

27 July 2021

**ASIC Markets Regulation
CP 343 Team**

By email: [REDACTED]

Dear CP 343 Team,

CP 343 Submission—Chi-X Australia

Chi-X Australia is grateful for the opportunity of providing a submission on ASIC Consultation Paper 343: *Crypto-assets as underlying assets for ETPs and other investment products* ('the CP').

The submission is segmented into this covering letter and **attachment one**, which consists of a table listing the proposals and questions asked in the CP and provides a CXA response to each.

This covering letter seeks to outline how Chi-X looks forward to engaging with ASIC on the proposals outlined in the CP and addressed in detail in **attachment one**. It identifies some of the challenges, benefits and risks of the proposals in CP 343 and seeks to outline some practical steps on how the identified risks may be mitigated. It is divided into the following sections:

1. **The big picture** – this section outlines the challenges of defining an overall regulatory perimeter for cryptocurrencies, given the inherent difficulties in predicting future cryptocurrency markets, and how this overall perimeter interacts with the approach in CP 343, where ASIC is proposing a bespoke framework for cryptocurrency ETPs;
2. **The benefits of ASIC's approach to regulating Market Operators** – this section focuses on the benefits of ASIC's general approach to regulating market operators, which provides the basis for the approach outlined in CP 343 for regulating cryptocurrencies as underlying assets of ETPs;
3. **The potential disadvantages of the ASIC approach** - this section focuses on the potential disadvantages of the ASIC approach, including:
 - (i) the potential impact on innovation, given the commercially sensitive issues raised by the proposals/questions in the CP, particularly those concerning how market operators and issuers engage with each other in areas of innovation and competition;
 - (ii) the broader impact of the proposals outlined in the CP;
4. **Steps to Address the Potential Risks of the CP Proposals** – this section outlines overarching steps that may minimise the risks posed by the potential disadvantages of the ASIC approach outlined in section 3.

The remainder of this covering letter discusses each of these topics.

1. The Big Picture - Challenges

Press articles on cryptocurrencies are ubiquitous. The following selection of articles in recent months demonstrates the range of views and strong emotions in this area. They are grouped below under three main headings: (a) the views of industry experts, which range from saying bitcoin has no value and/or should be unlawful, to the views of people who have invested billions of dollars in the asset; (b) main stream institutional acceptance of investment in bitcoin, and (c) the vibrant trading by retail investors in cryptocurrencies.

(a) Experts views: Bitcoin has no value/should be unlawful/Elon Musk

Retrieved on 19 July 2021 Hamish Douglass: *“Billionaire Magellan boss says bitcoin going to zero”* – see <https://www.afr.com/markets/equity-markets/billionaire-magellan-boss-says-bitcoin-going-to-zero-20210719-p58az5>

23 July 2021 The BIS & Martin Wolf: *“Bitcoin in particular has few redeeming public interest attributes when also considering its wasteful energy footprint.” In my view, such “currencies” should be illegal.* – see *“The Time to Embrace central bank digital currencies is now”*. <https://www.ft.com/content/7a93fb0a-ae95-44fc-a3d2-1398ef0ce1af>

February 2021 Elon Musk: *“In February, the price of Bitcoin soared after Tesla founder Elon Musk said the company had ploughed \$1.5bn into the cryptocurrency, and went on to reach a record high of more than \$60,000 in April.”* See <https://www.ft.com/content/a2c13ce0-6e66-4751-aa65-6c668d303101>

5 June 2021 Elon Musk: *“Bitcoin was down 4.6 per cent, sliding below \$37,000 a coin, after Tesla chief executive Elon Musk tweeted a meme suggesting a “break-up” with the world’s most popular cryptocurrency”* see <https://www.ft.com/content/8263e9ba-5991-4395-a2cd-73b0df2bb5b9>

22 July 2021 Elon Musk: *“Bitcoin, which dipped below \$30,000 earlier this week, is back above \$32,000 today, after influential tech chiefs Elon Musk and Jack Dorsey voiced their support at a conference on Wednesday.”* - <https://www.ft.com/content/f91f80d3-f9f3-470e-a5fb-19447679d145>

(b) Main stream Institutional & Regulatory Acceptance

19 May 2021: *“OSC head says now is the right time to green light cryptocurrency ETFs”* – see <https://www.theglobeandmail.com/business/article-osc-head-says-now-is-the-right-time-to-green-light-cryptocurrency-etfs/>

21 July 2021: *Bank of America is Clearing Crypto ETPs for Hedge Funds in Europe: Sources* – see <https://www.coindesk.com/bank-of-america-is-clearing-crypto-etps-for-hedge-funds-in-europe-sources>

21 July 2021: “BNY Mellon joins State Street in crypto trading push...Bank of New York Mellon has joined the consortium of six banks behind the launch of London-based [cryptocurrency trading platform] Pure Digital, three months after State Street became the first to announce its support for the planned exchange.” see <https://www.ft.com/content/e02f954e-e30f-4d7e-a88e-801474dcfe27>

8 July 2021: “Germany grants institutional funds the ability to invest in crypto” see <https://www.ft.com/content/c523fa52-25da-4d7e-8378-cc58bd1e6c89>

15 June 2021: A Global First: Bitcoin as National Currency...El Salvador puts the digital money on par with the U.S. dollar for all public and private debts. <https://www.wsj.com/articles/a-global-first-bitcoin-as-national-currency-11623796143?page=1>

(c) Trading by Australian Retail Investors in Cryptocurrencies

17 June 2021: “Binance Australia users consider class action over cryptocurrency exchange meltdowns” – see <https://www.dailytelegraph.com.au/news/nsw/binance-australia-users-consider-class-action-over-cryptocurrency-exchange-meltdowns/news-story/37f03aac915b776a244b4b4be249f49e>

19 April 2021: “More than 300,000 investors use BTC Market’s exchange [an Australian bitcoin exchange not regulated by ASIC] and Ms Bowler said there had been increasing interest in cryptocurrency in the last year with a 40 per cent increase in account openings during the last year” see <https://www.smh.com.au/business/small-business/coinbase-ipo-paves-way-for-local-market-20210419-p57kgz.html>

What these articles and emotions speak to, at the most fundamental level, is:

- the strong public interest in the effective regulation of services provided in relation to products that are invested in by phenomenally large numbers of investors, locally and globally;
- defining the services and products that trigger that regulation (a regulatory perimeter) is particularly challenging for cryptocurrencies.

This is the basic issue confronting regulators globally: how you do define the regulatory perimeter with respect to cryptocurrencies and what regulation is triggered by where that perimeter lies? This issue is being confronted at a time when the traded volumes of cryptocurrencies are significant: the Grayscale Bitcoin Trust currently has over US\$21billion in assets under management¹. As such, retail investors, including Australia investors, are already trading these products and doing so in large numbers.

CP 343 approaches the issue of defining the regulatory perimeter for cryptocurrencies in Australia, primarily in the context of the regulatory framework for exchange traded products, and there are benefits

¹ See https://ycharts.com/companies/GBTC/total_assets_under_management retrieved on 26 July 2021

and disadvantages in doing so:

Benefits: a framework may be delivered on a timely basis for investors to trade innovative products based on crypto currencies within the investor focused framework that applies to Australia's regulated markets;

Disadvantages: the framework for exchange traded products, including the Operating Rules of market operators, is not designed to define an overall 'regulatory perimeter' for financial services/investment products. Using the framework for regulating market operators and ETPs, to define an overall perimeter for cryptocurrency products, may create the benefits in the previous paragraph, but it also risks creating regulatory inconsistencies and inefficiencies, potentially diminishing competition between operators and issuers. This stems from the risk that it is ASIC selected criteria that is the dominant factor in what products are successful, not product innovation, best practice and investor preferences.

This issue is the dominant underlying theme of this submission and informs the answers provided by Chi-X to the CP questions.

2. Benefits of ASIC Framework

The ASIC framework for regulating market operators has delivered significant benefits for the Australian market place, including costs savings for market participants and product issuers that, on a conservative estimate, run into the hundreds of millions of dollars. That this has been achieved with foundation legislation in the Corporations Act that in some instances harkens back to compensation funds run by mutually owned stock exchanges, and paper share certificates, is no small feat. It is in large part due to ASIC's innovative regulatory approach that significant competition has developed between market operators on the quotation of investment products. This competition will continue and is likely to increase significantly.

The Corporations Act and associated rules, regulations and guidance, provide the foundations for regulating financial services in Australia and, all other things being equal, would be used to define a coherent overarching regulatory perimeter for cryptocurrencies. However, the Corporations Act framework is fundamentally unfit for defining the regulatory perimeter of a modern financial centre seeking to compete with other global centres that have a legislative, government and regulatory framework that is intensely focused on facilitating competition outcomes that enhance the services and products provided to investors (compare, for example, the interaction in the United Kingdom of the Financial Services and Markets Act 2000 and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001). This area and the relative merits of the legislative foundations in Australia and other financial centres, is beyond the scope of this submission. However, it is important to provide this context for the benefits of the ASIC approach in CP 343 of defining the regulatory perimeter for cryptocurrencies primarily through the framework for market operators: using the Corporations Act framework to define an overall regulatory perimeter is simply not an efficient or productive option.

The importance of this section 3, is to emphasise that while there are issues raised by the approach ASIC takes to the regulation of ETPs based on cryptocurrencies, it is the most efficient option available and ASIC is to be commended for undertaking this task. ASIC's approach to regulating market operators has

delivered such significant benefits, and the alternatives of defining a regulatory perimeter under the Corporations Act framework are so deficient, that the CP 343 proposals are appropriate overall steps to take. This sets the scene for the remaining two sections in this covering letter: the disadvantages of the ASIC approach and steps that can be taken to address them.

3. The Potential Disadvantages of the ASIC Approach

Having outlined the significant benefits of the ASIC approach in section 2, it is important to recognise and outline the potential disadvantages to that approach.

(a) Disincentives to Innovate/Commercially Sensitive Information

It is in keeping with the points made above (CP 343 is seeking to regulate crypto currencies through the framework for ETPs and market operators), that many of the issues raised in the CP go to the way in which market operators engage with prospective issuers on innovative new products.

For example, a new issuer of an innovative product based, say, on a new oil product may have a novel way of structuring the product, and using a non-WTI/Brent pricing mechanism, which will raise issues on how that product satisfies the requirements in the Chi-X/ASX Operating Rules and/or the Corporations Act. Each market operator will have a different way of responding to and working with a product issuer in these circumstances.

This aspect of a market operator's activity is a fundamental feature of its business and will differentiate it from its competitors.

This issue is raised by the CP because it seeks to define a regulatory perimeter in a framework that is not principally designed for that purpose. The Operating Rules of a market operator are designed to create a perimeter around products that are suitable for trading on a regulated market, but that is a very different issue from defining the 'regulatory perimeter' for the regulation of services and products generally. One very important distinguishing feature is that a market operator may legitimately work with an issuer on a new innovative product that address 'perimeter' issues in a way that is bespoke for that issuer and a direct result of a commercially sensitive and proprietary way of doing business.

This issue is raised on multiple occasions in the CP including, to give one example, the ways in which different market operators apply different rules and principles to determine the eligibility of an underlying asset.

(b) The impact of the proposals outlined in the CP

It is difficult to predict the future of cryptocurrency markets, so any attempt to analyse the impact of the CP proposals creates a number of imponderables. For example, if Mr Douglass is correct and the price of bitcoin goes to zero, or if Mr Wolfe is correct and bitcoin becomes unlawful, then the impact of the proposals is fundamentally different than if bitcoin increasingly becomes accepted as a national fiat currency and investment option.

In these circumstances, it may be more appropriate to outline the possible impacts, rather than seek to quantify them, and possible ways to mitigate the risks and negative impacts, while retaining the best possible chance of delivering the positive benefits.

In this context, it can be said that the proposals in the CP may have a wide ranging impact, including:

- (i) on the competitiveness of Australia as a financial centre;
- (ii) on the risks posed to retail investors of continuing to trade cryptocurrencies in largely unregulated environments;
- (iii) in the event a prescriptive approach is taken to legislating cryptocurrency standards (eg listing eligible assets, prescribing pricing standards, listing multiple custody requirements) there may be costs in having to revisit and update the regulatory framework for each new cryptocurrency/pricing arrangement/custody enhancement, including where new global best practices emerge that enhance services for investors, but are not currently prescribed;
- (iv) the proposals may disincentivise product issuer to innovate in the area of Australian ETPs, if a view is reached that such innovation comes without a distinct first mover advantage because it will be the subject of a public ASIC consultation process that requires the socialising of those innovations;
- (v) the proposals may diminish competition between market operators if they are prescribed in a manner that is aligned with the products to be traded on a single market.

4. The Critical Steps to Mitigate the Risks and Potential Negative Impacts of the CP Proposals

In these circumstances, Chi-X commends ASIC for its approach in CP 343 of seeking to provide a bespoke framework that is suitable for exchange traded products based upon cryptocurrencies. Chi-X is also of the view that there are two important steps that could be taken to address the most significant potential disadvantages in taking that approach:

(a) Engagement with Market Operators and Issuers

ASIC looks to a market operator to be the gatekeeper with respect to investment products traded on its market. Market operators undertake this role in the unique environment of balancing regulatory and supervision outcomes with the facilitation of innovation and business outcomes. The way in which this is achieved, while maintaining a solid and immutable foundation baseline of regulatory standards, must be for each market operator to determine, with appropriate ASIC intervention when genuine issues arise over that baseline.

Cryptocurrencies pose particular challenges for regulators and market operators over where that foundation baseline may be. However this challenge does not mean that it is for ASIC to solely determine how market operators will approach these issues. In the case of Chi-X, the issues will be determined in the way we usually approach innovation: seeking to deliver cost efficient innovation, while meeting clear and consistently applied regulatory standards, to enhance the services and products provided to customers and investors generally. Chi-X undertakes its investor protection role seriously and may effectively deliver the same goals ASIC is seeking to embed in prescriptive guidance/rules, through its own regulatory tools. In these circumstances, the most efficient way to deliver the most effective investor focused outcomes is likely to be through bilateral ASIC-CXA engagement.

An unavoidable consequence of the nature of cryptocurrencies, and the regulatory framework for market operators, is that the issues raised in the CP, and questions asked by ASIC, cover areas where it would be necessary, if Chi-X were to provide a full and complete answer, to outline proposed innovations yet to be delivered and other commercially sensitive material.

Chi-X is of the view that one important way to address the risks this poses, is for market operators and ASIC to continue to engage bilaterally on the innovative and bespoke methods each operator may have for bringing cryptocurrency ETPs to Australian investors.

(b) Avoiding Detailed Prescription

Chi-X is also of the view that taking an appropriate principles based approach that enables market operators and issuers to respond flexibly and dynamically, in a cost efficient and fit for purpose manner, and that delivers enhanced services to investors on a cost efficient basis, is a critical step that can be taken to mitigate the risks and potentially negative impacts of implementing the proposals in the CP. The cryptocurrency market is dynamic and rapidly changing. A principles based bilateral engagement with market operators is the most effective way of delivering an effective Australian framework for cryptocurrency ETPs.

How this may work in any particular instance (eg in the context of ASX or Chi-X Operating Rules and wider regulatory framework for ETPs and product issuers), is a matter which may be appropriately addressed on a case by case basis.

In summary: Chi-X looks forward to engaging with ASIC on the proposals outlined in the CP and addressed in detail in **attachment one**, using the principles outlined in section 4(a) and (b) of this covering letter to address the potential disadvantages outlined in section 3, while seeking to ensure we deliver the benefits in section 2, given the challenges outlined in section 1.

Please do not hesitate to contact Ross Pullen [REDACTED] or Michael Somes (details below) if you have any queries.

Yours faithfully

[REDACTED]

Michael Somes
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Chi-X Australia Pty Ltd
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Attachment One – CXA Answers to CP 343 Proposals and Questions

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
B1	<p>We propose to work with Australian market licensees to establish the following factors as the basis to identify particular crypto-assets that may be appropriate underlying assets for an ETP:</p> <p>(a) a high level of institutional support and acceptance of the crypto-asset being used for investment purposes;</p> <p>(b) the availability and willingness of service providers (including custodians, fund administrators, market makers and index providers) to support ETPs that invest in, or provide exposure to, the crypto-asset;</p> <p>(c) a mature spot market for the crypto-asset;</p>	Q1	Do you consider that crypto-asset ETPs should be available to retail investors through licensed Australian markets? Please provide details, including data on investor demand where available.	<p>Crypto assets, and products based upon them, are currently available to retail investors through unregulated onshore and offshore platforms. They are traded via these platforms in significant volumes.</p> <p>Crypto asset ETPs would provide a more enhanced regulatory framework for investors, and this is in the best interests of all stakeholders.</p>
		2	Do you consider that crypto-asset ETPs should be cleared and settled through licensed Australian clearing and settlement facilities? Please provide details.	<p>Cryptocurrencies should be cleared and settled through licenced clearing and settlement facilities, depending on the nature of each proposed product. ASX Clear and ASX Settlement have guidelines for engaging with market operators on a case by case basis in this regard. The highly liquid futures and spot markets may also be relevant in this regard</p>
		3	If you are a clearing participant, would you be willing to clear crypto-asset ETPs? Please provide your reasons	Not applicable
		4	If you are a trading participant, would you be willing to trade	Not applicable

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	(d) a regulated futures market for trading derivatives linked to the crypto-asset; and (e) the availability of robust and transparent pricing mechanisms for the crypto-asset, both throughout the trading day and to strike a daily net asset valuation (NAV) price.		crypto-asset ETPs? Please provide your reasons.	
		5	Do you agree with our approach to determining whether certain crypto-assets are appropriate underlying assets for ETPs on Australian markets? If not, why not?	CXA is supportive of model where principles are outlined in the Operating Rules of a market operator and issuers are encouraged to provide a submission to market operators on how those principles are satisfied on a case by case basis. This model would apply to crypto currencies by setting out the basic standards that must be met in the pricing, custody and risk management of the ETP. This model would enable issuers to respond to changes in the crypto currency market including changes in the relative dominance of a particular asset (eg Litecoin), the development of central bank crypto currencies, and the development of a market for digital tokens. This would enable the Australian market to continue evolving in a timely manner, reflecting global developments that deliver enhanced services to investors while ensuring ETPs satisfy the baseline principles outlined in the market operating rules and wider regulatory framework.
		6	Do you have any suggestions for additions or modifications to the factors in proposal B1? Please provide details.	The factors in proposal B1 are a good list of those that are currently relevant when considering whether a particular cryptocurrency has a readily available and transparent price and are subject to a reliable pricing framework. The

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
				degree of prescription may raise issues if an esoteric or unnecessarily restrictive interpretation is taken on what amounts, for example, to 'industry acceptance'.
		7	Do you have any suggestions for alternative mechanisms or principles that could achieve a similar outcome to the approach set out in proposal B1? Please provide details.	There is merit in applying a general principle: underlying assets must have a readily available and transparent price that is based on a reliable pricing framework and enables market participants and investors to determine the price at which units in the ETPs are and should be traded.
B2	We propose to work with Australian market licensees to establish a new category of permissible underlying asset for crypto-assets in their regulatory frameworks that, at a minimum, is consistent with the factors set out in proposal B1.	1	Do you agree that a new category of permissible underlying asset ought to be established by market operators for crypto-assets? If not, why not?	<p>Chi-X is of the view that there is merit in two high level approaches:</p> <ul style="list-style-type: none"> (a) Rely upon a combination of existing market operator rules that (i) contain general principles that apply to all underlying assets and (ii) apply appropriate filters for cryptocurrencies to ensure only those with readily available and transparent prices determined by a reliable pricing framework, may be the underlying assets of an ETP; or (b) Draft a new principles based rule that captures cryptocurrencies and then references relevant factors for eligibility in a place that can readily be

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
				<p>updated to accommodate new developments (including those which benefit investors).</p> <p>Chi-X has a preference for approach (a) as this may provide a flexible framework that enables Australia to keep pace with developments globally in what is a dynamic and rapidly changing industry and product.</p>
B3	<p>For crypto-assets, we propose the following good practices in relation to demonstrating a robust and transparent pricing mechanism:</p> <p>(a) The basis of the pricing mechanism for crypto-assets held by an ETP should be an index published by a widely regarded provider that:</p> <p>(i) reflects a substantial proportion of trading activity in the relevant pair(s), in a representative and unbiased manner;</p> <p>(ii) is designed to be resistant to manipulation;</p>	1	Do you agree with the good practices in proposal B3 with respect to the pricing mechanisms of underlying crypto-assets? If not, why not?	The principles are appropriate but should be sufficiently flexible to be applied on a case by case basis to products that meet the clear base line of readily available and transparent prices provided by a reliable pricing framework.
		2	Are there any practical problems associated with this approach? If so, please provide details.	A pricing agency may aggregate crypto prices in a way that is not characterised as a widely regarded index but nonetheless provides reliable pricing. Chi-X is of the view that the general principles of readily available and transparent prices provided by a reliable pricing framework are sufficient and deliver a standard that is at least the equivalent of a widely regarded index. .
		3	Do you think crypto-assets can be priced to a robust and transparent	Yes, there is a lot of evidence that crypto-assets can be priced to a robust and transparent standard on a

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	(iii) complies with recognised index selection principles such as the International Organization of Securities Commission (IOSCO) Principles for financial benchmarks, the EU Benchmarks Regulation, or other internationally recognised index selection principles; and (b) Pricing mechanisms which rely on a single crypto-asset spot market would be unable to achieve robust and transparent pricing.	4	standard? Please explain your views. Do you consider that a more robust and transparent pricing standard is achievable in relation to crypto-assets? For example, by using quoted derivatives on a regulated market. Please explain and provide examples where possible.	consistent basis over many years and during periods of significant market stress. It is not clear whether the question is seeking views on (a) whether ETPs based on a futures or other derivatives contract would be based on a more reliable priced asset than one based on actual bitcoin, or (b) if the questions is asking whether the presence of a liquid and high volume futures market for bitcoin is a factor in establishing reliable pricing for bitcoin generally, because of the impact of that regulated derivatives market on the market for the underlying assets. Chi-X is of the view that the latter point (b) is highly relevant: the cost and practicality of manipulating the price for the underlying asset becomes prohibitive if a highly liquid futures market exists for short term contracts in that underlying asset. This type of liquid contract is the best 'regulator' of manipulation and exists in relation to the CME contract for bitcoin futures.
B4	We propose not to include any further expectations in INFO 230 in relation to crypto-asset ETPs.	1	Are there any other good practice expectations in INFO 230 that need	No

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
			to be clarified or modified to accommodate crypto-asset ETPs?	
C1	<p>We propose the following good practices for REs in relation to the custody of crypto-assets: (a) The chosen custodian has specialist expertise and infrastructure relating to crypto-asset custody.</p> <p>(b) The crypto-assets are segregated on the blockchain. This means that unique public and private key(s) are maintained on behalf of the RE so that the scheme assets are not intermingled with other crypto-asset holdings.</p> <p>(c) The private keys used to access the scheme's crypto-assets are generated and stored in a way that minimises the risk of unauthorised access. For example: (i) solutions that hold private keys in hardware devices that are physically isolated with no connection to the internet</p>	2	Do you agree with our proposed good practices in relation to the custody of crypto-assets? If not, why not? Please provide any suggestions for good practice in the custody of crypto-assets.	<p>Yes.</p> <p>In keeping with comments elsewhere in this submission Chi-X is of the view that the principles in RG 133 are sufficient and should be applied to cryptocurrencies on a case by case basis. Doing this would enable product issuer to adopt global best practice including those which enhance investor protection even though they may not yet be on the ASIC list.</p>
		2	Are there any practical problems associated with this approach? If so, please provide details.	Chi-X is reluctant to preclude firms that otherwise may be expert in providing custody services from entering the crypto currency market purely because they have not previously undertaken crypto currency specific services. .
		3	Do you consider there should be any modifications to the set of good practices? Please provide details.	Chi-X would recommend the introduction of wording that accommodates custody providers that "have or are able to demonstrate how they will provide specialist expertise."
		4	Do you consider that crypto-assets can be held in custody, safely and securely? Please provide your reasons.	Yes, there are similarities between crypto currencies and other commodity assets which involve, for example, vault considerations. As standards for commodity vaults and custody have developed over time, so too it is to be

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	<p>(cold storage) are preferred. Private keys should not be held on internet-connected systems or networked hardware (hot storage) beyond what is strictly necessary for the operation of the product; and</p> <p>(ii) the hardware devices used to hold private keys should be subject to robust physical security practices.</p> <p>(d) Multi-signature or sharding-based signing approaches are used, rather than 'single private key' approaches.</p> <p>(e) Custodians have robust systems and practices for the receipt, validation, review, reporting and execution of instructions from the RE.</p> <p>(f) REs and custodians have robust cyber and physical security practices with respect to their operations, including appropriate</p>			<p>expected the custody for cryptocurrencies will also develop.</p> <p>The principles in RG 133 apply generally to custody providers and are adequate to cover the segregation, identification, tracing and security requirements for the custody of cryptocurrencies.</p>
		5	Do you have any suggestions for alternative mechanisms or principles that could replace some or all of the good practices set out in proposal C1? Please provide details.	It is not clear that crypto currencies require a bespoke custody regime separate from that applying to commodities.
		6	Should similar requirements to proposal C1 also be imposed through a market operator's regulatory framework for ETPs? If so, please provide reasons and how it could work in practice.	Conditions on quotation may be an appropriate avenue for imposing custody requirements. Chi-X will explore this on a bilateral basis with ASIC.

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	<p>internal governance and controls, risk management and business continuity practices.</p> <p>(g) The systems and organisational controls of the custodian are independently verified to an appropriate standard—for example, through a SOC 2 Type II or equivalent report.</p> <p>(h) REs and custodians have an appropriate compensation system in place in the event a crypto-asset held in custody for REs is lost.</p> <p>(i) If an external or sub-custodian is used, REs should have the appropriate competencies to assess the custodian’s compliance with RG 133.</p>			
C2	<p>We propose the following good practices in relation to the risk management systems of REs that hold crypto-assets:</p>	1	<p>Do you agree with our proposed good practices in relation to risk management systems for REs that hold crypto assets? If not, why not?</p>	<p>This question again raises issues around defining a regulatory perimeter through a framework for market operators and ETPs. There are issues raised by what “legally compliant and regulated crypto-asset trading</p>

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	<p>(a) If the RE undertakes trading activity in crypto-assets, it should do so on legally compliant and regulated crypto-asset trading platforms. For this proposal, we consider an appropriate baseline level of regulation to be know your customer (KYC) and anti-money laundering and counter-terrorism financing (AML/CTF) obligations.</p> <p>(b) The RE should ensure that authorised participants, market makers and other service providers that trade crypto-assets in connection with the product do so on crypto-asset trading platforms that meet the same standard as in proposal C2(a).</p> <p>(c) The RE is responsible for ensuring its risk management systems appropriately manage all other risks posed by cryptoassets.</p>	2	Are there any other regulations (other than KYC and AML/CTF) that should form part of an appropriate baseline level of regulation for crypto-asset trading platforms used by REs and connected service providers? Please provide details.	<p>platforms” actually means and how KYC/AML/CTF standards would be verified.</p> <p>Trading in cryptocurrencies by an RE and/or other entities associated with a quoted TP will depend on the ETP model and the process by which it prices units and ensures they track the underlying assets. As such, the risk management practices of an RE will be considered holistically by a market operator in the context of the product that is to be quoted. That holistic consideration will address issues of pricing and orderliness of the market for the underlying asset.</p> <p>Chi-X is of the view that this area is covered by the existing regulatory obligations of REs and any good practice should be principles based allowing for a case by case consideration that is linked to the product model.</p>
		3	Are there any practical problems associated with this approach? If so, please provide details.	
		4	Are there any other matters related to holding crypto-assets that ought to be recognised in the risk management systems of REs and highlighted through ASIC good practice information? Please provide details and any specific proposals.	
		5	Should similar requirements to proposal C2 also be imposed through a market operator’s regulatory framework for ETPs? If so, please provide reasons and	

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
			outline how it could work in practice.	
C3	<p>We propose the following good practices regarding the RE's disclosure obligations in relation to a PDS for a registered managed investment scheme that holds crypto-assets:</p> <p>(a) The RE should consider disclosing information about the unique characteristics of crypto-assets. This may include:</p> <p>(i) the technologies that underpin crypto-assets, such as blockchains, distributed ledger technology, cryptography and others;</p> <p>(ii) how crypto-assets are created, transferred and destroyed;</p> <p>(iii) how crypto-assets are valued and traded; and</p> <p>(iv) how crypto-assets are held in custody.</p>	6	Do you agree with our proposed expectations regarding disclosure obligations for registered managed investment schemes that hold crypto-assets? If not, please explain why not.	Chi-X supports a simple disclosure regime that is focused on concise and meaningful disclosures. In the context of disclosures for crypto- currency products, the most meaningful disclosure may be a simple and prominent statement that investors may lose the total sum of their investment. In particular, Chi-X is concerned that if a list of disclosure is imposed on issuers, then the meaning of the disclosures may be lost on retail investors who simply skip text addressing that risk.
		7	Are there any practical problems associated with this approach? If so, please provide details.	Chi-X is conscious that overly prescriptive disclosure requirements can have a counterproductive impact.
		8	Are there any additional categories of risks that ought to be specified by ASIC as good practice for disclosure in relation to registered managed investment schemes that hold crypto-assets?	Chi-X can see merit in a limited number of risks being specified to facilitate a meaningful and focused disclosure.

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	<p>(b) The RE should consider providing appropriate disclosure of the following and other risks:</p> <ul style="list-style-type: none"> (i) market risk—historically, cryptoassets have demonstrated that their investment performance can be highly volatile and there is a risk that they could have little to no value in the future; (ii) pricing risk—it may be difficult to value crypto-assets accurately and reliably given the nature of their trading and difficulty in identifying fundamentals; (iii) immutability—most crypto-assets are built on immutable blockchains, meaning that an incorrect or unauthorised transfer cannot be reversed and can only be undone by the recipient agreeing to return the crypto-assets in a separate transaction; 			

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	<p>(iv) increased regulation risk—both crypto-assets and their spot markets are largely unregulated at this moment. This may change in the future;</p> <p>(v) custody risk—the private keys may be lost or compromised, resulting in crypto-assets being inaccessible or accessed by unknown third parties without authorisation;</p> <p>(vi) cyber risk—the nature of cryptoassets may mean they are more susceptible to cyber risks; and</p> <p>(vii) environmental risk—crypto-assets, especially those based on proof-of work consensus mechanisms, by design require significant amounts of energy to operate.</p>			
C4	We propose not to issue any additional expectations about how the design and distribution	1	Are there any aspects of the DDO regime that need to be clarified for investment products that invest in,	Chi-X agrees with the ASIC position.

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	obligations (DDO) can be met for investment products that invest in, or provide exposure to, crypto-assets.		or provide exposure to, cryptoassets?	
D1	<p>We propose to work with market operators to establish that:</p> <p>(a) the approach used to determine and classify appropriate crypto-assets for investment entities is the same as that set out in Section B for ETPs;</p> <p>(b) in respect of the admission process, to be considered to have a structure and operations that are appropriate for a listed entity, a LIC that invests a material amount in crypto-assets is expected to:</p> <p>(i) have a custody solution for its crypto-assets that is consistent with the expectations for custody set out in proposal C1;</p> <p>(ii) ensure it only trades crypto-assets on crypto-asset markets that</p>	1	Do you agree that crypto-assets are capable of being appropriate assets for listed investment entities on Australian markets? If not, why not?	<p>The issues raised by the use of crypto currencies in listed investment entities, are different to those raised in respect of the use of this asset class in quoted ETPs.</p> <p>The relative focus of the CP on ETPs may indicate that a competitive advantage exists for listed investment entities in the lack of regulatory attention paid to the listed entity market.</p> <p>This would be an unfortunate outcome and a potentially significant distortion of the competition between listed entities and quoted ETPs.</p> <p>The listed entity product has its own bespoke issues in relation to those that are based on cryptocurrencies and these should be addressed separately.</p> <p>Chi-X also notes the relative lack of competition currently between market operators that provide listed funds.</p>

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	<p>are regulated in a manner consistent with proposal C2; and (iii) value crypto-assets held by the LIC using an approach that is consistent with expectations for pricing set out in proposal B3; (c) in respect of the admission process, to be considered to have a structure and operations that are appropriate for a listed entity, a LIT that invests a material amount in crypto-assets should value crypto-assets held by the LIT using an approach that is consistent with expectations for pricing set out in proposal B3; and (d) the expectations for the admission of LICs and LITs set out in subparagraphs (b) and (c) above should also be ongoing requirements of listing (e.g. they should be imposed as a condition of listing).</p> <p>Note: Listed investment entities must also provide adequate</p>	2	Do you agree with our proposed expectations for LICs and LITs that invest in crypto-assets to ensure equivalent standards are applied by market operators? If not, why not?	As stated above, listed entities that are based on cryptocurrencies pose separate issues to quoted ETPs and these should be addressed separately.
		3	Are there any practical problems associated with this approach? If so, please provide details.	
		4	Are there additional standards which ought to apply via market operators to LICs or LITs that invest in crypto-assets? If so, what are these expectations and why should they apply?	
		5	Should LICs and LITs only be able to invest significant funds in crypto-assets if this is either set out in their investment mandate or with member approval? If not, why not?	
		6	For the purposes of this proposal, we consider a material investment	

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
	disclosure at the time of listing (see paragraphs 69–75) and will be subject to DDO (see paragraphs 76–81).		is where an entity invests or plans to invest more than 5% of its funds in crypto-assets. Should another materiality threshold apply?	
E1	We propose to establish a new asset kind that can be selected when applying for a new AFS licence, or a variation to an existing AFS licence, to operate a registered managed investment scheme which holds a particular kind of asset. This asset kind will cover crypto-assets.	1	Do you agree with our proposal to establish a new asset kind that will cover crypto-assets?	<p>This question raises fundamental issues on the Australian regulatory framework for defining the regulatory perimeter which triggers regulatory standards and which are outlined in sections 3 and 4 of the covering letter. In keeping with those comments, Chi-X can see merit in:</p> <ul style="list-style-type: none"> (a) retaining the existing framework and applying existing terminology if at all possible to ensure Australia can develop in a way that is aligned with global best practice with minimal cost and maximum efficiency; (b) if (a) is not possible, then introducing a general principles based criterion for a new asset kind that will cover crypto assets, (c) as a last resort, given that it may require re-visiting each time a newly named product arises, listing some crypto assets by name. <p>If at all possible the aspects of the AFSL licensing regime raise din proposals E1 and E2 should be separately</p>

Proposal No.	Proposal	Q No.	Consultation Question	CXA Response
				addressed by ASIC in a way that does not impact on the timetable for introducing ETPs based on crypto currencies.
		2	Do you consider that crypto-assets may be captured by the existing asset kinds? If so, please explain.	Chi-X has a preference for exhausting the possibility of existing criteria being sufficient.
E2	When granting an AFS licensee's authorisation to operate a registered managed investment scheme which holds crypto-assets, we will restrict the crypto-assets the registered managed investment scheme can hold by reference to the factors set out in proposal B1. Accordingly, at this point in time, we consider that such authorisations could only be given to operate registered managed investment schemes that hold bitcoin or ether.	1	Do you agree with our approach to restrict the crypto-assets a registered managed investment scheme is authorised to hold (e.g. to bitcoin or ether)?	It is not certain that this proposal accommodates all current AFSL models for responsible entities.
		2	Do you consider there are any other aspects of the AFS licensing regime that need to be clarified or modified to accommodate investment products that invest in, or provide exposure to, crypto-assets?	This questions raises the fundamental issue in the covering letter of the Chi-X submission: the inefficiencies raised by addressing the regulatory perimeter for crypto currencies in a framework for market operators quoting ETPs.