



SUBMISSION PAPER:

ASIC Consultation Paper 343: Crypto-assets as underlying assets for ETPs and other investment products

August 2021

This Submission Paper was prepared by FinTech Australia working with and on behalf of its Members; over 300 FinTech Startups, VCs, Accelerators and Incubators across Australia.



Table of Contents

About this Submission	3
Submission Process	3
ASIC Consultation Paper 343	4
Introduction	4
No other INFO-230-related guidance	12
Responsible entity obligations	12
Risk management	15
Disclosure	17
Design and distribution obligations	18
Listed investment entities	19
AFS licensing	20
Conclusion	26
About FinTech Australia	26



About this Submission

This document was created by FinTech Australia in consultation with its Digital Currency and Blockchain Policy Group, which consists of over 50 company representatives.

Submission Process

In developing this submission, our Digital Currency and Blockchain Policy Group Group held a series of Member roundtables/teleconferences to discuss key issues relating to ASIC Consultation Paper 343.

We also particularly acknowledge the support and contribution of The Fold Legal to the topics explored in this submission.



ASIC Consultation Paper 343

Introduction

We would like to thank ASIC for allowing us the opportunity to respond to the ASIC Consultation Paper 343: Crypto-assets as underlying assets for ETPs and other investment products (**CP 343**).

Executive Summary

Crypto-assets are a growing industry and our members are encouraged that ASIC is proactively considering the potential to provide investors with access to exchange traded products (“**ETPs**”) where a crypto-asset is the underlying product. Our members acknowledge that the crypto-asset industry is innovative, volatile and complex. This raises complexity in working through the applicable regulatory requirements. However, our members are encouraged that ASIC is looking to facilitate trading of these assets through exchange traded products which comply with the requirements which would apply to ETPs with other underlying products.

Our members also note that any system which facilitates trading of ETPs which have crypto-assets as underlying products:

- Acknowledges the current regulatory framework;
- Balances consumer protections;
- Is consistent with the policy settings;
- Does not engender regulatory asymmetry; and
- Does not unduly influence how ETP issuers invest in crypto-assets or how investors invest in ETPs that have exposure to crypto-assets.

We have provided answers to the questions posed in CP 343 after extensive consultation with our members. We believe that the approach recommended in these answers will strike an appropriate balance between regulation, innovation, consumer protection, market efficiency and competition.

Context



Currently, how a crypto-asset is treated in Australia is dependent on the nature of the asset itself. Some crypto-assets may be regarded as a commodity (much like gold). Others will be financial products where they fall within the definition of a specific financial product¹ or within the broader overarching definitions of a financial product,² and are not otherwise exempt. This depends on the way in which a given crypto-asset is structured or the rights provided to a person who acquires and holds the product. Crypto-assets are most likely to be regulated as a security,³ interest in a managed investment scheme⁴ or a derivative⁵ (but there are others). ASIC has addressed this in INFO 225.⁶ It is worth noting that, where a facility which is a financial product itself invests in a crypto-asset, regardless of whether or not that crypto-asset is a financial product, the facility through which the investment is made is itself likely to be a financial product. Any person providing a financial service in relation to that facility which is a financial product, or operating a market in relation to that product may be required to hold the requisite licence to do so.

Currently, many Australians are buying, selling, holding, lending, staking or undertaking other activities in relation to crypto-assets. There is a view that most (if not all) of these activities currently fall outside the scope of financial services regulation and ASIC supervision. In addition, new crypto-asset investment services are beginning to emerge. Again there is a view that most of these services are similarly outside the scope of existing financial regulation. Whether or not this is the case is not relevant for the purposes of this submission. Some aspects of this are currently being considered in the Third Issues Paper of the Senate Select Committee into Australia as a Technology and Financial Centre. As such, we make no further comment in relation to this.

Whilst this submission makes no further comment in relation to the outcome of the Senate Committee, any regulation of ETPs which invest in crypto-assets by ASIC should align with the policy and commercial settings FinTech Australia outlined in their submission to the Senate Committee's third issues paper. It is also imperative that any regulation of crypto-assets does not place Australian businesses at a competitive disadvantage or on un-equal footing with unregulated foreign service providers.

¹ See *Corporations Act 2001* (Cth) ("**Corporations Act**"), s764A.

² See *Corporations Act*, ss763A – 763D.

³ *Corporations Act* s764A(1)(a).

⁴ *Corporations Act* s764A(1)(b) and (ba).

⁵ *Corporations Act* s764A(1)(c), see also s761D.

⁶ ASIC Information Sheet INFO 225 – Initial coin offerings and crypto-currencies (May 2019) (available online at <https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-crypto-assets/>).



It is also critical that any regulation does not unintentionally drive regulatory asymmetry and, in turn, lead to perverse regulatory outcomes that undermine consumer protection, market efficiency and competition. The inability to register schemes which have crypto-assets as an underlying product or to list these products on exchanges is an asymmetry. Our members are encouraged that ASIC is seeking to rectify this asymmetry as set out in this CP 343.

To this end, ASIC's approach to regulation should be asset agnostic when it comes to the underlying assets ETPs invest in, particularly in light of the robust regulatory framework that currently applies to ETPs. That is to say, either the assets in which an ETP invests in are themselves financial products (and therefore subject to regulation independently) or they are not, and the risk profile of the asset itself should not drive additional regulation separately from whether that asset is separately regulated. While crypto-assets may be a volatile and high risk asset class, there are many other unregulated high risk assets that ETPs may invest in, and ASIC permits these to be managed by the issuer taking into account the risk profile of the underlying asset.

The appetite for investment in crypto-assets is growing and becoming more mainstream. It is in this context that we are also seeing financial service providers turning to crypto-assets as a high growth asset that investors want to access via regulated products. Access to crypto-assets via ETPs should be regarded as a positive move for consumers, as it will provide consumers with the regulatory protections that apply to investments in ETPs, somewhat managing the risk posed to investors from investing directly in the underlying. However, our members are concerned that ASIC's proposed good practice may overstep the requirements which would otherwise be required of ETPs and ultimately discourage them from issuing products which invest in crypto-assets. ASIC's proposal may be overly burdensome and costly, without adding any meaningful consumer protections.

These requirements engender regulatory asymmetry in financial markets where:

- Investors can directly invest in crypto-assets in an unregulated environment with minimal protections and regulatory oversight; and
- Financial service providers who wish to offer investors exposure to crypto-assets in traditional investment vehicles are subject to regulatory requirements which go beyond their current requirements without adding any meaningful protections.

Our members are concerned that the cost of compliance and undue regulatory oversight will discourage ETPs to be developed which invest in crypto-assets. This will continue to limit access to crypto-assets via traditional investment vehicles. This is a poor consumer outcome as consumers will continue to access exposure to crypto-assets via direct markets and not via ETPs (and those consumers may not have an ability to understand the risks involved or how to



mitigate against them). By contrast, ETP providers have significant investment expertise, experience and skills, and whose offerings to retail clients are already subject to high regulatory protections.

Our members strongly encourage ASIC to reconsider the position it has taken on ETPs and crypto-assets in light of the points raised in this submission.

Definition

We note that the definition of crypto-assets in CP 343 is high level and generic. While ASIC's working understanding of crypto-assets may evolve over time, our members are concerned to make sure that any definition of crypto-asset is appropriate and readily identifies those assets that would fall within the definition. In this regard, we think that there is an opportunity to better define "crypto-asset". See our response to B2 below.

Suitability of crypto-assets and identifying features

B1Q1: 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.

Our members are of the view that crypto-asset ETPs should be available to retail investors. Investors will typically hold a range of investments which includes exposure to high risk investments. The proportion of their exposure will be dictated by the investor's risk tolerance. ETPs provide a layer of protection to retail investors that direct investment in crypto-assets does not as the ETP issuer is responsible to the retail clients and provides them with disclosure in relation to the investment, including the underlying.

Issuing and listing ETPs on a licensed market will provide benefits to retail clients such as liquidity, market efficiency, transparency, compliance and monitoring. By accessing these through established trading structures, retail clients will be able to access exposure to crypto assets without being required to have knowledge of the technology behind crypto markets.

We welcome ASIC's initiative to make crypto-asset ETPs available to retail investors through licenced Australian markets and believe there is retail investor demand for such products.

However, by limiting the ETPs offerings to BTC and ETH, we are disadvantaging retail investors. By restricting retail access to BTC and ETH, retail investors are denied the diversification



benefits and net gains they could potentially make from other crypto-assets. Limiting ETP offerings to BTC and ETH may expose investors to greater market volatility and illiquidity. Further, such limited offerings are unlikely to meet the investment objectives of investors. The result being that investors will be driven offshore to unregulated financial products or direct markets that do not have the benefit of robust regulatory oversight and access to any legal remedies. The cryptocurrency space is fast moving and there is a risk that any prescriptions may become out of date or irrelevant.

Research suggests that 47% of Australians earning over AUD\$100,000 p.a. have some exposure to crypto-assets, and 4 million Australians are likely to purchase crypto-assets in the next 12 months.⁷ Many of these individuals will not qualify as wholesale investors. This is a sizable addressable market and it would be disadvantageous to ETPs and, in turn investors, if ETPs were precluded from offering access to a range of crypto-assets. In the event that ETP investment was limited to certain crypto-assets, investors will find different avenues for gaining the exposure they desire whether it be through crypto currency exchanges or unregulated products overseas, which do not have the same protections afforded by ETPs. This would be a poor consumer outcome.

B1Q2 Do you consider that crypto-asset ETPs should be cleared and settled through licensed Australian clearing and settlement facilities? Please provide details.

Yes. These clearing and settlement facilities are already well established to clear and settle ETPs. We believe ETPs should be cleared and settled through licensed parties, broadly in the same manner as other commodity based ETPs.

B1Q3: If you are a clearing participant, would you be willing to clear crypto-asset ETPs? Please provide your reasons.

Our members are unable to comment on this as they are not clearing participants.

B1Q4: If you are a trading participant, would you be willing to trade crypto-asset ETPs? Please provide your reasons.

Our members, some of whom are trading participants, expressed that they would be willing to trade crypto-asset ETPs.

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<https://www.afr.com/companies/financial-services/four-million-aussies-set-to-buy-into-crypto-20210608-p57z2g>



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?

No. Our members are of the view that ETP issuers are best placed to form a view as to whether crypto-assets are an appropriate underlying asset having regard to the current regulatory framework and, if so, what exposure should ETPs have to crypto assets (both in terms of type and percentage). It is critical that ASIC's regulation of ETPs does not unduly influence ETP issuers' assessment of this.

Our members are also of the view that any framework that is developed needs to be highly flexible and agile given how quickly the market changes. Our members believe that ASIC will need to ensure it is regularly consulting with the industry so that it is able to support innovation of crypto-asset backed ETPs.

Further, our members believe futures trading (requirement B1(d)) is not required and can be substituted by a requirement that the crypto-asset be included in an index or price assessment published by S&P, Nasdaq, CBOE or any other reputable provider. This will align the requirements with the requirements for ETPs that invest in commodities.

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

Our members are of the view that the requirement for a regulated futures market for trading derivatives linked to the crypto-asset would limit the ability for ETPs to have underlying crypto-assets other than bitcoin and ether. ASIC should consider whether this is a necessary factor when determining whether a crypto-asset should be an underlying asset for an ETP.

We agree with a framework for selection; however, as above, we believe it is key that this framework is flexible as the market is constantly changing, therefore ASIC needs to ensure regular industry consultations. ASIC needs to be supportive of innovation around crypto-asset backed ETPs.

Some of our members believe that futures trading (the requirement that is listed in B1(d) of the Consultation Paper) is not required and would be better substituted by a requirement that the crypto-asset be included in an index or price assessment published by a reputable provider such as S&P, NASDAQ or CBOE. This will better align the requirements with that of other ETPs that invest in commodities.



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.

Please see our response to B1Q6 above.

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?

Our members believe that crypto-assets should be treated in the same way as commodities for the purposes of Info Sheet 230 in respect of the listed products. Crypto-assets are widely-owned bearer assets that are traded globally by as many as 140 million people.⁸ Existing ETP structures used for gold and other physical commodities are still relevant in the context of crypto-asset ETPs, specifically structured products and exchange traded funds.

A survey conducted by BTC Markets in February 2021 of 2000 Australian investors said that the #3 reason for investment hesitancy was the lack of financial advisor/investment advice in this sector. The inclusion of this new category would accelerate the appetite and capability of the investment community to adequately service the local investor base.

Robust and transparent pricing mechanisms

B3Q1: Do you agree with the good practices in proposal B3 with respect to the pricing mechanisms of underlying crypto-assets? If not, why not?

Our members agreed with the proposal in B3 with respect to pricing mechanisms. The crypto-asset market has a significant number of centralised and decentralised exchanges that offer hundreds of pairs for any given crypto-asset. In addition to the market's inherent volatility, the prices of pairs across markets can often drastically diverge. We agree that pricing underlying crypto-assets with an index would provide retail investors with confidence that they can transact in ETP units at a price at, or closely resembling the NAV of the underlying portfolio. We note that the Purpose BTC ETF, the first and only bitcoin ETF, is priced using the Tradeblock XBX Index to calculate its Net Asset Value.

⁸ Goldman Sachs Research Report ISSUE 98, May 21, 2021



B3Q2: Are there any practical problems associated with this approach? If so, please provide details.

There may be issues pricing a crypto-asset where it does not have a suitable index (either because the index does not exist, or because it does not meet ASIC's standards), or where it is only traded on a single spot market.

B3Q3: Do you think crypto-assets can be priced to a robust and transparent standard? Please explain your views.

We are confident that crypto-assets can be priced in a robust and transparent standard. An index standard is as robust and transparent as possible. It is used widely across all asset classes. Some BTC index examples are the CME Group BTC Reference Rate (BRR) and Bitcoin Real-Time Index (BRTI), Bloomberg BTC Index, S&P BTC Index, and NYSE BTC Index. As noted above, there is a considerable amount of pricing data for hundreds of pairs for any given crypto asset, with many markets offering the availability for APIs to receive pricing and other data. For example, the Tradeblock XBX index, used by Purpose's bitcoin ETF, draws on data from Coinbase Pro, Kraken, LMAX Digital and Bitstamp, and provides pricing data for a number of other crypto-assets, including Ether, Bitcoin Cash and Litecoin. As well as these price feeds, the index takes into account:

- weighting in respect of volume, with higher liquidity exchanges receiving greater weighting;
- price variance, with divergent prices influencing the index price less as the divergence increases; and
- inactivity, where the algorithm penalises stale ticks, with weighting gradually reduced as inactivity continues.

We would consider it conceivable that such an index could be adopted by ETP issuers, or a similar index developed if this does not meet required standards.

Note also that the nature of open and public blockchain ledgers permit unparalleled flows between exchanges in ways previously unseen in other commodities or financial products, making crypto-assets more robust and transparent.

B3Q4: 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.



We consider that any additional data points where available would assist in determining price and increasing transparency. While we agree that using quoted derivatives on a regulated market as a pricing data point would allow for more accurate pricing, we caution against making this a requirement for the determination of whether a crypto-asset is suitable as an underlying asset for an ETP for the reasons set out in response to B1Q6.

For example, there are well established crypto-assets, such as Litecoin, with large market caps that are traded in high volumes on liquid markets which do not have futures, meaning these assets could not be the underlying for an ETP.

No other INFO-230-related guidance

B4Q1: Are there any other good practice expectations in INFO 230 that need to be clarified or modified to accommodate crypto-asset ETPs?

No, our members are of the view that ETPs are sufficiently regulated and there is no need to add further good practice expectations in relation to crypto-asset investments for the reasons outlined in the Context section. Indeed, our members are strongly of the view that some of ASIC's good practice measures are not required or should not be determinative of whether a crypto-asset is a suitable underlying asset. This submission identifies those good practice measures that should be implemented and whether those good practice measures should be amended or not.

Responsible entity obligations

C1Q1: 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.

Yes, segregated client assets, cold storage of crypto-assets, multi-signature wallets and physical security across password and wallet systems are all essential best practices for crypto-asset custody. It is critical to recognise that the crypto custody industry is in the early stages and there are a few custody providers (many of which are not traditional financial institutions). It is highly likely that custody solutions will mature and diversify given the pace, investment and size of the crypto industry. In this context, some of ASIC's proposed practices appear overly prescriptive and tactical. For example, prescribing that transactions be signed



either by sharding-based or multi-signature approaches may prohibit custodians from utilising alternative or future signing methods that may provide better security, flexibility and scalability.

A more helpful approach would be to outline the factors that Responsible Entities (**REs**) should consider in determining what custody solutions may be appropriate for any crypto-asset holdings. As is the case with other risk management practices, REs should have the full discretion to select an appropriate custody solution for any crypto-assets holdings having regard to:

- the amount or percentage of any crypto-asset holding;
- the nature of the crypto-asset;
- the likely transaction volume at the fund level and the impact this may have on crypto-asset holdings;
- the RE's internal risk controls;
- the RE's current custody arrangements;
- the RE's insurance policies; and
- any other matter the RE considers relevant.

We suggest that ASIC works with insurers to assure that they are able to provide custodians with robust insurance policies.

C1Q2: Are there any practical problems associated with this approach? If so, please provide details.

As identified above, we would consider prescribing the method by which transactions are signed to be problematic, as it does not allow a signing entity to evaluate what is the best signing method for their specific circumstances, and may prohibit use of alternative or future methods that may provide better security, flexibility and scalability.

Members have also stressed that there is difficulty ensuring there are appropriate compensation arrangements in place. In particular, it is extremely difficult to source or secure comprehensive and reasonably priced professional indemnity insurance and cyber insurance for any business that is exposed to crypto-assets. Members have also stressed that access to insurance solutions is key to being able to offer ETPs. During a previous consultation, one of our members has noted that the only two providers of professional indemnity insurance to crypto-asset companies both reside overseas which may not meet requirements of some insurance suppliers. This difficulty seems to arise as a result of a disconnect between the insurance industry's understanding of the crypto-asset industry and the actual nature of a business in this industry. For ASIC to require these arrangements, the difficulty obtaining insurance may be a



barrier to offering these products. Whilst industry acknowledges the need to collaborate and find solutions to the lack of insurer capacity and appetite to insure businesses with exposure to crypto-assets, if ASIC was open to alternate arrangements this may assist.

C1Q3: Do you consider there should be any modifications to the set of good practices? Please provide details.

Yes, please see the response to C1Q1 above. It would be helpful for ASIC to reframe the proposed good practices to be more principles based and take into consideration the matters covered above.

Additionally, consideration should be had as to whether or not crypto-assets should be held in custody solutions in Australia. Any consideration of this will need to balance regulatory oversight, legal enforcement, consumer protections and the availability of Australian based custody solutions.

C1Q4: Do you consider that crypto-assets can be held in custody, safely and securely? Please provide your reasons.

Yes. Crypto-assets can be held safely and securely by a third party. Safety and security are dealt with regularly by ETPs holding commodities, as commodities need to be custodied and often have special storage requirements. There are a range of custody solutions which allow a third party to hold or control crypto-assets from a technological perspective. Some of these solutions also have the benefit of insurance or indemnity arrangements and fulfil a similar role as a traditional custodian with similar protections. We note that where a crypto asset is not considered to be a financial product, it may be held on trust and not by a custodian with the requisite AFSL. As such, it is a matter for each RE to form a view as to what custody solutions are appropriate for their ETP. However, generally, our members note that custody solutions that store crypto-assets in cold storage and provide cover for loss of crypto-assets both for fault and non-fault events, may provide secure and robust protection which may be appropriate for investment in crypto-assets.

The nature of private/public key pairs utilised in crypto-asset wallets means that the security of custody is dependent upon strong physical and IT security. The ownership of assets held under crypto-asset custody arrangements is also verifiable at any time on the public blockchain relating to the asset held. As such, an ETP for crypto-commodities would be inherently more transparent than a similar structure for physical commodities.



C1Q5: 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.

Yes, please see the response to C1Q1. It would be helpful for ASIC to reframe the proposed good practices to be more principles based and take into consideration the matters covered above.

C1Q6: 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.

We agree that a market operator may choose to also require the issuer of an ETP implement similar requirements to those proposed in C1 as part of its own regulatory framework, imposed as part of the process of listing ETPs. We note that to the extent that the product available on the financial market is a traditional ETP, on an ongoing basis, it should be treated the same way as any other listed product. Further, it would be an anomaly to require the market operator to implement additional security for these products, and may not be legally or technologically possible given the role of a market operator.

Risk management

C2Q1: Do you agree with our proposed good practices in relation to risk management systems for REs that hold crypto assets? If not, why not?

Our members agree with the proposal that the RE is responsible for ensuring its risk management systems adequately contemplate and manage the risks associated with crypto-asset investments. To this extent, we agree with these proposed good practices, provided they do not require a higher level of regulatory compliance than is required for other ETPs as this would act as a disincentive to issuing these products.

However, our members are of the view that it may be necessary for ASIC's other good practices to distinguish between centralised and decentralised exchanges. The proposal would permit crypto-assets to be traded on centralised exchanges but not decentralised exchanges.

Centralised exchanges in Australia must register as a digital currency exchange with AUSTRAC and comply with all applicable AML / CTF requirements. Similar requirements may apply in other jurisdictions. Where an RE seeks to trade on a centralised cryptocurrency exchange, our members are of the view that the exchange should be subject to AML / CTF regulation.



Our members acknowledge that decentralised exchanges may not conduct any KYC or comply with other AML / CTF requirements and accordingly may be higher risk. However, decentralised exchanges and decentralised applications provide trade functionality such as best trade execution and RSS feeds which is not available through centralised exchanges. Preventing REs from accessing this may prevent them from readily accessing this trade functionality putting them at a competitive disadvantage. This disadvantage also needs to be viewed in the context of the costs associated with investing in schemes. While there are likely to be benefits associated with pooling, schemes will charge management and administration fees on top of expenses associated with crypto investment. Accordingly, it is critical that RE can get access to the best pricing for any given crypto-asset investment or transaction.

Our members agree that the same rules should apply to any other authorised participants, market makers or service providers to prevent regulatory asymmetry which may disadvantage scheme members.

C2Q2: 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.

No, KYC/AML regulations applicable to digital currency exchanges are a suitable base and the principles proposed by ASIC give REs flexibility to adopt best practice solutions as they emerge.

This is because the AML / CTF regulations applicable to digital currency exchanges are a suitable base and the principles proposed by ASIC give REs flexibility to adopt best practice solutions as they emerge.

However, our members believe that there needs to be minimum capital requirements for regulated custody providers.

C2Q3: Are there any practical problems associated with this approach? If so, please provide details.

Please refer to our answers to C2Q1.

C2Q4: 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.



No. Our members are of the view that RE's need to consider the risk associated with crypto-asset investments and ensure that their risk management framework readily contemplates and appropriately manages those risks.

C2Q5: Should similar requirements to proposal C2 also be imposed through a market operator's regulatory framework for ETPs? If so, please provide reasons and outline how it could work in practice.

Yes. Similar requirements to proposal C1 also be imposed through a market operator's regulatory framework for ETPs to the extent that the product available on the financial market is itself a crypto-asset or is managed through a blockchain based system itself. However, to the extent the product is the same as any other traditional product on the basis that the RE is complying with these requirements it would be an anomaly to require the market operator to implement this level of security and, may not be legally or technologically possible given the role of a market operator.

Disclosure

C3Q1: 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.

While our members agree that any risk disclosure in a PDS, prospectus or information memorandum must identify the key risks associated with crypto-asset investments. FinTech Australia and its members agree that considerations listed in C3(b), such as market risk, pricing risk, immutability, regulation risk, custody risk, cyber risk and environmental risk are all important categories of risk that should be disclosed in a PDS. However, to avoid the above issue, disclosure should, if possible, be done in a way that avoids repeated and continuous PDS updates.

Accordingly, our members are of the view that ETP issuers will need to consider the key risks associated with any proposed crypto-asset investment and determine what risks are relevant and need to be addressed in the disclosure document. For this reason, our members are of the view that the proposed good practice should not be viewed as minimum requirements but rather framed as an illustration of the types of risks that need to be considered by product issuers.

Specifically, in respect of the environmental risk of crypto-assets, we note that Proof of Work blockchains do not inherently carry environmental risk, as this evaluation depends on the size of the network, and the uptake of renewable and green energy of its nodes. While we understand



that it is important to disclose environmental risks, we would not want any guidelines presupposing the risks of a particular crypto-asset, particularly where this may be otherwise mitigated. Additionally, tying environmental impact to a blockchain's consensus mechanism also introduces an issue whereby this disclosure could drastically change with a software update, requiring an update to the PDS.

Of course, guidance regarding risk disclosure cannot replace an RE's assessment of the risks. It is critical that the proposed good practice is published in this context and ETP issuers provide risk disclosure within this context.

C3Q2: Are there any practical problems associated with this approach? If so, please provide details.

Please see our response to C3Q2 above.

C3Q3: 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?

Please see our response to C3Q2 above. Our members are of the view that it would be difficult to identify all potential risks and ASIC should rather provide illustrative examples and not seek to address all risk categories.

Design and distribution obligations

C4Q1: Are there any aspects of the DDO regime that need to be clarified for investment products that invest in, or provide exposure to, crypto-assets?

No. Our members are of the view that the DDO regime provides a product governance framework for ETPs that invest in crypto-assets and therefore, supports consumer protection for retail clients investing in crypto-assets through ETPs. Issuers of ETPs (like other product issuers) will be required to prepare target market determinations to identify who is in the relevant target market for the product. If an ETP invests in crypto assets, the issuer will need to consider the impact any investment in crypto-assets will have on the target market determination. Of course, the impact will vary depending on the asset allocation of the ETP. Other DDO requirements including reviewing the target market determination and collecting information about the distribution of the product will allow ETPs to ensure investors who have the appropriate risk appetite for crypto-assets can make informed investment decisions when those investments are selected without a financial adviser.



We note that ASIC's guidance regarding managed investment schemes is likely to apply equally to ETPs with crypto-assets as underlying products. If ASIC was to further clarify the guidance in RG 274, we would request product specific guidance in relation to categorising the risk of the product. Unlike other ETPs which provide exposure to risky assets, the alternative to acquiring the ETP is not to not receive exposure to the asset, but to acquire the crypto-asset itself, and to not have protection of the RE. As such, the ETP may be less risky than the alternative scenario whereby the crypto-asset is acquired directly by the retail client. Guidance from ASIC regarding how these risks should be disclosed in the TMD would assist issuers in complying.

Listed investment entities

D1Q1: Do you agree that crypto-assets are capable of being appropriate assets for listed investment entities on Australian markets? If not, why not?

Yes. Crypto-assets are currently available as an investment asset overseas and major US investment banks have made crypto-assets available to customers. JP Morgan recently announced that all of their wealth management clients, irrespective of their size, can now gain exposure to cryptocurrency via ETPs. They are not the only major US bank to offer these products. If listed investment entities in Australia are unable to invest in crypto-assets, then Australian investors will be precluded from taking part in a well-managed product, with investors looking for solutions offshore to gain exposure to crypto-assets.

D1Q2: 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?

Yes. Please see our response in C1Q6 and C2Q5 for our reasons. They are almost all commodities and should be considered appropriate on that basis.

D1Q3: Are there any practical problems associated with this approach? If so, please provide details.

The approach to determine and classify appropriate crypto-assets for investment entities should be the same as for ETPs including robust and transparent pricing mechanisms for the crypto-asset. For unlisted registered MIS, pricing mechanisms do not need to be as liquid throughout the trading day, if liquidity is weekly or monthly. Having said that, the crypto-assets



that meet the minimum requirements that we support (refer above) typically will be liquid enough to meet daily liquidity requirements.

D1Q4: 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?

Our members do not believe any additional standards are required for LITs and LICs.

D1Q5: 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?

No. An LIC and LIT should be able to determine its investment mandate and any allocation to crypto-assets within that investment mandate. Ultimately, it is up to investors to determine whether a particular LIT or LIC is appropriate for them and, in doing so, will have regard to the investment mandate and asset allocation. No further approval should be required in order to invest or change an investment in crypto-assets if it's within the investment mandate and asset allocation range.

D1Q6: For the purposes of this proposal, we consider a material investment is where an entity invests or plans to invest more than 5% of its funds in crypto-assets. Should another materiality threshold apply?

No, 5% is an appropriate materiality threshold..

AFS licensing

E1Q1: Do you agree with our proposal to establish a new asset kind that will cover crypto-assets?

Crypto-assets are a type of commodity and should be covered by any asset class that currently permits investments in commodities.

Depending on the nature of a crypto-asset, it may already fall into one of the prescribed current asset kinds for a managed investment scheme:

- Derivatives
- Direct Real Property
- Film Schemes



- Financial assets
- IDPS-like
- Mortgages
- Primary Production
- Time Sharing Scheme

In this regard, our members do not think that a separate asset class is strictly necessary from a legal point of view.

However, this is not appropriate for all crypto-assets. Accordingly, our members agree with ASIC's proposal to establish a new asset kind covering crypto-assets. This will provide more certainty across the market when considering and defining these instruments. In order for this to be effective, the definition of crypto-assets must be sufficiently well thought out and structured in order to provide meaningful and comparable asset kind. It will also need to contemplate any overlap with existing asset classes that crypto-assets may fall within.

The certainty provided by the new asset category will benefit the industry in the medium term. In the short term, our members note the significant compliance costs and potential delay that will be required to accommodate a new category of crypto-asset, including the need for a Regulation Impact Statement and further delay in the amendment of laws, instruments or regulations, as well as the engagement of professional services for licence variation applications to accommodate the new asset category.

The present time for processing of licence applications or variations is not insignificant, and there will be a flood of applications or variations to existing licences if a new category of crypto-asset is created. ASIC should consider the internal cost and time-cost in processing these applications, which will delay and increase costs for new products being made available to Australian retail investors. To help mitigate this, ASIC could consider a streamlined licence variation process to include any new crypto-asset class given it is a minor change to an existing authorisation.

Our members also submit that a new category of crypto-asset should be implemented in such a way that offshore providers of investment products backed by crypto-assets are placed on a level playing field with Australian asset managers. That is, offshore providers should be restricted from unfairly competing with Australian regulated products.

E1Q2: Do you consider that crypto-assets may be captured by the existing asset kinds? If so, please explain.



Yes, in some instances they may be captured because they are already structured as one of the existing prescribed asset kinds or a financial product. ASIC's category should be limited to covering only those assets which are not already encompassed in a prescribed asset class.

E2Q1: 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)?

While we welcome ASIC's inclusion of bitcoin and ether as an underlying asset, our members do not agree that there should be a prescriptive list of crypto-asset that a registered managed investment scheme is authorised to hold.

As most crypto-assets are best dealt with as equivalent to commodities which may be traded digitally, we submit ASIC would be making policy decisions as to the kinds of investments which Australian investors should access if adopts this approach.

We respectfully submit that while there may be very sensible reasons for ASIC to seek to restrict registered managed investment schemes to holding Bitcoin and Ether, ASIC should consider the diversification benefits of other crypto assets and should not unduly restrict investment opportunities, as long as minimum standards are being met.

Our members are of the view that most crypto-assets are best dealt with as equivalent to commodities which may be traded digitally and that ASIC should not be making policy decisions as to the kinds of investments which Australian investors should access as this would involve regulatory overreach. Our members believe that ASIC should not place any limits on the types of crypto-assets that a registered managed investment scheme can invest in and REs should have full discretion to determine this having regard to the investment objective and investment benefits.

The suggestion to restrict suitable crypto-assets to BTC and ETH at this time, and a collaborative process with market operators to set a prescriptive formula to even consider crypto-assets, has an immediate cost to businesses wishing to offer crypto-assets. Our members are of the view that this approach is not justified from a regulatory policy point of view. Investors will continue to invest in crypto-assets beyond BTC and ETH. Our members believe investors are best protected if they can trade on regulated markets in Australia, where they have the best recourse to legal remedies. If access is not provided through ETPs, investors will look to alternate providers either onshore or offshore and will not have the benefit of those robust protections.



E2Q2: 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?

As outlined in our answer to C1Q2 above, it is extremely difficult (if not impossible) to source adequate professional indemnity insurance for any business with exposure to crypto-assets. In this context, the licensing requirements relating to compensation arrangements and insurance will need to be considered and a solution proposed for industry.

Additionally, there are no registered managed investment schemes that provide material exposure to crypto-assets. This may be due to the fact that the current licensing and regulatory regime requires assets to be separately placed into custody and there are no licensed custody providers offering crypto-custody at this time.

ASIC should, as part of this consultation, consider what other features of the licensing and registration regime should be amended to encourage and facilitate registered managed investment schemes, which can offer crypto-asset exposure to Australian retail investors. ASIC has also not provided any guidance as to how crypto-assets which are financial products can be the subject of licensing within a functional business model.

As part of the licensing framework to demonstrate organisational competency, a licensee is required to have one or more Responsible Managers with the knowledge and skills to support this requirement. Our members are interested in how this will be considered by ASIC in relation to crypto-assets. Additionally, clarification of the regulatory parameters for the AFS licensing regime around crypto-assets would greatly benefit both investment products and the crypto-currency and blockchain industry more broadly. Our members would welcome ASIC thoughts on this and its preferred approach.

There has not been a single registered managed investment scheme to date which provides material exposure to crypto assets to investors. We submit this may be as registered schemes must have assets separately custodied and there are no licensed custody providers offering crypto-custody at this time.

ASIC should, as part of this consultation, consider what other features of the MIS licensing regime should be amended to encourage and facilitate registered MISs which can offer crypto-asset exposure to Australian retail investors.

The absence of a single registered managed investment scheme holding crypto-assets being permitted to date in Australia also contrasts sharply with comments made during digital currency events by ASIC representatives encouraging innovation and implying that licensing should be



sought by those involved in crypto-asset businesses where crypto-assets are a financial product. Arguably there has not been adequate guidance issued by ASIC as to how crypto-assets which are financial products can be the subject of licensing within a business model.

Clarification of the regulatory perimeter for the AFS licensing regime around crypto-assets would greatly benefit both investment products and the crypto-currency and blockchain industry more broadly.

a. Likely compliance costs	The certainty provided by the new asset category will benefit the industry in the medium term. In the short term, we note the significant compliance costs and potential delay that will be required to accommodate a new category of crypto-asset including the need for a Regulation Impact Statement and further delay in the amendment of laws, instruments or regulations, as well as the engagement of professional services for licence variation applications to accommodate the new asset category.
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<p>b. Likely effect on competition</p>	<p>We submit that a new category of crypto-asset should be implemented in such a way that offshore providers of investment products backed by crypto-assets are placed on a level playing field with Australian asset managers, and are restricted from unfairly competing with unregulated products.</p> <p>The present time for processing of AFSL applications or variations is not insignificant, and there will be a flood of applications or variations to existing licences if a new category of crypto-asset is created. ASIC should consider the internal cost and time-cost in processing these applications, which will delay and increase costs for new products being made available to Australian retail investors.</p>
<p>c. Other impacts, costs or benefits</p>	<p>The suggestion to restrict suitable crypto-assets to Bitcoin and Ether at this time, and a collaborative process with market operators to set a prescriptive formula to even consider crypto-assets has an immediate cost to businesses wishing to offer crypto-assets.</p> <p>We believe it is not justified from a regulatory policy point of view.</p> <p>Retail investors will continue to invest in crypto-assets beyond BTC and ETH. We believe retail investors are best protected if they can trade on regulated markets in Australia, where they have the best recourse to legal remedies.</p>



Conclusion

Investment in crypto-assets is the next frontier for ETPs and our members are of the view that care must be taken that ASIC's good practice measures do not discourage investment in this asset class whilst appropriately balancing risk mitigation. We would welcome the opportunity to discuss this submission with ASIC.

About FinTech Australia

FinTech Australia is the peak industry body for the Australian fintech Industry, representing over 300 fintech Startups, Hubs, Accelerators and Venture Capital Funds across the nation.

Our vision is to make Australia one of the world's leading markets for fintech innovation and investment. This submission has been compiled by FinTech Australia and its members in an effort to drive cultural, policy and regulatory change toward realising this vision.

FinTech Australia would like to recognise the support of our Policy Partners, who provide guidance and advice to the association and its members in the development of our submissions:

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