L 35, Tower Two, International Towers Sydney
200 Barangaroo Avenue,
Barangaroo NSW 2000 AUS
T +61 2 9263 4000 **F** +61 2 9263 4111
www.gtlaw.com.au

27 May 2022

Director – Crypto Policy Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: crypto@treasury.gov.au

Dear Director

Crypto asset secondary service providers: licensing and custody requirements

Gilbert + Tobin welcomes the opportunity to comment on Treasury's proposals for crypto asset secondary service providers (**CASSPrs**), in the *Crypto asset secondary service providers: Licensing and custody requirements – Consultation Paper* dated 21 March 2022.

Attached to this letter are our responses to questions raised in the consultation paper.

Please do not hesitate to contact the authors should you wish to discuss the matters in this letter.

Yours faithfully

Gilbert + Tobin

Peter Reeves
Partner
M [redacted]

Robert O'Grady
Lawyer
M + [redacted]

Background

Gilbert + Tobin advises a broad range of primary and secondary service providers in both crypto asset and crypto asset adjacent industries. Our clients include some of the most recognised global and Australian based providers, projects and transactions, many of whom participated in the Select Committee on Australia as a Technology and Financial Centre (**Committee**) consultation process.

This breadth of industry experience sits behind our responses to Treasury's questions and our submission reflects the experiences, challenges, opportunities and client feedback that Gilbert + Tobin has received in its deep advisory role within the crypto asset industry over the past 7 years.

Gilbert + Tobin is generally supportive of the introduction of a comprehensive licensing framework to regulate the areas of customer risk within the crypto asset industry. We consider it appropriate that the first iteration of such framework be targeted at relationships involving information asymmetry and trust (being the relationship between secondary service providers and customers) rather than attempt to construct a framework that captures the entirety of the crypto asset ecosystem, which would not be practical at this time.

Our submission is based on certain key principles:

- **Licensing framework:** we consider it appropriate that a licensing framework be developed to regulate entities that provide crypto assets services to customers with a geographical nexus to Australia. This provides the benefits of regulatory clarity and consumer protection, while also levelling the playing field for providers in this space by setting minimum standards that must be adhered to by all participants (rather than adopting regulatory arbitrage or risk-based approaches to product establishment and distribution).

- **Commensurate regulation:** any crypto asset licensing framework should not be overly prescriptive or unnecessarily impede innovation. This should be based on the approach of 'clear scope, flexible obligations'. Our view is that the financial services licensing regime should not be imported into the crypto asset context, as it is premised on 'broad scope, prescriptive obligations'. We consider the CASSPr regime should be commensurate and graduated in its approach; either using scaled obligations or other regulatory carve outs. This is to ensure that market entry is not prohibitive while also adequately addressing key risks on a progressive basis.

- **Regulator capacity and knowledge:** we note the intention to appoint the Australian Securities & Investments Commission (**ASIC**) as the primary regulator to administer the CASSPr regime. While we understand the desire for leveraging existing regulatory resources, there is a general concern among industry participants (based on anecdotal experience and feedback) that ASIC may not yet have the resources to effectively administer a crypto asset regulatory regime. We wish to draw Treasury's attention to the outcomes in Singapore where regulator capacity resulted in poor administration of a crypto asset regime and significantly reduced Singapore's position as

a leader in this space. We encourage Treasury to consider the need for a regulator that is adequately resourced and to ensure significant resources are provided to ASIC to enable it to efficiently administer any proposed regime relating to crypto assets.

- **Future proofing:** any licensing framework should be developed with the long-term view that it will need to expand and flex to cover new products, entities and activities as they emerge. This includes naming conventions (eg, 'secondary' service provider may be limiting in the context of eventually capturing 'primary' service providers), anticipated organisational structures (eg, how the regime will apply to decentralised autonomous organisations (**DAOs**)), as well as an ability to expand or contract the framework as needed (eg, carve outs, regulator powers to vary the application of the regime).

We have provided responses to Treasury's specific questions in this submission for the purposes of developing clarity around the consultation objectives. However, we note there is a range of views and positions that sit behind such responses and we would be happy to discuss these with Treasury.

Responses to questions

Proposed terminology and definitions – terminology changes

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

We agree with the use of the term Crypto Asset Secondary Service Provider instead of 'digital currency exchange'. However, we make the following observations.

(a) After an extended consultation process, the Committee released its final report on 20 October 2021 (**Final Report**).[1] The Final Report discussed and evaluated, among other things, the need for establishing a market licensing regime for digital currency exchanges (**DCEs**) and a custody or depository regime for digital asset custody providers. The Australian Government's response to these Final Report recommendations agreed in principle to consult on an appropriate licensing regime for DCEs and to develop and consult on a possible custody and depository regime.[2] This consultation is the subject of the consultation paper (**CP**).

(b) The CP, via terminology changes and the proposed definition (discussed further below), appears to pursue a broader scope by referencing "crypto asset secondary service providers" (**CASSPrs**).[3] While we accept there may be cogent reasons for expanding the scope of service providers, the CP provides limited policy-based reasoning in this regard and appears to draw primarily from a simplified structure of an ecosystem for crypto assets adapted from Ankenbrand et al (2021)[4] in respect of which certain elements have a regulated financial services focus (eg, "investment product providers", "investment services", "investment protocols").

(c) We note the various comments in both the Final Report and the CP that the current Australian financial services licensing regime and Australian market licensing regime are not fit for purpose in their application to crypto assets. For example, the Final Report noted that the existing Australian market licensing regime "*is not well suited to become directly applicable to DCEs. As such the committee is recommending the creation of a new category of market licence*".[5] The CP makes the following comments:

[1] Australian Senate, *'Select Committee on Australia as a Technology and Financial Centre, Final Report'*, 20 October 2021. Available here: https://parlinfo.aph.gov.au/parlInfo/download/committees/reportsen/024747/toc_pdf/Finalreport.pdf;fileType=application%2Fpdf

[2] Australian Treasury, '*Transforming Australia's Payments System'*, 8 December 2021. Available here: https://treasury.gov.au/sites/default/files/2021-12/p2021-231824_1.pdf

[3] CP, p.2.

[4] CP, p.3.

[5] Final Report, p.13.

(i) "*the principles for regulating crypto assets are not identical to those behind financial product regulation and should not be treated as such*";[6]

(ii) "*products and services should be regulated according to the risks they could present. Products that use new technologies which reduce risk should be subject to different and lighter regulation than existing products*";[7]

(iii) "*much of the need for regulatory recourse that may be required for financial products does not necessarily exist for many crypto assets*";[8]

(iv) "*notwithstanding that the use case of any given financial product and crypto asset may be similar, the regulation of the two should be separate and distinct as they do not present the same potential risks*".[9]

(d) We agree that the existing financial services regulatory regime provides a useful base from which to develop a regime for crypto assets, however we encourage Treasury to remain mindful of the statements in the Final Report in relation to the suitability of the existing regime for crypto assets and the regulatory clarity that the industry is seeking.

(e) For example, the simplified structure of an ecosystem for crypto assets referenced above is limited (and therefore inaccurate) in relation to how it describes "issuers" in "primary services" and over-reaching in relation to how it describes "asset managers/brokers" in an "investment services" category. If this diagram (or something similar) were used to provide guidance in relation to the CASSPrs regime we believe it will undermine the objectives in relation to suitability and regulatory clarity.

(f) We understand the proposed CASSPr definition seeks to reflect the definition of 'virtual asset service provider' or 'VASP' as defined by the Financial Action Task Force (**FATF**).[10] We address elements of the proposed definition below.

Element	Comments
Any natural or legal person who, as a business, conducts one or more of the following activities or operations for or on behalf of another natural or legal person:	Guidance should be published in relation to clarifying the conduct of a business under the CASSPr regime (and therefore whether a person is caught by the regime). This should include commentary similar to that set out in paragraphs 58 to 61 of FATF *Updated Guidance for a Risk*

[6] CP, p.12

[7] CP, p.12.

[8] CP, p.13.

[9] CP, p.13.

[10] Financial Action Task Force, *Updated Guidance for a Risk Based Approach for Virtual Assets and Virtual Asset Service Providers*, 28 October 2021. Available here: https://www.fatf-gafi.org/publications/fatfrecommenda ions/documents/guidance-rba-virtual-assets-2021.html

Element		Comments
		Based Approach for Virtual Assets and Virtual Asset Service Providers, 28 October 2021[11] (***FATF Guidance***). It should be clarified (as we understand the intention of the CP to be) that "activities or operations" is intended to capture "operating a market". That is, this language includes the situation where a person operates a facility through which participants can exchange crypto assets for fiat currency or exchange crypto assets with each other. The jurisdictional application of the regime should be clarified. For example, either the activities or operations are conducted for or on behalf of Australian consumers (ie, similar to the Australian financial services licence (**AFSL**) regime) or the person conducting the business has a geographical nexus to Australia (ie, similar to the Australian anti-money laundering and counter-terrorism financing (**AML/CTF**) regime) that will trigger the application of the CASSPr regime.
i.	exchange between crypto assets and fiat currencies;	Consider defining "*fiat currencies*" by reference to "recognised legal tender" (similar to the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) (**AML/CTF Act**)). The definition of "exchange" should not extend to "issuers", as contemplated by the CP, but should remain within the scope of secondary service providers.
ii.	exchange between one or more forms of crypto assets;	Consider deleting "*forms of*". The purpose of this language is unclear and may be unnecessary when having regard to the definition of "crypto asset". The definition of "exchange" should not extend to "issuers", as contemplated by the CP.
iii.	transfer of crypto assets;	The definition of "transfer" should not extend to "issuers", as contemplated by the CP.
iv.	safekeeping and/or administration of [virtual] assets or instruments enabling control over crypto assets; and	Appropriate guidance should be provided in relation to the meaning of "*safekeeping*" and "*administration*".

[11] FATF Guidance.

Element		Comments
v.	participation in and provision of financial services related to an issuer's offer and/or sale of a crypto asset.	This limb should be deleted and not included in the definition. Such activity is already subject to the existing AFSL regime.

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

Given the proposed objectives of the consultation, in our view CASSPr is appropriate. However, we encourage Treasury to take a long-term view of any naming convention. That is, if the framework is expanded to capture primary service providers or issuers in the future, the CASSPr naming convention may be limiting and require adaptation to remain fit for purpose. For example, *crypto asset service provider* (ie CASPr) may be suitable.

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

The proposed definition set out in the CP is: "*… 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.*"[12]

We consider the use of the term "crypto asset" is appropriate having regard to the proposed intention of the Final Report and CP, rather than broader terms such as "digital asset" or "virtual asset".

We make the following additional observations.

(a) Given the intention that the CASSPr regime does not overlap with the AFSL regime, crypto assets that are not also captured by the AFSL regime should be expressly excluded from the definition of financial product under that regime.

(b) We encourage Treasury to clarify the meaning of "substantially affected" as this could have various meanings which could undermine the purpose of regulatory clarity. That is, is it a condition of the definition that a crypto asset rely on cryptographic proofs in order to function, or a broader construct of being generally subject to cryptographic proofs.

(c) We also encourage Treasury to consider and clarify the standard that is intended to be accompanied by "value". Value can be a subjective term having regard to the relevant holder.

[12] CP, p.10.

Therefore, Treasury may consider clarifying whether this is intended to refer to 'real or perceived' value.

(d) ASIC has adopted a different definition set out in *Information Sheet 225: Crypto Assets* (**INFO 225**), which defines a crypto asset as:

> "*a digital representation of value or rights (including rights to property), the ownership of which is evidenced cryptographically and that is held and transferred electronically by a type of distributed ledger technology, or another distributed cryptographically verifiable data structure*".[13]

In our view, this definition in INFO 225 may be more appropriate, particularly in relation to the intention to protect consumers. The proposed definition in the CP references "contractual" rights, which suggests that rights must be enforceable under a contract and therefore that whether the regime is triggered is subject to express terms that may be associated with or embedded in the crypto asset.

This definition not only refers to a broader set of rights, it adopts a broader connection with distributed ledger technology rather than a specific cryptographic proof.

(e) Definitions adopted by other jurisdictions include:

(i) Markets in Crypto-Asset (**MiCA**) Regulation in Europe adopts the definition: "*a digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology*";[14]

(ii) Financial Conduct Authority (**FCA**) in the United Kingdom adopts the definition: "*cryptoassets are cryptographically secured digital representations of value or contractual rights that use some type of distributed ledger technology (DLT) and can be transferred, stored or traded electronically";*[15]

(iii) The State of Wyoming adopts the definition: "*digital asset means a representation of economic, proprietary or access rights that is stored in a computer readable format, and includes digital consumer assets, digital securities and virtual currency."*[16]

(f) The definition may need to be considered further upon consideration of responses to the token mapping exercise.

---

[13] ASIC, INFO 225: Available here: https://asic.gov.au/regulatory-resources/digital-transformation/crypto-assets/

[14] Article 3, Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937. Available here: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020PC0593

[15] Definition available here: https://www.fca.org.uk/firms/cryptoassets

[16] 2019 Wyoming Digital Asset Statute (W.S. 34-29-101 et seq.), as amended in 2021. Available here: https://www.wyoleg.gov/Legislation/2019/sf0125

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

We agree that the definition for crypto asset should be *consistent* across regulatory frameworks. However, it may not be the case that a single definition (ie, the *same* definition) is appropriate for all regulatory frameworks. That is, the same definition may not be appropriate within, for example, AML/CTF laws as against intellectual property laws, which may be targeted at different features. However, they should not be inconsistent in terms of how they address the core characteristics of what a crypto asset is.

For example, the AML/CTF Act adopts the definition of digital currency as:

> "*(a) a digital representation of value that:*
>
> *(i) functions as a medium of exchange, a store of economic value, or a unit of account; and*
>
> *(ii) is not issued by or under the authority of a government body; and*
>
> *(iii) is interchangeable with money (including through the crediting of an account) and may be used as consideration for the supply of goods or services; and*
>
> *(iv) is generally available to members of the public without any restriction on its use as consideration; or*
>
> *(b) by means of exchange or digital process or crediting declared to be digital currency by the AML/CTF Rules,*
>
> *but does not include any right or thing that, under the AML/CTF Rules, is taken not to be digital currency for the purposes of this Act."*[17]

The digital currency definition under the AML/CTF Act is not the same as the proposed crypto asset definition in the CP, however they are not necessarily inconsistent. The definition under the AML/CTF Act is targeted at digital assets that carry money laundering and terrorism financing risks. That is, the regulatory objective of the AML/CTF Act is different to that of the proposed CASSPr regime.

[17] S.5, AML/CTF Act.

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

Having regard to the proposed definition of crypto asset, in particular that such an asset is a "*digital representation of value or … rights*" (note our comments above) and that the primary risk associated with CASSPrs is stated as being the potential loss of a consumer's assets or balance (in fiat or crypto) through the use of the CASSPrs' facilities, we do not believe that any crypto asset that fits the definition (which NFTs may do) should be carved out of the regime.

Should the need arise to exclude a particular crypto asset from the regime in the future (eg, following the token mapping exercise or new classes of assets being developed that warrant such an exclusion), the regime can allow for this either by exclusion from the definition of crypto asset or the requirement to hold a licence.

Proposed principles, scope and policy objectives of the new regime

6 Do you see these policy objectives as appropriate?

We note the proposed policy objectives are:

(a) *"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;*

(b) *support the AML/CTF regime and protect the community from the harms arising from criminals and their associates owning or controlling CASSPrs; and*

(c) *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."*[18]

We broadly agree that these policy objectives are appropriate. However, leaving aside the lack of clarity around who should meet the definition of *"retail consumer"* we do not necessarily agree that there should be different outcomes for retail consumers and "wholesale" consumers. The risks (as identified in the CP) that are faced by both groups is the same.

7 Are there policy objectives that should be expanded on, or others that should be included?

Centralised primary service providers in the crypto asset industry not only involve a trust relationship with customers, but also significant information asymmetry. Two commonly cited consumer vulnerabilities in the context of crypto assets are:

(a) insufficient disclosure of the features, benefits and risks associated with such assets; and

(b) deceptive and sometimes fraudulent conduct of issuers regarding the expressed intended performance of such assets.[19]

We suggest that Treasury address this aspect of the industry and have regard to the various submissions referred to in the Final Report that describe features of a "safe harbour" that could be

[18] CP, p.14.

[19] For example, ASIC enforcement against a range of issuers in the context of Initial Coin Offerings (**ICOs**) (see media release here: https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-274mr-asic-acts-against-misleading-initial-coin-offerings-and-crypto-asset-funds-targeted-at-retail-investors/).
For example, Australian Competition and Consumer Commission (**ACCC**) release on cryptocurrency trading scams (see media release here: https://www.accc.gov.au/media-release/australians-lose-over-70-million-to-bogus-investment-opportunities)

designed to achieve outcomes addressing the trust and information asymmetry issues that give rise to the risks for consumers associated with "primary services". An appropriate safe harbour could provide legal and regulatory certainty to industry participants and consumers and foster growth while the challenges around DAOs and token mapping are resolved in a manner that does not undermine the growth of the sector in Australia. Given the desire to position Australia as a crypto asset friendly jurisdiction as soon as possible while also not unnecessarily rushing the development of appropriate and commensurate regulation, we consider a safe harbour regime would be appropriate. That is, a safe harbour framework setting out the core principles associated with what Treasury considers to be the minimum standard for quality providers in the crypto asset space such that providers can comply with these standards in a manner that enables an intermediate stamp of quality while the CASSPr regime is fully developed and implemented.

Separately, while it may be the case that secondary service providers have the stamp of quality for consumers by being subject to the CASSPr regime, we expect that there will be obligations regarding the regulatory status of the assets in which they deal. The issues associated with characterisation of assets at the primary level (which is not proposed to be subject to the CASSPr regime), may place CASSPrs in a challenging position if there is no framework upon which they are entitled to rely when making determinations in relation to these assets. If a safe harbour were implemented where the issuance of an asset met identified criteria with respect to regulatory status, disclosure and consumer outcomes, CASSPrs may be better able to meet their obligations (and the objectives of the CP).

We note the comments in this section are not inconsistent with the proposition that the regime "*would not apply to decentralised platforms or protocols".*[20] That is, any expansion to primary service providers would only apply to centralised providers. In the context of decentralised arrangements where the customers of services and assets are also the providers of services and assets (for example, in the context of DAOs), the elements of trust and information asymmetry may not exist in a way that necessitates regulatory oversight or a safe harbour.

8 Do you agree with the proposed scope detailed above?

Subject to our comments in relation to questions 6 and 7, and our comments in relation to administration of the regime below, we believe that the proposed scope is appropriate.

We note the intention set out in the CP to have ASIC as the primary regulator administering the CASSPr regime.[21]

ASIC currently administers a range of regulatory regimes, including the AFSL regime. In ASIC's 2021 activity report measuring the application processing times for the 2020-2021 financial year, it was noted that 50% of AFSL applications were finalised within 93 days, 70% within 145 days and 90% within 251

[20] CP, p.14.

[21] CP, p.15.

days.[22] While these statistics indicate an application processing time of 3 to 8 (or more) months, the reported period ends on 30 June 2021. Anecdotal experience suggests these application processing times have become significantly longer in the second half of 2021 and into 2022.

Application processing times are generally longer where there is a new technology offering or reference to crypto assets. Anecdotal experience is that some applicants have experienced application times well in excess of 10 months.

If the effect of the CASSPr regime will be to apply a greater application caseload to ASIC, there is a risk that the objectives of the CP may not be achieved, particularly given the pace at which the crypto asset industry is developing.

Further, we note the various comments in both the Final Report and the CP that the current AFSL regime and Australian market licensing regime are not fit for purpose in their application to crypto assets. For example,

(a) the existing Australian market licensing regime "*is not well suited to become directly applicable to DCEs. As such the committee is recommending the creation of a new category of market licence*";[23]

(b) "*the principles for regulating crypto assets are not identical to those behind financial product regulation and should not be treated as such"*;[24]

(c) "*much of the need for regulatory recourse that may be required for financial products does not necessarily exist for many crypto assets"*;[25]

(d) "*notwithstanding that the use case of any given financial product and crypto asset may be similar, the regulation of the two should be separate and distinct as they do not present the same potential risks";*[26]

(e) "*the digital assets sector is still poorly understood by regulators and governments in Australia."*[27]

Having regard to these comments there is a risk that ASIC, in its proposed dual role as AFSL and CASSPr administrator, may, in seeking to achieve efficiencies (which would be understandable), not be in a position to administer the CASSPr regime in accordance with the stated objectives [28] (particularly if CASSPr licence applications are effectively viewed through an AFSL application "lens").

---

[22] Australian Securities & Investments Commission, *Report 700*, 'Licensing and professional registration activities: 2021 update', September 2021. Available here: https://download.asic.gov.au/media/h51b1rp5/rep700-published-15-september-2021.pdf.

[23] Final Report, p.134.

[24] CP, p.12.

[25] CP, p.13.

[26] CP, p.13.

[27] Final Report, p.133.

[28] CP, p.6.

We note that one of the overarching mandates for the Committee was to explore the ways in which Australia can remain competitive as a technology and financial centre (including with regard to crypto assets). One of the themes of the Final Report was the desire for regulatory clarity in the crypto asset industry. Consistently, the CP notes:

> "*Nonetheless, domestic providers may benefit from a more reliable and trustworthy crypto market here in Australia through a licencing* [sic.] *system or an Australian stamp of quality. For this reason, many industry players have called for a regulatory framework for secondary service providers (CASSPrs) to provide confidence to consumers about the services they offer and to improve the reputation and credibility of the sector".*[29]

The appointment of ASIC as the administrator of the CASSPr regime should have due regard to the objectives of the CP and the experience of our neighbours, which are informative.[30]

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 to our response to question 5.

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)?

The application of the AFSL regime and AML/CTF regime are well understood, and we believe that the proposal for a separate CASSPr regime as it applies to non-financial product crypto assets is achievable with appropriate regulatory guidance.

To the extent that a provider engaging with crypto assets enlivens the AFSL regime, we would expect that the AFS licensing requirements and obligations would encompass those that would be applicable to a provider enlivening the CASSPr regime insofar as such requirements and obligations relate to the services provided by, and the risks associated with, CASSPrs (as described in the CP). That is, in the event that financial services are provided by a CASSPr, the AFSL regime is the higher bar that addresses the objectives of both the CASSPr regime and the AFSL regime and the AFSL is the only licence that is required, provided that it covers all of the relevant services.

[29] CP, p.4.

[30] For example, Singapore has historically been known as a crypto friendly jurisdiction. However, this position has more recen ly been called into question as Singapore struggles to apply its digital payment token licence regime effec ively and has led to more than 100 out of 170 businesses having their licence application denied or withdrawn. See report here: https://asia.nikkei.com/Spotlight/Market-Spotlight/Crypto-entrepreneurs-find-Singapore-is-not-so-hospitable-after-all

Proposed obligations on crypto asset secondary service providers

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

As noted in the Final Report: "*there must be a balance between bringing digital assets into the regulated world while preserving their dynamism*".[31] This concept addresses the importance of not only which assets and activities to capture in regulation, but what obligations apply when regulating them.

An important outcome for this consultation is to make Australia a desirable jurisdiction in attracting crypto asset businesses by establishing a regulatory regime that is clear and flexible but also protects consumers. However, we also believe that any regulatory regime, in its application, should be commensurate and graduated in its approach; either through the use of scaled obligations or exemptions. The proposed obligations should be principles based and applied with sufficient flexibility to allow for changing business models, compliance processes and risk profiles.

Given the parallels between the proposed CASSPr regime and the AFSL regime and our comments above in relation to the administration of the regime by ASIC, we suggest that it is not appropriate, when considering how the proposed obligations will be met by CASSPrs, to import on a "wholesale basis" (as appears to have been done in relation to the obligations) the principles as to how such obligations should be met. Such principles should be objectively formulated having regard to the fact (as recognised by Treasury and as set out in the CP), crypto assets are different to financial products.

Subject to the above, our comments in relation to the proposed obligations are below, and we reiterate our previous comments in relation to a proposed "safe harbour". We do not consider that further obligations should apply.

Obligation	Comments
Do all things necessary to ensure that: the services covered by the licence are provided efficiently, honestly and fairly; and any market for crypto assets is operated in a fair, transparent and orderly manner.	We agree in principle to the inclusion of this obligation, noting that for clarity the obligations regarding service provision should be split from the market operation obligations. Separately, we refer Treasury to the Financial Services Legislation: Interim Report A (ALRC Report 37) published by the Australian Law Reform Commission (**ALRC**) which highlights the interpretation issues associated with the words "efficiently, honestly and fairly".[32] We encourage Treasury to consider the ALRC proposals

[31] Final Report, p.134.

[32] Available here: https://www.alrc.gov.au/wp-content/uploads/2021/11/ALRC-FSL-Interim-Report-A.pdf

Obligation	Comments
	regarding these words before implementing them as an obligation on CASSPrs.
Maintain adequate technological, and financial resources to provide services and manage risks, including by complying with the custody standards proposed in this consultation paper.	We agree in principle to the inclusion of this obligation, provided it is applied on a commensurate and flexible basis. In particular, financial requirements should not be prohibitive.
Have adequate dispute resolution arrangements in place, including internal and external dispute resolution arrangements.	We agree in principle to the inclusion of this obligation. We understand the intention is that the Australian Financial Complaints Authority (**AFCA**) will administer these processes. AFCA currently considers complaints about cryptocurrency services if the provider is an AFCA member. AFCA has scheduled a meeting with crypto asset industry members and advisers to understand the industry, its needs and issues relevant to crypto asset disputes.
Ensure directors and key persons responsible for operations are fit and proper persons and are clearly identified.	We agree in principle to the inclusion of this obligation.
Maintain minimum financial requirements including capital requirements.	We agree in principle to the inclusion of this obligation, provided it is applied on a commensurate and flexible basis. In particular, financial requirements should not be prohibitive.
Comply with client money obligations.	We agree in principle to the inclusion of this obligation.
Comply with all relevant Australian laws.	We agree in principle to the inclusion of this obligation on the basis that it is intended to apply to providers who may not already be subject to Australian laws.
Take reasonable steps to ensure that the crypto assets it provides access to are "true to label" e.g. that a product is not falsely described as a crypto asset, or that crypto assets are not misrepresented or described in a way that is intended to mislead.	We note these obligations are already captured in the context of prohibitions on misleading and deceptive conduct in the Australian consumer law (**ACL**).[33] While consideration may be given to apply comparable requirements on CASSPrs (eg, as has been applied to financial products through the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**))[34], this obligation (as currently proposed) appears ambiguous and may be difficult to comply with as the CASSPr will be somewhat reliant on information provided from other parties. We also reiterate our comments in

[33] See Schedule 2, *Competition and Consumer Act 2010* (Cth).

[34] See Division 2, ASIC Act.

Obligation	Comments
	relation to a "safe harbour", which would have the effect of bolstering the consumer protections the CP is proposing.
Respond in a timely manner to ensure scams are not sold through their platform.	This obligation is ambiguous and is arguably already captured by obligation 1. Clarification should be provided as to what, in addition to compliance with obligation 1, is required to discharge this obligation.
Not hawk specific crypto assets.	While we agree in principle to the inclusion of this obligation, this should apply to all crypto assets (not "specific" crypto assets).
Be regularly audited by independent auditors.	We agree in principle to the inclusion of this obligation. However, clarity should be given as to the type of audit required (eg, financial, technological) and the meaning of "regular" (given the speed of development in the space and the pace at which new services may be made available to consumers (ie, an audit may service little purpose in terms of consumer protection if new products are launched immediately following an annual audit)).
Comply with AML/CTF provisions (including a breach of these provisions being grounds for a licence cancellation).	"Comply with all relevant Australian laws" already captures this obligation and we consider it unnecessary. Further, a breach of AML/CTF provisions being a basis to cancel a licence seems unreasonable. This is not a feature of the AFSL regime, is ambiguous (as to what constitutes a breach – is a minor or technical breach that has been resolved with the Australian Transaction Reports and Analysis Centre (**AUSTRAC**) captured?), has the potential to be administered in an arbitrary and unfair fashion and cuts across AUSTRAC's function in relation to the administration of the AML/CTF regime.
Maintain adequate custody arrangements as proposed in the next section	See comments in custody response.

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

We consider that, provided the crypto assets distributed via airdrop are subject to the same regulations that apply to any other crypto assets, airdropping should not be banned. An additional consideration is the management of conflicts of interest, which can be incorporated as an additional obligation under the CASSPr licensing regime (ie, in addition to the obligations described at question 11).

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)?

No, we do not consider that a ban on personal advice is appropriate. As noted in the CP, one of the core policy considerations behind the CASSPr regime is the existence of information asymmetry between the provider and customer. Given this asymmetry, it is the case that customers may require advice before making any decisions with respect to dealing in crypto assets. A ban on personal advice could adversely impact customer outcomes if they are not able to access appropriate advice.

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

Not applicable.

Alternative options

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?

We do not support any proposal to bring all crypto assets into the AFSL regime. For the reasons discussed in the CP and the various other matters raised in our response, in our view the AFSL regime is not appropriate for crypto assets. Implementing this option risks implementing a regime that:

(a) is unnecessarily onerous;

(b) stifles innovation in the financial and non-financial sectors;

(c) entrenches current market participants in the financial system and does not promote fair competition;

(d) has a chilling effect on Australia's ambitions to be a hub for, and to realise the benefits of, growth in the sector (ie, businesses and talent will continue to leave Australia and Australia will not be perceived as a friendly jurisdiction in this sector); and

(e) will not enable the Government to achieve its objectives in relation to a regulatory regime for CASSPrs.

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

Not applicable.

17 Self-regulation: 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?

We broadly support the principles outlined in the codes provided in the CP. While voluntary codes of conduct can be preferable complementary frameworks, the implementation of a new licensing regime that assesses and approves providers in relation to crypto assets, in our view, responds to the objectives of the CP. Further, given other jurisdictions appear to be moving towards comprehensive crypto asset regulatory regimes and that Australia seeks to be a leader in this space, a voluntary code of conduct may be a less competitive proposition in the near to medium term.

If a code of conduct were to be implemented in lieu of the CASSPr licensing regime, in our view the code should be mandatory and be administered by a new regulatory body that is appropriately resourced and educated in the crypto asset industry.

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.

Not applicable.

Proposed custody obligations to safeguard private keys

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

The CP indicates that the proposal is to "*implement mandatory minimum, principles-based custody obligations for private-keys that are held or stored by CASSPrs on behalf of consumers*"[35]. This suggests that only those providers who hold consumer private keys will be captured, not custody providers who are transferred assets from consumers into the provider's own wallet (ie, the assets sit within the provider's wallet, not the consumer's wallet) and therefore the provider does not have access to or hold the consumer's private keys. The CP also states it will cover "*CASSPrs who maintain custody (either themselves or via third parties) of crypto assets on behalf of consumers.*"[36]

We note there are various types of custody arrangements in the market, including where:

(a) the custody provider takes control of the customer's private keys and has custody by virtue of access; or

(b) the custody provider holds the crypto assets in the provider's own wallet or account and adopts a sub-account structure to manage and segregate customer assets. Customers access their crypto assets through an application account layer.

We assume that the CASSPr regime is intended to capture both of these arrangements and that non-custodial wallet services (ie, wallets where the customer retains control of the wallet through private keys) are not captured. If correct, we wish to highlight to Treasury the complication that exists for an increasingly common solution that imports elements of both non-custodial and custodial services. Specifically, the process through which sharding occurs of the private key where the provider holds one shard and the customer holds the other shard. Neither party can sign transactions without the other party also signing the transaction. Given the level of control the customer has by virtue of holding a shard (ie, there is not the same level of trust required as exists with traditional custody providers that hold all the keys), these solutions are being positioned as non-custodial wallets. However, under the proposed CASSPr regime, it is unclear whether the provider is intended to be captured by virtue of holding a shard (but not all) of a private key. Clarity on this point should be provided.

Our comments on the proposed obligations follow.

[35] CP, p.20.

[36] CP, p.20.

Obligation	Comments
Holding assets on trust for the consumer.	We agree in principle with this obligation. However, as some crypto assets are a form of digital private property that are considered akin to a digital chattel, in some jurisdictions where custodians operate, custody arrangements are characterised as a form of bailment, not trust.[37] We suggest that allowances are made for custody of assets in jurisdictions where trust arrangements are not recognised for crypto assets. However, we recommend that a standard of sufficient equivalence be required such that consumer crypto assets cannot be captured in insolvency or administration arrangements.
Ensuring that consumers' assets are appropriately segregated.	We agree in principle with this obligation, which in application should refer to technological best practice with regard to asset tracing, record keeping and appropriate segregation mechanisms.
Maintain minimum financial requirements including capital requirements.	We agree in principle with this obligation, noting our above comments in relation to commensurate and flexible application of obligations (eg, where financial requirements should not be prohibitive).
Ensuring that the custodian of private keys has the requisite expertise and infrastructure.	We agree in principle with this obligation, noting our above comments in relation to commensurate and flexible application of obligations. This should also refer to technological best practice with regard to custody of private keys and should not be overly prescriptive. We also refer to our comments above regarding shards of private keys.
Private keys used to access the consumer's crypto assets must generated and stored in a way that minimises the risk of loss and unauthorised access.	We agree in principle with this obligation, noting our above comments in relation to commensurate and flexible application of obligations. This should also refer to technological best practice with regard to generation and storage methods for minimising risk of loss and unauthorised access. We also refer to our comments above regarding shards of private keys.
Adopt signing approaches that minimise 'single point of failure' risk.	We agree in principle with this obligation, noting our above comments in relation to commensurate and flexible application of

[37] For example, see application of digital assets in custody context considered to be a bailment in Wyoming. 2019 Wyoming Digital Asset Statute (W.S. 34-29-104 et seq.), as amended in 2021. Available here: https://www.wyoleg.gov/Legislation/2019/sf0125

Obligation	Comments
	obligations. This should also refer to technological best practice with regard to appropriate signing approaches. For example, we note that some custody providers do not use multi-signature practices. Rather, multiparty computation and internal sharding are used and becoming expected practice in the industry. Separately, we also refer to our comments above regarding shards of private keys as between the provider and the customer.
Robust cyber and physical security practices.	We agree in principle with this obligation, noting our above comments in relation to commensurate and flexible application of obligations. This should also refer to technological best practice with regard to cyber and security procedures.
Processes for redress and compensation in the event that crypto assets held in custody are lost.	We agree in principle with this obligation, noting our above comments in relation to commensurate and flexible application of obligations. We note the issues in the market with respect to insurance arrangements (financial services generally, and in particular in relation to financial product and non-financial product digital assets). We suggest that clear guidance be published as to what will constitute adequate processes and arrangements (ie, alternatives to insurance) in order to avoid this requirement effectively being a prohibition on obtaining a licence (which is the anecdotal experience).
When a third-party custodian is used, that CASSPrs have the appropriate competencies to assess the custodian's compliance necessary requirements.	We agree in principle with this obligation.
Any third-party custodians have robust systems and practices for the receipt, validation, review, reporting and execution of instructions from the CASSPr.	We agree in principle with this obligation.

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 do not currently propose any additional specific obligations that should be included. However, we encourage Treasury to consider imposing a framework around which custody providers may be required to implement recovery processes for lost keys.

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?

No, we do not agree that this is something that should be mandated. This is not a requirement that is imposed in relation to financial products and in our view there is no basis to impose such a requirement in relation to crypto assets, particularly where (at this stage) many reputable and market leading crypto asset custody providers are located offshore.

We note the general corporate law requirements around carrying on a business in Australia and the proposed CASSPr licensing regime remain and may, in any case, result in offshore custodians establishing a domestic presence in the same way that occurs in the AFSL regime.

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

We consider the principles are appropriate.

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

Given the intention to have the custody regime as a commensurate and flexible framework, we expect that there will be additional legislative clarity and/or guidance regarding the implementation of obligations. Such guidance should be developed with in consultation with established crypto asset custody providers.

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

Not applicable.

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

We refer to our response in relation to question 17, which comments apply equally to custody of crypto assets.

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

Not applicable.

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

Not applicable.

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

Not applicable.

Early views sought on token mapping

We do not propose providing views on the characterisation of specific tokens at this stage.