Blockchain Australia

PROMOTING BLOCKCHAIN INNOVATION IN AUSTRALIA

13 June 2022

Submission on Crypto Asset secondary service providers: Licensing and custody requirements Consultation Paper

Blockchain Australia is Australia's peak industry network for businesses implementing or evaluating blockchain or distributed ledger technology. Collectively, Blockchain Australia members and the industries they service advance the adoption of blockchain technology in Australia. The members and industry partners work together to advocate for appropriate regulatory and policy settings.

The development of this submission involved hundreds of engagements with stakeholders including digital currency exchanges that represent the vast majority of digital asset trade in Australia, members of the legal fraternity from across the country, academics and financial industry stakeholders.

The industry consultation was broad and the output below reflects a synthesis of those views. Though not unanimous in all respects the views with respect to the Treasury consultation were consistent. We seek a fit for purpose, technology neutral, regulatory framework with robust protections for consumers and a focus on driving innovation and investment.

The submission was supported by many digital asset exchanges in Australia and we thank our members in particular for their contributions.

In the preparation of this submission, Blockchain Australia was greatly assisted by The Fold Legal - Holley Nethercote - Blockchain & Digital Assets Services + Law - Piper Alderman - Hall and Wilcox. We extend our gratitude to them for their efforts.

Introduction

The blockchain and cryptocurrency industry does not lack hyperbole. It should not however be mistaken for an overstatement of the opportunity that it presents.

In 2019 when the Department of Industry released the National Blockchain Roadmap, Australia's place in an international narrative would most politely have been described as lacking.

In 2022 the narrative includes Australia as forward leaning, open minded and ready to play a part in the development of the international regulatory landscape.

Australia is, with cause, viewed as a strategically important jurisdiction. The success of the recently completed Blockchain Week is testament to that. It reflected the greatest concentration of international interest we have ever seen. By the numbers it represented millions of organic social impressions, participation by businesses that represent hundreds of billions of dollars in economic value, thousands of attendees including 6000 unique day one participants. The week is a snapshot of Australia's position in the world.

The 5 days spoke to the role of mainstream financial institutions, ecosystem builders, retail interest, regulation and the startup ecosystem. It will act as a time capsule reflecting what we achieved over a short period of time. Where we go from here will be referenced and benchmarked.

Importantly, the participation of the global community was underpinned by the understanding that our jurisdiction has an important role to play in developing a bespoke, fit for purpose regime.

Objectives

The Government's regulatory objectives set out in the consultation paper are:

- ensuring that regulation is **fit for purpose**, **technology neutral** and **risk-focussed**
- creating a **predictable**, **light touch**, **consistent** and **simple** legal framework;
- avoiding **undue restrictions**;
- recognising the **unique nature** of crypto assets; and
- harnessing the **strengths** of the private sector.

The industry shares this aim wholeheartedly. The development of a framework that can reflect these aims and provides confidence to Government in the protection of retail and non-retail consumers is achievable through the creation of greater transparency, certainty and investment opportunities.

Responses

1. **Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'?**

The principle of a holistic definition is welcomed. Reference to 'crypto' is not technology neutral and goes against the Government's regulatory objectives; reference to 'asset' will mean the legislation is an inadequate future fit.

The included and excluded scope of the term settled upon will be critical in determining whether it will be able to serve the intended purpose. We do not believe the discussion is yet mature enough to make that determination.

We do not agree with the use of the term CASSPr. A settled understanding of the scope of the term is required and the proposed term raises more questions than it answers.

The use of the term CASSPr is likely to result in confusion for a number of reasons including:

- 'Secondary service provider' has a particular meaning in the context of the current Corporations Act. A secondary service is provided when an Australian Financial Services (**AFS**) licensee or authorised representative causes or authorises a financial service to be provided to a retail client via an intermediary.

- Token exchanges can and do issue their own tokens, meaning they may not be only 'secondary service providers'. This complicates the inclusion of these businesses within this definition.
- The term "secondary" gives no indication of what the provision excludes as no indicia of "primary" service provider has been provided.
- Reference to more (globally) recognised terms such as Virtual Asset Service Provider (VASP) defined by the Financial Action Task Force (FATF) should be considered to ensure Australia's definition and position is developed on a basis that is thoroughly researched and considered better or more fit for purpose than what is being proposed as an international standard. Including a better understanding of the reasons why Australia is not aligned with the definition proposed by FATF.
- Services provided by those in the sector that are not currently contemplated, including but not limited to, crypto margin trading, staking, yielding, trade execution, investment platforms and advisory services.
- The issue of geography, or nexus to a jurisdiction is absent. This is an issue which may be relevant to anti-money laundering and counter terrorism finance considerations.

The development of this term has been conducted without industry consultation and has no overseas comparison. As such we are unable to speak to the intent in its creation. As an example, the phrase in the Consultation Paper "participation of financial services related to an issuer's offer and/or sale of a crypto asset" is unclear. What financial services would be provided in relation to the offer or issue of such crypto assets?

More information and direct discussion with industry is warranted.

2. **Are there alternative terms which would better capture the functions and entities outlined above?**

Our consultation with our members yielded a variety of responses indicative of the unsettled status of the terms. Most commonly Virtual Asset Service Provider (VASP) or Digital Currency Exchange (DCE) were suggested. Both are prominent in their industry use and application and by regulators dealing with the challenges of widespread adoption of terms, but are largely untested in litigation.

For reference VASPs are defined by FATF as:

> *"Any natural or legal person who is not covered elsewhere under the Recommendations, and as a business conducts one or more of the following activities or operations for or on behalf of another natural or legal person:*
>
> *i. exchange between virtual assets and fiat currencies;*
> *ii. exchange between one or more forms of virtual assets;*
> *iii. transfer of virtual assets;*
> *iv. safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and*
> *v. participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset."*

This excludes those who "merely provide ancillary infrastructure". The characterisation as a VASP will depend on their specific circumstances or context.

We note the FATF VASP recommendations in a number of respects are not considered appropriate or practical by the global blockchain industry, and such concerns should be taken into account before considering how Australia may adopt terms and recommendations from the FATF.

Proposed alternative terms included;

- Crypto Asset Provider
- Crypto Asset Services
- Digital Currency Business
- Crypto Asset Business
- Crypto Provider

It is our view that such terms should not be used. It is preferable to use globally accepted and settled terminology.

Why secondary?
The CASSPr definition unnecessarily includes the use of the term secondary. We surmise it may be included as a means of differentiating activities outside of the scope by design of this consultation.

The practical outcome is that the definition and descriptor in seeking to exclude elements of the sector that are interwoven in its development creates greater, not lesser uncertainty. Though not intended to be piecemeal the effect is the same.

This observation amplifies our concerns that the exclusion of what we presume to be "primary" at this stage will result in a poorer outcome in developing interoperability of terms across a fragmented regulatory framework beyond the Corporation Act.

We do not believe at this early stage of consultation discussion should be limited to centralised exchanges. Instead we strongly recommend that it be extended to potentially assist in clarifying the regulatory perimeter more broadly.

3. **Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments.**

The definition is overly broad.

To the layperson the language used may connote simplicity. Industry participants recognise that the scope of application is more likely far reaching and may capture all types of crypto assets including NFTs, governance and utility tokens. In addition, the proposed definition incentivises behaviour to keep proprietary database records of 'entitlements' to tokens as it would appear that something only becomes a regulated crypto asset once it is recorded on a blockchain (rather than before).

If this is the consequence of a deliberately broad but not fit for purpose definition then it is important to proactively discuss what crypto assets (or rather, activities and behaviours with tokens) are intended to be excluded and thereby determine appropriateness of the definition in the context of the makeup of the regulation and its parameters.

Consistency in terminology and definitions increases certainty.

It is our view that regulatory duplication is probable given the likelihood that the CASSPr regime captures businesses who will be subject to other financial service laws such as the ASIC Act, NCCP Act and the Corporations Act.

The Consultation Paper states that a "crypto asset" is defined by ASIC as:

> *"…a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof."*

This process would benefit from further discussions, including a review of terms and phrases considered and applied in other jurisdictions, such as the recent Responsible Financial Innovation Act proposed in the USA.

We refer to the submission of Holley Nethercote on this matter and by way of summary note their observations that many of these terms that are defined, undefined or applied in different environments, may cause confusion or unintended regulatory complexity:

> *However, we have identified several phrases in the proposed definition of 'crypto asset secondary service provider' that could lead to regulatory confusion or complexity. These are set out below:*
>
> - *'Natural or legal person' –*
> - *In terms of the receiver of the service: While the proposed CASSPr definition refers to a 'natural or legal person', elsewhere the Consultation Paper refers to 'retail consumers'. Other financial services laws use different terminology. For example, the Australian Consumer Law protections in the ASIC Act apply to 'consumers', which is a term defined in section 12BC. Importantly, the definition of 'consumers' in the ASIC Act includes small businesses. Many of the consumer protections in the Corporations Act apply to 'retail clients', which is defined in sections 761G and 761GA. Meanwhile, the NCCP Act refers to providing products or services to a 'consumer', which is defined as a natural person or strata corporation. The term 'natural or legal person' would apply to a much broader range of individuals and entities than the term 'consumer' or 'retail client'. We recommend using consistent terminology where possible, to reduce regulatory complexity and provide certainty about what CASSPr services to clients are intended to be captured by the new regime.*
> - *In terms of the provider of the service: the definition needs to be wide enough to capture tokens issued by decentralised autonomous organisations (**DAOs**) and we refer you to the submission made by Joni Pirovich of Blockchain & Digital Assets – Services + Law.*

- *'As a business' – Other financial services laws use the term 'carrying on a business'. We recommend using consistent language where possible. It is also important that the 'as a business' test is properly applied to avoid safekeeping of a person's own crypto wallet being captured by the CASSPr regime.*
- *'Exchange between crypto assets and fiat currencies' – The ordinary meaning of fiat currencies might seem obvious, however the term 'fiat currencies' is not a term used in the AML/CTF Act, ASIC Act, Corporations Act or NCCP Act. Rather, the AML-CTF Act uses the term 'money', which is defined to include physical currency, money held in an account and money held on deposit. Terminology should be consistent.*
- *'Exchange between one or more forms of crypto assets' – We assume that the policy intention is for crypto to crypto exchanges to be captured by this term, but suggest this be clarified.*
- *'Transfer of crypto assets' – We recommend clarifying this term further. Does this term mean transfer of crypto assets between wallets, or between legal persons/owners?*
- *'Safekeeping and/or administration' – It is unclear from the Consultation Paper whether 'safekeeping and/or administration' refers to custody arrangements, which would attract additional obligations under the CASSPr regime. Elsewhere in the Consultation Paper the term 'CASSPrs who maintain custody of crypto assets on behalf of consumers' is used. In our view, further detail about the meaning of 'safekeeping and/or administration' will be required as these are new terms, unless the CASSPr regime adopts similar language to, or comes within, the Corporations Act. Under section 766E of the Corporations Act, providing a custodial or depository service refers to an arrangement between the provider and the client, where a financial product or beneficial interest in a financial product is held by the provider in trust for or on behalf of the client or another person nominated by the client.*
- *'Virtual assets' – What assets would 'virtual assets' cover, compared to crypto assets?*
- *'Control' – This term is defined in the Corporations Act under section 50AA, albeit in relation to an entity controlling a second entity. Would this term be further defined in the CASSPr regime?*
    - *'Participation in and provision of financial services related to an issuer's offer and/or sale of a crypto asset' - There are multiple terms used in this phrase that could result in regulatory confusion or complexity, which we have detailed further below:*

- *While the term 'involved in' has a meaning under section 79 of the Corporations Act in the context of involvement in contraventions, the term 'participation in' is new. In the absence of there being issues in the operation of section 79, the language should be consistent where possible.*
- *'Financial services' is defined in section 766A of the Corporations Act, and also section 21BAB of the ASIC Act. The definition of 'financial services' in the ASIC Act is much broader than the Corporations Act definition. Which one, if either, would apply under the CASSPr regime?*
- *The term 'issuer' is defined in section 761E of Corporations Act. Would the same or similar definition be used under the CASSPr regime?*

Further, and more broadly, we note that the Consultation Paper proposes the introduction of other various concepts and terms, which already have well established meanings under the Corporations Act, such as personal advice, and client money. Where the CASSPr regime does not form part of the Corporations Act, such terms, concepts and provisions would have to be introduced and addressed separately.

4. **Do you agree with the proposal that one definition for crypto assets be developed to apply across all Australian regulatory frameworks?**

The principle is welcomed, the practical application will, in our experience, be challenging to achieve while retaining technological neutrality.

We support the use of consistent terminology across a wide range of regulatory frameworks. A baseline definition is a necessary starting point however the applicability of that baseline definition will in all likelihood need to be supplemented or augmented to provide the benefit of harmonisation.

A rigid approach, one that insists on exportability of terms will lead to unintended consequences across frameworks. The acknowledged fast evolving nature of this sector's product and service offer heightens that risk.

We refer to the submission of Joni Pirovich of Blockchain & Digital Assets – Services + Law, (BADASL) which states that a technology neutral definition would have to focus on defining a 'data structure' (where a crypto asset or token is an example of a data structure) and that

seeks to regulate certain of the 'digital activities' associated with the data structure (e.g. token exchange activities, token custody activities).

5. **Should CASSPrs who provide services for all types of crypto assets be included in the licensing regime, or should specific types of crypto assets be carved out (e.g. NFTs)?**

The assessment should be risk based. Reflecting the nature of the activity being undertaken with the crypto asset or token whilst remaining technologically neutral.

We refer to the submission of Piper Alderman at point 21:

> *It would risk violating technological neutrality, a stated purpose of the regulatory framework, to expressly carve out from a licensing regime particular types of crypto assets. Further, it is difficult to identify "types" or taxonomies of crypto assets in a way that is meaningful.*

We refer again to the submission of Piper Alderman at point 23:

> *Absent features which would render a crypto asset a financial product, crypto assets should be treated as digital property. As such, unless it is the intention of the government to regulate all online sales of digital representations of property (such as eBay and classified advertisements where there could be a component of cryptographic proof to an item being sold) the regulatory perimeter for licensing should rise where an exchange holds client assets and not turn on what "types" of crypto assets are offered.*

We note that the proposed regulation in the US, the Responsible Financial Innovation Act, adopts a rebuttable presumption approach to treating crypto-assets as commodities, that is consistent with our submission above, which further supports the position that crypto-assets should be treated as a form of property, not a financial product, by default. However we observe that the US has a specific regulator to supervise commodities markets whereas in Australia the oversight would be spread across ASIC and the ACCC.

6. **Do you see these policy objectives as appropriate?**
7. **Are there policy objectives that should be expanded on, or others that should be included?**

We address both questions 6 & 7 in this section.

This consultation proposes the following policy objectives to underpin a licensing regime:

- minimise the risks to consumers from the operational, custodial, and financial risks facing the use of CASSPrs. This will be achieved through mandating minimum standards of conduct for business operations and for dealing with retail consumers to act as policy guardrails;
- support the AML/CTF regime and protect the community from the harms arising from criminals and their associates owning or controlling CASSPrs; and
- provide regulatory certainty about the policy treatment of crypto assets and CASSPrs, and provide a signal to consumers to differentiate between high quality, operationally sound businesses, and those who are not.

We agree that the policy objectives are appropriate and add the following observations.

- We seek clarification of the meaning of "financial risks facing the use of CASSPrs". Noting that volatility in markets and the risk of financial loss from prices rising or falling should be distinguished from operational and custody risk.
- The policy outcomes refer only to retail customers. What is the rationale for the exclusion of non-retail clients such as corporations and institutions? Further feedback is required.
- A regulatory discussion and response must consider the ease with which Australians are able to access services that originate from overseas. The rapid development of DeFi protocols are one example. The relative complexity of user experience is being addressed and the ability to access these services will accelerate in the short to medium term. Questions related to the regulation of this segment of the sector should not be partitioned.
- We refer to the principle of technological neutrality in the development of policy, legislation and regulation. The cryptocurrency sector suffers from a significant education gap as well as a great deal of misinformation and misunderstanding. Maintaining technological neutrality with that backdrop is

very difficult. Active steps must be taken to counter this bias towards inaction.

Those steps should include the development of policy objectives that put a priority on the supported development of the sector.

- To foster and encourage innovation within the cryptocurrency and broader blockchain market.
- To create an environment that promotes and supports competition locally, regionally and globally.

The risk of not doing this is that there will be an overly burdensome regime and regulatory arbitrage. Participants and consumers will look to opportunities and access points that sit beyond our shores or accelerate the uptake of decentralised solutions.

This consultation process must develop locally but think globally. The framing of the questions and determinations do not appear to appropriately reflect the challenge and opportunity of cross border application.

A broader landscape view is more appropriate. We refer to the BADASL submission:

> *The policy objectives need to be recontextualised through the lens of the foundational policy issues presented by global decentralised technology.*

The European Union is focussed on markets in crypto assets and the US is focussed on stablecoin regulation alongside a US digital dollar (CBDC), which shows that the foundational, markets and currency issues need to be considered as a priority. Australia is out of step in this regard by focussing on retail crypto licensing first.

8. Do you agree with the proposed scope detailed above?

We are strongly of the view that the scope is too narrow and is likely to fail in mitigating the risks that industry and government seek to address in the development of the regime.

As detailed, the consultation paper leaves unanswered a number of questions including:

- Why "primary" issuers and decentralised protocols et al have been excluded from the scope and how in that case, the application of the regime can be expected to interoperate with that segment of the industry.
- How does the regime apply to crypto assets that would otherwise be considered financial products and how is this reconciled with the reference to financial services in the definition of "crypto assets".
- What and how is the view of overlap between existing regulatory regimes.
- Why is the definition of 'crypto assets' only intended to apply to those providing services to retail consumers with no rationale provided as to why wholesale clients are not afforded similar protections.
- The (continuing) challenge and burden on CASSPRs to undertake assessments as to whether products are within the definition of 'financial product' as defined in the Corporations Act.
- A failure on the part of the regime to provide clarity with respect to the definition of crypto assets that are not financial products. Ignoring the opportunity to provide detailed and instructive guidance including a published list of any crypto assets considered to be financial products with detailed reasoning, to readily meet the policy objective and need for regulatory clarity.
- The prospect of onerous duplication between the AFSL regime and the CASSPr regimes. Requiring clear exemptions in order to remove duplication.
- The applicability of the regime to representatives, employees and agents of a CASSPr.
- Recognition and preparation for the fact that licence applications for a new regime are likely to have (very) lengthy processing times in light of the observations of international jurisdictions that have sought to move in this direction.
- The intention or likelihood to involve crypto asset issuers, deposit takers and those providing payment services not covered in the scope of this consultation proposal.

9. **Should CASSPrs that engage with any crypto assets be required to be licenced, or should the requirement be specific to subsets of crypto assets? For example, how should the regime treat non-fungible token (NFT) platforms?**

We refer you to our response to Question 5 above and make the following further observations:

The application of the regime should, in keeping with the purpose of the regulatory outcomes, focus on the risk associated with the CASSPr offering and not focus on the type of crypto asset included in that service.

ASIC has consistently spoken to the potential of products to alter their (definitional) nature. The appropriate and retained focus on risk and service type will help to ensure that the approach is future proofed. We submit that a focus on appropriate custodial arrangements will allow for the retention of flexibility in ameliorating the risk associated with any crypto-asset or sub-set of same.

Ambiguity in application must be addressed in this consultation. Further advice is required with respect to:

- The interaction of regimes.
- Compliance requirements that accord, intersect or are carried across from those involving financial products.
- The application or need to hold an AFSL and relevant authorisations.
- The development of fit for purpose capital requirements and the proposed mechanism for determining their calculation.

10. How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g. in financial services)?

Industry has called upon and continues to call for greater engagement with key stakeholders by regulators. We welcome the improved dialogue particularly with the Treasury and with AUSTRAC, which have developed over time.

Broader engagement has been inadequate and slow.

We respectfully submit that deep domain experience with respect to this sector resides with industry. We call upon ASIC, ACCC, APRA and the RBA to proactively seek out industry feedback and remain ready, willing and able to facilitate such discussions.

The CASSPrs regime proposals require clear guidance with respect to the applicability of financial services regulation. Consultation with industry reflects a majority view that the CASSPr regime be incorporated in the Corporations Act. This view was not universal with a number of industry participants forming a view that a bespoke regime be developed.

The development of the regime must retain the flexibility to at first instance prioritise consumer protections for the financial services or products being provided. If the regime is incorporated within the Corporations Act it is probable that there would be a reduction in inconsistencies across definitions and legal concepts.

A first principles step may be in order. We refer you to point 34 in the submission of Piper Alderman:

> *As a precursor to considering regulatory duplication, it may be useful to consider how compliance with any existing regimes is, or is not, possible. For example professional indemnity insurance has historically not been available to crypto asset providers and so any regulatory framework which has practical requirements that cannot be met will amount to a de facto ban.*

We refer you to the submission of Holley Nethercote as examples of elements of the Corporations Act that could be "turned off" to aid a fit for purpose application:

a. *The application of the design and distribution regime as introduced by the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019.*
b. *The capital adequacy requirements imposed on custodians, product issuers, market makers and Australian Market licensees. There should be a bespoke "fit for purpose" capital adequacy regime for CASSPrs. For example, see paragraph 4.2.4 of the Australian Digital Currency Industry Code of Conduct.*
c. *The application of the Australian Markets Licensing regime. As with capital adequacy requirements, there should be a bespoke set of obligations for this regime that exclude the obligation to create and comply with complex market operating rules.*

The development of the sector continues apace. It is reasonable to surmise that the development of product offers for CASSPrs involve or will involve the dealing in financial products. The desire or need to hold a licence for dealing in financial products is readily identifiable. The pathway to such a licence is contingent upon regulatory certainty given the expectation that the cost and time associated with garnering such a licence is considerable.

It is also fair to note that the industry, being subject to much misinformation and misunderstanding, expects the process of gaining licences to be cumbersome and slower than ideally would be the case.

Once again, we posit that the intersection of DeFi and decentralised exchanges cannot be absent from this discussion. We otherwise run the risk that CASSPrs will be unduly handicapped in their ability to develop offerings when burdened by regime requirements that are not or cannot be applied to other players in the sector.

The encouragement of competition should be a key tenet of the regime. Incumbent financial service industry participants are at a material advantage over those who seek to innovate in the sector. There is an increasing appetite for convergence with mainstream broking and share trading platforms. The real time, 24/7 environment in which CASSPrs operate in, when coupled with non-custodial or appropriate custodial arrangements have the potential to revolutionise market segments.

The merging of these service offerings is not a matter of if, but when.

We must minimise the number of licensing regimes that may apply to a CASPPr, whilst maintaining and strengthening the protections they seek to apply to the sector using a risk based approach.

<u>We offer alternatives for discussion cognisant that the need to address first principles questions in the sector are to be prioritised.</u>

The inclusion of crypto assets within the existing AFSL regime

- The definition of crypto assets is not to be included within the definition of a financial product by default.
- Chapter 7 to be modified to accommodate a CASSPr regime.
- Definitions required including terms pertaining to assets, market services and custody. These definitions will need to be tailored to the product characteristics.
- Authorisations required under an AFSL.
- Ensuring that AFSL components are not drawn into the regime without an assessment of their appropriateness.

The flexibility of this type of regime will allow for CASSPrs to limit or expand their service offerings through tiered authorisations.

For completeness we refer you to the submission of The Fold Legal -

> *For completeness, we note that consumers are already familiar with the existing AFSL regime and that a holder of an AFSL is regulated. There is a marginal risk that*

customers will be of the view that CASSPrs will be subject to the same standards that apply to other financial services. However, in our view, this can be readily accommodated with a standard disclaimer warning (like the advertising warning in section 1018A of the Corporations Act) to address this. In addition, holding two separate licences may engender consumer confusion and it will be unclear what is covered by each licence. An existing example of this is the AFSL and credit licence regimes; consumer credit products sit with credit licensing regime, while margin lending, essentially an investment loan product, sits within the AFSL regime.

As a final point, we think it is critical that the definition of "crypto asset market services" contemplate the different exchange services in Australia. Under financial services laws, a provider can either:

"Make a market" under section 766D of the Corporations Act, which requires an AFSL authorisation; or

"Operate a market" under section 767A of the Corporations Act, which requires either a Tier 1 or Tier 2 markets licence.

In our experience, most exchanges act as a broker to fill an order for crypto assets, or they match buy and sell orders, and this latter activity will involve operating a market. However, other exchanges also act as the counterparty to trades and this will involve making a market. Clarification should be made that the market services that are provided in relation to crypto assets (that are not financial products) cover both the matching of customers for a trade and in situations where the CASSPr is acting as a counterparty to the transaction. However, regard should be had as to whether the capital requirements should be varied depending on the type of market service carried out by a CASSPr. We think that it is critical that this type of market licence is not the same as the existing market licence regime. Instead, it must be designed to reflect the way crypto markets operate and how trades are executed on crypto exchanges. For example, settlement and clearing, as well as volatility levers, would not be appropriate for crypto assets which can be traded 24 hours a day without settlement and subject to significant volatility.

We note particularly their observation with respect to Tier 1 or Tier 2 markets licences.

> *A Tier 1 or Tier 2 markets licence would not be appropriate for crypto market providers and a bespoke markets licence should be created that sets appropriate capital adequacy requirements and market trading rules.*

We strongly share the view that the imposition of a Tier 1 or Tier 2 markets licence would result in the CASSPr sector being decimated. With little prospect of any material number of participants remaining.

The inclusion of crypto assets in a new regime modelled on the AFSL regime

A number of stakeholders proffered the view that a new regime was a more appropriate pathway for regulatory reform. It is noted for the purposes of this submission that such a view warrants further (concurrent) discussion, particularly in light of the US regulatory approach which recognises crypto-assets as property / commodities as a starting point.

11. Are the proposed obligations appropriate? Are there any others that ought to apply?

We are broadly in agreement with the proposed obligations.

Robust standards and obligations for CASSPrs are welcomed. Whilst we characterise the preferred regulatory approach as “light touch” the reference more appropriately describes the impact on the development and operation of the sector not the standards the industry is required to meet.

The development of those obligations should reflect -

- A bias towards support of innovation and competition.
- A recognition of the evolving maturity of the sector and the necessary guardrails and transitional arrangements facing those industry participants who in good faith welcome greater regulatory oversight.
- Adequate capital adequacy as a mechanism for the assurance of retail investor protections versus burdensome capital adequacy that create uncompetitive and uneconomic trading and operational environments.

- Further development of safe harbour provisions for those that can meet interim threshold tests and afford realistic and achievable timeframes for the implementation and development of a new licensing regime.

Reflecting the complexity of the task at hand we ask for further clarity with respect to:

- The mandated role, if any, of the Australian Financial Complaints Authority.
- Dispute resolution procedures and standards for CASSPrs
- Detail surrounding obligations to maintain a risk management framework and how that should apply across a variety of risk based activities.
- Further information on the application and scope of licensee obligations stemming from the requirement that general conduct obligations extend to "all relevant Australian laws" in relation to the operation of CASSPrs.
- Recognition that the application of Australian Consumer laws are adequate and require no additional scope in the development of the regime.
- A clearer understanding of what constitutes a CASSPr responding "in a timely manner to ensure scams are not sold through their platform".
- How, and in what sum breaches of the CASSPr regime will attract civil and criminal penalties. As a flow on, the implications of any such breaches giving rise to cancellation of a CASSPr licence.
- Industry standards not yet being settled, the basis upon which organisational competency requirements for key individuals in the business will be assessed and determined.
- The need for anti-hawking requirements for products, deemed not to be financial products.
- Acknowledgment that the complexity of these products, coupled with the resourcing constraints of regulatory agencies are likely to lead to a backlog in determinations and a proposal or consideration of at a minimum short-term mechanisms for addressing these challenges.

We highlight the importance of domain experience and respectfully submit that the detail of many of the proposed obligations, affecting technology that is not well understood by regulators could lead to unwanted and unintended consequences. We recommend that caution be exercised and further industry input be sought in order to determine appropriateness of what is being proposed.

It is a salient reminder that the development of a fit for purpose regime requires a first principles consideration of the requirements that have been applied to traditional markets.

We believe it to be readily apparent that the technology we seek to regulate in this instance has the potential to be more transparent, less risky by virtue of non-custodial application and readily auditable in real time.

12. **Should there be a ban on CASSPrs airdropping crypto assets through the services they provide?**

No. An airdrop is a delivery mechanism.

The subject (product) of an airdrop may represent a wide variety of uses, value or application.

Regulated entities that utilise airdrops will do so subject to conduct requirements. A contravention of Australian Consumer Law as an avenue of enforcement is available under existing arrangements.

Further discussion about the requirement to opt in to receive airdrops as an option was raised by a number of stakeholders.

13. **Should there be a ban on not providing advice which takes into account a person's personal circumstances in respect of crypto assets available on a licensee's platform or service? That is, should the CASSPrs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto asset)?**

We pose threshold questions.

- Is a crypto asset a financial product? If so, then it is regulated under the existing regime and rules relating to those assets should and can remain dealt with in a manner consistent with the personal financial advice regime.
- We submit that it is prudent to move towards a situation where financial advisors who wish to provide clients crypto assets advice be able to do so. The discussion with respect to that outcome should involve the merit of an AFSL or AFSL like

authorisation. The ability to opt-in to such arrangements and the closer alignment of obligations of financial advisors in dealings with crypto assets as distinct from financial products.

- If assets are deemed not to be financial products, then what is the rationale behind banning the provision of personal advice? What standards or minimum competencies are or should be required to provide such personal advice?
- The consultation paper provides inadequate guidance with regard to this matter. Nor is sufficient guidance provided in relation to the delivery of general advice with respect to crypto assets.
- Why are we not encouraging or developing mechanisms to ensure that qualified persons are able and encouraged to provide those services to interested parties?
- In the event that CASSPrs are prohibited from providing such advice, who or what class of advisor can do so? We submit that the regulation of the provision of personal advice is prudent and overdue.
- This could be addressed in the same manner that any business selling a product may communicate with customers, that is subject to the obligations under the Australian Consumer Law.

14. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

Insufficient information has been provided in this consultation to allow for an accurate estimate of the cost of implementing these proposals.

15. Do you support bringing all crypto assets into the financial product regulatory regime? What benefits or drawbacks would this option present compared to other options in this paper?

No. We are unequivocally against bringing all crypto assets into the financial product regulatory regime. The option to do so, as a simplified path to regulatory certainty is flawed.

The complexity of the issues raised in this consultation response speaks to the work that must be done in order to create a fit for purpose regime that both protects consumers and encourages investment and innovation in the sector.

The opportunity to chart a similar path is in plain sight and available to many jurisdictions globally. The path has not been entertained because of the very clear impact it would have on the local development of the industry, inbound investment and a sure and rapid path to loss of talent.

If crypto assets were (all) determined to be financial products as a default, the following regulatory regime elements would apply -

- Parts of Chapter 5 of the Corporations Act;
- All of Chapter 7 of the Corporations Act; and
- The ASIC Act 2001 (Cth)

It is our contention that without wholesale and material carve-outs, contrary to the aim of defining all products as financial products, the local sector will have imposts and operational challenges that will render them uneconomic as ongoing concerns.

Such treatment is inconsistent with the principle of technological neutrality. A default "in" unless explicitly carved "out" will result in a de facto ban of a wide range of products that do not have the indicia of financial products. The approach is not consistent with the policy objectives as stated in this Treasury consultation.

The outcome of such an approach is almost certainly -

- An exodus of investment
- An offshoring of exchanges
- A drift to decentralised exchanges
- An end to inbound investment in the sector
- A pronounced appreciation in the risk of failure of local entities
- Outflows of funds from local exchanges
- Loss of direct and ancillary local employment

This option is a short cut. The work has not been done by regulators.

No token mapping exercise has been undertaken notwithstanding long standing requests from industry to commence that process.

We recommend that this process be commenced immediately and involve amongst others industry bodies, digital currency exchange representatives, legal experts, academia and the members of the Council of Financial Regulators.

16. **If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?**

Insufficient information has been provided in this consultation to allow for an accurate estimate of the cost of implementing these proposals.

17. **Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia?**

No. We are the peak industry body for blockchain businesses in Australia and are well versed in the challenges that face the sector. First among those challenges is FUD. Fear, uncertainty and doubt.

The misinformation and misunderstandings surrounding this sector are pronounced.

Local, regional and global opportunities warrant and require the firmest of regulatory footings. We do not support a self-regulatory model for CASSPRs in Australia. The industry has been leading the call for regulatory clarity for a number of years.

The industry can clearly see the benefit of certainty via a light touch regulatory approach and that call should be considered. A measured technologically neutral licensing regime for centralised exchanges would have an enormous global impact.

Confidence in the sector is led by those who are willing to signal that consideration should be given to the subject matter. That role is most readily enhanced by champions, advocates and willing participants in and across Government.

Regulatory certainty, or more accurately less uncertainty is required for this interest to move forward and realise its global ambitions. The protection of consumers and the confidence of consumers in those protections is best served through the implementation of mandated regime.

A self-regulatory model, can add to rather than be developed instead of mandated requirements by recommending and supporting further or ancillary best practices. Affording

businesses the opportunity to differentiate their product offer. The signal sent by mandating requirements will engender greater confidence in the sector both locally and internationally.

The development of a regime will encourage local and international investment. Give confidence to service providers that we, as a jurisdiction, have a commitment to the sector in the medium and longer term whilst taking the necessary steps in the short term to develop and communicate stronger consumer protections.

The inevitable convergence of traditional financial services businesses and the sector will be accelerated in a measured way. Providing local financial services institutions an opportunity to enhance their own global ambitions at a time that cross border applications are being embedded into finance at pace.

18. If you are a CASSPr, what do you estimate the cost and benefits of implementing this proposal would be? Please quantify monetary amounts where possible to aid the regulatory impact assessment process.

Insufficient information has been provided in this consultation to allow for an accurate estimate of the cost of implementing these proposals.

19. Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets?

The proposed obligations, though broadly appropriate, would benefit from greater clarity and we raise the following matters in that regard:

- What type of risk based matrix is to be applied to these requirements such that innovation is not inhibited and an exodus of local ecosystem participants is triggered by burdensome and not fit for purpose obligations?
- *"ensuring that consumers' assets are appropriately segregated;"*
    - The definition of "appropriately" requires clarification.
- *"maintain minimum financial requirements including capital requirements;"*
    - What, if any, are the proposed tiered capital arrangements to be applied to CASSPrs? Quantum, tier and transitional arrangements?

- The protections to be afforded institutional custody providers and how they are to differ from those providing services to retail consumers.
- If and how regard has been given to the difficulty that local ecosystem participants have in obtaining adequate insurance coverage?
- A view on what constitutes the requisite expertise and infrastructure noting the dearth of local traditional custodians in the space.
- A view on whether the obligations are in keeping with those applied to AFSL holders or whether a higher mandated standard is proposed.
- Depth of the technological understanding of those proposing these regulations such that the industry can be confident that tech neutrality is retained and appropriateness of obligations are enshrined in the development of standards.
- How segregation of assets are viewed and whether those views are consistent with industry best and/or common practice in the context of the global marketplace these opportunities present.
- The role of and liability associated with 3rd party custody providers and what if any licensing is to apply to such custodians.
- Independent audit obligations and how they will be reconciled with operational security concerns.
- A detailed view on what constitutes adequate redress and compensation and under what circumstances a breach would warrant such a response. Again, we raise the operational challenges that CASSPrs face in engaging in suitable insurance arrangements
- The appropriateness or otherwise of alternatives such as bonds or self insurance whilst the industry matures and is able to provide comprehensive commercially viable solutions.
- Consumers' ability to self custody and how it is and will continue to be a feature of the industry.
- A regulatory view on unhosted wallets.

These matters raised above act as a reminder that the solutions currently available in-market for financial assets may not be appropriate in part or in sum for these assets.

The narrowness of the CASSPr scope fails to acknowledge the real and concurrent need for consumers to be made aware of the risks associated with the underlying (not defined) primary service providers. The suggestion in this consultation being that risk is appropriately ameliorated if focused on the secondary service providers.

20. Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above?

We refer you to our answer at Question 21

21. There are no specific domestic location requirements for custodians. Do you think this is something that needs to be mandated? If so, what would this requirement consist of?

The industry view with respect to this matter is split.

Those in favour of specific domestic location requirements are in the minority. They view merit in having a specific domestic location requirement insofar as it makes those custodians more accountable under Australian law and generally makes recovery easier.

Those in favour of not mandating domestic location requirements are in the majority.

They view the risks associated with location being manageable or ameliorated through the requirement of certain minimum standards in any custody agreement. AFSL holders are able to avail themselves of such arrangements at present. Provision can be made for a responsible person located within Australia who has responsibility and liability for compliance with the custody requirements. Such that Australian laws will provide safeguards.

The lack of support and maturity of the local custody market reflects the operational challenges faced by businesses in this sector. It is common practice for offshore third-party custodians to be used in Australia.

The economic cost of mandating local custodians will inevitably be passed on to consumers.

22. Are the principles detailed above sufficient to appropriately safekeep client crypto assets?

Yes. Please refer to our responses to questions 20 and 21 above.

23. Should further standards be prescribed? If so, please provide details.

Please refer to our responses to questions 20 and 21 above.

24. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

Not Applicable.

As noted, we believe that any (additional) costs of a regime that mandates local custodian requirements will likely be borne by consumers failing which the cost will be absorbed by local businesses competing with international organisations with no such requirement.

25. Is an industry self-regulatory model appropriate for custodians of crypto assets in Australia?

We do not support a self-regulatory model for custodians of crypto assets in Australia.

The protection of consumers and the confidence of consumers in those protections is best served through the implementation of mandated regime.

A self-regulatory model, can add to rather than be developed instead of mandated requirements by recommending and supporting further or ancillary best practices. Affording businesses the opportunity to differentiate their product offer.

The signal sent by mandating requirements will engender greater confidence in the sector both locally and internationally.

26. Are there clear examples that demonstrate the appropriateness, or lack thereof, a self-regulatory regime?

Please refer to our response to questions 17 and 18 above.

27. Is there a failure with the current self-regulatory model being used by industry, and could this be improved?

There is no failure with the current self-regulatory regime.

A mandated regime, with appropriate protections serves both consumers and the perception of the industry.

28. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

Not Applicable.

As noted, we believe that any (additional) costs of a regime that mandates local custodian requirements will likely be borne by consumers failing which the cost will be absorbed by local businesses competing with international organisations with no such requirement.

29. Do you have any views on how the non-exhaustive list of crypto asset categories described ought to be classified as (1) crypto assets, (2) financial products or (3) other product services or asset type? Please provide your reasons.

We strongly recommend a token activity mapping exercise be undertaken as a matter of both priority and urgency. For example, the proposed Responsible Financial Innovation Act just introduced in the US suggests that tokens with less than an average daily trading volume of US$5m should not give rise to the proposed obligations under that Act which do apply to projects and people with tokens above that stated volume.

The myriad of questions and complexity of the developing token activity taxonomy cannot be appropriately addressed in a piecemeal fashion. These questions reflect such an outcome notwithstanding persistent and continuing requests from industry to commence a deliberate and wide ranging stakeholder engagement around this process.

Clear regulatory guidance has been absent.

We look to the responsible regulators and ask.

- What crypto assets are financial products?
- What specific features render a crypto asset a financial product?
- Why do the rights and obligations make the crypto asset a financial product?
- Why shouldn't crypto assets be treated as property at first instance?
- Why can't crypto assets that exhibit the indicia of property and subsequently add a feature, be re-characterised as a financial product?
- Are, can or should any crypto assets be characterised as "currency"?
- How are stablecoins viewed by regulators?
- What are the activities being undertaken with tokens for which there is market failure in need of amended or new legislation?

These questions are complex and the answers are far reaching in that they will reshape how we deal with an outward looking, digital first economy.

Industry seeks the opportunity to engage in a fulsome discussion. To ask, discuss and debate the measured and appropriate regulatory treatment of these products.

30. Are there any other descriptions of crypto assets that we should consider as part of the classification exercise? Please provide descriptions and examples.

We refer you to our answer at Question 29

We note the BADASL submission which suggests a category for labelling 'DAO tokens' so that retail consumers know when they are dealing in tokens that are not clearly within the Australian regulatory perimeter.

31. Are there other examples of crypto asset that are financial products?

We refer you to our answer at Question 29

32. Are there any crypto assets that ought to be banned in Australia? If so, which ones?

We refer you to our answer at Question 29 and make the following observation.

We strongly recommend, given the information available to the Government through the ACCC and ASIC in particular, that a warning list naming projects for which (established) complaints have been received. The list, to be determined by an assessment criteria that includes, volume of complaints, data points/evidence of scams or fraudulent activity, risk and scale of consumer harm.

The Consumer Law protections afforded Australians will remain a robust enforcement tool for those who engage in misleading and deceptive conduct.

Conclusion

We have an opportunity to develop our regulatory regime into a world leader in this sector. Fostering innovation by deliberately, and in a measured fashion, signalling our intent to determine the complexity of these regulatory perimeter matters.

It is our experience that Australia, having been absent from global discussions now, finds itself being considered forward leaning. The result is an opportunity to create a competitive international advantage and to attract global talent and investment at a time where developed economies around the world are struggling to avoid brain drain.

We view this consultation as a very important early step in the process of developing a fit for purpose regime and look forward to actively working across a wide range of government stakeholders in our shared purpose of protecting consumers whilst fostering innovation and opportunity for Australians in the digital assets sector.