

Token mapping: developing appropriate regulatory settings for the crypto sector

KPMG submission

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[KPMG.com.au](https://www.kpmg.com.au)

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Executive summary

KPMG Australia (KPMG) welcomes the opportunity to provide a submission to Treasury on its token mapping consultation (the consultation).

KPMG supports the government's commitment to improve the way Australia's regulatory system manages crypto assets in order to provide greater protections for consumers and ensure regulatory settings keep up with technological developments.

KPMG supports the government's commitment to improve the way Australia's regulatory system manages crypto assets in order to provide greater protections for consumers and ensure regulatory settings keep up with technological developments.

KPMG has previously recommended a token mapping exercise as a foundational step in determining regulatory requirements in submissions on licensing and custody requirements for crypto asset secondary service providers,¹ and the tax treatment of digital assets and transactions.²

After the token mapping exercise, licensing and custody reforms are an important next step for crypto reforms. KPMG's submission on licensing and custody requirements for crypto asset secondary service providers discussed proposed obligations on providers that aim to support consumer confidence and provide regulatory certainty to crypto businesses and service providers.

KPMG recognises the complexity in seeking to classify crypto assets given the ability for assets to serve multiple functions or purposes and the potential for this to change over time.

In this response, KPMG has outlined 15 recommendations at Section 1, and provided insights in relation to the consultation paper and directly responded to the consultation questions at Section 2.

If you would like to discuss the contents of this submission further, please do not hesitate to reach out.

Yours sincerely,

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¹ <https://kpmg.com/au/en/home/insights/2022/07/crypto-assets-kpmg-submission.html>

² <https://kpmg.com/au/en/home/insights/2022/11/tax-treatment-of-digital-assets-and-transactions-kpmg-submission.html>

Background

About KPMG

KPMG is a global organisation of independent professional firms, providing a full range of services to organisations across a wide range of industries, governments and not-for-profit sectors. We operate in 146 countries and territories and have more than 227,000 people working in member firms around the world. In Australia, KPMG has a long tradition of professionalism and integrity combined with our dynamic approach to advising clients in a digital-driven world.

Section 1:

KPMG recommendations

RECOMMENDATION 1:

KPMG considers that token mapping is a critical first step in understanding the crypto ecosystem and ensuring a consistent and fair approach to the regulation of crypto assets in Australia.

RECOMMENDATION 2:

KPMG considers that digital assets are too global in nature to have differing approaches to regulation, and that Australia's regulatory regime should aim to ensure alignment, where possible, to international best practice.

RECOMMENDATION 3:

KPMG is supportive of regulation of the crypto ecosystem as it will bring a number of benefits, including investor confidence, regulatory certainty, and reduced risk to consumers. Changes to the regulatory framework should aim to be as technology neutral as possible.

RECOMMENDATION 4:

KPMG recommends the token mapping process be completed before taking action on potential safeguards for consumers and investors. The token mapping exercise will play an important role in defining crypto assets and the appropriate corresponding regulatory requirements.

RECOMMENDATION 5:

KPMG recommends that measures such as rules for listing tokens, qualifying investors' capacity to understand risks, and regulatory and licensing requirements on exchanges and secondary service providers could be considered to help protect consumers from scams. It may also be helpful to consider how scams are addressed in relation to other types of products and services.

RECOMMENDATION 6:

KPMG does not consider that the concept of 'exclusive use or control' of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records, as it exists in both crypto networks and other data records. We believe there are better definitions of a crypto asset, and support the development of a single definition applied across all regulatory frameworks, that aligns with definitions used by the Financial Action Task Force.

RECOMMENDATION 7:

KPMG supports a crypto asset taxonomy that maps tokens based on their characteristics and use. KPMG recognises the complexity in seeking to classify crypto assets, however it is still a worthwhile and beneficial exercise in determining the right regulatory requirements for different types of assets.

RECOMMENDATION 8:

KPMG recommends the regulation of 'wrapped' real world assets should follow the regulation of the real-world asset itself, including relevant AML/CTF or KYC requirements. Consideration could also be made to any risk to financial stability and market integrity that may arise from hedging and synthetic leverage.

RECOMMENDATION 9:

KPMG considers there are a number of regulatory levers that would assist crypto asset service providers in promoting good consumer outcomes, including:

- ensuring listed token projects by crypto exchanges are audited, classified or differentiated from other offerings, subject to additional consumer protection requirements, and subject to a more stringent audit, review and approval process; and

- mandating transparency, independence, disclosure and management of conflicts of interests in crypto exchanges, and consideration of whether the operator of a crypto exchange should ensure that it is managed in a fair, orderly and transparent way.

RECOMMENDATION 10:

KPMG recommends that token mapping should be conducted more broadly than through the Corporations Act. When considering whether to define certain assets as financial products, it may be helpful to consider the objectives of the Corporations Act and consider consistency with comparable examples where non-crypto products have been included or excluded from the definition, or given conditional relief.

RECOMMENDATION 11:

KPMG considers that a dedicated crypto regulatory regime is needed for those assets that require regulatory guidelines but for which the existing regime is inappropriate. There are a number of considerations to assess including whether token issuers should be limited in what blockchains are used for wrapped asset projects.

RECOMMENDATION 12:

KPMG recommends that additional frameworks and guidelines should be provided for the area of intermediated crypto assets linked to intangible property.

RECOMMENDATION 13:

It may be beneficial to compare Australia's current general consumer protections in relation to the marketing of crypto assets and services with any additional protections that are provided overseas. These could then be assessed for their suitability for the Australian context.

RECOMMENDATION 14:

KPMG recommends that empowering a regulatory body to develop and provide guidance to users of Decentralised Finance would be beneficial to help them assess risk.

RECOMMENDATION 15:

KPMG considers it will be important to consider how the regulation of pawn broker lending will align with broader crypto regulation.

Section 2:

KPMG insights

KPMG insights

KPMG welcomes the government's commitment to improving the way Australia's regulatory system manages crypto assets, and considers that token mapping is a critical first step in understanding the crypto ecosystem and ensuring a consistent and fair approach to the regulation of crypto assets in Australia.

KPMG has previously recommended a token mapping exercise as a foundational step in determining regulatory requirements.

The consultation paper states that "token mapping is essential to understanding the crypto ecosystem and its interaction with Australia's existing regulatory frameworks – in particular, the financial services framework." While the financial services framework is an important aspect for crypto regulation, and will work for financial law, KPMG considers this approach may be too narrow and not work for other purposes such as consumer protection or tax regulation.

Fit for purpose regulation is essential to unlocking the innovation and benefits that technology advancements can provide. To minimise the limitations that regulatory frameworks can create, KPMG considers that regulations should be developed in consultation through a full industry consultation process, reviewed regularly, and aim to be as technology neutral as possible.

KPMG notes the comments in the consultation paper about international approaches to crypto ecosystem regulation. The consultation paper finds that globally, the regulatory frameworks for the crypto ecosystem are being actively considered with different approaches emerging. KPMG considers that digital assets are too global in nature to have differing approaches to regulation, and that Australia's regulatory regime should aim to ensure alignment, where possible, to international best practice.

We also note the difficulty of enforcing obligations on large international providers delivering services from overseas. However, in our view, the distributed and global nature of these services should not be a basis for excluding them from regulation in Australia.

Finally, KPMG considers there is a need to clearly outline the policy objectives that will underpin a regulatory regime for crypto assets.

Approach to token mapping

KPMG recognises the complexity in seeking to classify crypto assets given the ability for assets to serve multiple functions or purposes and the potential for this to change over time.

KPMG has previously outlined a number of categories that could arise when classifying assets according to their function or purpose. Given this consultation paper has outlined a number of categories of assets in its reference to a high-level taxonomy in paragraph 48 and footnotes 56-59, we have updated our wording to be consistent with the consultation paper.

- Payment tokens which predominately serve as a means of exchange and digital financial currency;
- Utility tokens (e.g., access to a football game, good/services or other right/benefit);
- Hybrid – combination of both. Could be used as a payment token currency but also utility;
- Security/equity (and/or asset) token – which provide interests similar to shares, units, debt or property assets for yield generation and investment purposes; and
- Non-fungible tokens (NFTs) which are predominantly used as a means of ensuring digital scarcity, uniqueness, and utility. NFTs can also have characteristics of being another token and as such, should also be appropriately categorised by its function or purpose other than simply/solely by possessing the characteristic of being 'non-fungible', for example a utility token (where the NFT grants access to some type of utility), or security token.

Further to the above, it may be worth considering whether to distinguish between collateralised and non-collateralised assets. This could impact the risk profile of the token and therefore be taken into consideration in a risk-based regulatory approach.

The robustness of the token mapping exercise with an ability to deal with changes and evolutions to digital assets through classification of tokens and related transactions will be critical. This may need inclusion of certain discretions for the regulators to deem classifications where

particular characteristics are unclear or unable to be determined on an ongoing basis.

RECOMMENDATION 1:

KPMG considers that token mapping is a critical first step in understanding the crypto ecosystem and ensuring a consistent and fair approach to the regulation of crypto assets in Australia.

RECOMMENDATION 2:

KPMG considers that digital assets are too global in nature to have differing approaches to regulation, and that Australia's regulatory regime should aim to ensure alignment, where possible, to international best practice.

Response to consultation questions

Q1) What do you think the role of Government should be in the regulation of the crypto ecosystem?

KPMG is supportive of regulation in Australia to support investor, consumer, and public confidence and provide certainty, which in turn will ensure that Australia retains its competitiveness and ability to attract investment.

An appropriate regulatory regime for the crypto ecosystem will bring a number of benefits, including better regulatory certainty, increased transparency of information, and improving the quality of services by setting a minimum standard for service providers.

It will also minimise the risks to consumers and offer improved investor and consumer protections, and help maintain financial stability, which could encourage and support further innovation in the sector.

Changes to the regulatory framework should aim to be as technology neutral as possible, to ensure it applies appropriately to the crypto asset landscape now but also future advancements in technology.

RECOMMENDATION 3:

KPMG is supportive of regulation of the crypto ecosystem as it will bring a number of benefits, including investor confidence, regulatory certainty, and reduced risk to consumers. Changes to the regulatory framework should aim to be as technology neutral as possible.

Q2) What are your views on potential safeguards for consumers and investors?

KPMG is supportive of safeguards for consumers and investors, such as licensing and custody reforms for the crypto environment.

However, we note that the token mapping exercise will form a foundational role in defining crypto assets and the corresponding regulatory requirements, and will also provide guidance in determining the assets that should be subject to oversight, reporting, disclosure and record-keeping requirements. As such, KPMG recommends the token mapping process be completed before taking action on safeguards.

When considering potential safeguards for consumers and investors, it will be important to provide guidance on which regulatory bodies will have oversight over the crypto ecosystem. For example, from a financial crime perspective, there is currently a lack of clear instructions on how or who should be monitoring crypto assets and transactions. It would be beneficial to provide greater guidance (either from AUSTRAC or another body) on this.

KPMG supports alignment with existing regulatory regimes, but notes that some products, services, or offerings may require more or less regulation in line with the risks associated.

In order to minimise regulatory burden, it is important to ensure any obligations and requirements introduced are appropriate according to the type of asset, service, or product being provided and captured under the regulatory regime. This will enhance regulatory certainty and limit the risks to consumers, without imposing unduly challenging requirements.

We also note that when considering safeguards, consideration should be given to key regulatory pillars such as anti-money laundering and counter-terrorism financing (AML/CTF), tax and financial stability. There are currently gaps in these regimes for regulating crypto assets and services which should be addressed.

RECOMMENDATION 4:

KPMG recommends the token mapping process be completed before taking action on potential safeguards for consumers and investors. The token mapping exercise will play an important role in defining crypto assets and the appropriate corresponding regulatory requirements.

Q3) Scams can be difficult for some consumers to identify.

a) Are there solutions (e.g., disclosure, code auditing or other requirements) that could be applied to safeguard consumers that choose to use crypto assets?

Giving the evolving nature of technology in this area, it can be difficult for consumers and regulation to keep up.

There are a number of measures that could be considered to safeguard consumers against scams when dealing with crypto assets. KPMG considers that it would be useful to set out rules for using the system – for example, there are rules that must be followed when listing on the ASX, and a similar approach could be considered for listing coins. This would make it easier for consumers to assess risk.

Another approach may be to qualify investors' capacity to understand the risks involved, in a manner similar to securities markets, where a 'sophisticated investor'³ is given an exemption under the Corporations Act to buy financial products without a regulated disclosure document such as a prospectus or product disclosure statement and where retail customers receive certain protections (including disclosure and product suitability e.g., under the design and distribution obligations).

b) What policy or regulatory levers could be used to ensure crypto token exchanges do not offer scam tokens or more broadly, prevent consumers from being exposed to scams involving crypto assets?

KPMG considers that there are a number of levers that could be used to help ensure crypto token exchanges do not offer scam tokens, or protect consumers from being exposed to scams. For example, regulatory and licensing requirements on crypto asset secondary service providers could help mitigate risks to consumers. KPMG has detailed recommendations on this in our previous submission,⁴ however KPMG notes the need to finalise the token mapping exercise before looking at this regulatory regime.

It may also be helpful to consider how scams are addressed in relation to other types of products and services. For example, the UK's confirmation of payee and contingent reimbursement model code in relation to payments systems, and the broader work and consultations that the ACCC undertakes in relation to scams and fraud prevention.

³ <https://moneysmart.gov.au/glossary/sophisticated-investor>

RECOMMENDATION 5:

KPMG recommends that measures such as rules for listing tokens, qualifying investors' capacity to understand risks, and regulatory and licensing requirements on exchanges and secondary service providers could be considered to help protect consumers from scams. It may also be helpful to consider how scams are addressed in relation to other types of products and services.

Q4) The concept of 'exclusive use or control' of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records.

a) How do you think the concepts could be used in a general definition of crypto token and crypto network for the purposes of future legislation?

b) What are the benefits and disadvantages of adopting this approach to define crypto tokens and crypto networks?

KPMG considers that it is difficult to say that the concept of 'exclusive use or control' of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records, as it exists in both crypto networks and other data records.

In our view there are better definitions of a crypto asset. As per our submission on licensing and custody requirements for crypto asset secondary service providers, KPMG supports the development of a single definition of crypto assets to be applied across the spectrum of regulatory frameworks. KPMG encourages alignment with the definitions used by the Financial Action Task Force given the likely adoption of these definitions by the OECD.

RECOMMENDATION 6:

KPMG does not consider that the concept of 'exclusive use or control' of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records, as it exists in both crypto networks and other data records. We believe there are better definitions of a crypto asset, and support the development of a single definition applied across all regulatory frameworks, that aligns with definitions used by the Financial Action Task Force.

⁴ <https://kpmg.com/au/en/home/insights/2022/07/crypto-assets-kpmg-submission.html>

Q5) This paper sets out some reasons for why a bespoke 'crypto asset' taxonomy may have minimal regulatory value.

a) What are additional supporting reasons or alternative views on the value of a bespoke taxonomy?

b) What are your views on the creation of a standalone regulatory framework that relies on a bespoke taxonomy?

c) In the absence of a bespoke taxonomy, what are your views on how to provide regulatory certainty to individuals and businesses using crypto networks and crypto assets in a non financial manner?

KPMG supports a crypto asset taxonomy that maps tokens based on their characteristics and use.

The taxonomy or token mapping exercise will form a foundational role in defining crypto assets and the corresponding regulatory requirements, and will also provide guidance in determining the assets that should be subject to oversight, reporting, disclosure and record-keeping requirements.

We note that the consultation paper outlines characteristics of different tokens that could be used in a token mapping or taxonomy exercise in paragraph 48 and footnotes 56-59, however has not used this approach. These examples are good, however, in our view could be more exhaustive.

KPMG recognises the complexity in seeking to classify crypto assets given the ability for assets to serve multiple functions or purposes and the potential for this to change over time, however it is still a worthwhile and beneficial exercise in determining the right regulatory requirements for different types of assets.

It will also be important to consider the ability of the taxonomy to deal with changes and evolutions to digital assets through classification of tokens and related transactions will be critical. This may necessitate inclusion of certain discretions for the regulators to deem classifications where particular characteristics are unclear or unable to be determined on an ongoing basis.

Finally, the token mapping exercise should be fit for purpose across all regulatory fields, such as tax, financial stability, AML/CTF, and consumer protection. This approach would also provide guidance for government regulatory bodies in determining the assets subject to oversight and reporting (e.g., AUSTRAC, ASIC, etc).

RECOMMENDATION 7:

KPMG supports a crypto asset taxonomy that maps tokens based on their characteristics and use. KPMG recognises the complexity in seeking to classify crypto assets, however it is still a worthwhile and beneficial exercise in determining the right regulatory requirements for different types of assets.

Q6) Some intermediated crypto assets are 'backed' by existing items, goods, or assets. These crypto assets can be broadly described as 'wrapped' real world assets.

a) Are reforms necessary to ensure a wrapped real world asset gets the same regulatory treatment as that of the asset backing it? Why? What reforms are needed?

b) Are reforms necessary to ensure issuers of wrapped real world assets can meet their obligations to redeem the relevant crypto tokens for the underlying good, product, or asset?

KPMG considers that given the underlying or existing asset is subject to existing regulation, the digital 'skin' or wrapping should not insulate users from the underlying regulation for the existing asset.

As such, the regulation of 'wrapped' real world assets should follow the regulation of the real-world asset itself, including relevant AML/CTF or KYC requirements.

As an example, some tokens may represent real estate assets. In this example, current financial regulations apply including licensing requirements.

In our view it is important to appropriately define wrapping and the relationship between wrapped real world assets and the asset itself as this is missing from the consultation paper. This would also enable consistent standards or assurance for these types of assets.

Consideration could also be made to any risk to financial stability and market integrity that may arise from hedging and synthetic leverage.

RECOMMENDATION 8:

KPMG recommends the regulation of 'wrapped' real world assets should follow the regulation of the real-world asset itself, including relevant AML/CTF or KYC requirements. Consideration could also be made to any risk to financial stability and market integrity that may arise from hedging and synthetic leverage.

Q7) It can be difficult to identify the arrangements that constitute an intermediated token system.

a) Should crypto asset service providers be required to ensure their users are able to access information that allows them to identify arrangements underpinning crypto tokens? How might this be achieved?

b) What are some other initiatives that crypto asset service providers could take to promote good consumer outcomes?

KPMG's submission on licensing and custody requirements for crypto asset secondary service providers (CASSPrs) explores potential regulatory obligations for CASSPrs to help mitigate risks to consumers. In response to Question 7, we note the following section from our previous submission:

We are of the view that several categories of providers may exist within the framework and be held accountable under any proposed regulatory framework. Accordingly, depending on the nature of the CASSPrs (i.e., exchange, broker, investment protocol etc), the specific obligations may be varied for each. For example, some categories might include:

- those with custody of crypto assets;
- those who are market makers;
- those who are crypto brokers or trading intermediaries;
- those who offer entirely decentralised and non-custodial services; or
- those participating in decentralised autonomous organisations (DAOs).

In respect of non-custodial services, it may be impractical to impose and enforce any regulatory regime given the potential absence of any individual entity or source of control or ownership within these services.

That is not to preclude entirely the regulatory oversight of such non-custodial and decentralised services, but rather to capture regulatory oversight in key consumer access or on-ramp points, such as CASSPrs.

Key areas of CASSPrs which KPMG consider should follow a risk-based regulation scheme include:

- ensuring listed token projects by crypto exchanges are audited, classified or differentiated from other offerings (i.e., mapped products), and subject to additional consumer protection requirements (i.e., disclaimers or warning); subject to a more

stringent audit, review and approval process; and

- mandating transparency, independence, disclosure and management of conflicts of interests in crypto exchanges (e.g., promoting own books, front running on market making, or otherwise manipulating a market), and consideration of whether the operator of a crypto exchange should ensure that it is managed in a fair, orderly and transparent way.

It is important to ensure that any regulation imposed achieves an appropriate balance of minimising risks without stifling innovation or driving activity outside of cooperative or well-intentioned stakeholders within the industry (i.e., dark web and criminal enterprise).

RECOMMENDATION 9:

KPMG considers there are a number of regulatory levers that would assist crypto asset service providers in promoting good consumer outcomes, including:

- ensuring listed token projects by crypto exchanges are audited, classified or differentiated from other offerings, subject to additional consumer protection requirements, and subject to a more stringent audit, review and approval process; and
- mandating transparency, independence, disclosure and management of conflicts of interests in crypto exchanges, and consideration of whether the operator of a crypto exchange should ensure that it is managed in a fair, orderly and transparent way.

Q8) In addition to the functional perimeter, the Corporations Act lists specific products that are financial products. The inclusion of specific financial products is intended to both: (i) provide guidance on the functional perimeter; (ii) add products that do not fall within the general financial functions.

a) Are there any kinds of intermediated crypto assets that ought to be specifically defined as financial products? Why?

b) Are there any kinds of crypto asset services that ought to be specifically defined as financial products? Why?

It may be beneficial to conduct token mapping more broadly than just the Corporations Act, including other financial services laws such as the *National Consumer Credit Protection Act*

2009 (Cth), the *AML/CTF Act 2006* (Cth), the *Australian Securities and Investments Commission Act 2001* (Cth), and taxation laws.

To determine if various intermediated crypto assets ought to be defined as financial products under the Corporations Act, KPMG notes that it may be helpful to consider the objectives of the Corporations Act, and also compare the purpose of including certain crypto assets into the definition of financial product against any similar purposes for which products have already been included or excluded from the definition, or given conditional relief.

The objectives of the Corporations Act may generally include the protection of consumers' interests and confidence (including investor protection), and promoting market stability and the overall creation of wealth for Australians. Accordingly, there may be a question of whether the inclusion of certain intermediated crypto assets as financial products supports the Corporations Act's objectives, as well as the associated regulatory impact.

As one example, Australian Carbon Credit Units (ACCUs) were added to the definition of financial product in the Corporations Act in 2011. The stated purpose of this included to protect purchasers of ACCUs in a new area where there was not familiarity with offsets credits issued by government, and to reduce the risk of misconduct in the market.⁵

It may also be relevant to consider circumstances where products have been excluded from the definition of financial product or to consider products for which relief has been provided in respect of the regulatory obligations unconditionally or conditionally. For example, when considering the issues that relate to non-cash payment (NCP) facilities, ASIC notes that if financial services in relation to NCP facilities are not conducted with competency and integrity, a substantial loss of value may arise, and there is a clear intention that NCP facilities be regulated under the financial services regulatory regime.⁶ However, ASIC goes on to explain that not all NCP facilities were intended to be caught by the regime, and it was also clear that not all NCP facilities should be subject to the full licensing, conduct and disclosure requirements.⁷ ASIC stated that this was because the cost of complying with these requirements may not be justified given the risk created by the NCP facility.⁸ Accordingly, certain products were

either declared to not be financial products (e.g. loyalty schemes), given unconditional licensing, conduct and disclosure relief (e.g. gift vouchers), or given conditional licensing, conduct and disclosure relief (e.g. low value NCP facilities).⁹

Accordingly, it may be helpful to consider whether the different intermediated crypto assets could be compared in a similar way to historical amendments and relief to the definition of financial product.

RECOMMENDATION 10:

KPMG recommends that token mapping should be conducted more broadly than through the Corporations Act. When considering whether to define certain assets as financial products, it may be helpful to consider the objectives of the Corporations Act and consider consistency with comparable examples where non-crypto products have been included or excluded from the definition, or given conditional relief.

Q9) Some regulatory frameworks in other jurisdictions have placed restrictions on the issuance of intermediated crypto assets to specific public crypto networks. What (if any) are appropriate measures for assessing the suitability of a specific public crypto network to host wrapped real world assets?

KPMG understands that some other jurisdictions are considering or have implemented regulatory frameworks around the issuance of intermediated crypto assets.

For example, the proposed European Union's Markets in Crypto-Assets (MiCA) Regulation puts some requirements on the information to be provided in the white paper on such asset-referenced technology and the underlying technology.¹⁰ While this does not explicitly refer to specific public crypto networks, this regulation does provide some insight on the suitability of these assets.

KPMG considers that a dedicated crypto regulatory regime is needed for those assets that require regulatory guidelines but for which the existing regime is inappropriate (e.g., United Kingdom, MiCA, United States, and Singapore).

⁵ Paragraph 1.13 of the Explanatory Memorandum to the Carbon Credits (Consequential Amendments) Bill 2011: https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r4535_ems_527563ec-4969-4ab1-bbfc-8d5a06b7bd05/upload_pdf/353708.pdf;fileType=application%2Fpdf.

⁶ Paragraph 9 of ASIC Policy Statement [PS 185], Proposed policy statement for non-cash payment facilities, Regulation impact statement (RIS), November 2005: https://download.asic.gov.au/media/1346264/RIS_ps185.pdf.

⁷ Paragraph 10 of ASIC Policy Statement [PS 185], Proposed policy statement for non-cash payment facilities, Regulation impact statement (RIS), November 2005: https://download.asic.gov.au/media/1346264/RIS_ps185.pdf.

⁸ *Ibid*.

⁹ Table 1 of ASIC Regulatory Guide 185: Non-cash payment facilities, 15 November 2005: <https://download.asic.gov.au/media/5702401/rg185-published-15-november-2005-20200727.pdf>

¹⁰ https://eur-lex.europa.eu/resource.html?uri=cellar:f69f89bb-fe54-11ea-b44f-01aa75ed71a1.0001.02/DOC_2&format=PDF

When considering this, it will be important to assess:

- Whether token issuers should be limited in what blockchains they use for wrapped asset projects; and
- If yes to the above, what are the criteria for assessing whether a public blockchain is appropriate for a wrapped asset project.

RECOMMENDATION 11:

KPMG considers that a dedicated crypto regulatory regime is needed for those assets that require regulatory guidelines but for which the existing regime is inappropriate. There are a number of considerations to assess including whether token issuers should be limited in what blockchains are used for wrapped asset projects.

Q10) Intermediated crypto assets involve crypto tokens linked to intangible property or other arrangements. Should there be limits, restrictions or frictions on the investment by consumers in relation to any arrangements not covered already by the financial services framework? Why?

KPMG considers that more guidance is needed on how the transaction of intermediated crypto assets linked to intangible property should be monitored. In our experience there is a lack of framework for this, and parties such as major banks do not have clarity on what needs to be done for these arrangements.

RECOMMENDATION 12:

KPMG recommends that additional frameworks and guidelines should be provided for the area of intermediated crypto assets linked to intangible property.

Q11) Some jurisdictions have implemented regulatory frameworks that address the marketing and promotion of products within the crypto ecosystem (including network tokens and public smart contracts). Would a

similar solution be suitable for Australia? If so, how might this be implemented?

KPMG notes that it may be beneficial to compare what general consumer protections are provided in relation to the marketing of crypto assets and services in Australia, to what additional regulatory protections are provided overseas that do not yet exist but may be suitable for Australia.

For example, in Dubai, the Virtual Assets Regulatory Authority (VARA) recently introduced regulations that include obligations relating to the marketing, advertising, and promotion of virtual assets (VA).¹¹ The regulations apply to certain entities (licensed and unlicensed by VARA) that provide specific activities in relation to VA.¹² In addition to similar consumer protections that exist under Australian law such as the prohibition on misleading consumers, VARA's regulations include VA specific obligations including to:

- not imply an urgency to buy VA in anticipation of future gains, or create a fear of missing out on future gains, by not buying now;¹³
- not advocate the purchase of VA using credit or other interest accruing facilities;¹⁴ and
- include a prominent disclaimer that the value of VA is variable (up and/or down), cannot be guaranteed, and can be highly volatile.¹⁵

Using this example, it could then be considered whether additional protections are suitable in Australia under the existing consumer protection regimes or through the introduction of new regimes.

RECOMMENDATION 13:

It may be beneficial to compare Australia's current general consumer protections in relation to the marketing of crypto assets and services with any additional protections that are provided overseas. These could then be assessed for their suitability for the Australian context.

¹¹ See VARA's website: <https://www.vara.ae/en/>

¹² See Paragraph 1 under the heading 'General Principles applicable to this Marketing Regulation in full' in VARA's Administrative Order 01/2022: Relating to Regulation of Marketing, Advertising and Promotions Related to Virtual Assets: <https://www.vara.ae/media/Administrative-Order-01-%20Regulatory-Guidelines-on-Marketing-Advertising-and-Promotions-related-to-Virtual-Assets-27Jan2023.pdf>

¹³ Paragraph 1(vii) under the heading 'II Marketing Regulation' in VARA's Administrative Order 01/2022: Relating to Regulation of Marketing, Advertising and Promotions Related to Virtual Assets: <https://www.vara.ae/media/Administrative-Order-01-%20Regulatory-Guidelines-on-Marketing-Advertising-and-Promotions-related-to-Virtual-Assets-27Jan2023.pdf>

¹⁴ Paragraph 1(viii) under the heading 'II Marketing Regulation' in VARA's Administrative Order 01/2022: Relating to Regulation of Marketing, Advertising and Promotions Related to Virtual Assets: <https://www.vara.ae/media/Administrative-Order-01-%20Regulatory-Guidelines-on-Marketing-Advertising-and-Promotions-related-to-Virtual-Assets-27Jan2023.pdf>

¹⁵ Paragraph 1(iii) under the heading 'II Marketing Regulation' in VARA's Administrative Order 01/2022: Relating to Regulation of Marketing, Advertising and Promotions Related to Virtual Assets: <https://www.vara.ae/media/Administrative-Order-01-%20Regulatory-Guidelines-on-Marketing-Advertising-and-Promotions-related-to-Virtual-Assets-27Jan2023.pdf>

Q12) Smart contracts are commonly developed as ‘free open source software’. They are often published and republished by entities other than their original authors.

a) What are the regulatory and policy levers available to encourage the development of smart contracts that comply with existing regulatory frameworks?

b) What are the regulatory and policy levers available to ensure smart contract applications comply with existing regulatory frameworks?

KPMG considers that empowering a regulatory body to develop and provide guidance to users of Decentralised Finance technologies would be beneficial. This guidance could provide information on higher and lower risk activities.

Additionally, setting appropriate standards for smart contracts would encourage applications that comply with existing regulatory frameworks. As an example, OpenZepplin is a third party currently providing smart contract standards.¹⁶ This approach could align “regulation by code” to the desired legislative outcomes.

RECOMMENDATION 14:

KPMG recommends that empowering a regulatory body to develop and provide guidance to users of Decentralised Finance would be beneficial to help them assess risk.

Q13) Some smart contract applications assist users to connect to smart contracts that implement a pawn broker style of collateralised lending (i.e., only recourse in the event of default is the collateral).

a) What are the key risk differences between smart contract and conventional pawn broker lending?

b) Is there quantifiable data on the consumer outcomes in conventional pawn broker lending compared with user outcomes for analogous services provided through smart contract applications?

While the consumer protections of the ASIC Act apply to pawn broker lending¹⁷, it generally sits outside the National Consumer Credit Protection Act (with some exceptions)¹⁸, and has its own regulatory framework. It will be important to consider how the regulation of pawn broker lending will align with broader crypto regulation.

¹⁶ <https://www.openzeppelin.com/>

¹⁷ See Part 2, Division 2 of the Australian Securities and Investments Commission Act 2001 (ASIC Act).

RECOMMENDATION 15:

KPMG considers it will be important to consider how the regulation of pawn broker lending will align with broader crypto regulation.

Q14) Some smart contract applications assist users to connect to automated market makers (AMM).

a) What are the key differences in risk between using an AMM and using the services of a crypto asset exchange?

b) Is there quantifiable data on consumer outcomes in trading on conventional crypto asset exchanges compared with user outcomes in trading on AMMs?

In some cases, automated market makers (AMMs) are able to provide better outcomes for consumers. By comparison, CeFi has limited visibility and requires trusting a centralised entity about proof of reserves.

AMM relies on smart contracts operating as intended or as marketed. Given this, some industry standards would be helpful to manage consumer risk. Alternatively, consumer guidance provided by the regulator could help increase consumer awareness of the different risks involved and help them make informed decisions, in a similar way to SmartTraveller guidance.

By contrast, CeFi relies on one central actor – a central operator – to ensure it is operating appropriately, including holding keys in a safe manner and holding necessary proof of reserves. Regulation on crypto asset secondary service providers will be important in addressing these risks.

¹⁸ See for example section 6(9) of the National Credit Code, which is Schedule 1 of the National Consumer Credit Protection Act 2009 (Cth), and states that the unjust transactions provisions apply to pawnbroking in certain circumstances.



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