3 June 2022

Director – Crypto Policy Unit, Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600
By email: crypto@treasury.gov.au

Dear Director

Comment on Consultation Paper
Crypto Asset Secondary Service Providers: Licensing and Custody Requirements

We write to provide our comments and recommendations on the above Consultation Paper. We do so in our personal capacities.

We are a team of academic social scientists—economists, lawyers, and accountants — researching and contributing to the design of the decentralised digital economy. We also have experience and expertise in the design of regulation and its implications, such as the effect of regulation on innovation and entrepreneurial discovery.

We are all members of the RMIT Blockchain Innovation Hub (RMIT BIH). The RMIT BIH was established in 2017 as the world's first research centre on the social science of blockchain technology. The RMIT BIH brings together academic researchers in the fields of economics, communications, finance, history, law, sociology, and political economy. Since then, this award-winning research centre has been at the forefront of bridging academic research with the design of digital economy business models, and the implications that has for institutions, including regulatory frameworks. RMIT BIH members were part of the Australian Government's National Blockchain Roadmap Steering Committee and RMIT BIH members have appeared before the Senate Select Committee on Australia as a Technology and Financial Centre along with other consultation processes.

Our attached comment is in four parts that aligns with the structure of the Consultation Paper. If you have any questions, please contact Aaron Lane by email to aaron.lane@rmit.edu.au.

Yours faithfully

Dr Aaron Lane
Dr Darcy Allen
Associate Professor Chris Berg
Dr Elizabeth Morton
Distinguished Professor Jason Potts

1. Proposed Principles, Scope, and Policy Objectives

1.1 Defining CASSPr

On terminology, the principle behind the term "Crypto Asset Secondary Service Provider" (CASSPr) as a general term to describe cryptocurrency businesses—rather than the narrower term of "digital currency exchange"—has some merit. That is, in a quickly evolving industry, it is good regulatory practice to adopt a more general term for centralised secondary services in Australia that does not lock in a particular business structure. We consider "crypto" to be an important aspect of the terminology rather than "virtual" or "digital" assets more broadly. Nevertheless, Treasury might consider shortening the abbreviation to "CASP" or "CASSP."

On substance, we consider that Treasury's current proposed CASSPr definition requires further refinement as follows:

i. We recommend making clear that a CASSPr is a centralised crypto asset secondary service provider. These may include retail digital currency exchanges, over the counter and wholesale cryptocurrency brokers and liquidity providers, and centralised cryptocurrency custody service providers. But the scope of the definition should not extend to decentralised services and ecosystems. For example, the Senate Select Committee into Australia as a Technology and Financial Centre (Senate Committee) did not envisage a regulatory regime that would capture Decentralised Exchanges (DEXs). Yet a DEX arguably operates as a business that "exchange between one or more forms of crypto assets" and can facilitate the "transfer of crypto assets".[1] The public policy rationale for extending a regulatory regime to DEXs is not strong in circumstances where consumers need to already possess crypto assets to use a DEX and there is no direct relationship between a DEX and the Australian financial system. There are also practical issues with enforceability. The intention to carve out decentralised platforms or protocols is stated in the Consultation Paper, but our view is that intention is not adequately reflected in the proposed definition – and it is the definition that will have legal force. Of course, the implications of this is that DeFi participants and primary services are excluded from this proposed regime. In our view this is a laudable feature of the proposal rather than a bug.

ii. We recommend that the terminology "carrying on a business" is used instead of "as a business" to ensure consistency with other provisions in the *Corporations Act* 2001 (Cth) (CA 2001).

iii. We recommend that related entities are carved out from the definition of "another person." For example, a Corporate Trustee, or a subsidiary of a parent company, may manage the "safekeeping and/or administration of virtual assets" on behalf of another person. The public policy rationale requiring a licence in these circumstances is not strong however as— if looking

[1] Consultation Paper, 10.

behind the corporate veil—the principal and agent are essentially the same person or under the same person's effective control.

iv. We recommend that the terms "virtual assets or instruments" be clarified and defined to distinguish these from "crypto assets."

v. We recommend clarifying the relationship and/or overlap between CASSPr and existing regimes, including the Australian Financial Services Licence (AFSL) regime. This requires an overarching understanding of the characterisation/mapping of crypto assets, which is critical for scoping the proposed regime. Moreover, amending the AFSL regime to exclude crypto assets is a preferable and more targeted approach as compared to having overlapping regimes. This is expanded on in points 1.4 and 1.5 below.

1.2 Defining Crypto Asset

We consider the ASIC definition of crypto asset is a good starting point and support the principle of applying a single definition of crypto assets across all Australian regulatory frameworks. We consider that the crypto asset definition requires further refinement as follows:

i. We recommend that the definition should also include reference to ""decentralised," "blockchain", or "distributed ledger technology". This inclusion is because it is not just cryptography that makes a crypto asset but the fact that it is built on the top of decentralised digital infrastructure (i.e., cryptography is one technology in a larger technology stack).

ii. We recommend that the definition include the "creation" to reflect the capability of the technology and crypto assets to create new types of crypto assets and quantities of particular crypto assets rather than being limited to digital representations.

iii. We recommend that further consideration is given to the limiting effect of "digital representation of value or contractual right" to be fully transferable across Australian regulatory Frameworks, particularly in respect to taxation and the definition of a CGT asset pursuant to section 108-5(1) *Income Tax Assessment Act* 1997 (Cth). In doing so, we also recognise the varied nature of metadata, bundling and reach across the crypto economy.

iv. We recommend that further consideration is given to the limiting effect of the term "asset" to be fully transferable across Australian regulatory Frameworks, particularly in respect to accounting standards. Whilst many crypto "assets" are in existence, there are equally available those that are akin crypto "liabilities", combination thereof, or some other categorisation (hybrid, utility, cash, or cash equivalent etc.). These issues along with more generally the interaction with other "asset" and "liability" definitions and treatments (e.g.,

definitions found within Australian accounting standards),[2] will be critical in seeking transferability. In this regard, we accept that different regulatory frameworks serve particular objectives and have developed over time through unique social-political contexts,[3] as such the ideal for complete transferability may be a difficult outcome to achieve.

v. Further, extending points 1.1(iv) and 1.1(v) above, defining crypto assets is a distinct task but directly affects the scope of a CASSPr regime. For this reason, we recommend that the token mapping exercise should be completed ahead of the introduction of the CASSPr regime.

1.3 Scope of Licensing Regime

As discussed above, we agree with the Treasury's assessment that the proposed licensing regime should apply to any business providing secondary crypto asset services.

1.4 Policy Objectives

We agree with the Treasury's assessment that crypto assets are distinct from traditional financial products and that there should be a distinct regulatory framework. We also agree that there is a distinction between decentralised platforms and centralised crypto asset businesses (i.e., CASSPrs) and note that the licensing regime is not intended to apply to decentralised platforms or protocols.

We agree that it is appropriate for a licensing regime to minimise the operational and custodial risks for retail consumers. However, we do not consider that it is appropriate for a licensing regime for CASSPrs to seek to minimise financial risk. There is financial risk inherent in acquiring or investing in any asset. As a general principle, consumers should be free to choose the mix of assets that aligns with their investment preferences and strategy. Of course, some consumers will acquire crypto assets for purposes other than investment such as transferring funds, facilitating use of a service, or participating in governance. To be sure, there is currently a perceived problem in the financial advisory industry where advisors are reluctant to provide advice to clients on crypto assets, due to a fear that they are not licensed or are not insured to provide this type of advice. But this is an issue to be addressed in the licensing of financial advisors, not something to be required of CASSPrs.

One policy objective that could be expanded upon is to explicitly note the risk of harm that consumers face from cryptocurrency scams (i.e., email phishing or fake investment scams using

[2] Of which for example make explicit distinction for cash or cash equivalents (which could, for example, be considered in respect to certain stable coins).
[3] See for example the comparison of taxation and accounting in Elizabeth Frances Morton, 'A historical review of the rise of tax effect accounting as a financial reporting norm' (2019) 24(4) *Accounting History* 562-590.

cryptocurrency).[4] We consider this to fall within the ambit of operational risks in that there is a risk that a CASSPrs platform is—unbeknown to the business—used to facilitate fraudulent transactions. The risks of scams is an issue distinct from money laundering risks and from risks of legitimate projects failing. This risk is significant, with Australian Competition and Consumer Commission statistics reporting that in 2019 "losses for cryptocurrency scams exceeded $21.6 million from 1810 reports."[5] Although the Treasury should be careful not to overstate the problem, as total illicit cryptocurrency transactions (including scams) account for less than one percent of total cryptocurrency transaction volume.[6]

We strongly encourage the Treasury to limit the policy objectives to be specifically targeted at addressing the unique challenges of crypto assets. For instance, general issues such as anticompetitive conduct, environmental sustainability, and misleading and deceptive conduct have existing statutes which would cover CASSPrs – and it would not be good regulatory practice to have different and competing obligations for CASSPrs.

1.5 Licensing Coverage and Limiting Regulatory Duplication

We recommend that the licensing regime be token-agnostic as there is likely to be continued innovation as to the function and form of crypto assets.

To avoid duplication of licensing requirements, we recommend that a cascading system is introduced whereby if an entity has an AFSL, for example, then it does not require a CASSPr licence. Further, we agree that ASIC should administer the proposed regime so that there are not multiple, and potentially overlapping, regulators. Indeed, ASIC should also enforce the Australian Consumer Law in relation to the conduct of CASSPrs, as it does with financial services. While AUSTRAC will continue to regulate CASSPrs that are "digital currency exchanges" for the purposes of the AML/CTF regime, we recommend that the Australian government introduce a "one-stop-shop" licensing portal.

[4] See Aaron M. Lane, 'Crypto theft is on the rise. Here's how the crimes are committed, and how you can protect yourself' (2022) *The Conversation.* <https://theconversation.com/crypto-theft-is-on-the-rise-heres-how-the-crimes-are-committed-and-how-you-can-protect-yourself-176027>.
[5] Australian Competition and Consumer Commission, *Targeting Scams 2019* (Report, 2020), 18.
[6] Chainalysis, *The 2022 Crypto Crime Report* (Report, February 2022).

2. Proposed Obligations on Crypto Asset Secondary Service Providers

2.1 Regulatory Possibilities

There are three regulatory options presented in the Consultation Paper – (1) regulating CASSPrs with distinct and specific obligations, (2) regulating CASSPrs under the existing financial services regime, or (3) self-regulation. In summary, we recommend the introduction of a combination of (1) and (3): a hybrid of high-level principle-based duties that are seen as fundamental to holding a licence and are unlikely to change as the technology develops and self-regulation through a mandatory industry code that contain more detailed obligations where minimum standards and best practice may be contested spaces, and which may change over time. Our recommendations are subject to our comments above on definitions.

Applying the existing financial services regime to CASSPrs would not be appropriate and we strongly recommend against adopting this alternative approach. To the extent that crypto assets are not currently subject to financial regulation, any of the presented options would impose some level of regulatory burden. To fulfil the objective of encouraging innovation and making Australia a destination of choice as a technology and financial centre, we recommend imposing the least possible burden targeted at perceived risks of consumer harm. Defining crypto assets as a financial product would require CASSPrs to hold an AFSL licence, which, as the Senate Committee heard, "carries many requirements that are not appropriate or relevant to the digital currency sector as it currently stands."[7] Indeed, as the Consultation Paper suggests, this would add a compliance burden onto CASSPrs without any regulatory benefit. In this industry, much more so than others, labour and capital is mobile. A regulatory environment that excessively raises the costs of doing business will lead CASSPrs to establish operations offshore and outside of Australia's regulatory control – the opposite of its objective. The Consultation Paper suggests that one way this could be mitigated is by allowing the government or the regulatory to exempt an individual entity from the operation of parts of the existing financial services obligations. While the suggestion is well intended, subjecting businesses to the whims of regulatory discretion does not provide regulatory certainty. Accordingly, we strongly recommend against this alternative option as well.

2.2 Proposed Regulatory Obligations

The table below summarises which proposed requirements could be obligations of holding a licence under legislation compared to proposed requirements that should be included in the industry code. The legislation could prescribe the areas that the industry code must cover and provide that a breach of the industry code breaches the licensing conditions.

[7] Senate Select Committee into Australia, Parliament of Australia, *Final Report* (Report, October 2021), 47.

Proposed Requirement	Recommended Basis	Comment
(1) do all things necessary to ensure that: the services covered by the licence are provided efficiently, honestly and fairly; and any market for crypto assets is operated in a fair, transparent and orderly manner.	Legislation	Recommend omitting “efficiently” as efficiency is achieved through the process of consumers and businesses participating in the operation of the market.
(2) maintain adequate technological, and financial resources to provide services and manage risks, including by complying with the custody standards.	Industry Code	Minimum standards particularly around technological resources are likely to be contested and change over time.
(3) have adequate dispute resolution arrangements in place, including internal and external dispute resolution arrangements.	Combination	Recommend legislation to provide private cause of action (where breach leads to loss or damage) and public cause of action. Industry code to provide internal and external appropriate dispute resolution.
(4) ensure directors and key persons responsible for operations are fit and proper persons and are clearly identified.	Legislation	Recommend “officers” in place of “key persons” consistent with the CA 2001.
(5) maintain minimum financial requirements including capital requirements.	Clarity Required	Query whether minimum financial requirements are needed if crypto assets are effectively held on trust for consumers - and where directors and officers have existing obligations to prevent insolvent trading. Further, this obligation needs to deal with variation in the scope of CASSPr definition.
(6) comply with client money obligations.	Legislation	Recommend clarifying if the intention is to mirror AFSL obligations. In principle, we agree with legislative obligations with safeguarding client crypto assets, keeping assets

Proposed Requirement	Recommended Basis	Comment
		separate, record keeping and reporting requirements - only where relevant.
(7) comply with all relevant Australian laws.	Clarity Required	Recommend removing this obligation or making it more specific so that unrelated matters are not grounds for breaching licence obligations. e.g., AFSL holders are required to comply with the financial services laws (s912A(c) CA 2001).
(8) take reasonable steps to ensure that the crypto assets it provides access to are “true to label” e.g. that a product is not falsely described as a crypto asset, or that crypto assets are not misrepresented or described in a way that is intended to mislead.	Remove	Recommend removal of this obligation as this duplicates adequate consumer protections in the Australian Consumer Law**.**
(9) respond in a timely manner to ensure scams are not sold through their platform.	Industry Code	Minimum standards and best practices are likely to be contested and change over time.
(10) not hawk specific crypto assets.	Clarity Required	Recommend clarifying what the purpose of this obligation is. If undisclosed conflict of interest or other asymmetric information, then we recommend the obligation imposes an information requirement rather than an outright ban.
(11) be regularly audited by independent auditors	Clarity Required	Recommend clarifying what is being audited (e.g., financials, transactions, custody, compliance) and by whom (i.e., who would be approved as an independent auditor). We recommend that these matters should be included in legislation. We recommend that the auditing standards be incorporated in the industry code.

Proposed Requirement	Recommended Basis	Comment
(12) comply with AML/CTF provisions (including a breach of these provisions being grounds for a licence cancellation).	Legislation	This is a valid obligation, but we recommend that it is incorporated into obligation (7) (noting our comments above). We note that this is the only item that indicates consequences of failing to meet the obligation - we recommend breaches are dealt with separately.
(13) maintain adequate custody arrangements	Combination	Similar to custody obligations for managed investment schemes noted in the Consultation Paper there seems merit in drawing a distinction between 'mandatory' requirements that are unlikely to change and that could be legislated and those 'good practices' that are likely to be contested and change over time. We note our further comments on this matter below.

2.3 Additional Proposals for Regulatory Obligations

The table below summaries our additional recommendations for regulatory obligations.

Proposed Requirement	Recommended Basis	Comment
Comply with disclosure requirements	Legislative	We recommend that consumers are easily able to understand remuneration/fee structures, amongst other information. This requirement could be incorporated into obligation (7) (noting our comments above).
Not to provide personal advice without a licence.	Legislative	We recommend that CASSPrs can give general advice with adequate disclosures. Personal advice should be regulated by the existing financial advisors regime.[8]

[8] It is pertinent to highlight here the definition of general advice for example in s 766B(4) CA 2001 is predicated on what is personal advice: s 766B(3) CA 2001. The continuum is not necessarily free from

Proposed Requirement	Recommended Basis	Comment
		This requirement could be incorporated into obligation (7) (noting our comments above).
Staff education	Industry Code	We recommend a requirement for CASSPrs to ensure that staff and representatives are adequately trained.
Consumer education	Industry Code	We recommend a requirement for CASSPrs to provide or link to basic information as relevant to its prospective retail consumers targeted at preventing scams, fraudulent activity, and custody management.

2.4 Recommendations Against Prohibitions

a) Airdrops

The Consultation Paper questions whether there should be a ban on CASSPrs airdropping crypto assets through the services they provide. We strongly recommend against this approach.

'Airdrops' are a substantial (potential) benefit to consumers for owning cryptocurrency, and such restrictions would be clearly detrimental to consumers. Airdrops also have an important economic role. In some cryptocurrency ecosystems, a broadly distributed token provides economic security for the underlying blockchain (such as in proof of stake systems) and more generally broad distribution facilitates the decentralisation that makes crypto assets unique. Given the regulatory uncertainty around public sales of tokens (particularly in the United States) airdrops are one of the key mechanisms to facilitate that decentralisation. In the future, airdrops could be a mechanism for mergers and acquisitions in the cryptocurrency ecosystems (similar to the corporate space where a company's shareholders might receive additional shares in another company as part of a commercial deal). Finally, CASSPrs may also be considering creating their own tokens (as many centralised exchanges have globally) - which is a positive sign of product differentiation and a competitive landscape ultimately benefits consumers. Accordingly, the

critique, as highlighted by the litigation between Westpac and ASIC in recent years, where Westpac were found to have provided personal advice, where a reasonable person would expect at least one aspect of their personal circumstances (whether objectives, financial situation or needs) were to have been taken into account - as per the requirement of s 766B(3)(b) CA 2001.

Australian government should not be preemptively banning otherwise lawful innovation. Such an approach would go against the objective of encouraging innovation and making Australia a destination of choice as a technology and financial centre and cause clear consumer detriment without any clear corresponding benefits.

b) Specific Crypto Assets

The Consultation Paper poses a broader question as to whether there are any crypto assets that ought to be banned in Australia. We strongly recommend against any proposals to ban any specific crypto assets or general categories of crypto assets.

Bans should only be considered in circumstances where a traditional analogue of those assets are themselves banned and would have to be considered on a case-by-case basis with a high bar for the ban to be enacted. We consider that the broader regulatory landscape (e.g., AML/CTF provisions, competition and consumer law, the criminal law, environmental protection laws), along with the common law and equity (e.g., contract, tort, fraud) will already cover the field in capturing undesirable or illegal activities. Legitimising CASSPrs through the proposed regulation will reinforce accountability against the provision of access to such undesirable or illegal activities. Moreover, the global reach of the technology and the fast-paced nature of the developments, raises issues of whether bans on specific crypto assets would be effective or merely tokenistic.

3. Proposed Custody Obligations

We recommend that custody obligations are regulated by way of an industry code as indicated in our comments in section 2.1 above. This would have the advantages of self-regulation noted in the Consultation Paper including "that industry participants will have the flexibility and limited regulatory barriers that could foster or encourage the growth of new and innovative blockchain or technology businesses in Australia".[9] Specifically, this approach would mean that there is a clear mechanism for industry to seek change to the regulatory requirements without needing legislative amendment in the context of minimum standards and best practices being certain to change over time. Indeed, it is sensible that best practice can continue to evolve. Our recommended approach would see custody obligations form part of the licensing conditions so that there is no risk that "some market participants may not adopt the code or maintain the standards most industry members adopt."[10]

The Australian government should have confidence in the ability of the Australian cryptocurrency industry participants to work collaboratively at establishing an industry code. The industry has a great record of participation in government and regulatory processes such as the National Blockchain Roadmap, the Senate Committee process. Additionally, the industry has an established industry body and a world-leading academic research centre. For our part, members of the RMIT Blockchain Innovation Hub will seek to play an active role in developing an industry code.

One area that we raise for further consideration and consultation is regarding the requirements of custody and liquidity. The key risk being addressed with these requirements is one of insolvency or winding up. That is, in an insolvency situation, consumers risk being left unsecured creditors who typically receive a small percentage - if anything - of the insolvent company's assets. The insolvency risk is distinct from other risks (such as theft) that other custody obligations (such as cybersecurity) will seek to address. Holding assets on trust and liquidity requirements address the insolvency risk in different ways (stock versus flows) but it is not clear why both would be required. Two retail scenarios are discussed here as examples – although we note there may need to be flexibility in the industry code on these matters to account for variation in obligations for retail and wholesale CASSPrs.

In a trust scenario, crypto assets to be held and maintained for the benefit of an individual consumer. CASSPrs could not deal with those crypto assets without express authority and would have to act in the consumer's best interest. The basic business model here can be likened to a safety deposit box in that a CASSPr provides the infrastructure to hold crypto assets (such as a web platform for crypto accessing assets, key management, cybersecurity, etc.) for payment of a subscription fee or cross-subsidised by another part of the business (such as an exchange

[9] Consultation Paper, 21.
[10] Consultation Paper, 21.

business or a premium offering). In this scenario, a customer is protected against the insolvency risk because the requirement to hold assets in trust means that these cannot be applied to pay secured or preferential creditors.

In a non-trust scenario, one consumer's crypto assets are pooled with other consumers crypto assets and a customer is entitled to redeem or deal with the assets at any time (or as governed by the contractual arrangements between the parties). As the CASSPr can deal with the crypto assets in this scenario, one basic business model here allows a CASSPr to put the crypto assets to work (e.g., investment in other crypto assets or non-crypto assets) and profit from a return on that investment. Another business model is facilitating buyers and sellers of crypto assets. In this scenario, a customer is protected against the insolvency risk because the liquidity requirement to hold a certain amount of crypto assets for consumers at any one time means that customers can redeem or deal with their assets as needed.

As such, we are also concerned that requiring both crypto assets to be held in trust and imposing liquidity requirements may prevent innovation and variation in business models and service offerings, which would harm competition and ultimately harm consumer welfare. We recommend that consideration and further consultation be given to whether a 'default' rule could be in place in legislation that could be replaced by provisions of an industry code - allowing individual CASSPrs to decide on the model that is most appropriate for their business, with this to be adequately disclosed to consumers.

4. Token Mapping

We understand that the token mapping exercise was a key recommendation of the Senate Committee and has been endorsed by the Federal government. Our recommendation is that the token mapping exercise is not done as an exercise for its own sake but is done specifically to inform the relationship and/or overlap with CASSPr and the existing AFSL regime (as we have discussed above at 1.1). Aside from this, the merit of a broad definition of crypto assets is that differential treatment of crypto assets with certain characteristics or functions is not required as the CASSPr regime will not seek to regulate the primary crypto asset ecosystem. As such, and as noted above at 1.5, we recommend that the licensing regime be token-agnostic.

Finally, we note that our recommendations surrounding the prohibition of specific crypto assets is dealt with above at section 2.4(b).