

SUBMISSION

# Crypto asset secondary service providers: Licensing and custody requirements

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## About Mycelium

Mycelium is a technology company, based in Brisbane, Australia.

We specialise in building with blockchain technology, particularly within the data and finance industries. Our focuses are:

1. Providing secure, accurate and timely data, as part of a decentralised network, to smart contracts, in order to enable blockchain-based transactions (with self-executing settlement);
2. Providing data analytics and ratings across the full supply chain of blockchain-based transactions; including data providers, decentralised platforms and applications and users;
3. Building decentralised platforms and applications with blockchain technology; and
4. Researching and investing in applications of blockchain technology, particularly relating to decentralised finance and other Web3 applications.

Mycelium is taking a considered approach to building with blockchain technology in Australia by ensuring that we: have strong partnerships and advisors within Australia; consistently speak with other teams building with blockchain technology in Australia and abroad; and keep a close eye on other progressive jurisdictions.

Building in Australia is a highly desirable outcome for us. In recent years, we have grown to employ over 60 Australians. Due to the nature of our work, we are largely interested in public blockchains. At the time of writing, the largest public blockchains are Bitcoin and Ethereum. However, by our estimations, there are currently over 1,200 public blockchains and over 12,000 cryptocurrencies.

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## Executive Summary:

We are grateful for the opportunity to contribute to this consultation. Our responses to the consultation questions are detailed in Annexure 1 below.

In Mycelium's submission to Senate Select Committee on Australia as a Technology and Financial Centre Third Issues Paper ("**Third Issues Paper**"),<sup>1</sup> we particularised some of the unique challenges and opportunities for those building and interacting with decentralised blockchain-based systems (including DAOs and DeFi protocols). In this paper, the Treasury describes these systems as "**decentralised platforms or protocols**". We understand that we are both referring to those platforms and protocols existing as a Permissionless Blockchain or one or more smart contracts deployed on a Permissionless Blockchain (further explained in Question 3), which includes decentralised autonomous organisations or decentralised organisations ("**DAOs**") (including blockchain layer DAOs and application layer DAOs)<sup>2</sup> and other decentralised applications. We broadly agree with the Treasury's view that these platforms and protocols, without custody or control from a centralised party, would not be subject to the CASSPr regime proposed in this consultation.

The majority of the blockchain, crypto asset and peripheral industries rely on decentralised platforms and protocols. All jurisdictions around the world are challenged with creating, adapting and applying regulation to meet these systems. Creating regulation which supports the development of these industries while also protecting consumers is the challenge that lies ahead for Australia.

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<sup>1</sup> Jack Deeb, 'Senate Select Committee on Australia as a Technology and Financial Centre' (Third Issues Paper, June 2021) ('*Senate Select Third Issues Paper*') <<https://www.aph.gov.au/DocumentStore.ashx?id=459cbc68-d056-4d3c-bed7-0ec54d1e7ca7&subId=709423>>.

<sup>2</sup> Blockchain networks can also be DAOs, with the Bitcoin network of miners or nodes being the earliest example, where the consensus mechanism (such as Proof of Work or Proof of Stake) and tokenomics of the blockchain (e.g. features such as bitcoin mining rewards) play a key role in attracting and maintaining a decentralised network of miners (or validators or other, depending on the consensus mechanism).

Mycelium's key recommendations in this paper are:

1. For crypto assets that are not financial products – because either there is no clearly identifiable issuer or because, by the nature of the technology or multi-characteristic features of the crypto asset, the financial product definition is not met – a regime separate to the financial product regulatory regime could be appropriate (such as a CASSPr regime). More specific detail is required to know whether the proposed CASSPr regime is appropriate (and globally competitive) or not (refer to Mycelium's responses to Questions 5 and 8).
2. For crypto assets that are financial products or that are substantially similar to financial products but where there is no clearly identifiable issuer, more work needs to be done. Mycelium proposes that Australia adopt an approach similar to Europe or the United Kingdom via an expansion of the Enhanced Regulatory Sandbox to allow for experimentation and development of market infrastructures based on distributed ledger technology (refer to Mycelium's responses to Questions 3 and 10).
3. Rules to ensure a comparable standard of consumer protection that exists in other areas of trade and commerce should be introduced, and tailored to address the specific characteristics of crypto assets that live within a global decentralised digital economy with a centralised entity or intermediary to ask questions or complain to. This objective could be substantially met through the ACCC enforcing relevant provisions under the Australian Consumer Law with respect to crypto assets, and specifically prohibitions against misleading and deceptive conduct, unfair contract terms and consumer guarantees. Meanwhile, the Treasury could consider the need to adapt the Australian Consumer Law to accommodate circumstances where the crypto asset is issued by an autonomous code, once such a crypto asset exits the Enhanced Regulatory Sandbox (refer to Mycelium's responses to Questions 5, 11, 13, 15 and 17).
4. The Australian Government should expedite the ratification (with appropriate amendments for the Australian law context) of the Coalition of Automated Legal Applications' ("COALA's") Model Law for Decentralized Autonomous Organizations, otherwise known as the "DAO Model Law" (refer to Mycelium's response to Question 17).

If you have any questions, or require further information, please do not hesitate to contact Jack Deeb at [REDACTED].

Yours sincerely,

A handwritten signature in black ink, appearing to be 'J Deeb', written over a horizontal line.

Jack Deeb (for Mycelium)

With thanks, for their contributions to this submission, to:

1. James Kwan, advisor to Mycelium;
2. Joni Pirovich, Principal of Blockchain & Digital Assets Pty Ltd – Services + Law;
3. Michael Bacina, Piper Alderman and Blockchain Australia;
4. Professor Stephen Gray, Malcolm Broomhead Chair in Finance at The University of Queensland;
5. Associate Professor Chris Berg, Principal Research Fellow at RMIT University and co-director and co-founder of the RMIT Blockchain Innovation Hub; and
6. Susannah Wilkinson, Digital Law Lead – APAC, Herbert Smith Freehills, and co-director of the Digital Law Association.



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## Annexure 1: Responses to Consultation Questions

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

On the basis that the two terms apply to the same subject (only centralised crypto token exchanges), Mycelium sees greater benefit in settling definition(s) and (preferably) international harmonisation, compared to renaming digital currency exchanges (“**DCEs**”) to CASSPrs.

With respect to the proposed definition, the reference in item (v) to any natural or legal person who, as a business, ‘participat[es] in and provi[des] financial services related to an issuer’s offer and/or sale of a crypto asset’ is unclear and should be refined or removed. For example, it seems like this activity may extend to financial advisors and software engineers who act in their capacity as advisors. Such activity would more appropriately be an incidental activity related to the primary act of issuance of a crypto asset, risks for which should be set out specifically or on a principles-basis. If there is to be minimum standards of legal recognition of tokens issued by DAOs (which is the Mycelium position) or regulation introduced (which is not the Mycelium position) for the ‘primary services’, the proposed CASSPr regime does not seek to deal with these so this particular inclusion related to the offer of a crypto asset should be removed.

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

Due to the breadth in nature of tokens (refer to Mycelium’s answer to Question 15), references to “currency” in DCE and “asset” in CASSPr may be misleading, particularly to retail consumers. Whilst all tokens display some characteristics of currency, most are currently used to trade, speculate or access utility. However, tokens are not always assets and may represent a wide variety of bundles of rights and obligations so it is incorrect to label them all as crypto assets. The breath of applications for tokens is expected to continue to increase into the future.

Assuming item (v) is refined or removed, Mycelium understands “secondary service provider” to generally refer to services provided by a centralised party who has custody or control of another party’s crypto assets, whether or not

the centralised party is technically a primary or secondary (or tertiary or other) actor. Providing these kinds of services is commonly understood within the industry to fall within the definition of “exchange” and within the remit of the existing DCE regime.

On these bases, if item (v) is refined or removed, “Crypto Token Exchange” would be a more appropriate term. If item (v) is not refined or removed (against Mycelium’s recommendation), “Crypto Token Service Provider” would be a more appropriate term.

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

Further to our comments in Question 2, “crypto token” is technically a more appropriate term than “crypto asset”. We agree with comments made in the Blockchain & Digital Assets Pty Ltd - Services + Law (“**BADASL**”) submission to this consultation that a broader foundational definition, such as “data structure”, with “crypto token” as a sub-definition, is more likely to apply across Australian regulatory frameworks and better inform retail consumers about the broad nature of tokens. This approach would likely lead to a regulatory framework with more appropriate foundations to promote consumer protection and market integrity.

Despite these comments, if Treasury feel the term “crypto asset” cannot be departed from (noting its use in other leading jurisdictions), Mycelium proposes some amendments and an additional requirement be added to the definition of a crypto asset for the asset to be deployed on a “Permissionless Blockchain”, being “*a public distributed ledger, allowing any entity to transact and produce blocks in accordance with the blockchain protocol, whereby the validity of the block is not determined by the identity of the producer.*”<sup>3</sup> Mycelium provides a working “Sufficient Decentralisation Test” below to determine whether a decentralised platform or application is “Sufficiently Decentralised”. In full, the proposed definition would read as:

“A crypto asset is:

1. a digital representation of value or contractual rights that can be transferred, stored or traded electronically;
2. whose ownership is either determined or otherwise substantially affected by a cryptographic proof; and
3. is deployed on a Permissionless Blockchain that is Sufficiently Decentralised.”

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<sup>3</sup>Coalition of Automated Legal Applications, ‘Model Law for Decentralized Autonomous Organizations (DAOs)’ (Report, 19 June 2021) 3 (26).

Permissionless Blockchains that are Sufficiently Decentralised are integral to driving much of the intrinsic properties valued in a crypto asset.

In particular – and as noted in Treasury’s consultation paper<sup>4</sup> – Permissionless Blockchains eliminate the requirement for a central authority/trusted intermediary to facilitate delivery of the crypto asset to the consumer or investor, and strengthens the security of the blockchain.

We note here that not all Permissionless Blockchains would be considered *Sufficiently Decentralised*, which reinforces the need to consider and define what constitutes that term.

### **Permissionless Blockchains lead to disintermediation**

Whereas traditional financial products and services require a trusted third party intermediary to stand between two independent parties that do not trust each other to facilitate the transaction, the automated and transparent qualities of a Permissionless Blockchain that is sufficiently decentralised mean equivalent transactions can take place without the need for the same kind of intermediary (or intermediaries) to have trust in the transaction processing and the counterparty obligations being fulfilled.

Disintermediation drives the following benefits for consumers and investors using crypto assets:

- **Eliminating fees and costs paid to the traditional intermediary or intermediaries who are not incentivised to reduce those fees:**

The costs of accessing financial products and services through the existing intermediated financial system are significant. As one example, in 2019 the ACCC’s inquiry into FX services found that for International Money Transfers (“**IMTs**”) executed in 2017-18, Australian consumers could have saved themselves \$150 million AUD if they had instead gone with the cheapest IMT supplier. Further, in February 2019 Australian customers of the “Big 4” banks sending 150 GBP to the UK could have executed the transfer for 20% less than they had paid if they had gone with the cheapest IMT supplier.<sup>5</sup> By contrast, while users incur historically volatile (but trending down due to scaling solutions<sup>6</sup> and Ethereum’s transition to proof-of-stake anticipated in 2022)<sup>7</sup> “gas” fees for transacting on the blockchain,

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<sup>4</sup> The Australian Government the Treasury, *Crypto asset secondary service providers: Licensing and custody requirements* (Consultation Paper, March 2022) 13 (‘CASSPr’).

<sup>5</sup> Australian Competition and Consumer Commission, *Foreign currency conversion services inquiry* (Final Report, July 2019) 8.

<sup>6</sup> Robert Stevens, *What Is Arbitrum? Speeding up Ethereum Using Optimistic Rollups* (Blog Post, 15 March 2022) <<https://decrypt.co/resources/what-is-arbitrum-speeding-up-ethereum-using-optimistic-rollups>>.

<sup>7</sup> Ethereum, *The Merge* (Web Page) <<https://ethereum.org/en/upgrades/merge/>>.

due to the combination of open source development and global competition, fees payable to an intermediary are substantially reduced or eliminated. In addition, the competition between “blockchain intermediaries” is unmatched by the structure of the existing intermediated financial system. Competition amongst blockchain intermediaries is fierce with the price of fees being a key factor for attraction and retention of users on any particular blockchain network and ultimately critical to the success of a blockchain which relies on global network effects.

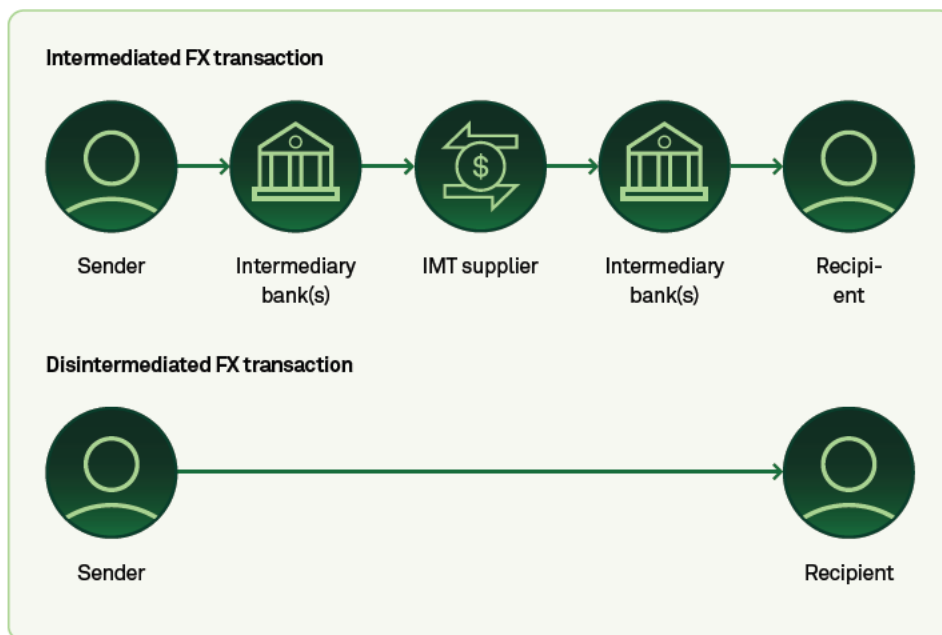


Figure 1: Comparing an intermediated FX transaction to a disintermediated FX transaction.

- Eliminating the risks emanating from the intermediary’s misconduct or risky behaviour:** By removing the traditional intermediary from the transaction, crypto asset transactions eliminate the possibility of harm done to the investor or consumer by a traditional intermediary’s misconduct or risky behaviour. However, new risks are introduced by the new and evolving structures which should be identified, discussed and prioritised before or at least concurrently to a CASSPr regime. For example, insufficiently decentralised platforms and protocols are significantly more exposed to phishing-like cyber attacks to control or manipulate transactions (see, for example, the Ronin Network hack).<sup>8</sup> The extent to which the management of risks has been centralised or intermediated in Australia’s intermediated traditional financial

<sup>8</sup> Prashant Jha, ‘The aftermath of Axle Infinity’s \$650M Ronin Bridge hack’, *Cointelegraph* (online, 12 April 2022) <<https://cointelegraph.com/news/the-aftermath-of-axle-infinity-s-650m-ronin-bridge-hack>>.

system are systemic in nature (and based on globally adopted principles of financial market infrastructure). In 2020, the Council for Financial Regulators reported that “Financial Market Infrastructure” (entities that enable, facilitate and support trading in Australia’s capital markets, including Central Counterparties that clear and settle trades) supported trades in Australian securities to an annual total of \$16 trillion AUD, and derivatives trades to an annual total of \$185 trillion AUD.<sup>9</sup> By contrast, crypto assets can avoid exposure to traditional intermediaries (nor the risks of dealing with those traditional intermediaries or the “benefits” of those traditional intermediaries performing the functions and obligations legislated upon them to manage financial market risks), because investors are either able to deal with each other directly, or engage with automated smart contracts on a unilateral basis.

### **Sufficiently Decentralised Permissionless Blockchains reinforce blockchain security**

Blockchains that rely on decentralised networks, particularly those that are sufficiently decentralised, are intended to be less susceptible to security breaches. For example, Bitcoin and Ethereum both currently exist as public, proof-of-work blockchains, where anyone globally can participate in the two activities of block proposal (“mining”) and block verification (“running a node”) without requiring permission from other network participants. In order to control or manipulate Bitcoin or Ethereum, an attacker would require more than 50% of the networks’ mining hash rate or computing power (known as a ‘51% attack’, which actually requires at least 61% of computing power). This is considered extremely unlikely, due to the prohibitive cost of assembling enough hash power and electricity to hijack the networks.<sup>10</sup>

However, for proof-of-stake blockchains like the Terra blockchain, where the network of validators perhaps is considered decentralised, transactions were not reliable or secure in the event of a market failure as seen in the recent UST/LUNA collapse. For a short period, the Terra blockchain was “switched off” because the low price of LUNA meant validators with staked LUNA were not incentivised to act properly and in good faith in validating transactions. This is because of either or both of the network of validators not looking for “bad” transactions and thus not slashing staked LUNA as punishment, which incentivised validators to act

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<sup>9</sup> Council of Financial Regulators, *Financial Market Infrastructure Regulatory Reforms* (Response, July 2020) 6.

<sup>10</sup> Jake Frankenfield, ‘What is a 51% Attack?’ *Investopedia* (Web Page, 27 April 2022) <<https://www.investopedia.com/terms/1/51-attack.asp>>.

in bad faith and not verify transactions or initiate fraudulent transactions for profit or to manipulate the market. This recent experience is relevant because it goes to the policy issue of determining a baseline for “Sufficient Decentralisation” that needs to be solved before or concurrently to the introduction of a CASSPr regime.

For these reasons, Mycelium considers it necessary for an additional limb to be added to the definition of a crypto asset requiring the asset to be deployed on a Permissionless Blockchain that is Sufficiently Decentralised. Embedding decentralisation into Australia’s definition of a crypto asset should be one part of developing a world-class regulatory framework for crypto assets that becomes synonymous with quality and fair, orderly and transparent markets for both financial stability and ultimately protection of consumers.

### **Market forces and self regulation should determine the degree to which a crypto asset is issued from a Sufficiently Decentralised organisation**

It is important to understand that the mere deployment of a crypto asset upon a Permissionless Blockchain, which mints the specified supply of tokens, does not guarantee that control over transfers or other actions with the crypto asset will be relinquished to automated and autonomous processes in source code. Often tokens issued by DAOs are decentralised in name only (“DINOs”), with centralised control reintroduced or concentrated within a single, or closed group of entities to some extent into the future. At the blockchain level, all Permissionless Blockchains exist along a spectrum between absolute decentralisation (with anyone able to validate and produce blocks on the blockchain) and absolute centralisation (only a single entity, or closed group may transact or produce blocks on the blockchain). There is a clear policy need to define what constitutes a *Sufficiently Decentralised* organisation.

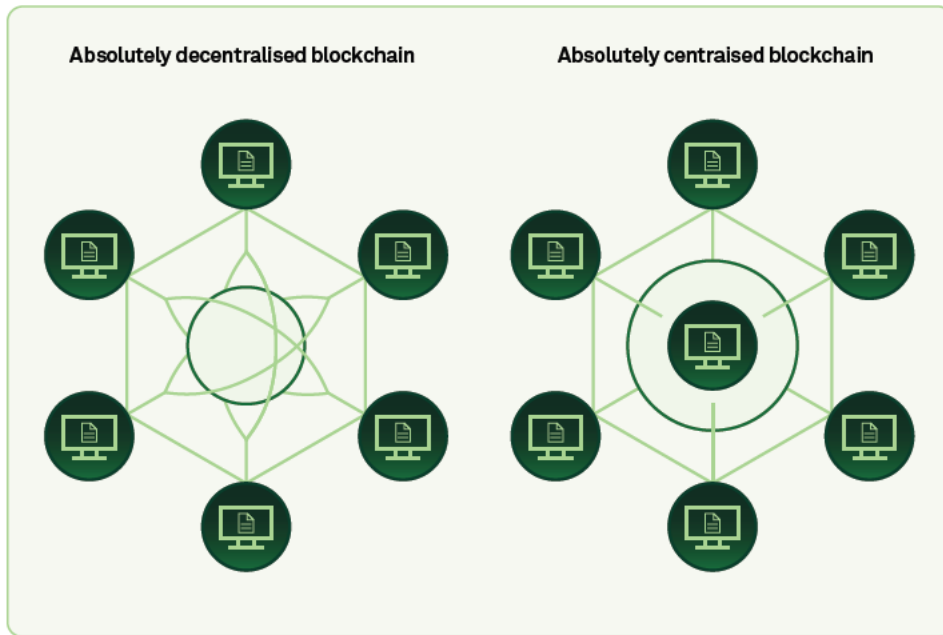


Figure 2: Comparing an absolutely decentralised blockchain to an absolutely centralised blockchain.

The level of decentralisation of a blockchain exists alongside a range of competing priorities a blockchain must respond to, including the ability to process transactions efficiently at scale and therefore necessitating some level of centralisation.

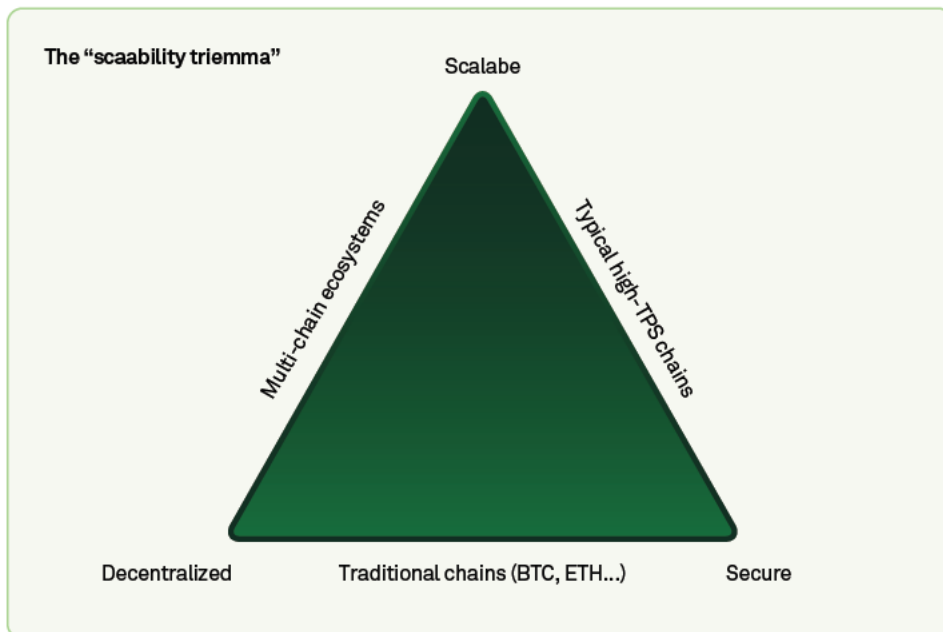


Figure 3 - Competition between the priorities that blockchains must respond to is referred to as the “scalability trilemma”.<sup>11</sup>

<sup>11</sup> Vitalik Buterin, “Why sharding is great: demystifying the technical properties” Vitalik (Blog Post, 7 April 2021) <<https://vitalik.ca/general/2021/04/07/sharding.html>>.

Similarly, crypto assets relating to platforms and protocols built and deployed on top of a Permissionless Blockchain via smart contract(s) also exist along a spectrum of decentralisation. While a number of different models exist for allocating governance authority within decentralised platforms and protocols, the prevailing model is to apportion governance rights via governance tokens, with each token representing one vote. Centralisation may arise where a single entity, or group of entities accumulates a majority of governance power so as to effectively control the management and administration of the platform or protocol's terms and conditions.

Rather than prescribing minimum prescriptive characteristics or standards of decentralisation to satisfy the definition of a crypto asset, Mycelium agrees with the BADASL submission that better approach is to define the minimum standards required for recognition of legal status, that address the policy issues (for example, the need for smart contract audits from a security and financial market perspective prior to launch and ongoing analytics to identify, deter, prevent and eliminate criminal behaviour and market manipulation). This allows for market efficiencies to determine the optimum level of decentralisation within the ecosystem that a crypto asset operates (apart from the requirement it be deployed on a Permissionless Blockchain). Such an approach would align with the 2014 Financial System Inquiry's recommendation to establish policy settings that are competitively as well as technologically neutral in nature,<sup>12</sup> by prescribing baseline requirements to be met to achieve legal recognition, but leaving the degree to which governance is centralised to be decided by those most affected, namely a platform's governance token holders and users.

With respect to market forces, markets are already demonstrating a positive correlation between the extent of a crypto asset's decentralisation and the asset's price. In 2021, a study on MakerDAO – an issuer of a popular stablecoin 'DAI' used to perform transactions in DeFi – reported a larger voter population and number of votes cast in its governance polls correlated with an increase in price for its governance token, 'MKR'.<sup>13</sup> By contrast, larger voter populations and votes cast were found to have the opposite effect on DAI, negatively impacting its ability to efficiently track the USD price.<sup>14</sup> The complex effects that can flow from a crypto asset's decentralisation should highlight the importance of preserving flexibility for

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<sup>12</sup> CASSPr (n 5) 12.

<sup>13</sup> Xiaotong Sun, Charalampos Stasinakis and Georgios Sermpinis, 'Decentralization illusion in DeFi: Evidence from MakerDAO' (University of Glasgow, 2022) 11.

<sup>14</sup> Ibid



markets to pursue the optimum level of decentralisation for a crypto asset, relative to its intended function and community of users, as opposed to a prescribed and unresponsive level set by regulation.

**Sufficient Decentralisation Test: ‘Sufficient Decentralisation’ of the issuer of a crypto asset could be subject to a code of conduct approved by a collection of regulators including ASIC, the ACCC and APRA**

As foreshadowed above, in addition to market forces, Mycelium sees considerable merit in giving the industry space to self-regulate certain factors and practices with respect to crypto assets and decentralised platforms and protocols, and specifically to develop a benchmark for Sufficient Decentralisation. Industry standards and practices could be subject to an approval process by multiple key regulators including ASIC (similar to the approval of financial services sector codes of conduct by ASIC - refer also to Question 17 response below), until further regulation is developed for decentralised platforms and protocols. This would serve the triple purpose of encouraging innovation (or, avoiding stymying innovation) within the Australian regulatory environment, enabling the regulatory framework to keep pace with industry developments and protect consumers.

An industry recognised and multi-regulator-approved test for Sufficient Decentralisation would effectively:

- Act as a “blue tick” for legitimate Sufficiently Decentralised platforms and protocols (including DAOs and DeFi protocols), and protect consumers.
- Incentivise DAOs with legitimate utility to innovate, compete with traditional financial consumer products, and deliver better products and overall choice to consumers.
- Improve traditional financial consumer products by opening the door for collaboration between legacy financial institutions like consumer banks and DeFi protocols or DAOs offering their users competitive financial products.
- Enhance consumer confidence and financial literacy.
- Boost institutional confidence and green-light wider participation from institutional players.

- Acknowledge the risk asymmetry between (a) transacting with a decentralised platform or protocol, compared to (b) transacting with a service provider who takes custody or control of crypto assets. Importantly, decentralised platforms and protocols generally follow pre-defined logic (and so can't default on their promises), but can be subject to other risks which should be dealt with at the policy level.
- Provide operational certainty to decentralised platforms and protocols (including DAOs and DeFi protocols) so they can continue to create economic value for the Australian economy and utility for Australian users.

In line with the former Government's comments that legislation for digital assets (i.e. all assets deployed on a blockchain, not just crypto assets) should be non-prescriptive, dynamic, and flexible in order to promote innovation,<sup>15</sup> broad principles around the following aspects of decentralised platforms and protocols would be helpful markers for a **'Sufficiently Decentralised Test'**. Mycelium provides a (non-exhaustive) working list of these below:

1. Published third party security and financial logic audit of smart contract code, including any associated data (ie, oracle) infrastructure;
2. No clearly identifiable controlling mind of the DAO, markers for this could include but are not restricted to;
  - a. Greater than a certain number of participants in the DAO;
  - b. No individual or group of individuals, exercises disproportionate power over the direction of the protocol;
  - c. If the blockchain protocol or application is not launched as a DAO (i.e. DAO-first), the preliminary legal structure, management and shareholders (or members) has published plans to progressively decentralise both the functionality of the blockchain protocol or application and its governance;
  - d. Third parties would no longer reasonably expect a person or group to carry out essential managerial or entrepreneurial efforts;<sup>16</sup> and

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<sup>15</sup> Hon Jane Hume, 'Address to Blockchain Week, Sydney' (Speech, Australian Blockchain Week 2022, 21 March 2022).

<sup>16</sup> William Hinman, 'Digital Asset Transactions: When Howey Met Gary (Plastic)' (Speech, Remarks at the Yahoo Finance All Markets Summit: Crypto, 14 June 2022).

- e. Those participants carrying out proposals agreed upon or ratified by the DAO collective (i.e. typically all persons that hold the DAO's governance token and/or elected global governance councils), may be a centralised party (e.g. a foundation or other service entity), or a leading core contributor of multiple core contributors, or a number of persons acting as signing parties on a multi-signature wallet (e.g. a DAO council), but these persons do not exercise centralised control or demonstrate influence over the protocol or governance that is inconsistent with the DAOs purpose;
4. Appropriate disclosures, including:
    1. Product disclosure statement (PDS) like documentation for decentralised platform or protocol and any associated crypto-assets, clearly outlining functionality (including mechanism design and financial engineering) and risks; and
    2. Strong and prominent disclaimers on website and social media making clear that the technology is experimental, not regulated in the same way as traditional financial products and interactions will occur via smart contract and without any secondary service provider(s) taking custody or control of crypto assets so there is risk of complete loss and exposure to new and different risks;
  5. Either:
    1. a published complaints and dispute resolution process for claims and maintaining tokens for self-insurance up to a certain portion of funds (denominated in fiat currency) "held" by the decentralised platform or protocol; or
    2. a process encoded and enforced through governance or smart contracts for the distribution of tokens in the event of failures or disagreements (see, for example, Tribute DAO's Rage Quit mechanism;<sup>17</sup> and
  6. A minimum financial buffer (denominated in fiat currency) that decreases the risk of a disorderly or non-compliant wind-up if the business fails.

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<sup>17</sup> Tribute DAO, Rage Quit (Web Page) <<https://tributedao.com/docs/contracts/adapters/exiting/rage-quit-adapter>>.

According to Joni Pirovich, Principal of BASASL:

“A foundational policy issue to solve is what constitutes a ‘sufficiently globally decentralised’ organisation? If Australia can introduce this definition or indicia of what constitutes a ‘sufficiently globally decentralised’ organisation, entrepreneurs and consumers will finally have a framework to better understand and choose whether to engage with the existing, regulated financial system in Australia - with all of its pros and cons - and/or the global and decentralised digital economy – again, with all of its pros and cons – whereby new Australian law would **recognise** DAOs, tokens and protocols and contribute minimum standards around that recognition rather than regulate as the domestic financial system is regulated.”

The industry has already demonstrated a strong track record of publishing documentation, policing its conduct and iteratively improving the level of consumer protection in crypto assets. The absence of traditional intermediaries and accompanying regulation, coupled with the open-sourced nature of decentralised platforms and protocols and requirements for technically-minded participants to develop, audit, use, govern and amend the decentralised platforms and protocols has already created an ecosystem whereby participants are highly incentivised to engage in robust review and scrutiny of crypto assets. Whilst tragic, the highly publicised collapse of the ‘Terra’ stablecoin and associated system (approximating a loss in excess of \$50 billion USD)<sup>18</sup> was preceded by a strong stream of public discourse expressing considerable concern regarding the viability of the protocol.<sup>19</sup> Mycelium’s strong view is that a robust regulatory framework around crypto assets that keeps pace with commercial innovation and industry best practice must include opportunities for the crypto asset industry to self-regulate its activities. To support the industry to feed insights back to regulators and policymakers in a timely way, regulators such as APRA should be specifically resourced to be present virtually and physically in the community to establish and maintain an open discourse as the industry identifies critical issues worthy of escalation and discussion with bodies like APRA.

Refer also to Mycelium’s response to Question 17 below.

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<sup>18</sup> Hannah Miller, ‘Terra’s \$64b bashing creates a crowd of crypto losers’, *Australian Financial Review* (online, 15 May 2022) <<https://www.afr.com/companies/financial-services/terra-s-64b-bashing-creates-a-crowd-of-crypto-losers-20220515-p5alhv>>.

<sup>19</sup> Lele Jima, ‘Top Hedge Fund Manager Who Warned Investors, Says Terra’s Project Was Destined to Fail Due to High Yield’, *The Crypto Basic* (online, 16 May 2022) <<https://thecryptobasic.com/2022/05/16/top-hedge-fund-manager-who-warned-investors-says-terras-project-was-destined-to-fail-due-to-high-yield/>>; David Morris, ‘Built to Fail? Why TerraUSD’s Growth Is Giving Finance Experts Nightmares’, *CoinDesk* (online, 23 April 2022) <<https://www.coindesk.com/built-to-fail-why-terrausds-growth-is-giving-finance-experts-nightmares/>>.

### **Consolidating governance power over a decentralised platform or protocol through purchases (or other means) should be regulated**

In instances where a single entity or closed group seeks to centralise governance power over a decentralised platform or protocol, Mycelium is in favour of rules to ensure the accumulation of governance power takes place in a transparent setting and to protect the rights of both the remaining minority governance rights holders and users of the relevant platform or protocol.

Treasury should collaborate with regulators and policymakers internationally to consider whether the following issues should be regulated in a manner analogous to the takeover of a corporate entity but taking into account the distinct characteristics of crypto assets:

- Protections against oppressive conduct (s232 Corps Act), which would likely require a minimum standard of the DAO implementing or building analytics reporting to the community and recommended actions to reverse or remediate that behaviour;
- ‘Takeover’ provisions when an address, or group of addresses acting in concert seek to acquire governance tokens over a certain threshold amount (Ch6 Corporations Act). However, takeover provisions that prescribe disclosure of information to the market and/or governance token holders should be carefully considered as to whether their application to crypto assets are redundant, given the transparent properties of a Permissionless Blockchain; and
- Compulsory acquisition of outstanding governance tokens held by minority holders by a single person or closed group consolidating a certain threshold of governance power (Ch6A Corporations Act).

### **Assets deployed on ‘permissioned’ blockchains should be excluded from the definition of a crypto asset**

In contrast to Sufficiently Decentralised Permissionless Blockchains, crypto assets can be deployed on blockchains that restrict the right to validate transactions and produce blocks on the blockchain restricted to a closed group of persons. All other people are required to obtain permission from the closed group to transact on the blockchain, erasing many of the benefits gained by disintermediating access to the asset through a Permissionless Blockchain and reintroducing much of the risks associated with intermediaries. For this reason, crypto assets not deployed on Sufficiently Decentralised Permissionless Blockchains should be excluded from the operation of the CASSPr regime.

Many of the traditional asset classes people are working to represent (“tokenise”) on a blockchain fall into this category, with either the intrinsic properties of the asset itself (for example, an interest in a Managed Investment Scheme), or the blockchain it is deployed upon administered by a closed group of entities. Introducing the additional requirement for an asset to be deployed on a Sufficiently Decentralised Permissionless Blockchain into the definition of a crypto asset, will substantially meet Treasury’s stated objective to preserve the existing regulatory treatment of the underlying asset where it is already subject to a regulatory regime.<sup>20</sup>

**The ‘Enhanced Regulatory Sandbox’ should be modified to accommodate market infrastructure initiatives relying on blockchain technology and crypto assets that overlap with the definition of a financial product**

Nevertheless, Mycelium believes that the markets for tokenised traditional asset classes (eg, carbon credits, equities, commodities, bonds, FX, etc.) will grow significantly in the years to come, and significant associated opportunities for market-leading jurisdictions to benefit from these developments. Crypto assets that simultaneously fulfil the definition of a financial product are similarly likely to increase in usage.

To allow Australia to remain globally competitive whilst controlling the level of risk consumers are exposed to, Mycelium recommends making a sandbox available for tokenised traditional assets and assets constituting both a crypto asset and a financial product, similar to the pilot regime that will be implemented by Europe<sup>21</sup> or the Financial Market Infrastructure Sandbox that will be implemented by the UK, both in 2023.<sup>22</sup>

Mycelium’s recommended approach to achieve this outcome is to modify the ‘Enhanced Regulatory Sandbox’<sup>23</sup> to encourage organisations interested in developing blockchains and blockchain-based market infrastructure to do so from Australia. For that to be an attractive proposition however, the following features would need to be changed:

- Increasing the limits on total customer exposure and individual customer exposure to a scale appropriate for market prototype market infrastructures. As a reference, the EU ‘Distributed Ledger

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<sup>20</sup> CASSPr (n 5) 12.

<sup>21</sup> European Commission, *REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on a pilot regime for market infrastructures based on distributed ledger technology*, (Explanatory Memorandum, 2020).

<sup>22</sup> HM Treasury, *UK regulatory approach to cryptoassets, stablecoins, and distributed ledger technology in financial markets: Response to the consultation and call to evidence* (Response, April 2022) 30.

<sup>23</sup> Australian Securities and Investments Commission, *Enhanced regulatory sandbox*, (Information Sheet 248, August 2020).

Technology Sandbox' accommodates total customer exposure up to \$5 billion (compared to the Enhanced Regulatory Sandboxes' \$5 million);<sup>24</sup>

- Eligibility to access the sandbox for crypto assets that overlap with the definition of a financial product but are issued by an autonomous smart contract as opposed to a person; and
- Broadening the range of eligible products permitted for wholesale clients to include derivatives.

According to Professor Stephen Gray, Malcolm Broomhead Chair in Finance at The University of Queensland:

“We don't yet understand the roles that blockchain technology will play in the future. In the meantime, it is important that Australia achieves an appropriate balance between (a) adopting a regulatory framework that does not stymie innovation; while (b) protecting consumers. This trade-off is currently under consideration in other jurisdictions and the regimes being developed in Europe and the UK would be a useful starting point for consideration in Australia. Given the pace of development and the associated opportunities that lie ahead for this technology, it is important that Australia does not lag behind other jurisdictions in developing a competitive regime.”

In addition, Joni Pirovich from BADASL states that:

“The tax incentives for individual entrepreneurs to remain in or be attracted to Australia will be critical. Tokens, particularly those involved in financial services innovation, are not often eligible in the employee share scheme start-up concessions, nor the early stage investment company (“**ESIC**”) tax concessions, nor the early stage venture capital limited partnership (“**ESVCLP**”) tax concessions. This is a structural flaw in attracting the best talent to and to stay in Australia and should be prioritised with the foundational policy issues at hand.”

### **Crypto assets moving from a permissionless to permissioned blockchain should be disqualified from the definition of a crypto asset**

Consistent with the proposed requirement that crypto assets be deployed on a Sufficiently Decentralised Permissionless Blockchain, assets transferred to a permissioned blockchain will lose their regulatory recognition as a crypto asset. As crypto assets are increasingly transferred,

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<sup>24</sup> Ibid.

or ‘bridged’ between blockchains, the possibility for assets to move from Sufficiently Decentralised and permissionless environments to permissioned environments similarly increases, eroding many of the attributes that accrue to the asset by virtue of its deployment on a Sufficiently Decentralised Permissionless Blockchain.

By extension, an ensuing regulatory framework will need to clarify how crypto assets moved to a permissioned environment should be dealt with for regulatory purposes. For example, questions such as who is responsible for backfilling disclosure and other regulatory obligations would need to be resolved.

### **Crypto assets should be carved out of the definition of a financial product**

Mycelium recommends a default assumption that a crypto asset is not a financial product. That assumption can be departed from if ASIC identifies that the associated decentralised platform or protocol is not Sufficiently Decentralised or if particular features of the crypto asset are identified as harmful to consumers.

According to Michael Bacina, Partner of the Blockchain Group at Piper Alderman:

“Australia has a prime opportunity to build on market best practices and the hard work done by overseas regulators to treat crypto-assets in a technologically neutral fashion and recognise them as a digital property or commodity, which, absent a clear indicia of being a financial product, should not be treated as financial products. To do otherwise without a wholesale reworking of Chapter 7 of the Corporations Act and associated compliance requirements for AFSL holders would invite an exodus of jobs and businesses from Australia and leave the retail consumer with less protection and choice. The growing NFT space is a prime example of crypto-asset evolution where a technology neutral approach is essential. There is no reason that a collectible card sold on eBay be treated other than as property, and an NFT should similarly not be a financial product by default.”



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

See Mycelium's answer to Question 3.

Due to the breadth of the proposed definition, even as modified by Mycelium, is unlikely to apply across all Australian regulatory frameworks without exceptions/sub-definitions (eg, taxation).

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**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)?**

No. For the reasons that follow, Mycelium is of the view that CASSPrs who provide services for specific kinds of crypto assets should be carved out of the proposed licensing and custody regime. Treasury should consider regulations with respect to the following:

1. To safeguard consumer interests with respect to risks not addressed through a Sufficiently Decentralised Permissionless Blockchain; and
2. Whether certain types of crypto assets require the introduction of specific regulations to respond to idiosyncratic risks associated either with the crypto asset itself, or the asset-specific services offered by the CASSPr.

**CASSPrs disrupt the trustless and permissionless qualities of crypto assets, but the risks and costs associated with some crypto assets do not warrant the CASSPr licencing and custody regime**

Under Mycelium's proposed definition for crypto assets (refer to Mycelium's response to Question 3), all crypto assets will deliver consistent benefits flowing from their Sufficient Decentralisation derived from their deployment upon a Sufficiently Decentralised Permissionless Blockchain. As identified by Treasury's consultation paper, CASSPrs interfere with said benefits of decentralisation by inserting an entity to mediate an investor or consumer's access to crypto assets.<sup>25</sup> While the extent to which CASSPrs diminish the benefits of decentralisation for consumer and investors may vary between situations, all CASSPrs will alter those benefits to some degree, and re-introduce some degree of the risks and costs associated with an intermediated service. However, the risks and costs associated with certain crypto assets do not warrant, or are fundamentally different to the risks and costs assumed by, the proposed CASSPr licensing and

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<sup>25</sup> CASSPr (n 5) 13.

custody regime. For example, licensing and custody of tokenised identity credentials will have far different risks and costs to the licensing and custody of art-only tokens and those with financial features.

Accordingly, Mycelium considers it appropriate to exempt CASSPrs providing services only with respect to specific, carved out crypto assets from a future specific licensing and custody regime.

### **Additional regulation and obligations are required to respond to consumer protection concerns not resolved via the deployment of a Sufficiently Decentralised Permissionless Blockchain**

While supportive of applying an eventual licensing and custody regime to all CASSPrs, Mycelium sees the potential need for additional regulation to respond to risks not resolved by a Sufficiently Decentralised Permissionless Blockchain. While Permissionless Blockchains obviate the need to trust a party to perform their contractual obligations because of the blockchain's automated and transparent qualities, consumers and investors can still be exposed to the following risks:

- **Unequal power dynamics:** much like any other area of commercial activity, crypto asset transactions can involve parties where one holds significant commercial advantages over the other. To ensure that consumers and investors are afforded a commensurate level of consumer protections that exists in other areas of trade and commerce in Australia, it is appropriate to constrain the freedom to contract with respect to crypto assets to avoid manifestly unfair outcomes that result from a significant imbalance of power between commercial parties.

To this end, Mycelium proposes that the unfair contract terms regime and consumer guarantees under Australian Consumer Law be extended to apply (with the necessary modifications) to crypto assets (for example, by giving legal personality to DAOs - see Mycelium's response to Question 17), so as to ensure a base level of consumer protection for retail consumers. The adoption of the unfair contract terms regime and consumer guarantees to crypto assets may also present the opportunity to cooperate with industry, by giving ASIC (or ACCC) the power to approve associated industry led minimum standards in relation to crypto assets – refer to Mycelium's response to Questions 3 and 25.

Mycelium also considers it appropriate to address an imbalance of power between governance token holders, by putting in place regulatory protection regarding the rights of minority governance token holders - refer to Mycelium's response to Question 3.

- **Fraudulent activity/scam artists:** Mycelium is particularly sensitive to the ongoing damage caused to individual consumers and the industry's general reputation, as a result of the well-publicised scams involving crypto assets.<sup>26</sup> To combat scams involving crypto assets, Mycelium is in favour of an actively enforced prohibition against misleading and deceptive conduct in relation to a crypto asset, that is targeted towards bad actors who are often repeating the behaviour without identification or penalty.<sup>27</sup>
- **Market manipulation:** Finally, the markets for crypto assets are still developing and so are particularly susceptible to being manipulated to unfairly benefit a single, or select few participants. Australia could contribute to improved confidence in the integrity of crypto asset markets by introducing a minimum standard of legal recognition (such as the Sufficient Decentralisation Test), proactively contributing to the development of fit-for-purpose prohibitions against market manipulation of crypto assets modelled on existing comparable provisions.<sup>28</sup>

### **Additional regulation and obligations maybe be required to respond to the unique features and risks of specific crypto assets**

Mycelium also envisions that particular types or categories of crypto assets may necessitate the introduction of targeted regulation. As one example, a NFT used to demonstrate title to a work of art may need specific rules to require that applicable terms and conditions that govern the relationship between the intellectual property rights within the work of art, and the rights accruing to the NFT holder, are linked or shown in the source code rather than on the issuer's website.

Regulations that address risks associated with specific crypto assets, or more accurately, specific activities in relation to those crypto assets, should be one of the questions Treasury consults on during its consultation on token mapping scheduled to occur later this year. Mycelium includes a preliminary list of risks particular to specific crypto asset types in its response to Question 29.

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<sup>26</sup> Australian Competition & Consumer Commission, *Australians Lose over \$70 million to bogus investment opportunities* (Media Release, August 2021) <<https://www.accc.gov.au/media-release/australians-lose-over-70-million-to-bogus-investment-opportunities>>.

<sup>27</sup> *Senate Select Third Issues Paper* (n 2).

<sup>28</sup> *Corporations Act 2001* (Cth) s 1041A.

### **Additional regulation and obligations maybe be required to respond to the unique features and risks of specific services provided by CASSPrs**

Finally, particular services provided by CASSPrs may require the imposition of additional regulations and obligations to ensure adequate consumer protections are put in place. As an example, for CASSPrs providing custodial services, it may be appropriate to limit discretion to reuse/rehypothecate crypto assets left in its custody as collateral for subsequent lending agreements through regulation.<sup>29</sup> Such obligations may take the form of additional licence requirements imposed upon a CASSPr, similar to the Treasury's position articulated in its consultation paper.<sup>30</sup>

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### **6. Do you see these policy objectives as appropriate?**

Mycelium agrees with these policy objectives as being appropriate alongside resolving industry-specific policy issues (for example, the "foundational policy issues" particularised in the BADASL submission).

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

See Mycelium's response to Question 6.

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

#### **Decentralised platforms and protocols that do not provide custodial services should be exempted from the requirement to hold a CASSPr licence**

Mycelium agrees with Treasury's proposed scope of entities that should be captured by the CASSPr licensing regime. Mycelium also agrees that decentralised platforms and protocols should be excluded from the requirement to hold a CASSPr licence, on the basis that Sufficiently Decentralised platforms and protocols do not give rise to the same risks as centralised service providers. Given that decentralised platforms and protocols should always transact crypto assets directly on a peer-to-peer basis directly between addresses, including any entity taking custody of crypto assets should automatically preclude decentralised platforms and protocols from the requirement to hold a CASSPr licence.

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<sup>29</sup> Authors note the absence of restrictions on entities and protocols from reusing borrowed assets to fund further transactions in DeFi increase the vulnerability in the system. BIS, 'DeFi risks and the decentralisation illusion', (Quarterly Review, December 2021) 29.

<sup>30</sup> CASSPr (n 5) 16.

Nevertheless, Mycelium is aware of protocols that offer custody as an incidental feature to its primary function, such as a decentralised exchange running an ‘off-chain’ order book to match buy and sell orders not recorded on a Sufficiently Decentralised Permissionless Blockchain.<sup>31</sup> While such entities should be required to hold a CASSPr licence, Treasury may wish to consider relaxing the financial amount required to satisfy the licensing requirement to maintain a minimum financial requirement to reflect the incidental nature of the custodial service. This approach would be consistent with the approach taken by ASIC with respect to AFSL holders providing custodial services as an ‘incidental provider’, by modifying the ‘Net Tangible Assets’ the AFSL holder is required to hold in order to maintain adequate financial resources.<sup>32</sup>

**AUSTRAC Licensing requirements should be integrated into the new regulatory framework for CASSPr with increased information security practices required in relation to the collection of personal and sensitive personal information alongside a commitment to ongoing experimentation and implementation of reliable privacy-enhancing technology**

Mycelium agrees that consideration should be given to how the existing AUSTRAC requirements may be integrated with the new regulatory model, and also considers that consideration should be given specifically to how the existing AML/CTF regime may be applied to decentralised platforms and protocols. In particular, Mycelium is in favour of carrying over Treasury’s stated position for the AML/CTF regime to be applied only in light of the potential risks, or lack thereof exhibited by decentralised protocols and platforms.<sup>33</sup> Mycelium has recently co-authored *zkKYC in DeFi*,<sup>34</sup> which considers these issues in detail and proposes an approach which achieves the objectives of the current financial crime (i.e. KYC policies in the context of AML/CFT) and privacy regulation, while accepting the characteristics of decentralised platforms and protocols.

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<sup>31</sup> Everett Hu, ‘Where does liquidity come from’, *dydx* (online, 25 May 2022) <<https://help.dydx.exchange/en/articles/2906266-where-does-liquidity-come-from>>.

<sup>32</sup> Australian Securities and Investments Commission, *Licensing: Financial requirements* (Regulatory Guide 166, April 2021) (‘ASIC 166’) 166.282-166 292.

<sup>33</sup> CASSPr (n 5) 12.

<sup>34</sup> Pieter Pauwels, Joni Pirovich, Peter Braunz and Jack Deeb, ‘*zkKYC in DeFi An approach for implementing the zkKYC solution concept in Decentralized Finance*’ (online, March 2022) <<https://eprint.iacr.org/2022/321.pdf>>.

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**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?**

See Mycelium's response to Question 5.

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**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)?**

In recognition that CASSPrs may potentially require an additional licence (in particular, an AFSL) to a CASSPrs licence in order to operate, Mycelium proposes Treasury consider turning off CASSPr obligations already covered by the AFSL, and to provide a streamlined process for licensed CASSPrs applying for an AFSL (similar to the proposed 'fast-track' licensing regime for Foreign Financial Service Providers).<sup>35</sup>

**'Turning off' analogous CASSPr licensing obligations where AFSL applies**

Consistent with Treasury's views on avoiding unnecessary regulatory duplication,<sup>36</sup> Mycelium recommends analogous licensing obligations under the CASSPr licence and an AFSL be aggregated by turning off the duplicated or substantially similar CASSPr obligations so that only the AFSL obligation applies. This approach would mirror that taken with respect to Regulated Superannuation Entities (RSEs) obligated to hold both an AFSL and an RSE licence, with compliance with the obligation to maintain adequate financial resources under the AFSL turned off for the duration the RSE holds a valid RSE licence.<sup>37</sup>

While in practice a CASSPr might fulfil their obligations under both their CASSPr licence and AFSL through the same action, expressly turning off obligations under the CASSPr licence where substantially covered by the AFSL would eliminate the possibility of a CASSPr having to unnecessarily demonstrate separate compliance with both sets of obligations in full.

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<sup>35</sup> Treasury Laws Amendment (Measures for Consultation) Bill 2021: Licensing exemptions for foreign financial service providers, 2021 (Cth) <Treasury Laws Amendment (Measures for Consultation) Bill 2021: Licensing exemptions for foreign financial service providers Exposure Draft>.

<sup>36</sup> CASSPrs (n 5) 14.

<sup>37</sup> ASIC 166 (n 33) 166.16.

Noting the consistency between the first seven CASSPr licensing obligations and the AFSL regime, those obligations could be switched off for the duration of the CASSPr holding a valid AFSL. Treasury's proposal for ASIC to have carriage of the CASSPr licensing regime would also facilitate the coordination between CASSPr and AFSL licensing regimes but as mentioned throughout this submission ASIC cannot be the only regulator involved and there is a case for more active involvement of APRA and the ACCC.

### **Establish a streamlined process for licensed CASSPrs to apply for AFSL**

The regulatory framework for CASSPrs could be further improved if the process for applying for an AFSL by licensed CASSPrs was streamlined by exempting directors and key persons from a further fit and proper test and solvency check when applying for an AFSL. Such an approach has most recently been proposed as part of the 'fast-track' licensing process for FFSPs, and Mycelium considers institutional investment into crypto assets in Australia could be similarly attracted by avoiding repeatedly imposing the fit and proper test upon key persons, without unacceptably eroding the integrity of the CASSPr licensing regime.

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

#### **CASSPrs should be required to disclose conflicts of interest as a condition of licence**

Mycelium notes that the general obligation imposed upon AFSL holders to have processes in place to manage conflicts of interest has not been carried over to apply to CASSPrs.<sup>38</sup> At a minimum, the Treasury should consider whether CASSPrs providing advice in respect of a governance token that is a crypto asset should be required to have arrangements in place to manage conflicts of interest, so as to ensure governance mechanisms work as intended.

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

No. Given that crypto assets may reflect value or contractual rights of a potentially infinite variety, a blanket prohibition on airdrops by CASSPrs will almost certainly have unintended consequences. Applying technology

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<sup>38</sup>Corporations Act 2001 (Cth) s 912 (1)(aa).

neutrality to this question would lead to the conclusion that service providers in other industries could not pass any (non-tokenised) benefits to their customers outside of their core service offering.

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**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)?**

Mycelium has no comment specifically on CASSPrs providing personal advice in respect of a crypto asset. However, Mycelium is in favour of CASSPrs that provide advice to be required to have arrangements in place to manage conflicts of interest, as a condition of licence – refer to Mycelium’s response to Question 11 above.

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

No comment

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**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?**

**Including crypto assets into the definition of a financial product would unnecessarily impede innovation**

Mycelium agrees with Treasury’s comment that capturing crypto assets into the definition of a financial product would unnecessarily impede innovation,<sup>39</sup> and lessen Australia’s attractiveness as a place to establish a crypto asset business. The proposed definition for a crypto asset, particularly if it is to apply across laws, is far broader than existing financial product definitions.

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<sup>39</sup>CASSPrs (n 5) 18.



Further, and as noted by Treasury,<sup>40</sup> the key concerns of trust, traditional intermediaries and information asymmetries driving much of financial product/service regulation are not a relevant concern for crypto assets deployed on a Permissionless Blockchain that is Sufficiently Decentralised in the absence of a CASSPr or DCE. The application of much of the financial services regulatory framework directed towards these concerns would therefore needlessly impose regulatory burden and red tape on crypto assets.

Accordingly, the regulatory framework for crypto assets should be drafted as a separate bespoke package, and for any interaction with the financial service regulatory framework to be limited to situations expressly provided for under legislation.

A separate regulatory framework for crypto assets would lessen the inadvertent application of regulation intended for intermediated financial services upon crypto assets. Conversely, a bespoke regulatory regime for crypto assets would assist in developing regulation to address specific risks characteristically exhibited by certain categories of crypto assets, without modifying the current operation of regulation for financial services and products.

According to Susannah Wilkinson, Digital Law Lead – APAC, Herbert Smith Freehills, and co-director of the Digital Law Association:

“The broad range of use cases for digital tokens, and their inevitable technological evolution, will influence the nature of the risks and issues faced by consumers by their adoption (both individually and systemically). Against this complexity, it is more important than ever to adhere to principles of sound public policy in regulatory reform.<sup>41</sup> Reform in the technology sector requires a risk-based framework, built on foundational principles to provide clarity, certainty and scalability to industry participants. Treasury should also consider crafting Australia’s approach in the context of the benefits of international harmonisation and global interoperability. We must consider a principles-based approach founded in a clear understanding of the technology and adopting proportionate means that minimise unintended consequences. A risk-based approach will help to identify, in a technology neutral way, where parallel regulatory

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<sup>40</sup>CASSPrs (n 5) 13.

<sup>41</sup> Patrick Zhang, David Masters and Anna Jaffe, ‘8 questions we think should be answered before regulating technology’ Atlassian (online, 18 January 2021) <<https://www.atlassian.com/blog/technology/regulating-technology>>.

regimes are already available to address particular identified harm, and how any bespoke digital asset regulation will dove-tail with these existing regimes in a light-touch, but effective way. For example in the context of financial services, where tokens or activities squarely present analogous risk to consumers as traditional financial products and services, industry participants should have a clear pathway to comply with the appropriate licencing regime and not be subject to duplication. Adequate resources will need to be allocated to regulators to enable streamlined processing, and processes to monitor and refine the regulatory approach should be built in by design, for example through expansion of the Enhanced Regulatory Sandbox. Assessment of proposed licensing for CASSPrs should be considered in parallel to other measures needed to holistically address (whether through regulation or enabling guidance) the priority challenges for Australia's digital economy (including legal recognition of DAOs) and the inevitable proliferation of digital activities in the digital economy beyond financial services.”

### **As a less preferable alternative, crypto assets could be included into the financial service regime**

Notwithstanding Mycelium's views above, it would be possible to deem its proposed definition of a crypto asset as a type of financial product. Similarly, it would be possible for the AFSL regime to extend to CASSPrs delivering services with respect to crypto assets. Given Mycelium's concerns over the inadvertent redundant application of much of the financial services regulatory framework with respect to crypto assets, Treasury would be strongly encouraged to consult closely with industry before pursuing this approach, to avoid the creation of unnecessary and uncompetitive regulatory red tape.

Taking a practical and longer term view, as a greater variety of assets are tokenised (loyalty programs, real estate, consumer goods), lack of differentiation between the crypto asset and financial product regulatory regimes is more likely to impede innovation within the Australian industry and lead to further regulatory reform needed down the line.

According to Associate Professor Chris Berg, Principal Research Fellow at RMIT University and co-director and co-founder of the RMIT Blockchain Innovation Hub:

“The Australian government should be careful not to overdraw the definition of a crypto asset so that it unreasonably brings into the financial services regime digital representations (often known as ‘digital twins’) of assets that are either non-financial, or already covered by parallel regulatory regimes. For example, non-fungible tokens can be used to represent and govern information about goods as they travel across supply chains. On the other side, traditional financial assets (such as fixed income products, equities, and real estate loans) are being tokenized in order to take advantage of more adaptable payment rails of blockchain as well as smart contract infrastructure - this tokenisation is one of the major focuses of the Australian Government’s Digital Financial Cooperative Research Centre. An excessive reductive approach to digital assets risks over-expanding the financial services regime’s scope as well as causing excessive complexity for projects that overlap different regimes.”

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

No comment

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**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?**

To bolster the rigour of self-regulation and to provide Government with a degree of oversight, Treasury should consider developing a mechanism for ASIC or alternative body (or bodies) to approve a code of conduct for decentralised platforms and protocol analogous to the approval process for codes of conduct covering certain species AFSL holders.<sup>42</sup> Monitoring and enforcing an approved code could be performed by an appropriate

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<sup>42</sup> Australian Securities and Investments Commission, *Approval of financial services sector codes of conduct* (Regulatory Guide 183, March 2013).

external dispute resolution provider. However, such an approach would likely require legal recognition of DAOs based on minimum standards or recognising decentralised platforms and protocols as separate legal entities (ie, DAOs), in order to enliven standing of DAOs and attribute liability and losses flowing from a breach of the code.

Mycelium restates its recommendation from its submission to the Third Issues Paper consultation: The Australian Government should expedite the ratification (with appropriate amendments for the Australian law context) of the Coalition of Automated Legal Applications' ("COALA's") Model Law for Decentralized Autonomous Organizations, otherwise known as the "DAO Model Law".<sup>43</sup>

Mycelium has canvassed some of the areas amenable to self-regulation in its responses above, which would include:

- A test for Sufficient Decentralisation for crypto assets and decentralised platforms and protocols;
- Unfair contracts regime; and
- Consumer guarantees by way of minimum standards of Australian legal recognition of DAOs.

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**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.**

No comment

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

No comment

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

No comment

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<sup>43</sup> Senate Select Third Issues Paper (n 2) 3.

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**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 comment

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

No comment

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

No comment

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

No comment

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

No comment

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

No comment

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

No comment

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

No comment

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**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.**

While Mycelium has no particular comment on the list of crypto assets proposed by Treasury, it considers the better approach might be to regulate the risks characteristically associated with different types of crypto assets and the activities possible with crypto assets.

The commercial drive to innovate with new crypto assets and the activities possible with those crypto assets is likely to leave any static list of crypto asset categories redundant, and will therefore require constant work simply to respond to the pace of the crypto asset industry. By contrast, the types of risk exhibited by crypto assets are likely to be more generic, and targeting generic risks would maintain consistency with Treasury's intention to craft principles-based regulation to CASSPrs. Identification of the relevant risks exhibited by specific crypto assets would in turn enable the Treasury to develop appropriate regulations to mitigate or eliminate the consequences flowing from those risks.

Many of those risks have been identified in the course of this submission, and are listed below:

- The risk of governance over a crypto asset being consolidated in a single entity, or small group of entities;
- The risk of a crypto asset function as a stable store of value and unit of exchange holding insufficient levels of collateral;
- The risk of a crypto asset exposing retail consumers to excessive levels of leverage; and
- The risk of ambiguity around the allocation of proprietary rights as between non-fungible real property and a digital representation of the non-fungible real property.

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

Refer to Mycelium's response to Question 29.

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

Refer to Mycelium's response to Question 29.

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

No comment