ASIC

Australian Securities & Investments Commission

Senate inquiry into digital currency

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A Executive summary

1 Digital currencies such as bitcoin have been developed as an alternative to traditional currencies that are legal tender in a particular place.

2 Digital currencies may be relevant to ASIC's role as Australia's financial services and financial markets regulator. ASIC's role as regulator and our responsibilities are detailed in Section B.

3 In general terms, there are two issues that arise for ASIC in relation to digital currencies:

(a) *digital currencies as financial products* - whether digital currencies, or facilities associated with these currencies, are financial products that are regulated under the *Corporations Act 2001* (Corporations Act) or the *Australian Securities and Investments Commission Act 2001* (ASIC Act).

(b) *criminal activity* - where digital currencies are being used to facilitate certain types of crime. In this area, ASIC's primary interest relates to financial crime under the legislation we administer, as well as assisting other agencies in their work on other types of crime.

ASIC's view on digital currency and the financial services regime

4 ASIC's view on how the laws we administer apply to digital currency is outlined in detail in Section C.

5 It is our view that digital currencies themselves do not fit within the current legal definitions of a 'financial product'. This means that a person does **not** need:

(a) an Australian market licence to operate a digital currency trading platform; and

(b) an Australian financial services (AFS) licence in order to:

(i) trade in digital currency;

(ii) hold a digital currency on behalf of another person;

(iii) provide advice in relation to digital currency; and

(iv) arrange for others to buy and sell digital currency.

6 Contracts for the sale and purchase of digital currencies are typically settled immediately and as a result are unlikely to be financial products (derivatives). However, if there is a delay between the entry of the agreement to sell and the delivery of the digital currency, the contract may be a derivative and the financial services and financial markets regimes would apply in the normal way.

7 ASIC has also considered how the law applies to facilities associated with digital currencies. It is our view that some facilities that are developed to enable the use of a digital currency to make payments may be a financial product that is regulated by ASIC (e.g. a bill payment facility utilising digital currencies may be a non cash payment facility), but this will depend on the way the facility works and its particular terms. Some other financial products that are associated with digital currency, such as contracts for difference over bitcoins, are also products that are regulated by ASIC.

8 ASIC has also provided policy advice to Government and the Financial System Inquiry in relation to bitcoins and other digital currencies. We have responded to requests for guidance from industry participants, as well as preparing more general information on the risks associated with digital currencies for consumers. This work is described in further detail in Section D.

Implications of regulatory change

9 ASIC notes that the law could be changed to accommodate digital currencies within existing regulatory regimes–for example by treating digital currencies in a similar way to national currencies or declaring digital currencies to be 'financial products'. Section E outlines our views on how the existing regulatory regime administered by ASIC would apply as a result of such changes, and difficulties that may arise in applying the existing requirements.

10 Treating digital currencies in a similar manner to national currencies may not result in a significant change to how digital currencies are regulated under the Corporations Act. Digital currencies will not become financial products under the Corporations Act only by virtue of being treated as 'currency'.

11 Treating digital currencies as currency may mean that some contracts for the purchase and sale of digital currencies (effectively contracts to exchange a digital currency for a national currency) could be financial products if the contracts are not settled immediately. As these contracts are typically settled immediately, it is likely that most digital currency transactions would not become regulated under financial services legislation.

12 Importantly, however, ASIC also notes that treating digital currencies as currency could be a more significant issue for other Australian regulators, and so broader consideration of the impact of such a change is appropriate.

13 Treating digital currencies as financial products may result in a large number of entities being regulated by ASIC and subject to obligations under the Corporations Act (though the number of affected persons is not currently known). However, this is likely to result in practical challenges as there are

key conceptual differences between digital currencies and facilities that are currently treated as financial products.

Other regulators and global considerations

14 There has been uncertainty about the treatment of digital currencies under existing regulatory regimes around the world. Much of this uncertainty results from the fact that digital currencies are a relatively new development and current legislation was typically not designed with digital currencies in mind.

15 ASIC understands that other domestic and international regulators are considering the regulation of digital currencies under the laws for which they are responsible. Section F provides information on other relevant Australian regulators and our liaison with them.

16 Section F also outlines some other international developments and decisions. In this respect ASIC notes that the Senate Economics References Committee's inquiry into digital currency is one of a number of Parliamentary inquiries considering the place of digital currencies within existing regulatory regimes and the broader payments system.

B Overview of ASIC's role and responsibilities

ASIC

17 ASIC regulates Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit.

18 The ASIC Act requires ASIC to:

(a) maintain, facilitate and improve the performance of the financial system and entities in it;

(b) promote confident and informed participation by investors and financial consumers in the financial system;

(c) administer the law effectively and with minimal procedural requirements;

(d) enforce and give effect to the law;

(e) receive, process and store, efficiently and quickly, information that is given to us; and

(f) make information about companies and other bodies available to the public as soon as practicable.

19 As the *financial services regulator*, we have responsibility for investor and consumer protection in financial services. We administer the AFS licensing regime and monitor financial services businesses to ensure that they operate efficiently, honestly and fairly. These businesses typically deal in superannuation, managed funds, deposit and payment products, shares and company securities, derivatives and insurance. We also administer consumer protection provisions as part of the Australian Consumer Law under the ASIC Act in relation to financial products and financial services.

20 As the *consumer credit regulator*, we license and regulate people and businesses engaging in consumer credit activities (including banks, credit unions, finance companies, and mortgage and finance brokers). We ensure that licensees meet the standards—including their responsibilities to consumers—that are set out in the *National Consumer Credit Protection Act 2009*.

21 As the *markets regulator*, we assess how effectively markets are complying with their legal obligations to operate fair, orderly and transparent financial markets. We also assess how effectively licensed clearing and settlement facilities are complying with their legal obligations to ensure their services are provided in a fair and effective way.

22 We also advise the Minister about authorising new markets and clearing and settlement facilities. On 1 August 2010, we assumed responsibility for the supervision of trading on Australia's domestic licensed equity, derivatives and futures markets.

23 As the *corporate regulator*, we ensure that companies, managed investment schemes and related entities meet their obligations under the Corporations Act. We register and regulate companies at every point from their incorporation through to their winding up, and ensure that company officers comply with their responsibilities. This 'cradle to grave' approach enhances regulatory oversight. We also register and, where necessary, take disciplinary action against company auditors and liquidators. We monitor public companies' financial reporting and disclosure and fundraising activities.

24 ASIC also has overall responsibility for *financial literacy* in Australia at a Commonwealth level. ASIC promotes financial literacy and consumer education in order to deliver on our objective to promote the confident and informed participation of consumers and investors in the financial system.

Financial services regulation

25 ASIC's role a regulator of the financial services industry is relevant to the digital currency industry.

26 The financial services regime for which we are responsible is contained in the Corporations Act and the ASIC Act. This regime is based on 'efficient markets theory' – the theory that markets drive efficiency and that markets operate most efficiently when there is a minimum of regulatory intervention.

27 The basic features of the current financial services regulatory regime were developed following these principles, and favour:

(a) efficient and flexible allocation of risk and resources, and a low cost of capital;

(b) promotion of competition, innovation and flexibility; and

(c) retail investors having access to a wide range of products.

28 Nevertheless, the underlying philosophy accepts that regulation is necessary to deal with factors that prevent the market operating efficiently (e.g. fraudulent conduct by industry participants, information asymmetries and anti-competitive conduct), as long as such regulation is set at the minimum level necessary to respond to market failures.

29 The financial services regulatory regime imposes conduct and disclosure rules. The regime's conduct regulation includes rules designed to ensure

industry participants behave with honesty, fairness, integrity and competence. The regime uses a licensing system to control who can operate within the industry, and, if they do not meet conduct standards, exclude them by licence cancellation or banning from providing financial services.

30 The regime's disclosure regulation includes rules designed to:

(a) overcome the information asymmetry between industry participants and investors by requiring disclosure of information required to facilitate informed decisions by investors; and

(b) promote transparency in financial markets, through, for example, continuous disclosure by companies of price-sensitive information.

31 The regime includes some additional investor protections to help address situations where investors are likely to be in a particular disadvantage relative to industry participants. An example of this is the system of internal and external dispute resolution, which provides a free accessible, fair and efficient process for retail investors and financial consumers. This system recognises that retail investors and financial consumers might otherwise find it difficult to resolve market disputes (e.g. through the courts) being non-expert and infrequent disputers with relatively few resources.

32 The financial services regime also includes the consumer protection provisions in the ASIC Act. These provisions apply in relation to financial services providers in lieu of the Australian Consumer Law administered by the ACCC. Among other things, the ASIC Act provisions state that financial service providers must not make false or misleading representations or engage in unconscionable conduct.

Financial products

33 The obligations under the Corporations Act financial services regulatory regime apply in relation to 'financial products'. In broad terms, financial products are facilities through which a person:

(a) makes a financial investment

(b) manages financial risk; or

(c) makes non-cash payments.

34 The legislation also provides that:

(a) certain things are financial products, even though they do not fall into any of the categories above; and

(b) certain things are not financial products, even though they do fall into one of the categories above.

35 The definition of financial product differs slightly between the Corporations Act and the ASIC Act. The definition of financial product in the

Corporations Act contains additional exclusions, such as for credit facilities and foreign exchange contracts that are settled immediately. As a result, a person may not be subject to the licensing, conduct and disclosure rules in the Corporations Act but may still have to comply with the ASIC Act general consumer protection obligations. These obligations are equivalent to the provisions administered by the ACCC in the *Competition and Consumer Act 2010*.

Financial services

36 The obligations under the financial services regulatory regime apply to persons who provide financial services in relation to financial products. The kinds of financial services are:

(a) 'dealing' in financial products by issuing, applying for, acquiring, varying or disposing of financial products (either as principal or on behalf of another person), or arranging for another person to deal in the financial product;

(b) providing financial product advice;

(c) making a market for a financial product;

(d) custodial or depository services; and

(e) operating a managed investment scheme.

Markets regulation

37 ASIC is responsible for regulating Australia's financial markets and one of its key priorities is to promote fair and efficient markets. ASIC regulates:

(a) listing and trading services;

Note: Listing services facilitate the public raising of capital by corporate entities through the offer of securities to investors. This activity traditionally takes place on licensed markets that are accessible, making listed securities available to retail investors as well as wholesale investors. Listing markets may also provide a venue for the admission of financial products issued by suitable third-party entities, such as warrants and exchange traded funds, which are also made available to retail and wholesale investors alike.

(b) clearing and settlement facilities (in conjunction with the RBA);

Note: Clearing and settlement facilities provide a regular mechanism for parties to transactions in financial products to meet obligations to each other arising out of transactions entered into on financial markets.

(c) derivative trade repositories;

Note: A derivative is a risk transfer agreement, the value of which is derived from the value of an underlying asset or index. A derivative trade repository is a facility to which

information about derivative transactions or positions relating to off-market derivative transactions can be reported.

(d) market participants;

(e) securities and derivatives dealers; and

(f) fund managers.

38 Australia's financial market infrastructure currently consists of:

(a) 18 licensed financial markets (including six overseas financial markets);

(b) eight licensed clearing and settlement facilities;

(c) 19 dark pools;

(d) 19 exempt professional financial markets; and

(e) one licensed and nine prescribed derivative trade repositories.

39 ASIC supervises market participants and securities dealers to ensure they comply with the Corporations Act and meet their obligations as AFS licensees (to the extent than a market participant holds an AFS licence) and under the market integrity rules (for market participants). In addition, ASIC supervises securities and derivatives markets for instances of conduct that might disrupt market integrity. This includes market manipulation, insider trading, breaches of the continuous disclosure obligations and abnormal algorithmic trading.

40 ASIC monitors the capital of trading-only participants. For market participants that are also clearing participants, ASX Clear sets and monitors their capital requirements under ASIC's supervision.

41 Market participants are also subject to:

(a) the operating rules of the markets of which they are a participant; and

(b) for participants of certain markets, the ASIC market integrity rules related to that market.

C Digital currencies and financial services

Key points

ASIC's view is that digital currencies do not fit within the legal definitions of 'financial product' in the Corporations Act or the ASIC Act. Industry holds the same view.

As a result, a person is not providing financial services when they operate a digital currency trading platform, provide advice on digital currencies or arrange for others to buy and sell digital currencies.

Some facilities involving digital currencies may be financial products.

42 There was initial uncertainty about how digital currencies fit within the existing financial services regulatory regime. As the regime was not designed with digital currencies or similar arrangements in mind, it can be difficult to determine how the existing legal rules and definitions should apply to new developments.

43 In particular, ASIC notes that there are conceptual differences between digital currencies and 'financial products' regulated under the Corporations Act and the ASIC Act. Many of the obligations under the legislation ASIC administers apply to the issuers of financial products, who are responsible for the obligations to product holders under the terms of the product. On the other hand, digital currencies do not have an identifiable 'issuer', as there is no centralised authority responsible for their creation or any obligations owed to digital currency holders.

Digital currencies

44 ASIC has considered how digital currencies fit within the existing financial services regulatory regime for which we are responsible. In particular, ASIC has considered whether digital currencies, such as bitcoin, are financial products.

ASIC's view

45 ASIC view is that digital currencies themselves do not fall within the current legal definition of a financial product. ASIC has communicated this view to industry participants.

46 As detailed at paragraph 33, in broad terms a financial product is a facility through which a person makes a financial investment, manages financial risk

or makes a non-cash payment. There is also a range of facilities that are specified to be financial products (whether or not they have one of those broad purposes). For example, foreign exchange contracts that are not settled immediately are a kind of facility that is expressly stated to be a financial product.

47 Digital currencies are not a facility through which a person makes a financial investment. ASIC notes that the definition of 'making a financial investment' does not include real property or bullion and we consider that it would similarly not include digital currencies.

48 Digital currencies are also not a facility through which a person manages financial risk. Facilities of this type, such as insurance contracts, allow the person who acquires the facility to manage the financial consequences of particular circumstances happening or the fluctuation of receipts or costs. Digital currencies do not have these features.

49 ASIC also considers that a digital currency is not a facility through which a person makes a non-cash payment. Digital currencies do not afford the holder any rights to make payments using the digital currency or to redeem it for cash. The ability of a person to use a unit of digital currency for making a payment depends on other arrangements under which another party agrees to accept payment in that form. Accordingly, ASIC considers that it is unlikely that a digital currency is a facility through which a person makes non-cash payments. It follows that digital currencies are themselves not financial products.

50 For similar reasons, ASIC also considers that digital currencies are not a currency or money for the purposes of the Corporations Act. Digital currencies such as bitcoins are more akin to a commodity. We note that this view is consistent with the views expressed by the Australian Taxation Office (ATO) that digital currencies are not a 'currency'. For this reason, we consider that contracts for the exchange of digital currency with a national currency are not foreign exchange contracts.

51 ASIC's view is that digital currencies are also not financial products under the ASIC Act. This means that the general consumer protection provisions of the *Competition and Consumer Act 2010* (administered by the ACCC) apply to digital currencies, rather than the equivalent provisions in the ASIC Act.

52 However, some digital currency businesses offer facilities which are related to digital currencies (such as non-cash payment facilities) which may be financial products. Contracts for the purchase and sale of digital currency that do not settle immediately may be derivatives (a kind of financial product). In cases of regulatory overlap, ASIC and the ACCC may refer powers to each other where it is prudent for matters within one regulator's jurisdiction to be dealt with by the other regulator.

53 We have advised industry participants that this is our view in response to inquiries about the regulatory obligations that apply to particular arrangements. We also note that this view is generally shared by legal firms who have represented digital currency businesses in their dealings with ASIC.

Facilities associated with digital currencies

54 ASIC has observed a wide range of digital currency businesses, many of which provide facilities associated with digital currencies. Some of these facilities for the use of digital currencies may be financial products, while others are not.

Facilities for buying and selling digital currencies

55 ASIC understands that when digital currencies are bought and sold, the exchange price is agreed and the digital currency is then transferred immediately. Contracts for the sale and purchase of digital currencies that are settled immediately are not financial products. As a result, the buying and selling of digital currency and operation of an exchange on which it can be bought and sold are generally not financial services or financial markets.

Digital currency ATMs

56 ATMs have been developed as a means of buying and selling bitcoins and other digital currency. Users insert cash or cards to exchange monetary value for the digital currency, and extract cash as the proceeds of sale. Purchased digital currency is immediately delivered to the user's virtual wallet.

57 The first bitcoin ATM in Australia was launched earlier this year. An ATM has also been released that supports the purchase of several different forms of digital currency (bitcoin, litecoin and dogecoin). Digital currency ATMs operate more widely in other jurisdictions.

58 Digital currency ATMs do not allow users to make a payment for goods or services using digital currency. Sales and purchases of digital currencies through ATMs are settled immediately. ASIC considers that:

(a) these ATMs are not a financial product; and

(b) buying and selling digital currencies through an ATM does not involve the provision of a financial service.

Escrow facilities supporting trading platforms

59 ASIC has also considered whether an escrow facility supporting the sale and purchase of bitcoins through a trading platform is a financial product, and

made a declaration that this facility is not a financial product for the purposes of the Corporations Act. ASIC's consideration of this particular facility is outlined in Section D.

Deferred settlement of a contract for purchase and sale of digital currency

60 As noted above, contracts for the sale or purchase of digital currencies that are settled immediately are not financial products and are not regulated by ASIC.

61 However, contracts for the sale or purchase of digital currencies could include a delay between agreeing the price and the delivery of the digital currency. These contracts would be derivatives – a kind of financial product.

62 If contracts for sale and purchase of digital currency were structured as derivatives, the financial services and financial markets regimes would apply in the usual way. In particular:

(a) a trading platform through which those contracts are entered may be a financial market; and

(b) market operators and/or contracting parties may be issuers of the derivative with obligations under the Corporations Act. The identity of the issuer and the obligations that apply to them would depend on the circumstances in which the contract is entered into.

Facilities for the transfer of digital currencies

63 Digital currencies can be received into, held in and sent from virtual wallets. Wallet software is available to be downloaded online, either as the software designed as part of the digital currency network or from other entities that have designed different wallet software. Whether any particular software will be a financial product will depend on its features.

64 For bitcoins, wallet software and applications for mobile devices are used to:

(a) generate a bitcoin address (which is required in order to receive a bitcoin);

(b) store details of addresses and matching private keys (which are needed to prove ownership); and

(c) transfer a bitcoin to another person's address by updating the ledger maintained on the bitcoin network.

65 ASIC understands that when a person uses wallet software to transfer digital currency to another person's address, the person initiating the transfer retains ultimate control. Once authorised, the transfer takes place without the assistance of intermediaries. Wallet software that merely facilitates the direct movement of digital currencies from the transferor to the recipient does not

involve the use of a non-cash payment facility. As a result, wallet software with the features outlined above would not be a financial product or involve the provision of a financial service.

66 Although most wallet providers appear to be based outside Australia, wallet software is widely available to persons in Australia. ASIC is also aware of Australian companies providing web-based wallet and mobile applications in addition to providing an exchange for buy/sell facilities.

Facilities that may be financial products

Digital currency offerings by regulated financial services providers

67 Some entities that are licensed to provide financial services in Australia have expanded their product offerings to incorporate use of digital currencies. These products are financial products and the obligations in the Corporations Act and ASIC Act apply to these products in the usual way. For example:

(a) derivatives (contracts for difference) are offered over digital currencies. These are contracts where the 'seller' will pay the 'buyer' the difference between the current value of a digital currency asset and its value when the payment is due. These contracts allow for speculation about digital currency price movements. Examples of this kind of financial product are contracts for difference over bitcoins offered by Plus500AU Pty Ltd, AVA Capital Markets Pty Ltd and IG Group.

(b) PayPal has announced that it will enable some merchants to receive payments in the form of bitcoins.[1] Such an arrangement may be a non-cash payment facility.

Facilities for paying for goods and services

68 ASIC is aware of facilities being offered to enable digital currency holders to pay for goods or services using the digital currency, regardless of whether the merchant offering the goods or services accepts payment in this form. These facilities involve the digital currency holder transferring the digital currency to an intermediary (the service provider), who then exchanges it for monetary value and completes the payment to the merchant. The intermediary may be providing a facility through which non-cash payments are made (a kind of financial product) and the facility provider may require an AFS licence.

69 Examples of this kind of facility include:

[1] PayPal has partnered with Bitcoin processors BitPay, Coinbase and GoCoin to merchants selling digital good to accept bitcoins as payment. Paypal users are not able to pay for other goods in bitcoins or store bitcoins in their Paypal wallet.

(a) the recently-announced Coinjar Swipe 'bitcoin to EFTPOS' card, which allows Coinjar customers to convert the value in their Coinjar bitcoin wallet to Australian dollars loaded onto an EFTPOS card.

(b) bitcoin-based bill payment facilities, such as the Living Room of Satoshi, which enabled users to send bitcoins and bill payment instructions to the facility provider, who then pays the bill in Australian dollars on their behalf.

70 There appears to be at least some limited availability of facilities allowing persons to pay for goods and services using digital currencies in Australia. None of the operators of these facilities currently have an AFS licence. Relief given by ASIC in relation to low value non-cash payment facilities (Class Order [CO 05/736]) may be available to persons who provide these facilities. The relief given by ASIC provides that persons do not need to hold an AFS licence to issue a low value non-cash payment facility[2] or comply with certain other obligations in relation to the facility.

Interaction between digital currency businesses and banks

71 We are aware of a number of banks taking steps to cease dealing with bitcoin related businesses due to concerns that digital currency providers pose an unacceptable level of risk to the banks' business and reputation.

72 ASIC does not have any power to intervene in decisions made by businesses in relation to digital currencies, and considers that this is a matter for the banks and businesses involved.

[2] A low value non-cash payment facility is one where:
a) the total amount available for making payments by any one person does not exceed $1,000;
b) the total amount available for making payments by all persons who hold a facility of that class does not exceed $10,000,000; and
c) the facility is not a component of another financial product.

D ASIC's work on digital currency issues

Key points

ASIC has provided guidance to industry and consumers on digital currencies and their place in the financial services regulatory regime. ASIC has also provided information to Treasury and the Financial System Inquiry.

ASIC has made a declaration that a particular escrow facility that supports a bitcoin trading platform is not a financial product.

ASIC considered that it would not be appropriate for the Corporations Act to apply to this facility as it is provided as a minor part of a broader, unregulated business.

Guidance and policy work

73 ASIC has received requests from industry for guidance on how the law applies to their particular digital currency arrangements. Where we have received such requests we have endeavoured to assist persons to understand their obligations. We have also met with relevant industry groups to discuss digital currencies and associated facilities.

74 ASIC has published information for consumers about digital currency and the risks involved in holding these currencies on our MoneySmart website. Our consumer guidance outlines that:

(a) exchanges for buying and selling digital currencies are not regulated;

(b) the value of digital currencies can fluctuate significantly;

(c) digital currency holders are unlikely to have any recourse if their currencies are stolen from their online wallet by hackers; and

(d) digital currencies may be used by criminals.

75 ASIC has received reports of misconduct relating to facilities that are associated with digital currencies. We have assessed these reports of misconduct consistent with our understanding of how the current law applies. Where we have had concerns that an entity may not be complying with its obligations, we have made further inquiries.

76 ASIC continues to review developments in the marketplace, including the failure of digital currency businesses. Examples of recent collapses include:

(a) MtGox, a Japanese bitcoin trading platform, which ceased trading in February 2014;

(b) Flexcoin, a Canadian bitcoin trading platform, which closed in March 2014 after having its bitcoins stolen; and

(c) Bitcoin Trader, a bitcoin arbitrage and mining company, which ceased operating in October 2014.

77 Where ASIC considers that an entity is not meeting its obligations under the laws we administer, we will consider regulatory action.

78 ASIC has also provided information to Treasury and the Financial System Inquiry on digital currencies and the issues they raise. We note that the Financial System Inquiry has proposed broadening regulation to include services involving alternative forms of medium of exchange to national currencies, such as digital currencies. In general we consider this to be consistent with our views on how the current regulatory structure may apply to facilities that enable the use of digital currencies for payment for goods and services.

Treatment of an escrow facility related to the trading of bitcoins

79 ASIC received an application for an AFS licence from an Australian business intending to operate a bitcoin trading platform. This business sought a licence in relation to the escrow facility that related to the trading of bitcoins (and not the trading platform itself).

80 Under the escrow facility:

(a) the buyer transfers the agreed purchase price into an account held by the platform operator, and the seller transfers the bitcoins to be purchased into a 'wallet' held by the platform operator;

(b) once the required balance of has been provided and the sale/purchase transaction is able to proceed, the platform operator transfers the purchase price to the seller and the bitcoins to the buyer to settle the transaction.

81 The buyer and seller may be exposed to the risk of loss of value of traditional currency or bitcoins in the event of the insolvency of the operator of the bitcoin trading platform.

82 ASIC took the view that the escrow facility may technically be a financial product (a non-cash payment facility). However, ASIC considered that this view was not without doubt.

83 ASIC made a declaration that the escrow facility was not a financial product. This declaration meant that the facility was not subject to the financial services regulatory regime and that the platform operator did not require an AFS licence.

84 ASIC made this decision because:

(a) the escrow facility is minor part of broader activities that are not regulated;

(b) the consumer risks in relation to the escrow facility (as opposed to risks in relation to the trading platform or any associated wallet software) resulting from the operator not being licensed are reasonably low; and

(c) there is a more significant risk that if the operator were granted an AFS licence consumers are likely to form a mistaken view that the entire range of activities undertaken by the platform operator are regulated by ASIC.

E Inclusion of digital currencies in the financial services regulatory regime

Key points

Treating digital currencies in the same manner as national currencies may result in exchange contracts being subject to consumer protection obligations in the ASIC Act. A broader extension of the financial services regulatory regime to digital currencies (to regulate them as financial products) may involve:

- trading platforms being required to hold an Australian market licence
- a wide range of businesses being required to hold an AFS licence and comply with obligations under the Corporations Act and the ASIC Act.
- application of product disclosure requirements in some circumstances.

The application of some of these requirements is likely to be difficult in practice.

The Financial System Inquiry has proposed broadening regulation to include services involving alternative forms of medium of exchange to national currencies, such as digital currencies.

85 As outlined in Section C, digital currencies such as bitcoins are not currently financial products.

86 Digital currencies could be treated in a similar manner to national currencies under financial services legislation. This may affect whether contracts for the purchase and sale of digital currencies would be considered to be financial products (i.e. as foreign exchange contracts). Potential implications of this approach are outlined below at paragraphs 89–96.

87 Digital currencies could be included in the regulatory regime as specific things that are declared to be financial products (under section 764A of the Corporations Act). Potential implications of including digital currencies in the financial services regime as a financial product are outlined below at paragraphs 97–112.

88 ASIC notes that there may be a range of difficulties associated with extending the existing regulatory regime to cover digital currencies in this manner. These issues would need to be considered in more detail in any proposals to apply this form of regulation to digital currencies or the sale and purchase of digital currencies.

Regulation of the sale and purchase of digital currency

Treating digital currencies as a 'currency'

89 If the provisions in the Corporations Act and ASIC Act that incorporate the concept of 'currency' were expanded to include digital currencies, some financial services laws would extend to cover contracts for the sale and purchase of digital currencies.

90 Contracts for the exchange of one currency for another (foreign exchange contracts) are treated as financial products for the purposes of the ASIC Act.

91 However, only foreign exchange contracts that are not settled immediately are financial products under the Corporations Act. This is because the definition of financial product in the ASIC Act is broader than in the Corporations Act.

92 Currency exchange contracts that are settled immediately are not financial products under the Corporations Act because they are specifically excluded from the definition of 'financial product'. The normal licensing and product disclosure requirements do not apply in relation to those contracts.

93 ASIC understands that contracts for exchanging national currency for digital currency through online platforms or ATMs are typically settled immediately. Accordingly, if digital currencies were treated as a 'currency', it is unlikely that persons who enter into contracts for the purchase or sale of digital currency, or provide services in relation to these contracts, would be regulated under the Corporations Act.

94 If a contract for the exchange of digital currency for a national currency was not settled immediately, it may be a financial product. Whether the parties to the contract would be subject to regulation under the Corporations Act would depend on whether they entered into the contract in the course of a business of issuing such contracts. For example, the operator of an exchange trading platform may be required to be licensed and provide a product disclosure statement, while a person who buys and sells digital currency to pay for goods and services may not.

95 As the ASIC Act applies to all foreign exchange contracts regardless of how they are settled, contracts for the sale or purchase of digital currency would be likely to be financial products under the ASIC Act. As a result, persons who provide services in relation to those contracts would be subject to the general consumer protection obligations in that legislation (see paragraph 32) rather than the equivalent provisions in the *Competition and Consumer Act 2010*.

Other regulators

96 We note that the application of legislation administered by other Australian regulators, in particular the ATO and AUSTRAC, also depends on what is considered to be currency or money. Accordingly, the impact of any change of this kind should be considered more broadly.

Treating digital currencies as financial products

Trading platforms as financial markets

97 If digital currencies were declared to be financial products, the trading platforms though which offers to buy and sell are matched would be financial markets. To operate in Australia, the platform operator may need to hold an Australian market licence unless covered by an exemption.

> Note: ASIC Regulatory Guide 172 *Australian market licences: Australian operators* provides guidance on circumstances in which a market is required to be operated under an Australian market licence.

98 Holders of Australian market licences are subject to a number of obligations, including, in general terms:

(a) ensuring that the market is a fair, orderly and transparent market;

(b) establishing operating rules and procedures for the market

(c) having adequate arrangements for operating the market, including handling conflicts of interest and enforcing the market's operating rules;

(d) having sufficient resources to operate the market; and

(e) establishing compensation arrangements.

99 The main responsibility for licensing financial markets operating in Australia lies with the Minister. ASIC plays an important but secondary role in financial market regulation.

100 If digital currencies were declared to be financial products, an example of an Australian digital currency business that could be required to obtain an Australian market licence is Independent Reserve.

101 Similarly, if digital currencies were declared to be financial products, it is possible that overseas digital currency trading platforms that are regularly used by Australian customers would need to obtain an Australian market licence. Although the legislation caters for streamlining of overseas entities where they are subject to adequate regulation in their home jurisdiction, we understand that this is unlikely to apply to digital currency trading platforms as these are largely unregulated.

102 The obligations associated with holding an Australian market licence would apply to the operator of a digital currency trading platform in the same way that they apply to existing Australian market licensees.

103 Operators of digital currency trading platforms that consider the compliance costs of obtaining and maintaining an Australian market licence to be burdensome could cease to offer services to Australian clients. Should digital currency trading platforms then only operate offshore, ASIC and operators of overseas digital currency trading platforms may not be in a position to accurately identify when services are being provided to persons in this jurisdiction.

Financial services licensing and conduct obligations

104 If digital currencies were declared to be financial products, a wide range of industry participants would be providing financial services to customers in Australia. These include:

(a) digital currency traders, including owners of digital currency ATMs, if they make a market for those products (i.e. by operating a platform where they will regularly buy or sell digital currency as a counterparty to the transaction), or arrange for other persons to acquire those products;

(b) persons who provide advice about whether to acquire, hold or sell digital currencies; and

(c) any other service providers who arrange for their customers to acquire or sell digital currencies or do so on their behalf.

105 A person who carries on a financial services business in Australia needs to hold an AFS licence. AFS licensees are subject to a range of obligations, including:

(a) providing financial services efficiently, honestly and fairly;

(b) having adequate resources to provide financial services;

(c) establishing internal dispute resolution processes and joining an ASIC-approved external dispute resolution scheme;

(d) supervision of their representatives, including ensuring that any representatives are adequately trained competent to provide financial services;

(e) establishing adequate compensation arrangements (typically professional indemnity insurance); and

(f) disclosure obligations where financial services are provided to retail clients.

106 ASIC notes that a significant number of overseas entities may need an AFS licence if they deal with buyers and sellers of digital currencies that are

located in Australia. It may not always be clear to these service providers whether or not the persons they are providing services to are located in Australia. It may also be difficult for digital currency businesses or ASIC to be certain that a particular person does not require an AFS licence because they do not provide services to Australian clients.

Product disclosure obligations

107 Product disclosure obligations apply where a financial product is offered for issue or sale to retail clients. In most situations, it is the person who issues the financial product who is required to prepare and provide disclosure documentation, such as Product Disclosure Statements (PDSs). In some circumstances a person who acquires a financial product for on-sale may be required to prepare and give a PDS if they offer the product to another person within 12 months.

108 Digital currencies in their current form do not have an identifiable 'issuer', as there is no centralised authority responsible for their creation or the obligations owed to digital currency holders. Rather, the creation and transfer of the digital currency is based on cryptographic protocol.

109 Using bitcoins as an example, the first person to whom the bitcoin is made available is the 'miner' – a person who has solved mathematical problems to identify a block of valid transactions and who is rewarded for this work with new bitcoins. As there is no issuer, miners would not receive disclosure documents.

110 Miners who acquire new units of bitcoin with the purpose of selling or transferring it, and who do so within one year of acquiring the bitcoin, may be required to prepare and provide a PDS to the person to whom they sell the bitcoin. In this case, the miners would be responsible at law for the content of the PDSs they distribute.

Note: See s1012C(6) and s1013A(2) of the Corporations Act.

111 ASIC considers that imposing this obligation on the initial holders of digital currency could be problematic. The disclosure obligations in the Corporations Act would also not apply to all persons who purchased digital currencies. In particular, only persons acquiring digital currencies from the original holder would receive a PDS.

112 Accordingly, if digital currencies were to be included in the financial services regulatory regime in this manner, it may be necessary to tailor the regime such that disclosure obligations applied consistently or not at all. Additionally, it may be more appropriate for any regulatory oversight to be focussed on trading platforms and facilities for making payments rather than mining activity.

Regulation of facilities for using digital currency as a form of payment

113 As described above, ASIC is of the view that some facilities of this kind are already covered by the financial services regime, but that this depends on the terms of the particular facility.

Financial System Inquiry

114 The Financial System Inquiry has proposed changes to the regulation of retail payment systems and retail payment service providers. It supports broadening regulation to include services involving alternative forms of medium of exchange to national currencies, such as digital currencies.

115 The proposals focus on regulation of payments systems that are widely used with sufficiently high transaction levels, and service providers that are responsible to end users for payments made through those systems.

116 It is not clear how arrangements for the transfer of digital currencies for the purpose of making payments for good or services would fit within these concepts. Generally it appears that regulation under the proposals would apply to the same kinds of entities that may be providers of non-cash payment facilities covered by existing requirements in the Corporations Act and ASIC Act, provided those facilities are sufficiently widely used.

117 Broadly the Financial System Inquiry supports application of base level consumer protection requirements to all retail payment service providers in the form of the ePayments Code (by making subscription to that Code mandatory as part of the financial services licensing requirements). It also supports prudential regulation of retail payment service providers that operate on a sufficiently large scale.

118 The ePayments Code provides a consumer protection regime, including:

(a) provision for disclosure of the terms and conditions of the payment facility;

(b) minimum expiry dates and disclosure of expiry dates;

(c) provision of receipts for transactions;

(d) disclosure of ATM fees;

(e) provision of statements of transactions;

(f) liability for unauthorised transactions; and

(g) complaints procedures.

119 Detailed consideration would need to be given to how these requirements would apply to a facility enabling the storage or use of value in the form of

digital currency.

F Other regulators

Key points

A number of Australian regulators are considering how digital currencies interact with their regulatory regimes.

ASIC has strong relationships with these regulators, including the RBA, ATO, AUSTRAC and the ACCC.

Overseas regulators are considering similar issues to their Australian counterparts.

120 ASIC understands that other Australian and international regulators have been considering how digital currencies such as bitcoins interact with the laws for which they are responsible. ASIC also understands that digital currency businesses have identified a range of issues with the application of these laws to their operations.

Domestic agencies

121 There has been some public comment by other domestic regulatory agencies on the treatment of digital currencies.

Reserve Bank of Australia

122 The RBA is Australia's central bank. Its duty is to contribute to the stability of the currency, full employment, and the economic prosperity and welfare of the Australian people. It does this by setting the cash rate to meet an agreed medium-term inflation target, working to maintain a strong financial system and efficient payments system, and issuing the nation's banknotes.

123 ASIC has a strong working relationship with the RBA, including through our joint membership of the Council of Financial Regulators (CFR). ASIC staff are involved in a number of joint working groups with the RBA and the other CFR agencies. We also hold regular meetings with the RBA and other CFR agency staff to share market intelligence, particularly in times of market volatility.

124 ASIC and RBA hold quarterly meetings to discuss other areas of mutual interest, as well as more frequent meetings when the need arises.

125 ASIC notes that the RBA has made submissions to the FSI noting development of digital currencies is an issue to be watched. The RBA

considers that risks to the Australian payments system posed by digital currencies are minimal as usage is very limited, but that this position will need to be reassessed if the digital currencies become more widely adopted.

Australian Taxation Office

126 The ATO is the principal revenue collection agency of the Australian Government. The ATO is responsible for administering Australia's taxation legislation as well as aspects of aspects of Australia's superannuation system.

127 ASIC has a close strategic relationship with the ATO. ASIC and the ATO signed a new memorandum of understanding on 24 December 2012, which sets out the high-level parameters by which the agencies work together on areas of common risk.

128 ASIC and the ATO have established information sharing guidelines to clarify how and when information should be shared. Information is released through one formal channel with a single point of contact at each agency. ASIC and ATO staff often attend regular and risk-specific working groups to discuss strategic matters and operational risks, and exchange ideas and information to mitigate those risks.

129 The ATO has issued draft rulings on the tax treatment of digital currencies in Australia. The ATO's view is that Bitcoin (and other similar digital currencies) is neither money nor a foreign currency, and the supply of bitcoin is not a financial supply for goods and services tax purposes. Bitcoin is, however, an asset for capital gains tax purposes. The ATO considers that transacting with bitcoins (and other similar digital currencies) is akin to a barter arrangement, with similar tax consequences.

Australian Transaction Reports and Analysis Centre

130 AUSTRAC is Australia's anti-money laundering regulator and specialist financial intelligence unit. It oversees compliance with the reporting requirements of the *Financial Transaction Reports Act 1988* and compliance with the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* by a wide range of financial services providers, the gambling industry and other entities.

131 The information that AUSTRAC obtains can be extremely useful to ASIC in administering the Corporations Act and identifying high-risk entities. ASIC has entered into a memorandum of understanding with AUSTRAC. This document sets out the basis for collaboration, cooperation and mutual assistance between the agencies.

132 ASIC and AUSTRAC have both nominated liaison staff responsible for managing the relationship and monitoring referrals of information between

the agencies. Regular meetings are held between the agencies to facilitate close cooperation and ensure that the liaison arrangements are working effectively.

133 ASIC understands that AUSTRAC is considering whether digital currencies are covered by its regulatory framework and issues associated with the definition of 'money' in the legislation for which it is responsible. These issues are expected to be addressed through the statutory review of AUSTRAC's legislation that is being conducted by the Attorney General's Department. The review is expected to be completed in mid-2015.

Australian Competition and Consumer Commission

134 ASIC and the ACCC share jurisdiction for Australia's consumer protection laws. We maintain a strong working relationship with the ACCC, and have signed a memorandum of understanding that provides a framework for the exchange of information and mutual assistance. We work with the ACCC, and other state-based consumer law regulators, to identify emerging issues and, where appropriate, coordinate our activities.

135 Because of our shared jurisdiction in relation to consumer protection, both agencies have, on occasion, referred powers to each other where it is prudent for matters notionally within one regulator's jurisdiction to be dealt with by the other regulator.

International developments

Canada

136 The Canadian Senate's Standing Committee on Banking Trade and Commerce has commenced a study on the use of digital currency to determine how it should be treated, including whether it should be regulated. At hearings before the Committee, Canada's largest virtual exchange (CAVirtEX) made submissions in support of regulation to 'transform exchanges into serious business, with proper check-and-balances in place to give consumers confidence in transacting with digital currency'. It was noted that bank cooperation is needed for the exchanges to continue to operate, and that such cooperation may require government regulation. The Committee has heard from a range of persons and agencies, including the Department of Finance, Bank of Canada, Canada Revenue Agency, Canadian Payments Association, academics, the Bitcoin Strategy Group, bitcoin exchanges, the makers of Bitcoin ATMs and companies involved in payment systems.

United States

137 In March 2013, the United States' Financial Crimes Enforcement Network issued interpretive guidance, defining the term 'virtual currency' and outlining regulations regarding the use of virtual currencies. As a consequence, virtual currencies are regulated by the U.S. Department of the Treasury. Transactions valued at more than $10,000 must be reported by companies involved in issuing or trading virtual currencies.

138 In August 2013, the U.S. Senate Committee on Homeland Security and Governmental Affairs launched a study into creating a regulatory framework for virtual currencies. Its first hearing focused on potential benefits and risks related to virtual currencies.

139 In March 2014, the IRS announced that digital currencies are to be treated as property rather than currency for tax purposes. This means that gains in digital currency value will be treated as capital gains and transactions made using digital currencies would be a taxable event, and subject to information reporting obligations.

United Kingdom

140 In March 2014, HM Revenue and Customs issued a policy paper on the tax treatment of income received from, and charges made in connection with, activities involving digital currencies.

141 In this paper, HM Revenue and Customs advises that:

(a) income received from Bitcoin mining activities will generally be outside the scope of the United Kingdom's consumption tax (the VAT);

(b) income received by miners for other activities, such as for the provision of services in connection with the verification of specific transactions for which specific charges are made, will be exempt from VAT as falling within the definition of 'transactions, including negotiation, concerning deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments';

(c) when Bitcoin is exchanged for traditional currencies, no VAT will be due on the value of the Bitcoins themselves; and

(d) charges (in whatever form) made over and above the value of the Bitcoin for arranging or carrying out any transactions in Bitcoin will be exempt from VAT.

142 However, the VAT is payable in the normal way by persons who supply goods or services in exchange for digital currencies.

European Union

143 In December 2013, the European Banking Authority issued a warning about risks of buying, holding or trading virtual currencies.

144 In December 2013, in response to a request for a written response to be provided to the European Parliament, the European Commission advised that:

> 1. The Commission is actively following the developments with regard to virtual currencies, working closely with the ECB and the EBA. At this stage no option is excluded, including regulatory intervention. The Commission will continue to monitor this matter closely.
>
> 2. In general, bitcoin is understood as a universal, completely decentralised payment system and an open source, peer-to-peer digital currency that is issued not by a central authority, but by its developers, and is used and accepted only among members of a specific community. Thus, it cannot be easily identified as and treated for regulatory purposes like a traditional currency, a payment system or a commodity. Although some national Central Banks, like e.g. the Bank of Finland, have taken a position on this matter, it would appear that this debate is still in an early phase. Therefore, a final position on this important matter has not yet been taken at EU level.
>
> 4. The use of virtual currencies may present opportunities for crime (e.g. money laundering) and risks for consumers. The Commission shares the opinion of the EBA that it is important as a first step, to increase users' awareness about the risks of security breaches and the lack of protection (e.g. deposit guarantee scheme or refund right) when using virtual currencies as means of payment.
>
> 5. The developments with regard to virtual currencies from the perspective of the stability of prices, of the financial system and of the payment system are closely monitored by the ECB. Last year a report was issued concluding that in the current situation virtual currency schemes do not appear to pose a risk to price or financial stability, but that the ECB will continue to monitor the phenomenon.

145 In February 2014, a motion was made to the European Parliament for a resolution on bitcoin that calls on the Commission to keep a close eye on Bitcoin and its spread, and Calls on the Commission to look into the positive and negative implications of the spread of Bitcoin and the market distortions to which it could give rise.

146 The EU Court of Justice is hearing a matter to decide if transactions between virtual and traditional currencies can be classed as a service under EU value-added tax rules. Sweden's tax authorities are challenging an earlier Swedish court ruling that found VAT should not be charged on bitcoin trades

Germany

147 In August 2013, the German Finance ministry announced that bitcoins are a 'Rechnungseinheiten', which means private money that is not fully recognized as traditional currency but is subject to German tax laws. As a result, bitcoins may be subject to value-added taxation.

China

148 In December 2013, the People's Bank of China released a statement indicating that Chinese financial institutions and payment systems are prevented from accepting bitcoins.

Financial Action Task Force

149 The Financial Action Task Force (FATF) has published a paper on virtual currencies and key money laundering and terrorism financing risks. FATF is an independent intergovernmental body that develops and promotes policies to protect the global financial system against money laundering and terrorism financing.