FinTech Australia

Senate Standing Committees on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

Re: Digital Assets (Market Regulation) Bill 2023

Thank you for the opportunity to provide feedback to the Senate inquiry into the Digital Assets (Market Regulation) Bill 2023 (the "**Bill**").

About FinTech Australia

FinTech Australia is the peak industry body for the Australian fintech sector, representing over 420 fintech companies and startups across Australia. Our membership includes businesses involved in providing crypto asset and blockchain products and services, including major digital currency exchanges ("**DCEs**").

FinTech Australia and its members welcome Senator Bragg's continued consideration of the need for regulatory certainty in the fintech market. The complexity of the current regulatory framework was highlighted in the recommendations of the Senate Select Committee on Australia as a Technology and Financial Centre's 2021 Report.

We acknowledge the efforts to address the concerns of industry stakeholders about the regulation of digital assets with the Bill and the consultative approach taken in its development. The pace of innovation of the fintech industry imposes a difficult balancing act for lawmakers to ensure that regulation provides certainty, while anticipating future developments.

It is vital that any changes to our regulatory regimes carefully consider their impacts on both the digital assets industry and broader financial services industries in Australia and internationally. The digital assets sector should be subject to fair and consistent regulation which provides consumers with appropriate protections.

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Current regulatory landscape and timelines

Over recent years, digital assets and the activities associated with their use have evolved into a complex and rapidly evolving ecosystem. It has spurred innovation in the fintech sector and created new business models, each generating new opportunities and risks.

Concurrently, a range of Australian laws[1] may apply to crypto assets participants such as issuers of crypto-assets (including token), crypto asset intermediaries, miners and transaction processors, crypto-asset exchange and trading platform, crypto-asset investments products, crypto-asset payment and merchant service providers, wallet providers and custody service providers. Cryptocurrency exchanges must also register with AUSTRAC.[2]

Noting this, crypto assets, and consideration of how to regulate these assets should not exist in a vacuum. This sector may touch on a wide ambit of Australia's laws including financial services and markets legislation – e.g. laws in Chapter 7 of the Corporations Act, consumer protections as set out in the ASIC Act and the Australian Consumer Law, Australia's AML/CTF Act and applicable sanctions regimes, and various tax laws.

In the past some of these existing laws have been amended to address specific, limited concerns relating to certain types of crypto assets. It is clear a broader regulatory approach is now required, and this Bill appears designed to address some of the more specific issues this industry faces. However, our members are concerned the Bill may not fully account for the broader context of crypto assets within Australia's current legal frameworks.

In March 2023, the Australian Government conducted a comprehensive "token mapping" exercise to start considering how crypto assets and related services should be regulated. FinTech Australia considers this was a good first step in a financial services regulatory landscape where many legislative definitions do not adequately capture the scope of products on offer. Fintech Australia anticipates that the outcomes of the token mapping exercise and the Government's forthcoming targeted consultation it will inform, on more specific licensing and custody obligations, will have valuable insights which may enhance the outcomes targeted by this Bill.

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[1] *Corporations Act 200*1 (Cth) ;Australian Securities and Investment Commission Act 2001 (Cth); *National Credit Consumer Protection Act* 2009 (Cth), *Electronic Transactions Act 1999* (Cth); *Anti-Money Laudering and Counter-Terroism Financing Act 2006* (Cth); Competition and Consumer Act 2010.

[2] AUSTRAC, Digital Currency Exchange Providers | AUSTRAC (2021) Austrac.gov.au <https://www.austrac.gov.au/business/industry-specific-guidance/digital-currency-exchange-providers>.

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Care must be taken to ensure that any changes provide clarity as to the relevant laws which apply. To this end, it may be necessary to consider the extent to which the definition of "regulated digital asset" encompasses assets which are financial products, and accordingly, whether these assets would be subject to this Bill at all. Similarly, it may be relevant to consider the proposed reform of Australia's payments system regulation, as this may encompass "stablecoins" as has been identified by the CFR.

Broadly, we encourage further improvements to the Bill's integration with existing regulatory frameworks and forthcoming Government consultation processes. Additionally, Fintech Australia queries whether the Bill should also apply to decentralised platforms or offerings, and the provision of financial advice in relation to crypto assets.

Internationally, the regulation of crypto assets is seeing a trend where any new regimes regulate crypto assets only to the extent that existing regimes do not apply. The EU's Markets in Crypto-Assets regulation ("**MiCA**") is a key example of regulation that uses this approach. MiCA aims to regulate crypto assets not already defined as a financial instrument by the EU's 2nd Markets in Financial Instruments Directive. As raised in our previous submission to a draft of this Bill and our submission to the recent "token mapping" exercise, FinTech Australia recommends a similar approach in Australia and appreciates steps to achieve this in the revised Bill. A new regime should regulate crypto assets only to the extent that they are not regulated under an existing financial services regime.

Application and definitions

The Bill proposes a series of factors which require a person to obtain a licence with authorisations for operating a digital asset exchange, or providing custody or stablecoin issuance services.

Fintech Australia welcomes the following improvements to the previous draft of this Bill, consulted on in late 2022, and the implementation of some of the recommendations we made in our submission:

- Improving the definitions of *"Digital Asset", "Asset-referenced token (ARTs)", "Regulated Digital Assets"* to draw on European Union's Markets in Cryptoassets (MiCA) Regulations[3] definitions;
- A person may now apply for a digital asset exchange under s 22 of the Bill. The broader application is consistent from other legislation, which generally refers to a broader definition of "person" encompassing individuals, partnerships, unincorporated associations, and trusts;
- Part 3 of the Bill now provides that authorised deposit-taking institutions (ADI) must comply with certain reporting requirements set out in the rules relating to designated CDBC not limited to certain Bank and digital Yuan;
- The Bill now requires a person to hold a licence granted by ASIC or recognised foreign licence to provide a digital asset custody service or issue stablecoins in Australia, not limited to digital asset exchanges;
- The 'fairly, orderly and transparently' obligation is now restricted to the exchange authorisation; and
- Streamlining the proposed licensing framework, using authorisations rather than individual and potentially duplicative licences, to more closely reflect the existing AFSL financial services and credit licensing regimes.

While we appreciate the enhancements made to the previous draft of the Bill, our members identified the following areas of ambiguity in the Bill's definitions.

"Electronic Money Token", "Exchange Token Definition", "Exchange", and "Regulated Digital Assets"

Our members raised concerns about the distinction between the definitions of "*Electronic Money Token*" and "*Exchange token*"[4]. By way of example, electronic money tokens may encompass tokens such as USDC and Tether, however the scope of exchange token is unclear. Additionally, concerns were raised regarding the concept of defining a token based solely on its primary function as a medium of exchange, without defining what constitutes an exchange purpose or when it qualifies as the predominant purpose. Other legislation, such as those pertaining to financial services and consumer credit,

[3] European Parliament, EUR-Lex - 52020PC0593 - EN - EUR-Lex (2019) Europa.eu <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020PC0593>.
[4] Digital Asset (Market Regulation) Bill 2023 (Cth) cl 5.

incorporate specific criteria to determine purposes and their predominance (e.g. 'personal, domestic, or household' for consumer credit).

Further, we note:

- the term "exchange" throughout the Bill is not specifically defined;
- many "regulated digital assets" may fall within the carve out for products which are financial products under the Corporations Act – limiting the scope of the Bill and creating duplication;
- the language in the definition of "digital asset" being "a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology" is not technology neutral. This may also encompass assets such as digital artworks and NFTs; and
- the Bill is silent on whether "governance tokens" are covered.

Stablecoins

The Bill defines stablecoins as *"a regulated digital asset of either of the following kinds: (a) an asset-referenced token; (b) an electronic money token"* which suggests the definition will capture both commodity-backed tokens and fiat-backed tokens.

We note the definition of "*stablecoin*" could encompass tokens that may not typically be classified as stablecoins, such as asset-backed tokens. Examples of such tokens could include Gold and Silver Standard and the BetaCarbon Token. Consequently, these asset-backed tokens would fall within the purview of the stablecoin issuance licensing framework.

In response to the token mapping consultation, there was a prevailing sentiment among our members that asset-backed tokens should be subject to regulation where it is a financial product. However, where they are not, regulation should be technology neutral. For instance, the ownership and storage of gold is not subject to specific regulation and, therefore, the question arises as to whether tokenising it should warrant additional regulation unless it becomes subject to financial services regulation by, for example, being a managed investment scheme.

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Licence requirements and rules

We make a general comment that the Bill relies heavily on Rules for many definitions and substantive requirements and obligations. This approach makes it difficult to comment on their appropriateness, as they are yet to be prescribed.

In developing licensing requirements for digital asset exchanges, digital asset custodians and stablecoin issuers, any obligations and standards imposed should be based on the individual risks of each service. For example, FinTech Australia notes that the proposed digital asset exchange requirements are more stringent and onerous than those required for the custody authorisation. We agree this is an appropriate approach considering that the risk posed by a failure for a digital asset exchange service to operate in a way that is fair, orderly and transparent could impact the entire market.

Digital asset exchange

Our members note "operating" and a "digital asset exchange" are not defined. This may make it difficult to ascertain who requires a licence and in what circumstances.

We also note the lack of detail regarding the obligations of an exchange - in particular, it is unclear what "regulation" is required for the "the conduct of the exchange's participants". Members query whether this relates to a licencing requirement or whether it is simply a set of rules that must be complied with. The current provisions also do not indicate what "participation" may look like given the breadth of activities covered.

Members agree with the segregation of participants' funds from those of the licensee, as well as the requirements to report on participants' holdings and provide disclosures in a standard form regarding how participants' funds are protected.

Members also support the concept of being able to hold participants' funds in omnibus accounts. This is particularly important because holding each customer's crypto assets in a separate wallet would generally be unworkable, and any additional protection this may provide is unlikely to be proportionate to this obligation.

Custody

Minimum capital requirements, while supported in principle, could be unviable for smaller players if set too high. These requirements should be proportionate to the risk. While beyond the scope of this Bill, some members suggested that a logical way to tailor any capital requirements would be to set a minimum requirement and include a portion of the requirement that scales according to the size of the businesses.

Further, for certain business models, consumers may be protected more effectively if aspects of capital requirements could be met in crypto assets. Some members suggest that if consumers hold a right to the crypto asset itself under the business model – ensuring the business maintains capital adequacy in that asset would more directly protect that right.

Members have also raised concerns that the requirement to have the totality of the custody service provided in Australia may be limiting since there are highly competent custody providers in jurisdictions comparable to Australia. These custody services are relatively nascent in Australia and some flexibility should be afforded as this market develops.

Members note that a "digital asset custody service" includes "safekeeping, servicing or management" which extends beyond the type of services usually considered to be "custodial" in nature and does not include a requirement that assets be held on behalf of another person.

In relation to the exemption under section 52 of the Bill, where certain custody services are exempt from requirements if the provision of that service started before the commencement of the Act, members have raised concerns that this exemption could lead to a situation where the assets of some customers of a custody provider fall under the regulatory regime while others do not.

Stablecoin issuance

A member raised concerns about a lack of governance requirements on the actual issuance of stablecoins (e.g. requirements of signatories and signing keys, centralisation risks and fit and proper person tests).

Further, queries were raised about:

- whether the same suite of requirements would apply where a stablecoin is CBDC backed;
- the treatment of foreign issued stablecoins and whether there should be a disclosure requirement for exchanges dealing in these that Australian issuance requirements have not been met; and
- whether the requirement to hold FIAT reserves with an ADI would create competition issues and encourage debanking by ADIs, particularly as more bans issue their own stablecoins.

Debanking

Section 20 of the Bill outlines some of the requirements for a stablecoin licensee. This includes the requirement to hold the full amount of the face value of the liabilities for the stablecoins on issue from the licensee in accounts kept with an ADI in Australia. FinTech Australia considers that this requirement may pose a significant barrier to some of our members who have been subject to 'debanking' in Australia. 'Debanking' is where a bank declines to offer or continue to provide a banking service.[5] It can have a devastating impact on the debanked business and has significantly affected a large proportion of our members, particularly digital asset businesses. FinTech Australia recommends considering the impact of this requirement and suitable alternatives for licence holders who have been debanked or are at risk of being debanked.

FinTech Australia also calls on the Government to respond to and urgently implement the policy responses to debanking recommended in August last year by the Council of Financial Regulators.

Passporting provisions

The Bill proposes an exemption for entities which already hold a recognised foreign licence.

Although many members support in principle recognition of certain foreign licenses, we note this exemption would not apply to the majority of FinTech Australia's members and, if it does not operate on a reciprocal basis, it will create an unfair advantage for

[5] See Chapter 4 'De-banking' of the Final Report of the Select Committee on Australia as a Technology and Financial Centre dated 20 October 2021.

larger, more established international entrants. Creating a level playing field between local and international players will support the many homegrown crypto success stories which have arisen over the last decade in Australia.

Any passporting requirements should also be considered in light of the existing passporting regime for foreign financial service providers. This regime only permits those holding certain equivalent authorisations or licences specified in subordinate legislation to 'passport' into Australia to provide services to wholesale clients. We also note no such exemption exists for markets.

Financial products exclusion

The exclusion in the Bill which provides that a "regulated digital asset … does not include a financial product within the meaning of chapter 7 of the Corporations Act" indicates that this Bill is intended to operate alongside existing financial services licensing regimes. This exclusion means it will remain necessary to assess whether a digital asset is a financial product. As there is a high likelihood that many crypto assets, including "asset referenced tokens" are financial products, this may reduce the impact and scope of the activities regulated by the Bill.

In practice, this also means that regulated entities would likely need both AFSLs and digital asset licenses to operate in Australia. This adds unnecessary additional complexity for DCEs in particular, which have uplifted their compliance to the point where they can maintain an AFSL. Moreover, it does not add any additional consumer protection given the AFSL regime has long been recognised as a robust framework for consumer protection.

Regard should also be given to the different standards and obligations for market operators and custodians under Chapter 7 of the Corporations Act and whether these should be reflected in any other digital asset specific regime. Additionally, where conduct would require a person hold an Australian markets licence, or a relevant payments authorisation this conduct should also be excluded from this digital asset specific regime.

As raised in previous submissions, our members generally do not support a bespoke licensing regime separate to financial services licensing for crypto service providers.

Implementation timeline

FinTech Australia supports greater flexibility in the implementation timeline, in consideration of the new regulated population, ASIC's licensing capacity and service level, and the lack of detail currently available on specific obligations and requirements.

The Bill proposes a deferred Commencement Date of 6 months from the date of Royal Assent and a 3-month transition period where certain obligations do not apply to the regulated activities. Fintech Australia remains concerned that this short 9-month timeline may disproportionately impact members who do not currently have the internal capabilities to quickly adapt to a new licensing regime. A longer transition period would assist applicants to effectively comply with the new regime and reduce unnecessary strain on regulators. This is particularly relevant with most substantive obligations and requirements being delegated to rules and currently unknown.

Under the current AFSL regime, a licence application can take up to 12 months. We recommend that the transition period is lengthened to 24 months, in consideration of the licensing regulator's ability to process the expected high volume of new applications for a new licensing regime. We also note the approaches taken in relation to the recent extension of licensing to claims handling and debt management services, where a safe harbour was provided to applicants which applied by a specified date. This gave greater flexibility and certainty in relation to consideration of applications by the regulator and minimised disruption.

Regulator guidance and capacity

Fintech Australia considers that ASIC would need to provide guidance during the transitional period to ensure market participants understand how these new and existing licensing regimes interact and apply to their activities.

With a new licensing framework, it will also be important to ensure sufficient resourcing in ASIC's licensing team to address the influx of new applications. This is a quickly developing space and an inability to process licensing applications expediently might make Australia less competitive as a jurisdiction for crypto innovation.

Role of the Parliamentary Joint Committee on Corporations and Financial Services

FinTech Australia acknowledges the important role of the Parliamentary Joint Committee and the impact of the inquiries it has conducted. However, we consider the

Parliamentary Joint Committee provisions to be unnecessary. As expressed previously, we are concerned that this novel provision could create an ongoing inquiry outside of the legislation. A statutory review of the legislation would be the usual and more appropriate legislative review mechanism.

Other issues

The Bill does not address several of the key issues raised during the token mapping consultation and the consultation on the draft version of this Bill, such as:

- **Decentralised Autonomous Organisation (DAOs) and Decentraised Exchanges (DEXs)** - Finding a solution to the decentralisation issue and determining the implications if Decentralised Autonomous Organizations (DAOs) and Decentralised Exchanges (DEXs) avoid regulation due to the lack of legal personhood.
- **Crypto Asset Rewards, staking, yielding** - the Bill does not provide regulatory framework relating to crypto assets rewards, including airdrops, forks, staking and non-fungible tokens (NFT).
- **ASIC supervision** - ASIC has been designated to supervise digital asset exchanges operated in Australia.[6] However, we note that there is no designated supervising entity for digital asset custody services and stablecoin issuers.
- **ASIC Act consumer protections -** Our members also query whether the consumer protections under the ASIC Act would apply to "regulated digital assets".

[6] See section 12.