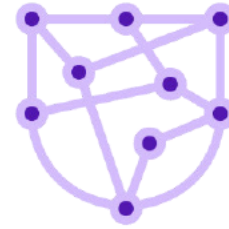


Dr. Michael G. Kollo
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Director – Crypto Policy Unit
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The Treasury Langton
Crescent PARKES ACT 2600

Dear Sir/Madam,

Please find attached our responses to the consultation paper entitled: “Crypto asset secondary service providers: Licensing and custody requirements.”.

Clanz is an Australian Crypto Exchange and Digital Asset Management firm. We started our journey in this space some three years ago, and now employ over 30 people, are raising capital, and looking to grow and develop our business in Australia. We therefore represent a good sample of the Australian start-up ecosystem and are hopefully able to offer you a valuable perspective for this young industry. We are of course happy to continue to be involved further after the consultation period, and to be integrated into any think tanks or committees that you may end up setting up.

As for me personally, I have a career in institutional asset management, largely based in London. Having grown up in Perth and Sydney where I attended UNSW, I completed my PhD at the London School of Economics in 2007 and went onto a career in asset management working at Blackrock, Fidelity, RAM, and Axa Investment Managers. I have taught quantitative finance at both London School of Economics and Imperial College and advised multiple fintech and cybertech startups during my time there. I spent a lot of time developing, managing, and presenting investment products globally, and was the Global Strategist for AI and Quantitative strategies for Axa, a 700bn asset manager. We moved to Sydney some four years ago, where I continued working in the Super industry, and later pivoted to the technology startup space, working at Faethm, a great Australian AI innovation startup that was recently sold to Pearsons. My field of expertise is in the application of quantitative methods in asset management, technology and the intersection with institutional asset management.

Many of my answers below I provide based on expertise in asset management, rather than legal, and am happy to contribute to the ongoing conversation in that capacity if I can be helpful. I think blockchain as a source of economic value, and industry creation is extremely valuable for Australia, as one of several high-tech industries looking to grow and expand. Crypto assets provide an interesting way into the value chain for these technologies and should be managed and regulated with

care to enable greater adoption, while at the same time not dissuading young companies in innovating and growing in this area. I provide my comments in this spirit and am happy to discuss further if I can be of help.

Kind regards,

Dr Michael G. Kollo

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Start of the Response.

The Government is keen to harness the economic benefits from the technological innovations arising from the crypto ecosystem for Australia and create a local crypto ecosystem that consumers can trust. This will need to be done while managing the risks crypto assets could present to consumers, the financial system, and the real economy.

Financial Product or Consumer Product

This depends on if the utility of owning / using the specified digital asset is primarily around the price appreciation and trading of said instrument, or a utility that is non-financial (but can be translated into a financial benefit). In an open marketplace, all utilities are translated into financial terms, discounted to present value, and traded. Therefore, any asset that is exchanged in a liquid trading facility, in a sufficiently frequent way, and that trading takes place based on the price utility of purchase or sale, should be caught as a financial asset.

In other words, finance is an abstraction of real economic activity into a 'price' that is denominated in a currency. This abstraction allows very different economic effects and activities, both realised and those expected, can be traded uniformly.

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

It is a good title, except for the concept of 'secondary' seems to establish a strong differentiation between the primary issuers and the secondary trading of that issue. Unfortunately, many trading houses can themselves be issuers (eg Binance has its own coin), just as blockchain issuers will actively change the supply of their coin to create certain price effects. I think it will be difficult to clearly differentiate 'primary' from 'secondary' as you may do with a company issuing stock (primary), and a broker trading that stock (Secondary).

Also, do you expect to capture the companies that provide data, models and analytics, as they are not strictly facilitating trading, but they are providing a service into the secondary market?

It feels like a term that captures specifically the transactions relating to crypto assets would be useful to embed here, rather than the term 'service'.

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

Just removing the 'secondary' would be useful.

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

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

Yes

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)?

Ideally all providers of crypto assets should be held under the CASSPr classification, though there may be consideration for primary (issuance, minting) and secondary (trading, management, custodian) differentiation.

6. Are these policy objectives appropriate?

They are appropriate, though it may be useful to have some more structure around this area.

Custodian risk, or the risk of outright theft of capital, and the insurance that is required to backstop this. Ideally you want to have a central licensing body that is providing certification for custodians. This will ensure that there is a hard backstop for fraud and theft of personal accounts, and this will largely address the current and existing shortfalls in the system. This is effectively deposit insurance for the banking system.

The operational risks of using firms should be no different to the standard ones that govern all consumer facing businesses. If I send money to a foreign exchange, or to a used car sales shop, or a subscription service, and the money is lost en-route, or mis-represented, it is a similar operational problem. I don't believe unique treatment should be provided, other than guidance as to what a good two-step verification may look like for example for logins.

The financial risks facing the use of a CASSPrs. My interpretation that you are looking at the financial risks of using a financial service, which feels like a disclosure of financial risks that is standard in the current regulation. For example, the one that separates retail and wholesale investors.

7. Should they be expanded upon.

The current Crypto exchange providers very much frame Crypto as a gambling service. They advertise themselves at similar venues to the gambling companies, target similar clients, and ultimately talk about Crypto investing as a 'one shot bet'.

This very much mis-represents the investment nature of the instrument, its long-term return and economic value, not to mention its complexity.

The level of education and farming of crypto assets should be considered, and perhaps the spirit of the law should encourage the industry to talk to investors about the ongoing risks and volatility profile an investment, rather than describe it as a short-term 'bet' as it currently does. I doubt you can regulate this effectively but putting the spirit of this under the financial risks I think would enrich the outcome.

8. Do you agree with the proposed scope above?

I agree, and think it is a fair scope.

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?

I believe that innovation in this space will be significant, and so it is hard to codify a regulatory regime that specifies the types of crypto assets, and that has any longevity.

It requires for the regulator to provide guidance, possibly in the spirit rather than the letter, to the kinds of assets that we expect to emerge from the Crypto industries and that will be held under the license.

For example, assets that are traded on top of any blockchain, and has a certain amount of secondary market liquidity to trade, could be classified as subject. This would capture many future innovations in this space. Clearly, it may drive investment in illiquid crypto assets, and those without active trading. I would argue that as with private equity, this kind of asset is likely to be more

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)?

This is a challenge, and one that is probably not going to be easily solved in the near term.

Where possible, I would suggest placing CASSPrs under a broad umbrella of the financial services regulation, under the spirit of the laws made in that space. For example, agencies should provide clear guidance to the risks of investment for decentralised crypto currencies / coins and tokens in a similar way to how traditional investments do.

Those assets that present unique risks due to their decentralised nature, for example a DeFi contract that is based on a blockchain, but not in Australian jurisdiction will need to be clearly articulated to investors looking to earn staking rewards.

However, the law should be careful to avoid cases where these institutions require double reporting, because the regulations specific to CASSPrs are duplicating the traditional regulation with small changes.

11. Are the proposed obligations appropriate?

Many of the obligations outlined apply generally to any financial instrument, and not appear to be digital asset specific. I agree that general principles of good business: transparency, communication, responsible selling practises that prohibit 'hawking' should be present in this industry, just as it is (hopefully) present in others.

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

The act of distribution, through airdropping or other mechanisms, is possibly not a concern. The distribution mechanism is only a concern if it allows the agent to subvert disclosures and rules that would otherwise be in place if they were not engaging in that distribution.

13. Should there be a ban on not providing advice which considers a person's personal circumstances in respect of crypto assets available on a licensee's platform or service?

I do not think that investment related information (such as risk, or economic value) relating to crypto assets should always necessarily consider the person's personal financial circumstances. While it is desirable to consider investment in the context of the total investment picture, necessitating this, also necessitates buyers to fully disclose and discuss their financial position with a crypto provider.

This path will take crypto assets directly into a regulatory framework that must be considered within the full financial advice context, and this is likely to place significant burden on crypto product providers.

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

This will massively change the business model of crypto investment product information or even access. We estimate that we will need to effectively rehire our team in financial advice, as well as build a more complete front-end to enable to client to provide financial information beyond.

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?

I support a staged moved instead of a single stroke. I would suggest naming the most important and popular crypto assets, such as Bitcoin, Ethereum, Solana, etc. into the regime as most of the high-level investment would take place in these, say top 20 currencies. The choice of this list is perhaps contentious and could be revised quarterly or annually to provide some flexibility.

There are clearly compliance costs that CASSPr will need to face, including the communication and treatment of these assets as financial investments, and the collection of them as investment products.

However, this would unlock a great deal of capital and investment opportunities across the financial services industry. The benefits of the greater adoption and

investment would be a net positive for the industry. In the short term this would result in buying pressure in the named currencies. In the medium term, it would incentivise people to build more apps and projects that launched currencies, hoping to become part of the basket of presented currencies.

The choice for membership in the recognised currencies would relate to stability, liquidity, credibility and other criterion that would satisfy an expert panel that the digital asset met a minimum threshold of stability and sophistication.

Finally, this would also open the doors for more complex, leveraged and derivatives-based products in this space.

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

It is a significant cost of a compliance team, probably 2-3 persons full time, roughly amounting to 500k-1mn a year in running costs, plus another 200k in service costs., so probably over a million and a half. Again, small players will struggle to pay this. Finding these persons within the current labour shortage will not be easy.

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?

The voluntary code of conducts is weak in their ability to provide investors and clients with the feeling of safety and security. Having certification bodies, partly private for example, could be a better solution. For example, relying on private sector rating agencies to provide credible feedback to customers could equally be effective.

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.

It is hard to universally estimate the cost of implementation, given that each firm will use their discretion. Let's say for example that a principle-based set of rules will require less reporting, and should be embedded within the product and software builds of the firm.

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

The processes around compensation in case of loss (point 9) may not be appropriate for crypto wallets held by clients. Unless it is explicitly due to the negligence of the CASSPr agent, the crypto wallet itself should be the sole and direct responsibility of the client, in fact that's how these have been built in the first place.

Similarly, looking at Point 3, you will note that capital requirements are necessary either because of the nature of the instruments themselves require it: eg futures

contracts and/or derivatives. However, if the custodian risk is not present, companies will be ok to hold less capital against losses not due to their actions.

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

It may be appropriate to mandate external agencies providing custodian services for accounts that are a particular size. Eg, accounts that are greater than \$100,000 require an external agency to provide custodian services.

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?

Custodians are an ultimate legal backstop for security of assets. In that sense, they must be reachable within the jurisdiction of the law. They will need to have a significant legal entity domestically or be domiciled in countries where the legal reach is reasonable.

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

Ultimately, the safekeeping of assets will be due to the cyber security of the CASSPr and the chosen custodian. As with banks, there will be leaks in assets, and the question of who pays must be well defined early on. For example, for smaller items, the customer themselves may be responsible for security, but for larger amounts, ideally the custodian provides a guarantee.

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

None.

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

As a CASSPr we are already in discussions with external custodians for the assets.

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

I do not believe that is appropriate. As mentioned above, the custodian function is effectively a legal backstop to ensure a minimum level of safety and security.

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

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

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

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.

Any asset with a significant secondary market liquidity, that ultimately generates its perceived utility as a storage of value and/or as a trading asset should be classified as a financial product. This is like commodities or other assets that derive their value through trade.

However, there are other crypto coins specifically that have utility in use, such as utility tokens. These may be received as other products and assets, perhaps the same way as gift cards are non-tradable (ideally) representations of utility based on a value that spends at a specific store.

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

Holding governance tokens in DAO may be an interesting grey area to consider. These afford the user some element of control over systems but may not directly afford the user a financial value.

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

I believe most crypto currencies and coins that have a second market liquidity could be considered financial products, or at least assets that are investible. Certainly, derivatives based on the value of these assets should be, as should portfolios constructed on them.

Staking should be considered a financial product, as the utility is a financial return, and the risk is a counter-party risk, like a loan book.

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

I wouldn't think that any should be banned, and in fact banning any instrument feels like a failure of classification and communication. Investors should be able to take all different levels of risk so long as the parameters are well defined and communicated.

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