



HOLLEY NETHERCOTE LAWYERS

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Email: crypto@treasury.gov.au

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

Dear Director,

RE: Regulating Digital Asset Platforms - Proposal Paper

Thank you for the opportunity to provide feedback on Treasury's Regulating Digital Asset Platforms Proposal Paper (**the Proposal Paper**).

As set out in our response to Treasury's 'Token mapping' and 'Regulating crypto asset secondary service providers' consultation papers,¹ we support improvements to the regulatory framework for the crypto ecosystem in Australia. Appropriate regulation will be critical to providing regulatory certainty to digital asset businesses and improving consumer confidence in the sector.

We support expanding the existing financial services and consumer credit regulatory regime to improve regulation of the crypto ecosystem. We have provided feedback on the proposed regulatory regime below.

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 34 staff across our Melbourne and Sydney offices, our firm has a preventative-law focus and

¹ Our previous submissions are available here: <https://www.hnlaw.com.au/our-submission-to-treasury-on-token-mapping/> and <https://www.hnlaw.com.au/wp-content/uploads/2019/08/Holley-Nethercote-CASSPr-submission-2022.pdf>

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. We also presented in person in February 2023, on behalf of IDAXA², to the FSB in response to their consultation paper proposing regulation, supervision and oversight of crypto-asset activities and markets.

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 via the HN Hub.³

SUMMARY

We submit that:

- The existing regime in Chapter 7 of the Corporations Act contains appropriate mechanisms to accommodate the regulation of services provided in connection with digital assets.
- The proposed framework largely does not address the activities of influencers and other unregulated persons providing advice with respect to digital assets (although noting many digital assets should be exempted from the framework, including non-financial digital assets).
- Areas of uncertainty should be addressed, relating to custody, non-custodial exchanges, and the regulatory status of staking arrangements.
- The proposed approach is so complex it is likely unworkable. A better approach would be more closely aligned to the methods suggested by international standards setters and Europe's MiCa regime.
- The legislation and explanatory materials should include examples to provide guidance to industry.

RESPONSE TO PROPOSAL PAPER

1. A 'Digital asset facility' is proposed to be a financial product.

As set in our previous submission, we support incorporating crypto regulation into the existing financial services regulatory regime.

² <https://www.idaxa.org/>. IDAXA represents some of the world's largest crypto asset service providers, as well as many of the world's in-country crypto asset industry bodies who in turn represent crypto asset service providers.

³ <https://www.hnlaw.com.au/hn-hub-home/>

The Corporations Act's Chapter 7 includes a number of licensing regimes. One relevant regime is the Australian Financial Services Licensing (**AFSL**) regime, which is triggered when particular elements are present:

- a. A *person* carries on a financial services business; and⁴
- b. provides a *financial service* (such as financial product advice⁵, dealing (including issuing)⁶, or making a market⁷ for a financial product or operating a registered scheme⁸);
- c. with respect to a specifically defined *financial product* (such as securities⁹) or a generally defined *financial product* (such as a facility through which a person makes non-cash payments¹⁰).

The Proposal Paper suggests introducing a new type of financial product, called a 'digital asset facility'. A digital asset *facility* will be an asset holding arrangement. A 'low-value facility' exemption would be introduced, similar to the 'low value facility' exemption for non-cash payment facilities. It would apply to digital asset facilities holding less than \$1,500 per customer and less than \$5 million in total.¹¹ Platform providers and other intermediaries performing financial services in relation to digital asset facilities (e.g. brokers, arrangers, agents, market makers, and advisers) would be required to hold an AFSL.¹²

As set out in our previous submission, in our view the simpler approach would be for crypto regulation to be applied, at least in most intermediated token systems, so that both the token and the token system are captured or excluded, depending on their characteristics and functions. This is demonstrated using the 'fruit, tree, orchard' analogy¹³ below:

⁴ Corporations Act s911A(1)

⁵ Corporations Act, s766B

⁶ Corporations Act, s766C

⁷ Corporations Act, s766D

⁸ Corporations Act, s766A(1)(d)




⁹ Corporations Act, s764A(1)(a)

¹⁰ Corporations Act, s763D

¹¹ Page 21 of the Proposal Paper.

¹² Page 12 of the Proposal Paper.

¹³ The analogy could also include a reference to the land on which the fruit trees are grown, which is the base-layer protocol (e.g. the Ethereum blockchain). Holley Nethercote's view is that it should not be regulated, in the same way communication protocols like HTTP (website data exchange), SMTP (email) and FTP (file transfers) are free and open. Treasury is not proposing that it be regulated (some other countries are), and so we have not made an issue of it in this paper.

	 Fruit	 Fruit Tree	 Orchard growers
Current Regime	Financial product (eg. A security)	Financial service (eg. Advising, dealing, making a market)	Person carrying on a financial service
Proposed Regime	Digital asset facilities	Advising, dealing, making a market or providing a custodial or depository service in a digital asset facility, and operating a digital asset platform. Additionally, new minimum standards for certain transactional functions performed by digital asset platforms in respect of digital assets that are not financial products (e.g. asset tokenisation).	Platform providers and other intermediaries performing financial services in relation to digital asset facilities (e.g. brokers, arrangers, agents, market makers, and advisers)
Alternative option	Digital assets	Advising, dealing, making a market or providing a custodial or depository service in a digital asset.	A person (in the case of a centralised or permissioned blockchain) or a DAO or similar autonomous organisation (in the case of a decentralised or permissionless blockchain) who provides a financial service with respect to a digital asset

Whilst the proposed approach incorporates digital asset regulation into the existing financial services regulatory regime, which we support in principle, the concept of a 'digital asset facility' as a financial product seems a rather uncomfortable fit. This does not address one of the key risks associated with digital asset misconduct: a person, such as a influencer can

recommend a digital asset without any need for an AFSL (although we agree that many digital assets are non-financial and should be excluded from the AFSL regime). In our view, the provision of financial advice in relation to a regulated token should be covered as well. This approach would help to reduce the risk of 'pump and dump' schemes, and would be more in line with the existing regulatory framework For example:

A celebrity like Kim Kardashian could strongly recommend a new digital asset called EMAX 2.0 to her 359 million Instagram followers, and provide a link for followers to purchase. Thousands of Australian consumers could buy this unregulated digital asset, and assuming the Australian consumers used offshore digital asset facilities to acquire the digital asset, the behaviour in Australia would not require an AFSL, so ASIC's regulatory powers would not be enlivened (unless the digital assets met the existing definition of a financial product).¹⁴

2. Areas of uncertainty should be addressed.

It is unclear from the Proposal Paper as to how non-custodial digital asset exchanges would be regulated. Having regard to the proposed low-value facility exemption, which would apply to digital asset facilities holding less than \$1,500 per customer and less than \$5 million in total, it appears that non-custodial digital asset exchanges would not be captured under the proposed regime. Treasury has expressed verbally that this is not its intention. So, the application of the regime to non-custodial exchanges should be clarified.

We also believe that the concept of bailment as it relates to custody, as set out in the Proposal Paper requires further consideration. Given that existing custodians under financial services laws may typically operate omnibus arrangements in many circumstances, we note that the concept of bailment does not sit well with the fact that such assets that may be pooled, but separately accounted for.

Bailment typically involves a single chattel, such the owner of a taxi, handing physical possession of a taxi to the taxi driver, the bailee, where the taxi driver returns exactly the same taxi at the end of their shift. However, the petrol in the taxi is replaceable. Where the driver is required to return the taxi with a full tank of equivalent petrol, this is more accurately characterised as a *mutuum* than a bailment and in any event, we are not sure that this is an appropriate concept for the purpose of characterising such custodial arrangements in relation to digital assets.

We also recommend providing further guidance about how the proposed regulation of digital asset platforms with a token staking function¹⁵ would interact with the existing regulatory regime for managed investment schemes. Token staking (depending on the circumstances) can constitute a managed investment scheme or some other financial product under the current financial services regime.

¹⁴ This is an unlikely example, because Kim K has probably learned from her mistakes. She was fined USD \$1.6m by the SEC for touting EMAX tokens and not disclosing the fee she was paid: [SEC.gov | SEC Charges Kim Kardashian for Unlawfully Touting Crypto Security](#)

¹⁵ Page 40 of the Proposal Paper.

3. A simpler approach is needed that is aligned to international standards.

Treasury's current proposal is highly complex and inconsistent with the approaches recommended by the international standards setting bodies (**SSBs**), as well as MiCa. The following table illustrates this point – where SSBs and Mica define virtual, digital or crypto assets and recommend regulating the service provider, Australia has chosen a different, more complex path:

FATF – Virtual Asset ¹⁶	FSB – Digital Asset ¹⁷	FSB – Crypto Asset ¹⁸	IOSCO – Crypto asset ¹⁹	MiCa – crypto asset ²⁰	Treasury's Proposal Paper – Digital Asset ²¹
digital representation of value	digital representation of value	private digital asset	an asset, sometimes called a digital asset,	digital representation of a value	A "digital asset" is a token and the entitlements it grants a holder.
that can be digitally traded or transferred	which can be used for payment	that depends primarily on cryptography and distributed ledger or similar technology	that is issued and/or transferred using distributed ledger or blockchain technology.	or of a right	A "token" is a record in a token-based system.
and can be used for payment	or investment purposes		...including, but not limited to, so-called "virtual currencies," "coins," and "tokens."	that is able to be transferred and stored electronically	A "token-based" system is a system of record for entitlements that accrue directly to any person holding a specific record
or investment purposes			To the extent digital assets rely on cryptographic protocols, these types of assets	using distributed ledger technology or similar technology	The "entitlement" is the rights, benefits, or claims flowing from any kind of

¹⁶ Financial Action Task Force, *Updated Guidance for a Risk-Based Approach: Virtual Assets and Virtual Asset Service Providers*, October 2021, paragraph [44], available at: <https://www.fatf-gafi.org/en/publications/Fatfrecommendations/Guidance-rba-virtual-assets-2021.html>

¹⁷ Financial Stability Board, *Regulation, Supervision and Oversight of 'Global Stablecoin' Arrangements: Final Report and High-Level Recommendations*, October 2020, page5, available at: <https://www.fsb.org/wp-content/uploads/P131020-3.pdf>.

¹⁸ Ibid.

¹⁹ International Organization of Securities Commissions, *Policy Recommendations for Crypto and Digital Asset Markets Consultation Report*, May 2023, page 3, available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD734.pdf>.

²⁰ European Parliament legislative resolution of 20 April 2023 on the proposal for regulation of the European Parliament and of the Council on Markets in Crypto-assets and amending Directive (EU) 2019/1937, Article 3(5), available at: https://www.europarl.europa.eu/doceo/document/TA-9-2023-0117_EN.html.

²¹ Proposal Paper, Annexure 3.

			are commonly referred to as "crypto-assets."		arrangement (encompassing legal rights, commercial arrangements, established conventions and, social understandings).
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The problem with legislative complexity is that it is more difficult to enact into legislation, there is more room for misinterpretation, and it is more difficult to enforce. The Australian Law Reform Commission’s background paper explores legislative complexity, and elaborates on the drivers and features of legislative complexity, as well as how to manage and reduce complexity.²²

4. Provide guidance and examples in the legislation and Explanatory Memorandum

As set out in our previous submission, we strongly support examples of popular digital assets and digital asset services being included in the Explanatory Memorandum for any legislation as examples of what is intended to be inside and outside of the regulatory perimeter. Similarly, it would be useful for ASIC regulatory guidance to include examples that provide clarity about the regulator’s views on the application of any new legislation.

It will be critical that stakeholders are given sufficient opportunity to consider and respond to draft legislation when it released for consultation given the legal complexities involved.

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

Yours sincerely,

Paul Derham, Michael Mavromatis, Katherine Temple

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²² See <https://www.alrc.gov.au/publication/fsl2/>