Article Information

Authors: Jade McGlynn, Luke Misthos, Michael Bacina
Service: Blockchain, FinTech
Sector: Financial Services, IT & Telecommunications

A clear regulatory framework for the digital assets sector in Australia: Bragg Report released

Michael Bacina, Jade McGlynn and Luke Misthos of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

On 20 October 2021, the Senate Select Committee on Australia as a Technology and Financial Centre (**Committee**), chaired by Senator Andrew Bragg (together the **Bragg Report**), released its eagerly anticipated final report.

Following on from two interim reports which made a range of recommendations to recognise and better realise the potential of the digital asset industry, this final report focuses on several issues that have been raised to the Committee as key areas affecting the competitiveness of Australia's technology, finance and digital asset industries; specifically: the lack of fit-for-purpose regulation of cryptocurrencies and digital assets; issues relating to 'de-banking' of digital currency-related companies; the policy environment for neobanks in Australia; and options to replace the Offshore Banking Unit.

Based on more than 100 submissions, the Committee's final report makes 12 recommendations which according to Sen. Bragg, together form a clear regulatory framework for the digital assets sector in Australia.

The full report is available here.

Below is a summary of the Committee's 12 recommendations:-

1. The Australian Government establish a new market licensing regime for Digital Currency Exchanges, including capital adequacy, auditing and responsible person tests

At this stage, Australian digital currency exchanges (DCEs) have very limited regulatory oversight, despite being responsible for managing billions of dollars of trades and holding approximately AUD $4 trillion worth of digital assets. The AML/CTF Act currently imposes obligations regarding the prevention of money laundering and terrorism financing on crypto-to-fiat DCE's who are deemed to be providing a designated service (that is, to register with AUSTRAC), but overall, there is no specific legislation or regulations in this space relating to DCEs. The Committee describes these AMF/CTF obligations as "light touch". This lack of regulation means there are limited consumer protections in place for the services DCEs provide to consumers. The Committee is of the view that a new DCE licensing regime will address this gap in regulation, enhancing DCE consumer protection and operational integrity – without imposing onerous obligations feared to drive local operators out of the market.

2. The Australian Government establish a custody or depository regime for digital assets with minimum standards under the Treasury portfolio.

The Committee found that custody arrangements for digital assets presents some unique risks that are not analogous to traditional assets (for example the potential for private keys to be lost or stolen) and that introducing a regulated framework for these arrangements will enhance consumer confidence and encourage investment in the digital asset space. The Committee is of the view that having a clear framework in place will spur the development of a custodial industry for digital assets in Australia and enhance economic opportunities. The Committee notes that many of the general risks and market constructs required for digital asset custody are broadly similar to those for traditional assets and that the Committee received submissions on how a broad custodial framework should work. Those proposals will assist the government in developing a bespoke custodial or depository regime for digital assets which will also align with the general

principles for custody of traditional assets. ASIC has published, in Report 705 sensible guidance on custody issues for exchange traded products such as a Bitcoin ETF.

3. 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.

Very few digital assets being traded and/or developed in Australia appear to meet the legislative definition of a financial product or service under the Corporations Act. However, the Australian Securities & Investments Committee (ASIC) has made it clear that any crypto asset that does meet this definition will require the issuer to hold an Australian financial services licence. This has created uncertainty around when digital assets will fall under ASIC's perimeter and is an issue that the Committees wishes to address to give investors and market participants the clarity they need. While acknowledging that ASIC has recently undertaken some consultation in this area of exchange traded products, the Committee called for further work in relation to other crypto-asset products.

The Committee acknowledged that a number of submissions proposed a variety of digital asset definitions which could be inserted into the Corporations Act to bring relevant digital assets within the scope of the financial services regulatory regime. However, before any new definitions should be adopted, the government will conduct a token mapping exercise to assist in developing an appropriate regulatory model. Jurisdictions globally have taken a number of different approaches to classifying digital assets for the purpose of developing suitable regulatory frameworks and that the Committee sensibly suggests Australia should also ensure these are approaches considered in the development of our own framework.

4. That the Australian Government establish a new Decentralised Autonomous Organisation company structure.

Decentralised Autonomous Organisations (DAOs) are a new type of organisation that, instead of being governed by a central owner or small group, operates on a distributed basis, relying on blockchain powered smart contracts to allow members to make coordinated decisions based on common goals. Due to DAOs lack of centralised ownership and control, these organisations do not fall clearly into Australia's existing corporate structure. The Committee highlighted that legal liability for DAO members (ie, network participants) for these organisations is unclear, which has become a barrier for the establishment of projects of significant scale in Australia. The Committee believes introducing a new corporate structure that caters for DAOs will drive innovation and economic activity and make Australia a magnet for DAOs and projects. Wyoming's recent legal legislative recognition of a DAO legal entity and the Coalition of Automated Legal Application's published model law for DAOs may help determine a framework that suits Australia's specific corporate goals.

5. 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'.

AUSTRAC is the entity responsible for implementing AML/CTF guidelines released by the international Financial Action Task Force (FATF) on virtual asset service providers (VASP). The pending 'travel rule', which at a high level requires certain customer data be disclosed and transferred between counterparties in a digital asset transaction, is a subject of contention, and jurisdictions who wish to impose it are encountering numerous implementation issues. The Committee believes that the ideal interpretation and implementation of the 'travel rule' in a digital asset context, must strike a balance between appropriately managing risks, without undermining the operation of legitimate digital asset businesses. However, technological solutions to allow VASPs to observe the 'travel rule' are still under development and should be adopted at the earliest opportunity. Given this need for clarity, the Committee shares the view that it would like the AML/CTF regulations be further clarified to ensure they are fit for purpose for DCEs and other crypto-related businesses, as well as in relation to how the travel rule should be imposed on VASPs.

6. 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.

There are many concerns about the treatment of digital assets when they are held as an investment or traded This concern is attributed to the reality that many digital asset transactions take place some steps away from a crypto-to-fiat-currency trade, so it can be very challenging for taxpayers to properly assess their CGT liabilities under the current tax law and determine the ATO guidance for these transactions. According to the Committee, the lack of clarity on this matter 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 manage and have multiple transactions occur in high frequency. As a result of these issues, the Committee believes that CGT rules should be modified so that digital asset transactions only result in a taxable event when they 'genuinely result in a clearly definable capital gain or loss'. The Committee has recommended that this kind of amendment may require the creation of a new CGT asset or event class that enables specific concessions or exemptions to be applied.

7. 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.

While Bitcoin mining has been a growing area of investment, the Committee notes the energy intensive process of crypto mining is an area of concern and argues that it should not undermine Australia's net zero emissions targets. Therefore, the Committee recommends that companies engaging in intensive crypto mining should receive a tax break if they are able to source their own renewables. The objective is to ensure crypto mining does not become a major source of carbon emission in the future and to ensure there are climate-friendly safeguards in place for the growth of the space.

8. The Treasury lead a policy review of the viability of a retail Central Bank Digital Currency in Australia.

Central Bank Digital Currencies (CBDCs) are being considered in numerus jurisdictions globally. The Committee argues it is important for Australia to continually investigate and pilot potential options for a CBDC so the opportunity for innovating is not lost. While the Reserve Bank of Australia is currently exploring options for a wholesale CBDC, still takes the view that there is no public policy case for implementing a retail CBDC in Australia. Nevertheless, the Committee has recommended that the viability of a retail CBDC be explored to ensure that Australia maximises any potential opportunities in this area. The review process, if accepted, would occur within the Treasury, and so have a more policy driven approach than if conducted at RBA.

9. The Australian Government enact the recommendation from the 2019 ACCC inquiry that a scheme to address the due diligence requirements of banks be put in place, and that this occur by June 2022.

In Australia, the issue of de-banking has been an increasingly growing concern, and the Committee identified the lack of banking options for companies which are often de-banked is hampering innovation and investment in Australia. A key issue surrounding de-banking is underdeveloped regulatory arrangements, particularly in the digital asset space. Banks can easily point to a lack of digital asset framework as a reason to de-bank a business. The Committee believes a clearer regulatory framework is likely to provide banks with confidence to deal with crypto businesses.
Work by the Australian Competition and Consumer Committee (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. This Committee has urged the government to speed up the pending Council of Financial Regulators working group and implement a scheme to address due diligence requirements of banks.

10. 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.

This recommendation came after a number of submissions detailing the lack of transparency around decisions taken by banks to de-bank them. Very little reason or justification is needed or provided by banks to de-bank a company. The Committee noted that, in some cases, companies that were providing competition to the banks were also at risk of being de-banked.. To provide greater fairness and transparency, the Committee recommended the development of a de-banking process that involves the Australian Financial Complaints Authority (AFCA) and that a due process be followed with, reasons for de-banking provided and an appeals mechanism. If enacted, this should ensure companies are not de-banked for unknown reasons.

11. 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.

The Farrell Review into payments, undertaken by Scott Farrell included findings similar to that of Recommendation 10 when considering de-banking. The review includes recommendations which would facilitate better access to key payment systems such as the New Payments Platform (NPP), allowing payment service providers the ability to circumvent the need to rely on any particular bank to access payment systems. The Farrell Review recommended that the Reserve Bank of Australia (RBA) develop common access requirements for payments systems in consultation with the operators of those payment systems, and that these common access requirements form part of a new payments licence to facilitate access for licensees to those systems. Recommendation 11 reinforces this sentiment and continues to push for common access requirements for the NPP.

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

The current Offshore Banking Unit (OBU) regime broadly permits Australian fund managers to pay a lower rate of tax on activities that relate to offshore managed funds. With this current regime set to be abolished at the end of the 2022-23 income year, the Committee has recommended the establishment of a Global Markets Initiative (GMI). Many submissions

argued that the abolishment of the OBU regime would exacerbate the tax-related issues being faced by the funds management industry. To replace the OBU, the Australian Financial Markets Association (AFMA) formulated the GMI regime which will aim allow Australia's tax settings as they apply to financial centres of business to be largely maintained while ameliorating concerns posed when the OECD reviewed the OBU regime. The goal of the GMI is to ensure that Australian-based financial market participants are able to equitably compete in international markets.