HOLLEY NETHERCOTE
LAWYERS

Our Ref JV:KT:14706

27 May 2022

Email: crypto@treasury.gov.au

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

Dear Director,

RE: Crypto asset secondary service providers consultation

Thank you for the opportunity to provide feedback on Treasury's consultation paper *'Crypto asset secondary service providers: Licensing and custody requirements'* (**the Consultation Paper**).

We support improvements to the regulation of crypto assets in Australia, which we see as critical to providing regulatory certainty to crypto businesses and improving consumer confidence in the sector. While we are broadly supportive of the licensing and custody obligations set out in the Consultation Paper, there is still significant uncertainty about how the proposed regime would interact with existing financial services laws and the Australian Financial Complaints Authority (**AFCA**). Furthermore, it is unclear if and how advice and dealing conduct in relation to crypto assets would be regulated under the proposed regime.

Our approach in this submission is to highlight areas of potential regulatory uncertainty, particularly where the proposed crypto asset secondary service provider (**CASSPr**) regime would potentially overlap with other financial services laws.[1]

We also explain our view on why we think "alternative Option 1: Regulating CASSPrs under the financial services regime" is the better option presented in the Consultation Paper.

We have provided further feedback in response to the consultation questions below.

[1] Such as the *Corporations Act 2001* (**Corporations Act**), *Australian Securities and Investments Commission Act 2001* (**ASIC Act**), *National Consumer Credit Protection Act 2009* (**NCCP Act**) and *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (**AML/CTF Act**).

ABOUT US

Established since 1995, Holley Nethercote Lawyers are experts in financial services law and regulation. We are also experts in credit, financial crime and commercial law. Employing over 30 staff across our Melbourne and Sydney offices, our firm has a preventative-law focus and deep regulatory expertise. We are one of Australia's leading law firms in distributed ledger and other digital technologies so far as they impact on the financial services and credit sectors, and we act for some of the world's largest digital currency exchanges. We were also heavily involved in consulting with AUSTRAC on the creation of Australia's current Digital Currency Exchange regime, were primary authors of Blockchain Australia's Code of Conduct for Digital Currency Businesses and chair Blockchain Australia's Financial Crime Committee.

Holley Nethercote also provides non-legal services, including Australian Financial Services Licence (**AFSL**) and Australian Credit Licence (**ACL**) application support, training, template compliance documents and regulatory updates.

SUMMARY OF OUR VIEW

We believe that CASSPrs should be regulated under the Corporations Act, which is currently undergoing a number of reviews in order to simplify and clarify certain aspects of that legislation, including the Australian Law Reform Commission's Review of the Legislative Framework for Corporations and Financial Services Regulation (**ALRC Review**).[2] However, substantial carve-outs relating to design and distribution obligations, capital adequacy, compensation arrangements, and Australian Markets licensing should be applied. Instead, fit-for-purpose obligations in these areas should be imposed after extensive consultation with industry.

RESPONSE TO CONSULTATION QUESTIONS

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

The use of the term CASSPr could result in some confusion, as 'secondary service provider' has a particular meaning in the context of the Corporations Act. A secondary service is provided when an Australian Financial Services (**AFS**) licensee or authorised representative causes or authorises a financial service to be provided to a retail client via an intermediary.[3]

As a secondary service provider, the licensee or authorised representative must meet the regulatory requirements in the Corporations Act that apply when financial services are provided to retail clients, despite those services being provided via an intermediary.[4] The intermediary must also meet the relevant requirements in the Corporations Act when passing on a secondary service to a retail client, including licensing requirements.[5] The concept of a 'secondary service provider' does not exist under the NCCP Act.

In our experience, some crypto asset exchanges also issue their own cryptocurrencies, meaning they are not just secondary service providers. This could mean the term CASSPr is

[2] If the ALRC ultimately recommends that certain financial services law elements of the Corporations Act should be implemented in a new piece of legislation, we recommend that the CASSPr regime be embedded in that new piece of legislation.
[3] *Corporations Act 2001* s 52; *ASIC RG 175: Licensing: Financial product advisers*, 175.39.
[4] Secondary service providers are provided some regulatory relief in relation to providing Financial Services Guides (**FSGs**) to clients – *Corporations Regulations 2001* Reg 7.7.02(7).
[5] ASIC RG 175.49.

not suitable for these businesses.

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

Other potential terms could include Crypto Asset Provider, Crypto Asset Services or Australian Crypto Asset Services.

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

The term "crypto asset secondary service provider" is defined for the purposes of the Consultation Paper as follows:

Any natural or legal person who, as a business, conducts one or more of the following activities or operations for or on behalf of another natural or legal person:

i. exchange between crypto assets and fiat currencies;
ii. exchange between one or more forms of crypto assets;
iii. transfer of crypto assets;
iv. safekeeping and/or administration of virtual assets or instruments enabling control over crypto assets; and
v. participation in and provision of financial services related to an issuer's offer and/or sale of a crypto asset.[6]

The Consultation Paper states that a "crypto asset" is defined by ASIC as: "…*a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof*."

We suggest the CASSPr regime include a jurisdiction test generally. Also, we have identified several phrases in the proposed definition of 'crypto asset secondary service provider' that could lead to regulatory confusion or complexity. These are set out below:

- *'Natural or legal person'* –
    - In terms of the receiver of the service: While the proposed CASSPr definition refers to a 'natural or legal person', elsewhere the Consultation Paper refers to 'retail consumers'. Other financial services laws use different terminology. For example, the Australian Consumer Law protections in the ASIC Act apply to 'consumers', which is a term defined in section 12BC. Importantly, the definition of 'consumers' in the ASIC Act includes small businesses.[7] Many of the consumer protections in the Corporations Act apply to 'retail clients', which is defined in sections 761G and 761GA.[8] Meanwhile, the NCCP Act refers to providing products or services to a 'consumer', which is defined as a natural person or strata corporation.[9] The term 'natural or legal person' would apply to a much broader range of individuals and entities than the term 'consumer' or 'retail client'. We recommend using consistent terminology where possible, to

[6] Financial Action Task Force, *Updated Guidance for a Risk Based Approach for Virtual Assets and Virtual Asset Service Providers*, FATF, 2021, accessed on 3 February 2022.
[7] ASIC Act s 12BC(2).
[8] Retail and wholesale clients are further defined in the *Corporations Regulations 2001.*
[9] NCCP Act s 5.

reduce regulatory complexity and provide certainty about what CASSPr services to clients are intended to be captured by the new regime.
    - In terms of the provider of the service: the definition needs to be wide enough to capture tokens issued by decentralised autonomous organisations (**DAOs**) and we refer you to the submission made by Joni Pirovich of Blockchain & Digital Assets – Services + Law (the **Pirovich submission**).
- *'As a business'* – Other financial services laws use the term 'carrying on a business'.[10] We recommend using consistent language where possible. It is also important that the 'as a business' test is properly applied to avoid safekeeping of a person's own crypto wallet being captured by the CASSPr regime.
- '*Exchange between crypto assets and fiat currencies*' – The ordinary meaning of fiat currencies might seem obvious, however the term 'fiat currencies' is not a term used in the AML/CTF Act, ASIC Act, Corporations Act or NCCP Act. Rather, the AML-CTF Act uses the term 'money', which is defined to include physical currency, money held in an account and money held on deposit.[11] Terminology should be consistent. We also note that the definition of asset is problematic as outlined in the Pirovich submission. For example, some crypto tokens are in fact debt instruments and operate very differently to an asset.
- '*Exchange between one or more forms of crypto assets*' – We assume that the policy intention is for crypto to crypto exchanges to be captured by this term, but suggest this be clarified.
- '*Transfer of crypto assets*' – We recommend clarifying this term further. Does this term mean transfer of crypto assets between wallets, or between legal persons/owners?
- '*Safekeeping and/or administration'* – It is unclear from the Consultation Paper whether 'safekeeping and/or administration' refers to custody arrangements, which would attract additional obligations under the CASSPr regime. Elsewhere in the Consultation Paper the term 'CASSPrs who maintain custody of crypto assets on behalf of consumers' is used. In our view, further detail about the meaning of 'safekeeping and/or administration' will be required as these are new terms, unless the CASSPr regime adopts similar language to, or comes within, the Corporations Act. Under section 766E of the Corporations Act, providing a custodial or depository service refers to an arrangement between the provider and the client, where a financial product or beneficial interest in a financial product is held by the provider in trust for or on behalf of the client or another person nominated by the client.
- '*Virtual assets'* – What assets would 'virtual assets' cover, compared to crypto assets?
- '*Control'* – This term is defined in the Corporations Act under section 50AA, albeit in relation to an entity controlling a second entity. Would this term be further defined in the CASSPr regime?
- *'Participation in and provision of financial services related to an issuer's offer and/or sale of a crypto asset'* - There are multiple terms used in this phrase that could result in regulatory confusion or complexity, which we have detailed further below:
    - While the term 'involved in' has a meaning under section 79 of the Corporations Act in the context of involvement in contraventions, the term 'participation in' is new. In the absence of there being issues in the operation of section 79, the language should be consistent where possible.
    - 'Financial services' is defined in section 766A of the Corporations Act,[12] and also section 21BAB of the ASIC Act. The definition of 'financial services' in the ASIC Act is much broader than the Corporations Act definition. Which one, if either, would apply under the CASSPr regime?

[10] For example, Corporations Act ss 18, 20, 21.
[11] AML/CTF Act s 5.
[12] 'Carrying on a financial services business' is also defined in s 911A.

- The term 'issuer' is defined in section 761E of Corporations Act. Would the same or similar definition be used under the CASSPr regime?

Further, and more broadly, we note that the Consultation Paper proposes the introduction of other various concepts and terms, which already have well established meanings under the Corporations Act, such as *personal advice*, and *client money*. Where the CASSPr regime does not form part of the Corporations Act, such terms, concepts and provisions would have to be introduced and addressed separately.

In our view, inconsistency in terminology and definitions is likely to increase regulatory complexity and confusion for crypto businesses. This could also make it more difficult to reduce regulatory duplication, as some crypto businesses might be captured by definitions in the CASSPr regime in addition to other financial services laws, such as the Corporations Act, ASIC Act or NCCP Act, due to inconsistencies in terminology and interpretation.

The Consultation Paper says that 'to the extent entities provide a service in respect of a crypto asset which meets the definition of financial product they will need to comply with the existing relevant regulatory regimes'. This is somewhat confounding when the proposed CASSPr definition refers specifically to 'financial services', which is a term necessarily linked to the definition of a financial product. We note that the Government also wants to ensure that providers are not subject to multiple regulatory regimes (e.g. having an AFSL or an Australian market licence, as well as a CASSPr licence). However, it is unclear from the Consultation Paper how this would be achieved in practice, particularly for crypto businesses offering multiple products, some of which are 'financial products' under the Corporations Act and others that are not.

It seems that the proposed regime would not remove the current need for crypto businesses to undertake a detailed assessment about whether their product is a financial product under the Corporations Act. Rather, it would simply require them to also consider whether it's regulated under this separate proposed CASSPr regime. It seems that some crypto businesses would be regulated under multiple regimes because they are conducting activities or operations in relation to multiple types of crypto assets, or assets that change.

We note that the Consultation Paper says that the proposed licensing regime will apply to all secondary service providers who operate as 'brokers, dealers or operate a market' for crypto assets and secondary service providers who offer custodial services in relation to crypto assets. However, it is unclear whether these activities would be entirely captured by the proposed CASSPr definition. For example, 'dealing' is defined in the Corporations Act under section 766C to capture a range of conduct, including 'arranging to deal'. Would this type of 'dealing' conduct be covered by the CASSPr regime?

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

Yes. We support consistent terminology across regulatory frameworks where possible. However, there are complexities in applying this in practice. For example, the AML/CTF Act digital currency exchange register applies to 'digital currency' as defined in section 5. The proposed definition of crypto assets is much broader than the definition of digital currency. While ultimately a policy decision for Government, it would be a significant shift for the AML/CTF Act to capture crypto assets that are not digital currencies, given the current objects of the AML/CTF Act relate to money laundering and financing of terrorism – concepts that the framers of the law at the time believed were inherently linked to the use

of currencies.[13] We note that the definition in that legislation needs to change. Even the Financial Action Taskforce (FATFs)'s much more recent definition of a virtual asset[14] is crafted from an AML/CTF perspective but not from a prudential regulation perspective.[15] This makes aligning definitions difficult.

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

In our view, carving out particular types of crypto assets is likely to increase regulatory complexity and make it more difficult to 'future proof' the CASSPr regime. Regardless of the policy decision made by Government on types of crypto assets covered by the CASSPr regime, it will be important to very clearly define the limits of the regime to provide certainty to crypto businesses.

Interestingly, in discussions with our clients which range from international crypto groups to local Australian crypto start-ups, their views on regulation reflect their history. Regulated clients prefer the new regime to be similar in scope. Unregulated clients prefer a light-touch regime with limited regulatory intervention. All clients want a fit-for-purpose regime that recognises the nuance of providing crypto assets services, which ultimately extends to all parts of financial markets.

6. Do you see these policy objectives as appropriate?

Yes.

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

No.

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

In our view, the key issue that arises from the Consultation Paper is if and how the regime will apply to crypto assets that would otherwise be considered financial products under the Corporations Act. While the definition of 'crypto assets' includes reference to providing financial services, the Consultation Paper states that the proposed tailored licensing framework is only intended to apply to entities providing retail consumers with access to crypto assets which are *not* financial products. The Consultation Paper also states '*To the extent entities provide a service in respect of a crypto asset which meets the definition of financial product they will need to comply with the existing relevant regulatory regimes.*'[16]

As noted above, this means that crypto businesses would still need to undertake an assessment of whether their products fall within the definition of 'financial product' under the Corporations Act – the proposed CASSPr regime would not provide any further clarity on

[13] See AML/CTF Act s 3.
[14] https://www.fatf-gafi.org/glossary/u-z/.
[15] The Bank for International Settlements is coordinating work with various committees and international bodies including the IMF and World Bank to arrive at methods of prudential regulation for crypto assets. This implicitly requires a consideration of how they are defined. See, for example, page 1 of *Prudential treatment of cryptoasset exposures: https://www.bis.org/bcbs/publ/d519.pdf*
[16] Page 14.

that front. The new regime would simply add another set of legislative definitions that must be considered.

Unless the regime is brought within the Corporations Act, perhaps the only way to avoid duplication between the CASSPr and AFSL regimes is to exempt CASSPrs from the requirements to have a CASSPr licence if already licenced under the AFSL regime for the same product. This is unlikely to remove all duplication though.

It is also unclear if and how the CASSPr regime will apply to representatives. For example, would the CASSPr regime have an authorised representative model, or would representatives be limited to employees and other agents of the CASSPr?

Please refer to our response to question 3 above for further commentary on regulatory duplication in the context of the proposed CASSPr definition. We have also provided further comments on the scope of the regime in relation to financial advice in response to question 13 below.

9. Should CASSPrs that engage with any crypto assets be required to be licenced, or should the requirement be specific to subsets of crypto assets? For example, how should the regime treat non-fungible token (NFT) platforms?

See our response to question 5 above.

10. How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g. in financial services)?

In our view, incorporating the CASSPr regime in the Corporations Act (or a new version of the financial services components of that Act, depending on the outcome of the ALRC Review) helps minimise regulatory duplication. Recently, we have seen this done successfully for claims handling and settling services[17] and superannuation trustee services.[18] We should learn from our experience with regulating consumer credit, whereby the NCCP Act was created separate to the financial services regime. Many financial services businesses hold both an ACL and AFSL. These businesses must comply with both the credit and financial services regulatory regimes in addition to the ASIC Act and AML/CTF Act. Significant reforms to the NCCP Act, such as recent changes to breach reporting obligations, have now aligned the consumer credit regulatory regime in many respects with the Corporations Act to address inconsistencies. It seems that a separate CASSPr regime could see the same outcomes.

The Corporations Act is a flexible regime, where it is possible to 'turn on and turn off' different obligations depending on the consumer protections required for the financial services or products being provided. Incorporating the CASSPr regime would remove the need for a separate licensing and regulatory regime, and would reduce inconsistencies across definitions and legal concepts. This in turn would provide additional regulatory certainty and clarity to crypto businesses. Certain obligations should in our view, be "turned off" if this approach is taken, including:

[17] Corporations Act s766A(1)(eb).
[18] Corporations Act s766A(1)(ec).

a. The application of the design and distribution regime as introduced by the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019.[19]
b. The capital adequacy requirements imposed on custodians, product issuers, market makers and Australian Market licensees, and the compensation arrangement imposed when financial services are provided to retail clients.[20] There should be a bespoke "fit for purpose" capital adequacy regime for CASSPrs, and arrangements that provide alternatives to holding professional indemnity insurance. For example, see paragraph 4.2.4 of the Australian Digital Currency Industry Code of Conduct.[21]
c. The application of the Australian Markets Licensing regime. As with capital adequacy requirements, there should be a bespoke set of obligations for this regime that exclude the obligation to create and comply with complex market operating rules.

If the above traditional regulatory measures are not "turned off" and replaced with fit-for-purpose measures, then innovation in the CASSPr sector will be stifled and Australia will not be a destination of choice for providers in what is a trillion-dollar sector. The legislative framework should impose a review in the future to consider the effectiveness of the lighter regulatory obligations.

Please refer to our responses to questions 3, 8 and 13 for further relevant comments.

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

As per our response to question 10 above, our general view is that incorporating the CASSPr regime into the Corporations Act would be more appropriate than trying to replicate particular Corporations Act obligations in a separate piece of legislation. However, we have provided further comments on the proposed obligations set out in the Consultation Paper below:

- (3) *Have adequate dispute resolution arrangements in place, including internal and external dispute resolution arrangements* – It is unclear under the obligation whether CASSPrs would be required to be members of the Australian Financial Complaints Authority. Presumably this is the Government's intention, but this should be clarified. Also, would CASSPrs need to comply with internal dispute resolution requirements in ASIC's Regulatory Guide 271, or would different standards apply?
- (7) *Comply with all relevant Australian laws* – Under the general conduct obligations for AFS licensees in the Corporations Act, licensees must comply with the financial services laws, which are defined in section 761A.[22] Under these general conduct obligations, licensees also need to take reasonable steps to ensure their representatives comply with financial services laws.[23] It appears the proposed corresponding obligation for CASSPrs would be much broader. We recommend clarifying which laws would be considered under 'all relevant Australian laws'.

[19] This regime excludes certain activities. For example, it excludes application to most kinds of fully paid ordinary shares.
[20] Corporations Act s 912B.
[21] https://blockchainaustralia.org/wp-content/uploads/2021/10/Code-of-Conduct-October-2021.pdf. This provision was introduced into the code after wide consultation because so many digital currency exchanges were unable to secure PI insurance. Also, PI insurance is limited in that it is an insurance policy that exists to cover the insured entity– not its customers directly - in certain situations.
[22] Corporations Act s 912A(1)(c).
[23] Corporations Act s 912A(1)(ca).

- (8) *Take reasonable steps to ensure that the crypto assets it provides access to are 'true to label'* - This obligation is intended to prohibit a product being falsely described as a crypto assets, or misrepresentations about crypto assets. We note that misleading and deceptive conduct is already prohibited under the Australian Consumer Law.[24] We believe the existing laws (which may be clarified as a result of the ALRC Review) are adequate. Introducing another obligation would only add to the complexity (the current laws have been criticised by the judiciary as being overly complex and essentially, "legislative porridge".[25])
- (9) *Respond in a timely manner to ensure scams are not sold through their platform* - We recommend clarifying whether this obligations is intended to apply to selling scam crypto assets via a platform, or otherwise allowing scammers to use a CASSPr service or platform.
- (12) *Comply with AML/CTF provisions* – Complying with AML/CTF provisions would likely be covered by 'apply with all relevant Australian laws' (7) above.

We also refer you to our submission to the Senate Select Committee on Australia as a Technology and Financial Centre, which sets out survey responses from nine large digital currency exchanges about the obligations they think should apply to their businesses.[26]

The Consultation Paper notes that breaches of the CASSPr regime will attract civil and criminal penalties, but these are not specified. It is also unclear what administrative powers will be provided to the regulator (such as powers to cancel a CASSPr licence). Only obligation (12) above is specified as a proposed ground for cancelling a CASSPr licence. The Consultation Paper also doesn't state whether breaches of the new regime would entitle consumers to seek compensation from CASSPrs.

It is also unclear how the CASSPr regime would interact with AFS licensees' general conduct obligation to comply with 'financial services laws',[27] and report breaches of these laws.[28] AFSL holders must report breaches of 'financial services laws' to the regulator in certain situations. It is unclear from the Consultation Paper if the CASSPr regime would be considered a 'financial services law' for general conduct or breach reporting purposes. The answer will have significant implications for crypto businesses that have AFSLs.

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

Arguably, depending on the relevant facts, this conduct would be captured by the proposed anti-hawking prohibition for CASSPrs or spam laws.[29] This conduct would also potentially contravene the Australian Consumer Law, depending on the circumstances.

If the Government decides that particular prohibitions are required in relation to airdropping crypto assets, at a minimum we recommend linking these requirements to scams. For example, CASSPrs need to take reasonable steps to ensure airdrop is not fraudulent.

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[24] *Competition and Consumer Act 2010* Schedule 2 Part 2-1; ASIC Act Division 2 Part 2.
[25] *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq) (includes Corrigenda dated 1 October 2013 and 22 November 2012) [2012] FCA 1028 (21 September 2012).*

[26] See page 5 of our submission, available at: https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Financial_Technology_and_Regulatory_Technology/AusTechFinCentre/Submissions
[27] Corporations Act s 912A(1)(c)-(ca).
[28] Corporations Act s 912DAA.
[29] *Spam Act 2003* Part 2.

13. Should there be a ban on not providing advice which takes into account a person's personal circumstances in respect of crypto assets available on a licensee's platform or service? That is, should the CASSPrs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto asset)?

The Consultation Paper has asked for feedback on whether there should be a ban on CASSPrs providing personal advice in respect of crypto assets available on a CASSPr's platform or service. However, there are no details about proposed regulation of advice beyond this question, including how advice provided by non-CASSPrs (for example, unlicensed 'finfluencers' or existing AFSL holders such as financial advisers). There are also no details about if or how the provision of general advice in relation to crypto assets might be regulated. This should be clarified.

If the proposed personal advice ban would only apply to CASSPr licensees, it would seem a strange outcome that completely unlicensed entities that provide advice to consumers on crypto assets could give the equivalent of personal advice but licensees could not.

Currently, Australia's financial product advice definition is being reviewed by both the ALRC Review and the Quality of Advice Review.[30] The recommendations from these reviews should apply as a starting point (with appropriate adjustments after consultation) to how CASSPr's provide advice.

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

No comment.

15. Do you support bringing all crypto assets into the financial product regulatory regime? What benefits or drawbacks would this option present compared to other options in this paper?

See our response to question 10 above.

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

No comment.

17. Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia?

In our view, legislation is required to provide regulatory certainty to industry and to improve consumer confidence in crypto businesses. A lack of regulation can discourage domestic and international investment, make important service provider relationships more difficult, decrease consumer confidence and disadvantage industry participants with a more conservative legal risk appetite. Importantly, an appropriate legislative framework for that

[30] https://treasury.gov.au/sites/default/files/2022-03/quality-of-advice-tor-251252.pdf.

sector could set a minimum legal standard that is conducive to the banks wanting to bank regulated entities in the sector.

The objective is to provide an appropriate level of regulation to protect consumers, reduce systemic risk and encourage trust with stakeholders (particularly banks) without hindering innovation. This is the sentiment we continue to hear in the industry.

We drafted the Blockchain Australia's Code of Conduct for Digital Currency Businesses, which was referenced in the Consultation Paper. The Code was an effective starting place before any crypto-specific regulation existed. However, the industry has now matured and is becoming increasingly mainstream. It is time for a more formal licensing regime that provides clarity to industry and protections for consumers.

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

No comment.

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

The proposed custody obligations appear appropriate, and are broadly similar to those in the Code of Conduct for Digital Currency Businesses.

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

We recommend clarifying the role and liability of third party custodians, including whether these custodians will be required to be licensed.

We also note that the Code of Conduct for Digital Currency Businesses has additional obligations for custodians under clause 4.2.4,[31] which are set out below:

> *4.2.4. Where a Blockchain Australia Certified Digital Currency Business provides a service of storing, holding, owning or controlling Digital Currency on behalf of a customer, it will:*
>
> *a) Hold Digital Currency of the same type and amount as that which is owed or obligated to the customer, and provide evidence of this upon request by the customer;*
>
> *b) Not sell, transfer, assign, lend, hypothecate, pledge, encumber or otherwise use the Digital Currency except in accordance with the express directions of the customer.*

21. There are no specific domestic location requirements for custodians. Do you think this is something that needs to be mandated? If so, what would this requirement consist of?

In our view, there is merit in prescribing a specific location requirement for custodians, which requires that custodians be located either in Australia, or in a jurisdiction with

[31] Available at: https://blockchainaustralia.org/wp-content/uploads/2021/05/Australian-Digital-Currency-Industry-Code-of-Conduct.pdf.

substantially equivalent laws, standards, requirements and protections as those that apply in this jurisdiction.

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

Please refer to our responses to questions 20 and 21 above.

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

Please refer to our responses to questions 20 and 21 above.

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

No comment.

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

Please refer to our response to question 17 above.

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

Please refer to our response to question 17 above.

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

Please refer to our response to question 17 above. We note that the current Code of Conduct for Digital Currency Businesses does not require external financial audits to be completed. This is an area that could be strengthened in the Code, to reflect the emerging maturity of the sector.

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

No comment.

29. Do you have any views on how the non-exhaustive list of crypto asset categories described ought to be classified as (1) crypto assets, (2) financial products or (3) other product services or asset type? Please provide your reasons.

As noted in our response to question 10 above, our preferred approach would be to include crypto assets as a type of financial product under the Corporations Act. With this approach, the above asset categories could simply be classified as a financial product, or other product services or asset type. The type of financial product, and therefore the required licensing authorisations, would need to be considered on a case by case basis depending on the product and services offered.

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

No comment.

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

No comment.

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

Given the rapidly evolving nature of crypto assets, we recommend legislated criteria for banning future crypto assets, where required. This criteria could include evidence of scams or fraudulent activity, likelihood of consumer harm etc.

Please contact jakeh@hnlaw.com.au if you have any questions or wish to discuss our submission.

Yours sincerely,

Paul Derham, Michael Mavromatis, Jesse Vermiglio, Katherine Temple, Jake Huang

Holley Nethercote Lawyers