

Article Information

Authors: Michael Bacina, Barbara Vrettos, Jade McGlynn, Luke Misthos

Service: Blockchain, FinTech

Sector: Financial Services, IT & Telecommunications

Blockchain Bites: AUSTRAC guidance for DCEs: review red flag indicators, SEC Chairman proposes to lock cryptocurrency into the securities system, Square seeks ASX listing with acquisition of Afterpay, US Infrastructure Bill: Crypto Tax Concerns Continue

Michael Bacina, Barbara Vrettos, 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.

Recent AUSTRAC guidance for DCEs: review red flag indicators

Digital currency exchanges (DCE) registered with AUSTRAC, have ongoing obligations, including to:

1. Regularly review their AML/CTF Program and money-laundering and terrorist-financing (ML/TF); and
2. take into account any feedback provided by AUSTRAC in respect of the DCE industry, that is relevant to identification, mitigation and management ML/TF risks arising from the provision of any item 50A designated services.

[AUSTRAC](#) recently provided guidance that DCEs should be considering and incorporating FATF's guidance and insights on ML/TF, in particular [FATF's](#) Virtual Assets Red Flag Indicators of Money Laundering and Terrorist Financing Report.

In particular, the report provides guidance on the following types of Red Flags:

1. Technological features that increase anonymity such as peer-to-peer exchanges and anonymity-enhanced cryptocurrencies;
2. Geographical risks;
3. Irregular, unusual or uncommon transactional patterns;
4. Illogical transaction sizes for the consumer;
5. Unusual sender or recipient profiles; and
6. Sources of funds or wealth.

DCE's should be reviewing the red flag indicators against their own transaction monitoring program and considering the case studies provided to improve their AML/CTF Programs, to make sure they would have identified the red flag or had procedures in place to mitigate the ML/TF risks.

AUSTRAC's guidance also noted that virtual assets are dynamic and rapidly evolving and indicated that FATF's guidance on the regulation of virtual asset service providers should be followed for further insight into evolving ML/TF risks and updates to come later this year.

SEC Chairman proposes to lock cryptocurrency into the securities system

SEC Chairman, Gary Gensler has entered into the ongoing debate regarding whether crypto-investors need more protections. Echoing CFTC Commissioner Dan Berkovitz's [comments that](#) "unlicensed decentralized finance (DeFi) markets may be illegal", Gensler agrees that there should be additional regulation of cryptocurrencies in the US. Australia regularly looks to the US for leadership on regulation of technology, so the position the SEC takes is sure to be followed

with interest.

During an interview at the Virtual Aspen Security Forum, [Gensler called on Congress to grant the SEC more authority to police cryptocurrency trading](#), outlining his concerns for the crypto sector, stating that in certain applications:

This asset class is ripe with fraud, scams and abuses” and “If we don’t address the issues, a lot of people will get hurt

It’s unfortunate that this narrative continues to be spread, as Chainalysis’ Crypto Crime Report provides sound data that rejects such myths. Gensler unfortunately didn’t provide any figure or evidence to support his very bold claims.

Speaking in his personal capacity and not on behalf of the SEC body, Gensler also publicised his belief that most cryptocurrencies are securities and therefore, already under the purview of the SEC, [saying](#):

We need additional congressional authorities to prevent transactions, products and platforms from falling between regulatory cracks“

If indeed digital currencies were all securities, this comment invites the question of what further powers Congress would need to give the SEC to do its job. Of course the real problem seems to be that the SEC, and Gensler, have failed to identify particular cryptocurrencies which would be securities under US law or set out why that would be the case.

Gensler’s strong position that most crypto investors are not educated enough to judge and understand the risks of investing in crypto assets is a remarkable refusal to respect the individual choices of digital currency purchasers. Gensler said:

we just don’t have enough investor protection. And frankly at this time, it’s more like the Wild West.

This makes little sense in light of a string of SEC prosecutions and existing laws against misleading and deceptive practices. Gensler’s call for an increase in regulation, without any evidence of a problem or any examples of why existing laws are inadequate to address the problems he refers to, is quite strange. We respectfully submit this show a lack of understanding of digital currency markets. His comments may come as a surprise to some considering [his background as an MIT professor](#) who taught subjects on digital currencies and blockchain.

There is no doubt that fit for purpose regulation could address concerns, particularly in relation to products which hold customers assets, via custody requirements, but as we note above, it is already against the law to mislead or deceive purchasers of any products (whether a security or not) and it is not usually the role of regulators to seek to restrict what assets a purchaser should be free to choose to purchase (or not).

As has been seen with the [recent response to definitions in the US Infrastructure Bill](#), careful and measured steps towards digital currency regulation is important, lest changes chase away the very innovation that government says it is trying to encourage.

Coming full circle: Square seeks ASX listing with acquisition of Afterpay

The Australian Stock Exchange (ASX) has not been viewed as taking a friendly stance towards digital currency, most recently having the embarrassing situation of Aminoca Brands reaching a AUD\$1B valuation after being removed from the bourse in March last year.

That approach may need to change swiftly, with fintech giant Square preparing for a dual-listing in connection with their acquisition of market-darling Afterpay. Square’s market capitalisation exceeds USD\$150 billion which could make it the second largest company traded on the ASX behind BHB and ahead of every single banking sector stock.

Many believe the ASX will be unlikely to block a listing of the size of Square, despite having reservations about digital currency and digital asset listings, and there is no sign that Square will be reducing their involvement in the digital currency space. Square has reported an increase in Bitcoin revenues by 200 per cent year-on-year for the quarter and owns reserves in 8,027 Bitcoin, with plans to increase their holdings. Additional ASX listed companies with digital asset business lines are inevitable.

Central to the merger is the unification of Afterpay's 15 million US customers and the millions of merchants who use Square's payments products. Square may be planning to integrate Afterpay's network into Square's Cash App product, which also allows US and UK users to trade in shares and Bitcoin, receive and send payments and operate outside of traditional banking infrastructure, avoiding fees and moving value faster.

Square's listing should be closely watched as it will give an indication of what, if any, modifications or assurances the ASX will seek from Square around their digital currency lines, and how the ASX may warm up to other digital currency centric businesses.

US Infrastructure Bill: Crypto Tax Concerns Continue

A digital asset specific clause in the [2,702 page US Infrastructure Bill](#) almost brought the entire USD\$1 trillion package to a halt recently. The problem included the way that the Bill defined a 'broker', broadening the definition to include a person who "[is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person](#)". Such broad drafting naturally would capture both miners, digital currency exchanges and potentially node operators of blockchain infrastructure.

The US Infrastructure Bill, at its core, is legislation used to plan and budget for reforms to US infrastructure including roads and highways. The US Joint Committee on Taxation (JCT) [reported](#) that the provision dealing with the definition of crypto 'brokers' could raise [USD\\$28 billion](#) towards the costs of the infrastructure package, a figure that may reduce if miners, node operators and digital currency exchanges were no longer included in that definition.

The change proposed relates to *information reporting* rather than a new tax. However, it is not clear how the JCT has calculated the USD\$28 billion figure which seems to be an estimated increase in tax revenue arising from additional reporting.

The revised definition of a broker was subject to strong pushback which resulted in a bipartisan amendment being agreed which would have narrowed the definition but unfortunately a single elderly Senator chose to block that amendment unless his military spending amendment was added to the bill, [ultimately causing the Infrastructure Bill to pass the US Senate with the original language](#) (and without the Senator's military spending boost).

The digital asset industry is grappling with the possibility of new reporting and the undesirable consequences of the Bill, including that it may be ['unworkable'](#) in practice. [However commentators](#) have indicated that it's not all doom and gloom as the changes don't take effect for [another 2 years](#), and will be used as part of rule making by government agencies so may not result in as broad a practical application as the amendment suggests. There remain other ways to clarify the intention of the definitions without redrafting the foolishly broad provisions, such as through guidance and speeches.

One thing that has been clear from this process is that digital currency businesses have started moving into an active engagement with government, including using major lobbying firms in Washington, which is a shift from the earlier days of digital currency, when there was far less engagement. We hope Australian lawmakers can learn from this experience to ensure that when changes are proposed to laws to encompass digital assets, they are carefully considered and seek to avoid unintended consequences.