid basis for a technological solution to be able to facilitate that. That seems to be where a lot of jurisdictions in the world are coming out at the moment.[106]

Publication of list of DCEs registered with AUSTRAC

3.106 It was also pointed out by Mr Alex Harper, CEO, Swyftx Pty Ltd that it is not possible to search and identify the DCEs registered with AUSTRAC.[107] CPA Australia made the same point, noting that AUSTRAC discloses on its website which DCEs have had their registration cancelled, suspended or refused, but does not list currently registered DCEs, making it difficult to compare the number of these businesses in Australia with other countries. CPA Australia recommended that the names of AUSTRAC-registered digital currency exchange providers should be made publicly available, to increase visibility over the size and nature of this sector.[108]

3.107 Piper Alderman submitted that regulators 'have a key role to play in addressing market hesitation in regards to risk profiles for certain [DCEs] and also consumer protection in this regard', and commented:

> It can only be beneficial for the protection of consumers, for a public list [of DCEs registered with AUSTRAC] to be made available and we respectfully suggest such a register be made available at a "website level" such that visitors to a website can verify for themselves that the website is connected to a registered digital currency exchange.[109]

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[105] *Proof Committee Hansard*, 27 August 2021, p. 36.

[106] *Proof Committee Hansard*, 27 August 2021, p. 36.

[107] *Proof Committee Hansard*, 6 August 2021, p. 11.

[108] CPA Australia, *Submission 12*, p. 4.

[109] *Submission 72*, pp. 10-11.

3.108 On this issue Mr Bradley Brown, National Manager, Education, Capability and Communication, AUSTRAC, responded:

> When the legislation was established in the past, in 2017, and implemented in 2018, we had significant engagement with the sector, in terms of industry associations representing businesses at that time that we knew were in operation. Certainly, there was a significant concern given its infancy, in terms of regulation, that, if there were a public register of those businesses, they would likely not be able to hold and retain bank accounts. That certainly is a matter that is also under the consideration of this committee. Hence AUSTRAC didn't publicly list the register at that time. We are further considering the merits of the release of that register now that we are three years into the operation of the digital currency exchange regulations in Australia. We are engaging with businesses in relation to the merits and what we would need to consider in relation to its release.[110]

3.109 Mr Daniel, Mossop, Assistant Secretary, Transnational Crime Policy Branch, Department of Home Affairs, added:

> The issue of not being able to obtain or hold a bank account was certainly a concern for industry at the time. There was also the related issue that the public release of a register and the technical differences between registration and licensing of AML/CTF regulation versus other regulation about the proprietary of a business might not be as transparent to the public as you would hope, or it might not be as obvious to the public as you would hope, and there would be a quasi sign of government endorsement rather than a list of entities that are registered with AUSTRAC for ongoing supervision. We didn't want to confuse the market with that nuance. They were the two reasons why the list was, at the time, not made public.[111]

Tax treatment of cryptocurrencies and other digital assets

3.110 A number of submitters and witnesses raised issues relating to how cryptocurrencies and other digital assets are treated for tax purposes in Australia.

3.111 The Australian Taxation Office (ATO) provided an overview in its submission of how cryptocurrencies are currently treated for taxation purposes in Australia. Different rules apply depending on whether the asset is held as an investment or for other purposes.

3.112 Where cryptocurrencies are held as an investment, Capital Gains Tax (CGT) rules apply when these assets are disposed. Under the current ATO guidance, disposal of a cryptocurrency asset can occur when someone:

- sells or gifts cryptocurrency;
- trades or exchanges cryptocurrency (including the disposal of one cryptocurrency for another cryptocurrency);

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110 *Proof Committee Hansard*, 27 August 2021, p. 35.

111 *Proof Committee Hansard*, 27 August 2021, p. 35.

- converts cryptocurrency to fiat currency, such as Australian dollars; or
- uses cryptocurrency to obtain goods or services.[112]

3.113 The ATO explained the background to assessing cryptocurrencies as CGT assets:

> In response to growth in the use of cryptocurrencies, the ATO provided public guidance in 2014 that took the view that cryptocurrencies do not fall within the definition of a 'foreign currency' for tax purposes. That view is based on the concept of a 'currency'...that is legally recognised and adopted under the laws of a country as the monetary unit and means of discharging monetary obligations for all transactions and payments in that country. This view was supported by the Administrative Appeals Tribunal decision on 16 June 2020 in the Seribu Pty Ltd case.
>
> As a consequence a cryptocurrency being a CGT asset and not a foreign currency for income tax purposes, the large majority of clients will account for any gains or losses on capital account. One benefit of this treatment is that taxpayers who hold their cryptocurrency for at least 12 months as an investment can access the 50% CGT discount. This is akin to how investors holding company shares account for their gains and losses.[113]

3.114 Cryptocurrency that is kept or used mainly to buy goods and services for personal use (e.g. clothes, food or pay personal bills) is not subject to capital gains tax.[114]

3.115 For businesses trading in cryptocurrencies, similarly to a share trader, trading stock rules apply, and not the CGT rules.[115] Proceeds from the sale of cryptocurrency held as trading stock in a business are ordinary income, and the cost of acquiring cryptocurrency held as trading stock is tax deductible.[116]

3.116 Businesses or sole traders that are paid cryptocurrency for goods or services, will have these payments taxed as regular income, based on the value of the

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[112] ATO, 'Transacting with cryptocurrency', https://www.ato.gov.au/general/gen/tax-treatment-of-crypto-currencies-in-australia---specifically-bitcoin/?anchor=Transactingwithcryptocurrency#Transactingwithcryptocurrency (accessed 22 September 2021).

[113] ATO, *Submission 77*, pp. 10-11.

[114] ATO, *Submission 77*, p. 11. This 'personal use asset' exemption to the CGT rules does not apply if the cryptocurrency is kept or used mainly: as an investment; in a profit-making scheme; or in the course of carrying on a business. See: ATO, 'Transacting with cryptocurrency', https://www.ato.gov.au/general/gen/tax-treatment-of-crypto-currencies-in-australia---specifically-bitcoin/?anchor=Transactingwithcryptocurrency#Transactingwithcryptocurrency (accessed 22 September 2021).

[115] ATO, *Submission 77*, p. 11.

[116] ATO, 'Cryptocurrency used in business', https://www.ato.gov.au/general/gen/tax-treatment-of-crypto-currencies-in-australia---specifically-bitcoin/?anchor=Cryptocurrencyusedinbusiness#Cryptocurrencyusedinbusiness (accessed 22 September 2021).

cryptocurrency in Australian dollars at the time of the transaction. This is the same process as receiving any other non-cash consideration under a barter transaction.[117]

ATO visibility of tax accruing from crypto-asset holdings

3.117 The ATO noted that it is difficult to accurately estimate how much CGT revenue is raised specifically from cryptocurrencies, as a taxpayer's capital gain or loss for an income year is reported 'as a single figure which may comprise gains and losses from the disposal of a cryptocurrency as well as disposals of other CGT assets such as shares, property and collectables'.[118]

3.118 The ATO operates a data-matching program to collect details of cryptocurrency transactions from Australian based cryptocurrency exchanges, to identify where taxpayers are inadvertently or deliberately misrepresenting their cryptocurrency activities in their tax affairs.[119] The ATO noted that it is generally unable to acquire this data from DCEs operating internationally, however this is partially mitigated by the fact that the ATO can detect incoming and outgoing funds to offshore DCEs through AUSTRAC and International Funds Transfer Instruction (IFTI) transactions.[120]

OECD work on tax treatment of crypto-assets

3.119 Internationally, the OECD is progressing work on the tax treatment of crypto-assets, publishing a paper in October 2020 *Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues*, which examined the current approaches taken to these issues in over 50 jurisdictions.[121] The ATO noted that the OECD is currently developing a tax transparency framework for Crypto-Assets and digital money products, which 'seeks to address the risks associated with the lack of transparency in Crypto-Asset and digital money products, by establishing a new reporting regime for these sort of products'. The ATO stated that it 'is hoped a draft will be available in late 2021'.[122]

Awareness of tax rules for cryptocurrency transactions

3.120 The ATO noted that there is widespread misunderstanding around the tax implications of investing in cryptocurrencies, particularly among retail

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117 ATO, *Submission 77*, p. 11.

118 ATO, *Submission 77*, p. 11.

119 ATO, *Submission 77*, pp. 11-12.

120 ATO, *Submission 77*, p. 13.

121 OECD, *Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues*, October 2020, available at https://www.oecd.org/tax/tax-policy/taxing-virtual-currencies-an-overview-of-tax-treatments-and-emerging-tax-policy-issues.htm (accessed 24 September 2021).

122 ATO, *Submission 77*, p. 11.

investors. Mr Adam O'Grady, Assistant Commissioner, Risk and Strategy, Individuals and Intermediaries at the ATO, told the committee:

> [There's] a lack of understanding of how [cryptocurrencies] interact with the tax system, which is why we've increased a lot of our public advice and guidance in the last couple of years. We've had formal rulings for some time, but we've gone out and created more streamlined fact sheets, which we did this tax time as part of our media campaign. We've put out other messages to the community to spread that information about what they're expected to do if they're investing in cryptocurrency, including what the record requirements are.[123]

3.121 Some submitters and witnesses put forward the view that further guidance and educational efforts to increase awareness of the taxation implications of digital assets are required.

3.122 Blockchain Australia submitted that while the ATO 'has elevated information campaigns surrounding the need for consumers to report gains/losses from participation in the cryptocurrency sector', education and clarity concerning the tax implications of cryptocurrency and digital assets is still lacking for the average consumer without the assistance of professional taxation advice.[124] Further:

> 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.
>
> …
>
> 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.[125]

3.123 CPA Australia submitted it has observed 'mixed levels of awareness amongst cryptocurrency holders as to their Australian tax obligations, as well as the potential international tax issues that may arise when trading in international markets'.[126]

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123 *Proof Committee Hansard*, 8 September 2021, p. 40.

124 Blockchain Australia, *Submission 71*, p. 49.

125 Blockchain Australia, *Submission 71*, pp. 49-50.

126 CPA Australia, *Submission 12*, p. 5.

Submitter views on tax rules for cryptocurrencies and other crypto-assets

3.124 A range of submitters and witnesses commented on the need to update Australia's taxation regulations and guidance in light of the rapidly evolving changes in technology and the digital economy.

3.125 Mr Scott Chamberlain, Entrepreneurial Fellow at the ANU School of Law, commented that Australia's tax laws do not compare favourably

> Our tax laws unavoidably complicate the establishment of Digital Asset Projects compared to competing jurisdictions like Singapore that have favourable income tax laws and do not have CGT or GST.
>
> Any digital asset project will inevitably have significant tax issues to solve about how staked and pre-mined assets should be treated from a tax perspective when created and distributed. One particular example is the impossibility of a miner giving a complying Tax Invoice in return for fees paid to include a transaction in one of the miner's blocks.[127]

3.126 FinTech Australia submitted that current CGT arrangements are incompatible with the products and services offered in the digital and crypto-asset industry, particularly for DeFi products. It stated that the central concern is 'a lack of guidance from the ATO about the application of existing principles to new and emerging technologies',[128] and explained further:

> One of the most considerable barriers to entry for the mainstream adoption of DeFi products is the numerous taxable events that arise when a crypto-asset token interacts with a protocol. Under the current regime, whenever a token interacts with a protocol where it is swapped, accessed, burned, staked or exchanged a CGT event may be triggered. Many of these interactions are merely features of the technology and not taxable events, as they don't give rise to any gain or right to the asset itself. It would be particularly onerous to have to consider the tax impact on each protocol interaction, especially in that context. Generally speaking, it would be akin to having to consider the income tax regime each time your computer sends a TCP/IP packet to a website on the internet. If this level of friction existed for early users of the internet, the innovation, products and industry we have today would likely never have been created.
>
> The consequence of this is that any user who is trying to interact with these protocols in order to gain the benefit of its utility may not only trigger a taxing event but also reset the acquisition date for the CGT asset, which would impact the taxpayer's eligibility for the 50% CGT discount for assets held for at least 12 months. These tax frictions can result in users being less willing to use these innovative platforms.[129]

3.127 An example of a swap event where the application of CGT would not appear to be reasonable is a token swap where the underlying blockchain that

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[127] Mr Scott Chamberlain, *Submission 24*, p. 5.

[128] FinTech Australia, *Submission 62*, p. 13.

[129] FinTech Australia, *Submission 62*, p. 13

supports the token is being upgraded or replaced; in this scenario, one digital token is replaced for another at a predetermined rate, and the original token(s) are discarded rather than traded. This event is more akin to a stock split for traditional securities than a trade between assets.[130] A further example raised would be the use of a cryptocurrency (e.g. Bitcoin or Ether) to purchase an NFT; in this instance, the use of the cryptocurrency could potentially be taken to represent a CGT disposal event, regardless of whether an actual gain or loss has been realised from the purchase of the NFT.

3.128 FinTech Australia noted that ATO guidance has not kept pace with developments in DeFi and related technology, stating that current guidance 'does not distinguish between types of transactions in determining tax outcomes':

> The lack of legislative or regulatory guidance in turn increases uncertainty with respect to cryptocurrency and DeFi, and disincentivises entrepreneurs from launching platforms in Australia (in favour of other jurisdictions with more attractive tax regimes, such as Singapore).[131]

3.129 FinTech Australia recommended that the government should 'consult with industry to improve the tax regime's application to crypto-assets and DeFi and provide greater tax certainty to the industry'. Further, it recommended that the ATO should 'issue more up-to-date and detailed guidance in respect of crypto-assets beyond general guidance around crypto-crypto-and crypto-fiat disposals'.[132]

3.130 Ms Razwina Raihman raised the issue of CGT treatment when a cryptocurrency is deposited or lent into a cryptocurrency interest account:

> Certain platforms which operate in a bank like way offer interest on cryptocurrency deposits and lending. For example, one can currently deposit 1 Bitcoin into a Nexo…interest bearing account and earn 4% interest in kind per annum. The cryptocurrency is used much like banks use money to generate interest.
>
> …
>
> An issue has arisen, however, in that the ATO has intimated that depositing or lending cryptocurrency into such an interest bearing account is considered a disposal of the cryptocurrency thus triggering a capital gains tax event.[133]

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130 See: Shehan Chandrasekera, 'How Cryptocurrency Swaps Are Taxed', *Forbes*, 19 December 2019, https://www.forbes.com/sites/shehanchandrasekera/2019/12/19/how-cryptocurrency-swaps-are-taxed/?sh=76d2821f6f56 (accessed 11 October 2021).

131 FinTech Australia, *Submission 62*, p. 14.

132 FinTech Australia, *Submission 62*, p. 14.

133 Ms Razwina Raihman, *Submission 83*, p. 1.

3.131 Ms Raihman argued that, similarly to making a deposit into a bank account to earn interest, a deposit of cryptocurrency into a cryptocurrency account should not trigger a CGT disposal:

> It is clearly not the intention of investors to dispose of the cryptocurrency because they retain the right to withdraw exactly the same amount of cryptocurrency they deposited plus any interest. It is unfair to impose a capital gains tax burden on such investors when they are not intending to or not truly effecting a disposal.
>
> …
>
> It is submitted that the tax laws should be amended so that cryptocurrency deposits or lending into interest bearing accounts should be exempt from capital gains disposals.[134]

3.132 A joint submission from a number of academics from RMIT University (RMIT academics' submission) agreed that the current CGT treatment of cryptocurrency is in need of reform:

> Operating in what is treated as a barter economy, where transactions can occur multiple levels beyond fiat currency, means the compliance burden for taxpayers is increasingly complex and uncertain. Taxpayers' compliance becomes increasingly abstract and therefore increases the risk of inadvertent non-compliance.[135]

3.133 The RMIT academics' submission recommended the introduction of 'a new CGT asset/event class that enables specific concessions or exemptions to be applied and confirm the timing and approach to taxable events', with the aim of simplifying the CGT regime, reducing regulatory burdens and encouraging compliance.[136] Modifications in this area could, for example, ensure that for certain crypto-assets, taxable events would occur only when: cryptocurrency is exchanged with fiat currency (most commonly the Australian dollar); cryptocurrency is used in the acquisition or disposal of a non-fungible token (such as a piece of digital art); or cryptocurrency is used in the acquisition or disposal of non-tokenised/tangible goods or services.[137]

3.134 The proposal for an alternative taxing point, where crypto-to-crypto transactions are ignored for CGT purposes and CGT is only triggered when crypto assets are transferred to Australian dollars or fiat, was supported by FinTech Australia for cryptocurrency trading transactions, on the basis that

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[134] Ms Razwina Raihman, *Submission 83*, p. 1.

[135] Dr Darcy W.E. Allen, Associate Professor Chris Berg, Professor Sinclair Davidson, Dr Aaron M. Lane, Dr Trent MacDonald, Dr Elizabeth Morton and Distinguished Professor Jason Potts (RMIT academics' submission), *Submission 67*, p. 9.

[136] RMIT academics' submission, *Submission* 67, p. 9.

[137] RMIT academics' submission, *Submission* 67, p. 9. The submission notes that for the latter two categories, depending on the CGT classification of the respective token (e.g. personal use asset, collectable) these transactions may yield the normal CGT concessional treatments.

'the current tax treatment of crypto asset transactions is a disincentive for taxpayers to invest in crypto assets':

> Under the current regime, tax liabilities arise for taxpayers in respect of transactions (i.e. crypto-to-crypto trading transactions) where the taxpayer does not receive cash to support payment of the actual tax liability. This is compounded by the fluctuating and sometimes volatile value of crypto assets which can result in potentially large tax liabilities. The proposed Alternative Taxing Point would decrease the compliance burden for taxpayers and it would drive revenue over time through increased trade volumes and increased participation in the crypto market, which would offset any short term loss of revenue as cost to the ATO.[138]

3.135 FinTech Australia suggested that one option for implementing this proposal could be a CGT roll-over for crypto-to-crypto transactions:

> [A roll-over] could allow the transfer of like-for-like cryptocurrency without an adverse tax impact, by allowing any taxing point to be deferred until the disposal of the crypto currency for fiat or cash. This would have the effect of not eliminating the ATO's collection of revenue, but deferring the taxing point to a point in time where the taxpayer actually made a gain to enable them to cover any tax liability owing to the ATO.[139]

3.136 FinTech Australia emphasised however, that while the proposal to remove crypto-to-crypto CGT taxation points is welcomed in respect of crypto trading transactions, further discussion is required surrounding tax solutions to transactions beyond crypto trading. It commented that in characterising crypto-assets for the purpose of tax law, crypto transactions cannot all be simplified as being the equivalent of traditional share trading, 'as there are a range of crypto use-cases and asset types that expand beyond cryptocurrency trading and this is an area that is continuing to evolve'. Further:

> To date, the ATO guidance on the tax treatment of crypto transactions has focused on cryptocurrency trading (with the majority of its guidance being released in 2014). This contributes to significant uncertainty in the industry, especially as the current guidance does not distinguish between types of crypto asset transactions in determining tax outcomes. For example, NFTs are a type of crypto asset which have been utilised more broadly in recent years... The ATO has only published a single private ruling which is binding only for the intended recipient and provides that the taxpayer's specific NFT artworks are CGT assets. An NFT can be more than artwork, and clear guidance would assist to improve certainty in the market and ultimately increase use of crypto assets. NFTs are just one example of the new and emerging technologies that have been developed since the ATO last published its guidance in 2014. The industry is continuously developing new DeFi protocols that allow users to stake, lend, borrow, and generate interest in novel ways, such as yield farming.[140]

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138 FinTech Australia, Answers to Questions on Notice, p. 9.

139 FinTech Australia, Answers to Questions on Notice, p. 9.

140 FinTech Australia, Answers to Questions on Notice, pp. 9-10.

3.137 FinTech Australia stated support for the establishment of a cryptocurrency working group by the ATO 'to assist it in issuing guidance on the taxation of cryptocurrency (including DeFi protocols) in a timely manner so as to provide greater certainty to the sector'.[141] Blockchain Australia submitted:

> 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.[142]

3.138 Cointree noted in its submission that several overseas jurisdictions have tax settings more favourable than Australia's for the treatment of digital assets:

> In the EU cryptocurrencies are exempt from Value Added Tax (VAT), in the UK their VAT is only applicable to goods purchased with cryptocurrencies, and Singapore has no GST on cryptocurrencies. Singapore already has a low corporate tax rate of 17% while Hungary specifically dropped their capital gains tax on cryptocurrency from 30.5% to 15% to attract more investment. It's clear that leading nations recognise that low crypto taxes are a key factor in growing their cryptocurrency ecosystem.

3.139 Cointree recommended increasing Australia's competitiveness by extending the 'personal use' exemption for individuals' cryptocurrency holdings:

> [Australia] could give clear regulations that classify cryptocurrency as a personal asset, so that any purchases below $10,000 can be disregarded for CGT purposes.
>
> This reinforces retail consumers' role in the ecosystem, as their individually small investments are collectively sufficient to bootstrap innovative projects until larger institutional players are ready to adopt them. It will also attract significant capital to Australia.[143]

3.140 Carta, an Australian DeFi start-up, submitted that 'founders, investors and other stakeholders are worried about the tax treatment of fund raising using any form of token sales' for DeFi applications. Carta noted that there is uncertainty about whether DeFi tokens will be treated as a utility or an investment for tax purposes, and commented:

> On the one hand, if tokens are treated as a utility by the [ATO] and [ASIC], they will be subject to [GST]. This tax treatment is not an appealing feature for most investors and users of the ecosystem. As a result, this tax treatment will prevent or impede newcomers into the Australian

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141 FinTech Australia, Answers to Questions on Notice, p. 10.

142 Blockchain Australia, *Submission 71*, p. 50.

143 Cointree, *Submission 58*, p. 7.

> FinTech/DeFi market, and limit competition in the financial services market as a barrier to entry.
>
> ...
>
> If, however, the use of tokens for fund raising by start-ups is categorized as an investment by ATO and ASIC, it will be subject to Security laws. The approach by regulators in Australia… The major drawbacks of securities laws as applied to token sales (ICOs) are:
>
> 1. It expects companies to disclose both historical financial data and "forward-looking" information. These FinTech start-ups depend only on white papers.
>
> 2. It requires company financial statement to be reviewed by a certified auditor. It is difficult to audit an extraordinarily complex code that underlies the DeFi application. It requires a careful review of even the most basic aspects of the code.
>
> 3. It requires…extensive information about a company's board of directors and management. Given the nature of technology, developers are the decision makers.
>
> The statutory designation of token sales (ICOs) as "securities" will not automatically place them in an efficient regulatory scheme that supports innovation and free flowing capital.[144]

Need to evolve tax settings as cryptocurrencies become utilised as currency

3.141 CPA Australia expressed the view that the Australia's current tax settings are generally acceptable, but may need to evolve further over time:

> The tax treatment of cryptocurrency should reflect the evolving nature of the market and the range of regulatory responses by governments across the globe. The ATO's current application of existing rules to cryptocurrencies is, in our view, correct with different treatments depending on whether the cryptocurrency is held as an investment or for business.
>
> …
>
> If the function of cryptocurrencies evolves from a speculative asset to one that more closely reflects money (e.g. Bitcoin used in the same way as EFTPOS) and that a range of associated financial instruments (e.g. Bitcoin-linked funds) will be introduced, the government may wish to assess the flexibility of existing legislation such as the tax rules for foreign exchange gains and losses, and the taxation of financial arrangements to accommodate cryptocurrencies and to identify any areas where further legislative clarity is required.[145]

3.142 Several submitters argued that, given some other jurisdictions are recognising Bitcoin as legal tender (with El Salvador having implemented this measure

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[144] Carta, *Submission 29*, p. 2.

[145] CPA Australia, *Submission 12*, pp. 5-6.

and other jurisdictions reportedly considering it), the ATO's current position that Bitcoin is not a foreign currency for tax purposes may have to shift.[146]

3.143 The RMIT academics' joint submission called for the ATO to update guidance 'to reflect the changing global position of Bitcoin and consider that Bitcoin may now meet the definition of a financial currency and therefore may be captured within the foreign exchange regime'.[147]

3.144 Bitaroo, an Australian DCE, argued in its submission that Bitcoin should be reclassified as a foreign currency for tax purposes, and that foreign currencies should be made CGT exempt:

> Earlier this month El Salvador passed the 'Bitcoin Law', a bill that classifies Bitcoin as its legal tender. The effect this will have on the economy of El Salvador and particularly on its unbanked citizens is profound. It is expected that other countries will soon follow suit.
>
> …
>
> The UK…exempts gains (and losses) on foreign currencies. Not so in Australia. This leads to a strange scenario in which if one buys USD (thinking they would spend it overseas) but then later exchanges all or part of it back to AUD, this becomes a taxable event.
>
> By recognising Bitcoin as a foreign currency and by exempting capital gains tax on foreign currencies, Australia has a unique but rapidly diminishing opportunity to position itself as a global and forward-thinking leader in this space.[148]

Other proposals relating to taxation of digital assets

3.145 Some submitters argued that in addition to CGT issues, other taxation issues relating to digital assets need to be considered.

Arguments for a broader taxation review dealing with crypto-assets

3.146 The Digital Law Association argued for a root-and-branch review of Australia's tax laws to make them suitable for the emerging digital and decentralised economy. It stated:

> Australia's tax settings are outdated, are not fit for purpose in the digital and decentralised economy and are not technology neutral. The current Australian tax settings do not make Australia an attractive jurisdiction to launch, undertake or participate in digital asset businesses. The ATO is not sufficiently resourced to produce timely guidance that deals with the complexities of digital asset transactions, particularly DeFi transactions.[149]

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146 Bitaroo, *Submission 5*, p. 3; RMIT academics' submission, *Submission 67*, p. 10.

147 RMIT academics' submission, *Submission* 67, p. 9.

148 Bitaroo, *Submission 5*, p. 3.

149 Digital Law Association, *Submission 49*, p. 14.

3.147 The DLA noted that various industry proposals in recent years in relation to the tax issues associated with issuing, holding and transacting with digital assets have been implemented in legislation, 'at a cost to the attractiveness of Australia as a place for digital asset business activity'.[150] It recommended that the Treasurer instruct the Board of Taxation to undertake 'a comprehensive review of the federal, state and territory tax systems' by April 2022, to recommend amendments required 'so the tax law does not produce anomalous outcomes to the economic intention of digital transactions'.[151]

3.148 Blockchain Australia endorsed the DLA's recommendation for a comprehensive review of Australia's tax settings in light of the emergence of digital assets. It submitted:

> 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.[152]

Tax treatment for stablecoins backed by fiat currencies

3.149 The RMIT academics' joint submission recommended that stablecoins that are backed by fiat-currency should be treated as that currency for the purposes of taxation (for example, under this arrangement if a business receives USDC, a US-dollar backed stablecoin, as payment, then the business is taken to have received US dollars).[153] The submission explained:

> Business is now being done in stablecoins—including for internal transactions inside a corporate group, between cryptocurrency exchanges, as payment for services, and for blockchain foundation grants. This technology allows cheaper, quicker and more secure transactions. Stablecoins (and other cryptocurrencies more broadly) could be considered a “non-cash payment facility” requiring licensing and product disclosures. For tax purposes, it is not consistent to treat US dollars in an online bank account (for which there are well-established tax rules), for example, and US-backed stablecoin in an online cryptocurrency exchange wallet differently when these are functionally the same transaction.[154]

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150 Digital Law Association, *Submission 49*, p. 14.

151 Digital Law Association, *Submission 49*, p. 14.

152 Blockchain Australia, *Submission 72*, p. 50.

153 RMIT academics' submission, *Submission 67*, p. 11.

154 RMIT academics' submission, *Submission 67*, p. 11.

Organising taxation around cryptocurrency digital wallets

3.150 The RMIT academics' submission noted that cryptocurrency transactions undertaken directly between individuals (i.e. direct from one individual's digital cryptocurrency wallet to another's) are at heightened risk of money laundering and terrorism financing vulnerabilities, compared with transactions mediated by a DCE. The submission stated that cryptocurrency wallets:

> …represent a core infrastructure of the digital economy and a natural point of asset and income flow. Therefore, wallets represent a key point in the blockchain architecture to capture the tax burden for crypto-economic activities.[155]

3.151 The submission argued that as such, the government should take steps to adopt a wallet-centric approach to cryptocurrency taxation:

> The Federal government should introduce a set of standards, or whitelist, for wallets to signify compliance quality (such as public accessibility, integration with ATO API, taxpayer identity, and key storage requirements). This would enable greater ability for streamlining taxation points and compliance burdens. Further, whitelisting wallets opens opportunities in time to enact automated tax collection, such as final taxing of crypto-activities and wallet-centric simplified taxation regime.[156]

Clarity around tax status for not-for-profit blockchain foundations

3.152 Mr Scott Chamberlain, Entrepreneurial Fellow at the ANU School of Law, argued that Australia should clarify the ability for not-for-profit blockchain foundations to operate with tax emptions:

> Australia does have one area of comparative advantage in respect of tax: tax exempt not-for-profits (NFPs). Most Digital Asset Projects involve an NFP foundation at the heart of the ecosystem. This entity is responsible for promoting and curating the community assets. In some cases, it might also act as the treasury. This is a wholly appropriate function for an NFP.
>
> In Australia, an NFP is tax exempt if it is established for the principal purpose of the development of Australia's information technology resources. At first glance, this would appear to include undertaking the functions of a foundation of blockchain ecosystem.
>
> If Australia could make it easy and certain to establish a tax exempt NFP for a blockchain ecosystem this would greatly improve Australia's attractiveness as a destination jurisdiction for Digital Asset Projects and remove many tax problems.[157]

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[155] RMIT academics' submission, *Submission 67*, p. 12.

[156] RMIT academics' submission, *Submission 67*, p. 12.

[157] Mr Scott Chamberlain, *Submission 24*, p. 5.

Regulatory framework for new types of decentralised organisations

3.153 A number of submitters presented evidence on the growing use of 'new forms of governance and community participation' for blockchain projects, which are necessitated by the decentralised nature of these projects.[158]

3.154 Mr Scott Chamberlain stated that these nascent governance structures have taken many forms, including:

- Decentralised Autonomous Organisations (DAOs): these amount to common law partnerships, syndicates or unincorporated associations whose activities and investment decisions are co-ordinated by code or smart contracts.
- Legal Autonomous Organisations (LAOs): traditional legal entities whose internal management is coordinated through code or smart contracts.
- Code Coordinated Communities (CCCs): a catch-all term for coordination via code that includes situations where the parameters of the blockchain protocol itself can be altered by agreement between its users.[159]

3.155 Mycelium, a Brisbane-based technology firm working in areas including decentralised finance, submitted that DAOs are one of the two most common kinds of decentralised systems currently being used (with the other being public blockchains such as Bitcoin and Ethereum).[160]

3.156 The RMIT academics' submission noted that DAOs represent a new category of organisation that operates on decentralised blockchain infrastructure, whose operations are pre-determined in open source code and enforced through smart contracts.[161]

3.157 DAOs are being used globally for many purposes including investment, charity, fundraising, borrowing, and buying NFTs. For example, a DAO can accept donations from anyone around the world and the members can decide how to spend donations.[162]

3.158 Currently, DAOs and other blockchain projects with decentralised governance structures are not readily recognised within existing regulatory categories under Australian law. Mycelium submitted that this means that DAOs are not

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158 Mr Scott Chamberlain, *Submission 24*, p. 6.

159 Mr Scott Chamberlain, *Submission 24*, pp. 6-7.

160 Mycelium, *Submission 19*, p. 4.

161 RMIT academics' submission, *Submission 67*, p. 13.

162 Cathy Hackl, 'What are DAOs and Why You Should Pay Attention', *Forbes*, 1 June 2021, https://www.forbes.com/sites/cathyhackl/2021/06/01/what-are-daos-and-why-you-should-pay-attention/ (accessed 12 October 2021). See also: Benjamin Pirus, 'Funding surpasses $2 million for this charity DAO', *Coin Telegraph*, 2 June 2021, https://cointelegraph.com/news/funding-surpasses-2-million-for-this-charity-dao (accessed 12 October 2021).

recognised as entities with legal personality or limited liability, and commented further:

> Until such recognition, we are left with DAOs who do not operate as people within the eyes of the law. Currently, most Australian lawyers interpret DAOs as partnerships. These interpretations each lead to concerns that, amongst an organisation of potentially infinite parties, each individual party could be held personally liable for the debts of the organisation.
>
> The current legal status of DAOs is analogous to the legal status of corporations prior to limited liability companies. Prior to limited liability companies, it was untenable for individual shareholders to have 'moral culpability' for the actions of corporations, as they lacked the power and control mechanisms to discipline errant management.
>
> It is equally untenable for individual stakeholders of decentralised systems, such as decentralised financial applications, to have moral culpability for the actions of those decentralised systems, because the individuals lack the power and control mechanisms to discipline errant decision-making.[163]

3.159 Mycelium argued that under current interpretations of the Corporations Act, multiple parties involved in the design and operation of DAOs are subject to legal uncertainty as to their responsibilities and potential liabilities.[164]

3.160 Several submitters argued for the introduction of a DAO legal structure in Australia.[165] The Digital Law Association argued that DAOs:

> …will increasingly feature as a business model in the digital and decentralised economy and must be given legal recognition, the clear ability to hold property and contract, as well as limited liability.[166]

3.161 The RMIT academics' submission recommended:

> A new category of company should be created under the Corporations Act – a Limited Liability DAO (LLD). This would require legislative changes.

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[163] Mycelium, *Submission 19*, p. 6.

[164] Mycelium, *Submission 19*, pp. 10-11. This includes: software developers who code the decentralised system (or part of the system); auditors who review the code to ensure it works as intended and is secure; governors, who participate in proposals and votes in order to make changes to the decentralised system; token-holders, who hold some rights (governance, economic, utility, etc.) in relation to the system; oracles, who provide data to decentralised systems, allowing them to make decisions or execute transactions; graphical user interface (GUI) providers, who build, deploy or maintain a GUI (including a website or app) to the decentralised system; and users, who use the decentralised system.

[165] Mycelium, *Submission 19*, p. 3; Herbert Smith Freehills, *Submission 60.1*, pp. 4-5; Digital Law Association, *Submission 49*, p. 29.

[166] Digital Law Association, *Submission 49*, p. 29.

> However, existing mechanisms such as changing a type of company or replaceable rules could be adapted for the LLD.[167]

3.162 Herbert Smith Freehills (HSF) suggested that the introduction of a DAO Limited entity in the Corporations Act would provide:

- appropriate corporate oversight and guidance for a new business model manifesting in the digital economy, particularly in respect of digital asset transactions; and
- clarity and recognition as to the cross over between Digital Assets and DAOs and how their integration into existing regulatory regimes should be facilitated with an eye to both functions. (For example, a constitution document set up as a smart legal contract could operate as both a DAO and a digital asset).[168]

3.163 Introducing a new entity structure in the Corporations Act, regulated under the Treasury portfolio, would not be uncommon in Australian practice; for example, the Treasury has just finished a consultation process on draft legislation that would introduce a Collective Corporate Investment Vehicle structure in the Corporations Act.[169]

3.164 Some jurisdictions internationally are starting to develop legal structures for DAOs, with Wyoming becoming the first US state to recognise DAOs as a legal entity in July 2021.[170] Under the Wyoming model, a DAO is simply defined as a type of Wyoming limited liability company (LLC). In other words, the DAO Law clarifies that DAOs can use the LLC legal entity form as long as the DAO meets other requirements set out in the DAO Law (for example, requiring the DAO to maintain a registered agent in Wyoming, and requiring a publicly available identifier to be kept of any smart contract directly used to 'manage, facilitate or operate' the DAO).[171]

3.165 The Coalition of Automated Legal Applications (COALA) has published a model law for DAOs which can be applied and adapted by different jurisdictions. The DAO Model Law developed by COALA is designed to 'provide answers to questions that have troubled those that have observed the growth of decentralised systems, such as: legal personality, liability, dispute resolution and taxation'.[172] Proponents of a new DAO legal structure in

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[167] RMIT academics' submission, *Submission 67*, p. 13.

[168] Herbert Smith Freehills, *Submission 60.1*, p. 4.

[169] Treasury, 'Corporate Collective Investment Vehicles - Regulatory and Tax Frameworks', https://treasury.gov.au/consultation/c2021-200373 (accessed 13 October 2021).

[170] Herbert Smith Freehills, *Submission 60.1*, pp. 4-5.

[171] Holland & Hart LLP, 'Crypto, DAOs, and the Wyoming Frontier', https://www.jdsupra.com/legalnews/crypto-daos-and-the-wyoming-frontier-9251606/ (accessed 13 October 2021).

[172] Mycelium, *Submission 19*, p. 5.

Australia suggested that the COALA Model Law could be used as a starting point for developing a law in Australia (rather than being adopted directly).[173]

DAOs based on the 'unincorporated joint venture' structure

3.166 Mr Chamberlain argued that while one possible solution to the issue of how to accommodate decentralised governance structures is enabling DAOs to incorporate, such as in the Wyoming model, in his view a 'better approach is to clarify circumstances in which a CCC or blockchain community are unincorporated joint ventures':

> This model is similar to a partnership but involves no pooling of assets, sharing or profit, or joint and several liability. Instead, participants share outputs, not profit, retain ownership of the assets they contribute to the venture, and solely liable for their own conduct, and have no ability to bind other participants.[174]

3.167 Mr Chamberlain expanded on this proposal in further information provided to the committee, putting forward a detailed model for how a DAO model based on the model of an unincorporated joint venture could work if creating a new corporate structure for DAOs under the Corporations Act is not a viable reform option.[175] Mr Chamberlain summarised this proposal for a 'decentralised public network':

> Properly structured, [unincorporated joint ventures] are not partnerships. Parties share the outputs (not profits) from their collaboration, bear their own costs, and tend to retain ownership of their inputs. While the joint venture tends to be co-ordinated through a management committee, the parties are severally liable to third parties for their own actions, pay their own tax, and retain their own insurance.
>
> …
>
> This proposal adopts the unincorporated joint venture model. It creates a special type of unincorporated joint venture – called a "decentralised public network". Under this model, the code is the network's rules, and the users have no liability to each other and limited liability to third parties for their participation in the decentralised public network, excluding crime and fraud. The overarching aim is to reinforce user's reliance on their network's code, and not the law.[176]

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[173] Mycelium, *Submission 19*, p. 3; Herbert Smith Freehills, *Submission 60.1*, pp. 4-5; Digital Law Association, *Submission 49*, p. 29; RMIT academics' submission, *Submission 67*, p. 13.

[174] Mr Scott Chamberlain, *Submission 24*, p. 7.

[175] Mr Scott Chamberlain, 'Great Australian DAOs: A Proposal for Recognising Decentralised Public Networks and Their Digital Assets Under Australian Law', Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 16 September 2021).

[176] Mr Scott Chamberlain, Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 16 September 2021), p. 3.

Issues relating to digital asset infrastructure and cryptocurrency 'mining'

3.168 As noted in Chapter 2, cryptocurrencies and other digital assets are created and maintained using real-world infrastructure, predominantly data storage and computational power.

3.169 Blockchain Australia noted that because of the size and history of Bitcoin, a lot of the computation power required for crypto-assets has been used to 'mine' Bitcoin.[177] The process of Bitcoin mining, whereby 'proof of work' computations are conducted to verify new Bitcoin transactions, is explained by the RBA as follows:

> Bitcoin transactions are verified by other users of the network, and the process of compiling, verifying and confirming transactions is often referred to as 'mining'. In particular, complex codes need to be solved to confirm transactions and make sure the system is not corrupted. The Bitcoin system increases the complexity of these codes as more computing power is used to solve them. A new block of transactions is compiled approximately every ten minutes. 'Miners' want to solve the codes and process transactions because they are rewarded with new bitcoins… The increase in competition between miners for new bitcoins has seen large increases in the amount of computing power and electricity required (which is often used for air conditioning to cool computer systems). While it is difficult to calculate with precision, some estimates suggest that the annual energy consumption of the Bitcoin system is similar to that of countries like Greece, Colombia or Switzerland.[178]

3.170 The RBA noted in its submission that the very high use of energy involved in 'mining' cryptocurrencies, most notably Bitcoin, is 'attracting increasing attention from governments and policymakers'.[179]

3.171 Dr John Hawkins submitted:

> Another negative externality from cryptocurrencies is the large amount of greenhouse gases emitted in the process of creating them. These emissions have been estimated to bigger than those from entire countries. An appropriate carbon price should be imposed on cryptocurrency miners. If this is not possible, it strengthens the case for regulations that discourage their growth.[180]

3.172 Mr Michael Tilley questioned whether the carbon impact of cryptocurrency mining is exaggerated, noting that the University of Cambridge Judge Business School found in a 2020 study that 76 per cent of the energy utilised

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177 Blockchain Australia, *Submission 71.1*, p. 11.

178 Reserve Bank of Australia, 'Explainer: Cryptocurrencies', p. 2, available at https://www.rba.gov.au/education/resources/explainers/cryptocurrencies.html (accessed 11 October 2021).

179 RBA, *Submission 37*, p. 3.

180 Dr John Hawkins, *Submission 36*, p. 2 (internal citations omitted).

globally by proof of work miners in 2019 was sourced from generators utilising renewable source material other than coal or gas.[181]

3.173 The Climate Change Authority (CCA) noted that the biggest factor in determining the level of carbon emissions associated with cryptocurrency mining activity is the emissions intensity of the electricity used to power the necessary computer processing. The CCA commented further:

> Cryptocurrency miners in Australia could directly address their emissions through purchasing renewable electricity. For example, large electricity users can enter into power purchase agreements for renewable electricity with an electricity generation company. An alternative would be to purchase large-scale generation certificates created under the Renewable Energy Target. While the electricity delivered to the customer is still from the grid, either approach ensures the customer's power use is backed by renewable electricity generation and could be regarded as carbon neutral.
>
> It would also be possible for the emissions from cryptocurrency transactions to be addressed through the purchase of carbon offsets, such as Australian Carbon Credit Units (ACCUs) which are issued by the Clean Energy Regulator under the Government's Emissions Reduction Fund scheme. Other offsets are also available for purchase—the purchaser should undertake due diligence to satisfy themselves that offsets they are considering purchasing are of high integrity—that is, they represent genuine, additional abatement activities.[182]

3.174 Blockchain Australia emphasised that the physical infrastructure required to support digital assets 'is becoming a new asset class', and commented further:

> Many digital asset infrastructure providers are moving to the US. Unlike roads or "poles and wires", digital asset infrastructure is relatively mobile. Because the biggest input cost is energy, companies are incentivised to move to countries where energy is abundant and cheap, including in remote areas. Increasingly, this energy is coming from renewable sources or capturing so-called "stranded" energy assets that cannot easily be put to productive use. Some instances of this include renewables curtailment (using excess renewables capacity such as hydroelectricity in the wet season or solar power in the middle of the day) and gas flaring (turning gas created as a by-product of resource extraction into a valuable commodity).
>
> Given Australia's significant potential solar capacity, there is an opportunity for a new economy to develop around digital asset infrastructure as part of a broader sustainable crypto-asset ecosystem.[183]

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[181] Mr Michael Tilley, *Submission 70*, p. 2.

[182] Correspondence from Mr Brad Archer, Chief Executive Officer, Climate Change Authority (received 12 October 2021), p. 2.

[183] Blockchain Australia, *Submission 71.1*, pp. 11-12. See also: Mr Andrew Noble, *Submission 16*, pp. 2-5.

3.175 The ATO noted in its submission that global markets 'are looking to capitalise on the regulatory policy settings in countries such as China, that has moved to ban Bitcoin mining altogether':

> Large commercial Bitcoin miners operating in China are now looking for other countries to host their businesses. Mining relies on an abundance of affordable electricity and reliable internet connectivity and large institutional investors are looking for markets where they can mine bitcoins using renewable sources.[184]

3.176 Submitters highlighted that the opportunity in digital assets infrastructure extends beyond cryptocurrency mining. For example, Distributed Storage Systems and Holon Global Investments both highlighted the revenue streams being derived by companies in Australia building cloud data storage infrastructure for the Filecoin ecosystem, a decentralised and distributed open data platform.[185]

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[184] Australian Taxation Office, *Submission 77*, p. 13.

[185] Distributed Storage Solutions, *Submission 69*, pp. 1-2; Holon Global Investments, *Submission 10*, pp. 4-6.

Chapter 4
De-banking

4.1 This chapter outlines the issues raised in relation to de-banking. It covers the affected sectors, examples, effects, reasons provided to businesses, the regulatory landscape, the response from the banks and suggestions made to the committee to address the issue. De-banking has an important impact on competition and the effectiveness of the Anti-Money Laundering and Counter-Terrorism (AML/CTF) regulations.

De-banking

4.2 De-banking, also known as unbanking, is 'when a bank chooses to no longer offer banking services to a customer'.[1] Dr Dimitrios Salampasis, Swinburne University of Technology, elaborated on this explanation:

> Debanking or denial of banking services refers to the behaviour adopted by banking and nonbanking financial institutions, which have the ability to refuse service, restrict or even shut down a customer's account and customer relationship, in general (individual, business or country) resulting in loss of access to the regulated global financial system.[2]

4.3 Bitaroo, an Australian Bitcoin-only exchange, noted that the power of the banks over their customers is significant:

> Banks have the ability to freeze accounts instantly, shut them down with little notice and even ban customers from using their services ever again. No reason needs to be given and currently no regulator has the power to force banks to reveal the reasoning behind such decisions, thus leaving many Australians with fewer banking options at best or outright unbanked at worst.[3]

Examples of debanking

4.4 Aus Merchant, a bespoke Digital Currency Exchange (DCE), reported that it has 'encountered significant obstacles in setting up and running its business activities from the existing major banking providers'. It indicated that 'the current state of play is that all of the major banks will not do business with digital asset companies'.[4]

4.5 Bitcoin Babe, an Australian based peer-to-peer Bitcoin exchange, told the committee that it encountered de-banking in 2014 and since then the company

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1 NAB, *Submission 52*, p. [2].

2 Dr Dimitrios Salampasis, *Submission 11*, p. 5.

3 Bitaroo, *Submission 5*, p. 1.

4 Aus Merchant, *Submission 27*, p. [3].

and founder have been de-banked from or denied access to banking products from 90 banks. It was pointed out that:

> Many participants in the digital asset space either start off as, or remain, small businesses. They may not have teams of lawyers and policy advisers who are able to step in and negotiate with large banks or regulators. There is no human resources department to monitor or coach them through the hardships of running a small business in an area that seemingly fights back at every turn. Founders and owners of small businesses risk losing everything at the whim of the banks and regulators, even when fully compliant. The personal toll this takes and how this affect the mental health of small business owners and employees is significant and should be considered by the Committee.[5]

4.6 Bitcoin Babe added that:

> Our view is that Australian banks, institutions, and credit unions are unfairly penalising new and innovative businesses by seeking to minimise their own compliance duties. There have been no prior breaches to the AML/CTF Act or incidents that warrant the debanking of Bitcoin Babe and its founder…[6]

4.7 Crypto.com, which enables the use of cryptocurrency, also reported that it has experienced de-banking in Australia as well as overseas.[7]

4.8 Mr Allan Flynn spoke about his experience of de-banking when he started a digital currency exchange trading Bitcoin which resulted in the closure of his business. In summary, since 2017, over 65 Australian banks denied him service for his digital currency operation 'without any care of my lawful safe-harbor KYC practices, DCE registration or AML/CTF policies as required by the AML/CTF Act'.[8]

4.9 Mr Flynn noted that '[t]ypically prior to each closure the bank has frozen services without notice. On occasions an account will then be closed prior to or at the same time as receiving a standard letter warning of pending closure, citing terms and conditions'. Mr Flynn also submitted that banks 'even claimed erroneously that the AML/CTF Act required them to close accounts. A defence which AUSTRAC denied'.[9] He encouraged the committee to think of access to banking services as a right.[10]

4.10 A submitter described their experience of trying to open bank accounts for a 'company owner residing overseas (Ukraine) for a registered Digital Currency

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5 Bitcoin Babe, *Submission 54*, pp. [2-3].

6 Bitcoin Babe, *Submission 54*, p. [3].

7 Crypto.com, *Submission 55*, p. 3.

8 Mr Allan Flynn, *Submission 57*, p. [3].

9 Mr Allan Flynn, *Submission 57*, pp. [1-2].

10 Mr Allan Flynn, *Submission 57*, p. [3].

Exchange they desired to begin operating in Australia'. They reported that some banks refused service to blockchain or cryptocurrency related businesses and delays with identity verification.[11]

4.11 Verida, a company that develops decentralised technologies for developers, the private sector, governments and citizens, told the committee about its experience of using Airwallex in Singapore with no issues compared with using the same company as their banking provider for its Australian entity. Their application for the Australian entity was denied with no reason given. It added:

> The lack of rationale for declining the application feeds into the 'culture of silence' about this problem which we feel is impacting the Blockchain industry more broadly. We regularly hear complaints from other Blockchain businesses about being debanked and the lack of transparency from bank and payments providers.[12]

4.12 Verida noted that Airwallex 'maintains jurisdiction specific Sign Up Terms':

> Those terms will apply to the country the entity is incorporated in. Airwallex is a front-end for banking. They have service agreements with banks in the back-end whose infrastructure they utilise, and they must uphold those agreements. In this situation, ANZ is their back-end provider.[13]

4.13 Wise, an online money transfer service, reported that:

> in the past 4 to 5 years Wise has had difficulty accessing payment services through Australian banks. Often, discussions have been terminated by the relevant bank after initial meetings without any further assessments made. This has resulted in Wise having to use international banks operating in Australia rather than a preferred local bank.[14]

4.14 Revolut Australia, part of Revolut group, a financial technology group of companies offering financial services to both retail and business customers, indicated that they have experienced 'risk aversion related to FX and remittance activity'.[15]

4.15 FinTech Australia reported on the experiences of its members:

> Throughout all the instances of debanking conveyed to us by our members, there is one commonality; that debanking is sudden and generally done without reason or explanation. One of our members has been debanked four times since 2018; consisting of one instance of

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[11] Name Withheld, *Submission 1*, p. 1.

[12] Verida, *Submission 4*, p. 2.

[13] Verida, *Submission 4*, p. 2.

[14] Wise, *Submission 18*, p. 1.

[15] Revolut, *Submission 44*, p. 8.

> debanking in 2018, once in 2019 and twice in 2020. 23 members have reported experiences with being debanked.[16]

What sectors are affected?

4.16 While it was noted that de-banking is an issue across the FinTech sector, the evidence to the committee focused on the crypto space and there was also some evidence from money remitters and payments FinTechs.

4.17 FinTech Australia told the committee that de-banking 'is a considerable issue across the entire fintech market'. It noted that the issue is 'complex, as it affects companies broadly across different fintech verticals, such a payments, loans, remittance services, crypto-asset exchanges and others'.[17] It noted that de-banking is a particular issue for crypto-asset businesses with some members reporting that:

> they and their clients have either had bank accounts blocked or closed due to buying and selling crypto-asset or interrogated about what they intend to spend their money on, and whether it involves crypto-asset. Debanking has a chilling effect on the entire industry.[18]

4.18 The Reserve Bank of Australia (RBA) reported it is aware that in recent years many fintechs have 'faced challenges in obtaining and retaining access to the core banking and payment services that they need to provide services to Australian customers'. The RBA noted that:

> A range of fintechs have been affected, most notably providers of international money transfers and digital currency exchanges, but also fintechs offering other services.[19]

4.19 The Department of Home Affairs and the Australian Transaction Reports and Analysis Centre (AUSTRAC) stated that the range of businesses impacted by the withdrawal of banking services has expanded over the past decade, with remittance providers, DCEs providers, non-profit organisations and fintech businesses 'disproportionally facing bank account closures'.[20]

4.20 Mr Michael Bacina, Partner, Piper Alderman, also noted that 'digital asset companies routinely have difficulties obtaining reliable banking services'.[21]

4.21 The Digital Law Association (DLA) reported that Australian banks are 'very reluctant to provide services to Australian FinTechs in the blockchain and

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16 FinTech Australia, *Submission 62*, p. 23.

17 FinTech Australia, *Submission 62*, p. 23.

18 FinTech Australia, *Submission 62*, pp. 25-26.

19 RBA, *Submission 37*, p. 4.

20 Department of Home Affairs and AUSTRAC, Answers to written questions on notice provided 7 October 2021, p. 1.

21 Piper Alderman, *Submission 72*, p. 9.

digital asset space'. DLA added that '[l]arge banks have adopted policy decisions not to have such businesses as customers, and smaller banks and financial institutions have followed suit'.[22] This point was echoed by La Trobe LawTech at La Trobe Law School.[23]

4.22 Dr Dimitrios Salampasis noted that with the 'rise of financial technologies, the FinTech industry and the emergence of cryptocurrencies and the cryptocurrency assets market, there have been numerous circumstances of debanking worldwide',[24] including Australia.[25]

4.23 Independent Reserve, an Australian DCE, confirmed:

> A pervasive issue for the digital asset and cryptocurrency sector is de-banking where businesses in the industry cannot secure the most basic of banking services…[26]

4.24 Mawson Infrastructure Group, a digital asset infrastructure business, also noted that 'crypto asset businesses or DCEs have limited access to banking services and no access to the major banks in Australia'.[27]

4.25 FinTech Australia similarly reported that de-banking presents challenges for payments fintechs 'as it not only severs a fintech's access to a bank account, it also removes their ability to access the payments rails or infrastructure which are essential to their operations'.[28] Nium, a payments platform, also reported that it has experienced de-banking in Australia.[29]

Effects of de-banking

4.26 The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) was of the view that the 'seriousness of debanking cannot be understated' explaining:

> Technology and financial businesses who have been debanked must allocate precious capacity to correcting the operational damage caused by a loss of financial services. This damage can include legal processes and time spent securing alternate services, if they can be found at all. We are aware

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22 Digital Law Association, *Submission 49*, p. 27.

23 La Trobe LawTech, *Submission 14*, p. 5.

24 Dr Dimitrios Salampasis, *Submission 11*, pp. 7-8.

25 Dr Dimitrios Salampasis, *Submission 11*, p. 6.

26 Independent Reserve, *Submission 17*, p. [4]. See also Dr Darcey W.E. Allen, Associate Professor Chris Berg, Professor Sinclair Davidson, Dr Aaron M. Lane, Dr Trent MacDonald, Dr Elizabeth Morton and Distinguished Professor Jason Potts, *Submission 67*, p. 17.

27 Mawson Infrastructure Group, *Submission 68*, p. 7.

28 FinTech Australia, *Submission 62*, p. 26.

29 Nium, *Submission 63*, p. 5.

> that this process of renewal can take as much as 6 months, despite many businesses being given only 30 days' notice of account closure.[30]

4.27 ASBFEO cautioned the committee that the 'persistent inability of start-ups, many of which are small businesses, to access basic banking services, risks stunting Australia's technology and financial industries through unintentionally limiting competition before their true potential can be realised'.[31]

4.28 FinTech Australia also took a similar view:

> As it stands today, fintechs both locally grown and expanding into Australia are at the mercy of the whims of the banks. Just one directive from a bank can put a fintech company out of business through no fault of their own and with no recourse. This is because a bank, without consultation, can withdraw services not just from a fintech but from its customers. This has happened, and it continues to happen with worrying frequency. It is not an anomaly; it is a pattern, and it occurs with opaque and dismissive reasoning from the bank. Fintechs who have been affected are afraid to speak out for fear of further alienation. This issue, if left unaddressed, will undermine the future of the fintech industry and result in a severe reduction in the number of operating companies. A resolution is critical to the future state of the fintech industry.[32]

4.29 Ms Michaela Juric, Bitcoin Babe told the committee about the business and personal effects of de-banking she has experienced:

> As of yesterday I have been debanked and banned from 91 banks and financial institutions. That's 91 lifetime bans. No reasons given, no case by case assessments or discussions engaged and no recourse available. While the act of debanking and DCE is widely known, even more concerning is when our customers receive calls from their own banks telling them our services are a scam whenever they try to make a bitcoin purchase, or even going as far as debanking our customers. Suggestions have been made for banks to be recognised as utility, given society's high dependence on their services. But will this really make a difference? I've had bank bans prevent me from signing up with electricity, gas, phone and internet providers. This leaves me concerned that slapping a new label on them won't fix the underlying issue.[33]

4.30 Aus Merchant reported that its experience with de-banking 'has caused significant inherent risks for our DCE activities. We are regulated by AUSTRAC, and offer all of our compliance documentation to support

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30 ASBFEO, *Submission 6*, p. 1.

31 ASBFEO, *Submission 6*, p. 1.

32 Ms Rebecca Schot-Guppy, CEO, FinTech Australia, *Proof Committee Hansard*, 8 September 2021, p. 1.

33 Ms Michaela Juric, Bitcoin Babe, *Proof Committee Hansard*, 8 September 2021, p. 11.

onboarding, and yet get a default negative response causing our business to seriously consider moving our traditional banking offshore'.[34]

4.31 Swyftx, an Australian cryptocurrency broker, noted:

> The unwillingness of traditional banks to facilitate digital asset businesses by refusing to do business with them has introduced an unnecessary and significant risk to both the growth and innovation of the digital asset businesses and also to Australian consumers.[35]

4.32 Swyftx added that the number of Authorised Deposit-taking Institutions (ADIs) in Australia willing to bank digital asset companies 'is unsustainably small', adding that this:

> concentrates the risk of failure of the entire industry to almost a single point, which is unacceptable from a consumer's point of view. Protection of Australians requires that the traditional banking system provide its services (which constitute critical infrastructure) to digital asset service providers in a fair manner.[36]

4.33 Crypto.com reported that following its experience of de-banking the 'subsequent search for alternative banks has been challenging'.[37] It added that this 'affects our customers directly':

> Whilst we have invested significant working capital to support customer's purchases of crypto, withdrawals out of our exchange have been dramatically impacted. Funds are locked in our digital wallets with withdrawal limits put in place. In normal circumstances, these funds would be held in a safeguarded account at an APRA-regulated financial institution ("banks"), in compliance with our AFS license, providing customers the assurance that their funds are safe.[38]

4.34 Bitaroo reported that 'most Australian digital exchanges opted to use a payment processor as their fiat rails banking solution', however, [t]his comes at a cost that is being passed, directly or indirectly, to the users'. It added:

> There are currently only a handful of such payment processors in the market. Disconcertingly this demonstrates that the entire digital exchanges industry is potentially exposed to almost a single point of failure instead of being able to enjoy the dozens of options that the Australian banking industry has to offer.[39]

4.35 Wise pointed out:

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[34] Aus Merchant, *Submission 27*, p. [3].

[35] Swyftx, *Submission 21*, p. [3].

[36] Swyftx, *Submission 21*, pp. [3-4].

[37] Crypto.com, *Submission 55*, p. 3.

[38] Crypto.com, *Submission 55*, p. 3.

[39] Bitaroo, *Submission 5*, p. 2.

> In countries where Wise isn't engaged directly with the central bank we are obliged to use the services of established banks. This leads to the potential for disruption to our product that can significantly impact those sending money to family back home, forcing those customers to use traditional banking products for their cross-border payments, which are often less transparent, slower and more costly. This can negatively impact financial inclusion, reduce competition and reduce consumer choice.[40]

4.36 Wise added that there are market implications of de-banking:

> It leads to ineffective mitigation of money laundering and terrorism financing (AML/CTF). Like our product, we operate with a high degree of transparency with our banking partners. Transparency helps to build trust but strong communication is also essential in tackling the inherent risk of money laundering and fraud.
>
> If banks close their doors and are not willing to have an open dialogue about trends, controls and solutions, they're not contributing to the effective prevention of AML/CTF. De-risking also contributes to restricting access to provision of business bank accounts. Restricted market access for a subset of consumers is a market failure. This drives ineffective competition between PSPs [Payment Service Providers] and incumbents, and may also lead to the concentration of risk.[41]

4.37 Nium told the committee that it 'has bank relationships in 40 countries around the world, yet Australia is the only market where we've been debanked'.[42] It submitted that de-banking:

> has significant impact on how a fintech makes decisions when investing in Australia, how a fintech operates within Australia, and ultimately deters both innovation as well as viable solutions to increase financial inclusion within Australia and to key corridors throughout the Asia Pacific region.[43]

4.38 Nium stressed that:

> Fintechs are consistently one decision away (by the banks) from shutting down our respective businesses in Australia. That bears significant knock-on effects on what drives investment decisions globally and how Australia is considered as a destination for continued investment and resource dedication.[44]

4.39 FinTech Australia reported on the effects of de-banking for individuals, businesses and the wider fintech ecosystem:

> One member noted that repeated debanking events took a significant mental, financial and motivational toll on their business and team. They

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40 Wise, *Submission 18*, p. 2.

41 Wise, *Submission 18*, pp 2-3.

42 Mr Michael Minassian, Regional Head of Consumer, APAC, Nium, *Proof Committee Hansard*, 8 September 2021, p. 12.

43 Nium, *Submission 63*, p. 5.

44 Nium, *Submission 63*, p. 5.

> were only able to remain afloat due to investment from an international bank. It also stalled any prospect of growth or international expansion plans for up to 36 months. This was particularly damaging, as in this time multiple international fintechs entered the Australian market offering similar services damaging Australia's potential to be a fintech hub. Debanking is an issue that extends beyond the borders of Australia and is impacting the jobs and growth potential of Australia companies and their ability to compete in Australia and international[ly].[45]

4.40 It added:

> One of our members ultimately noted that due to this environment, a fintech generally needs to leave Australia to survive, which is again incredibly damaging to the growth of innovation and job opportunity in Australia, and our country's capacity to develop as a world leading centre of financial technology innovation.[46]

Effects of de-banking on financial intelligence collection

4.41 Home Affairs and AUSTRAC raised concerns that when businesses across entire sectors are being subject to de-banking, this can create gaps in AUSTRAC's financial intelligence capabilities and actually increase the risk of money laundering and terrorism financing activities occurring:

> As Australia's financial intelligence unit, AUSTRAC is particularly concerned that the closure of bank accounts across entire industry sectors can result in de-banked businesses being less open about the nature of their business relationships with banks. This leads to a loss of transparency, making it more difficult to distinguish lawful activity from unlawful activity.
>
> It also requires de-banked businesses to change financial institutions frequently, which leads to banks having a less sophisticated understanding of expected transaction types and volume, due to limited historic data.
>
> Contrary to mitigating and managing ML/TF risks, these activities can lead to businesses seeking alternative methods to conduct their transactions, such as increased reliance on cash or virtual assets, thereby increasing their exposure to criminal exploitation.
>
> For AUSTRAC, the de-banking of businesses can lead to underground activities, resulting in a loss of financial reporting. This can impact AUSTRAC's intelligence efforts and limit intelligence able to be shared with law enforcement and intelligence partners. This subsequently impacts law enforcement and intelligence visibility, operations and intervention. For AUSTRAC's regulatory operations, challenges arise in attempting to re-engage and re-affirm that a business may be providing services. AUSTRAC has undertaken multiple campaigns to identify unregistered

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45 FinTech Australia, *Submission 62*, p. 25.

46 FinTech Australia, *Submission 62*, p. 25.

> remittance businesses and similarly, identify newer business entrants that may be providing DCE services while unregistered.[47]

Reasons given for de-banking

4.42 A lack of information in relation to the reasons for de-banking was a common theme in evidence to the committee. ASBFEO reported that debanked businesses 'are rarely provided with an official reason for the decision, leaving them unsure of how to alter operations to correct perceived issues'. However, ASBFEO indicated that some have been told unofficially that:

- they are too high risk;
- they carry too great an AUSTRAC risk; or
- they are not an area the bank will service because of 'commercial reasons'.[48]

4.43 Mr Flynn recounted the reasons offered by banks to deny service to him which included: 'Your business is too small; Your business is too large; There's not enough government regulation; We aren't into that; and We already closed your account previously'.[49]

4.44 The RBA indicated that there seem to be a number of factors involved which include:

> financial institutions' focus on the profitability of their relationships, 'know your customer' (KYC) compliance costs, and apparent heightened risk aversion and uncertainty among financial institutions about AML/CTF and sanctions obligations. Difficulties in assessing risks associated with small and unique fintech businesses may also be a factor.[50]

4.45 Piper Alderman noted that:

> Banks have broad discretion to suspend and limit access to users' accounts with no obligation to provide reasons or any opportunity to review that decision. Australia, has no 'right' to banking, despite the absence of banking meaning that a business has extremely limited ability to serve customers. The dramatic drop in the use of cash and rise of online commerce further highlights this situation.[51]

4.46 Wise reported its experience in Australia:

> conversations with relevant domestic banks…rarely advance beyond preliminaries. At each bank, discussions were terminated early by the

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47 Department of Home Affairs and AUSTRAC, Answers to written questions on notice provided 7 October 2021, p. 2.

48 ASBFEO, *Submission 6*, p. 1.

49 Mr Allan Flynn, *Submission 57*, p. [3].

50 RBA, *Submission 37*, p. 4.

51 Piper Alderman, *Submission 72*, p. 9.

> relevant bank and the reasons for non-provision of service were broadly in the same vein. That is, concerns about "compliance".[52]

4.47 Where some detail was provided, concerns appear to centre on risk in relation to financial crime. Mawson Infrastructure Group stated that the major reason given by banks is the AML/CTF risk to banks. It argued that this position is 'unwarranted and without merit' as the 'crypto sector and DCEs…are regulated by AUSTRAC in the same way as any other entity is in Australia'.[53] ADC Forum also noted that '[b]anks have argued that there are AML/CTF risks associated with banking the blockchain industry'.[54]

4.48 Revolut reported that in their experience 'the sticking point with banking partners tends to be related to concerns regarding financial crime'.[55]

4.49 Dr Dimitrios Salampasis noted that 'banking and non-banking institutions globally receive enormous pressure from national and international regulators to be in compliance, especially in relation to AML/CTF requirements'. De-banking is therefore:

> 'informed' by the discretionary and calculated risk perceived by banking and non-banking financial institutions…in order to avoid being in breach of national and international compliance requirements, especially AML/CTF, imposed by national and international regulators. Moreover, such behaviour can also be driven by the fact that an individual or organization may be associated or be…located in a high-risk jurisdiction that is on a 'blacklist' due to high risk for money laundering, financing terrorism or inability to comply with international standards. Additional drivers of debanking can include increased capital requirements, profitability, prudential requirements, reputational risk and geopolitical situations. By [de-banking],banking and non-banking financial institutions aim at minimizing the risk of being penalised with large regulatory fines due to potential violations…[56]

4.50 Crypto.com told the committee about its understanding of the reasons for de-banking:

> We understand there has been a reduced risk appetite by many of the financial services incumbents in the wake of the COVID-19 pandemic and also in light of AUSTRAC's heightened concerns and their ability to take enforcement action. This resulted in the cessation of our banking partnerships with minimal explanation and no opportunity to discuss options.[57]

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52 Wise, *Submission 18*, p. 2.

53 Mawson Infrastructure Group, *Submission 68*, p. 7.

54 ADC Forum, *Submission 35*, p. 14.

55 Revolut, *Submission 44*, p. 9.

56 Dr Dimitrios Salampasis, *Submission 11*, pp. 5-6.

57 Crypto.com, *Submission 55*, p. 3.

4.51 Dr Max Parasol submitted:

> Banks can withdraw banking services from a business and surrounding personal accounts for various reasons such as money laundering and criminal conduct. Banks are, understandably, highly sensitive to the reputational damage that accompanies being implicated in a money laundering or terrorist financing incident. Currently under Australia's anti-money laundering and counter-terrorism financing ('AML/CTF') laws, banks have a broad discretion to close bank accounts.[58]

4.52 In relation to why Verida was declined in Australia and not in Singapore, it offered the following analysis:

> • We can't know for sure, due to the lack of disclosures on the rejection correspondence in relation to our application, but can only infer from other similar experiences in the industry.
>
> – We believe it's likely due to a lack of internal understanding and risk management processes on how to assess risk associated with startups in the Blockchain and crypto sector.
> – The lack of a regulatory framework development from the Government on token classifications and risk exposure. Such a framework may help banks in maturing their own risk management policies.
> – The lack of firm support for Blockchain businesses at the Government level to help encourage banks and payments companies to support businesses like ours.[59]

4.53 The Digital Law Association noted that policy decisions to not have Australian FinTechs in the blockchain and digital asset space as customers:

> are presented as positions taken after an assessment of money laundering, terrorist financing and proliferation financing risk posed by the sector. There is however no convincing evidence that appropriate risk assessments were undertaken as required by international standards adopted by the Australian government.[60]

4.54 La Trobe LawTech at La Trobe Law School also noted that:

> Australian banks generally justify their de-banking decisions based on the risks posed by FinTech companies. We have however encountered little evidence of consistent and appropriate appraisals of money laundering or terrorist financing risks posed by an affected customer. An appropriate assessment of that risk requires the bank to consider the customer's risk management processes. In very few cases do Australian banks actually collect such information before banking services are denied. International anti-money laundering and counter terrorist financing standards require banks to undertake individual assessments and not to engage in large-scale

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58 Dr Max Parasol, *Submission 20*, p. 13.

59 Verida, *Submission 4*, p. 3.

60 Digital Law Association, *Submission 49*, p. 27.

> denials of service to industry sectors. While banks often cite these standards to support their denials of service there is therefore no clear evidence that Australian banks actually comply with the standards in relation to their debanking decisions.[61]

4.55 FinTech Australia reported:

> At least two members were debanked without any explanation regarding why this occurred. Another noted that the official reason provided to them in writing by the offending bank was "commercial reasons". Whilst another member debanked by a big 4 bank noted that the bank's motivation to debank them changed depending on who they spoke to. After closing one member's accounts funds were supposed to be sent by cheque. However, this money is still held by the bank, and has not been released. Rather disturbingly, one member has been advised by several big four banks that they have been debanked as the fintech does not fit their business model.[62]

4.56 FinTech Australia noted the difficulties that this lack of information causes for the businesses:

> The lack of information and clarity surrounding the reasons for debanking increases the difficulty of identifying and fixing the relevant issues. Unless a business understands what the issues are, they cannot be fixed, impinging its ability to find new banking partners and may well contribute to reputational damage and harm growth and competition in the sector in the long-term.[63]

4.57 FinTech Australia noted that despite the lack of information two key reasons for de-banking are emerging: AUSTRAC and anti-money laundering and counter-terrorism financing legislation and anti-competitive conduct.[64]

4.58 Financial Inclusion By Design saw de-banking as a 'form of financial exclusion' suggesting that 'banks should be required to provide a transparent reason for debanking a customer' as '[h]iding behand risk governance language – or even worse simply citing "commercial reasons" – is unacceptable and reputationally destructive for banks, Australia's banking system and broader economy.[65] In their view debanking is driven by:

- Outdated reliance of Standard Industrial Classification (SIC) Codes to understand the nature of a business and therefore its risk; SIC Codes are not fit for purpose in the era of the digital economy;
- Reduced risk appetite driven by disproportionately fearful, biased and reactive responses in risk governance at Big 4 banks due to successful actions brought by AUSTRAC;

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61 La Trobe LawTech, *Submission 14*, pp. 1-2.

62 FinTech Australia, *Submission 62*, p. 24.

63 FinTech Australia, *Submission 62*, p. 24.

64 FinTech Australia, *Submission 62*, p. 24.

65 Financial Inclusion By Design, *Submission 3*, p. 2.

- Inadequate investment in compliance technology such as regtech solutions that can surface and analyse billions of data points in real time to reduce the entire end-to-end risk on non-compliance. Ironically, Australia leads the way in regtech, for example, ASX-listed companies Identitii Limited and Kyckr Limited are just two examples.[66]

Bank response on de-banking

4.59 The Australian Banking Association noted that '[a]cross the globe, banks offer services in accordance with their risk-appetite, risk-profile, and their skills and capability to manage the legal obligations and risks associated with customers operating in certain sectors'.[67]

4.60 The CBA stressed that it 'does not have a policy or make decisions to cease a customer relationship due to competitive or market factors'.[68] CBA reported that:

> when making a decision about lending to new business customers, we take a range of risk considerations into account including the terms and conditions of any loan documentation and possible security provisions provided. This also includes managing compliance risks as well as decisions regarding the financial viability of the business – an important factor for our shareholders, our prudential standing, and essential for the business customer itself to avoid assuming the risk of overcommitting.[69]

4.61 CBA added that the Australian financial services industry is 'subject to a number of regulatory requirements, including prudential lending obligations and anti-money laundering and counter-terrorism financing (AML/CTF) laws'.[70]

4.62 NAB stressed that each customer is considered on a case-by-case basis and outlined a number of reasons why debanking may occur:

- Commercial consideration – The cost and resources of NAB to support and oversee a customer may be greater than the commercial benefit of doing so. For example, the monitoring and oversight of a fintech's underlying activity may be cost prohibitive meaning that the risk of the fintech may be greater than any possible commercial benefit.
- Security and resilience – NAB may hold concerns about the level of security and resilience of a fintech's technology system or business process. For example, an incidence of material fraud.
- Financial Crime – NAB may hold concerns around an entity's management of Anti-Money Laundering or Counter Terrorism

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66 Financial Inclusion By Design, *Submission 3*, p. 3.

67 ABA, *Submission 30*, p. 4.

68 CBA, *Submission 40*, p. 1.

69 CBA, *Submission 40*, p. 2.

70 CBA, *Submission 40*, p. 2.

Financing (AML/CTF) requirements or their capability to meet these requirements. This could include a lack of evidence about how the entity will meet their requirements, or an entity may not have sufficient processes to monitor who their customers are.

- Product misuse – NAB has experienced instances of some fintechs using certain banking products for purposes which they are not intended. A product may be designed and offered according to certain commercial, risk or regulatory parameters. NAB may stop offering that product to a customer if it is not being used in-line with its intended design or use.[71]

4.63 NAB added that de-banking decisions 'are informed by NAB's risk appetite to provide business transaction services to fintechs'. Where a decision to de-bank is taken 'this will be communicated to the customer in writing', however:

> In some specific areas such as financial crime, we are not always able to be specific about the reason for de-banking due to legislative requirements.[72]

4.64 NAB reported that the customer 'will be provided with time to provide alternative banking arrangements in most cases' and if they request more time this is considered on a case-by-case basis.[73]

4.65 Westpac submitted that they 'are not actively looking to exit customers where we can provide banking services that fall within our risk appetite and comply with our legislative obligations'. Westpac also indicated there are a range of reasons why de-banking occurs including 'management of financial crime-related risks, dealing with companies which become deregistered, fraud and certain convictions, among others'.[74]

4.66 Westpac told the committee that it has in place 'a comprehensive Financial Crime Risk Management Framework…which is designed to ensure we meet our obligations under the AML/CTF Act'. It added that 'Westpac does not consider FinTech to be higher risk or out of appetite per se. However, there could be segments of the FinTech sector that operate in higher risk areas or have higher risk aspects and these may result in a decision to decline or cease to offer banking services'.[75]

4.67 Before a decision to de-bank is taken Westpac 'will undertake a process to gather further information'. If the decision is made to de-bank a customer 'generally a standard 30-day notice period is provided to the customer' and they will also consider requests to extend this period on a case-by-cases basis.

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71 NAB, *Submission 52*, pp. [1-2].

72 NAB, *Submission 52*, p. [2].

73 NAB, *Submission 52*, p. [2].

74 Westpac, *Submission 51*, p. 1.

75 Westpac, *Submission 51*, pp. 1-2.

Westpac noted that there may be circumstances where it determines that a 'shorter notice period is necessary to manage the risk'.[76]

4.68 The ANZ reported that the following criteria are assessed when either commencing or discontinuing a banking relationship with a fintech and they include:

- The viability of the entity's business model and their ability to service any financial obligations to us;
- The standard of the entity's management personnel;
- The adequacy of the entity's governance arrangements;
- The type of business that the entity proposes to, or does, carry on and our technical ability to manage the banking and other risks associated with that business line;
- Any changes to that business after we commence banking them which may alter the risks (compliance and otherwise) of the customer;
- The ability and willingness of the entity to meet their policies and legal compliance obligations, including whether they have been the subject of any regulatory actions and/or undertaken any necessary remedial action;
- The way in which the entity manages (or fails to manage) customer fraud claims;
- the commercial viability of providing services to the entity taking into account the revenue to be received on the account and the costs incurred to service it, which will include compliance activities that we need to undertake to bank them safely and legally.[77]

4.69 At a hearing Mr Adrian O'Shaughnessy, Executive Director, Policy, Australian Banking Association discussed this issue with the committee and stated:

> The simplest obligation is that the government require[s] banks to explain to regulators where the money is coming from and where the money is going to. If you heard from the managing director of Bitaroo, he himself said that it's not possible to do that with a number of these types of assets.[78]

4.70 Mr O'Shaughnessy offered reasons why organisations, particularly in the digital asset space are being de-banked:

> Right now, today, when we look at virtual assets, it is an unregulated environment. When you look at the obligations, how banks operate, they each have a different and unique strategy, the types of markets they service. They all have a risk appetite. They have expectations from their correspondent banks overseas and they all have a risk profile. After that, they then say, 'What are our skills, capacity and capability to manage the risk?' When it comes to today, when it comes to virtual assets, it's an

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[76] Westpac, *Submission 51*, p. 2.

[77] ANZ, *Submission 80*, pp. 1-2.

[78] Mr Adrian O'Shoughnessy, ABA, *Proof Committee Hansard*, 27 August 2021, p. 24.

> unregulated environment, an unregulated product, an unregulated activity. When you have legal obligations under the AML/CTF and the corps act and you have regulators that are willing to impose billion dollar fines, the risk far exceeds the risk appetite for a bank to say, 'My strategy is to be able to partner with or serve customers in that particular sector of the economy.'…[79]

4.71 Mr O'Shaughnessy further explained the reason why in some cases they are unable to provide a lot of detail when de-banking a business:

> There are a number of obligations in the AML/CTF Act. There is one in section 123 of the act called the tipping off provision. Where a bank or another type of reporting entity forms a suspicion of an illegal or criminal activity and reports that to AUSTRAC, there is a very clear—and it comes with criminal liability—obligation on the bank and the individuals in the bank to not tip off that individual or entity that a suspicion has been formed, because that allows law enforcement then to observe that activity and take action. So I understand that frustration that some entities in the market have—that silence when suddenly banking services are cut off—but it is a legal obligation on banks and other reporting entities to do such a thing.[80]

4.72 When speaking about the need for increased transparency or an appeals mechanism Mr O'Shaughnessy emphasised that:

> Section 123 of the AML/CTF Act comes with criminal consequences if a bank officer tips off an entity or an individual on which a suspicious matter report has been made to AUSTRAC. That binds the bank and that individual. They cannot tell anyone else. They cannot tell AFCA. It is a strict obligation...We have actually talked to AFCA on this, and they do have updated guidance under which, if a customer makes a complaint, AFCA is able to explain to the customer the different legislative obligations imposed on banks.[81]

4.73 It was stressed to the committee that digital assets are new and unregulated and with that comes risk. In summary, 'Australian banks adhere to the [Financial Action Task Force] standards and regulations on anti-money laundering and counterterrorism financing, and, as part of that, they have to manage the risk. Virtually, right now, it is very difficult for any bank across the globe to manage the risk in providing banking services to these types of entities in this unregulated part of the market.'[82]

4.74 In order to move forward Mr O'Shaughnessy suggested:

- once the Financial Action Task Force finalises its standards for virtual assets, Australia should adopt and implement those into national law;

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[79] Mr Adrian O'Shaughnessy, ABA, *Proof Committee Hansard*, 27 August 2021, p. 26.

[80] Mr Adrian O'Shaughnessy, ABA, *Proof Committee Hansard*, 27 August 2021, p. 24.

[81] Mr Adrian O'Shaughnessy, ABA, *Proof Committee Hansard*, 27 August 2021, p. 28.

[82] Mr Adrian O'Shaughnessy, ABA, *Proof Committee Hansard*, 27 August 2021, p. 26.

- looking to and working with other jurisdictions more advanced in this area to establish a taxonomy of virtual assets which would allow the design of governance policies, regulation, consumer protection and cyber security standards; and
- a move from registering with AUSTRAC to licensing obligations.[83]

Regulatory landscape

Domestic AML/CTF Act

4.75 The Department of Home Affairs (Home Affairs) is responsible for administering the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) which in 2018 was extended to regulate DCEs. The AML/CTF Act:

> applies a risk-based approach to combating financial crime. The risk-based approach extends to new technologies, for which regulated businesses must understand and mitigate any ML/TF risks prior to adopting them. The risk-based approach represents a balanced approach to new technologies, that minimises restrictions on innovation while also helping to ensure that associated risks are understood and addressed before they can be exploited by criminals.[84]

4.76 Home Affairs indicated that it is aware that 'Australian banks, when concerned about the ML, TF and sanctions risks posed by particular customers, sometimes choose to 'de-bank' these customers by withdrawing the provision of financial services'. It added that the decision to de-bank a customer 'sits with the relevant financial institution, and the AML/CTF Act does not mandate this practice'.[85] Home Affairs stated that:

> The blanket de-banking of whole industry sectors and classes of customers goes beyond the risk-based approach to AML/CTF regulation, which is premised on a customer-by-customer assessment of risk and appropriate mitigation measures, rather than the complete disengagement from risk. At the same time, the AML/CTF Act does not require any financial institution to provide services to particular customers—this would go well beyond the scope of AML/CTF regulation.[86]

4.77 Home Affairs emphasised that this risk-based approach recognises that 'each individual business is in the best position to assess the ML/TF risks it faces in relation to the customers, products, and services it offers, and ensure that the procedures and policies put in place are proportionate to those risks'. The approach also recognises 'that the drivers of de-banking are complex and go beyond ML or TF concerns', adding that:

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83 Mr Adrian O'Shaughnessy, ABA, *Proof Committee Hansard*, 27 August 2021, p. 27.

84 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 3.

85 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 5.

86 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 5.

> A range of additional factors may lead to a customer being de-banked, e.g. commercial considerations; reputational risk; uncertainty associated with new business models; expectations of overseas correspondent banks; and a range of other regulatory requirements relevant to the financial sector.[87]

4.78 AUSTRAC stated that it 'has and will continue to emphasise that banks must consider those risks as related to the individual business or entity, as opposed to any general cohort of businesses'.[88] At the same time, AUSTRAC 'expects businesses operating in the remittance, DCE and fintech sectors to understand and meet their AML/CTF obligations':

> These sectors are being exploited by criminals, and that is why the AML/CTF Act extends to these types of businesses. The nature of these businesses may provide opportunities to put in place appropriate compliance frameworks and technology quickly and easily, compared with more complex and larger entities. Efforts to strengthen and protect their own businesses demonstrates a strong willingness and culture of compliance, and should build trust with the banking sector.[89]

4.79 Bitaroo noted assurances from the Chief Executive of AUSTRAC that 'Australia's AML/CTF Act does not impose requirements on a reporting entity to close accounts or terminate a business relationship'. However, it noted that 'the reality remains that individuals, businesses, and digital exchanges particularly have been, are, and will continue to be shut down on a whim without an option to object or any form of government intervention'.[90]

AUSTRAC responses to de-banking

4.80 AUSTRAC stated to the committee that it 'takes its role as Australia's AML/CTF regulator seriously and has a strong, ongoing focus on building capability, professionalism and levels of compliance across its regulated population'. It stated further:

> [AUSTRAC] does this in a variety of ways including through ongoing education, outreach and engagement, and provision of guidance to assist reporting entities to identify, mitigate and manage their ML/TF risks.
>
> AUSTRAC continues to produce sectoral ML/TF risk assessments that are informed through engagement with law enforcement agencies and industry experts. The risk assessments enable reporting entities to better understand the risks they face and implement appropriate systems and controls to mitigate and manage these risks.

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87 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 5.

88 Department of Home Affairs and AUSTRAC, Answers to written questions on notice provided 7 October 2021, p. 3.

89 Department of Home Affairs and AUSTRAC, Answers to written questions on notice provided 7 October 2021, p. 3.

90 Bitaroo, *Submission 5*, p. 2.

> AUSTRAC recently completed a three-month registration pilot trialling enhanced application forms and vetting processes for remittance and DCE providers. The aim is to ensure more rigour around the assessment of an applicant's probity, suitability and capacity. AUSTRAC is considering the outcomes of the pilot and future steps to strengthen the registration process.[91]

International standards and risk-based approach

4.81 De-banking is a global issue. The Financial Action Task Force (FATF) is an inter-governmental body that sets international standards to prevent money laundering and terrorist financing. Australia is a member and the government has committed to ensure that Australian laws and practices meet the FATF standards.[92] The standards require banks to take a risk based approach to enforcement but FATF has also stated the expectation that:

> Implementation by financial institutions should be aimed at managing (not avoiding) risks. What is not in line with the FATF standards is the wholesale cutting loose of entire countries and classes of customer, without taking into account, seriously and comprehensively, their level of money laundering and terrorist financing risk and applicable risk mitigation measures for those countries and for customers within a particular sector.[93]

4.82 FATF has issued guidance on a risk-based approach.[94] However, La Trobe LawTech noted that:

> The experience of smaller FinTechs in Australia is that Australian banks do not comply with these standards. The banks, when pressed, generally refer to standing policy decisions that they will not engage with businesses involved in crypto. Individual risk assessments may be undertaken in relation to large FinTechs but in the majority of cases FinTechs are not even given an opportunity to provide information about their business model and risk control measures. The lack of appropriate consideration of the risk and risk management information of an individual applicant does not meet the FATF standards.[95]

4.83 In February 2021 FATF announced a new project to study and mitigate the unintended consequences resulting from the incorrect implementation of the FATF Standards. The project focuses on four main areas:

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91 Department of Home Affairs and AUSTRAC, Answers to written questions on notice provided 7 October 2021, pp. 3-4.

92 La Trobe LawTech, La Trobe Law School, *Submission 14*, p. 5.

93 Outcomes of the FATF Plenary meeting, Paris, 21-23 October 2015, statement on FATF action regarding de-risking. See also Digital Law Association, *Submission 49*, pp. 27-28.

94 FATF, Guidance on the Risk-Based Approach for Effective Supervision and Enforcement by AML/CFT Supervisors of the Financial Sector and Law Enforcement, 2015.

95 La Trobe LawTech, La Trobe Law School, *Submission 14*, p. 7. See also Digital Law Association, *Submission 49*, p. 28.

- De-risking, or the loss or limitation of access to financial services. This practice has affected non-profit organisations (NPOs), money value transfer service providers, and correspondent banking relationships, in particular;
- Financial exclusion, a phenomenon whereby individuals are excluded from the formal financial system and denied access to basic financial services;
- Undue targeting of NPOs through non-implementation of the FATF's risk-based approach;
- The curtailment of human rights (with a focus on due process and procedural rights) stemming from the misuse of the FATF Standards or AML/CFT assessment processes to enact, justify, or implement laws, which may violate rights such as due process or the right to a fair trial.[96]

4.84 In June 2021, FATF indicated that it 'will now build upon its existing work, and begin identifying possible further mitigation options'.[97]

Questions around competition

4.85 Questions were also raised about whether de-banking could amount to anti-competitive behaviour. Financial Inclusion By Design noted that the 'most commonly targeted fintechs for debanking are in the cryptocurrency, payments and neo-lending areas [which has] raised the question whether this behaviour by the banks is anti-competitive'.[98] It added they 'do not believe there is a *purposeful* misuse of market power by the Big 4 banks with respect to debanking of fintechs. However, it is entirely possible that the impact of debanking may be anti-competitive, depending on how the ACCC would define the relevant market'.[99]

4.86 Similarly, Wise submitted that 'limiting the access of startup and scale-up companies to local business bank accounts can have an anti-competitive effect even if the intent is not anti-competitive'.[100]

4.87 Swyftx also questioned whether this behaviour is anti-competitive:

> The basis for traditional banks unwillingness to bank digital assets companies to date, which have relied on some arbitrary and ill-advised notion of "increased risk" related to digital assets is no longer an

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96 FATF, 'Mitigating the Unintended Consequences of the FATF Standards', https://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html (accessed 28 September 2021).

97 FATF, 'Mitigating the Unintended Consequences of the FATF Standards', https://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html (accessed 28 September 2021).

98 Financial Inclusion by Design, *Submission 3*, p. 3.

99 Financial Inclusion by Design, *Submission 3*, p. 3 (emphasis in original).

100 Wise, *Submission 18*, p. 2.

> acceptable or good faith approach, and is beginning to look like anti-competitive behaviour born of self-interest and at the expense of consumer confidence and protection.[101]

4.88 Dr Parasol posited whether the 'broad discretion afforded to Australian banks to de-bank may conflict with Australia's Open Banking aspirations that seeks to make banking products more competitive for consumers'. He noted:

> There are potential competition issues relating to industry-wide bank account closures. However, de-banking where non-bank firms that compete with banks are being dropped as clients by traditional banks, often citing risk or regulatory concerns, is potentially anticompetitive behaviour. De-banking occurs in the sense that FinTechs have been stopped from gaining access to the payment infrastructure because they pose a commercial threat to the major banks.[102]

4.89 Dr Parasol added:

> This commercial threat to banks is real. For some crypto assets, the transfer of assets is processed for a few cents. A bank transfer can often cost two hundred dollars for that same transfer.[103]

4.90 Wise argued that:

> Blanket debanking, which has been occurring in Australia, has been increasing AML/CTF risks and gives rise to serious questions about the misuse of market power by the traditional financial institutions. The loss to the consumer through the increased costs associated with debanking along with the barrier that this phenomenon poses to innovation in the payments space is considerable.[104]

4.91 Nium pointed out that because de-banking 'lies in the concentrated banking sector [this] further perpetuates anticompetitive and incumbent-driven models, depriving the Australian market of the widespread benefits of financial technology innovation'.[105]

4.92 FinTech Australia provided examples in relation to anti-competitive conduct:

> it has been suggested to us by our members that it is often the case that companies subject to offboarding challenge the banks' current market position, and that it may be done, at least partly, as a commercially convenient outcome for the bank. One member received reasons from the bank including that they were debanked because: they were a fintech; they held an Australian Credit Licence; they were a payments company; they issued cards in a scheme; and one of their accounts had been historically been overdrawn. Many of these indicate that the bank's motivations may have been genuinely anti-competitive. A lender member also submitted

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101 Swyftx, *Submission 21*, p. [4].

102 Dr Max Parasol, *Submission 20* p. 13.

103 Dr Max Parasol, *Submission 20* p. 13.

104 Wise, *Submission 18*, p. [3].

105 Nium, *Submission 63*, p. 5.

> that from their experience, debanking by larger financial institutions is driven by anti-competitive motives. They note that the dynamic of having the established financial institutions own the payment architecture in Australia means that established players use their market dominance to prevent competition, meaning they do not have to compete with fintechs on cost or convenience to the consumer. This is not a good outcome for consumers.[106]

4.93 FinTech Australia added:

> Allowing banks to debank fintechs gives them the position of defacto gatekeepers to innovation, as they then become the arbiters of who should and should not be provided banking services, and therefore a viable chance at success in Australia. The practical effect of this is that banks are seen as a single point of failure for a fintech company and present a risk to the health and viability of a business.[107]

4.94 Speaking at a hearing, in relation to a question about the de-banking of remittance providers, Mr Joseph, Healy, Chief Executive Officer, Judo Bank, pointed out:

> You have to remember that we have one of the most profitable banking systems in the world, which is a good thing. But it's one of the most profitable banking systems in the world because it's weak in terms of competition, so all of the incentive of the incumbent system is to maintain the status quo, whilst obviously publicly towing the line in terms of being supportive of competition, or at least not blocking competition. But the reality is that we have a system that is heavily concentrated and dominated by powerful players who have an ability, if not to stop, to slow down innovation, and that's not good.
>
> I go back to my opening remarks, obviously we're working in a market economy and a critical part of a market economy is real competition and real innovation. Powerful players, particularly privileged players like the banks, should not be allowed to frustrate innovation and competition. Again, if you're running these organisations you want to protect what you've got. I think in the cross-border currency payments business the amount of innovation and competition there has been hugely impressive and that has got to be encouraged.[108]

ACCC response on competition

4.95 The ACCC informed the committee that it has investigated potential breaches of the *Competition and Consumer Act 2010* (CCA) as a result of allegations of de-banking but the investigations did not establish a breach. It submitted that the 'establishment of an effective due diligence scheme would more easily allow

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106 FinTech Australia, *Submission 62*, p. 25.

107 FinTech Australia, *Submission 62*, p. 25.

108 *Proof Committee Hansard*, 8 September 2021, p. 22.

the ACCC to examine whether the denial of banking or payment services raises concerns under the CCA'.[109]

4.96 The ACCC saw de-banking as 'having the potential to be a significant threat to competition', noting that it looked at this issue as part of its 2019 inquiry into the supply of foreign currency conversion services in Australia.[110]

4.97 The 2019 ACCC inquiry found that de-banking and the prospect of de-banking raise costs for the following groups:

- New IMT entrants seeking to secure banking services
  - These costs, or the inability to sure banking services, can act as a barrier to entry and therefore threaten competition.
- Existing non-bank IMT suppliers.
  - These costs include potentially high compliance costs to maintain access to bank services. These additional costs can hamper non-bank IMT suppliers' ability to price services competitively and win customers, especially given bank IMT suppliers do not face these same costs.[111]

4.98 The 2019 inquiry found that 'de-banking was a significant issue for non-bank IMT [International money transfer] suppliers'[112] with the ACCC reporting that:

> Some non-bank IMT suppliers have been denied access to bank services or have found access to bank services under threat. In the examples we considered in the inquiry, the need to comply with Australia's anti-money laundering and counter terrorism financing (AML/CTF) laws has been a factor in the banks' decisions to withdraw access to banking services for non-bank rivals. However, inherent to issues relating to de-banking is the difficulty in distinguishing between accounts being closed due to legitimate AML/CTF concerns, and accounts being closed for anti-competitive reasons.[113]

4.99 The ACCC report recommended the government:

> form a working group tasked with consulting on the development of a scheme through which IMT suppliers can address the due diligence requirements of the banks or providers of payment system infrastructure, including in relation to AML/CTF requirements.
>
> The Working Group should begin a public consultation process on the merits and design of such a scheme by 31 December 2019 and conclude that process by 30 June 2020. The Working Group should consider any alternative solutions to address the issue of de-banking that are raised by stakeholders during the public consultation process.

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109 ACCC, *Submission 9*, p. 3.

110 ACCC, *Submission 9*, p. 1.

111 ACCC, *Submission 9*, p. 2.

112 ACCC, *Submission 9*, p. 2.

113 ACCC, *Submission 9*, p. 2.

> By 31 December 2020, the scheme should be operational or the Working Group should have set out any alternative approach it will initiate to ensure that non-bank IMT suppliers are able to obtain efficient access to the banking and payment services they need to compete in the supply of IMT services to Australian consumers.[114]

4.100 The government agreed to 'urgently conduct further work on the issue of de-banking, where third party providers are denied access to banking services by the major banks, who are also their competitors. The government indicated that it would:

> establish a taskforce to consult with all relevant stakeholders and report back with further reform options, ensuring that compliance with Australia's anti-money laundering and counter-terrorism laws does not unnecessarily stifle competition.[115]

4.101 The committee sought an update on this work which was provided by ACCC officials who confirmed the government has set up a working group led by Treasury which is being overseen by the Council of Financial Regulators. Ms Leah Won General Manager, Competition Enforcement and Financial Services, ACCC informed the committee:

> we recommended at the end of that foreign exchange inquiry that a working group be formed to look at the issues, but our recommendation was associated with a due diligence scheme being put in place to really streamline the process for both the banks and the businesses to give them a common language about what was actually required to satisfy the banks that they were a reasonable AML/CTF risk. It was our strong view when we did the inquiry that it was important to have multiple parts of government in the room for that discussion, and that's why we welcome the formation of this working group. We think it's really critical that AUSTRAC and Home Affairs, as well as the other financial services regulators—and us, to the extent that we've got good visibility over the problem—are in the room and can work together towards a sensible solution. That working group was suspended through some of the COVID period, but it is now reformed. I think it is actively working and will report back to the Council of Financial Regulators.[116]

4.102 The June 2021 Quarterly Statement by the Council of Financial Regulators (CFR) outlined work on Australia's role in the G20 Roadmap for Enhancing Cross-border payments and noted:

> A related issue has been the withdrawal of banking services ('de-banking') from payments and other financial service providers. Participants discussed trends and drivers of decisions to 'de-bank' these providers.

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[114] ACCC, *Foreign currency conversion services inquiry,* final report, July 2019, p. 11.

[115] The Hon Josh Frydenberg MP, Treasurer of the Commonwealth of Australia, 'ACCC finds consumers are paying too much in foreign transaction fees', *Media release*, 2 September 2019.

[116] *Proof Committee Hansard*, 8 September 2021, p. 36.

> They agreed that agencies would undertake further work to explore the underlying causes and examine possible policy responses.[117]

4.103 The ABA indicated that it 'welcomes and supports the Council undertaking further work to explore the underlying causes and examine possible policy responses and will assist the Council's research as this issue is explored'.[118]

Update on the CFR's work on de-banking

4.104 The RBA provided further information to the committee on behalf of the CFR, outlining the progress of its work to date on de-banking. It noted the establishment of a CFR working group on de-banking in June 2021, to examine possible policy responses on these issues. Membership of the working group comprises representatives of APRA, ASIC, the RBA, the Treasury, the ACCC, AUSTRAC and the Department of Home Affairs.[119]

4.105 The focus of the CFR working group is 'payments and other financial services providers, including international money transfer (IMT) and financial technology (fintech) firms'. It was noted that this scope is broader than the taskforce established following the ACCC's Foreign Currency Conversion Services Inquiry, which was focused on IMTs.[120] The RBA noted further in its correspondence:

> The CFR working group is in its early stages and it will be some time before conclusions are reached. However information from Treasury's engagement with fintechs, banks and regulators on de-banking provides useful background to the issue. It highlights that a range of factors may drive decisions about whether to bank a firm. However, the fine balance between banks' AML/CTF risks and compliance costs on one hand, and their returns from servicing small fintech and IMT firms on the other, appears to be key. Banks' risk appetites may also have been affected by recent substantial penalties for AML/CTF breaches, highlighting that the policy objective of preventing money laundering and terrorist financing may at times conflict with that of promoting the provision of competitive and efficient financial services. Issues of uncertainty about AML/CTF compliance obligations and transparency of de-banking decisions have also been raised. So far, the regulators have seen no evidence that de-banking is occurring as a competitive strategy.
>
> The CFR working group will continue to explore these issues and potential policy options that could address or mitigate them. At this time a deadline for completion of this work has not been set.[121]

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117 Quarterly Statement by the Council of Financial Regulators – June 2021.

118 ABA, *Submission 30*, p. 4.

119 Reserve Bank of Australia, Correspondence to the committee dated 8 October 2021, p. 1.

120 Reserve Bank of Australia, Correspondence to the committee dated 8 October 2021, p. 1.

121 Reserve Bank of Australia, Correspondence to the committee dated 8 October 2021, pp. 1-2.

ASIC response

4.106 ASIC noted that it 'does not have a regulatory role in relation to concerns about debanking', stating that it considers the 'response to debanking is a policy matter for the Australian Government'. ASIC emphasised actions it has taken which have been consistent with increasing the availability and accessibility of banking services.[122]

Suggestions to improve the framework governing de-banking practices

4.107 Suggestions from submitters in relation to improving practices around de-banking centred on achieving better regulation and more transparency.

Regulation

4.108 Noting the discussion in Chapter 3 around potential regulatory reforms relating to digital assets, a number of submitters and witnesses argued that an improved regulatory framework would also assist mitigate de-banking issues for the sector.

4.109 Mr Bacina submitted that '[a] clearer regulatory position around digital asset products…will remove any regulatory uncertainty which may be underpinning bank decisions on grants account privileges'.[123]

4.110 Swyftx argued that:

> A clear regulatory regime is needed which provides for government to prevent traditional banks withholding services to digital asset service providers (acting as unauthorised gatekeepers to the system), but which also establishes clear and robust registration and licensing requirements for digital asset service providers to assuage both consumer and bank concerns around the particular risks posed by individual digital asset service providers.[124]

4.111 Mawson Infrastructure Group suggested:

- The introduction of a well understood and clear regulatory framework will give banks more confidence in dealing with crypto businesses;
- Banks must ensure that all banking services are available to crypto businesses; and
- We believe APRA may need to revisit and revise its treatment and risk weighting of crypto business and consumer deposits so that it is considered no different to any form of Tier 1 capital for banks.[125]

4.112 Dr Parasol acknowledged the AML/CTF risk for banks, adding that 'they may be unwilling to take a risk on the Crypto Exchange industry without

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122 ASIC, *Submission 61*, p. 10.

123 Mr Michael Bacina, *Submission 72*, p. 9.

124 Swyftx, *Submission 21*, p. [4].

125 Mawson Infrastructure Group, *Submission 68*, p. 7.

regulatory guidance. Regulatory guidance should, as a result, be drafted in a way that is consistent with the AML/CTF Act'.[126]

4.113 Crypto.com also recommended:

> the regulators conduct coordinated analysis of the crypto industry in order to provide a benchmark and guidance to the incumbent banks in relation to the appropriate risk parameters to be applied when working with fintech businesses. This will help banks understand when they will and will not be at odds with the regulators' expectations.[127]

4.114 ADC Forum was of the view that the AML/CTF risks can be mitigated:

> Deep forensics on the blockchain by companies like Chain Analysis show less than 1% of all crypto transactions are used for ML/TF purposes. As the blockchain is an immutable, distributed, secure and transparent ledger all transactions can be traced and tracked unlike cash. In our submission, the economic and business risks of not banking this emerging sector far outweigh any AML/CTF risks presented.[128]

4.115 Revolut pointed out the:

> anti-money laundering technology available from companies such as Elliptic (which Revolut uses to monitor and screen all crypto withdrawals in jurisdictions where that feature is offered) is exceptionally precise and advanced, and is used by a number of government crime agencies in Europe, as well as some banks. We believe a greater effort by banks to engage and understand this type of technology is key to banks better targeting the financial crime risks relating to crypto (rather than taking a blanket ban approach to all crypto businesses).[129]

4.116 Aus Merchant advised the committee that it is currently in the process of 'onboarding to a US based bank as a risk mitigation strategy'. When it asked to onboard as a digital asset company:

> [the US bank] responded with a digital asset specific onboarding compliance and due diligence procedure. This makes me question what is stopping Australian Banks from working with the industry to provide these same enhanced due diligence procedures. We suggested this to the Australian banks as a solution on more than one occasion, specifically when the notification of account closure came through, however a standardised "risk off" without compromise approach was maintained.[130]

4.117 Noting that the legislation encourages banks to operate in a risk averse manner, Independent Reserve expressed the view that:

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[126] Dr Max Parasol, *Submission 20*, p. 14.

[127] Crypto.com, *Submission 55*, p. 4.

[128] ADC Forum, *Submission 35*, p. 14.

[129] Revolut, *Submission 44*, p. 9.

[130] Aus Merchant, *Submission 27*, p. [4].

> it is the responsibility of the digital asset and cryptocurrency industry and law makers to design the industry such that banks want to do business with the sector.
>
> Independent Reserve recommends as a first step in this process, to put in place minimum requirements and licensing for the custody of digital assets and cryptocurrency. AUSTRAC already ensures that all DCEs must adhere to the AML/CTF Act 2006. If we can add a licence and minimum standards to the custody and security of customer assets, there is a demonstration of clear and comprehensive consumer protections in place.[131]

Risk mitigation and guidance

4.118 Dr Salampasis also emphasised the need for 'regulators to provide assistance to banking and non-banking financial institutions so as to recalibrate risk assessment models and redevelop risk mitigation strategies on a case-by-case rather than wholesale debanking'.[132]

4.119 Wise also submitted:

> The lodestar of de-risking practice should be bespoke risk-based approaches and the assessment of new customer relationships and due diligence requirements that are made on a case-by-case basis of the level of risk identified.[133]

4.120 To address de-banking Nium recommended: AUSTRAC provide clear guidance for financial institutions; an industry-wide de-banking process to provide certainty and transparency; and to provide entities an opportunity to appeal a de-banking decision with an appropriate regulatory body.[134]

Greater transparency

4.121 Ms Rebecca Shot-Guppy, CEO FinTech Australia spoke about how to address this issue:

> As we've mentioned our submission, the balance of power needs to be readjusted. This issue needs to be resolved so that the needs of both banks and fintechs can be met and that a cohesive ecosystem can be supported. Banks should have an imperative to work with their partners to solve regulatory challenges, not shut the door on them. An appeals process should be put in place to manage this. This problem can be also managed by giving fintechs better and direct access to payment rails, to allow them to operate around the banks. Providing further clarification on the regulatory obligations of banks and their fintech partners will also reduce the risk of this practice occurring.[135]

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131 Independent Reserve, *Submission 17*, p. [5].

132 Dr Dimitrios Salampasis, *Submission 11*, p. 10.

133 Wise, *Submission 18*, p. 3.

134 Nium, *Submission 63*, pp. 6-7.

135 Ms Rebecca Shot-Guppy, *Proof Committee Hansard*, 8 September 2021, p. 1.

4.122 Specifically, FinTech Australia suggested that:

- AUSTRAC introduce clearer guidelines for banks and fintechs in relation to the obligations with an aim of reducing the occurrence of de-banking;
- an industry-wide de-banking process should be developed to provide certainty;
- an appeals process should be implemented to hold banks accountable for de-banking activities; and
- the ACCC investigate whether de-banking is undertaken for anti-competitive reasons.[136]

4.123 To address the issue of de-banking, the ASBFEO recommended that an appropriate entity 'be empowered to require a financial institution to provide clarity around the robustness of decision making around a decision to withdraw or deny a financial service to a legally operating business'. In addition '[c]onsideration should also be given as to whether this might then be published and whether a review could be undertaken by the Australian Financial Complaints Authority of the decision'.[137]

4.124 Financial Inclusion By Design suggested that there is a need for:

> an accountability framework, such as an Australian Banking Association Code of Conduct and an external complaints mechanism (e.g. AFCA or an Ombudsman), to ensure that debanking is not the result of a generic and anonymous risk management exercise because that is categorically unfair and unreasonable given the enormous negative economic business, social and personal impacts that such a decision unleashes.[138]

4.125 Financial Inclusion By Design also suggested that the issue of debanking should be referred to the ACCC for an in-depth inquiry.[139]

AFCA

4.126 The Australian Financial Complaints Authority (AFCA) 'is the independent external dispute resolution scheme for the financial sector'. AFCA advised that they receive 'complaints involving claims of de-banking from time to time' and two of the typical claims made are:

- a bank closed the complainant's account without consent
- a credit provider decided to stop providing a credit facility to the complainant.[140]

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136 FinTech Australia, *Submission 62*, p. 28.

137 ASBFEO, *Submission 6*, p. 1.

138 Financial Inclusion By Design, *Submission 3*, p.p. 2-3.

139 Financial Inclusion By Design, *Submission 3*, p. 3.

140 AFCA, *Submission 73*, p. 1.

4.127 However, AFCA noted that it has 'limited jurisdiction to deal with complaints about commercial decisions made by banks and other financial firms. This includes whether or not the firm will provide a financial service or product to a consumer or a small business'.[141]

4.128 AFCA indicated that for a complaint about account closure, they consider:

- whether product terms and conditions allow the financial firm to close the account or stop providing a service
- whether the firm has fairly exercised its rights by taking into account:
  - obligations under the relevant laws and codes of practice
  - good industry practice
  - customer conduct
  - the impact of the account closure on the customer
- whether the firm provided sufficient notice
- what is fair in all the circumstances.[142]

4.129 AFCA further advised:

> To date, AFCA has not seen any particular trend of de-banking complaints by cryptocurrency or digital asset businesses, or the Fintech sector more broadly. Generally speaking, complaints made to AFCA involving de-banking issues, such as account closures and credit facilities, have arisen across consumer and small business complainant types. They appear to be due to factors such as the conduct or risk profile of the account holder and their transaction activities, or other commercial decisions made by a bank as to the provision of products and services to a particular consumer or small business.[143]

Access to payments systems

4.130 As noted above, as a suggestion to address de-banking, Fintech Australia suggested greater access to the payments architecture:

> One potential solution to the risk of debanking for a fintech is direct access to the payments architecture in Australia. Although this does come with considerable compliance and capital costs for access to the New Payments Platform [NPP].[144]

4.131 NPP Australia provided the committee with an update in its work enabling third party payment initiation, due to be delivered by mid-2022, which will be helpful for FinTechs but won't solve the issue of de-banking for payments companies:

> As communicated to the Committee previously, the biggest improvement we expect to see in relation to the needs of fintechs is enabling third-party

141 AFCA, *Submission 73*, pp. 1-2.

142 AFCA, *Submission 73*, p. 2.

143 AFCA, *Submission 73*, p. 2.

144 Fintech Australia, *Submission 62*, p. 27.

> payment initiation with the delivery of the NPP's PayTo service (formerly known as the 'Mandated Payments Service').
>
> This will allow non ADIs, whether they are directly connected to the NPP or indirectly connected via a sponsoring entity, to send instructions across the NPP for payments to be made from a customer's account, with the customer's authorisation. PayTo enables a more digital and enhanced customer experience, providing customers with more visibility and control over their payment arrangements.[145]

4.132 In October 2020 Mr Scott Farrell led a review into the Australian Payments System which reported in June 2021 and was released in August 2021. The review covers access to the NPP and other payments infrastructure and recommended a new tiered payments licensing framework for payments providers which, if implemented, would see broader access to the NPP for businesses who fit under this new licence category but are not full ADIs. The final report noted that while the recommendations won't solve de-banking:

> The proposed licencing regime should facilitate better direct access to key payment systems. Direct access would allow PSPs an ability to circumvent the need to rely on a bank to get access to payment systems. Moreover, setting out functional definitions of payment services should provide a basis with which AUSTRAC can provide guidance and certainty to PSPs [payment service providers] around the AML/CTF obligations. Finally, PSPs that holder a payments licence may provide further confidence to banks in their ability to meet minimum level of standards around information and security obligations.[146]

4.133 The review also found that there is 'considerable scope to provide transparency and clarity over the requirements for gaining direct access to payment systems'.[147] and recommended that the RBA develop 'common access requirements in consultation with the operators of payment systems'.[148] These common access requirements would form part of the payments licence.[149]

4.134 Currently Treasury is consulting on the recommendations of the review ahead of the government finalising a response.[150]

4.135 On 28 September 2021 it was reported that Wise received approval to become the first non-bank with direct access to the NPP which would allow it to clear and settle its own payments in real time:

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145 NPPA, Answer to written question on notice, received 3 August 2021, p. [1].

146 Australian Government, *Payments System Review: From system to ecosystem*, June 2021, p. 88.

147 Australian Government, *Payments System Review: From system to ecosystem*, June 2021, p. 68.

148 Australian Government, *Payments System Review: From system to ecosystem*, June 2021, p. 70.

149 Australian Government, *Payments System Review: From system to ecosystem*, June 2021, p. 69.

150 See: Treasury, 'Review of the Australian Payments System – Final report', https://treasury.gov.au/publication/p2021-198587 (accessed 28 September 2021).

> Wise says its mission is to make international payments instant and eventually free. It is already connected to real-time networks in Britain, Singapore and parts of the EU; once it goes live with the NPP next year, customers will be able to send funds to those countries for immediate withdrawal, just like sending an email.[151]

4.136 It was reported that NPP Australia Chief Executive Mr Adrian Lovney 'said the payments operator wanted to see broader licensing, to lift the number of direct connections by non-banks'.[152]

[151] Mr James Eyers, *AFR,* 28 September 2021, pp. 13, 19.

[152] Mr James Eyers, 'Wise to plug directly into real-time payments, cutting out banks' role', *AFR*, 28 September 2021, pp. 13, 19.

Chapter 5
Other matters

5.1 The committee took evidence during this phase of the inquiry on several other issues. This chapter covers evidence received in relation to: the policy environment for neobanks in Australia; and options to replace the Offshore Banking Unit (OBU).

Policy environment for neobanks

5.2 The committee was interested to explore whether recent changes in the neobank sector, including as the closure of Xinja and the acquisition of 86 400 by NAB, have resulted in any significant effects on competition or signalled the need for changes in the regulatory landscape.

Increasing competition

5.3 Revolut has announced its intention to apply for an Australian banking licence. It expressed the view that 'digital based neobanks have demonstrated the potential for increasing competition in the banking sector', citing that:

> digital banks have significantly improved the ability for customers to apply for new accounts which in turn drives competition via account switching.[1]

5.4 However, Revolut pointed out that there 'are still very high barriers to entry in the banking sector and equally high barriers in building sustainable and profitable banking businesses. The difficulties of entering the local market primarily consist of regulatory hurdles, capital requirements, achieving operational readiness, customer acquisition costs and the friction associated with account switching'.[2] While noting that 'high barriers should be expected in a sector tasked with protecting consumer's money', Revolut listed elements of the regulatory framework which are particularly burdensome which relate to:

- the current regulatory framework for payment services providers;
- direct integration with Australian payment rails;
- information asymmetry; and
- international recognition.[3]

5.5 Revolut also submitted that the licence process to full ADI status is lengthy 'which means that any applicant must have access to significant sources of

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1 Revolut, *Submission 44*, p. 9.

2 Revolut, *Submission 44*, p. 9.

3 Revolut, *Submission 44*, p. 10.

working capital to operation for this period of time'.[4] Revolut noted that these hurdles remain 'despite policy intervention that has improved or is improving barriers to entry'.[5]

5.6 The Australian Finance Industry Association (AFIA) submitted that in relation to neobanks:[6]

> Policy settings have limited opportunities for firms to obtain ADI status in Australia. There have been a small number of successful new entrants, such as 'small business' bank, Judo Bank. However, overall, the number and market penetration of digital banks is much lower than overseas, in particular the United Kingdom. In Australia, the four major banks make up around 80 per cent market share.[7]

5.7 Focusing on opportunities within the digital banking sector and ways to improve the regulatory environment, AFIA suggested:

- Leveraging the Australian Prudential Regulation Authority (APRA)'s upcoming evolution of its licencing framework to promote a pro-competition agenda.
- Providing more clarity and transparency in the ADI licensing process.
- Providing more clarity and enhancing the Consumer Data Right (CDR) framework and Open Banking regime.
- Addressing immediate and urgent skills shortages through targeted immigration initiatives.
- Ensuring a stable regulatory environment.[8]

5.8 Judo Bank, a specialist SME bank, acknowledged that much has been done in recent years to encourage greater competition but submitted that more can be done. It highlighted three issues in relation to the banking market that they believe are important from a public policy perspective:

- The importance of competition to drive choice, innovation and better customer outcomes. The banking market today lacks meaningful competition in key sectors.
- The need for a public policy environment that is pro-competition. The prevailing policy environment could do more to promote competition.
- A recognition that not all new entrants into a market will succeed, some will fail, but that should be seen as an opportunity to learn rather than an excuse to constrain new entrants.[9]

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4 Revolut, *Submission 44*, p. 10.

5 Revolut, *Submission 44*, p. 10.

6 AFIA suggested the use of a more inclusive generic term 'digital bank' for firms operating through a wholly digital business model that have, are in the process of, or are contemplating becoming an authorised deposit-taking institution (ADI). AFIA, *Submission 59*, p. 2.

7 AFIA, *Submission 59*, p. 2.

8 AFIA, *Submission 59*, p. 2.

9 Judo Bank, *Submission 64*, p. [3].

5.9 Judo Bank added that new entrants should be able to demonstrate the following 'must haves':

- Access to material levels of capital for the first five years of operation. At Judo, we said to our investors at the outset that we would need ~$1.5bn of equity capital over our first five years.
- A clear and sustainable comparative advantage that meets a market need, and that comparative advantage should be anchored by a strong sense of Purpose: and
- A strong management team that understands the businesses, the many risks that banking entails, with a demonstrable track record in running a bank.[10]

5.10 Mr Joseph, Healy, Chief Executive Officer, Judo Bank elaborated on these points at a hearing:

> In entering the banking market, we believe that there are three must-haves to be successful. You must have access to sufficient capital to sustain the business over a five-year horizon. It's not sufficient to come in and raise a small amount of capital and then come back looking for more capital. You've got to be quite clear on how much capital you need over the medium to long term. So we would be clear with our investors that we needed $1½ billion over the first five years of our business and that they should know that before investing. So that's the first must-have. The second must-have is: you must have a very clear comparative advantage. What is the problem that you're seeking to solve that the market can't solve itself already? So what is the nature of that comparative advantage? We said we felt that the SME economy was being badly served by the banks and it was an opportunity to build a business that addressed that market failure. The third must-have is experienced management, and I don't just mean one or two individuals but experience in depth—the understanding of how to build and how to run banks. I think, when you look at the failures not just here but in other markets around the world, there has been a weakness in at least one of those three must-haves. You can't sustain a business model in the banking sector without being strong in all three. The weakest link will bring you down.[11]

5.11 In relation to competition, Mr Healy offered his view:

> As I mentioned earlier, in the context of the banking and financial services sector, this economy needs a lot more competition. As I understand it, we do not have a regulatory framework that is pro-competition. We have a regulator, in the form of APRA, that is concerned with the stability of the banking system, which is understandable. We have a regulator, in the form of ASIC, that is concerned with the integrity of the way the markets operate. We have a regulator, in the form of the ACCC, that wants to prevent a reduction in competition. But that's different from being pro-competition. One of the weaknesses in our regulatory architecture today is that we lack a pro-competition policy framework.

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[10] Judo Bank, *Submission 64,* p. [3].

[11] *Proof Committee Hansard*, 8 September 2021, pp. 20-21.

> …I think it's important to think about the future of competition. When you get a large incumbent buying a small new startup—I personally do not believe it is in the best interests of the market for that to happen. I think it's in the best interests of the market that these new startups, these fintechs, are allowed to flourish. The reality is that access to capital will quite often force smaller players into the arms of bigger players. But I personally feel that that does nothing to promote competition in the future. So my strong bias would be to allow new entrants, new innovations, to flourish and not have them captured by the stifling bureaucracy that you will find inside large incumbents. I've been in banking for over 35 years here and overseas. I can't think of any example—but I'm sure there may be one or two—where a small, agile innovator that is suddenly acquired by a large incumbent goes on to prosper. What happens is that they get suffocated, stifled and, ultimately, killed by bureaucracy. Specifically, in the context of the financial services sector, I think there is a real opportunity to have a very pro-competition approach that stops smaller players, smaller startup innovators, from being subject to acquisition by large incumbents.[12]

Importance of capital

5.12 FinTech Australia supports the approval of new banks 'to increase competition and sustainability of the banking sector'. It also pointed out that in order for this to occur 'it is critical that neobanks are able to raise sufficient capital', suggesting:

> One solution may be to increase access to capital to neobanks. Currently, there is a lack of incentives for early-stage investors. As discussed…in respect of venture capital, greater tax incentives for early-stage investment are likely to promote access to capital for neobanks. In particular, current policy prohibits Venture Capital Limited Partnerships ("VCLPs") and ESVCLPs from investing in ADIs. Furthermore, ADIs are also excluded from a range of investor incentives that are made available to foreign investors (such as the SIV scheme). These measures create barriers to access capital which is essential for a bank to operate.[13]

5.13 FinTech Australia recommended promoting access to capital for neobanks by removing restrictions surrounding venture capital investment in ADIs.[14]

5.14 The importance of capital for success was also highlighted by Financial Inclusion by Design.[15]

ACCC view on competition

5.15 Noting recent changes in the neobank sector with Xinja ceasing its retail banking operations and 86 400 acquired by NAB, the ACCC did not see these departures 'as indicative of competition substantially lessening, nor detracting

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[12] *Proof Committee Hansard*, 8 September 2021, pp. 22-23.

[13] FinTech Australia, *Submission 62*, p. 29.

[14] FinTech Australia, *Submission 62*, p. 29.

[15] Financial Inclusion by Design, *Submission 3*, p. 4.

from other signs of increasing competition we are seeing in the banking sector'. For example:

> the exits do not appear to have deterred new entrants, with APRA Chair, Wayne Byres observing in March 2021 that APRA is considering licensing applications from upwards of a dozen ADIs. In addition, Judo (a bank focused on SME lending that was licenced around the same time as Xinja as 86 400) has built a loan book of over $2 billion and has reportedly raised over $500 million in equity to fund operations and growth.[16]

5.16 The ACCC added that it would 'continue to closely scrutinise any proposed acquisitions of emerging competitors or current challengers, particularly acquisitions by major banks'.[17]

5.17 APRA noted that 'there is a healthy pipeline for new applications and continued demand for an updated licensing framework to facilitate the entry of new competitors'.[18]

Regulation

5.18 Dr Dimitrios Salampasis pointed out that:

> Compared to other countries, neobanks in Australia operate under a complex regulatory framework. Major regulatory bodies include the Treasury, APRA, ASIC, ACCC, AUSTRAC, and RBA, dictating legislative vehicles, such as, the Banking Act, prudential standards, consumer data and privacy, registration, and disclosure obligations…[19]

5.19 FinTech Australia pointed out:

> the current regulatory landscape is confusing for new banking entrants. [APRA] has often created additional obligations, or changed obligations, in relation to the requirements for prospective ADIs to gain ADI status. As a result, members consider the process of obtaining an ADI to be too opaque.[20]

5.20 FinTech Australia recommended providing further clarity regarding the process to become an ADI.[21]

5.21 The Customer Owned Banking Association (COBA) is the industry association for Australia's customer owned banking institutions (mutual banks, credit unions and building societies). It pointed out that 'Neobanks and COBA

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16 ACCC, *Submission 9*, p. 3. See also APRA Chair Wayne Byres, *Speech to the 2021 AFR Banking Summit*, 30 March 2021.

17 ACCC, *Submission 9*, p. 3.

18 ACCC, *Submission 9*, p. 3.

19 Dr Dimitrios Salampasis, *Submission 11*, p. 11.

20 FinTech Australia, *Submission 62*, p. 29.

21 FinTech Australia, *Submission 62*, p. 29.

members face the same regulatory and operating environment'. COBA argued that the:

> increasing diversion of scarce resources away from customer service and innovation to meet new compliance obligations hits challenger banks hardest and gifts a competitive advantage to major banks. The ultimate losers from this entrenched trend are all banking customers who need a vibrant, dynamic and innovative retail banking market.[22]

5.22 COBA further explained:

> A decade ago, financial services regulation, while complex, did not have the same pace and volume of regulatory change. While banking was subject to increasing consumer and prudential regulation, since then a global financial crisis, various inquiries, a Royal Commission, exponential technological change and a global pandemic have created wave after wave of regulatory change.[23]

5.23 COBA submitted that the 'solution to addressing the regulatory compliance burden is ensuring there is better regulation and better regulatory policymaking'. It argued for 'consistent and rigorous application of Regulation Impact Statement (RIS) processes informed by principles such as COBA's [eight] Principles of Proportionate Regulation'.[24]

5.24 Wise, noted elements of the regulatory framework for neobanks which overlap with the service provided by Wise. It suggested that 'there is a need to expedite the changes to the PPF [Purchased Payment Facilities] Framework along the lines explored in the Council of Financial Regulators review' of the Regulation of Stored-value Facilities in Australia.[25] Wise continued:

> Specifically changes in the regulation of Stored Value Facilities and other payments products should be graduated and relate to the risk for consumers rather than be set at arbitrary levels.[26]

5.25 Wise welcomed the announcement by the Minister that a new framework will be developed by ASIC, APRA and Treasury and that there will be consultation with industry.[27]

5.26 AFIA argued that policy settings 'have limited opportunities for firms to obtain ADI status in Australia' and 'the number and market penetration of digital

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22 COBA, *Submission 47*, p. 8.

23 COBA, *Submission 47*, p. 9.

24 COBA, *Submission 47*, p. 11.

25 Wise, *Submission 18*, p. [3]. The CFR report is dated October 2019.

26 Wise, *Submission 18*, p. [3].

27 Wise, *Submission 18*, p. [3]. See also Senator the Hon Jane Hume, Assistant Minister for Superannuation, Financial Services and Financial Technology, 'Supporting competition and innovation in payments services', *Media release*, 6 November 2020.

banks is much lower than overseas, in particular the United Kingdom'. AFIA recommended:

> 1. Leveraging APRA's upcoming evolution of its licencing framework to promote a pro-competition agenda.
>
> 2. Providing more clarity and transparency in the ADI licensing process.
>
> 3. Providing more clarity and enhancing the Consumer Data Right (CDR) framework and Open Banking regime.
>
> 4. Addressing immediate and urgent skills shortages through targeted immigration initiatives.
>
> 5. Ensuring a stable regulatory environment.[28]

5.27 The Australian Banking Association (ABA) noted that in March 2021, 'APRA published an Information Paper outlining their revised approach for new entrants, providing guidance on a pathway to sustainability':

> APRA recognised that new Authorised deposit-taking institution (**ADIs**) have unique challenges and their risk profiles differ when compared to established ADIs. APRA's approach to new entrant ADIs seeks to strike an appropriate balance between supporting entities to enter and thrive in the banking sector, while ensuring financial system stability and protecting the interests of depositors.[29]

5.28 To encourage a variety of potential applicants, the ABA highlighted the two pathways available to become an ADI: the direct and restricted pathways. Elaborating on the restricted pathway:

> The restricted pathway facilitates entry into the banking sector for a wider variety of applicants. The restricted pathway is suitable for applicants that do not have the resources and capabilities to establish an ADI and need time to develop these. This pathway allows applicants to conduct limited banking business as a 'Restricted ADI' before meeting the requirements of the full prudential framework. APRA's approach is to assist applicants in seeking the investment required to operationalise their business, test their business model, progress their compliance with the prudential framework and ultimately their application for an ADI licence.
>
> The restricted ADI licence allows an entity time to develop resources and capabilities and to conduct limited, low risk or traditional banking business during its start-up phase. The ABA considers the APRA approach best-practice and the paths efficiently facilitate the entrance of new players into the market.[30]

5.29 The RBA noted that it has 'taken a number of actions that are supportive of access to the payments system for new entrants, including neobanks'. These include: imposing access regimes on the Visa and Mastercard credit card

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[28] AFIA, *Submission 59*, p. 2.

[29] ABA, *Submission 30*, p. 5.

[30] ABA, *Submission 30*, p. 5.

schemes, to give access to a wider range of entities in the early 2000s which was further expanded in 2014; supporting competition in banking and payment services through its policy on access to Exchange Settlement Accounts (ESA); and in 2018, following liberalisation of the use of the term 'bank' and the introduction of APRA's restricted ADI regime, the RBA 'removed a requirement for all banks to hold an ESA for use in a contingency, even if they used an agent to settle their transaction under normal circumstances' with this change 'intended to reduce the cost and regulatory complexity for neobanks and other smaller institutions that chose to become banks, providing them the option to apply for an ESA at their own discretion.'[31]

AML/CTF regulation

5.30 Home Affairs and AUSTRAC reported that the AML/CTF Act 'regulates a wide range of financial services…including services typically provided by neobanks, such as opening accounts and accepting or transferring money between accounts'. However, the AML/CTF Act 'only applies to 'designated services' that satisfy the geographical link test under subsection 6(6) of the Act, such as 'authorised deposit-taking institutions' (ADIs). It noted that:

> The geographical link test requires that for an entity that provides a designated service to be regulated under the AML/CTF Act it must be domiciled in Australia. This has posed challenges for the effective regulation of neobanks as they are often based offshore, and their digital nature means they do not require a physical office in Australia in order to provide their services here.[32]

5.31 Home Affairs and AUSTRAC advised that:

> To ensure neobanks are appropriately regulated, [APRA] can designate neobanks as ADIs under the Banking Act 1959. This brings these neobanks on-shore, satisfying the geographical link test, and ensuring that they are regulated as ADIs under the AML/CTF Act.
>
> Authorised deposit-taking institutions must:
>
> - enrol with AUSTRAC
> - adopt and maintain an AML/CTF program to identify, mitigate and manage the ML/TF risks they may face
> - collect information and verify the identities of their customers and undertake ongoing customer due diligence
> - report suspicious matters, transactions involving physical currency that exceed $10,000 or more and international funds transfer instructions to AUSTRAC, and

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31 RBA, *Submission 37*, p. 5.

32 Department of Home Affairs and AUSTRAC, *Submission 23*, p. 5.

- keep records relating to customer identification, transactions, and their AML/CTF program and its adoption.[33]

APRA's views

5.32 APRA provided the committee with information about its revised ADI licensing framework, following the introduction in 2018 of a restricted ADI licensing framework which provides an alternative pathway to a full licence for new banking entrants:

> Earlier in 2021, APRA commenced consultation on an updated approach to licensing and supervising new ADIs. The revised approach follows a review of APRA's ADI licensing regime which found there should be a greater focus on longer term sustainability, rather than the short-term ambition of receiving a licence. The review also took into account matters such as those raised in the Committee's third issues paper, namely, the closure of Xinja and the transfer of 86 400.[34]

5.33 APRA advised that under the revised approach:

- Restricted ADIs would be required to achieve a limited launch of both an income generating asset product and a deposit product before being granted an ADI licence;
- there is increased clarity around capital requirements at different stages for new entrants, aimed at reducing volatility in capital levels and facilitating a transition to the methodology for established ADIs over time; and
- new entrants would be expected to have more advanced planning for a potential exit, including an option to return deposits.[35]

5.34 APRA noted that it:

> expects these changes to enhance the chances of longer-term sustainability of new entrants in the banking sector. In doing so, this would increase their ability to assert competitive pressure on incumbents, both now and into the future.[36]

5.35 When asked about the updated guidance from APRA, Mr Joseph, Healy, Chief Executive Officer, Judo Bank was of the view that 'the new guidelines are appropriate'. He explained:

> It's important that businesses aspiring to become banks are capitalised properly, have a very clear business strategy and have competent people managing those businesses so that the chances of success are strengthened. The risk, and the issue which APRA is guarding against, is when there's weakness in any of the three things that I just mentioned—that new entrants are undercapitalised or don't have access to the capital they need

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33 Department of Home Affairs and AUSTRAC, *Submission 23*, pp. 5-6.

34 APRA, *Submission 26*, p. 2.

35 APRA, *Submission 26*, pp. 2-3.

36 APRA, *Submission 26*, p. 3.

> to grow, that they don't have a clear competitive advantage with products that are generally going to make them a profit and that they may not have the great strength in management expertise to launch, develop and grow a bank successfully.
>
> I feel that there's an element of learning from past experience, but that the general principle of increased competition is something that we have to see as a very important principle.[37]

Options to replace the Offshore Banking Unit

5.36 On 12 March 2021, the government announced it would consult with industry and introduce legislation into Parliament to reform the Offshore Banking Unit (OBU) with the current regime to be abolished from the end of the 2022-23 income year.[38]

5.37 On 17 March 2021, the government introduced the Treasury Laws Amendment (2021 Measures No 2) Bill 2021 which has the effect of removing the concessional tax treatment for offshore banking units.[39] The ABA indicated that it understands:

> the Government intends to consult with industry on alternative approaches to the now grandfathered offshore banking unit regime to support the industry and ensure activity remains in Australia.[40]

5.38 The Financial Services Council (FSC) noted that:

> The OBU regime is used by a number of local fund managers and life insurers to ensure that Australia is globally competitive in these industries. The OBU regime broadly permits an Australian funds manager to pay a lower rate of tax on activities that relate to offshore managed funds (and similarly for life insurers).[41]

5.39 Mr Robert, Colquhoun, Director, Policy, Australian Financial Markets Association (AFMA), provided context by speaking about the types of jobs created by an OBU:

> The variety of activities is quite broad, but one of the cohorts of OBUs that I want to bring to the committee's attention, particularly given the fintech focus of this committee, is that we have a number of members who are trading global markets from Australia and they are hiring hundreds of people who are very bright—the best of the breed in terms of talent. They are very sharp people who are trading markets in a way which results in them being quite profitable. They are highly paid, highly skilled people. Absent the pandemic, they would be looking to scale the globe for the best

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37 *Proof Committee Hansard*, 8 September 2021, p. 20.

38 The Hon Josh Frydenberg MP, Treasurer of the Commonwealth of Australia, 'Amending Australia's Offshore Banking Unit Regime', *Media release*, 12 March 2021.

39 ABA, *Submission 30*, p. 5.

40 ABA, *Submission 30*, p. 5.

41 FSC, *Submission 39*, p. 13.

> and brightest and bring them to Australia, and probably still are. From my perspective and AFMA's perspective these are mature fintechs…[42]

5.40 The FSC argued:

> The abolition of the OBU regime will exacerbate the tax-related issues being faced by the funds management industry from the adverse policy climate facing funds managers, particularly from the proposed tightening of the AMIT [Attribution Managed Investment Trusts] penalty regime and the proposed removal of the Capital Gains Tax (CGT) discount at fund level...[43]

5.41 The FSC suggested that:

> All of these changes put together will cause substantial cost and disruption to the industry for no clear benefit. As the Government is considering changes to other tax policies to offset the problems caused by an adverse change relating to OBUs, then we strongly suggest abandoning the proposed changes to AMIT penalties…and the CGT discount at fund level… This will ensure the Government is not placing additional burdens onto the industry, in addition to the burden occurring from the removal of the OBU regime.[44]

5.42 AFMA noted that the reform of the OBU is being undertaken in response to concerns raised by the OECD's Forum on Harmful Tax Practices. AFMA noted that this OECD forum articulates five key factors that will be relevant to the assessment as to whether a concessional taxation regime is viewed as a harmful tax practice:

- the regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities;
- the regime is ring-fenced from the domestic economy;
- the regime lacks transparency;
- there is no effective exchange of information with respect to the regime; and
- the regime fails to require substantial activities.[45]

5.43 AFMA stated that in relation to the OBU regime, the only two factors identified by the OECD that are of potential relevance are the first two; that is, that the regime imposes no or low effective tax rate on geographically mobile income and that the regime is ring-fenced from the domestic economy.[46]

5.44 AFMA expressed its view that:

> the framework through which the OECD assesses a concessional taxation regime as being a potentially harmful tax practice is flawed and the OBU

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42 *Proof Committee Hansard*, 8 September 2021, p. 9.

43 FSC, *Submission 39*, p. 14.

44 FSC, *Submission 39*, p. 14.

45 AFMA, *Submission 56*, p. 2.

46 AFMA, *Submission 56*, p. 2.

> regime does not distort the allocation of capital or investment to Australia but merely allows Australia to leverage its other non-tax benefits to compete with other regional jurisdictions'.[47]

5.45 Nevertheless, AFMA argued that when considering options to replace the OBU regime 'it is necessary to ensure that any options will withstand the scrutiny of the OECD to the extent that the OECD Forum on Harmful Tax Practices will remain operative…'. AFMA noted recent developments in the international tax landscape that would inform the new OBU regime and the work of the OECD Forum on Harmful Tax Practice. It pointed out that:

> On 1 July 2021, the OECD announced that 130 jurisdictions had signed up to the two-pillar solution to address tax challenges arising from the digitisation of the global economy. Of particular importance, Pillar Two of the solution seeks to ensure that companies with associate-inclusive turnover of EUR 750 million or more have a taxable income taxed at an effective tax rate of 15% or higher.[48]

5.46 The 'two pillar' agreement was finalised on 8 October 2021, with 136 countries and jurisdictions representing more than 90 per cent of global GDP signing up to the agreement which includes a minimum 15 per cent tax rate for multinational enterprises from 2023.[49]

5.47 AFMA pointed out that in addressing the concerns articulated by the OECD Forum on Harmful Tax Practices, AFMA's view is that 'any regime with a tax rate of 15% or higher could not be considered to meet the "low or no tax" criterion'.[50]

Proposals from submitters to replace the OBU

5.48 AFMA noted that it has formulated the 'Global Markets Incentive (GMI) Regime 'which will allow Australia's tax settings as they apply to financial centre business to be largely maintained while ameliorating any concerns of the OECD Forum identified through its review of the OBU regime'.[51]

5.49 AFMA told the committee that the proposed GMI regime would 'allow Australia's tax settings as they apply to financial centre business to be largely maintained while ameliorating any concerns of the OECD Forum identified through its review of the OBU regime'. It added:

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47 AFMA, *Submission 56*, p. 1.

48 AFMA, *Submission 56*, p. 2.

49 OECD, 'International community strikes a ground-breaking tax deal for the digital age', https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm (accessed 11 October 2021).

50 AFMA, *Submission 56*, p. 3.

51 AFMA, *Submission 56*, p. 4.

> The goal of the GMI is to ensure that Australian-based financial market participants are able to equitably compete in international markets. Current financial markets operate on an international basis and enable participants to access a range of services and products both in their local market and from foreign providers. The Australian tax system should not adversely impact an Australian-based entity's competitiveness in these markets.[52]

5.50 AFMA offered the following explanation of the principal features of the proposed GMI regime:

- A tax rate of 15% to apply to eligible GMI activities;
  - The nature of activities to be included in the GMI should also take into account whether the activity is one which Australia wishes to incentivise as part of its drive to be a technology and financial centre and how impactful the removal of the non-resident ring-fencing would be to existing domestic tax revenue.
  - Certain OBU trading activities are currently not ring-fenced in the OBU rules (or the ringfence has no practical effect as a result of non-tax reasons). The inclusion of these activities in the GMI should not result in significant tax revenue consequences.
- GMI activities to be determined with reference to the existing suite of eligible OB-activities;
  - The definition of an eligible counterparty can be defined to exclude individuals and/or small business entities under section 328 of the [Income Tax Assessment Act]. This will ensure that the GMI regime only applies to financial market participants of sufficient scale and does not inadvertently create new domestic low tax markets for non-AUD financial products and services, thereby mitigating material adverse Federal tax revenue impacts.
  - A restriction based on the nature of the counterparty (i.e. individual or small business) should not cause ring-fencing concerns as the restrictions would apply to both residents and non-residents.
- GMI activities able to be conducted with any eligible counterparty (both domestic and international), thereby removing the ring-fencing concern that was expressed in relation to the OBU regime;
- Given that the focus of the GMI regime is to allow Australia to compete in relation to transactions that would otherwise be conducted with international competitors, a prohibition against GMI activities being denominated in AUD.[53]

5.51 Providing an update at a hearing, Mr Colquhoun reported that Treasury has started the consultation process and they have engaged with AFMA. He added:

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[52] AFMA, *Submission 56*, p. 4.

[53] AFMA, *Submission 56*, p. 4.

> I think where we are now is a point of inflection where the work thus far has been to repeal the regime in a manner which both satisfies the OECD concerns, gets us off the grade list from the European Union perspective to avoid the concerns with the securitisation industry, and then grandfathers the regime with appropriate time to enable us to look at replacement rate…one the hardest aspects of the work engaging with the OECD regarding their review was to get clarity on what the low or no tax criterion was. Was 15 per cent acceptable? Was 20 per cent acceptable? Was anything below the headline tax rate going to be a problem? I think the step change is the announcement of the pillar 2 rate. I think that's something that we can build on.[54]

5.52 Mr Michael, Potter, Policy Director, Economics and Tax, FSC indicated that they had the same interaction with Treasury.[55]

5.53 Mr Colquhoun, AFMA, provided suggestions on how to move forward by providing some background and context:

> The OBU regime was designed back in 1986—that was its first generation—and it was revamped in 1992. The policy basis behind it was to allow Australia to intermediate transactions that otherwise wouldn't have a nexus with Australia. So you are dealing with offshore counterparties and predominantly offshore assets. I don't think that needs to change. We don't want to concessionally tax business that will be here by virtue of being domestic in nature. So I think the framework for the OBU in terms of primarily allowing Australian companies compete in global markets—hence the global markets initiative—is still the right one. We have an issue with ring fencing from the OECD perspective. We think we can deal with that by limiting it to institutional businesses and counterparties—no small business and no individuals—and we think we can make it work in terms of taking out AUD transactions as well, because they will have a general nexus to Australia. Our members say 15 per cent is sufficiently competitive to keep business here and to attract business from other jurisdictions.[56]

5.54 Mr Potter supported AFMA's position indicating:

> A rate of 15 per cent, while it is obviously higher than 10 per cent, would still be of substantial benefit. The proposal they have put forward, a GMI, sounds like a worthwhile one to explore. In that context, we are obviously disappointed that the OBU regime was removed but we understand the reasons for it being removed.[57]

5.55 The Australia Finance & Technology Centre Advisory Group (AFTCAG) provided information to the committee setting out 'options to reform the OBU that would maintain and enhance Australia's global position'. AFTCAG

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54 *Proof Committee Hansard*, 8 September 2021, p. 7.

55 *Proof Committee Hansard*, 8 September 2021, p. 7.

56 *Proof Committee Hansard*, 8 September 2021, p. 9.

57 *Proof Committee Hansard*, 8 September 2021, p. 9.

highlighted that the OBU concessional tax rate could be aligned with the OECD's Pillar 2 proposal, which is intended to be met on a blended company tax rate basis. It explained further:

> We note a blended Australian income tax rate for many taxpayers in the funds management sector would be a combination of a revised 15% OBU regime rate and their normal 25% tax rate for base rate entities (broadly companies with aggregated turnover less than $50 million) in respect of other income, to achieve a blended rate in excess of the Pillar 2 minimum rate of 15%.[58]

5.56 AFTCAG stated that on this basis, the reforms would then only need to address issues with "ring fencing". AFTCAG proposed two alternative options to address these issues:

- extending the OBU regime to similar Australian arrangements, with an Australian income cap equal to eligible foreign OB income (AFTCAG's preferred option); or
- extending the OBU regime to similar Australian arrangements, with an Australian income cap equal to the amount which eligible foreign OB income increases from the date of effect.[59]

Comparison with Singapore's Financial Sector Incentive

5.57 Following a request from the committee to the OECD on its views on replacement options for the OBU, including comparisons with Singapore's Financial Sector Incentive (FSI), OECD Secretary-General Mr Mathias Cormann responded to the committee:

> In case Australia were to implement a new regime with features similar to the FSI, it would need to ensure that all the FHTPs [Forum on Harmful Tax Practices] criteria are met, including the substantial activities requirements for taxpayers benefiting from the regime. This means that the core income-generating activities of such taxpayers should take place in Australia, with an adequate number of full-time qualified employees and adequate amount of operating expenditure. The regime itself and the ongoing compliance with the substantial activities requirements would then be reviewed by the FHTP.[60]

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[58] Correspondence from the Australia Finance & Technology Centre Advisory Group (received 8 October 2021), p. 1.

[59] Correspondence from the Australia Finance & Technology Centre Advisory Group (received 8 October 2021), p. 1.

[60] OECD Secretary-General Mr Mathias Cormann, correspondence dated 28 September 2021.

Chapter 6
Conclusions and Recommendations

6.1 This chapter outlines the committee's conclusions and recommendations on the issues examined during the committee's inquiry. Taken together, the committee's recommendations will address significant issues of concern and increase Australia's competitiveness as a technology and financial hub in our region.

Cryptocurrency and digital assets

6.2 With a global market totalling in the trillions of dollars, crypto-assets are a phenomenon that is rapidly moving from the periphery towards the centre of technology development and financial markets. The tremendous potential of blockchain technology and decentralised finance are becoming recognised in jurisdictions all over the world.

6.3 As noted in Chapter 2, survey data shows that 17 per cent of Australians currently own cryptocurrency, with a further 13 per cent of survey respondents stating they plan to buy cryptocurrency in the next 12 months. This makes Australia one of the world's most significant adopters of cryptocurrencies on a per capita basis. The Australian Taxation Office (ATO) has noted a 'dramatic increase' in trading of cryptocurrencies and other digital assets by Australians since the beginning of 2020.

6.4 Despite the significant number of Australians already investing in cryptocurrencies and other digital assets, and new jobs being created by innovative businesses in this industry, the digital assets sector is still poorly understood by regulators and governments in Australia. The committee has sought to help rectify this throughout this phase of its inquiry, by engaging extensively with businesses and peak bodies in the digital assets sector, as well as academics and regulators.

6.5 The potential economic opportunities are enormous if Australia is able to create a forward-leaning environment for new and emerging digital asset products. It is clear that Australia needs a robust policy and regulatory framework for digital assets, in order to protect consumers, promote investment in Australia and deliver enhanced market competition.

6.6 As with any new area of technological innovation, some of the early models and products in the digital assets space will not stand the test of time, while others will prove to be the foundation upon which new waves of innovation and opportunity are unleashed. Government's role is not to pick winners but to provide a steady framework within which innovation can thrive.

6.7 Governments and regulators the world over are grappling with the best way to bring digital assets within a suitable regulatory framework. While there is a need for regulation to ensure trust in the industry and protect consumers, the global nature of digital businesses means that overly burdensome requirements in a jurisdiction such as Australia will simply drive companies elsewhere.

6.8 As such, there must be a balance between bringing digital assets into the regulated world while preserving their dynamism. The committee is proposing a range of complementary reforms that seek to accomplish this goal and set Australia up for the future, bringing it into line with the leading jurisdictions in the world.

6.9 The committee's recommendations cover: market licensing for digital currency exchanges; custodial and depository services; token mapping; a new regulatory structure for Decentralised Autonomous Organisations; Anti-Money Laundering and Counter-Terrorism Financing guidelines; tax arrangements for digital assets; Central Bank Digital Currencies; and issues relating to the energy intensity of crypto-asset generation.

6.10 These recommendations represent an ambitious agenda. It is important that Australia takes concrete action to move our position forward.

Market licensing regime for Digital Currency Exchanges

6.11 The committee heard that Australian Digital Currency Exchanges (DCEs) are currently subject to limited regulatory oversight, despite some of these exchanges managing billions of dollars' worth of trades annually and holding hundreds of millions worth of client assets in custody.

6.12 While DCEs are required to register with AUSTRAC for the purposes of meeting anti-money laundering and counter-terrorism financing (AML/CTF) obligations, the committee also heard concerns that the current registration process with AUSTRAC appears in practice to be 'light touch' and imposes minimal obligations on DCEs. It was suggested that rather than registration there should be a licensing regime with appropriate obligations and requirements around the custody of digital assets.

6.13 The committee is of the view that a more thorough regulatory framework will assist the industry to mature. Indeed, many in the industry are calling for increased regulation so as to ensure that consumers can have increased confidence in their businesses and shoddy operators are weeded out. A licensing regime will demonstrate that comprehensive consumer protections are in place, and can also help to address bank concerns about risks posed by individual digital asset providers.

6.14 The existing Market Licence regime under the *Corporations Act 2001*, which is currently applied to a limited number of stock exchanges and other financial

markets, is not well suited to become directly applicable to DCEs. As such, the committee is recommending the creation of a new category of market licence that enables DCEs to demonstrate a high level of commitment to consumer protection and operational integrity, without imposing obligations that are so onerous as to drive local operators out of the market.

6.15 The key requirements of a new DCE Market Licence category should include, at a minimum, requirements relating to capital adequacy, auditing and responsible person tests. These requirements should be scalable with the size of the business, so that newer operators are still able to function in accordance with licence requirements as they scale up their operations.

Recommendation 1

6.16 The committee recommends that the Australian Government establish a market licensing regime for Digital Currency Exchanges, including capital adequacy, auditing and responsible person tests under the Treasury portfolio.

Custodial and depository services for digital assets

6.17 Submitters and witnesses to the inquiry emphasised the need for clear arrangements in relation to custodial and depository services for digital assets.

6.18 Currently some crypto-asset businesses such as DCEs perform custodial and depository functions on behalf of their customers, while some consumers effectively self-manage custody of their crypto-assets. Unlike for traditional financial assets, there are limited consumer protections in place for custody services provided for consumers holding crypto-assets.

6.19 Custody arrangements for digital assets present some unique risks that are not analogous to traditional assets (for example, there are particular vulnerabilities around the exposure of private keys for crypto-assets to loss or theft, depending on the storage solution utilised). Introducing a regulated framework for these arrangements will enhance consumer confidence and encourage investment.

6.20 Having a clear framework in place will also spur the development of a custodial industry for digital assets in Australia. There are significant economic opportunities in this space if Australia can become a leading jurisdiction. Australia already has a large custody sector for traditional financial and physical assets, with approximately AUD $4 trillion in value held by custodial service providers,[1] so it makes sense to leverage this advantage into the emerging world of custodial arrangements for digital assets.

[1] Australian Custodial Services Association, *Submission 76*, p. 1.

6.21 While custody arrangements for digital assets do pose some unique risks, many of the general risks and market constructs required are broadly similar to those for traditional assets. The committee has received detailed submissions on how a custodial framework for digital assets should work. These will assist the government in developing a bespoke custodial or depository regime for digital assets, which aligns with the general principles for custody of traditional assets while dealing with the unique features of digital assets. This reform should be implemented as soon as possible to help Australia become a global leader in this space.

Recommendation 2

6.22 The committee recommends that the Australian Government establish a custody or depository regime for digital assets with minimum standards under the Treasury portfolio.

Token mapping exercise to better characterise digital assets

6.23 Any rigorous regulatory framework in Australia needs to appropriately classify the various types of crypto-asset tokens and other digital assets being developed in the market.

6.24 Very few digital assets being traded and/or developed in Australia currently meet the legislative definitions for financial products and services under the Corporations Act that would bring them within ASIC's regulatory perimeter. ASIC has made it clear, however, that any crypto-assets which do meet these legislative criteria are subject to its regulation, meaning that issuers of these products can be required to meet Australian Financial Services Licence obligations.

6.25 The current uncertainty around when particular digital assets fall within ASIC's regulatory perimeter needs to be addressed to give investors and market participants the clarity they need to operate efficiently. While ASIC's current consultation process in relation to the development of exchange-traded products with crypto-assets as underlying assets is welcome, further work is needed in relation to other crypto-asset products.

6.26 Submitters and witnesses to the inquiry proposed a variety of definitions or classifications that could be inserted into the Corporations Act to bring relevant digital assets within the existing financial services regulatory regime. In the committee's view, the first step required is to conduct a government-led token mapping exercise to assist in developing an appropriate regulatory model.

6.27 It is worth noting that jurisdictions around world have taken a range of approaches to classifying digital assets for the purpose of developing appropriate regulatory frameworks. A token mapping exercise here should take account of the emerging approaches worldwide. It should lead to a clear

typology of digital assets for the purposes of financial regulation in Australia, that is flexible enough to account for changing technologies and is able to be refined as developments continue into the future.

Recommendation 3

6.28 The committee recommends that the Australian Government, through Treasury and with input from other relevant regulators and experts, conduct a token mapping exercise to determine the best way to characterise the various types of digital asset tokens in Australia.

Regulatory structure for Decentralised Autonomous Organisations

6.29 The committee heard evidence about the rapid uptake of Decentralised Finance (DeFi) applications in recent times, particularly in the last 18 months. DeFi protocols seek to replicate or supersede traditional financial services and products, by utilising a decentralised structure that removes the need for intermediaries and centralised control.

6.30 Many DeFi protocols and other blockchain projects are now being set up with a decentralised ownership structure, through a model known as a Decentralised Autonomous Organisation (DAO). These structures represent a new category of organisation that operates on decentralised blockchain infrastructure, whose operations are pre-determined in open source code and enforced through smart contracts.[2]

6.31 The fact of decentralised ownership, control and operation among network participants means that DAOs do not clearly fall within any of Australia's existing company structures. Legal liability for members (i.e. token holders) for these organisations is currently unclear, and this regulatory uncertainty is preventing the establishment of projects of significant scale in Australia.

6.32 Several submitters and witnesses have proposed that a new legal structure should be established in Australia to give DAOs separate legal identity, with DAO token holders given limited liability.

6.33 The committee is of the view that this innovation will drive economic activity in this space and be a magnet for Australian innovation for DAOs, driving local jobs and tax revenue. There are limited examples internationally of a legal DAO structure being implemented, with the US state of Wyoming a recent example of a jurisdiction that has legislated in this area. Already Wyoming's proactive stance has seen it attract significant business activity, with companies looking for regulatory certainty in this area. Australia should be at the forefront of this area.

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[2] See: *Submission 67*, p. 13.

6.34 The Coalition of Automated Legal Applications (COALA) has published a model law for DAOs, which is a useful starting point for developing a legal DAO structure in Australia. It is worth noting that there are other already existing company structures in Australia (for example, the no-liability mining company structure) that manage liability differently to standard company arrangements. Introducing a new DAO entity structure in the Corporations Act, regulated under the Treasury portfolio, would not be uncommon in Australia; for example, the Treasury has just finished a consultation process on draft legislation that would introduce a Collective Corporate Investment Vehicle structure in the Corporations Act.

6.35 The government should examine the COALA model and other international examples in developing a DAO company structure that suits Australia's specific corporate frameworks.

Recommendation 4

6.36 The committee recommends that the Australian Government establish a new Decentralised Autonomous Organisation company structure.

Anti-Money Laundering and Counter-Terrorism Financing guidelines

6.37 The committee heard that AUSTRAC has taken a proactive approach in engaging with the digital assets industry in development and implementation of AML/CTF measures for DCEs.

6.38 AUSTRAC is responsible for implementing guidelines released by the international Financial Action Task Force (FATF) on virtual asset service providers. In particular, the 'travel rule' has been the subject of much debate, with jurisdictions that have sought to strictly implement this rule to date encountering numerous implementation issues.

6.39 AUSTRAC's interpretation of the AML/CTF regulations and FATF guidelines need to strike a balance between appropriately managing risks, without implementing the travel rule in a way that undermines the operation of legitimate digital asset businesses. Industry participants have expressed well founded concerns that the implementation of the travel rule will place unnecessarily burdensome cost pressures on business, particularly if implementation is rushed. The committee considers that technological solutions to address the driver of the travel rule should be adopted at the earliest opportunity, rather than relying on a punitive approach.

6.40 Given the above, the committee's view is that Australia's AML/CTF regulations should be clarified to ensure they are fit for purpose for DCEs and any other relevant crypto-asset businesses. These regulations should not undermine innovation and should give consideration to the driver of the travel rule.

Recommendation 5

6.41 The committee recommends that the Anti-Money Laundering and Counter-Terrorism Financing regulations be clarified to ensure they are fit for purpose, do not undermine innovation and give consideration to the driver of the Financial Action Task Force 'travel rule'.

Taxation arrangements for digital assets

6.42 The committee heard that Australia's current taxation regulations and guidance relating to cryptocurrencies and other digital assets need updating in order to keep pace with the rapid evolution of technology. In particular, the rapid uptake and innovation in Decentralised Finance (DeFi) applications since 2019 was raised as an area for which there is significant uncertainty around the application of tax rules.

6.43 Australia's current tax regime for digital assets compares less favourably with other jurisdictions such as Singapore, which may be a significant factor in determining whether potential projects choose to domicile in Australia. In the words of one witness, our tax laws 'unavoidably complicate the establishment of Digital Asset Projects compared to competing jurisdictions like Singapore that have favourable income tax laws and do not have CGT or GST'.[3]

6.44 A number of stakeholders expressed concern about a lack of clear guidance from the ATO about the application of existing principles in the tax law to new and emerging technologies. While the ATO has provided general guidance around taxation points for crypto-crypto and crypto-fiat disposals, industry and legal submitters called for more specific and detailed guidance.

Capital Gains Tax treatment of digital assets

6.45 Particular concerns were raised about the Capital Gains Tax (CGT) treatment of digital assets when they are held as an investment.

6.46 Because many digital asset transactions take place several steps away from a crypto-to-fiat-currency trade, it can be very difficult for taxpayers to correctly assess their CGT liabilities under the current tax law and ATO guidance for these transactions.

6.47 The lack of clarity on these issues is compounded for newer DeFi digital assets, which can operate in ways that fall outside of the scope of what the CGT regime is generally equipped to deal with. The committee heard that one of the most considerable barriers to entry for DeFi products is the numerous taxable events that may arise when a crypto-asset token interacts with a DeFi protocol. Industry stakeholders argued that many of these interactions are features of the way the technology operates and do not result in material changes to asset

[3] Mr Scott Chamberlain, *Submission 24*, p. 4.

ownership; as such they should not constitute taxable events for CGT purposes.

6.48 The committee considers that the CGT rules need updating to enable digital asset transactions to be undertaken with confidence as to their tax implications. The rules need to be structured in a way that does not undermine new technology applications such as those seen in DeFi projects.

6.49 Some submitters to the inquiry argued that CGT taxation points should be removed altogether for crypto-to-crypto transactions; that is, CGT should only be applied at the 'on and off ramp' points where digital assets are traded for fiat currency or similar. While the committee agrees that this would simplify the CGT rules for digital assets considerably, this approach may risk leakage of tax revenue in cases where significant crypto-to-crypto transactions are occurring in ways that accrue a clearly definable capital benefit.

6.50 As such, the committee is recommending that the CGT rules be amended so that digital asset transactions only result in a taxable event for CGT purposes when they genuinely result in a clearly definable capital gain or loss. This may require the creation of a new CGT asset or event class that enables specific concessions or exemptions to be applied. Treasury and the ATO need to proactively work with industry to develop the relevant changes and provide clarity in this area, including by ensuring that ATO guidance is updated at least every six months to keep pace with new technology developments.

Recommendation 6

6.51 The committee recommends that the Capital Gains Tax (CGT) regime be amended so that digital asset transactions only create a CGT event when they genuinely result in a clearly definable capital gain or loss.

Other tax proposals

6.52 The committee received several other tax-related proposals from submitters, such as changes to the tax treatment of stablecoins and reviewing certain cryptocurrencies' status as their use becomes more closely aligned to that of a foreign currency. The committee considers that Treasury and the ATO should keep a watching brief on these issues to determine the need for future reform.

6.53 Several industry bodies recommended a root-and-branch review of Australia's tax laws to ensure that it is fit-for-purpose for the emerging digital asset economy.[4] While the committee is not inclined to recommend a wholesale review at this time, these views emphasise the importance of governments, policymakers and the ATO adopting a proactive approach in this area to ensure that Australia does not get left behind.

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4 Digital Law Association, *Submission 49*, p.14; Blockchain Australia, *Submission 72*, p. 50.

Energy intensity of cryptocurrency 'mining'

6.54 Some submitters raised concerns about the energy consumption associated with some digital asset protocols, in particular the energy intensity of Bitcoin mining.

6.55 It is important that where cryptocurrency mining and related activities are taking place in Australia, these activities should not undermine Australia's net zero emissions obligations. As such, the committee considers that companies engaging in these activities should be incentivised to source their own renewable energy, via a company tax discount.

Recommendation 7

6.56 The committee recommends that the Australian Government amend relevant legislation so that businesses undertaking digital asset 'mining' and related activities in Australia receive a company tax discount of 10 per cent if they source their own renewable energy for these activities.

Review of Central Bank Digital Currencies

6.57 Central Bank Digital Currencies are likely to be implemented in a growing number of jurisdictions in the coming years, at both the wholesale level and the retail level. It is important that Australia continues to actively investigate and pilot potential options for a CBDC so that the opportunity is not lost should this become a pressing concern in future.

6.58 The committee notes the work the Reserve Bank of Australia (RBA) is currently undertaking exploring options for a wholesale CBDC, building on the 2019 development of a limited proof-of-concept of a DLT-based interbank payment system using a tokenised form of CBDC backed by exchange settlement account balances held at the RBA.

6.59 The committee further notes the evidence of the RBA that while it has an open mind as to whether a case could be developed for a retail or general use CBDC, it does not currently see a public policy case for implementing a retail CBDC in Australia.

6.60 The committee considers that the viability of a retail CBDC should continue to be further investigated, through a review led by the Treasury. This will help ensure that Australia maximises any potential opportunities in this area. The committee notes that the recent Payments system review undertaken by Mr Scott Farrell recommended that Treasury's payments policy function should be enhanced, including in relation to implementing a strategic plan for the payments ecosystem.[5] Treasury leading a review of the viability of a retail CBDC would be consistent with this approach.

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[5] Mr Scott Farrell, *Payments system review: From system to ecosystem*, June 2021, Recommendation 11, p. xii.

Recommendation 8

6.61 The committee recommends that the Treasury lead a policy review of the viability of a retail Central Bank Digital Currency in Australia.

De-banking

6.62 Throughout the inquiry the committee has been concerned to hear about the de-banking of Fintech businesses, particularly those highlighted during this phase of the inquiry in remittance, payments and the digital assets sectors. De-banking affects not only the business itself; the committee was told of the effects on individuals and their families as well as customers.

6.63 The committee recognises the power banks have over their customers in this regard and the time and possible reputational effects of having to find an alternate services, if they can be found. The committee also understands that it is difficult for individuals and businesses to say on the public record that they have had challenges with financial institutions, as they fear creating even more challenges for themselves.

6.64 The committee is concerned that the lack of banking options for digital assets companies in particular is not only hampering innovation and investment in Australia but is potentially creating a single point of failure for the industry (with only a small number of ADIs willing to bank these businesses) and also leading to ineffective competition and a concentration of risk. De-banking may also push businesses and consumers to engage with less regulated or unregulated channels which are not subject to AML/CTF laws.

6.65 The committee recognises that de-banking is a complex problem occurring for a number of reasons. A key issue is underdeveloped regulatory arrangements, particularly in the digital asset space. Currently banks can point to the lack of a digital assets framework as a reason to de-bank a business.

6.66 Another issue contributing to de-banking is the risk of severe penalties associated with a breach of AML/CTF obligations. This leads to risk aversion where banking services are ceased or not entered into at all. For example, the committee heard instead that banks have taken policy decisions not to engage with crypto businesses even if they have been successfully operating for some time.

6.67 De-banking is a global issue. The committee notes that Australia is a member of the Financial Action Task Force (FATF) which sets international standards to prevent money laundering and terrorist financing. These standards require banks to take a risk based approach to enforcement and guidance has been issued. However, FATF emphasised that this approach should not result in the de-banking of entire sectors. There should be appropriate consideration of the risk and risk mitigation strategies of individual applicants.

6.68 Despite assurances from banks that engagement occurs with individual customers to conduct risk assessments, the personal stories provided to the committee disputed that there are appropriate risk assessments undertaken and/or that it occurs consistently.

6.69 The committee is not about forcing banks to take on businesses, but a clearer regulatory framework will provide banks confidence in dealing with crypto businesses.

Regulatory arrangements

6.70 Work by the Australian Competition and Consumer Commission (ACCC) in 2019, through its inquiry into the supply of foreign currency conversion services in Australia, recommended that the government establish a working group to consult on the development of a scheme through which the due diligence requirements of the banks can be addressed. The Council of Financial Regulators (CFR) has now established a cross-agency working group in June 2021 to further examine issues relating to de-banking and potential policy responses. However, there is no current timeframe on when this working group will finalise any policy recommendations.

6.71 The committee is of the view that this work should be progressed and concluded as soon as possible. This work would more easily allow the ACCC to examine whether the denial of banking or payment services raises concerns under the *Competition and Consumer Act 2010*. A due diligence scheme should be implemented no later than June 2022.

Recommendation 9

6.72 The committee recommends that the Australian Government, through the Council of Financial Regulators, enact the recommendation from the 2019 ACCC inquiry into the supply of foreign currency conversion services in Australia that a scheme to address the due diligence requirements of banks be put in place, and that this occur by June 2022.

Need for greater transparency

6.73 The committee is concerned that there appears to be a disturbing lack of transparency around decisions taken by banks to de-bank businesses, even taking into account an explanation provided by the ABA about the anti-tipping off provisions under the AML/CTF Act preventing them from providing details to potential customers.

6.74 The committee was also concerned by suggestions that banks may find it convenient to de-bank businesses which could provide competition. However, with the opacity around de-banking decisions, it is not possible to determine whether businesses are being de-banked for valid reasons. While acknowledging the anti-tipping off provisions, the committee is concerned

about the lack of detail provided to some customers which means they can take no corrective action and they have no recourse.

6.75 The committee is of the view that in order to provide increased certainty and transparency, a de-banking process involving the Australian Financial Complaints Authority should be developed and this should include an appeals mechanism.

Recommendation 10

6.76 The committee recommends that in order to increase certainty and transparency around de-banking, the Australian Government develop a clear process for businesses that have been de-banked. This should be anchored around the Australian Financial Complaints Authority which services licensed entities.

6.77 The committee also notes the recent review of the payments system undertaken by Mr Scott Farrell (Farrell Review), which included similar findings in relation to the issue of de-banking. The review includes recommendations which would facilitate better access to key payment systems such as the NPP, allowing payment service providers the ability to circumvent the need to rely on a bank for access to payments systems.

6.78 In particular, the Farrell Review recommended that the RBA should develop common access requirements for payments systems in consultation with the operators of payment systems, and that these common access requirements form part of a new payments licence to facilitate access for licensees to those systems.[6] The committee notes that consultation is underway on the recommendations of the Farrell Review in order to finalise a government response.

Recommendation 11

6.79 The committee recommends that, in accordance with the findings of Mr Scott Farrell's recent Payments system review, common access requirements for the New Payments Platform should be developed by the Reserve Bank of Australia, in order to reduce the reliance of payments businesses on the major banks for the provision of banking services.

Other issues raised during the inquiry

6.80 The committee also took evidence on several other issues during this phase of its inquiry, including the policy environment for neobanks, the impact of corporate law on new investment, and options for replacing the Offshore Banking Unit.

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[6] Mr Scott Farrell, *Payments system review: From system to ecosystem*, June 2021, Recommendation 11, p. 70.

Policy environment for neobanks

6.81 Given the recent changes in the neobank sector, including the closure of Xinja and the acquisition of 86 400, the committee wanted to discuss these developments to see if they may threaten increasing competition or signal the need for regulatory changes.

6.82 After speaking with the key regulators the committee was pleased to hear that the ACCC did not see these changes as indicative of competition substantially lessening and noted that they would continue to closely scrutinise any proposed acquisitions of emerging competitors or challengers. APRA told the committee about its updated approach to licensing and supervising new ADIs following the review of APRA's ADI licensing regime which found there should be a greater focus on longer term sustainability to increase the ability to assert competitive pressure on incumbents. The committee expects that this updated approach will lead to positive outcomes in the future for prospective banking licensees.

Options for replacing the Offshore Banking Unit

6.83 The committee's issues paper for this phase of the inquiry sought options to replace the Offshore Banking Unit (OBU) that would maintain and enhance Australia's global position. After considering the suggestions put forward by submitters and witnesses, the committee is supportive of the suggestion by the Australian Financial Markets Association to replace the OBU with a Global Markets Incentive.

Recommendation 12

6.84 The committee recommends that the Australian Government establish a Global Markets Incentive to replace the Offshore Banking Unit regime by the end of 2022.

Senator Andrew Bragg
Chair

Additional comments from Labor Senators

1.1 Labor Senators note the increasing uptake of digital assets by Australian investors and consumers, especially among younger Australians.

1.2 Representatives of the cryptocurrency industry presented arguments to this inquiry that this increased uptake necessitates greater regulatory intervention to drive further growth and establish Australia as a global leader in Financial Technology.

1.3 It is the view of Labor Senators that the increased uptake of digital assets requires regulation to ensure the best interests of everyday Australian investors and consumers are protected—first and foremost—and that currently, regulatory shortfalls are leaving Australians at risk.

1.4 Labor Senators were concerned to note the prevalence of scams based on crypto asset product offerings. ASIC noted in its submission that scams relating to crypto-assets are an increasing problem, having received a significantly higher number of crypto-related scam reports, compared to previous years.[1]

1.5 In relation to recommendations in the inquiry's report advocating for various changes in taxation arrangements, Labor Senators note that the Government must ensure that any new financial arrangements meet global and community expectations on tax fairness.

1.6 Labor Senators acknowledge the heartfelt stories provided through evidence to the inquiry on the human impact de-banking has caused to the lives of individuals concerned.

1.7 Labor Senators were concerned that the Committee's report did not identify any "technological solutions to address the driver of the travel rule", despite suggesting that these should be adopted in the first instance. Labor Senators note that as at July 2021, the Financial Action Task Force's advice is that "there has not yet been sufficient advancement in the global implementation of the travel rule or the development of associated technological solutions."

1.8 The Financial Action Task Force has recommended that "all jurisdictions need to implement the revised FATF Standards, including travel rule requirements". It is the view of Labor Senators that AUSTRAC should work with DCE's to ensure that Australia's AML/CTF controls do not create a permissive environment for terrorism financing and cybercrime and that this should include consideration of the implementation of a travel rule requirement.

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1 ASIC, *Submission 61*, p. 7.

Senator Marielle Smith
Deputy Chair

Senator Jess Walsh

Appendix 1
Submissions, answers to questions on notice and correspondence

1 *Name Withheld*
2 Interactive Games & Entertainment Association (IGEA)
3 Financial Inclusion By Design
4 Verida
5 Bitaroo
6 Australian Small Business and Family Enterprise Ombudsman
7 Holley Nethercote Lawyers
8 Dr Anton Didenko
9 Australian Competition & Consumer Commission
10 Holon Global Investments Limited
11 Dr Dimitrios Salampasis
12 CPA Australia
13 R3
14 La Trobe LawTech, La Trobe Law School
15 Ripple
16 Mr Andrew Noble
17 Independent Reserve Pty Ltd
18 Wise
19 Mycelium
20 Dr Max Parasol
21 Swyftx Pty Ltd
22 Elas Digital
23 Department of Home Affairs and AUSTRAC
- 23.1 Supplementary to submission 23

24 Mr Scott Chamberlain
25 Resilium Insurance Broking Pty Ltd
26 Australian Prudential Regulation Authority
27 Aus Merchant Pty Ltd
28 Dr Joseph Liu, Dr Weiping He and Ms Catherine Zhou
29 Carta
30 Australian Banking Association
31 Australian Investment Council
32 Square Peg
33 MHC Digital Finance
34 Kraken
35 ADC Forum

36 Dr John Hawkins
37 Reserve Bank of Australia
38 TCM Capital
39 Financial Services Council
40 Commonwealth Bank of Australia
41 KPMG
42 Australian Trade and Investment Commission (Austrade)
43 Finder
- 43.1 Supplementary to submission 43

44 Revolut Australia
45 The RegTech Association
46 NSW Government
47 Customer Owned Banking Association
48 IDAXA
49 Digital Law Association
- 49.1 Supplementary to submission 49

50 Business Council of Australia
51 Westpac
52 National Australia Bank
53 MYOB
54 Bitcoin Babe
55 Crypto.com
56 Australian Financial Markets Association
57 Mr Allan Flynn
58 Cointree
59 Australian Finance Industry Association (AFIA)
60 Herbert Smith Freehills
- 60.1 Supplementary to submission 60

61 Australian Securities and Investments Commission
62 FinTech Australia
63 Nium
64 Judo Bank
65 ASX
- 65.1 Supplementary to submission 65

66 Mr Adam Butler
67 Dr Darcy W.E. Allen, Associate Professor Chris Berg, Professor Sinclair Davidson, Dr Aaron M. Lane, Dr Trent MacDonald, Dr Elizabeth Morton and Distinguished Professor Jason Potts
68 Mawson Infrastructure Group
69 Distributed Storage Solutions
70 Mr MIchael Tilley
71 Blockchain Australia

- 71.1 Supplementary to submission 71

72 Piper Alderman
73 Australian Financial Complaints Authority
74 Mr John Xu
75 Caleb and Brown
76 Australian Custodial Services Association
77 Australian Taxation Office
78 Afterpay
79 Leslie Harvey
80 ANZ Bank
81 Tech Council
82 Australian Bitcoin Industry Body
83 Ms Razwina Raihman
84 *Confidential*
85 *Confidential*
86 *Confidential*
87 *Confidential*
88 BC Technology Group Limited

Answer to Question on Notice

1 New Payments Platform Australia – Answer to a written question on notice (received 3 August 2021)
2 Mawson Infrastructure Group - Answers to questions on notice from a public hearing held 6 August 2021, Canberra (received 13 August 2021)
3 Holon Global Investments - Answers to questions on notice from a public hearing held 6 August 2021, Canberra (received 19 August 2021)
4 Revolut Australia - Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 1 September 2021)
5 ADC Forum - Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 7 September 2021)
6 Finder - Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 10 September 2021)
7 Australian Banking Association - Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 10 September 2021)
8 Reserve Bank of Australia - Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 16 September 2021)
9 Mr Scott Chamberlain - Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 16 September 2021)

10 Australian Financial Complaints Authority - Answers to questions on notice from a public hearing held 8 September 2021, Canberra (received 24 September 2021)
11 Australian Competition and Consumer Commission - Answers to questions on notice from a public hearing held 8 September 2021, Canberra (received 24 September 2021)
12 Bitcoin Babe - Answers to questions on notice from a public hearing held 8 September 2021, Canberra (received 24 September 2021)
13 Aus Merchant - Answers to questions on notice from a public hearing held 8 September 2021, Canberra (received 24 September 2021)
14 ASX - Answers to questions on notice from a public hearing held 8 September 2021, Canberra (received 28 September 2021)
15 Australian Securities and Investments Commission - Answers to questions on notice from a public hearing held 27 August 2021, Canberra (received 30 September 2021)
16 Australian Taxation Office - Answers to questions on notice from a public hearing held 8 September 2021, Canberra (received 5 October 2021)
17 FinTech Australia - Answers to questions on notice from a public hearing held 8 September 2021, Canberra (received 1 October 2021)
18 Department of Home Affairs - Answer to a written question on notice (received 6 October 2021)
19 New Payments Platform Australia - Answer to a written question on notice (received 6 October 2021)
20 Australian Prudential Regulation Authority - Answer to a written question on notice (received 12 October 2021)
21 TCM Capital - Answer to question on notice from a public hearing held 6 August hearing, Canberra (received 28 August 2021)

Correspondence

1 Correspondence from OECD Secretary-General, Mr Mathias Cormann (received 30 September 2021)
2 Correspondence from the RBA on behalf of the Council of Financial Regulators (received 8 October 2021)
3 Correspondence from the Australia Finance & Technology Centre Advisory Group (received 8 October 2021)
4 Correspondence from Mr Brad Archer, Chief Executive Officer, Climate Change Authority (received 12 October 2021)

Appendix 2
Public hearings and witnesses

Friday, 6 August 2021
Main Committee Room
and via videoconference
Parliament House
Canberra

Blockchain Australia
- Mr Steve Vallas, Chief Executive Officer
- Mr Michael Bacina, Partner, Piper Alderman
- Ms Chloe White, Managing Director, Genesis Block

Independent Reserve Pty Ltd
- Mr Adrian Przelozny, Chief Executive Officer
- Mr Duncan Tebb, Head of Risk and Operations
- Ms Lasanka Perera, COO

Kraken
- Ms Sonia Mayenco, Compliance Officer and Head of Compliance APAC

Swyftx Pty Ltd
- Mr Alex Harper, Chief Executive Officer
- Mr Michael Harris

Digital Law Association
- Ms Joni Pirovich, Director

Herbert Smith Freehills
- Ms Natasha Blycha, Global Head of Digital Law
- Ms Susannah Wilkinson, Digital Law Lead, Australia
- Mr Ewan MacDonald, Special Council

Holley Nethercote Lawyers
- Mr Paul Derham, Managing Partner
- Ms Sarah Archer, Senior Associate

TCM Capital
- Mr Fred Pucci, Partner and Chief Risk & Compliance Officer
- Mr Jon Deane, Partner and Chief Executive Officer

Holon Global Investments Limited
- Mr Heath Behncke, Managing Director

Mawson Infrastructure Group

- Mr James Manning, Chief Executive Officer

Friday, 27 August 2021

Committee Room 2S1
and via videoconference
Parliament House
Canberra

Finder

- Mr Fred Schebesta, Co-founder and CEO
- Mr Ben King, Head of Public Affairs & CSR
- Mr James O'Donoghue, Ventures Product Leader
- Mr Michael Browne, Compliance Director

Revolut Australia

- Mr Matt Baxby, CEO
- Mr Scott Jamieson, Chief Compliance Officer

Bitaroo

- Mr Ethan Timor, Managing Director

Dr Joseph Liu, Dr Weiping He (Monash University)

Mr Scott Chamberlain, Private capacity

Academics affiliated with the RMIT Blockchain Innovation Hub

- Dr Aaron Lane, Research Fellow, RMIT Blockchain Innovation Hub
- Dr Darcy Allen
- Associate Professor Chris Berg

ADC Forum

- Mr Matt Faubel, Chair, ADC Program Committee
- Ms Loretta Joseph, Chair, ADC Cyber Security Council
- Dr Jane Thomason, ADC Special Advisor, Blockchain and Member, ADC Faculty
- Mr Greg Medcraft, ADC Special Advisor, Financial Services

Australian Banking Association

- Mr Aidan O'Shaughnessy, Executive Director, Policy

Reserve Bank of Australia

- Dr Tony Richards, Head, Payments Policy Department
- Mr Chris Thompson, Deputy Head, Payments Policy Department

Department of Home Affairs and AUSTRAC

- Mr Daniel Mossop, Assistant Secretary, Transnational Crime Policy Branch, Department of Home Affairs
- Ms Jane Annear, Assistant Secretary, Online Harms Policy Branch
- Mr Bradley Brown, National Manager, Education, Capability and Communication, AUSTRAC

Australian Securities and Investments Commission

- Ms Cathie Armour, ASIC Commissioner
- Mr Mark Adams, Senior Executive Leader, Strategic Intelligence
- Ms Hema Raman, Senior Lawyer, Markets

Department of the Treasury

- Ms Nghi Luu, Assistant Secretary, Market Group
- Mr Adam Bogiatzis, Director, Banking and Capital Markets Branch
- Mr Paul Fischer, Acting Assistant Secretary, Corporate and International Tax Division

Wednesday, 8 September 2021

Committee Room 2S1
and via videoconference
Parliament House
Canberra

FinTech Australia

- Ms Rebecca Schot-Guppy, CEO

Australian Financial Markets Association

- Mr Robert Colquhoun, Director, Policy, Financial Controller & Company Secretary

Financial Services Council

- Mr Blake Briggs, Deputy CEO
- Mr Michael Potter, Policy Director Economics and Tax

Aus Merchant Pty Ltd

- Mr Mitchell Travers, Managing Director

Bitcoin Babe

- Ms Michaela Juric

Nium

- Mr Michael Minassian, Regional Head of Consumer, APAC

Judo Bank

- Mr Joseph Healy, CEO

ASX

- Mr Kevin Lewis, Special Counsel, Regulatory Policy
- Mr Dan Chesterman, Group Executive, Technology & Data and Chief Information Officer

Afterpay

- Ms Lee Hatton, Executive Vice President, New Platforms
- Mr Daniel Kassabgi, Executive Vice President, Corporate Affairs

Australian Financial Complaints Authority

- Dr June Smith, Deputy Chief Ombudsman
- Ms Evelyn Halls, Lead Ombudsman Banking and Finance
- Ms Suanne Russell, Lead Ombudsman Small Business
- Mr Shail Singh, Senior Ombudsman Investments and Advice

Australian Competition & Consumer Commission

- Mr Marcus Bezzi, Executive General Manager Specialist Advice & Services
- Mr Paul Franklin, Executive General Manager Data Right
- Ms Leah Won, General Manager Competition Enforcement & Financial Services

Australian Taxation Office

- Ms Hoa Wood, Deputy Commissioner, Individuals and Intermediarie
- Mr Adam O'Grady, Assistant Commissioner, Risk and Strategy - Individuals
- Mr Matthew Hay, Deputy Commissioner, Strategy and Architecture