

Crypto Crunch

SUMMER 2022



About Crypto Crunch

Welcome to the first edition of Crypto Crunch!

The cryptocurrency industry is moving at lightning pace with the rapid advancement of technology, new use cases, wider adoption, and integration with mainstream industries and markets. This makes the industry ripe for legal and regulatory change, and we are seeing Governments and regulators abroad grappling with how best to regulate this industry and ensure that consumers are adequately protected, especially in light of recent failures that include FTX, Celsius, Three Arrows and TerraUSD / Luna, among others.

In this context, keeping on top of key regulatory and legal developments here and abroad can be hard. To help you, we have created Crypto Crunch to provide you with a snapshot of key regulatory and legal developments and our thoughts on them. The focus will be on domestic changes, but we will provide updates on key changes abroad, too (where it is instructive)!

Please reach out if you have any questions.



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Draft CPS 230

APRA has published a new draft standard, CPS 230 Operational resilience (**Draft CPS 230**), for consultation that will apply to banks, general insurers, life insurers, private health insurers and superannuation funds. The draft standard is proposed to apply from 1 January 2024. The consultation closed on 21 October 2022, and we are awaiting APRA's response.

The intent is Draft CPS 230 will replace the existing Prudential Standards on Outsourcing and Business Continuity Management.

What does Draft CPS230 cover?

Draft CPS 230 sets out minimum standards for managing operational risk, including updated requirements for business continuity and service provider management. This draft standard is intended to ensure that APRA-regulated entities are well-positioned to meet the challenges of rapid change in the industry and technology more generally.

Draft CPS 230 focuses on three key themes:

1. **Strengthening** operational risk management by imposing requirements,
2. **Improving** business continuity planning, and
3. **Enhancing** third-party risk management.

So, the big question is, **what does this all mean for crypto businesses that may not be regulated by APRA?**

We are seeing a growing trend of crypto products, services and blockchain technology being integrated with TradFI. Recent examples include ANZ's stablecoin a\$dc, CBA designing a crypto solution for its customers, the merger of Swyftx and Superhero, and the evolution of crypto payment solutions, crypto derivatives and margin trading, and crypto ETFs and registered schemes.

As APRA-regulated entities look to offer crypto solutions to customers or partner with crypto providers to access blockchain technology, they will need to consider the operational risks associated with this. In this context, the operational risks associated with crypto-assets are an emerging area that regulated entities will

need to ensure that they have in place prudent processes and controls.

APRA's recent [letter to industry in April 2022](#) suggests operational risks relating to crypto-assets include fraud, asset security, cyber, conduct, financial crime, AML/CTF and technology failure risks.

To date, regulated entities have found it difficult to assess the risks associated with crypto-assets and design appropriate controls and risk management solutions. In our experience, most of this boils down to the emerging technology, knowledge asymmetry and a perception of the risks (inherent and residual). However, we are seeing a maturing approach develop as regulated entities launch crypto solutions.

APRA expects that all regulated entities will conduct appropriate due diligence and a comprehensive risk assessment before engaging in activities associated with crypto-assets and apply robust risk management controls. With this in mind, crypto-related service providers can expect to respond to detailed due diligence processes and receive robust legal agreements to manage the services (including risk, reporting, incidents and business continuity).

On top of this, APRA is still considering the appropriate prudential framework for crypto-assets in Australia in consultation with local and foreign regulators. This framework will include requirements for credit, market, liquidity and other risks associated with crypto-assets. Expect to see APRA consultation on this, with the priority being to consult on draft requirements for banks following the Basel Committee's consultation on the prudential treatment for crypto-asset exposures.

Purchased Payment Facilities

APRA has released a [consultation paper](#) in relation to changing the prudential capital requirements for purchased payment facilities to better align with the capital requirements that apply to other regulated entities.

While the proposed changes will not automatically apply to crypto-assets (particularly stablecoins), APRA has flagged that it will conduct a more fulsome review of purchased payment facilities in 2023. We suspect that APRA may also consider the regulation of stablecoins as part of this review.

ASIC

Enforcement Priorities

ASIC has announced new key enforcement priorities for 2022-23 as part of its [Corporate Plan](#), including broadening its focus to include digitally enabled misconduct, extending to scams and crypto-assets.

ASIC's focus on the area of crypto-assets will include both regulated and unregulated assets, with ASIC proposing to take enforcement actions to protect consumers from crypto-asset-related harm. It will also include crypto-assets that mimic traditional financial products but have been designed to avoid regulation.

ASIC's other crypto-related plans include:

- Assessing the Product Disclosure Statements and Target Market Determinations issued by Australia's major crypto offerings,
- Delivering a regulatory model for exchange-traded products that have underlying crypto-assets, and
- Raising public awareness of the risks inherent in crypto-assets.

Read more about the latest Corporate Plan [here](#). We have also released an [article](#) on ASIC's Corporate Plan.

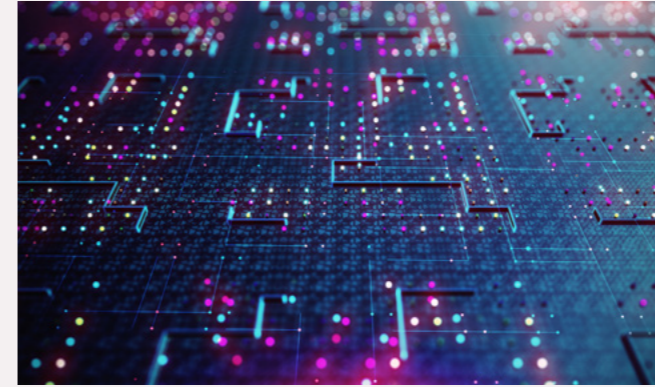
ASIC reiterated its focus on crypto-assets at their [Annual Forum](#) earlier in November.

Enforcement Activities

Since announcing its focus on crypto-assets, ASIC has not wasted time and has taken decisive action. Recent ASIC enforcement action includes:

- Issuing three new interim stop orders to Holon Investments Australia Limited (**Holon**) and their digital-assets funds. Please check out our [recent article](#) that walks through some of the key points ASIC considered and also provides our thoughts on ongoing compliance with the TMD obligations for crypto funds and generally.
- Commencing civil penalty proceedings in the Federal Court against BPS Financial Pty Ltd (BPS) for allegedly making false, misleading or deceptive representations, and engaging in unlicensed conduct in relation to a non-cash payment facility involving a crypto-asset token called Qoin. See ASIC's [media release](#).
- Suspending FTX's Australian financial services licence following the FTX global scandal and the appointment of Korda Mentha as administrator to the Australian FTX companies. See ASIC's [media release](#).
- Commencing ASIC civil penalty proceedings in the Federal Court against Block Earner alleging it provided unlicensed financial services in relation to its crypto-asset-based yield products on the basis that the products were an unregistered managed investment scheme, a facility for making an investment and/or derivative. See ASIC's [media release](#).

We suspect that this is just the start of ASIC's enforcement activities and more is to come over the next 12 months.



AUSTRAC

On 15 November 2022, AUSTRAC released a [consultation](#) on draft guidance in relation to providing financial services to customers that financial institutions consider to be high risk.

The consultation follows the debanking of remitters, fintech businesses and digital currency exchanges (DCEs) in recent years. This debanking has come in the form of declining to provide services, withdrawing services, or only providing limited services to certain industries. In doing so, financial institutions have often cited reputational and regulatory risk exposure and commercial considerations.

AUSTRAC recognises that debanking can make operating a business impossible and can lead to blackspots in the financial system. This is due to the fact debanking reduces the capacity of Australia's anti-money laundering and counter-terrorism financing (AML/CTF) framework to detect and prevent money laundering, terrorism financing and other serious crime within our economy.

Under the AML/CTF Act 2006, banks are required to take a risk-based approach to dealing with customers in higher-risk sectors. This approach takes into account the nature, size and complexity of the business proportionate to the level of money laundering, terrorism and serious crime risk they face.

To date, banks have applied a blanket debanking approach instead of looking at and assessing risks for each customer on a case-by-case basis. The guidance in the consultation paper is intended to reframe the approach and assist banks and high-risk clients to have meaningful engagement.

The consultation closes on 21 December 2021.



Reserve Bank CBDC Pilot

The Reserve Bank of Australia (**RBA**) has announced that it is collaborating with the Digital Finance Cooperative Research Centre (**DFCRC**) on a research project to explore use cases for a central bank digital currency (**CBDC**) in Australia.

The RBA has previously looked into the feasibility and possible technical design of CBDC and the use of distributed ledger technology. The RBA has now turned its attention to the use cases for a CBDC and the economic benefits of introducing one.

The project will focus on innovative use cases and business models that would be supported by a CBDC. The project, which will run for 12 months, will develop a limited scale CBDC pilot that the RBA will back. The RBA has invited industry stakeholders to develop specific use cases to demonstrate the innovation and value added to households and businesses by a CBDC. The Project will select a range of projects to provide insight and an understanding of the potential benefits of a CBDC.

For more information, see the [DFCRC's website](#) to access the white paper that details the objectives and approach to this project and how industry stakeholders can engage and for information on the status of the pilot.



ACCC

The Australian Competition and Consumer Commission (**ACCC**) has released a series of recommendations in its [Interim Report on Regulatory Reform](#) to increase the regulation of digital platforms and digital platform firms.

In this report, a digital platform is broadly defined to mean “a network that enables users (either consumers, businesses, or both) to interact with one another”. While crypto-asset service providers are not specifically listed, this definition may capture some providers depending on how their platform is structured.

Some of the recommendations for digital platforms include added additional measures to protect consumers and small businesses:

- Imposing mandatory processes to prevent and remove scams, harmful apps and fake reviews, including:
 - a notice-and-action mechanism.
 - verification of certain business users.
 - additional verification of advertisers of financial services and products (including crypto-assets).
 - improved review verification disclosures.
 - public reporting on mitigation efforts.

- Imposing mandatory internal dispute resolution standards that ensure accessibility, timeliness, accountability, the ability to escalate to a human representative and transparency.
- Providing access to an independent external ombuds scheme.
- Introducing additional competition measures to protect and promote competition in markets for digital platform services that should be implemented through a new power to make mandatory codes of conduct for ‘designated’ digital platforms based on principles set out in legislation. Each code would be for a single type of digital platform service (i.e. service-specific codes) and contain targeted obligations based on the legislated principles.
- Enabling targeted obligations for mandatory codes based on legislated principles that have regard to anti-competitive practices, impediments to consumer switching and interoperability, lack of transparency, unfair dealings and exclusivity.

The 5th Interim Report also includes recommendations for the ACCC to create industry-specific codes of conduct for designated digital platform services.

The ACCC’s Digital Platform Services Inquiry will conclude in early 2025.

Exchange Traded Products

Crypto ETF Closures

The number of available exchange-traded funds (**ETFs**) that provide exposure to crypto-assets is shrinking. This follows recent applications to de-list the following ETFs:

- An application by K2 Asset Management on 2 November 2022 to de-quote the Cosmos Purpose Bitcoin Access ETF and the Cosmos Purpose Ethereum Access ETF.
- An application by the Trust Company (RE Services) Limited ACN 003 278 831 (which is part of Perpetual to de-quote the 3iQ CoinShares Bitcoin Feeder ETF and 3iQ CoinShares Ether Feeder ETF.

The Crypto Winter certainly hasn’t been kind to ETFs, with trading volumes lower than anticipated. It will be interesting to see what happens with the remaining Global X 21Shares Bitcoin ETF and Global x 21Shares Ethereum ETF, which is currently listed on Cboe and whether new ETFs launch while asset prices are low.

Updated Guidance

ASIC has updated the naming conventions for exchange traded products (**ETPs**) in [Info Sheet 230](#). At its core, the main change is removing the number of labels used and instead shifting focus to correctly characterising the risks associated with ETPs. This is a logical extension of ASIC’s recent enforcement action concerning risk categorisation in target market determinations.

Retail investors will often obtain ETPs through a share/investment trading platform and they do not receive the original disclosure documents, such as a PDS that outlines the product features and product risks. ASIC is of the view that setting strong ETP naming conventions can assist retail clients in ascertaining product features and risks and increase consumer protection.

The reissued Info Sheet 230 contains the updated naming conventions and definitions, replacing the six former naming labels with:

- Primary labels – which identify the product structure.
- Secondary labels – which identify the ETP risk and investment strategies.

There are two primary labels available:

- **ETF** – which is for an ETP that is issued by a collective investment vehicle such as a registered managed investment scheme (**MIS**) or corporate collective investment vehicle (**CCIV**) sub-fund; or
- **Structured** – which is for an ETP that is a security or derivative that gives financial exposure to some of the performance of underlying assets.

There are now only two secondary labels available. These labels are only used when appropriate. Some ETPs will not require a secondary label. The labels are:

- **Active** – this term is used before the primary label above to indicate that the ETP is a product with an active investment objective such that underlying investments are held or traded in a way that does not track or replicate the returns of a robust and transparent index or benchmark, or to track the performance of a specific security.
- **Complex** – this term is also used before the primary label. This label is used for an ETP where the investment strategy:
 - uses debt or leverage to make a financial investment;
 - uses short selling;
 - uses derivatives, other than disclosed hedging of exchange rate or interest rate risks, to:
 - gain non-temporary material economic exposure to implement the underlying investment strategy; or
 - create a net leveraged or net inverse position for the portfolio; or
 - hedge funds defined in RG 240.

For the ETFs currently listed on CBOE, not much will change in light of the updates to Info Sheet 230. These will be ETFs and the secondary labels will not apply.

Senator Bragg Crypto Bill

Senator Bragg released a *Digital Assets (Market Regulation) Bill 2022 (DA Bill)* on 19 September 2022 for public consultation. The consultation closed on 31 October 2022.

The DA Bill proposes to set up three different licences and regulatory frameworks for:

- Digital asset exchanges,
- Digital asset custody providers, and;
- Stablecoin issuers.

The DA Bill is an important step in encouraging open and meaningful conversations about how the cryptocurrency, digital assets and blockchain industry should be regulated, especially in light of recent events. In particular, the DA Bill raises the following key questions:

- What digital assets should be regulated?
- What services should be regulated?
- What licensing and regulatory requirements should apply?
- How should this licensing and regulatory regime interact with other existing regimes?
- To what extent should any Australian licensing and regulatory regime align with international approaches?
- Which Australian regulatory body should be ultimately responsible for the management and regulation?

We suspect there will be several changes proposed to the DA Bill in light of feedback from industry stakeholders in relation to:

- Interaction with other regulatory regimes;
- Streamlining the licence structure;
- Clarifying the scope of what is a digital asset;
- Clarifying what stablecoins are subject to regulation;
- Clarifying the regulatory requirements that will apply; and
- CBDC regulation.

It will be interesting to see what happens with the DA Bill in light of the Government's agenda and regulatory headwinds offshore.

Government's Agenda

Token Mapping

The Hon Stephen Jones MP Assistant Treasurer Minister for Financial Services and Hon Dr Andrew Leigh MP Assistant Minister for Competition, Charities and Treasury jointly announced on 22 August 2022 that the Government is seeking to improve the regulatory framework for crypto-assets to keep up with developments and protect consumers. The first step is to conduct a token mapping exercise, with a public consultation paper to be released soon. We understand the likely timing for the consultation paper is December 2022. See [media release](#) for more information.

Legislation

Following the collapse of FTX, Treasury has indicated that it will open consultations to safeguard crypto custody arrangements and regulate exchanges next year following the token mapping consultation. Not much detail has been released but watch this space.

It will be interesting to see if Treasury will build on the work undertaken by Senator Bragg in relation to the DA Bill and to what extent Treasury will have regard to the regulatory approaches in other jurisdictions such as Singapore, Hong Kong, Japan, Europe and the United Kingdom (which we cover below).



Tax and Crypto

Is Crypto Foreign Currency?

The [Government announced](#) on 22 June 2022 that it will introduce legislation to exclude crypto-assets from being treated as a foreign currency for Australian income tax purposes, removing any uncertainty following the decision of the Government of El Salvador to adopt Bitcoin as legal tender.

Following this, Treasury released [draft legislation](#) for consultation on 6 September 2022. The draft legislation clarifies that foreign currency excludes government-issued digital currencies (i.e. CBDCs) and includes digital currencies that are not government-issued but have been adopted as legal tender.

The consultation closed on 30 September 2022, and we are awaiting Treasury's response.

Staking and Airdrops

The ATO issued [information](#) on the tax treatment of staking and airdrops on 7 September 2022.

- **Staking:** Staking rewards are usually paid in a native token and can be earned in a variety of different ways. The ATO has clarified that any staking reward is ordinary income at the time of receipt, and taxpayers must declare staking rewards in their tax return as other income. Taxpayers may also need to consider whether any tokens earned as staking rewards that are later sold, give rise to any capital gain or loss and the tax implications of this.
- **Airdrops:** If a taxpayer receives tokens distributed in an initial airdrop, they do not derive ordinary income or make a capital gain at the time of receipt. The cost base of the token is zero if the token is free. If the token is not free, the cost base will be the amount paid or the value provided. A taxpayer must determine any capital gain at the time of a CGT event of an airdropped token. Alternatively, if a taxpayer, receives an established token as part of an airdrop, then in that case the token is ordinary income at the time of receipt and must be declared as other income in their income tax return.

Board of Taxation Review

In August 2022, the Board of Taxation published a [Consultation Guide](#) that provided an overview of crypto-assets, the current taxation treatment within Australia, as well as some recent relevant government reports and announcements. It raised several questions for consultation. The questions relate to the current tax treatment, taxpayer awareness, characteristics and features of crypto-assets, lessons learnt from overseas, required changes and administration of tax laws. Submissions were due on 30 September 2022, with the final report to be released by Government by 31 December 2022.

The purpose of the review conducted by the Board of Taxation is to develop an appropriate policy framework for the tax treatment of crypto-assets. As part of this, the Board will assess whether Australian taxation laws adequately address the creation, exchange and disposal of crypto-assets. In recommending the preferred approach, the Board will consider whether a separate set of tax principles need to be established, the Australian tax laws need to be amended or updated or whether a new taxing regime should be established.



About Hamilton Locke Funds & Financial Services

As Australia's fastest-growing law firm, Hamilton Locke is a law firm with a difference.

We are focused on transforming the traditional approach to corporate and commercial legal counsel. We react quickly to change while continuously driving maximum value for clients, and we hire and develop the best talent from across the globe. By making use of modern systems and technology, our team is freed up from bureaucracy and administration to really focus on doing what they do best – solving complex client problems.

Our Funds and Financial Services Team at Hamilton Locke (formerly, The Fold Legal) has become one of the go-to firms for cryptocurrency, blockchain, fintech and insurtech businesses seeking regulatory advice. We are now one of Australia's largest financial services teams as a result of the recent merger of The Fold Legal and Hamilton Locke.

We are known for our technical expertise and industry knowledge, which we use to provide practical solutions for our fintech, cryptocurrency and digital asset clients. Our ranking recognises our financial and credit services expertise in Chambers and Partners Asia-Pacific and FinTech Legal Guides. Reflecting our commitment to client service, we also won Best Law & Related Services Firm (<\$30mil) across several specialist categories over the past three years based on direct feedback from our clients.

We have been deeply steeped in the FinTech space since early 2013 and continue to deepen and strengthen this experience as one of Australia's largest and most diverse financial services practices.

We are technical specialists with a broad and deep understanding of blockchain technology, cryptocurrencies and digital assets, exchange, Decentralised Autonomous Organisations (DAO), alternate platforms and cryptocurrency products and service offerings.

Our knowledge of cryptocurrencies and digital assets, combined with our traditional financial services expertise, is market leading. We use our industry knowledge and expertise to deliver practical, compliant, and innovative solutions for our clients.

We have worked with cryptocurrency and digital asset exchanges, miners, cryptocurrency and digital asset payment businesses, cryptocurrency and digital asset platforms, DAOs and token issuers to design innovative and compliant offerings.

We are a partner and member of [Blockchain Australia](#), [FinTech Australia](#) and [Insurtech Australia](#).



FinTech Australia



Key contacts



Michele Levine - Partner

Michele is an innovative and trusted financial services lawyer that develops strong and attentive relationships with her clients. Michele acts for a broad range of clients across financial services, credit, insurance, fintech, payments and cryptocurrency. She provides support on all legal aspects, including regulatory advice on product design, service offerings, distribution, licensing, agreements, compliance obligations, transactions and regulator engagement and enforcement.

Michele understands the regulatory environment (current and emerging) and is well-placed to advise on regulatory requirements and risk mitigation strategies for businesses of all sizes. She is passionate about fintech and leads our relationship with Blockchain Australia and Fintech Australia.

Michele Levine has also recently been awarded 'Professional Advisor Leader of the Year' at Blockchain Australia's Blockies 2022 Awards.

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Jaime Lumsden - Partner

Jaime is a leading Australian expert on the application of the financial services and consumer credit regulatory regime. She delivers fearless and technically excellent advice across a range of industries, including life and general insurance, payments products, derivatives, foreign exchange, horse racing syndicates, wealth management, charitable fundraisers, business and consumer credit, but now pay later, and cryptocurrency (a niche area, where few others have the expertise and understanding).

She has been instrumental in the product design and structuring of several buy now pay later and cryptocurrency products to minimise or scale regulation in order to viably compete with incumbents and to speed up launch dates. The majority of her work involves developing novel solutions for innovative clients who need a flexible and creative approach to emerging problems in the fintech space.

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Charmian provides legal and compliance advice to a broad range of financial services industry participants, including insurance brokers, general insurers, underwriting agencies, fintechs and insurtechs. She is often engaged to provide legal sign-off on product design and development and insurance distribution, including group purchasing arrangements. She is sought out for her niche expertise in innovative insurance solutions including, parametric products, discretionary mutuals and aggregate deductible schemes.

Charmian advises on all aspects of financial services law. She loves nothing more than devising new risk products and solutions – like peer-to-peer models and other alternative risk vehicles. She also thrives on helping businesses grow and develop over time, from seed funding through to acquisition or IPO. Startups often seek her out when they need a sounding board to refine their ideas. She creatively finds new solutions that are within the boundaries of the law yet commercial in their execution.

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Erik's extensive expertise covers financial services law, funds management (including all forms of collective investment vehicles), capital raisings and structuring and provision of financial products and services to wholesale and retail clients. Underpinning this is his deep knowledge of financial services regulatory matters, including financial services licensing, marketing, disclosure, distribution and issuance of financial products.

Erik offers clients over fifteen years of specialist experience in investment funds and financial services regulation. He has advised major financial services providers on the structuring, establishment and promotion of listed and unlisted funds, and capital raisings and fund restructures.

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Simon has seen the financial services industry from many angles, having worked for the regulator, a fund manager, a big four bank and a leading law firm. He brings his broad experience in financial services and regulatory advice to help his clients create cutting-edge service offerings that are both innovative and practical.

Simon's clients are financial services businesses that hold or operate under an AFS licence, or intend to obtain an AFS licence. Simon has significant experience in wealth management and advises his clients on legal, regulatory, M&A and litigious matters. He has deep technical expertise from decades spent liaising with the regulator, managing disputes, drafting contracts and disclosure documents, and negotiating complex transactions. Simon advises on all areas of financial services law, with a particular focus on financial advice, managed accounts and regulatory disputes.

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Brendan is independently recognised as a 'leading lawyer' (Chambers Asia Pacific Guide 2014 – 2019) in the field of investment funds, and acts for fund managers in a wide range of commercial transactions. His work includes structuring and advising on property funds (wholesale and retail), preparing product disclosure statements/offer documents, joint venture agreements and other commercial agreements in relation to complex acquisition and funding arrangements, the application of the Corporations Act and ASIC regulatory policy.

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