

MinterEllison.

27 May 2022

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

EMAIL: crypto@treasury.gov.au

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

MinterEllison appreciates the opportunity to make a submission in relation to the Treasury Consultation Paper 'Crypto asset secondary service providers: Licensing and custody requirements', released on 21 March 2022 (**Consultation Paper**).

MinterEllison is a leading Australian Law firm. We advise major financial institutions, fintechs, crypto asset secondary service providers (**CASSPrs**), token issuers, financial advice firms and other financial intermediaries in Australia and overseas.

The views expressed in our submissions are ours alone and do not necessarily reflect the views of our clients.

The technological innovations underlying the crypto industry are having a significant impact on all aspects of life and the economy, not just the financial industry. Crypto assets themselves are a rapidly growing part of the global market. The International Monetary Fund estimates the market capitalisation of crypto to be \$2.5 trillion.¹ As crypto assets gain more mainstream awareness and acceptance, there is significant benefit in having a properly regulated ecosystem that affords certainty to consumers and legitimacy to players in the industry. A well-regulated crypto market in Australia also has the potential to promote Australia as a global hub for the fintech sector.

The crypto market is currently experiencing a period of volatility following the TerraUSD collapse, which saw an algorithmic stablecoin meant to be tied to the US dollar plummet in value, erasing about \$45 billion in value. It is therefore also important for regulation of the crypto industry to promote consumer and investor protection.

CASSPr Licensing

We agree that CASSPrs should be the primary subject of regulation as they act as the main gateway between most consumers and the crypto industry. However, we believe that it would only make sense to establish a separate regulatory regime for CASSPrs if the obligations will be distinct from the current requirements of the financial services regime. As the proposed obligations are largely similar to our current Australian financial services licensing (**AFSL**) regime, we are concerned that establishing a new standalone regime would add complexity and uncertainty to the financial system. We therefore believe that CASSPrs should be regulated under the existing financial services regime, and have made proposals below as to the content and structure for the application of that regime.

Custody

We support the proposed custody regime for CASSPrs.

¹ International Monetary Fund, 'Global Financial Stability Report: COVID-19, Crypto, and Climate: Navigating Challenging Transitions' (Report, 2021) 42.

Token Mapping

We recommend categorising tokens into the following categories: means of exchange, investment, utility and hybrid.

Our detailed submissions in response to the proposals and questions raised in the Consultation Paper are set out below.

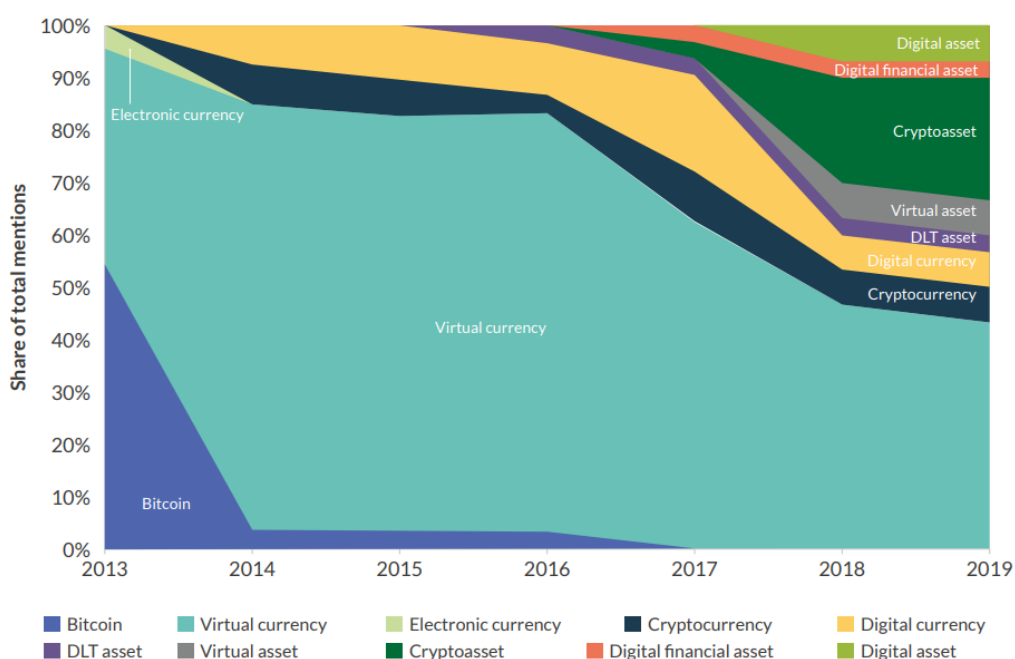
1. Definitions

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

1.1 We prefer usage of the term Crypto Asset Service Provider (**CASP**) over CASSPr (and will refer to CASSPrs as CASPs for the rest of this submission). While the term 'digital currency exchange' has previously been used as part of regulatory guidance in Australia, the term 'CASP' is more in step with the term 'VASP' used by other jurisdictions and entities such as the Financial Action Task Force and Hong Kong to describe these service providers. For reference, we have included a chart below from the Cambridge Centre for Alternative Finance which shows the terminology used by regulators from 23 selected jurisdictions,² as well as selected international organisations (e.g. FATF, FSB).³

1.2 The chart shows that although 'virtual currency' has been the most popular term overall, its use has been decreasing since 2016. Instead, there is an increasing trend for the term 'crypto asset'. Accordingly, we recommend aligning Australia with a growing number of jurisdictions and keeping with the trend towards the use of 'crypto asset' over 'virtual asset'. Additionally, we note that the Australian Securities and Investments Commission (**ASIC**) has consistently used the term 'crypto asset' in its guidance.⁴

Figure 5: Evolution of the terminology used by regulators (2013-2019)



1.3 It will be important to ensure that the definition of a CASP does not capture any primary providers such as token issuers and decentralised platforms or protocols. Token issuers and decentralised

² Abu Dhabi, Australia, Bermuda, Canada, Estonia, European Union, France, Germany, Gibraltar, Hong Kong, India, Israel, Japan, Malta, Mexico, People's Republic of China, Russia, Singapore, South Korea, Switzerland, Thailand, United Kingdom, United States. These jurisdictions were chosen based on 'the level of domestic cryptoasset activity and the relative magnitude of the regulatory response': Cambridge Centre for Alternative Finance, 'Global Cryptoasset Regulatory Landscape Study' (Report, 2019) 10.

³ Cambridge Centre for Alternative Finance, 'Global Cryptoasset Regulatory Landscape Study' (Report, 2019) 35.

⁴ ASIC, INFO 225, available online <<https://asic.gov.au/regulatory-resources/digital-transformation/crypto-assets/>>.

platforms are distinct from CASPs as they play different roles to CASPs. We recommend excluding primary providers and decentralised platforms/protocols from the CASP definition.

- 1.4 Paragraph (v) of the proposed definition refers to participation in and provision of financial services related to the offer or sale of a crypto asset. It is unclear what is meant by the reference to 'financial services'. What financial services are contemplated? This is particularly challenging if the CASP regime is not part of the financial services regime and a crypto asset is not a financial product. In that case, no 'financial services' would be provided.
- 1.5 We suggest replacing paragraph (v) with '(v) arranging for the issue, sale or purchase of a crypto asset to or by another person, and (vi) providing a recommendation or a statement of opinion, or a report of either of those things, that is intended to influence a decision in relation to a crypto asset or class of crypto assets, or an interest in a crypto asset or a class of crypto assets or which could reasonably be regarded as being intended to have such an influence. These concepts are based on aspects of the definition of financial service in the Corporations Act and like that definition may require further exemptions.
- 1.6 We consider that expanding CASPs to capture 'participation' (as is currently envisioned in the proposed definition) casts the net too wide, particularly as there is no definition of 'participation' and the term could potentially capture activities beyond the intended scope of the proposed licensing regime and its policy objectives.

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

- 1.7 As suggested above, we consider that the term 'CASP' should be used as opposed to 'CASSPr'. We note that 'crypto-asset service provider' (i.e. CASP) is the term used in the EU draft MiCA Bill.⁵ We therefore believe that using the term CASPs will help to harmonise crypto regulation across jurisdictions globally.

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

- 1.8 We recommend that Treasury adopt the definition provided by the Financial Stability Board (**FSB**) and adopted by the Hong Kong Monetary Authority in a recent discussion paper.⁶ The FSB defines a crypto-asset as 'a type of private digital asset that depends primarily on cryptography and distributed ledger or similar technology'.⁷
- 1.9 We believe that this definition is preferable because it does not limit the types of crypto assets captured based on particular features or characteristics and also allows room for regulation to evolve with future innovation and technology. The currently proposed definition of crypto asset is too narrow, specifically drawing only on a need for 'cryptographic proof'. Our suggested definition, links crypto assets to distributed ledger technology⁸ or similar technology, thus future-proofing the term.
- 1.10 Our proposed definition also more closely aligns with the European Union's definition, which states that a crypto asset is 'a digital representation of values or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology'.⁹

⁵ Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM/2020/593 final. 'Crypto asset service provider' is defined in Article 3(8) to mean 'any person whose occupation or business is the provision of one or more crypto-asset services to third parties on a professional basis.' 'Crypto asset service' is defined in Article 3(9) to mean 'any of the services and activities listed below relating to any crypto-asset:

- a) the custody and administration of crypto-assets on behalf of third parties;
- b) the operation of a trading platform for crypto-assets;
- c) the exchange of crypto-assets for fiat currency that is legal tender;
- d) the exchange of crypto-assets for other crypto-assets;
- e) the execution of orders for crypto-assets on behalf of third parties;
- f) placing of crypto-assets;
- g) the reception and transmission of orders for crypto-assets on behalf of third parties
- h) providing advice on crypto-assets'.

⁶ Hong Kong Monetary Authority, 'Discussion Paper on Crypto-assets and Stablecoins' (Discussion Paper 2022) 3.

⁷ Financial Stability Board, 'Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements' (Report 2020) 5.

⁸ Distributed ledger technology is 'a class of technologies that support the recording of encrypted data held on a distributed ledger; electronically accessible, from multiple locations, by a network of participants; and that can be updated by those participants, based on agreed consensus, protocol or procedures.' (Thomson Reuters 'Special Report: Cryptos on the rise' (Report, 2021) 5.)

⁹ Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM/2020/593 final, Article 3(1)(3).

- 1.11 Currently regulated products that often utilise some form of technology such as stored value cards (**SVCs**) would not be captured by this definition, as they do not use distributed ledger or similar technologies.

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

- 1.12 We strongly agree with this proposal. Consistent definitions should be used throughout financial services legislation. We note that the Australian Law Reform Commission is also proposing that each Commonwealth Act relevant to the regulation of corporations and financial services enact uniform legislation for commonly used terms such as 'financial product' and 'financial service'.
- 1.13 Where possible, we believe there is merit in attempting to harmonise the Australian definition with international standards, or at least ensuring that our definition is not out of step with other leading international standards. As the UK noted in its response to their equivalent consultation paper, 'the government will also continue to work with international partners to ensure common standards, recognising the borderless nature of crypto assets activity.'¹⁰ A 2022 Thomson Reuters report also recognised that 'the principal challenge is the need for an internationally coherent policy approach, including definitions and jurisdictional perimeters, and in terms of exchanges, prevention of market manipulation and systemic risks.'¹¹ Global harmonisation of regulation will provide much better certainty for the crypto industry, bearing in mind its borderless nature.

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

DeFi

- 1.14 We suggest rethinking the proposed blanket carve-out for certain aspects of Decentralised Finance (**DeFi**), including Decentralised Exchanges (**DEXs**). Although page 14 of the consultation paper states that the presently contemplated crypto-asset regime 'would not apply to decentralised platforms or protocols', we query both what this statement means in practice, and whether this is the most desirable outcome. Does this statement mean that the entire realm of DeFi would remain unregulated, or only certain aspects, such as DEXs themselves? For the purposes of this submission, we have assumed that the intention of this proposed licensing regime is to regulate the activity carried out with crypto assets, rather than the underlying tokens. This means, to the extent that activities a licensee carries out may interact with DeFi, such as custodial obligations, these activities should be regulated.
- 1.15 We recognise that DeFi raises unique challenges for regulation, such as the lack of a centralised party to regulate and challenges validating the quality of the underlying assets on the platform. However, we do not recommend excluding DeFi in its entirety from the scope of the CASP regulation.
- 1.16 To the extent that DeFi platforms also have brokers, or CASPs caught within the proposed regulatory regime interact with DeFi, we believe they should be regulated as well, to ensure consumer protection applies when consumers are engaging with unfamiliar and risky crypto assets. We draw Treasury's attention to the guidance of the Financial Action Task Force (**FATF**) guidance released in October 2021, which suggests that DeFi protocol creators, owners, operators or others who maintain control or sufficient influence over the DeFi protocol 'may fall under the FATF definition of a VASP [equivalent to a CASP] where they are providing or actively facilitating VASP services.'¹² In fact, the FATF goes further, suggesting that if a DeFi platform has no entity running it, a jurisdiction should attempt to identify an entity carrying out virtual asset activities to attach licensing obligations to.¹³ We do not suggest that the Australian regime should implement a similar wide-ranging power to permit the regulator to 'search' for an entity that constitutes a CASP on a DeFi platform without a controlling entity. However, we agree with the FATF's conclusion that DeFi protocol creators, owners, operators or others who maintain control or sufficient influence over the DeFi protocol may satisfy the definition of a CASP where they are

¹⁰ HM Treasury, 'UK regulatory approach to cryptoassets, stablecoins and distributed ledger technology in financial markets: Response to the consultation and call for evidence' (Report, 2021) 2.26.

¹¹ Thomson Reuters 'Special Report: Cryptos on the rise 2022- A Complex regulatory future emerges ' (Report, 2022) 3.

¹² Financial Action Task Force, 'Updated Guidance: A Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers' (Report, 2021) 27.

¹³ Financial Action Task Force, 'Updated Guidance: A Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers' (Report, 2021) 17.

providing or actively facilitating CASP services in relation to DeFi. For this reason, we do not believe that a blanket exemption for DeFi is appropriate.

Wholesale investors

- 1.17 We recommend that there be carve-outs for CASPs servicing wholesale investors, such that there are less stringent compliance obligations for these CASPs. That is, we believe that the distinction between retail and wholesale clients should also apply to CASPs and crypto assets in accordance with the current AFSL regime.

CBDCs

- 1.18 We consider that CBDCs should be carved out on the basis that, as agreed by the EU and G7, CBDCs are not crypto assets.¹⁴ Crypto-assets are private assets which rely on the use of distributed ledger technology or similar technology, while CBDCs are sovereign in nature and their issuance is not contingent upon the use of any specific technology. CBDCs are envisioned as a new form of central bank currency, and will therefore possess the status of legal currency, which is a further distinction from crypto assets.

Stablecoins

- 1.19 We also believe that a carve out should be considered for stablecoins. Stablecoins are a subcategory of cryptocurrencies, typically pegged or linked to the price of another asset or pool of assets, designed to maintain a stable value.¹⁵ Unlike other crypto assets which are merely *perceived* as something of value by its users, stablecoins are therefore pegged to, or backed by, something of value.¹⁶ Separate treatment of stablecoins would be consistent with the EU's proposed MiCA Bill, which exempts asset-referenced tokens (stablecoins) or e-money tokens (stablecoins pegged to a fiat currency) from the requirements to publish a crypto-asset white paper and comply with certain obligations.¹⁷
- 1.20 However, we do not believe that this carve out should apply to algorithmic stablecoins, which purport to maintain a stable value through an on-chain algorithm which facilitates changes in supply and demand between the stablecoins and the asset they are referenced to (whether physical, financial, or another crypto-asset). Algorithmic stablecoins can be particularly vulnerable to speculative attacks when the system is under-collateralised,¹⁸ as illustrated by the recent devaluation of the TerraUSD peg. Conversely, non-algorithmic stablecoins (being asset-linked tokens, see our categorisation in response to Question 29 below), which we consider this carve out should apply to, are less volatile because the coins are backed by actual physical reserves in the possession of stablecoin issuers, ensuring greater stability, and less risk for investors.
- 1.21 We note that to the extent stablecoins act as payment, they would be classified as currency and should be regulated as such.

Social assets

- 1.22 We further submit that membership or social crypto assets should be carved out. These would be what the Financial Action Task Force (**FATF**) describes as 'closed loop items that are non-transferable, non-exchangeable, and cannot be used for payment or investment purposes'.¹⁹ The FATF provides the examples of airline miles, credit card awards or similar loyalty program rewards or points, 'which an individual cannot sell onward in a secondary market outside of the closed-loop system'.²⁰

NFTs

¹⁴ European Parliament, 'Crypto-assets: Key developments, regulatory concerns and responses' (Study, 2020) 27; G7 'Public Policy Principles for Retail Central Bank Digital Currencies (CBDCs)' (Report 2021) 4.

¹⁵ European Parliament, 'Crypto-assets: Key developments, regulatory concerns and responses' (Study, 2020) 20; Financial Stability Board, 'Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements' (Report 2020) 5.

¹⁶ European Parliament, 'Crypto-assets: Key developments, regulatory concerns and responses' (Study, 2020) 34.

¹⁷ Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM/2020/593 final.

¹⁸ Financial Stability Board, 'Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements' (Report 2020) 5.

¹⁹ Financial Action Task Force, 'Updated Guidance: A Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers' (Report, 2021) 32.

²⁰ Financial Action Task Force, 'Updated Guidance: A Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers' (Report, 2021) 32.

1.23 We do not believe there should be a carve out for NFTs. For further discussion of NFTs, please see our response to question 9 below.

2. Policy objectives of the new CASP licence

2.1 We do not agree with the proposal to implement a new CASP licensing regime.

2.2 Establishing a new regime and requiring financial service providers to apply for a separate CASP licence would be costly and inefficient. It will also add further complexity to our current financial services regime and create unnecessary duplication of our legislative framework. We explore this further under the heading 'Alternative option 1' below.

Question 6: Do you see the proposed policy objectives as appropriate?

2.3 Subject to our response to Question 7, we agree with the proposed policy objectives.

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

2.4 We recommend adding an additional policy objective 'to encourage growth and innovation within the crypto asset industry and bolster Australia as a digital and crypto hub'. We believe that this is consistent with the government's intention that the regulatory regime does not act to stifle new developments in technology, in line with the [Digital Economy Strategy](#).

Question 8: Do you agree with the proposed scope detailed above?

2.5 We agree that the CASP regime should apply to all secondary service providers who operate as brokers, dealers or operate a market for crypto assets and those who offer custodial services in relation to crypto assets. In line with our submission in Question 1 above, we recommend that the regime should also extend to entities that engage in advising on crypto assets, as well as those advertising crypto assets, which is in line with crypto regulation in the UK and Singapore.

Question 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?

2.6 We consider that all CASPs that provide services in relation to any crypto assets should be required to be licensed. This would simplify the application of the regime and ensures it has broad application. There should also be a power for subsets of crypto assets to be carved out from the framework where appropriate as the ecosystem matures. A tiered system should be implemented, in which CASPs are granted a licence to perform certain actions, as opposed to having a blanket licence that covers the field. This ensures that the regulator can satisfy itself of the capability of the CASP in relation to the particular activities it engages in.

2.7 In relation to NFTs, they operate using the same underlying technology as any other crypto asset – they are comprised of a unique digital code stored on a blockchain, which is a form of distributed or digital ledger.²¹ NFTs are also seen as investment assets to many, with the market for trading and selling NFTs rapidly growing.

2.8 Internationally, there is a lack of clear regulation or guidance on how NFTs should be treated within existing financial services frameworks.²² For example, Article 4(2) of the EU draft MiCA Bill provides that issuers of 'crypto assets that are unique and non-fungible' do not need to publish or register a white paper for them. The FATF's guidance released in October 2021 advocates for a presumption that NFTs are not virtual assets unless they are being used for 'payment or investment purposes in practice'.²³

2.9 Ultimately, we consider that the tiered approach we have suggested allows for alignment with overseas regulation of NFTs and other new forms of crypto assets, and will not stifle innovation. For instance, the regulator can determine that a licence which grants a CASP the right to store client's NFTs is easier to obtain, or subject to less stringent conditions, than a licence permits facilitation of peer-to-peer exchange of NFTs.

²¹ Thomson Reuters, 'Special Report: Cryptos on the rise 2022- A Complex regulatory future emerges' (Report, 2022) 12.

²² Thomson Reuters, 'Special Report: Cryptos on the rise 2022- A Complex regulatory future emerges' (Report, 2022) 12-14.

²³ Financial Action Task Force, 'Updated Guidance: A Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers' (Report, 2021) 24.

Question 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)?

- 2.10 Clarity in the definitions being introduced is of the utmost importance to reduce regulatory duplication. Please also see our response to 'Alternative Option 1: Regulation under the existing financial services regime'.

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

- 2.11 Please see our response below to 'Alternative Option 1: Regulation under the existing financial services regime'.
- 2.12 We also believe that obligation (9) could be clearer and require CASPs to be proactive and respond within a reasonable time to attempt to stop scams once they are aware or ought reasonably be aware that scams are being sold through their platform.

3. Banning of airdropping and personal advice

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

- 3.1 We do not agree that there should be a ban on airdropping crypto assets. We recommend some form of regulation around airdropping to ensure consumer protection, but an all-out ban is heavy handed and will likely negatively impact the industry. We consider that proper advertising regulation for crypto assets and the application of the *Privacy Act 1988* (Cth) is sufficient to mitigate the risks carried with allowing airdropping.

Question 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)?

- 3.2 We do not think that there should be a ban on providing personal advice which takes into account an individual's personal circumstances in respect of crypto assets, as this would seem to lead to inappropriate outcomes. For example, in practice this would allow advisors to recommend an investment in exchange traded funds (**ETFs**) comprised of crypto assets, but not recommend the underlying assets themselves. This will likely cause confusion within the market and create barriers for clients to receive critical information before they make investments.
- 3.3 We believe this is contrary to the desired policy outcome of providing greater education to and protection of consumers. In our opinion, it would be better to regulate the provision of such advice, and impose requirements to ensure that there are adequate safeguards before products are recommended. Furthermore, licensing requirements and anti-hawking provisions should serve to mitigate any risks from the provision of personal advice.

4. Alternative option 1: Regulation under the existing financial services regime and estimated costs associated

Question 14: If you are a CASSPr, what do you estimate the cost of implementing this proposal (new CASSPr licensing regime) to be?

- 4.1 This question is not applicable to MinterEllison.

Question 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?

- 4.2 We support the proposal to bring all crypto assets into the financial product regulatory regime by incorporating CASP licensing requirements into the current AFSL regime. This will reduce regulatory duplication as the proposed obligations for a CASP licence are similar, and in many cases identical, to current AFSL obligations. Additionally, if crypto assets are to be classified as financial products through the token mapping exercise, regulating CASPs through the existing AFSL regime functionally makes sense. Using the existing regime will also lessen the need to educate existing players about a new process and obligations (thus reducing costs for compliance). This approach is similar to the approach taken by the United Kingdom, where there

is a specific section for crypto assets regulation within the financial services regime with unique definition modifications which suit the market.

- 4.3 We acknowledge that incorporating the CASP regime within the existing financial services regime could be seen as adding to the existing complexity of the AFSL regime. We note that the Australian Law Reform Commission (**ALRC**) is currently reviewing the Financial Services Regulation: ALRC Report 137, with its Final Report due on 30 November 2023, and that the ALRC has already raised issues regarding the numerous definitions within the corporations and financial services legislation.²⁴
- 4.4 We therefore believe that it is important to take the recommendations of the ALRC into account when designing the CASP regime, whether it is incorporated into the AFSL regime or not.

Question 16: If you are a CASSPr, what do you estimate the cost of implementing this proposal (Regulating CASSPrs under the financial service regime) to be?

- 4.5 This question is not applicable to MinterEllison.

5. Alternative option 2: Self-regulation by the industry

Question 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?

- 5.1 While there are benefits in self-regulation – principally the ability to develop a responsive regime that is tailored to the circumstances of the activity being regulated – we are concerned that self-regulation may not provide the level of consumer confidence required to put the crypto industry on the best footing for success and may not provide the Australia regulatory system with the credibility required to promote Australia's global competitiveness.
- 5.2 Self-regulation is likely to raise questions regarding the robustness of consumer protection in Australia, and Australian CASPs would not derive the level of assurance from self-regulation that would be provided by a government-issued licence. Given the international and diverse nature of the crypto asset markets, global crypto providers have advocated for regulatory authorities to prioritise cross-border and cross-sectoral cooperation. A self-regulated model will likely result in inconsistent practices worldwide.

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

- 5.3 This question is not applicable to MinterEllison.

6. Custody Issues

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

- 6.1 We believe that all of the proposed obligations listed are appropriate in relation to the custody of crypto assets. However, we believe that further clarity could be provided in relation to certain obligations, in particular, the obligation for responsible entities to have processes for redress and compensation in the event that crypto assets held in custody are lost, to supplement the Australian Financial Complaints Authority redress scheme.

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

- 6.2 We do not consider that any additional obligations need to be imposed.

Question 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?

- 6.3 We believe that there should be specific domestic location requirements for custodians. However, in recognition that there are very few custodians in Australia and imposing these requirements

²⁴ Australian Government, *Report A: Summary- Financial Services Legislation* (Report 137, November 2021) [6].

immediately with stifle innovation or risk generating a monopoly, we believe Treasury should consider a transition period, and/or a relief for similar jurisdictions. This would be analogous to the comparable jurisdiction relief available for foreign financial services providers servicing the Australian market.

- 6.4 Custodial entities based overseas who want to provide custodial services in Australia, and/or to Australian consumers, should therefore still be subject to licensing requirements in accordance with the existing AFSL system, subject to similar exemptions as the current scheme.

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

- 6.5 We believe that the principles detailed above are sufficient to appropriately safekeep client crypto assets. In particular, the stringent obligations surrounding protection of client's data, especially their private keys, and robust cyber and physical security practices, are essential aspects of a regime that facilitates protection of retail consumers.

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

- 6.6 We do not believe that further standards should be prescribed.

Question 24: If you are a CASSPr, what do you estimate the cost of implementing this proposal (proposed custody obligations) to be?

- 6.7 This question is not applicable to MinterEllison.

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

- 6.8 We believe that an industry self-regulatory model for custodians of crypto assets presents many of the same shortcomings as a broader self-regulatory approach to crypto assets, which we outlined above. In our view, it is particularly important that custodians of crypto are subject to regulatory oversight and accountability, as the risks associated with private keys make it one of the most essential aspects of crypto-assets requiring consumer protection.

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

- 6.9 We refer to our discussion above under question 17.

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

- 6.10 We do not believe that the model currently being used by industry would constitute a self-regulatory model. Based on our experience, the industry is still largely attempting to understand how, and whether, crypto assets and corollary services provided fall within the existing licensing regime. Aside from Blockchain Australia developing a [Code of Conduct](#), we are not aware of any other examples of self-regulation in this area within Australia. Although the Code of Conduct does contain some provisions relating to consumer protection such as maintaining reserves of an equivalent or greater amount to the AUD value of all hot wallet balances, and AML/CTF obligations, it does not address custodial arrangements, and lacks sufficient or external enforcement mechanisms.

Question 28: If you are a CASSPr, what do you estimate the cost of implementing this proposal (alternative option: Industry self-regulation) to be?

- 6.11 This question is not applicable to MinterEllison.

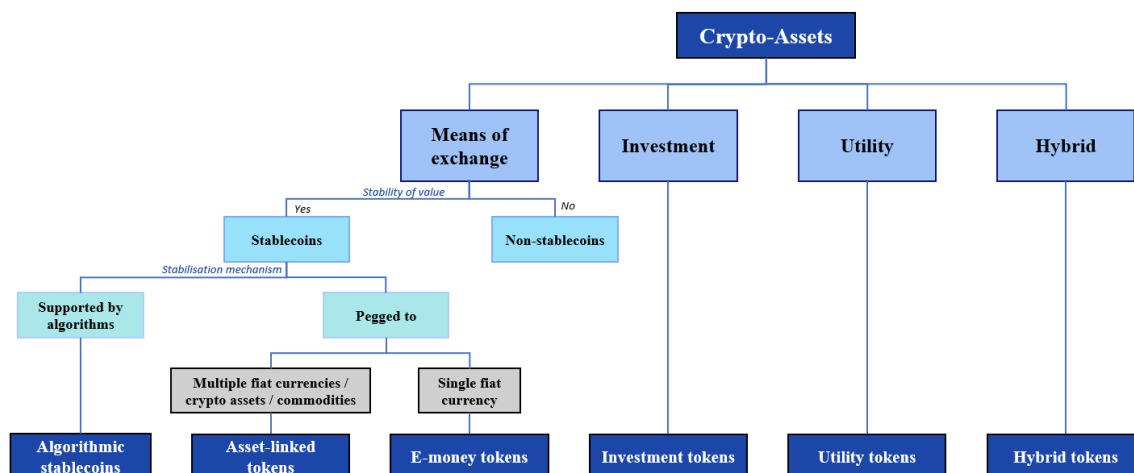
7. Token-mapping

Question 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.

- 7.1 We do not agree with the non-exhaustive list of crypto asset categories. Such a large number of categories will cause confusion, and the categories that have been suggested are too prescriptive and narrow, meaning they will be unable to keep pace with changes in the technology – a particular concern in an ever-evolving space like crypto.

7.2 Instead, we believe crypto assets should be classified according to the diagram below, which is based on the classification diagram by the Bank for International Settlements,²⁵ and aligns with the four categories proposed by the European Securities and Markets Agency.²⁶ We support a regime that regulates token activities, as opposed to regulating token characterisations at the time of issuance (see also our discussion around hybrid tokens in Paragraph 7.5 below)

Classification of crypto assets



7.3 The Global Cryptoasset Regulatory Landscape Study published in 2019 by the Cambridge Centre for Alternative Finance stated that 'regulatory guidance and legislative initiatives on crypto assets seem to be converging towards the three-category classification (payment, utility and security tokens).'²⁷ We believe that these three categories should form the basis of classifying crypto assets in Australia's regulatory regime.

7.4 Payment tokens are primarily used as a means of value exchange; utility tokens grant access to a digital platform or service; security tokens are an investment instrument. We suggest that the first category 'means of exchange' tokens could be either subdivided or supplemented further into: algorithmic stablecoins (stablecoins which have a stable value supported by algorithmic stabilisation mechanisms); asset-linked tokens (stablecoins which are pegged to multiple fiat currencies/crypto assets/commodities); or e-money tokens (stablecoins pegged to a single fiat currency). These categories and their subdivisions are in accordance with the classification of crypto assets by the Bank for International Settlements, and considered by the Hong Kong Monetary Authority. It is also similar to the classification within the EU's proposed MiCA Bill, where the 3 subcategories of crypto assets are asset-referenced tokens (stablecoins); e-money tokens (stablecoins pegged to a fiat currency); and utility tokens (intended to provide access to a good or service, accepted only by their issuers).²⁸

7.5 We also recommend adding 'hybrid tokens' as an additional category, in recognition of the fact that some crypto assets can serve multiple functions and/or their function can alter over the life cycle of the asset. That is, an individual crypto asset, can at various stages either be engaging in 'primary market activities' like token issuance and distribution, 'secondary market activities' such as trading, clearing, settlement and servicing, or in 'tangential activities' which support and ensure that primary and secondary market activities are conducted in an efficient manner.²⁹ A hybrid category facilitates greater flexibility for tokens which may move between these life cycle phases, ensuring the full range of assets including those subject to future technological developments can be categorised. We do recognise that hybrid tokens warrant particular attention and raise unique regulatory challenges to the extent that it may be unclear whether legal obligations associated with each function of the token ought to be considered cumulative or hierarchical.³⁰

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

²⁵ Bank for International Settlements, 'Supervising cryptoassets for anti-money laundering' (Report, 2021) 6.
²⁶ European Securities and Markets Authority, 'Advice: Initial Coin Offerings and Crypto-Assets' (ESMA50-157-1391, 2019) 5.
²⁷ Cambridge Centre for Alternative Finance, 'Global Cryptoasset Regulatory Landscape Study' (Report, 2019) 18.
²⁸ Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937, COM/2020/593 final, Article 3(3)-(5).
²⁹ Thomson Reuters 'Special Report: Cryptos on the rise' (Report, 2021) 4.
³⁰ Cambridge Centre for Alternative Finance, 'Global Cryptoasset Regulatory Landscape Study' (Report, 2019) 18.

7.6 Please refer to our response to Question 29 above.

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

7.7 Given we believe that CASPs should be regulated under the AFSL regime, we believe that crypto assets should be classified as financial products for the purposes of licensing (but not disclosure).

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

7.8 We believe that crypto assets should only be banned in Australia in circumstances where their risks to consumers is substantial, and unable to be effectively regulated to mitigate those risks.

7.9 We do not believe that this applies to any of the crypto-assets outlined above as part of the non-exhaustive list. However, it is important that the regulation has the power to ban or limit the availability of crypto assets where there are significant concerns about the regulatory or consumer risks associated with them.

Please contact us if you have any questions about any of our submissions. We have a strong commitment to working with Treasury and the industry to establish a regulatory framework for CASPs that is fit for purpose and innovation and consumer focused. We would welcome the opportunity to meet with Treasury to discuss our submission or other matters relating to the regulation of CASPs and crypto assets in Australia.

Yours faithfully
MinterEllison

A handwritten signature in black ink, appearing to read 'R. Batten', with a long, sweeping underline that extends to the right.

Richard Batten
Partner

Partner: Richard Batten T: +61 2 9921 4712
richard.batten@minterellison.com