Digital Assets Team
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Dear Digital Asset Team,

We appreciate the opportunity to comment on the indicated update of INFO 225 via CP 381

In general, we are not of the view that regulation of the offering of financial products and services in relation to crypto and digital assets will somehow suppress innovation and hold back the "democratisation" of finance.

With regards to regulation of crypto trading platforms, it is difficult to understand how regulating platforms offering "trading" products involving similar activities and similar risks with other financial products stifles innovation. For example, how is "trading" a Bitcoin/USDC pair any different from "trading" a USD/JPY pair?

Australian citizens should have every right to involve themselves in taking risk in financial markets. For this reason, we support the overall approach ASIC is taking in the proposed update to INFO 225. It is crucial that regulatory outcomes for investor protection and market integrity are the same as, or consistent with, those required in traditional financial markets. Why should digital asset investors be exposed to lack of market surveillance, and thereby increasing the risk of manipulative market practices (including pyramid and Ponzi schemes, 'pump and dump' schemes, wash-trading, front-running, fraudulent, misleading, insufficient disclosures and inaccurate market data?

Digital assets except for very specific exemptions such a "meme" coins should be classified as financial products.

With regards to the classification of digital assets as financial products, a possible course of legislative reform is discussed herein.

Digital Assets - Financial Products

Verifying the status of digital asset products available in Australia as "financial products" for the purposes of the regulatory regimes as administered by the Australian Securities and Investments Commission (***ASIC***) is important for the protection of retail and wholesale participants in the financial system which includes and extends to digital assets.

Currently, digital asset products or the majority of them could be characterised as "financial products" by ASIC under the umbrella provisions, s763A of the *Corporations Act* 2001 (***CA***) and/or s12BAA(1) of the *ASIC Act* (***AA***) and thereby providers of such would be subject to myriad obligations under the *CA* and/or the *AA* including s912A of the *CA*. Relevantly, s763A of the *CA* provides as follows:

"*(1) A financial product is a facility through which, or through the acquisition of which, a person does one or more of the following:*

(a) makes a financial investment;
(b) manages financial risk;
(c) makes non-cash payments."

Providers of most digital asset providers would be hard pressed to argue that their products or the majority of them do not fall within the definition of "financial product" in s763A of the *CA* and s12BAA(1) of the *AA*. Nevertheless, it may be the case that arguments could be successfully raised that particular products do not, for example, fall within the meaning of making "non-cash payments".

S764A of the *CA* and 12BAA(7) of the *AA* provide for "specific things that are financial products". "Financial products" as set out in s764A and s12BAA(7) include:

(a) "a security" (s764A(1)(a); s12BAA(7)(a));
(b) "a derivative" (s764(1)(c); s12BAA(7)(c));
(c) "a debenture ..." (s764(1)(j); s12BAA(7)(i));
(d) a "foreign exchange contract" that is not:
    (i) a derivative; or
    (ii) a contract to exchange one currency (whether Australian or not) for another that is to be settled immediately (s764(1)(k); s12BAA(7)(j);
(e) a "credit facility" (s12BAA(7)(k));
(f) an "Australian Carbon Credit Unit" (s764(1)(ka); s12BAA(7)(l)).
(g) a "margin lending facility" (s764(1)(l)); and
(h) "anything declared by the regulations to be a financial product for the purposes of this Chapter" (s764(1)(m); s12BAA(7)(m)).

ASIC could rely on a number of existing "specific things that are financial products" in characterising specific digital asset products for the purposes of licensing and enforcement such as a derivative, a debenture or a margin lending facility depending on the design of the digital asset product.

S764A of the *CA* and 12BAA(7) of the *AA* are, in keeping with the legislature's approach to inclusive, prescriptive legislation that sits alongside principle-based legislation, "living" provisions. That is, products may be and are added to the lists of "specific things" as they emerge in the financial system.

For example, in 2011, Parliament passed amending legislation to include "Australian carbon credit units" (**ACCUs**) and "eligible international emissions units" (**EIEUs**) in the list of "(s)pecific things that are financial products" as set out in s764A of the *CA*: (s764(1)(ka)). The equivalent change was made to s12BAA(7).

The *Explanatory Memorandum to the Carbon Credits (Consequential Amendments) Act* 2011 (***EM***) provides apposite insight as to the rationale for the change:

"*1.12 Amendments to the Corporations Act 2001 and the Australian Securities and Investments Commission Act 2001 are needed to regulate financial services relating to ACCUs and eligible international emissions units, similar to other financial products.*

1.13 These amendments will provide a strong regulatory regime to protect purchasers of ACCUs in a new area where there will not be familiarity with offsets credits issued by government. It will also reduce the risk of misconduct in the market. Appropriate adjustments to the regime to fit the characteristics of units and avoid unnecessary compliance costs will be made.

1.14 Defining ACCUs and eligible international emissions units as financial products will trigger the application of provisions relating to financial services and markets, and product disclosure, under Chapter 7 of the Corporations Act 2001 [***Schedule 1, Part 1, items 9-11*** *]. It will also trigger the general consumer protection provisions in Part 2 of Division 2 of the Australian Securities and Investments Commission Act 2001 (the ASIC Act) [* ***Schedule 1, Part 1, item 5*** *]*"

ACCUs are a heterogenous, government regulated product. The pricing of ACCUs varies significantly depending on the methodology of generation, the geographic location of generation, co-benefits such as indigenous generation and other factors.

Also included in the 2011 legislative reform was the inclusion of EIEUs. An EIEU is defined by the Clean Energy Regulator (**CER**) as follows:

(a) a certified emission reduction unit (**CERU**) (other than a temporary certified emission reduction or a long - term certified emission reduction); or
(b) an emission reduction unit (**ERU**); or
(c) a removal unit (**RMU**); or
(d) a prescribed unit issued in accordance with the Kyoto rules; or
(e) a safeguard mechanism credit unit if legislative rules made for the purposes of this paragraph specify that kind of unit.

The CER distinguishes between CERUs, ERUs and RMUs and allows them to be traded through the Australian regulated registry system, the Australian National Registry of Emission Units (**ANREU**).

Each CERU, ERU or RMU listed on the ANREU has a unique serial number that identifies:

(a) the unit as a CERU, the Kyoto party that issued it, the Kyoto commitment period that it was issued for and the CDM project number of the CER;
(b) the unit as an ERU, the Kyoto party that issued it, the Kyoto commitment period that it was issued for and the JI project number of the ERU; or
(c) the unit as an RMU, the Kyoto party that issued it, the Kyoto commitment period that it was issued for, the Kyoto project number of the RMU and the year of issue.

Arguably, the EIEUs are significantly more heterogenous environmental products than ACCUs. In that context, EIEUs are available to be traded in the Australian environmental regulatory framework whilst being treated as financial products for the purposes of the Australian financial regulatory framework.

So too, notwithstanding the heterogenous nature of digital asset products currently available to consumers in Australia, the legislature could readily include digital asset products in the s764A(1) and s12BAA(7) definition of "specific things that are financial products" by way of legislative reform.

In terms referred to in the *EM*'s justification for the inclusion of ACCUs and EIEUs in s764A and s12BAA(7), the inclusion of digital assets in the list of financial products in these provisions:

(a) provide a strong regulatory regime to protect purchasers of digital asset products;

(b) reduce risk of misconduct in the market;

(c) in defining digital asset products as financial products this will "trigger the application of provisions relating to financial services and markets and product disclosure" under Chapter 7 of the *CA* and it will also "trigger the general consumer protection provisions" in Part 2 of Division 2 of the *AA*.

Such a course of legislative reform would effectively proleptically quell any controversy as to the status of digital assets in the Australian financial system.

Ipso facto, in "dealing" with financial products within the meaning of s766A(1)(b) of the *CA*, providers of digital asset products in Australia will thereby be required to possess an Australian Financial Services Licence (**AFSL**) subject to the operation of Part 7.6 Division 4, s913A ff of the *CA*.

So too, if the provider of digital assets in Australia is operating a market within the meaning of Part 7.2, Divisions 3 and 4, ss792A ff, the provider will be required to possess an Australian Market Licence (**AML**).

Accompanying the possession of an AFSL and/or an AML is a raft of well-tested elements of regulatory consumer protection and maintenance of market integrity.

With Regards to "Market Making" - An Observation.

One aspect of potential reform is the consideration of the question: should the market maker AFSL authorisation require the market maker to be onshore? It is well understood that the vast amount of "market making" comes from offshore participants, the identity of whom may or may not be relevant to the grant or maintenance of the AFSL where the "market making" bids/offers are merely passed on with a spread.

If the actual market making is coming from offshore, it should be considered as to how the "market maker" is held to account by the regulator given the raft of protective measures otherwise likely to be imposed on the holder of the AFSL. Transparency of such arrangements should be part and parcel of the process of application and maintenance of the AFSL.

Yours Sincerely

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