



# Response to Consultation Regarding Crypto-assets as underlying assets for ETPs and other investment products initiated by ASIC (CP343)

July 2021

*This comment letter is provided by CF Benchmarks, the UK Financial Conduct Authority (FCA) regulated Administrator of Cryptocurrency Benchmarks, including the CME CF Bitcoin Reference Rate – the most widely benchmark price for bitcoin that is the settlement mechanism for CFTC regulated bitcoin futures contracts (to date over \$350bn of contracts settled) listed for trading by CME Group and is tracked by a number of ETPs listed for trading on the TSX, Brasil, Bolsa, Balcao (B3), XETRA and SIX.*

## Introduction

The Australian Securities and Investment Commission (ASIC) has published a consultation paper regarding proposed minimum standards; (i) for the listing and trading of any ETPs that reference crypto assets on licensed Australian exchanges within Australia and (ii) for product issuers that intend offer ETPs that reference crypto assets. These minimum standards seek to (i) ensure the integrity of the markets operated in Australia *vis a vis* ETPs and meet the existing requirements of ETPs as codified in INFO230 and (ii) ensure that Responsible Entities (REs) fulfil their obligations to members as codified in a series Regulatory Guides and Class Orders that have been published by ASIC. The consultation covers a number of areas. As a regulated Benchmark Administrator CF Benchmarks' expertise is predominantly centred around crypto-asset data, how it is used to support crypto-asset ETPs and the role it plays in ensuring ETPs comply with prevailing regulations so its comments will be confined to these matters. It is important to note however that this function not only applies to the operation of crypto-asset ETPs once trading but also the analysis that is undertaken (as this will require evaluating crypto-asset market data) to establish the fulfilment of any stated criteria before a crypto asset ETP is launched.

## Meeting INFO 230 Expectations: Suitability of crypto-assets and identifying features

ASIC has laid out a series of high-level principles the following proposals when considering the eligibility of crypto assets to serve as underlying assets for any ETPs that may be listed for trading. In answer to the specific questions:

### ***B1Q5 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?***

The criteria that have been out by ASIC in B1 are certainly the appropriate principles that should be considered to form the basis of an evaluation of a crypto asset that can be an underlying asset to an ETP and meet the objectives of INFO230. However, given the specifics of the markets for crypto assets CF Benchmarks is of the view that in relation to some of the criteria

#### ***(a) a high level of institutional support and acceptance of the crypto-asset being used for investment purposes;***

Although "Institutional support and acceptance" would clearly imply a degree of market maturity (a desirable quality) for a crypto asset it is a difficult concept to measure, and the definitions would vary from jurisdiction to jurisdiction and hence data can be inconsistent. This criterion needs to be applied carefully and perhaps

#### ***(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;***

CF Benchmarks regards the availability of such service providers as *sine non qua* for any ETP (whether crypto asset based or not) to be able to meet the expectations of INFO230 and should be a cornerstone measure of any proposed standards regime

#### ***(c) a mature spot market for the crypto-asset***

As the ASIC has acknowledged in the consultation paper the spot markets for cryptocurrency are not regulated within Australia, and globally very few jurisdictions have implemented a comprehensive regulatory regime for spot crypto-asset trading. Furthermore, the decentralised nature of crypto asset trading means that there are well over 200 venues where crypto assets are purported to be traded that all publish their "market data". In considering whether a "mature spot market" exists for a given crypto-asset data will have to be utilised and conclusions drawn - this causes a number of issues *vis a vis* the proposed criteria:

**Fake Volumes:** As has been evidenced previously by a number of market participants and observers the veracity of this "trade data" can be difficult to establish and much of which is likely to be fabricated<sup>1</sup> for promotional purposes, ASIC goes on to elucidate this concern in Section 42 of the consultation paper.

**Market Integrity:** Given the lack of capital markets regulatory oversight of spot crypto asset markets the integrity of such markets (whether they have been subject to forms of market manipulation) can be hard to determine.

**Compliance with appropriate regulations including AML/KYC:** not all crypto asset spot venues comply with all appropriate AML/KYC regulations, including some very large and well-known venues, who through incorporating in offshore "haven" jurisdictions have, until very recently, escaped censure.<sup>2</sup>

**"Trading":** Crypto asset trading takes many forms., many crypto-asset markets facilitate the trading of crypto-assets against other crypto assets (including so called "stablecoins") whilst relatively few do so against major currencies – such as USD, EUR, AUD. ASIC should consider whether it views trading of crypto-assets against other cryptoassets as trading that is *pari passu* with that of crypto assets against major currencies such as USD and EUR.

Given these issues CF Benchmarks would suggest that both listing exchanges and RE's should apply strict standards to **sourcing data** in consideration of this criteria, specifically how they can rely on the data they utilise and what due diligence has been performed on the crypto-asset spot venues they have sourced the data from, given the lack of a regulatory framework that any venue has not **to date** been censured offers no assurance of it being in compliance with the appropriate regulation. Furthermore, any analysis of the data that is used or evidence a mature spot market should provide granularity as to the exact trading markets ie. crypto-asset against USD or other crypto-assets and the rationale for co-mingling such data

**B1Q6** *Do you have any suggestions for additions or modifications to the factors in proposal B1? Please provide details.*

See above response to B1Q5

**B1Q7** *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.*

See above response to B1Q5

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<sup>1</sup> Bitwise Asset Management, 2019, "Presentation to the US Securities & Exchange Commission, Bitwise Asset Management"

<sup>2</sup> <https://www.bloomberg.com/news/articles/2021-06-27/u-k-financial-regulator-bars-crypto-exchange-binance>

**B2Q1** 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?

CF Benchmarks is in agreement that the establishment of a new category of permissible underlying asset for crypto-assets is an appropriate means by which to achieve ASICs aims.

### Meeting INFO 230 Expectations: Robust and Transparent Pricing Mechanisms

**B3Q1** Do you agree with the good practices in proposal B3 with respect to the pricing mechanisms of underlying cryptoassets? If not, why not?

In general CF Benchmarks is of the view that the proposals laid out are strong foundations for requirements associated with pricing mechanisms for underlying crypto-assets. Specifically in relation to the requirements that;

***“The issuer should be satisfied that the index methodology sets out a robust framework for selecting constituent crypto-asset trading platforms and that the index provider reviews their list of constituent crypto-asset trading platforms on a regular basis.”***

CF Benchmarks has followed such a process for the crypto-asset indices it provides for a number of years:

- Raw transaction and order data from crypto-asset spot venues that meet its published criteria:
  - <https://docs-cfbenchmarks.s3.amazonaws.com/CF+Constituent+Exchanges+Criteria.pdf>
  - Crypto-asset spot venues are verified as conforming the criteria upon inclusion
  - Crypto-asset spot venues are reviewed annually thereafter to confirm continued conformance
  - CF Benchmarks oversight organs provide oversight of this process and meeting minutes are published on the CF Benchmarks website

CF Benchmarks experience in settling regulated crypto derivatives contracts and supporting crypto-asset ETPs in other jurisdictions believe this requirement is necessary to ensure the integrity of any any pricing mechanism for crypto-assets as it is in effect a quality assurance measure for **input data**.

***“The issuer should be satisfied that the index is designed in a way that is resistant to manipulation. This should be demonstrated both in the way constituent crypto-asset trading platforms are selected and retained, and in the way the index is calculated.”***

Resistance to manipulation is a priority aim of the design methodology underlying all CF Benchmarks indices. All CF Benchmarks methodologies contain specific manipulation resistance measures and whose efficacy is under continuous monitoring. CF Benchmarks has published extensive and detailed analysis of how its measures to promote manipulation resistance operate and the patterns of data that have been observed in the raw Input data that it utilises from crypto-asset spot venues, please see [‘An analysis of the suitability of the CME CF BRR for the creation of regulated financial products’](#).

Given the unregulated nature of the crypto-asset spot markets that provide the underlying data for the calculation of crypto-asset indices CF Benchmarks believes that a crypto-asset index provider for a pricing mechanism used by a crypto-asset ETP should also be under an obligation to **surveil** the index. This allows

the crypto index provider to be able to detect any actual or attempted manipulation and analyse the necessary changes to its methodology or crypto-asset spot markets that are used as input data sources as necessary.

***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.***

Robust pricing standards can indeed be achieved by utilising data from regulated derivatives markets. However, these also come with their own challenges. Typically, a crypto-asset ETP would likely be holding "physical" crypto-assets and thus require a measure of the "spot" market as a representative pricing mechanism. Derivative contracts trade with embedded premiums/discounts, in the crypto-asset space these can be very significant and hence derivative based pricing mechanisms may not be representative of ETPs that hold "physical" crypto-assets. Having said that it could of course be possible for a crypto-asset ETP to hold regulated derivative contracts as opposed to "physical" crypto assets. In this case a pricing mechanism based on regulated crypto-asset derivatives is likely to be the more representative and hence appropriate measure.

In general, it is CF Benchmarks' view that the measures proposed by ASIC in conjunction with CF Benchmarks recommendations would achieve a pricing standard with high integrity and *pari passu* with the expectations of INFO 230 for pricing mechanisms for ETPs.