



| | |
|-------------------------|--|
| Committee | Select Committee on Australia as a Technology and Financial Centre |
| Question No. | QoN 001 |
| Date | 27 August 2021 |
| Topic | Unlicensed Conduct Warning |
| Reference | Spoken, 27 August 2021, Hansard pages 38-39 |
| Committee member | Senator Bragg |

Question

Hansard Page 38

CHAIR: Okay. There's continual research that says that one in five Australians have exposure to crypto-assets directly. So there are going to be people out there, seeing these things, who are not investing in, or not engaging in, these products. I'll just be careful with my language here. They're going to one of these digital currency exchanges and they're buying bitcoin and they're not even thinking about derivatives. You're saying, through your official channels, that Australians should be wary of investing in crypto-asset related financial products and

Hansard Page 39

services, which is a broadbrush approach, an umbrella approach, I would have thought. That's what I'm trying to understand. Your communication is covering all the bases, but what you're saying today to the committee is that you were trying to target one particular thing.

Ms Armour: We were specifically trying to target what we call unlicensed conduct, which is where people who should have a licence are offering products without being licensed. That's what we were specifically targeting. But, more broadly, we have had a lot of reports of misconduct related to crypto-assets. And this week the ACCC published their information on their experience with scam reports to them. So there is a separate issue, and it's an issue, obviously, that's very important to ASIC and the broader community, and also to industry—to make sure that we're dealing with any behaviour that falls into that category as well.

CHAIR: There's no question about that. So how many complaints have you received about cryptocurrency?

Ms Armour: Did we actually answer that on notice? We have received quite a number of complaints about cryptocurrency. We'll give you the specific numbers.

CHAIR: It would be good to know. I understand that you've got a difficult job, operating in this particular space which is not a clear area of regulation. But I would say that, in your public statements, you put out catch-all statements to focus on one particular element. It does seem like a very broad approach that is potentially damaging. Given we don't know how many complaints you've had, it's hard to marry up those two things.

Ms Armour: We're very happy to provide you with the information. We do have that information. When you think about the breadth of the services that we regulate, it is interesting that we do receive the level of complaints we do in relation to this one product, and we're very happy to be working with your committee and also, more broadly, with industry to see what we can do to deal with that. We have issued public warnings in relation to specific entities and companies. Where we have a specific concern, we have done that.

Answer

Complaints received by ASIC about organisations, activities, or individuals in the market are recorded as reports of misconduct. Reports of misconduct received by ASIC can cover any subject matter. For example, they may cover organisations or activities ASIC regulates such as financial products and services under the *Corporations Act 2001* (the **Corporations Act**) or matters that fall outside ASIC's jurisdiction.

Answer in relation to number of complaints about crypto-assets

When ASIC receives reports of misconduct, a manual process is completed to categorise them. The manual process includes considering the claims made by the person lodging the report.

Table #1 shows the reports of misconduct received between 1 July 2019 and 31 August 2021 that have a connection to crypto-assets as identified by the person making the report as well as the total reports of misconduct received during those periods.

| Table #1 | | |
|---|---|------------------------------------|
| Time period during which reports were received | Reports of misconduct with connection to crypto-assets | Total reports of misconduct |
| 1 July 2019-30 June 2020 | 566 | 9,748 |
| 1 July 2020-30 June 2021 | 1,443 | 10,905 |
| 1 July 2021-31 August 2021 | 133 | 1,608 |

The categories applied internally are reviewed each financial year and adjusted when there is an increase in reports about a particular area of misconduct. From 1 July 2020 a new category was introduced to more consistently capture allegations about scams with a connection to crypto-assets. Table #2 shows the reports of misconduct received between 1 July 2020 and 31 August 2021 that fall within this category (subset of Table #1).

| Table #2 | |
|---|---|
| Time period during which reports were received | Reports of misconduct about scams with a connection to crypto-assets |
| 1 July 2020-30 June 2021 | 1,343 |
| 1 July 2021-31 August 2021 | 106 |

If the person lodging the report claims that they have been dealing with a scam, we generally rely on that person's interpretation and place the case in the scams category. We may also assign a case to that category where we assess that it is appropriate.

The totals for the 2020-2021 financial year include several instances when we received multiple reports about different suspected scams. In particular, we received 613 reports about one entity. We [issued an alert](#) regarding the suspicious website identified in the reports.

ASIC has released other alerts or warnings identifying and explaining other patterns of misconduct we have identified in relation to financial scams, including those connected to crypto-assets. See for example:

- [ASIC warns against fake news articles promoting investment scams | ASIC - Australian Securities and Investments Commission](#)
- [Financial scams double in 2021: reporting up more than 200% | ASIC - Australian Securities and Investments Commission](#)
- [Warning: websites displaying fake ASIC endorsements](#)
- [That celebrity-endorsed bitcoin ad is probably a scam](#)

Answer in relation to the number of complaints and the warning released by ASIC

Where ASIC receives reports about crypto-asset trading platforms that are not suspected to be false, we consider whether the allegations made in the report raise an issue in our jurisdiction. This analysis includes considering whether financial products and services are being offered to Australians without an appropriate licence.

During 2021 there were at least nine reports of misconduct about trading on crypto-asset platforms where the person reporting identified that they had traded in a crypto-asset related financial product such as futures. A number of these reports claimed to represent multiple people who had experienced monetary losses.

Reports of misconduct is one source of intelligence taken into consideration by ASIC in publishing this [Warning: Trading crypto-asset related financial products through unlicensed entities](#) on 18 August 2021. The warning reminded consumers about trading crypto-asset related financial products like derivatives through unlicensed entities and sought to highlight the absence of safeguards under the *Corporations Act 2001*.

There are many considerations and factors that inform targeted operational decisions such as the publication of the warning noted above. For example, other matters that informed the operational decision to publish the warning include:

- ASIC's legislative responsibilities and regulatory priorities;
- sources of intelligence such as:
 - activity identified by ASIC officers in the market that appeared to be unlicensed conduct under the *Corporations Act 2001*;
 - what we learned from engaging with peer regulators based overseas;
 - what we learned from engaging with entities or other stakeholders in the market;
 - publicly available information from sources such as social media; and
- public regulatory responses seen overseas by peer regulators responding to similar unlicensed activities.



| | |
|-------------------------|--|
| Inquiry | Select Committee on Australia as a Technology and Financial Centre |
| Question No. | 002 |
| Date | 27 August 2021 |
| Topic | Digital currency exchanges regulated by ASIC |
| Reference | Spoken, 27 August 2021, Hansard page 39 |
| Committee member | Senator Bragg |

Question

CHAIR: These crypto-exchange platforms' only regulatory obligation is to be licensed with AUSTRAC. ASIC doesn't have any direct regulatory obligation or engagement with digital current exchanges—is that right?

Ms Armour: I think that is broadly correct. We do want to have engagement with the industry, so we do engage in that sense. When you're talking about engagement, are you meaning that we don't regulate someone—is that your concern?

CHAIR: Yes. I'm just trying to establish formal arrangements here because, as far as the committee can see, the exchanges are registered with AUSTRAC and that's it.

Ms Armour: Yes, but if the exchanges provide, for example, as part of their offering, financial products over the product that's quoted on the exchange, then we would have an engagement with them. They may also have an Australian financial services licence. If they did that, we would then have an engagement with them. It is a little bit—

CHAIR: Of these exchanges, how many have an AFSL?

Ms Armour: I don't know whether Ms Raman knows the answer to that one.

Ms Raman: It's hard to tell, largely because we don't necessarily have a system that monitors crypto as a specific item to pull up AFSLs that might also offer—

CHAIR: So you don't know how many. Do you think you could find out?

Ms Raman: Registries aren't made to collect that kind of information, but we can take it on notice to see if it is something that we can find out through other mechanisms.

CHAIR: I think the question is: have any AFSLs been issued to digital currency exchanges? I think that would be highly relevant and topical. If you could find that out, it would be much appreciated.

Answer

ASIC's licensing registers and systems record details about entities ASIC regulates under the legislation we administer. They do not record a regulated entity's activities in relation to 'crypto-assets'¹ or whether they are also registered as a digital currency exchange (**DCE**) with AUSTRAC.

Using other information sources available to ASIC (including confidential information) we are able to identify that, as at August 2021, there were:

- at least 9 Australian financial services licence (**AFSL**) holders who were also registered by AUSTRAC as DCEs; and
- at least 5 companies that were authorised representatives of AFSL holders who were also registered by AUSTRAC as DCEs.

We note that there may be more entities that are both regulated by AUSTRAC as a DCE and ASIC.

¹ Capital expenditure is required to change ASIC's licensing application forms, registers and systems. We note that in Consultation Paper 343 *Crypto-assets as underlying assets for ETPs and other investment products*, ASIC has proposed a new category of asset-kind called 'crypto-assets' for the purposes of administering the financial services licensing requirements for responsible entities operating a registered managed investment scheme that directly invest in 'crypto-assets'. This proposal is yet to be finalised. If the proposed approach was to be implemented, this would require capital expenditure to change ASIC's forms, systems and registers to capture this new category of 'crypto-assets' in relation to Australian financial services licensees.



| | |
|-------------------------|--|
| Inquiry | Select Committee on Australia as a Technology and Financial Centre |
| Question No. | 003 |
| Date | 27 August 2021 |
| Topic | Custody arrangements in the UK and Singapore |
| Reference | Spoken, 27 August 2021, Hansard pages 40 & 41 |
| Committee member | Senator Bragg |

Question

Hansard page 40

CHAIR: Are you familiar enough to answer a couple of questions about the custody arrangements in the UK and Singapore, Mr Adams or Ms Armour?

Ms Armour: Probably not.

Mr Adams: I don't think so.

Hansard page 41

CHAIR: Can you take this on notice, then. If you can supply some information on notice about the custody arrangements in Singapore and the UK and how those securities regulators enforce those laws, that could be very useful. My sense would be that those arrangements would be something that you could obtain through your various interactions with those countries' regulators. They seem to be quite similar legal systems, so I think that would aid the committee's deliberation. Are you happy to do that?

Ms Armour: Yes, we are happy to do that.

Mr Adams: Happy to take it on notice.

CHAIR: Alright. That's good. Senator Smith, do you have any other things you would like to ask ASIC?

Senator MARIELLE SMITH: No, thank you, Chair.

CHAIR: We will look forward to those issues coming back on notice—on how many complaints you have had and issues in relation to custody. It will be very, very useful to get that back on notice. Thank you very much for your time this afternoon

Answer

In answering this question on notice, ASIC requested information from the UK Financial Conduct Authority (FCA) and the Monetary Authority of Singapore (MAS) in response to three common questions.

Below we provide a response in a consolidated form of the responses received from FCA, UK about custodial requirements in relation to crypto-assets in their jurisdiction. Followed by the answers provided by MAS of Singapore.

1. What are the current legal custodial requirements that apply in relation to crypto-asset service providers in UK – where the crypto-asset is a financial product or payments product/service and where it is not? [Note: By service provider - we're interested in any entity that holds custody of a crypto-asset (including where the service provider holds crypto-assets in custody as part of a range of services the entity provides in relation to crypto-assets)] We acknowledge that where the crypto-asset is not a financial product or payments product/service, it may be outside your current remit, but we would still appreciate any information you know about what (if any) requirements may apply.

FCA response:

- There are currently no specific (FCA) custodial requirements for firms offering (or holding) unregulated cryptoassets. In the limited circumstances where crypto-assets fall within the FCA's perimeter (i.e. security tokens), firms carrying out regulated activities relating to custody of these are likely to be subject to our general custody rules and requirements.
- The UK's legal framework for custody is set out in the FCA's client assets rules (CASS). Chapter 6 of CASS (CASS 6) provides detailed rules for investment firms to follow when holding regulated assets in custody as part of their investment business. These rules include requirements on segregation, arrangements with third parties, use of assets and appropriate recordkeeping practices and controls to reduce risk of loss or misuse of assets.
- In respect of custody, the regulated activity is typically 'safeguarding and administering investments' (Article 40 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001). Therefore, a firm safeguarding and administering a security token in the UK is likely to be subject to CASS 6 (CASS 6.1.1R).
- It may also be worth noting that e-money also falls under our remit and that e-money providers are required to safeguard funds (eg: segregation) – see <https://www.fca.org.uk/firms/emi-payment-institutions-safeguarding-requirements> for more details.. Emoney is an electronic representation of money; it is electronically stored monetary value represented by a claim on the electronic money issuer; is issued on the receipt of funds; and must be accepted by a person other than the issuer. Bitcoin types of token would unlikely constitute emoney. As part of our work with HM Treasury focusing on the regulatory framework for stablecoins, we are considering whether existing payments regulations could and should be extended to include stablecoins, particularly those backed by fiat money.
- The FCA is the AML/CTF supervisor of UK cryptoasset businesses involving all types of crypto-assets (including unregulated crypto-assets). This means that all custodian wallet providers conducting crypto-asset business in the UK are required to be registered with the FCA. For further details, please see here: <https://www.fca.org.uk/firms/financial-crime/cryptoassets-aml-ctf-regime>.

MAS response:

- MAS has informed ASIC there are no special custodial requirements at present for businesses that provide crypto-asset related services (whether in relation to crypto-assets that are financial products or not) or issue financial products with underlying crypto-assets.
- They informed ASIC that there are no requirements specific to 'digital capital markets products' or 'capital market products' for which the underlying are digital assets for example, a collective investment scheme investing in digital assets.
- They noted that existing custody rules for 'capital market products' apply. The Securities and Futures Act (SF Act) requirements apply to financial instruments and products regardless of form. That is, if the 'digital asset' is a financial product such as a security, the SF Act custody requirements apply.
- MAS also noted that the Payment Services Act (PS Act) regulates digital payment services providers ("DPT Service Providers") who provide a digital payment token service in Singapore. The primary objective of the PS Act is to regulate DPT Service Providers for money laundering and terrorist financing risk. The PS Act does not impose requirements nor regulate how DPT Service providers should provide custody of digital payment tokens.
- In January 2021, the PS (Amendment) Act ("Amendment Act") was passed, wherein providing custody for digital payment tokens will be a regulated activity of DPT Service Providers under the PS Act. The Amendment Act also gives MAS the power to impose user protections measures and such measures may include imposing requirements on how DPT Service Providers should provide custody of digital payment tokens. At present, MAS has issued no proposals for requirements for the custody of digital payment tokens under the Payment Services Act.

- MAS provided links to the Explanatory Brief to the Amendment Act and the Amendment Act itself for further information.
 - i. <https://www.mas.gov.sg/news/speeches/2020/explanatory-brief-for-payment-services-amendment-bill>
 - ii. <https://sso.agc.gov.sg/Bills-Supp/41-2020/Published/20201102?DocDate=20201102>.
2. What may be proposed legal custodial requirements by way of potential law reform in relation to crypto-asset service providers in UK – where the crypto-asset is a financial product or payments product/service and where it is not.

FCA response:

- We as an organisation continue to develop our understanding of the Crypto-assets market and crypto-related activities; custody is a particular area of focus for us.
- We regularly assess how both distributed ledger technology (DLT) and crypto-assets are being used, developing greater understanding of how this impacts custody arrangements. This includes working with our [Regulatory Sandbox](#) team to provide support on innovative propositions involving custody activities with a view to ensure that firms continue to provide adequate client assets protection.
- We appreciate that custody of crypto-assets may operate differently than custody of traditional securities (e.g. the use/storage of a private key and issues around access to tokens). We are considering whether there are any gaps in our existing CASS rules and regulatory toolkit and whether we should be considering taking further action (e.g. it could for instance include providing further clarity or additional rules in this space).

MAS response:

- MAS has indicated there is no public consultation for requirements related to custody of crypto-assets that are financial products or in relation to crypto-assets that are not financial products.
3. If not required by law, what industry custodial standards are considered good practice within UK for the holding of crypto-assets – again, whether a crypto-asset that is a financial or payments product/service or not.

FCA response:

- We are not aware of any industry rules or standards in relation specifically to custody of unregulated tokens. However, we know that this is an area of interest for the industry.
- The FCA's Principles for Business ([PRIN](#)) contain 11 high level principles which apply to all FCA regulated firms. This includes, among other requirements, a requirement to arrange adequate protection for clients' assets when it is responsible for them (Principle 10). These Principles may apply, in certain circumstances, to unregulated activities carried out by authorised firms.
- Not specific to custody but see <https://www.fca.org.uk/news/news-stories/consumer-warning-binance-markets-limited-and-binance-group> for an example of the type of action the FCA has recently taken in respect of crypto-assets.

MAS Answer:

- MAS has informed ASIC that there are no industry custodial standards for crypto-assets.