



PROMOTING  
BLOCKCHAIN  
INNOVATION  
IN AUSTRALIA

**Blockchain Australia – Submission to  
Andrew Bragg  
Digital Assets (Market Regulation) Bill  
2022**

**November 2022**

## Table of Contents

<b>1. Blockchain Australia</b>	<b>3</b>
<b>2. Executive Summary</b>	<b>4</b>
<b>3. Recommendations</b>	<b>6</b>
Digital Asset Custody Requirements	8
Alignment to international regulatory frameworks	8
<b>4. Detailed Responses</b>	<b>9</b>
4.1. Regulation Objectives	9
<b>4.2. Definitions</b>	<b>10</b>
4.2.1. Digital Asset	10
4.2.2. Digital Asset Exchange	10
4.2.3. Stablecoin	10
4.3. Licensing	11
4.4. Interaction with Existing Legislation	12
4.5. Maintenance of Capital Adequacy	13
4.6. Monitoring of activities	13
4.7. Segregation and Custody of Funds	14
4.8. Transitional arrangements	15
4.9. Digital Asset Custody Requirements	16
4.10. Alignment to international regulatory frameworks	16
4.11. Insurance	17



## 1. Blockchain Australia

This submission is made by Blockchain Australia, in collaboration with its members and industry stakeholders.

Blockchain Australia is the peak industry body representing Australian businesses and business professionals participating in the digital economy through blockchain technology. Blockchain Australia encourages the responsible adoption of blockchain technology by the government and industry sectors across Australia as a means to drive innovation and create jobs in Australia.

The Blockchain Australia membership base consists of 120+ leading cryptocurrency and Blockchain centric businesses and 100+ individuals across multiple verticals including:

- Accounting and Taxation
- Artificial Intelligence
- Banking
- Cyber Security
- Art
- Development
- Building & Construction
- Digital ID
- Energy and Resources
- Entertainment
- Gaming
- Health and Wellbeing
- Insurance
- Investment
- Legal
- Professional Services
- Recruitment
- Real Estate
- Risk and Compliance
- Supply Chain
- Venture Capital

The sector contributes AU\$2.1 billion and employs around 11,600 people ([Source](#)) and with supportive reform these figures could increase to AU\$68.4 billion and over 206,000 people employed in the sector.

We seek a fit-for-purpose, technology-enabling regulatory framework with clear guideposts for consumers and a focus on driving innovation and Investment.

We thank Senator Bragg for taking the time to consider our submission.

Gordon Little

Policy, Blockchain Australia

## 2. Executive Summary

Blockchain Australia wishes to thank Senator Bragg for the opportunity to respond to the Digital Assets (Market Regulation) Bill 2022. The association is very appreciative of the support the Senator has provided to the sector and looks forward to working with him and his office to drive the development of an appropriate regulatory framework for digital assets.

We are conscious that a number of our members have made submissions on behalf of their organisations and we have drawn on the content of those for ours. Those submissions include:

- Caleb & Brown
- Hamilton Locke
- Blockchain Assets Pty Ltd
- Piper Alderman
- Ripple

While we do not wish to duplicate what those submissions have put forward we do wish to draw your attention to the following key points.

A number of our members are already operating within the current regulatory framework and have spent time and money to ensure they meet the existing legislative requirements. Within the bill there is no consideration of the interplay with the other existing licensing regimes including any overlap or how the different licence (i.e., AFSL, Market Operators, Credit, Custody, Banking and Payments) regimes should interact in relation to digital assets.

Alignment to the evolving international regulatory frameworks is also of key importance to our members, many of whom operate multi-geography businesses and who are looking for consistency of regulation to allow them to build truly scalable global businesses and readily passport into other jurisdictions.

Of particular concern is the need for Australia to have a regulatory regime that supports the deployment of capital and building of global businesses from within Australia, encouraging the creation of jobs within Australia. To this end, there is an argument that crypto-intermediaries offering services to Australian retail consumers should be obliged to obtain a domestic license to promote full compliance with Australian regulatory standards and domestic recourse for consumers.

A global precedent for this has already been established when The European Union (EU) lawmakers passed the Markets in Crypto Assets Regulation (MiCA) bill which requires CASPs to establish an EU presence, have at least one local director and impose strict reverse



PROMOTING  
BLOCKCHAIN  
INNOVATION  
IN AUSTRALIA

solicitation requirements.

For the purposes of this submission, we have focused on non-financial products which are not covered under the existing regulatory framework. We believe that more work needs to be done to deal with situations where non-financial products become financial products. For example, DAO's would fall outside of this legislation.

### 3. Recommendations

The following are the key recommendations from our submission

Topic	Recommendation
Regulatory Objectives	<p>We believe that the objectives set out in Chapter 7 of the Corporations Act 2001 are applicable to the successful operation of the industry. However, different digital asset business models would necessitate some tailoring of the objectives. We also believe the regulation should encourage innovation and investment in the sector.</p>
Definition of Digital Assets	<p><b>Digital Assets</b> - We recommend that the definition should only be finalised post the token mapping and have NFT's removed which is consistent with the MiCA framework.</p> <p><b>Digital Asset Exchange</b> - The definition is too broad and should be narrowed.</p> <p><b>Stablecoins</b> - The definition of stablecoins is extremely broad and could capture non-fiat backed and wrapped assets, we would suggest narrowing the definition to focus on these specific risks.</p>
Licensing	<p>We would propose 1 license with three authorisations.</p> <ul style="list-style-type: none"> <li>● Stablecoins (Issuance)</li> <li>● Exchanges</li> <li>● Custody</li> </ul> <p>To assist new entrants (start-ups) introduce thresholds to cater for small operators so they are not overburdened.</p>



	<p>Consideration should be given to whether it is appropriate to allow passporting of foreign-issued AUD stablecoins which will not hold reserves onshore.</p>
<p>Interaction with existing regulation</p>	<p>The proposed legislation needs to clearly articulate how it will interact with existing AFSL, Market Operators, Credit, Custody, Banking and Payments regulatory requirements (including licensing).</p> <p>Consideration should be given to allowing participants who have an existing financial services license to be deemed to have met certain obligations under this proposal, while requiring them to meet other specific obligations under this bill.</p>
<p>Maintenance of Capital Adequacy</p>	<p>We recommend a tiered approach to the capital adequacy requirements, with further consultation needed on tiering thresholds.</p>
<p>Monitoring Activities</p>	<p>The legislation does not specify detailed monitoring requirements. This detail is needed and where possible should be consistent with the requirements with existing obligations for exchange operators while recognising and making allowances for the nuances inherent in operating a crypto exchange.</p>
<p>Segregation and Custody of Funds</p>	<p>ASIC have promulgated RG 133 to provide relief for omnibus accounts. We believe this relief should be extended to digital assets with specific conditions to accommodate the specific technologies used to hold and manage the accounts.</p> <p>To ensure investors are informed on how their assets are being held, we believe reporting by exchanges on a client's holdings, accompanied by disclosure on what arrangements</p>

	<p>exist for client asset protection, would allow clients to take appropriate actions themselves to protect their assets. To ensure consistency of reporting we believe a standard form for such disclosures to be made to retail clients for use by authorised exchanges should be included within the legislative framework.</p>
<p>Transitional Arrangements</p>	<p>As there are little to no existing resources or experience in implementing this type of licensing regime in any of the regulators, as such we believe an 18 -24 month timeframe is more appropriate.</p> <p>In addition to a transition period, an exemption regime should also be considered for Digital Asset Exchanges and Digital Asset Custody Services, and such exemption should be valid till the license application is approved, rejected, or withdrawn.</p>
<p>Digital Asset Custody Requirements</p>	<p>Given the complexity and nuances of providing custody for digital assets we recommend that a separate consultation be undertaken on the rules for custody of non-financial products. Consideration should also be given as to whether these rules should apply to any AFSL licensee that provides custody services for digital assets.</p>
<p>Alignment to international regulatory frameworks</p>	<p>The bill needs to be reviewed in light of recent legislation being introduced in Europe, the UK and the United States to ensure, where possible, consistency from a global consistency point of view.</p>



## 4. Detailed Responses

### 4.1. Regulation Objectives

Any proposed legislation in the field of crypto-assets should provide certainty while being able to keep pace with innovation and technological developments and be founded on an incentive-based approach.

Although the proposed legislation is for digital assets and not specifically financial products we believe the objectives set out in Chapter 7 of the Corporations Act 2001 are broadly applicable to the successful operation of the industry. However, we believe the different digital asset business models would necessitate some tailoring of the requirements.

One of the key benefits of blockchain technology is that it has enabled greater financial inclusion (often referred to as the democratisation of finance) and reduced wealth inequality. In addition to those objectives listed in Chapter 7, we believe it is critical that any regulation governing digital assets should be to:

- encourage financial inclusion;
- reduce wealth inequality;
- provide consumer protection;
- encourage investment into the local industry;
- encourage technological innovation; and
- encourage competition.

## 4.2. Definitions

### 4.2.1. Digital Asset

The definition of “digital asset” is much broader than the definition that ASIC has used in Info Sheet 225. It is also different to the definition used in the AML/CTF Act.

- This creates different definitions across different regimes, which may engender complexity and confusion.
- The definition would capture anything on the blockchain, including NFTs.
- This definition pre-empts the token mapping exercise, which is critical to determine what and how digital assets should be regulated and how those regulations should interact with existing regulatory regimes. We recommend that the definition should only be finalised post the token mapping exercise.

### 4.2.2. Digital Asset Exchange

The definition of “digital asset exchange” includes the exchange of digital assets for other digital assets which is a very broad definition and would bring into the regime digital assets that might be excluded under the definition of a digital asset in the legislation.

It is also inconsistent with the language used in MiCA that excludes “crypto-assets that are unique and not fungible with other crypto-assets, including digital art and collectibles, whose value is attributable to each crypto asset’s unique characteristics and the utility it gives to the token holder”.

### 4.2.3. Stablecoin

The definition of stablecoins is extremely broad and could capture non-fiat backed and wrapped assets. Most legislative proposals globally have focused on the specific risks associated with stablecoins which purport to be pegged to fiat currency and/or fiat backed. The regulatory requirements relating to holding fiat reserves in a bank account only make sense in the context of fiat-backed stablecoins. We would suggest narrowing the definition to focus on these specific risks.

Consideration should be given to whether it is appropriate to allow passporting of foreign-issued AUD stablecoins which will not hold reserves onshore and present different risks to Australian consumers. It is likely that Australian consumers will find it more difficult to assess the risks of purchasing foreign passported AUD stablecoins. Further, there is no real

ability to enforce the requirements on offshore token issuers who may issue AUD backed tokens. This may encourage businesses to issue tokens from countries that have the lowest level of regulation. It does not encourage businesses to issue stablecoins in Australia. There is also no regulation of decentralised stablecoins.

Crypto businesses will lean to sub-optimal product designs to avoid regulation, and this encourages token issuers to either move offshore or to redesign products to fall outside of regulation.

### 4.3. Licensing

The legislation proposes three different licenses for non-financial products. We would propose 1 license with three authorisations.

- Stablecoins (Issuance)
- Exchanges
- Custody

In introducing MiCA the EU has understood that small to medium-sized enterprises and start-ups should not be subject to excessive and disproportionate administrative burdens. To protect against this MiCA has introduced thresholds under which certain obligations do not apply. For example under article 4 sec 2(b) (b) where over 12 months period the total consideration of an offer to the public of crypto-assets in the Union does not exceed EUR 1 000 000, or the equivalent amount in another currency or in crypto-assets certain requirements are waived.

Consideration should be given as to whether it is appropriate to allow passporting of foreign-issued AUD stablecoins which will not hold reserves onshore and present different risks to Australian consumers. It is likely that Australian consumers will find it more difficult to assess the risks of purchasing foreign passported AUD stablecoins. Further, there is no real ability to enforce the requirements on offshore token issuers who may issue AUD-backed tokens. This may encourage businesses to issue tokens from countries that have the lowest level of regulation. It does not encourage businesses to issue stablecoins in Australia. There is also no regulation of decentralised stablecoins.

Crypto businesses will lean to sub-optimal product designs to avoid regulation, and this encourages token issuers to either move offshore or to redesign products to fall outside of regulation.

#### 4.4. Interaction with Existing Legislation

The introduction of any new legislation needs to provide guidance on how it will interact with existing obligations. Any legislation seeking to introduce a framework for digital assets will need to clearly articulate how that legislation will interact with existing AFSL, Market Operators, Credit, Custody, Banking, and Payments regulatory obligations.

This is a fundamental issue as the Bill includes a broad definition of “digital asset”, which may also meet the definition of a financial product, purchased payment facility or consumer credit. In these circumstances, operators need certainty on which takes precedence or if both regimes apply (and, if so, how).

It also raises issues of duplicative licenses and regulations rather than creating a streamlined approach to licensing that enables seamless integration between regimes, which encourages and is critical to businesses designing compliant products and services. It also creates alignment between TradFi and crypto solutions by applying similar requirements across incumbents and new entrants.

Draft legislative proposals in other jurisdictions generally seek to regulate non-security digital assets under a bespoke regulatory regime that addresses the specific features and risks of those assets which are different from traditional securities and financial products. For example, continuous disclosure obligations do not make sense in the context of many cryptocurrencies where there is no centralised issuer who can give ongoing disclosure. Also, ongoing disclosure does not necessarily make sense in the context of cryptocurrencies where the rights and obligations attaching to the asset are encoded at the initial point of issuance. MiCA excludes financial instruments from its scope. The US draft Responsible Financial Innovation Act would regulate non-security cryptocurrencies as commodities.

We believe consideration should also be given to allow participants who have an existing financial services license to be deemed to have met certain obligations under this proposal. This would remove duplicate reporting obligations and ensure these participants are held to the highest standards imposed under these licenses. For example, in the consultation with Treasury on CASSPR, it positioned that existing AFSL holders would not be required to have additional licenses. There would need to be guidance on the type of AFSL required to allow both financial and non-financial products.

This approach is consistent with the approach being taken under MiCA whereby “Credit institutions authorised under Directive 2013/36/EU of the European Parliament and of the Council should not need another authorisation under this Regulation in order to issue asset-referenced tokens.”

While additional licenses may not be required for AFSL holders, regard should be had as to what regulatory requirements should apply to AFSL holders under this bill and any associated legislative instruments in relation to the stablecoins, exchange, and custody.

#### 4.5. Maintenance of Capital Adequacy

While we support the requirement that exchanges maintain capital adequacy, care must be taken to ensure the right balance between investor protection and fostering innovation is achieved. Capital adequacy requirements that are too onerous will drive innovation and investment offshore.

To ensure that a range of participants can participate we recommend that a tiered approach to capital adequacy be implemented based on Asset Under Custody. Further consultation will be required on the tiering thresholds and triggers.

#### 4.6. Monitoring of activities

There is a requirement for a digital asset exchange to operate “fair, orderly and transparently”. The approach under AFS licensing of “honestly, fairly and efficiently” are similar in effect and have been appropriately considered at length in Australian case law. On this basis, we would recommend using the same terminology as the semantic differences between these terms could lead to regulatory uncertainty.

The requirements listed in proposed section 10(2) do not provide any actual requirements as they have all been noted as being part of the rules to be released. More details for these requirements need to be in the legislation in the same way it does for AFSL and ACL. Further, details of the rules should be released proximately to the bill for a consultation to enable the industry to properly assess the appropriateness and impact of the proposed legislative change.

In considering bespoke requirements for digital currency exchange we encourage the government to where possible keep these consistent with the requirements with existing obligations for exchange operators while recognising and making allowances for the nuances inherent in operating a crypto exchange.

Caleb and Browns submission provides context for the types of monitoring controls our members have or would be looking to implement, noting that it is important to distinguish between operating on a fractional reserve basis and the practice of maintaining fully backed reserves while utilising an omnibus account.

Please also be aware that participants will require time to implement automated monitoring and surveillance technology.

#### 4.7. Segregation and Custody of Funds

Currently, it is unclear how the draft Bill seeks to introduce requirements around segregation and custody of funds (including digital assets and any other kinds of assets). Current market practice includes segregation at the individual client's asset level or maintaining segregation of clients' assets from those of the exchange generally.

An important aspect of client asset protection is their awareness of the mechanisms by which an exchange holds their assets, and generally what arrangements are available for their protection, both in the event of insolvency and unauthorised access. A client that is aware of the type and level of risks their assets (that are typically held by the firm on trust) may be exposed to would be able to make fully informed decisions about which exchanges to patronise and whether to implement any additional protection mechanisms.

To ensure investors are informed on how their assets are being held, we believe reporting by exchanges on a client's holdings, accompanied by disclosure on what arrangements exist for client asset protection, would allow clients to take appropriate actions themselves to protect their assets. To ensure consistency of reporting we believe a standard form for such disclosures to be made to retail clients for use by authorised exchanges should be included within the legislative framework.

ASIC has promulgated RG 133 to provide relief for omnibus accounts for custodial providers to hold certain classes of assets separately, particularly where not doing so would substantially add to the cost of holding these assets or scheme property. We believe this relief should be extended to digital assets with specific conditions to accommodate for the specific technologies used to hold and manage the accounts.

Existing custodial technology used by crypto exchanges such as MPC, Multi-sig, and other similar arrangements can provide clients with protections that are materially equivalent to those afforded by individually segregated client accounts.

## 4.8. Transitional arrangements

It is proposed that the Bill commence 6 months after royal assent and the transition period is 3 months. This is a fundamental change to an industry that is highly technical, complex, and regulated only under AML/CTF and the Australian Consumer Law.

ASIC's current service standard is 4 to 9 months to assess license applications (with most taking at least 6 months and some taking 12 months or more, especially in cases involving crypto). This timeframe is not long by any stretch and relies heavily on existing infrastructure and trained analysts.

As there is little to no existing resources or experience in implementing this type of licensing regime in any of the regulators, we believe an 18 -24 month timeframe is more appropriate.

In addition to a transition period, an exemption regime should also be considered for Digital Asset Exchanges and Digital Asset Custody Services, who currently operate in Australia, and such exemption should be valid till the license application is approved, rejected, or withdrawn. It would also be beneficial for the list of exempted entities to be made public, to ensure consumers and end-users have a ready reference as to which entities are covered under the exemption regime. An exemption regime, as outlined above, will ensure minimal disruption to Digital Asset services while license applications are being processed, and will therefore minimise disruptions to consumers and end-users during the transition to a licensing regime.

## 4.9. Digital Asset Custody Requirements

The requirements listed in proposed section 14(2) do not provide any actual requirements as they have all been noted as being part of the rules to be released. The details of these requirements need to be in the legislation for consideration.

There are only 3 requirements for custody licenses compared to 8 for Digital Asset Exchanges, despite fears and general industry sentiment that custody is the more pressing and significant risk. For example, there are no requirements for the segregation of assets, requirements for outsourcing custody or cybersecurity controls.

As currently drafted, the provisions of Part 2, Division 3 (Digital asset custody services) when read with Part 7, Section 48 (Application to digital asset custody services) appear to indicate that the Digital Asset Custody Service License requirement does not apply to those providers who provided Digital Asset Custody Services before the commencement of the Draft Digital Assets Bill. We, therefore, welcome clarification around the grandfathering of the Digital Asset Custody Service License.

The definition of custody is extremely broad. It should be made clear that custody of digital assets means holding or storing cryptographic keys and the ability to initiate or prevent digital asset transfers. The current definition could cover non-custodial or other services which do not present equivalent risks to consumers because the intermediary does not have the ability to initiate transactions on behalf of a consumer.

Given the complexity and nuances in providing custody for digital assets we recommend that a separate consultation be undertaken on the rules for custody of non-financial products.

## 4.10. Alignment to international regulatory frameworks

Crypto-assets markets are global and go beyond borders and global crypto providers are already designing products to avoid regulation or achieve regulatory arbitrage. Any legislation introduced in Australia exacerbates this if it does not fit harmoniously within the existing regimes and incorporates interaction and evolution with similar regimes in other developed markets.

An example is the MiCA regulations which provide a regulated pathway for token offerings. Without a similar regime, token issuers will go offshore.



#### 4.11. Insurance

Without clear legislation and certainty of the licensing regime, it is difficult for insurers in the sector to be able to provide policies. Where insurance can be sourced the cost is prohibitive and the exclusion can render it ineffective at protecting investors.

Having said that, there is no guarantee that an insurance market will follow the introduction of a licensing regime. Consideration should be given to alternative risk mitigation approaches, e.g. bonds and guarantees to give the insurance market time to mature and create capacity.

The lack of appropriate insurance impacts product issuers, crypto exchanges, and financial advisors who are increasingly being asked to provide advice on digital assets investments.