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1 December 2023

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

By email: crypto@treasury.gov.au

Hamilton Locke Submission – Treasury's Regulating digital asset platforms Consultation Paper – October 2023

Dear Treasury,

We welcome the opportunity to submit a response in relation to Treasury's proposed regulating digital asset platforms consultation paper (**Consultation Paper**).

We strongly support the Government's multi-stage reform agenda for developing appropriate regulatory settings for the crypto sector. We understand that for many in the sector, regulation is anticipated and welcomed, and we stand committed to assisting the sector and the Government in developing a bespoke and fit for purpose crypto regulatory framework. We have previously provided submissions to Treasury's token mapping consultation paper in February 2023, the Crypto asset secondary service providers: Licensing and custody requirements Consultation Paper in March 2022, and to the Senate Economics Committee inquiry into the draft Digital Assets (Market Regulation) Bill 2023 in May 2023.

We recognise that this Consultation Paper serves as an opportunity to ensure that the appropriate legislative framework is developed to:

- provide regulatory certainty to support the continued growth of the industry;
- protect consumers;
- promote competitive offerings;
- facilitate technology development and innovation;
- help encourage capital flows to Australia from other jurisdictions; and
- help solidify Australia as a competitive market that can grow and attract talent.

We welcome any feedback you may have in respect of this submission, and we look forward to the outcome of this consultative process.

Yours faithfully

Jaime Lumsden

Partner

Hamilton Locke

Michele Levine

Partner

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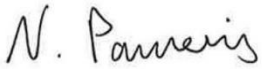

Nicholas Pavouris

Senior Associate

Hamilton Locke

Submission Paper

In response to Treasury's Regulating digital asset platforms Consultation Paper – October 2023

About Hamilton Locke – Funds and Financial Services

Hamilton Locke is Australia's fastest growing law firm, which is focused on transforming the traditional approach to corporate and commercial legal services. Hamilton Locke is a full service corporate law firm, which is a part of the HPX Group, that delivers essential corporate services across legal, governance, risk and compliance helping businesses grow and thrive.

The Funds and Financial Services Team at Hamilton Locke (formerly, The Fold Legal) has become one of the go-to firms for cryptocurrency, blockchain, fintech and insurtech businesses seeking regulatory advice. Our Funds and Financial Services team is also one of Australia's largest as a result of the merger between The Fold Legal and Hamilton Locke.

We are known for our technical expertise and industry knowledge, which we use to provide practical solutions for our fintech, cryptocurrency and digital asset clients. Our expertise in financial and credit services is recognised by our ranking in Chambers and Partners Asia-Pacific and FinTech Legal Guides. Reflecting our commitment to client service, we also won Best Law & Related Services Firm (<$30mil) across several specialist categories the past 3 years based on direct feedback from our clients.

Collectively, we have been deeply steeped in the fintech space since early 2013 and we continue to deepen and strengthen this experience as one of Australia's largest and most diverse financial services practices.

We are technical specialists that have a broad and deep understanding of blockchain technology, cryptocurrencies and digital assets, exchanges, Decentralised Autonomous Organisations (**DAO**), alternate platforms and cryptocurrency products and service offerings. Our knowledge of cryptocurrencies and digital assets, combined with our traditional financial services expertise, is market leading. We use our industry knowledge and expertise to deliver practical, compliant, and innovative solutions for our clients. We have worked with cryptocurrency and digital asset exchanges, miners, cryptocurrency and digital asset payment businesses, cryptocurrency and digital asset platforms, DAOs and token issuers to design innovative and compliant offerings.

We are a partner and member of Blockchain Australia, FinTech Australia and InsurTech Australia.

Executive Summary

The regulation of the digital assets industry is an important step for both local and global industries. As we have seen with other industries (most notably new energy), uncertainty stifles innovation, and a clear pathway to regulation provides the strongest foundation for true innovation, growth, consumer protection and a competitive market.

We support Treasury's proposed approach in the Consultation Paper and are encouraged by the efforts Treasury has made to proactively engage with industry to make efforts to ensure that the development of regulation broadly aligns with the realities and risks of the industry as well as the expectations of key stakeholders.

The Consultation Paper presents a regulatory framework that seeks to leverage the existing financial services regulatory framework while drawing on:

- the learnings from the token mapping consultation;[1]
- IOSCO's recommendations;[2] and
- the approaches adopted by other jurisdictions.

The outcome is a considered and pragmatic approach to regulating digital assets, which seeks to regulate key activities and not the digital assets themselves. We note that there are some issues, challenges, and gaps in the Consultation Paper that still need to be considered, and our submission seeks to provide practical solutions for each of these matters. However, given the depth and scope of these matters, we respectfully recommend that Treasury provides industry with another opportunity to consult on the proposed regulatory framework before any legislative drafting process commences. This will provide industry with another opportunity to identify and propose solutions in a meaningful and tangible way, which we believe will streamline the legislative drafting process and give industry the best opportunity to prepare for the transition to regulation.

As the digital asset industry is a global industry with no borders, we acknowledge the challenge in designing a regulatory framework and seeking to enforce it. We anticipate that over time, mutual recognition and passporting regimes will become essential to positioning Australia as a global leader in digital assets. For this reason, we strongly recommend that Treasury build out the regulatory requirements in a manner that is consistent with ISOCO's recommendations and aligns with the approach taken by jurisdictions that have appropriately balanced customer protection and innovation.

We also think it is critical that Australia seeks to front run the curve on regulating decentralised solutions to better foster a burgeoning industry in Australia. This involves designing incentives and regulatory certainty for DAOs to register and operate in Australia.

Finally, regulatory reform does not guarantee banking and insurance solutions for industry. It is critical that Australia adopt a collaborative approach to resolving these issues, which is likely to require meaningful collaboration between regulators, banks, insurers and industry. As part of this, we need to move beyond a single risk assessment for industry at large and work on a practical pathway to reliable and consistent banking and insurance solutions.

[1] Treasury's Token Mapping Consultation Paper dated February 2023.
[2] IOSCO's Policy Recommendations for Crypto and Digital Asset Markets Final Report dated 16 November 2023.

Our Submission

We commend Treasury's efforts in developing a robust regulatory framework for digital assets that seeks to balance consumer protection and innovation. Generally, the proposals in the Consultation Paper are sensible and reasonable and are broadly consistent with the recent final report on crypto market regulation issued by IOSCO.[3] However, there are a number of issues, challenges and gaps that we believe still need to be worked through in finalising the Australian response to digital asset reform. To help inform Treasury of these matters, our submission is structured as follows:

- Section 1: This section outlines key issues and challenges with the proposed approach in the Consultation Paper and proposes potential solutions for Treasury's consideration;
- Section 2: This section highlights areas not covered by the Consultation Paper and our recommendations;
- Section 3: This section considers the future areas for consideration and our recommendations; and
- Section 4: This section answers the specific questions asked by Treasury in the Consultation Paper.

Unless specified otherwise, all references in this submission to:

- Sections are to sections of the *Corporations Act 2001* (Cth); and
- Regulations are to regulations of the *Corporations Regulations 2001* (Cth).

1. Issues and Challenges

Given the scope of the proposed regulatory reform in the Consultation Paper, we believe it is critical that any issues and challenges are identified, considered and resolved before the legislative drafting process commences.

To help inform Treasury on these matters, this section of our submission details these issues and challenges at a conceptual level. It also outlines further questions we believe need to be explored and, where possible, proposes potential solutions for consideration.

1.1 Digital Asset Facilities

We understand that a digital asset facility (**DAF**) is proposed to be a regulated financial product. A facility will be a DAF if it is an asset holding arrangement. Asset holding includes holding tokens and / or holding real world assets that back tokens.

A facility will also be a DAF if it performs any one or more "financialised functions", being token trading, token staking, asset tokenisation and crowdfunding.

We understand that the concept of a DAF has been broadly modelled on the non-cash payment facility (**NCPF**), margin lending facility and investor directed portfolio services (**IDPS**) products that are currently regulated under the *Corporations Act 2001* (Cth). We broadly support the way in which a DAF is proposed to be characterised but wish to highlight some execution challenges.

In particular, the concept of "dealing" does not readily apply to non-cash payment facilities. This is because dealing is currently defined as "issuing, applying for, acquiring, varying or disposing of a financial product". If the relevant financial product is the DAF, then a financial service will be provided when a person first acquires a DAF (which we assume will be at the point that a customer opens an account on the DAF, similarly to how it is treated for a NCPF). However, each transaction processed

[3] International Organization of Securities Commissions (IOSCO), Final Report on *Policy Recommendations for Crypto and Digital Asset Markets*, 16 November 2023.

through a NCPF is not generally characterised as a financial service, and similarly, neither would each transaction processed through a DAF.

It is our understanding, based on the Consultation Paper, that each transaction through a DAF is intended to be a dealing service (as brokers are stated to be dealing when they deal "through" a DAF). We support this approach, as we strongly believe that each transaction through a DAF (which will involve one or more financialised functions) should be a financial service, such that a financial service is provided to a consumer each time they:

- Place further digital assets (not cash) in custody with a DAF;
- Trade a token on a DAF;
- Stake a token through a DAF;
- Acquire an asset-backed token issued through a DAF (asset tokenisation); or
- Contribute to a crowdfunding initiative and purchase a token via a DAF.

In order to achieve this outcome, a new definition of dealing will need to be included to capture each of the above as a financial service, as none of these will amount to the issue or acquisition of a DAF (except possibly on the first occasion a consumer does one of these things through a new DAF).

We consider that the appropriate authorisation for a DAF is akin to that for a registered managed investment scheme, being "Operate a digital asset facility" (notwithstanding the similarities to NCPFs, margin loans, and IDPSs). We take this view because it is the ongoing operation of the DAF that will amount to financial services, not just the issue of the DAF as a product.

1.2 Intermediaries

We support the notion that intermediaries who facilitate transactions through a DAF should be regulated and be required to hold an AFSL with appropriate authorisations.

We note that there are two models for intermediaries in the crypto market, being:

- Agents, who act on behalf of exchanges – it is quite common that large global exchanges with complex corporate groups will use a local agent to facilitate trades on the global exchange; and
- Brokers who act on behalf of the client to facilitate trades on an exchange.

However, currently the way these 'so-called' agents and brokers operate is not consistent with the way intermediaries operate for other financial products. To help demonstrate this, and how we think it should be regulated, we provide an illustrative example of each and how the proposed regulatory regime should apply in the table below.

Intermediary Type	Business description	Proposed regulatory regime
Broker	An exchange located in Australia facilitates trades with customers (**Broker**). The Broker is the counterparty to the trade but sources liquidity from third party providers (i.e. other larger exchanges) (**Liquidity Provider**) to fulfill customer trades. This is often referred to as a brokerage model. A customer initiates a trade with the Broker. To execute the trade, the Broker transacts with its Liquidity Provider to purchase the token. Once the Broker has the token in its wallet with the Liquidity	In this example, the Broker is not operating as a conventional broker as that term is understood in other sectors at all. In fact, the Broker will be a DAF (because it is providing the financialised function of token trading) and will be required to comply with the NTA requirements if it engages in asset-holding activities. This is because the DAF is the counterparty to the trade and is not merely facilitating a trade with some other DAF (being the Liquidity Provider).

	Provider, it transfers the token from the Liquidity Provider to its own platform and then immediately to the customer's wallet to satisfy the trade between itself and its customer.	However, if Brokers who currently operate using this model wish to do so, they could restructure into a true broker model, as it is understood in other financial services sectors, in which case it should then be regulated as we have outlined below this table. In this model, the Broker would not be the counterparty to the trade, but would arrange, on behalf of the customer, the trade on a DAF for the benefit of the customer. While it may be the case that this model (and the agency model described below) is never (or rarely) used in the digital assets industry, it is necessary to understand and make the distinctions between these arrangements so that there is consistency with the way licence authorisations work in other financial sectors.
Agent	A global exchange operates in a number of jurisdictions including Australia. In Australia, the global exchange has a wholly-owned subsidiary incorporated in Australia (**AusCo**) that contracts directly with clients. AusCo provides trading functionality to customers in Australia. A customer initiates a trade on AusCo and AusCo is the counterparty to the trade. To execute the trade, AusCo pushes the trade to the global exchange. The global exchange fulfils the trade and the trade is executed, with the assets being transferred to AusCo first and then AusCo transfers the assets to the customer to satisfy the trade between itself and its customer.	In this example, AusCo is acting as a local agent of the global exchange, not a broker of the customer. This is because AusCo is essentially acting as a local shopfront for the global exchange. However, because the agent is the counterparty to the trade, it is itself a DAF (because it is providing the financialised function of token trading). As currently proposed, the local agent will need to be a DAF as it is liable to the customers under the contract with them and should be subject to NTA requirements if it engages in asset-holding. However, if local agents who currently operate using this model wish to do so, they could restructure into a true agency model, as it is understood in other financial services sectors, in which case it should then be regulated as we have outlined below this table. In this model, the agent would not be the counterparty to the trade but would, on behalf of the exchange, facilitate the customer entering into trades on the exchange.

Intermediaries that are counterparties to trades are not genuine intermediaries and should be regulated as a DAF as we outlined above in section 1.1. All further references in this section to intermediaries, brokers and agents should be understood to be a reference to a true intermediary, unless specified otherwise.

We consider it appropriate to treat brokers and agents in the digital asset space using similar principles to those used for brokers and agents in the general insurance industry and other financial sectors that use this model.

Accordingly, we recommend that the following authorisations be used for genuine intermediaries:

- Agent – dealing by issuing, acquiring, varying or disposing of a DAF (we note that the addition of 'transacting through' may be needed); and
- Broker – applying for, acquiring, varying or disposing of a DAF (we note that the addition of 'transacting through' may be needed).

Some agents and brokers operate their own custodial wallets for customers. We assume that in this case, while an intermediary may be an agent or broker for the purpose of facilitating a financialised function on another DAF, such an intermediary will also be its own DAF in relation to the custody function it provides and will also need an authorisation in this regard to operate a DAF.

However, some brokers don't operate wallets but will merely hold tokens in transit. That is, they will execute the trade on an exchange, receive the tokens into their own wallet, and then remit the tokens to the verified wallet address provided by the customer.

It is unclear what rules will apply to tokens in transit. In our view, we do not think it is appropriate for a broker to be regulated as a DAF in its own right for this activity; however, we do consider that the temporary holding of assets in this way should be subject to asset holding rules, that are similar to the current client money rules. We posit that these asset holding rules may:

- Require any assets in transit to be held in a wallet with a DAF that is "designated" as an intermediary trust account;
- Impose a time limit on the holding of these assets, such as the rule that is imposed in respect of premium refunds, which requires brokers to remit premium refunds to the person entitled to it within 7 days of receipt; and
- Require any assets held in an intermediary trust account to be segregated from all other assets and protected from insolvency, as are client monies.

It is also possible that some DAFs may provide both trading functionality as principal and as a broker. The regulatory regime will need to contemplate this and make it clear what rules apply to what model from a financialised function point of view. We do not see any issues with different requirements applying to a single DAF provided it is clear what requirements apply to each model.

In addition, it is our view that the term "broker" as it relates to digital assets should be a restricted term and should only be available where the licence authorises the holder to use it (which authorisation would be granted only where the broker acts as a true intermediary on behalf of the customer).

1.3 Advice

The Consultation Paper captures intermediaries who advise in respect of DAFs. Our understanding is that the proposed regulation of advice will apply at the DAF level (not at the digital asset level) such that intermediaries will have obligations when recommending the use of a given DAF for asset holding or one of the financialised functions, but not when recommending the tokens that will be the subject of any financialised function. Conceptually, we agree with this approach, but we discuss in sections 1.8 and 1.18 below some of the consequences that may arise in light of the proposed design and

distribution obligations and trading digital assets that are not a financial product with digital assets that are financial products.

1.4 Trust Account Rules

We understand that the client money rules are to apply to digital assets. We assume the client money rules will also apply to both fiat held by a DAF and fiat held by an intermediary.

There are references in the Consultation Paper to the concept of "pre-funding" an account being part of the concept of a DAF. It is unclear, therefore, if the act of pre-funding an account of itself will constitute a type of dealing in a DAF or if it will simply amount to the holding of fiat that is subject to existing client money rules.

Currently, section 1017E imposes client money rules on product issuers when a client provides application moneys for a particular financial product, but for whatever reason that financial product is not immediately issued. Section 1017E does not apply when a customer pre-funds an account but has not yet applied for a specific financial product. In these circumstances, the client money rules in section 981B will apply.[4] This is because the AFS licensee is receiving money that is paid in connection with a financial service that 'may' be provided, that is, there is the possibility that a financial product will be issued at some other time.[5]

In our view, we believe that pre-funding an account in a DAF should be subject to the current client money rules and should not be treated as a separate 'dealing' activity. Nothing may actually turn on this distinction. However, we are of the view the DAFs should be treated in the same way as other financial products, unless there is a risk specific to DAFs that needs to be managed or mitigated in a different way. At this stage, we cannot perceive any such different risk.

We note also that there is the potential for a digital wallet funded with fiat or cryptocurrency to amount to a stored value product where payment functionality attaches to the wallet. It is likely that this is already the case for many exchanges with digital wallets with payment capabilities but solving it under the current regime is impossible (particularly since cryptocurrency cannot be held in an account with an ADI, which is one of the criteria for the most relevant stored value exemption).

We acknowledge that Treasury is separately consulting on stored value facilities as part of the broader payment reforms that are underway, and it is unclear at this stage how digital wallets will be caught by these reforms. We presume that any wallet that constitutes a stored value facility will be subject to the regulatory requirements for stored value facilities, which are likely to be more onerous than the current financial services laws and proposals in the Consultation Paper having regard to both current ADI and purchased payment facility requirements. However, to ensure DAFs are not subject to duplicative requirements, it will be critical that both the stored value facilities changes and the regulatory framework in the Consultation Paper are appropriately aligned.

Until we have a greater sense of how these regimes will ultimately co-exist, the following questions need to be considered and further explored:

- If pre-funding an account with a DAF is to be its own separate dealing activity in a DAF, is the intention to preclude the stored value rules?
- Will fiat held in digital cryptocurrency wallets be subject to stored value regulation or will the client money rules in the Corporations Act apply?

In our view, the mere act of pre-funding an account with a DAF should not be a dealing activity in and of itself. No payment in advance of the provision of a financial product is considered a dealing activity for any other financial product. Rather, it is considered to be a payment for a financial product in

[4] Except in relation derivatives purchased OTC by wholesale clients which are exempt under regulation 7.8.01A *Corporations Regulations 2001* (Cth).
[5] Section 981A *Corporations Act 2001* (Cth).

advance of the issue of that product and subject to client money rules. We consider that the more appropriate treatment is that:

- Any funds held by a DAF be subject to client money rules. Consideration needs to be had as to whether the existing s981B / s1017E trust account rules are appropriate, or if changes should be made for DAFs; and
- If the wallet in which the funds are held has payment functionality connected, such that it meets the stored value product definition, then:
    - Any rules that apply to stored value products should apply;
    - Except that, if stored value funds are not themselves to be subject to client money rules (and there is an argument that they are not at present), then in our view, the funds held in the wallet by the DAF should still be subject to client money rules as money held in a DAF (unless any additional stored value rules impose a higher standard of consumer protection than the client money rules).[6]

We note that stablecoins will be considered further as part of the broader payments regulatory reform and are currently not contemplated by the proposals in the Consultation Paper. Once the stablecoin regime is developed, it will be critical to ensure that it appropriately aligns with the proposals in the Consultation Paper.

1.5 Control and Custody

Control

A person will be considered to be holding digital assets in custody where they have 'factual control'. We understand that the digital assets custody rules will apply to all non-financial product digital assets, including where held through a financial product structure e.g. BTC held by ETF, but that the custody rules for financial products will apply to all digital assets that are financial products (and accordingly will not apply to non-financial product digital assets held through a financial product structure).

We are comfortable with the concept of factual control as the trigger for custody rules, as factual control appears to impose a test of whether a person, factually, is able to do anything with the digital assets and preclude others from doing things with those assets. This concept is broad and should pick up all or most cases where digital assets are at risk.

However, it is unclear whether Treasury proposes to apply the test of full factual control[7] or positive control only. This is something that should be clarified before the legislative drafting process. This is critical as there may be instances where a DAF has positive control but not full factual control and this should be further workshopped with industry.

[6] We note that, at present, there is real doubt about whether funds under any non-cash payment facility, including stored value facilities, are subject to the client money rules. This is because (as explained above for a DAF), the dealing service for an NCPF is its issue – not additional contributions. If this is correct, then the client money rules do not apply because the money is not paid to acquire, or acquire an increased interest in, a financial product. This also means the funds are not protected under the Corporations Act in insolvency. Many providers choose to voluntarily hold such funds in trust accounts. Setting aside whether it is even money that is permitted to be held in trust, voluntarily holding the funds in trust does not cure the fact that the funds are not protected in insolvency. As we have proposed for a DAF, it is our view that the dealing definition of NCPF should be expanded to include every non-cash payment made under the NCPF. This would trigger the client money rules for an NCPF for each payment made. We presume this issue will be addressed by the Payments Review, and our commentary that stored value rules should supersede the client money rules is based on the assumption that either stored value facilities will be subject to the client money rules or will be subject to more stringent controls. If this is not the case, then we think fiat money contributed to a DAF should remain subject to the client money rules as a DAF to ensure its protection in insolvency rather than being superseded by any stored value facility rules.

[7] 'Full factual control' means positive control (a factual ability to use, dispose of, or transfer an asset) and negative control (a factual ability to exclude others from using the asset).

Custody rules

We question, however, if it is appropriate for financial products that are digital assets to remain subject to traditional custody rules. We raise this because currently traditional custodians are not set up to provide custody of digital assets (whether financial products or not) and in many cases have nothing to do with the blockchain or have a very limited understanding of it. It is unclear how quickly this will change, or if DAFs providing custody of digital assets will expand their AFSL to include custody for financial products. Even if they choose to do so, the current AFSL custody authorisation is already one for which it is difficult to demonstrate organisational competence due to the difficulty in finding people with this experience, especially outside of managed investment schemes.

In our view, consideration should be given as to whether all digital assets, whether financial products or not, should be custodied by DAFs under the DAF authorisation, given that DAFs are more likely to have in-depth knowledge and experience relevant to providing a secure custody solution for any kind of digital asset (whether a financial product or not). This approach will also mitigate opportunities for regulatory arbitrage and hopefully should encourage the market not to artificially design a product to either fall within or outside of either financial services laws or the proposed regime discussed in this Consultation Paper.

If it is considered appropriate for financial product digital assets to remain custodied under existing financial product rules, we suggest that when assessing organisational competence for custody for a business that proposes to only custody financial products that are digital assets, ASIC should have reference more to whether that AFSL can demonstrate competence in the custody of digital assets (as this format appears to present unique risks) than whether it can demonstrate traditional competence in the custody of those financial products, and that digital asset custody experience should be sufficient for a DAF to obtain a custody authorisation for financial products. It may be appropriate to limit such a custody authorisation to custody of the specified financial products in digital asset form only.

Intermediaries

We think it is appropriate for intermediaries to be a DAF if they provide a wallet and indefinite custody of digital assets. Alternatively, if intermediaries only provide transitory custody i.e. between liquidity providers and the customer, then custody of digital assets in this circumstance should be treated under client money / asset rules as set out in section 1.2 above, and should not trigger a need to hold an AFSL as a DAF and NTA requirements for custody.

Stock

We also assume, as nothing in the Consultation Paper suggests to the contrary, that a DAF or intermediary that has its own supply of digital assets (i.e. tokens of which it is the legal and beneficial owner) for trading or investment purposes will not:

- Need to hold its own tokens subject to custody arrangements; and
- Have the value of its own assets included for the purposes of the NTA calculation.

1.6 Outsourcing

Further, based on the current proposal, DAF providers will still be required to hold $5 million NTA if they outsource custody to someone who is not licensed in Australia. We suspect that this will raise issues for global businesses and local businesses who need to access global custody solutions, especially given there currently is no local market for digital asset custody in Australia. We propose that an approach similar to “APRA CPS 231 Outsourcing” should be considered, so that businesses have the option to custody overseas provided they ensure contractually that certain minimum protections are in place.

In addition, it is suggested that customers will need to contract directly with the custodian. This is highly unusual and does not reflect current outsourcing models in the financial services industry. This

requirement is a major disincentive to outsourcing custody and it removes any control the DAF has over its custody provider. We suspect the intent behind this is to protect customer assets in the event of insolvency. In our view, there are better ways to address this, and this could include robust client asset rules (similar to client money rules) that protect assets in liquidation, asset segregation, ring-fencing rules and providing customer step-in rights in certain circumstances.

1.7 Omnibus

While the Consultation Paper does not address how assets need to be held on trust, we presume DAFs will have the ability to hold all assets in one or more omnibus wallets[8] provided:

- Each wallet is a designated trust wallet;
- That wallet only holds customer assets and does not hold any corporate assets;
- The DAF maintains a general ledger that identifies what assets belong to which customers; and
- Regular reconciliations are performed.

This is similar to the relief currently provided for omnibus accounts in Regulatory Guide 133: Funds management and custodial services: Holding assets (**RG 133**).[9] However, significant accommodations will need to be made to better cater for digital assets given these cannot be held in a bank account. On this basis, we recommend that a new regulatory guide is developed for digital asset custody, instead of making changes in RG 133 to accommodate digital asset custody.

We acknowledge that this is an implementation point and probably best addressed in ASIC regulatory guidance. However, it would be preferable if the ultimate legislative instrument or explanatory memorandum contemplated this. Practically, it is better to have a legislatively set position on this rather than rely on ASIC reaching this outcome via regulatory guidance issued following a separate and additional consultation process.

1.8 Market rules

In designing market rules, it is critical to factor in the different types of markets for tokens:

- Operating a market – this is where buy and sell trades are matched via an order book (which may be automated); and
- Making a market – this is where the DAF will be the counterparty to all trades. This may involve either automation or OTC trades.

New markets type rules are proposed to apply to the trading of digital assets that are not financial products, while existing markets rules will continue to apply to digital assets that are financial products.

In our view, different market rules should apply to 'operating' and 'making' a market in digital assets and it is critical that any proposed market rules recognise the type of market being regulated, the risks associated with the market, the global nature of crypto markets and the immutability of crypto transactions. We are not market experts, but we suspect the risks associated with traditional markets do not necessarily exist for crypto markets – e.g. trust and settlement issues, market manipulation and transparent pricing. We encourage Treasury to further consult with exchanges in Australia to get a better understanding of the benefits and risks of crypto markets so that appropriate market rules can be designed and implemented.

[8] We understand that exchanges operate sophisticated wallet management systems that may involve using a number of omnibus wallets for both administrative, liquidity and security purposes. For example, an exchange may have a cold and hot wallet for each token listed on their exchange. Accordingly, it is important that any omnibus requirements contemplate that more than one wallet and type of wallet may be used.

[9] ASIC Regulatory Guide 133: Funds management and custodial services: Holding assets, 13 June 2022, paragraphs 133.150 to 133.162.

Further, it is unclear what rules will apply if a non-financial product digital asset is exchanged for a financial product digital asset or vice versa – will it be the token trading rules or the market rules? This needs to be further considered and one potential approach may be to apply the rules on one transaction side – i.e. the rules that should apply are the rules that apply to the type of asset being bought, not sold.

In addition, some financial products are currently illiquid because they are not tradeable on existing markets, for example, private debentures and interests in horse racing syndicates. Consideration should be given to whether, for products that cannot be traded (or cannot be efficiently traded) on existing Tier 1 or Tier 2 markets, it is appropriate to exclude these financial products from existing financial products markets regulation when in digital asset form, given the public benefit of creating efficient and accessible markets for these products on the blockchain.

1.9 Digital Asset Platforms

We understand that a digital asset platform is a multilateral asset holding arrangement where customers can transact. It is implied in one place in the Consultation Paper that this is a broader type of digital asset facility, but it is unclear, especially as the Consultation Paper later says a digital asset facility can only do one thing. That is, each DAF can only provide custody, offer token trading, offer token staking, or be in respect of one tokenisation project or one crowdfunding project.

We support the notion that each asset tokenisation project and each token crowdfunding project should be its own DAF. However, we do not think it is appropriate for custody, token trading, and token staking to be separate DAFs. We understand from working with our clients that token staking and token trading are fundamentally linked to the custody of the tokens, and that accordingly it makes sense for these three functions to be offered through one DAF.

Therefore, it is our view that a single DAF should be able to do:

- Any one or more of custody, token trading and token staking in combination; or
- One asset tokenisation project; or
- One token crowdfunding project.

We assume that multiple DAFs can be operated under one AFSL with the appropriate authorisations.

We also note that the Consultation Paper contemplates that multiple parties may participate in a DAF and that this is not an uncommon arrangement. We have never encountered this structure, with the exception of corporate groups that use different entities for different functions. We are unsure if this is the structure that is referenced here. However, whether it is or it isn't, we note that it seems counter-intuitive to have a multi-party DAF if a DAF can only provide one function, because generally there would need to be multiple functions in order for there to be multiple providers.

1.10 Minimum Standards for Asset Holding

We strongly encourage Treasury and ASIC to work and consult with industry on what are appropriate minimum standards for asset holding given the nascent industry, risks associated with DAFs and potential technology solutions. It is also critical that when designing any minimum standards, traditional custodian requirements are not applied as a given and there is a focus on determining what requirements appropriately manage the risks associated with custody of digital assets. For this reason, we would caution against automatically requiring compliance with standards such as SOC1 and SOC2 as these standards may not best fit the risks associated with DAFs. The fact that some Australian public exchanges have required custodians for crypto spot ETFs to comply with either SOC1 or SOC2 as part of the listing processes for ETFs should not change the need for an approach to be created from the ground up.

We are not technical experts so we cannot advise specifically on all the proposed *additional standards for token holders.* However, we note that the requirement for business continuity

arrangements for custody software service providers is reasonable and consistent with the requirements for other technological solutions in the financial services industry.

1.11 Stablecoins

The terms stablecoin can be used to refer to fiat backed and asset backed tokens. Given the proposed digital asset regulation and the forthcoming changes to stored value facilities, we believe the term 'stablecoin' should be a restricted term that should only be used for digital tokens that are backed by fiat. There may be different ways to achieve this and an analysis of this will need to be considered in more depth when consultation commences for stablecoins as part of the stored value facilities consultation process, which form part of the broader payment reforms.

1.12 Safe Harbour

We do not consider that there is a need for a safe harbour. While digital asset business may desire regulatory certainty, they are, in this respect, no different to any other business seeking regulatory certainty.

Other financial services business, especially fintechs developing novel solutions to real world problems, suffer the same issues that digital asset businesses do in determining how the regulation applies. To create a safe harbour for digital assets would be to provide that industry with special benefits as compared to other financial services business, and we do not consider this appropriate or necessary. Such an approach may also give rise to a number of problems, including creating a rules-based approach to regulation as opposed to principles-based rules. The risk with a rules-based approach is that it encourages conduct regulators to develop whitelists of digital assets that are not financial products and blacklists of digital assets that are financial products. This approach is fraught for a number of reasons:

- It is extraordinarily difficult to maintain whitelists and blacklists given the significant volumes of tokens, ongoing token changes and the emergence of new tokens;
- This approach is inconsistent with the current approach adopted for other products in the market;
- We query whether conduct regulators such as ASIC currently have the in-house expertise and capacity to be assessing such a diverse and large range of tokens against the financial services laws on an ongoing basis; and
- While it can be initially helpful to industry, it can become challenging as the conduct regulator may be able to take enforcement action simply on the basis a token is now a blacklisted.

The normal way in which certainty is garnered is through court decisions, and this takes some time after the advent of a new piece of legislation or the introduction of a new innovation like the blockchain. However, we note ASIC is currently litigating a number of cases involving digital assets and the court judgements for these are likely to provide useful insights to the regulatory perimeter of existing financial services law for digital assets.

We also note that ASIC usually does provide regulatory guidance on new areas of law that they are responsible for enforcing. ASIC published Information Sheet 225 Crypto-assets (re-issued in October 2021) to help industry understand which tokens may be financial products. However, we don't think this is sufficiently helpful to industry and following implementation of a regulatory framework for digital assets, we suggest that ASIC issue updated guidance (in the nature of a complete regulatory guide) that identifies the types of rights, entitlements and features that may cause a token to be a financial product and provides illustrative examples.

1.13 Low Value facility exemption

DAFs that hold assets below certain limits are proposed to be exempt from the requirement to hold an AFSL if:

- The total value of DAF entitlements held by any one client of the platform provider does not exceed $1,500 at any one time; and
- The total amount of assets held by the DAF provider does not exceed $5 million at any time.

This exemption is based on the exemption for NCPFs, however, while we support the notion of an exemption, we query whether the limits proposed are appropriate for DAFs. This is because the exemption for NCPFs is based on transactions in process – that is, there is a dollar limit per transaction and a total dollar limit for all transactions currently being processed. While a transaction is in processing, it counts towards the limit. Once the transaction completes processing, that part of the limit becomes available again to be re-used. This approach doesn't necessarily suit an asset holding arrangement as the function is not transactional, but rather static.

For this reason, in our view, there should not be any individual account limits, and additionally we query what is an appropriate total limit for DAFs. A good starting point may be the current and proposed dollar limits for stored value facilities which, as an arrangement that holds fiat indefinitely until an instruction is received, seems more analogous to a token asset holding arrangement.

Another important issue is how to value the total assets of a DAF given a DAF will hold assets which may be illiquid or volatile. Providers of non-cash payment facilities and stored value facilities can easily operate within limits as the value of the assets (being fiat currency) does not generally change, whereas a DAF could exceed the limit for no other reason that because the market has a good day.

A more appropriate method might be to allow for a buffer by which the assets can exceed the threshold on a temporary basis, by performing the calculation over a rolling period (for example, a 30, 60 or 90-day rolling average) and / or a grace period to rectify exceeding the threshold before a breach is considered to have occurred.

1.14 Licensing requirements

Competency

We understand that an AFSL for a DAF will be subject to the same competency requirements as other AFSLs. We support this and agree it is appropriate, but suggest that:

- To facilitate transitional arrangements, experience operating a digital asset business that provided custody services or the regulated financialised functions before the inception of the new regime should be accepted to demonstrate competency for AFSL purposes;
- If financial product digital assets will remain subject to the existing financial product custody regime, that experience providing digital asset custody services be considered relevant to obtaining a custody authorisation for financial products that will be offered as digital assets.

However, we note that organisational competency requirements on responsible managers are managed through ASIC regulatory guides and not through the Corporations Act and it will be necessary for ASIC to work with industry in ensuring that the competency requirements are suitable.

Compensation Arrangements

Under the current financial services regime, having adequate compensation arrangements is a requirement for many businesses that provide financial services to retail clients, and currently the only acceptable way of demonstrating compliance is to take out a complying policy of professional indemnity insurance with an APRA regulated insurer.

Licensees are able to apply to ASIC for relief, but in our experience, ASIC is generally reluctant to approve other arrangements.

We are concerned that if compensation arrangements are mandated for DAFs in the form of professional indemnity insurance, there is no real market for this product at this point in time. Few businesses have been able to source policies to date, but these are either:

- For very small-scale businesses which can be demonstrated to be low risk;
- Very narrow policies which are unlikely to meet many of the requirements that currently exist for AFSLs; or
- Extraordinarily expensive given the narrow and limited risk protection provided by insurers (and likely unaffordable outside of larger more well-established crypto businesses).

Many insurers simply won't offer terms as soon as they hear "cryptocurrency". Those that are willing to discuss it often have real misconceptions that are a struggle to correct in order to provide for a genuine risk assessment of the insured business. When terms are offered, they are frequently not merely expensive, but genuinely unaffordable, or there is no willingness to provide coverage. It is unclear how much (or when) the market will shift if DAFs suddenly require PI insurance for AFSLs. We note that an insurance market will not simply materialise just because regulatory reform may impose insurance requirements.

On this basis, we urge Treasury to consider legislating alternative compensation arrangements, such as the security bonds that were a feature of the early financial services regime, discretionary mutuals set up for the digital asset industry, and self-insurance arrangements for asset-rich DAFs. Otherwise, DAFs will each need to apply to ASIC for separate relief from the requirement to hold PI insurance and for ASIC to approve any alternate compensation arrangement.

1.15 Financial Requirements

A DAF is proposed to need to hold $5 million net tangible assets unless the facility outsources custody. If the facility outsources custody, the facility will still need to hold 0.5% of the value of the DAF. This amount is considered appropriate to cover the administrative costs of an orderly wind-up. We do not have any insights to offer in terms of the costs of an orderly wind-up, so insofar as we can determine, the requirement appears reasonable but may not reflect the actual cost of an orderly wind-up.

It is unclear how the 'value' of the DAF will be calculated for the purposes of calculating NTA. Presumably the value of all tokens in an asset holding arrangement need to be counted, even if custody has been outsourced, but the issue with valuing the assets of the DAF for the purposes of the NTA calculation that we highlighted for the low value exemption (see section 1.13) will equally apply to this calculation. That is, if assets are illiquid or volatile, what value is to be attributed to them and is there an expectation of continuous real-time monitoring of value?

As outlined earlier in this submission (see section 1.2), we think that if a broker operates digital wallets and holds digital assets in custody indefinitely (or if they are in fact the counterparty to the trade and so not a broker at all), then they should need an AFSL to operate a DAF and be subject to the NTA requirement (where relevant), but brokers who are acting as a true intermediary and are just passing assets to the customer should not be.

We do think it is appropriate for true intermediaries to be subject to other requirements in lieu of the NTA requirement, like an obligation to hold digital assets in a designated trust wallet(s), to only hold the assets for a short period of time, and to always have on file an address to which to send a customer's digital assets. This would align the treatment of digital assets in the intermediary's possession with the treatment of the fiat money that the intermediary handles. Similarly, true intermediaries should be subject to a surplus liquid funds requirement on identical terms as applies to other financial services intermediaries who hold more than $100,000 of client money or property at any one time. We also recommend that similar liquid surplus funds requirements be imposed on any DAFs that will be subject to client money rules in relation to account pre-funding.

In addition, we note that all AFS licensees are required to meet certain base-level financial requirements including:[10]

- Solvency and net positive asset requirements;
- Cash needs requirements; and
- Audit requirements.

We think that it is appropriate for DAFs to also meet these requirements. We also note that AFS licensees that transact as principal need to meet adjusted surplus liquid funds (**ASLF**) requirements.[11] It is unclear if the ASLF requirement would apply to DAFs in respect of the 'financialised functions' or not. In our view, it should, although if the DAF also provides custody, it is likely the NTA requirement will represent the higher threshold.

1.16 Conflicted Remuneration

It is proposed in the Consultation Paper that the conflicted remuneration provisions in Division 4 of Part 7.7A of the Corporations Act will apply. We assume this will be the traditional model of conflicted remuneration, which applies when an AFS licensee or representative provides financial product advice to retail clients (in this case in relation to DAFs) and not the life insurance model, which applies when advising, dealing or referring. We note that the conflicted remuneration provisions will not apply to any digital assets as these assets are not financial products.

We suspect that the advice requirements will apply to any opinion or recommendation provided in relation to accessing a financialised function via a DAF. However, this may need further clarification given the DAF is the financial product and not the financialised function. This is a similar point to that which we raised in section 1.1 above in relation to introducing special dealing activities to capture the financialised functions.

Conceptually, we are comfortable with this approach provided that:

- Clarity is provided as to who is a retail client vs a wholesale client for DAFs (please see section 2.3 below);
- The conflicted remuneration provisions will not apply to mere referrals; and
- The conflicted remuneration provisions will not apply when a licensee or representative merely provides dealing activities.

1.17 Hawking

It is proposed in the Consultation Paper that the hawking requirements in Division 8 of Part 7.7A of the Corporations Act apply to DAFs. We think this is sensible and do not have any concerns with this.

1.18 Design and distribution obligations (DDO)

The Consultation Paper proposes that DAFs and distributors will need to comply with the DDO requirements in Part 7.8A of the Corporations Act. This will involve the DAF preparing a 'target market determination' (**TMD**) in relation to the facility contract itself, which would consider the costs and features of the platform, as well as the types of digital assets made available. Ordinarily, a TMD is prepared for the product, not the terms of the product (i.e. PDS). Accordingly, we anticipate that any TMD will apply to the relevant DAF.

Further, we understand that at a Treasury roundtable for exchanges it was proposed that the TMD requirement would require DAFs to determine the risk of their facility based on the types of tokens and services made available through it. We are concerned that this approach is not practical and will give rise to issues from a compliance point of view. We are also concerned it may result in DAFs that

[10] ASIC Regulatory Guide 166: AFS licensing: Financial requirements, 7 September 2023, paragraph 166.2.
[11] ASIC Regulatory Guide 166: AFS licensing: Financial requirements, 7 September 2023, section D.

list certain tokens that are considered risky being unable to distribute any tokens on the DAF to retail clients because the DAF itself is now classified as unsuitable for retail clients merely because of the presence of risky tokens.

As Treasury would appreciate, there are thousands of tokens available in the marketplace and some exchanges have hundreds of tokens available. These tokens can vary from stablecoins, alt coins, NFTs and others. Each token is bespoke, and the risks associated will differ accordingly. It is quite clear that Treasury is not seeking to regulate digital assets themselves given the approach adopted in the Consultation Paper. However, requiring a TMD to have regard to the types of tokens will invariably result in quasi regulation of tokens and we don't believe this is appropriate.

Over the past 12 months, ASIC has taken a hardline stance in relation to how an issuer characterises the risks associated with their financial product. This has been the subject of many of the product intervention orders and enforcement actions ASIC has taken this year. We foreshadow this being a more acute and contentious issue for DAFs if the risk assessment piece for the TMD needs to have regard to the tokens available and their respective risk profiles. We are of the view that grouping tokens into different risk classes will not resolve this – it is simply too complex, artificial and unwieldly to manage on an ongoing basis.

We note that the approach proposed in the Consultation Paper is not required for other platforms that provide access to a range of financial products. For example, a TMD for an IDPS does not require a risk rating for the IDPS based on all the different types of investments available on the investment menu. Rather, the individual PDS for each investment addresses the risk level. We acknowledge this approach will not be available for digital assets that are not financial products as a PDS will not be required. However, we don't think risk rating at the token level is helpful and may provide customers with a false sense of risk.

This is something that Treasury should be mindful of and consider in the context of the application of DDO, particularly in light of the risk lens ASIC applies in its enforcement of DDO. A better approach would be to move away from risk ratings and to require TMDs for DAFs to identify all the material risks for the target market. This would require extensive risk disclosure and we believe this approach is more suitable and in line with international practice.

1.19 Facility Guides

We conceptually agree with the approach that a DAF is required to prepare a Facility Guide. We disagree that a separate Facility Guide should be required for each DAF function for the reasons outlined above in section 1.9. Accordingly, we recommend that a separate Facility Guide be required for:

- Asset holding, trading and staking; and
- Each separate asset tokenisation and crowd funding project or initiative.

We also strongly recommend that Facility Guides require simple and high-level disclosure and that all efforts be made to ensure that the Facility Guide is a short-form disclosure document and that it's not overly complex, long and cumbersome to read.

In this regard, we refer to the reference in the Consultation Paper to the Facility Guide containing "references and links to the full disclosure". In our experience, this requirement can result in extraordinarily long disclosure documents that do not add much benefit to the reader, especially given that disclosure is not a cure all. A better approach is to ensure that the facility has a TMD and that the TMD identifies the service and the risks associated with it.

1.20 Facility Contracts

Subject to our comments in section 1.22 below, we conceptually agree with the approach taken to Facility Contracts in the Consultation Paper. We also refer to our comments in relation to Facility

Guides in section 1.19 and suggest that Facility Contracts be prepared on a similar basis such that a Facility Contract is required for:

- Asset holding, trading and staking; and
- Each separate asset tokenisation and crowd funding project or initiative.

In addition, we note that as currently proposed Facility Contracts do not enable any discretionary trading. We are aware that there may be some providers in the market that do provide discretionary trading solutions and rebalancing options based on an agreed mandate. It is not clear if there is any intent to capture these models and, if so how, given tokens will not be subject to any advice requirements.

Further, the Consultation Paper proposes that there should be a set of transparent and non-discriminatory criteria governing "fees, commissions, rebates or benefits paid or received by users and platform providers" (**Fees and Charges**). It is possible that a DAF may provide different trading options order book matching, OTC and broking via the one DAF. The Fees and Charges may vary depending on the trading option selected and we believe that this should be contemplated and not prohibited.

1.21 Listing criteria

We think it is sensible that DAFs develop listing criteria for tokens that will be accessible through a DAF as part of the DAFs broader risk and compliance frameworks to ensure compliance with financial service laws.

However, we are concerned that the proposed requirement to have listing criteria, submit that criteria to ASIC and publish a summary of the listing criteria is not appropriate and out of step with the requirements that apply to existing financial products. IDPS providers are not required to publish similar information about how they add products to their approved product lists. It is simply a matter for the provider to have a process to do this and an up to date approved product list. We do not see any reason for DAFs to have greater obligations than IDPSs and recommend that these requirements be removed.

1.22 Token disclosures

We agree with the proposal that a copy of the disclosure document for a digital asset that is a financial product should be provided to customers. We believe that the appropriate way of doing so is to refer to the disclosure in the Facility Guide in a manner similar to how IDPS Guides do for financial products. We do not think it is necessary for this to be added as a legal obligation as proposed in the Facility Contract as the disclosure requirements for Facility Guides can address this. In addition, we do not think it is appropriate for the Facility Contract to include an obligation to provide any document outlining the rights and obligations of any digital assets that are not financial products, which are available in the DAF. In our view, a better approach is for the DAF to provide links to the whitepapers or information on the DAF in a manner that is readily accessible.

Finally, we do not think it is appropriate for the DAF provider to be required under the Facility Contract to provide a summary of digital assets that do not have any entitlements. Again, the DAF should provide links to publicly accessible information in a manner that is readily accessible.

1.23 Asset Tokenisation

Businesses that wish to tokenise assets will need to hold an AFSL as a DAF because they will hold in custody the assets that back the tokens and will perform the financialised function of asset tokenisation. In our view, it is appropriate for token issuers to be able to operate their own DAF for their asset tokenisation project and that there is no need for asset backed tokens to be intermediated via a DAF.

Once an asset backed token has been minted, any platform that facilitates trading or token staking in respect of that asset-backed token will also be a DAF and will need to hold an AFSL and comply with the proposed regulatory requirements.

In our view, it is appropriate for all DAFs involved in the digital asset value chain to be subject to the proposed regulatory regime for asset tokenisation.

We assume that the authorised representative regime will apply to providers of DAFs in the same way it does to other financial products. Generally, custody cannot be done as authorised representative (because an authorised representative acts on behalf of its licensee, and custody is a service that is provided as a principal). The exception is where the licensee is the primary custodian, and then outsources it to its own authorised representative. It is unclear if this will be available to DAFs, due to the fact the customer has to enter into a contract directly with the outsourced custodian. In our view, this structure should be available, as some asset tokenisers use a separate company to provide custody, so that the assets backing the tokens are held separately by an entity that does nothing except custody of the assets and so is less exposed to insolvency risks and provides greater consumer protection. If this structure is not available, it may incentivise asset tokenisers to use simpler models that offer less consumer protection in order to avoid duplicative AFSL requirements.

We are also aware of some intermediary businesses that exist that will allow a consumer to bring their own real world asset and tokenise it. It is unclear if these operators are contemplated by the asset tokenisation rules, and therefore won't be regulated.

1.24 Crowdfunding

Any projects that wish to raise funds via a token issue will be intermediated via a DAF and subject to a number of requirements. This approach is similar to the crowd funding regime in Chapter 7 of the Corporations Act. However, the financialised function of crowdfunding does not facilitate direct capital raises similar to those permitted under Chapter 6C of the Corporations Act, which involve the issue or sale of securities (which are financial products) as these will remain regulated as financial products.

This proposal may impact the way in which industry currently funds crypto projects and may result in the outflow of crypto projects offshore. At the same time, we acknowledge the need to address risks like pump and dump schemes.

An alternative approach to the proposed crowdfunding requirements may be to enable projects to directly raise capital via an initial coin offering (**ICO**) without a DAF licence, provided the project will not hold any of the tokens issued as part of the ICO (i.e. provide a custodial wallet), on a basis that is similar to the self-dealing exemption for capital raises. If a project will hold tokens issued as part of an ICO, then it would make sense for the project to be regulated as a DAF and comply with the proposed licensing and regulatory requirements.

If a self-dealing exemption is permitted for ICOs as suggested, the question arises whether any limits on the total number or value of tokens issued or sold via an ICO should be imposed. This is because the current self-dealing exemption for securities is predicated on the basis that the capital raise is not a 'public offer'. As ICOs are usually public, replicating a public offer requirement may be challenging (although not impossible – it would merely require ICOs to be offered in a more limited way). However, it may be appropriate to not use the 'no public offer' requirement and instead limit or cap the scale of the offer and / or require certain disclosure documents.

In circumstances where an ICO may be launched outside of a DAF, it will be important to consider whether and what disclosures should be mandated. For security capital raises, a prospectus is required unless an exemption applies. For ICOs, it may be appropriate to require a shortform and basic disclosure document subject to exemptions. For example, a disclosure document may not be required if the project raises funds under a dollar threshold or from certain investors (e.g. wholesale, sophisticated or professional clients). Similar exemptions currently exist for securities and may be a helpful starting point.

We also think it is worthwhile considering whether any ICO (whether direct or intermediated via a platform), should be subject to the same disclosure requirements. This will provide consistency with project fundraising and mitigate any potential regulatory arbitrage.

2. Issues not addressed in the Consultation Paper

We understand there is an intention to defer some issues for regulation at a later date, after initially implementing a foundational regime for digital assets. While we appreciate the tension between regulating something and providing (albeit imperfect) consumer protection and delaying regulation to implement a more ideal model but exposing consumers to further harm, we have flagged below matters for Treasury's consideration either now or in the future.

2.1 Decentralised

The Consultation paper does not specifically address decentralised autonomous organisations (**DAOs**) and it is not clear whether DAOs will be separately regulated at a future time. This is still a gap that needs to be considered in light of approaches adopted in other jurisdictions.

This is important as we assume that the test for 'factual control' will be when a legal person has that factual control. It is possible a DAO may be caught by the regulatory regime if they are not sufficiently decentralised and can exercise factual control via transaction validation or governance proposals. In this case, the question remains of what is a DAO legally? This needs to be explored further as it may dampen Australian innovation efforts and give rise to potential enforcement issues. For example, Australian innovators may be less likely to launch DAOs onshore as it can take some time for a DAO to sufficiently decentralise (i.e. have a large number of unique nodes/validators across a range of geographies). It may also disincentivise Australians from participating in DAOs if there is a risk that their activities will be caught and may give rise to some form of personal liability. There is currently uncertainty as to the degree of any liability due to differing views (and no case law in Australia) on the legal nature of a DAO.

2.2 Representatives

The Consultation Paper does not address whether the current representative model for AFSLs will equally apply to DAFs. At present, certain financial services can be provided by representatives that are authorised by an AFS licensee under section 911B. The representative model is often used by intermediaries, and we do not see any reason why DAFs should not be able to appoint authorised representatives. However, we do not think that DAFs should be able to operate as an authorised representative, because operating a DAF appears to be an activity one does in one's own right (like making a market, which is also an activity that cannot be done as an authorised representative).

Some consideration should be given to how a DAF can appoint an authorised representative. That is, if a DAF has an authorisation like 'operate a DAF', can they appoint an authorised representative to 'deal in a DAF' if they hold that authorisation, or will they also need to have 'dealing' authorisations in relation to DAFs to appoint agents, for example.

2.3 Wholesale vs retail clients

The Consultation Paper also does not address whether the DAF licensing regime will distinguish between wholesale and retail clients and, if so, what this will be relevant to and what wholesale client tests should apply.

We are of the view that there should be no exemption from the need to hold an AFSL when providing a DAF only to wholesale clients – that is, *all* clients should have the benefit of the regulatory protections for asset holding. However, as is the case for other financial products, we do believe that status as a wholesale client should change the application of certain regulatory requirements such as those for advice, disclosure, hawking and conflicted remuneration. Specifically, we do not consider that the following should apply to wholesale clients:

- Facility Guide and Facility Contract;
- Design and distribution obligations;
- Any best interest duty when providing advice on a DAF;
- Conflicted remuneration when advising on a DAF; and

- Hawking rules.

Accordingly, it will be necessary to consider what wholesale client tests are relevant and appropriate.

In our view, many of the available wholesale client tests will not be easily accessible for DAFs as:

- The product value test of $500,000 is unlikely to be triggered in its current form and it will be necessary to determine whether a different dollar amount should be used;[12] and
- The sophisticated client test is predicated on a PDS being provided and it is currently proposed that a DAF will need to provide a Facility Guide and Facility Contract, not a PDS.[13] If DAFs were to have the ability to access this test, then section 761GA will need to be amended to also include Facility Guides and / or Facility Contracts.

We believe that net income and net asset test is likely to be the most appropriate wholesale client test.[14] However, regard should be had to whether any bespoke tests are required for DAFs given the nature of the facility and financialised functions that will be provided through DAFs.

2.4 De-banking

The Consultation Paper does not consider or address the current issues facing the sector more broadly in relation to maintaining banking relationships. This is an important issue, as the client money rules are proposed to apply to DAFs, and those rules require that a licensee establish a designated trust account with an ADI. As it currently stands in the industry, most DAF licence applicants would be unable to establish a complying client money account, having been debanked, which will functionally render them unable to operate in a future licensed environment.

There is generally an unwillingness for any banks in Australia to provide banking services to this sector. We are aware that crypto businesses currently operating with an AFSL for other regulated financial products continue to run into banking difficulties and we anticipate this continuing in the future. Accordingly, it follows that just because a licensing regime for DAFs is established, it does not mean that banking practices will change or follow and there is no evidence to suggest that the requirement to hold an AFSL will suddenly motivate the banks to change their risk tolerance, particularly in light of the focus on scams in the crypto industry.

We think that there is an opportunity for Treasury to further address the banking issues that continue to subsist in the industry and it may be worth looking to other jurisdictions to see how they are addressing this. We understand that other jurisdictions particularly in Asia have developed a collaborative relationship between regulators, banks and the crypto industry to innovate and work together. We strongly recommend that a similar approach be adopted with any proposed roll out of the licensing regime for DAFs.

2.5 Non-custodial wallets

Currently, under the Consultation Paper, non-custodial wallets do not appear to fit within the proposed regulatory regime. It is not clear if the intention is for these types of wallets to be captured under the proposed regulation or if the intention is instead for these to be unregulated. Under the proposed regulation, a customer that is transacting through their non-custodial wallet would not be subject to any protections under the regime until such time as they received a service that involved a DAF either providing custody or some other financialised function. It is also unclear what Treasury would consider to be a non-custodial wallet and whether this would capture white-labelled non-custodial wallets provided by platforms e.g. gaming platforms.

[12] Section 761G(7) *Corporations Act 2001* (Cth).
[13] Section 761GA(f) *Corporations Act 2001* (Cth) and Part 7.1 Division 2 *Corporations Regulations 2001* (Cth).
[14] Section 761G(7)(c)(i) *Corporations Act 2001* (Cth) and regulation 7.1.28 *Corporations Regulations 2001* (Cth).

2.6 Bitcoin ATMs

The Consultation Paper does not specifically address Bitcoin ATMs and whether these ATMs will be a DAF. We understand that a number of Bitcoin ATMs currently exist in the market and that these ATMs require customers to connect their non-custodial wallet to trade Bitcoin (whether buy or sell). For these ATMs, we are of the view that the ATM is unlikely to provide custody, but is likely to provide the financialised function of trading. However, this should be clarified before the legislative drafting process commences.

3. Concepts and Provisions for Further Consideration

3.1 Future considerations

We note that margin lending for tokens, collateralised loans and debenture-like arrangements are not proposed to be dealt with in the initial round of regulation, but may be future subjects of regulation.

We understand the need to balance consumer protection with the delays required to produce comprehensive legislation. However, we note that products of this type are high-risk and are currently at the forefront of ASIC's enforcement action, with judgements pending or cases waiting to be heard on a number of structures that fall within these classifications. Some of these structures are definitely not regulated:

- Margin lending for digital assets (with the exception of an outstanding question about whether these products are subject to DDO) and collateralised lending (other than for a personal, domestic or household purpose), are both credit for investment purposes and not subject to the consumer credit regime;
- Debenture-like structures usually avoid regulation as a debenture because the loan made is not 'money' as defined.

These products clearly have a financial product purpose as they are functionally identical to existing financial products:

- Margin loans for digital assets are analogous to margin loans for securities;
- Collateralised lending (other than those likely subject to consumer lending regulation) is often structured in ways that are analogous to non-standard margin lending for securities (otherwise known as 'securities lending'); and
- Debenture-like structures are analogous (as the name implies) to debentures.

If these products are not, as a result of various court judgements, brought within the definition of 'financial product' (which seems likely for at least some of these structures, for which this question is not really before the courts at present), and they are also not regulated under this digital asset regulation, then some of the highest risk digital asset structures and products currently on the market will not be regulated at all in any way, shape or form and consumers will continue to be vulnerable to these arrangements. This is important as staking product solutions may be designed as a debenture-like structure may continue unregulated either under financial services laws or the proposals in the Consultation Paper.

While we acknowledge that the Consultation Paper notes these may be the subject of future regulation, unless a specific review or consultation is already contemplated (as is the case for stablecoins under the Payment Framework Review), the reality is that any future consideration of regulating these products will be a number of years away.

4. Response to Consultation Questions

We have provided responses to the specific Consultation Questions proposed by Treasury, to the extent that we are qualified to respond.

Set	Questions	Responses
1	Prior consultation submissions have suggested the Corporations Act should be amended to include a specific 'safe harbour' from the regulatory remit of the financial services laws for networks and tokens that are used for a non-financial purpose by individuals and businesses. What are the benefits and risks that would be associated with this? What would be the practical outcome of a safe harbour?	We have provided a summary of the full response we outlined in section 1.12 of our submission. We do not consider it appropriate or necessary for safe harbour provisions to be included. While industry will always desire the certainty created by it, no other financial services sector has a safe harbour and would amount to special treatment in favour of the digital asset industry. It is not appropriate to provide a favourable safe harbour for digital assets, when it is apparent that other fintechs struggle with the same issues around the regulatory perimeter.
2	Does this proposed exemption [low value facility exemption] appropriately balance the potential consumer harms, while allowing for innovation? Are the proposed thresholds appropriate? How should the threshold be monitored and implemented in the context of digital assets with high volatility or where illiquid markets may make it difficult to price tokens?	We have provided a summary of the full response we outlined in section 1.13 of our submission. This proposed low value facility exemption is based on the exemption that exists for NCPFs. We support having an exemption in place, however, do not believe the limits proposed are appropriate. The NCPF exemption relies on the fact that transactions are continuously processed and therefore cleared. However, this approach is not suited to asset holding arrangements. Instead, we think it would be more appropriate to have limits that are more closely aligned with stored value facilities. Additionally given the difficulty in establishing the value of highly volatile digital assets, a rolling period is used to calculate the value of the facility and a grace period is contemplated.
3	What would be the impact on existing brokers in the market? Does the proposed create additional risk or opportunities for regulatory arbitrage? How could these be mitigated?	We have provided a summary of the full response we outlined in sections 1.2 and 1.3 of our submission. Intermediaries in the industry currently consist of agent and brokers. However, we do not think that brokers currently operate in a manner that is consistent with the broker model for other financial products. Currently, some brokers act as a counterparty to the trade and source liquidity from third party

Set	Questions	Responses
		providers to fulfill trades. Where brokers continue to operate like this, they will be captured by the proposed regulatory regime and this is appropriate. However, if a broker operated in the same way as other brokers in other financial services (i.e. arranging on behalf of the customer to trade on an exchange for the benefit of the customer), a more tailored licence authorisation would be required. In particular for brokers, they would be applying for, acquiring, varying or disposing of a DAF. Where these brokers operate custodial wallets, they are likely to be a DAF in their own right and need a relevant authorisation. However, where brokers do not operate custodial wallets and only deal in tokens in transit, it is unclear what rules would apply to these types of operators. We do not think it is necessary for them to be regulated as a DAF, but there should be in place temporary asset holding rules (akin to client money rules). We posit that these asset holding rules may: • require any assets in transit to be held in a wallet with a DAF that is "designated" as an intermediary trust wallet; • impose a time limit on the holding of these assets, such as the rule that is imposed in respect of premium refunds, which requires brokers to remit premium refunds to the person entitled to it within 7 days of receipt; and • require any assets held in an intermediary trust account to be segregated from all other assets and protected from insolvency, as are client monies. We are also of the view that the term "broker" as it relates to digital assets should be a restricted term and only available where authorised under a licence and where the broker is acting a true intermediary on behalf of the customer.
4	Are the financial requirements suitable for the purpose of addressing the cost of orderly winding up? Should NTA be tailored based on the activities performed	We have provided a summary of the full response we outlined in section 1.15 of our submission. We do not have any additional insight into the

Set	Questions	Responses
	by the platform provider? Does the distinction between total NTA needed for custodian and non-custodian make sense in the digital asset context?	adequacy of the NTA requirement to manage an orderly windup, but not it may not reflect the actual costs of an orderly wind-up. We do not believe it is clear how the value of a DAF is determined for the purposes of the NTA requirement given the difficulty in determining the value of the assets given their volatility or lack of liquidity. We note that there is no current requirement for surplus liquid funds or adjusted liquid surplus fund requirements to be imposed on DAFs that either hold client money or act as principal.
5	Should a form of the financial advice framework be expanded to digital assets that are not financial products? Is this appropriate? If so, please outline a suggested framework.	No. We do not consider this appropriate, as it deviates from the "same thing, same treatment" principles. See our further comments on advice in section 1.3 of our submission.
6	Automated systems are common in token marketplaces. Does this approach to pre-agreed and disclosed rules make it possible for the rules to be encoded in software so automated systems can be compliant? Should there be an ability for *discretionary* facilities dealing in digital assets to be licensed (using the managed investment scheme framework or similar)?	We do not have any comment on this question.
7	Do you agree with the proposal to adopt the 'minimum standards for asset holders' for digital asset facilities? Do you agree with the proposal to tailor the minimum standards to permit 'bailment' arrangements and require currency to be held in limited types of cash equivalents? What parts (if any) of the minimum standards require further tailoring? The 'minimum standards for asset holders' would require tokens to be held on trust. Does this break any important security mechanisms or businesses models for existing token holders? What would be held on trust (e.g. the facility, the platform entitlements, the accounts, a physical record of 'private keys', or something else)?	We have provided a summary of the full response we outlined in section 1.10 of our submission. We think that it is necessary to consult with industry on the appropriate minimum standards for asset holding given the unique risks that apply to DAFs relative to other traditional custodians. We agree that bailment arrangements should be permitted. To prevent them limits the potential to tokenise real world assets, which has real value and benefits (including making assets tradeable in ways they are not off-chain). Additionally, if bailment arrangements exist off chain, it is difficult to see why they should not be permitted on-chain, as the risk attaching to the bailment does not change (the risk attaching to token custody etc does, which is why we agree there should be regulation of asset

Set	Questions	Responses
		holding). We have no comment on the security mechanisms that apply to tokens being held on trust.
8	Do you agree with proposed additional standards for token holders? What should be included or removed?	Yes, but we strongly encourage Treasury to further consult with industry on the proposed technology standards. This is because these standards may be difficult and give rise to issues for tokens already in circulation.
9	This proposal places the burden on all platform providers (rather than just those facilitating trading) to be the primary enforcement mechanism against market misconduct. Do you agree with this approach? Should failing to make reasonable efforts to identify, prevent, and disrupt market misconduct be an offence? Should market misconduct in respect of digital assets that are not financial products be an offence?	We have provided a summary of the full response we outlined in sections 1.21 and 1.22 of our submission. We believe it is sensible for DAFs to have listing criteria and to make relevant token disclosures. However, the requirements that are proposed appear to be out of step with existing financial products and believe that the system should better mirror IDPS providers who are only required to have in place a process for adding new products and an up to date approved product list. We think that token disclosure requirements should not exceed that of other financial products and it is appropriate to ensure that whitepapers or information about tokens are merely readily accessible to customers, rather than to require every document outlining the rights and obligations of products that are not financial products to customers by a DAF. The role that DAFs play as an exchange is limited, they are rarely the token issuer and are not able to necessarily source all documentation about any given document. In many cases a token does not have any information readily available. It would be incredibly burdensome and impossible for a DAF to achieve a real time up to date database of all documentation relating to the tokens that are traded via the DAF. Whilst we believe that all DAFs will endeavour to minimise market manipulation, we think it may only be appropriate for trading platforms to be required to make reasonable efforts to identify, prevent, and disrupt market misconduct. However, this will require greater collaboration between market regulators and the industry to facilitate. It will also need to have regard to the nature of crypto markets and the different ways in which crypto is traded –

Set	Questions	Responses
		operating a market (order book matching), making a market (OTC and counterparty to the trade) and broking a trade.
10	The requirements for a token trading system could include rules that currently apply to 'crossing systems'[15] in Australia and rules that apply to non-discretionary trading venues in other jurisdictions. Do you agree with suggested requirements outlined above? What additional requirements should also be considered? Are there any requirements listed above or that you are aware of that would need different settings due to the unique structure of token marketplaces?	We do not have any comment on this question. We strongly recommend that Treasury further consult with industry on this and, in doing so, have regard to the nature of crypto markets and the different ways in which crypto is traded – operating a market (order book matching), making a market (OTC and counterparty to the trade) and broking a trade.
11	What are the risks of the proposed approach [staking]? Do you agree with suggested requirements? What additional requirements should also be considered? Does the proposed approach for token staking systems achieve the intended regulatory outcomes? How can the requirements ensure Australian businesses are contributing positively to these public networks?	We agree with the proposed approach regarding staking. However, we encourage Treasury to consider whether debenture-like products should be regulated as these products may be used for staking solutions. Please refer to section 3 above for more detail.
12	How can the proposed approach [asset tokenisation] be improved? Do you agree with the stated policy goals and do you think this approach will satisfy them?	We agree with the proposed approach and draw additional attention to our comments in section 1.23 of our submission. We note that Treasury has clarified in roundtables that asset tokenisation will not need to be intermediated via a DAF but rather that any person that asset tokenises can and will be regulated as a DAF and must obtain a licence.
13	Is requiring digital asset facilities to be the intermediary for non-financial fundraising appropriate? If so, does the proposed approach strike the right balance between the rigorous processes for financial crowdsource funding and the status quo	We agree with the proposed approach and draw additional attention to our comments in section 1.24 of our submission in relation to exemptions and limits for fundraising.

[15] Like crossing systems, token trading occurs 'off-book' from the perspective of a network observer. See Market Integrity Rules 2017 for the rules that apply to crossing systems.

Set	Questions	Responses
	of having no formal regime? What requirements would you suggest be added or removed from the proposed approach? Can you provide an alternate set of requirements that would be more appropriate?	
14	Do you agree with this proposed approach [custody only arrangements]? Are there alternate approaches that should be considered which would enable a non-financial business to continue operating while using a regulated custodian?	Yes, we agree with this approach. However, please refer to sections 1.5, 1.6, 1.7, 1.15, 2.2 and 2.5 in relation to issues, challenges and gaps we have identified with the proposed approach to custody.
15	Should these activities or other activities be added to the four financialised functions that apply to transactions involving digital assets that are not financial products? Why? What are the added risks and benefits?	We think it is appropriate for debenture-like arrangements and margin lending like arrangements to be regulated in some form. Please refer to section 3 for more detail.
16	Is this transitory period appropriate? What should be considered in determining an appropriate transitionary period?	We consider the transition period to be appropriate, but it should work on the basis that digital assets businesses applying for an AFSL should be permitted to continue trading after the end of the transition period, provided they have lodged an AFSL application with ASIC, up until such time as ASIC makes a decision on the application. This approach has been used in the last few transitions (including claims handling and settling services and debt management services) and we think it balances consumer protection with the realities of resourcing a new wave of licensing with the need for businesses to be able to continue to operate.