

30 July 2021

Australian Securities and Investments Commission
By email: [REDACTED]

Dear Commissioners

Consultation Paper 343 - Crypto-assets as underlying assets for ETPs and other investment products (Consultation Paper)

We write to provide a response to the above consultation paper which we have enclosed as an appendix.

Background

We make this submission in our personal capacities. We wish to note, however, our relevant affiliations because our response is drawn from this professional experience. We are both affiliated with the RMIT Blockchain Innovation Hub (**RMIT BIH**). The RMIT BIH was established in 2017 as the world's first research centre on the social science of blockchain technology. The RMIT BIH brings together academic researchers in the fields of economics, communications, finance, history, law, sociology, and political economy. This award-winning research centre is at the forefront of bridging academic research with the design of digital economy business models, and the implications that has for institutions, including established regulatory frameworks. Further, Chris Berg is a member of the Australian Government's National Blockchain Roadmap Advisory Committee while Aaron Lane is affiliated with Duxton Hill, a law firm specialising in fraud, misconduct and financial crime, where he advises on cryptocurrency matters.

The Consultation Paper notes the work being undertaken by the Senate Select Committee on Australia as a Technology and Financial Centre (**Senate Select Committee**). We, along with our colleagues from the RMIT BIH, have made submissions and appeared before Senate Select Committee.

Further information

We appreciate the opportunity to provide ASIC with a response to the Consultation Paper. If you have any further questions or wish to discuss please contact Aaron Lane [REDACTED]

Yours faithfully

Dr Aaron M. Lane

Assoc. Prof. Chris Berg

Section B – Meeting INFO 230 expectations

We start from the proposition that the choice of cryptocurrency assets held by investors is ultimately subject to market discipline. CoinMarketCap currently lists nearly 6,000 tokens. If we define a cryptocurrency as “any fungible token that can be traded on any exchange” then there are tens of thousands of cryptocurrencies in existence.

Since the development of decentralised exchanges (i.e., fully-onchain exchanges like Uniswap), both technically sophisticated and unsophisticated investors have virtually unimpeded access to the full universe of cryptocurrencies and can gain exposure to any asset they see fit. For technically unsophisticated investors, this un-intermediated access can however be a source of risk - particularly around the self-management of funds. ETPs can be seen as a tool for consumer protection, allowing investors exposure to cryptocurrencies without having to negotiate decentralised exchanges and private key management, and provide investors with a professional, curatorial layer on top of a complex blockchain ecosystem. It is reasonable that investors who are able to gain exposure to an asset directly should also be able to gain exposure to that asset through an ETP – and benefit from professional advice.

While we strongly support a principles-based approach to determining the appropriateness of crypto-assets in ETPs, those principles should not be so narrowly drawn as to reduce the consumer safety and value benefits of ETPs themselves. Accordingly, it is our view that ASIC should take a wider rather than narrower approach to which cryptocurrencies can be offered through ETPs.

In our view, the Consultation Paper has drawn an unnecessarily and counterproductively strict boundary around the assets that can be considered as part of an ETP. The Consultation Paper suggests that cryptocurrencies should be considered appropriate underlying assets for ETPs if they have: 1) a high level of institutional support; 2) willing service providers (such as custodians) to support the asset; 3) a mature spot market; 4) “a regulated futures market for trading derivatives linked to the crypto-asset”; and 5) robust and transparent pricing. The Consultation Paper concludes that the only assets which satisfy these criteria are Bitcoin and Ethereum. In particular, the fourth criteria is an excessive constraint and penalises many otherwise mature cryptocurrencies that easily satisfy the other criteria. Cryptocurrency derivatives - and, more critically, the regulatory frameworks that would allow for their regulation - are in a very early stage of development. Accordingly, the Consultation Paper’s justification for this criterion is hard to parse. The reasonable requirements of robust pricing mechanisms, high levels of institutional support, and liquid markets can be satisfied in the absence of a licensed derivatives market for cryptocurrencies.

While we favour a market approach to the question of which cryptocurrencies should be considered appropriate for ETPs, we understand that ASIC may prefer a more moderate approach. A reasonable mid-way position is to accept as underlying assets any cryptocurrency which is traded on major Australian exchanges - that is, cryptocurrencies which have liquid markets in Australia and the demand for which has been validated by existing firms in the cryptocurrency markets. This would expand the availability of crypto-assets for ETPs to “layer 1” assets such as Algorand, Litecoin, Polkadot, Cardano, and ERC-20 (Ethereum) tokens such as Uniswap, Compound, and ChainLink. The point of allowing these assets in ETPs is not to endorse the long-run viability of their projects but to align access to assets and access to exchange traded products.

Section C – Responsible entity obligations

Crypto assets are currently being held in custody, safely and securely. Of course, custody management is not a unique issue to crypto assets. Nevertheless, for crypto assets, we agree that there is a heightened risk around private keys as compared to other traditional assets. Accordingly, we agree that responsible entities will need to have appropriate risk management measures in place and consider that ASIC's proposed "good practices" relating to custody management are sensible and we note that ASIC has not proposed a single "best practice". Indeed, ASIC states, "we recognise that custody offerings continue to evolve in line with developments in technology and changes in risks." In this context it is important for regulators not to be prescriptive with how risks are to be managed but provide responsible entities with flexibility and allow responsible experimentation with innovation in custody management.

Adopting this approach is not to say that custody management will not be regulated. Custody management falls under the operation of the scheme. Section 601FC of the *Corporations Act 2001* (Corporations Act) provides that the responsible entity of a registered scheme holds scheme property on trust for scheme member and has a duty to ensure that the scheme property is held separate from any other property. Section 601FB(2) of the Corporations Act allows the responsible entity to appoint an agent to manage aspects of the scheme's operations on its behalf. In making those custody management decisions, including the appointment of agents, the responsible entity and its officers must exercise reasonable care and diligence (sections 601FC and 601FD of the Corporations Act in addition to other common law and equitable duties). In our view, these existing statutory duties already provide protection to consumer investors around custody management.

In relation to risk management, ASIC proposes that if a responsible entity "undertakes trading activity in crypto-assets, it should do so on legally compliant and regulated crypto-asset trading platforms." There are two distinct issues to address. First, "legally compliant" is incredibly broad to encompass any area of a digital currency exchange's operations that may have no bearing on the responsible entity or the scheme's property – so some remoteness test is required to limit the responsible entity's due diligence obligations. As such, any areas of regulation over and above KYC and AML/CTF compliance should be subjected to further consultation. Second, "regulated platforms" suggest that there is a specific licensing regime in place. ASIC will be aware that the Senate Select Committee into Australia as a Technology and Financial Centre is currently considering the regulation of the regulation of cryptocurrencies and digital assets as part of its current inquiry (currently due to report on 30 October 2021).¹ Accordingly, we consider that this aspect of ASIC's proposal may be premature. To the extent that "regulated platform" is limited to KYC and AML/CTF, there is also a practical difficulty for responsible entities. Digital currency exchange providers (including cryptocurrency exchanges) operating in Australia are legally required to register with AUSTRAC but this register is not public. Currently, only details of refusals and cancellations are publicly available on AUSTRAC's website. Accordingly, a responsible entity is unable to quickly ascertain whether a digital currency exchange is currently registered and compliant and the conditions of such registration (if applicable). We recommend that ASIC request AUSTRAC to publish the full register of registered cryptocurrency exchanges. This register could be integrated with ASIC's company information systems and its approved information brokers.

¹ Note that the authors have made joint written submissions and appeared before the Senate Committee with other colleagues from RMIT University.

AARON LANE AND CHRIS BERG

RESPONSE TO ASIC CONSULTATION PAPER 343

Section D – Listed investment entities

See response to Section B.

Section E – AFS Licensing

See response to Section B.