**Governing Crypto Assets**

1. **Introduction to Crypto assets**

***What is a Crypto Asset?***

The term crypto asset refers to a class of asset that encompasses several different individual assets, including cryptocurrencies (such as Bitcoin or Ethereum), stablecoins, tokens or non-fungible tokens (**NFTS**). The Australian Securities and Investments Commission (**ASIC**) defines crypto assets as:

“*A digital representation of value or contractual rights that can be transferred, stored or traded electronically. Crypto assets use cryptography, distributed ledger technology or other technology to provide features such as security and pseudo-anonymity”.*

Crypto assets are an asset with adigital representation and use cryptography or distributed ledger technology (**DLT**).

***What is Distributed Ledger Technology?***

DLT is a type of technology that records and tracks data in a ‘distributed’ network. This means that multiple participants have secure and consistent access to information on the ledger. It is secured using cryptography, a complex set of mathematical algorithms. The most common type of DLT is blockchain.

***How does blockchain work?***

1. Every transaction gets sent to the network where it is checked by others in the network. If the transaction is verified, it will then be grouped into a ‘block’ with other transactions. Once the block is complete, it is given a unique hash as well as the hash from the previous block.
2. The block is the connected to the previous block in a chain of data. The block links securely using the specific hash codes.
3. Once added to the chain, the block cannot be edited as any change to the block will create a new hash which won’t link to the previous block.
4. **Crypto Assets and the Australian Regulatory Framework**

The Australian Government has expressed a commitment to regulating crypto assets, particularly in the areas of financial integrity and consumer protection. As part of their commitment, the Australian Government has adopted a ‘token-mapping’ strategy and flagged that token-mapping will inform future policy development by ensuring consistency in regulating economic activity, facilitate existing policy goals and allow responsible actors to innovate with the appropriate regulatory oversight.[[1]](#footnote-1)

Token-mapping refers to the process of identifying key activities and functions of the crypto ecosystem and mapping them against existing regulatory frameworks.

The government has identified that some parts of the crypto ecosystem are regulated under existing legal provisions. Existing regulators and the applicable provisions are summarised below:

***Australian Securities and Investments Commission (ASIC)***

Entities that provide financial products or services are required to hold an Australian Financial Services Licence (**AFSL**) and entities who operate a financial market in Australia need a Market Licence.

ASIC regulates crypto assets when they fall within the definition of a ‘financial product’. Whether a particular asset is considered a financial product depends on the individual characteristics of the asset. ASIC has released an information sheet to help entities navigate whether a digital asset offering is regulated as a financial product.[[2]](#footnote-2) ASIC has also released a consultation paper advising that Exchange Traded Products (**ETPs**), which invest in crypto assets, are classified as financial products and are regulated through ASIC.[[3]](#footnote-3)

Where crypto assets are considered a financial product, they require an AFSL and will be subject to all the obligations attached to the licence.

**Example: *Australian Securities and Investments Commission v Bit Trade Pty Ltd* [2024] FCA 953**

In August 2024, ASIC brought a successful case against a provider of a crypto asset exchange. Bit Trade P/L, who operate the Kraken crypto exchange, failed to comply with the design and distribution obligations required when offering a margin trading product. Bit Trade P/L was required to issue Target Market Determinations (**TMDs**) to all retail customers before issuing the product. This is required to ensure that the product is appropriate for the consumer.

The key issue was whether the Kraken Crypto Exchange was considered a financial product, which was required to issue TMDs. Some credit facilities are exempt from this obligation and Bit Trade P/L argued they were one of them. Ultimately, the case came down to whether Bit Trade offered ‘debt’ through their margin extension product. The Federal Court found that, regardless of whether consumers actually incurred debt, Bit Trade P/L offered a product where they *could* incur debt and would need to issue TMDs. Therefore, Bit Trade was in breach of their obligations.

***Australian Transaction Reports and Analysis Centre (AUSTRAC)***

Some digital asset businesses are required to register with AUSTRAC under the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth)*.* The scope of this Act was expanded in 2018 to include regulation of digital currencies exchanges, which includes cryptocurrency. Digital currency exchange providers must register with AUSTRAC and meet their reporting and compliance obligations.

***Australian Taxation Office (ATO)***

The ATO has provided several different Tax Determinations to outline the tax treatment of crypto assets. If the crypto asset is received as a ‘staking reward’, the value is to be included as [assessable income](https://www.ato.gov.au/individuals-and-families/investments-and-assets/crypto-asset-investments/transactions-acquiring-and-disposing-of-crypto-assets/staking-rewards-and-airdrops). However, crypto assets are more commonly used for investment purposes, which means the crypto assets will be considered a capital asset and [CGT provisions](https://www.ato.gov.au/individuals-and-families/investments-and-assets/crypto-asset-investments/how-to-work-out-and-report-cgt-on-crypto) will apply.

If a [business accepts crypto assets as a form of payment](https://www.ato.gov.au/businesses-and-organisations/income-deductions-and-concessions/income-and-deductions-for-business/crypto-assets-and-business/crypto-assets-used-in-business#ato-Receivingcryptoassetsaspaymentforservices), they must account for these transactions in the same way they would for fiat currency and ensure they comply with goods and services tax obligations under the *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

1. **Proposed Regulatory Framework**

The Australian Government has been working towards regulating crypto assets for some time. The *Digital Assets (Market Regulation) Bill 2023*(Cth) was introduced to Parliament but was rejected in September 2023 in the Senate for lacking detail and certainty for investors.

In October 2023, the government released a paper proposing new regulation for Digital Asset Platforms*.*[[4]](#footnote-4) They propose to regulate crypto assets using existing licencing frameworks. This is in line with the international recommendation that regulations should be consistent between traditional and emerging financial intermediaries.

This proposal involves introducing a new financial product, known as a ‘digital asset facility’ (**DAF**), which will cover digital asset custody arrangements as well as multi-function digital asset platforms that allow consumers to transfer and withdraw tokens. The proposal predominately focuses on ensuring providers of these products are licenced.

Given that the DAF will, itself, be considered a financial product, entities providing services in relation to DAFs will be required to hold an AFSL. Such entities include platform providers (entities who issue DAFs), brokers and dealers (who arrange for consumers to use the DAF), and financial advisors (given that they provide advice in respect of DAF). Their licence would require that these entities comply with the general obligations, financial requirements and other relevant obligations. These obligations cover general requirements such as having appropriate dispute resolution and risk management systems, and ensuring that they comply with Australian financial laws, but also cover more tailored requirements including solvency and positive net asset requirements.

1. Australian Government The Treasury, *Token-Mapping* (Consultation Paper, February 2023) <<https://treasury.gov.au/sites/default/files/2023-02/c2023-341659-cp.pdf>> [↑](#footnote-ref-1)
2. ASIC, *Crypto-assets* (Information Sheet 225, October 2021) < https://asic.gov.au/regulatory-resources/digital-transformation/crypto-assets/#part-c>. [↑](#footnote-ref-2)
3. ASIC, *Crypto-assets as underlying assets for ETPs and other investment products* (Consultation Paper 343, June 2021) <https://download.asic.gov.au/media/yhbgvq02/cp343-published-30-june-2021.pdf>. [↑](#footnote-ref-3)
4. Australian Government, *Regulating digital asset platforms*(Proposal Paper, October 2023) <https://treasury.gov.au/sites/default/files/2023-10/c2023-427004-proposal-paper-finalised.pdf>. [↑](#footnote-ref-4)