

Consultation Response:

Crypto asset secondary service providers: Licensing and custody requirements

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27th May 2022

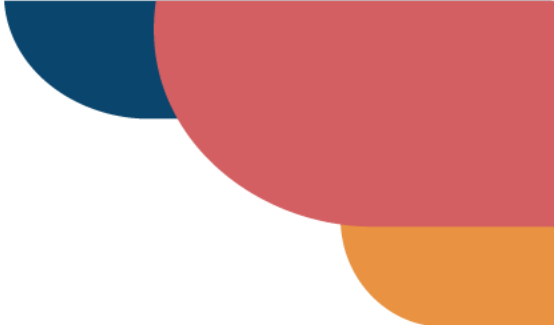


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ABOUT NOVATTI

Novatti Group Ltd is listed on the Australian Stock Exchange with code (ASX:NOV). Novatti has over 4,000 shareholders.

Novatti has over 200 employees in areas such as Software Engineering, Information Technology, Financial Operations, Business development and Administration. Novatti exports software and financial services to over 20 countries, and has operations in Europe, Malaysia and the United States.

Novatti's business to business payment services include Issuing, Acquiring, Cross border payments and Subscription billing. Novatti is currently bringing to market a fiat backed Stablecoin service.

Novatti is regulated within Australia as follows:

- ASIC – Australian Financial Services Licence for Non-Cash Payments
- AUSTRAC – Remittance Network Provider
- AFCA – Member

Novatti has also applied to APRA for a Restricted banking license through its subsidiary Novatti IBA Pty Ltd.

In presenting this submission, Novatti has relied on and drawn from:

- Experience as a licenced provider of innovative payment services which has been a vital part of its operations since 2014
- Knowledge of the Blockchain and Digital Assets industry again based on operational experience, R&D and innovation
- Consultation with our clients who operate within this sector.

CONSULTATION RESPONSES

<p>Q3. Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments.</p>	<p>Novatti accepts the proposed definition change, except for point v:</p> <p style="text-align: center;"><i>V. participation in and provision of financial services related to an issuer's offer and/or sale of a crypto asset.</i></p> <p>The basis for this point is unclear, in terms of what it aims to cover. For example: The definition of an "issuer of a crypto asset" where the issuer is deemed to be a technology/product provider, with the crypto asset being "created" and distributed by another party who would be recognised as a CASSPr (i.e: stablecoin as a service, NFT developer). In accordance with this paper's definition, this is classified as a "primary" service provider, however here it appears to fall under the definition of a "secondary" service provider.</p>
<p>Q6. Do you see these policy objectives as appropriate?</p>	<p>Novatti accepts the policy objectives set out by this consultation paper.</p> <p>Based on our understanding and experience as an AFSL holder, we recognise the importance of regulatory regimes and requirements for their purpose to uphold and maintain acceptable standards, with consumer protections at the forefront of this objective.</p>
<p>Q8. Do you agree with the proposed scope detailed above?</p>	<p>As a current holder of an AFS license, Novatti believes the need for standalone CASSPr licensing (separated from the traditional AFSL regime), is paramount to the success of establishing regulatory guidelines.</p> <p>Due to the agile nature of blockchain and crypto asset development and innovation, a dedicated regime will allow for ease of adoption and updating of rules and requirements.</p>
<p>Q10. 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)?</p>	<p>Upon analysis of our own operations and licensing requirements, Novatti would prefer to see a separation of crypto assets from existing regulatory regimes, given that the guidelines driven and operating in these regimes are heavily focused on the traditional finance industry. As such, there would be no need for CASSPr's to obtain additional licensing, preventing such "crossovers" or duplications.</p>

<p>Q11. Are the proposed obligations appropriate? Are there any others that ought to apply?</p>	<p>Novatti accepts the majority of the obligations proposed, and recognises the requirement of such obligations through experience with its own AFSL and various financial services licensing and regulatory requirements.</p> <p>Based on this experience, we believe further consideration is required for the following proposed obligations:</p> <ul style="list-style-type: none"> ● PO(3) – In order to satisfy external dispute resolution requirements, adequate resources are required. It is broadly recognised throughout the Crypto Asset industry that existing ombudsman schemes (i.e: AFCA) are not readily equipped to handle such issues. As such, consideration should be provided for the following: <ul style="list-style-type: none"> ○ Adequate adjustments and resourcing be provided to AFCA in order to establish formal policies and procedures in consultation with industry. ○ An independent body (similar to that of the Financial Ombudsman Service) be established to service the Crypto Asset industry and its consumers. ● PO(5) – Further clarification on how this proposed obligation would interact with PO(3), as addressed in Q19.
<p>Q15. 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?</p>	<p>As a current AFSL holder, Novatti rejects the proposal to regulate Crypto Assets under the current Financial Services regime. As previously mentioned, the AFSL regime would not be fit for purpose, due to its historic development surrounding traditional financial products and schemes.</p> <p>Furthermore, without the clear definition and classification of Crypto Assets (whether they would be defined as a “financial product”) and the intended purpose of said assets within a CASSPr, then consideration cannot be given for this suggestion.</p> <p>Based on Novatti’s current operational requirements, concern would be held for:</p> <ul style="list-style-type: none"> ● Risk of impacts on existing business operations and requirements, where Crypto Assets are not involved. ● Risk to stakeholder engagements through the addition of Crypto Assets as a Financial Product (i.e: Insurance, 3rd party services and integrations etc.) ● Overall risk of consumer comprehension and awareness

	in relation to the products or services being provided.
<p>Q17. 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?</p>	<p>Novatti rejects the proposal for CASSPr's to self regulate, based on existing industry sentiments.</p> <p>Based on our understanding and experience as an AFSL holder, we recognise the importance of regulatory regimes and requirements for their purpose to uphold and maintain acceptable standards, with consumer protections at the forefront of this.</p>
<p>Q19. Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets?</p>	<p>Novatti accepts the majority of the obligations proposed and recognises the requirement of such obligations through experience with its own AFSL requirements.</p> <p>Based on this experience, we believe further consideration is required for the following proposed obligations:</p> <ul style="list-style-type: none"> ● PO(3) – The way in which minimum capital requirements are calculated and applied, are adjusted based on the Crypto Asset being dealt with and its risk. For example: <ul style="list-style-type: none"> ○ An “asset-backed” crypto asset (i.e: Stablecoins) would require a 1:1 backing of the asset it is representing. In the example of a stablecoin, the fiat asset held is equal to the crypto asset distributed to the payee and would be recognised as similar to “base level financial requirements” (as described in RG166). As such, the requirement for additional capital requirements (i.e: SLF) would not be required. ● PO(4), (5), (6), (7), and (8) - Definition of the expectations surrounding the execution of these practices to establish a minimum standard, through consultation with industry professionals. ● PO(9) - Separation of “point of failure” to ensure CASSPr's are not unfairly liable for circumstances beyond their control. For example: <ul style="list-style-type: none"> ○ A CASSPr would be liable for compensation costs resulting from the loss of assets incurred due to a failure in implementing satisfactory security

	<p>practices.</p> <ul style="list-style-type: none"> ○ A CASSPr would not be liable for compensation costs resulting from the loss of assets incurred due to a consumer sharing their username and password with a 3rd party, thus voiding the security of their assets.
<p>Q20. Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above?</p>	<p>Novatti believes that further consideration should be given to the right of the consumer to engage in “self-custody” practices.</p> <p>Self-custody is defined as the holding of a Crypto Asset in a prescribed wallet, whereby the owner can or may be the only holder of the private key securing its balance.</p> <p>Novatti is aware of several services in the market, within this sector, that allow its customers to buy or sell Crypto Assets with fiat, however, does not allow the consumer to withdraw the Crypto Asset from the service for their own use or custody. This creates several issues for the consumer including:</p> <ul style="list-style-type: none"> ● Confusion surrounding legal ownership of the Crypto Asset ● Confusion surrounding whether the Crypto Asset exists ● Concern surrounding the “forced” custody regiment of the Crypto Asset, and the protections in place by the CASSPr. <p>By affording consumers with the option to self-custody, these consumer concerns are alleviated, and provide clarity to the ownership and existence of the Crypto Assets obtained.</p>
<p>Q21. 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?</p>	<p>Novatti is of the opinion that domestic location requirements should not be mandated in relation to private keys. We believe security of a client’s Crypto Assets are paramount to upholding the integrity and trust in the services provided – hence the due diligence conducted prior to making such decisions is of priority.</p> <p>In line with these due diligence practices, “jurisdictional risk” is a component of our research and is being considered during our decision-making process. Should this risk score exceed our appetite, then the solution will no longer be considered for implementation. When assessing a third-party custodian provider, these “jurisdictional risks” are assessed and applied in the same manner.</p>

<p>Q22. Should further standards be prescribed? If so, please provide details</p>	<p>Per the response provided by Novatti in Q21, we would be confident in making the recommendation to include the assessment of “jurisdictional risk” as a proposed custody obligation.</p> <p>Furthermore, rules surrounding the disclosure by a CASSPr of use of a third-party custodian should be mandated for the purposes of consumer transparency.</p>
<p>Q25. Is an industry self-regulatory model appropriate for custodians of crypto assets in Australia?</p>	<p>Novatti rejects the proposal for CASSPr’s to self-regulate its custodial requirements, based on existing industry sentiments.</p> <p>Based on our understanding and experience as an AFSL holder, we recognise the importance of regulatory regimes and requirements for their purpose to uphold and maintain acceptable standards, with consumer protections at the forefront of this.</p>
<p>Q29. 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.</p>	<p>Novatti tentatively accepts the list of Crypto Assets, with anticipation for its formal release.</p> <p>In relation to the classification of Crypto Assets as its namesake or a financial product, we are of the belief that the assets themselves should remain as “Crypto Assets”, with consideration shifted to Services, and whether or not they perform a “financial service”.</p> <p>Crypto Assets (in their majority) are decentralised, with no controlling ability by the asset issuer. As such, the functionality of the Crypto Asset as a “financial product” is dependent on the sole discretion of the owner.</p> <p>It would be virtually impossible to govern the Asset themselves based on application of classification.</p>
<p>Further consideration: permissioned blockchain environments</p>	<p>The parameters of a blockchain’s protocol, when assessing a Crypto Asset have not been of significant discussion, or inclusion - specifically in relation to its presence on a public, private, consortium, or hybrid blockchain.</p> <p>Per the diagram provided in figure 1 of the consultation paper, “Tokenisers” are assumed by us to mean the “issuer” (or minter) of a Crypto Asset. The Tokeniser is classified as a “primary service” provider.</p>

Based on this assumption, the Tokeniser would be the entity who determines the “type” of blockchain their Crypto Asset would operate on. Novatti accepts “primary services” are not captured under the proposed definitions being discussed. However, we believe further investigation should take place, specifically when either one or more occur:

- An entity shares the sole functionality of both the primary and secondary service provider (i.e: solely issuing and distributing a token).
- An entity (or entities) can control the Crypto Asset through “permissioned” protocols (i.e: ledger rollback, asset freezing or wallet blacklisting).
- An entity can control the distribution, redemption (i.e burning), utility, or market for the Crypto Asset.

While we recognise there may be further characteristics to define such instances, we request that consideration be given to the regulatory and compliance requirements for primary service providers who meet these characteristics.

CONCLUSION

Novatti welcomes the implementation of regulatory measures that will bring clarity to the industry and its consumers.

As an AFSL holder and Remittance Network Provider, we recognise the significance of regulatory frameworks and requirements for their role in upholding and maintaining acceptable standards, with consumer protections at the forefront.

To guarantee innovation is not impeded, Crypto Assets should be recognised under their own regulatory framework to ensure robustness and agility. Continuous involvement and communication with the industry will be crucial to execution.

CONTACT DETAILS

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