

SUBMISSION TO AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION

CP 343 SUBMISSION – TCM CAPITAL

Emailed to: [REDACTED]

We participated in a Joint Submission with MHC Digital Finance, Blockchain Assets Pty Ltd, and Apollo Capital, in which we presented joint responses to CP 343 as a whole. This submission targets certain sections of CP 343 that we have identified as warranting a deeper discussion and analysis.

And we have also incorporated comments from OSL Digital Securities Limited (“**OSLDS**”) in this document (where it is indicated), as we believe the policy discussion in Australia may also benefit from insights and experience gained from a jurisdiction which has already issued its first virtual asset-specific licence under the statutory powers of its pre-existing securities laws. OSLDS is current the first and only licensee to hold such a licence, which permits OSLDS to deal in security token financial products.

In this Submission, we focus on:

1. What “**fair, orderly and transparent**” means, or should mean, for digital asset¹ markets;
2. **Market surveillance** practices for macro markets, and lessons for digital asset markets;
3. The **diversification benefits** that digital asset investments can bring to retail investor portfolios, and the degree to which they might impact the financial system in Australia;
4. The **generational context** of digital assets; and
5. The **opportunity** for ASIC to support innovation.

1. Fair, orderly and transparent (FOT) markets

We refer to the ASX’s Fair Orderly and Transparent Paper², which sets out ASX’s interpretations of fair, orderly and transparent markets. The Paper highlights key differences between:

- (a) Systems (including rules and processes) that a market operator may implement to govern trading, to help sustain an orderly market and avoid a disorderly market; and
- (b) Market phenomena³.

¹ In this Submission we refer to *crypto-assets* as *digital assets*.

² **Fair Orderly and Transparent Paper** (current 1 February 2016) published by ASX Limited.

³ In Footnote 24 of the Paper, ASX notes that Perram J’s statement quoted in the text above was qualified by an observation ([2010] FCA 534, at paragraphs 95 and 100) that:

“I do not think that the pursuit of orderly markets carries with it the eradication of volatile or unpredictable markets. ... I conclude that the trading behaviour exhibited in [this case] was highly unusual, unprecedented over nearly a decade and inconsistent with an informed response to the data.”

The Paper acknowledges that liquidity is a key factor for a fair, orderly and transparent market. The Paper quotes⁴ the FSR Explanatory Memorandum:

“... liquidity is needed for an orderly market”.

In CP 343, paragraph 20, ASIC states that:

... ASIC, along with Australian market licensees, shares responsibility for ensuring that the admission and monitoring standards for ETPs continue to support fair, orderly and transparent markets, particularly in the context of ETPs that have unique or novel features as noted in [INFO 230](#).

In INFO 230, ASIC states that (with our **highlighting** added, including in **red**):

While this information sheet seeks to provide guidance around certain novel or unique features of ETPs recently admitted to quotation, there will undoubtedly be other novel features or products (not currently captured) as the market continues to evolve. If a new ETP application has unique or new attributes for the Australian market, licensed exchanges should make a detailed assessment of these features and their application against the current regulatory framework, including ASIC guidance that may be relevant to issuers of ETPs. They should then discuss the application with ASIC before making an admission decision.

Licensed exchanges should be satisfied that the underlying assets of ETPs have robust and transparent pricing mechanisms. This **supports market liquidity** and gives retail investors confidence that they can transact in the ETP units at a price at, or closely resembling, the net asset value (NAV) of the underlying investment portfolio.

Where products have **more complex** or **less liquid** constituents, licensed exchanges should be satisfied and be able to demonstrate that there is a robust and transparent pricing mechanism in a range of market conditions, including those with a degree of market stress. If this pricing mechanism is compromised then the price may not be correct, leading to a lack of confidence in pricing which undermines orderly trading in the product. We would also expect licensed exchanges to consider whether any additional retail investor protections are appropriate where the underlying assets are considered **illiquid, high risk or complex**.

The backdrop to CP 343 appears to be ASIC’s position that liquidity is necessary but not sufficient. ASIC appears to be saying that something else, called “robust and transparent pricing mechanisms”, are additionally required to meet the minimum standards for fair, orderly and transparent markets.

In light of Perram J’s statement quoted above, we would submit that market phenomena can affect confidence in pricing, but lack of confidence caused by market phenomena does not per se make the market unfair, disorderly or lacking in transparency.

However, I also accept ... that the actual price fluctuations observed were caused by everyday market phenomena. There is no particular contradiction involved in concluding that the events were highly anomalous but nevertheless caused only by ordinary market events: a once in fifty year market event will eventually occur; someone always wins the lottery. The occurrence of such a market anomaly does not, however, indicate the absence of reliable operations nor the absence of price continuity or depth. Markets, from time to time, exhibit chaotic behaviour but without more that does not, I think, render them disorderly.”

⁴ In Footnote 31 of the Paper.

Market phenomena are multiplied in illiquid markets. Even if a market operator instigates particularly robust systems to govern trading, they may not be enough to compensate for the inherent tendency of the market to be unfair, disorderly or not transparent, due to the illiquidity.

In our view liquidity is the mother of FOT solutions.

We submit that, on all accounts, digital asset markets are highly liquid, especially for the top 20 digital assets by market capitalisation.

The global daily transacted volume⁵ of a top 20 digital asset is typically equal to circa {2 to 8} % of the market capitalisation of the digital asset. This contrasts with circa {0.2 to 0.8} % for ASX 200 stocks. That is, digital assets are typically circa 10x more liquid than blue chip stocks.

We submit that digital asset market pricing is simple. Digital asset prices are unequivocally transparent. Transactions are recorded on the corresponding blockchains. Pricing is far more transparent than in traditional markets, where liquidity and market activity is not fully visible to retail participants (for example, due to real-time market data being a valuable subscription-based data service not universally available to retail users, as well as trading venues selectively offering low-latency order routing gateways only to premium tier fee-paying institutions, thereby multiplying the effects of information asymmetry).

We query what ASIC was intending by introducing the concepts of complexity or “high risk” in INFO 230 as relevant factors for determining whether markets are FOT. We query whether those concepts make sense only in circumstances where the pricing mechanism is complex, or where pricing may be risky due to dependencies on intermediate calculations. We submit that the current market for the most popular digital assets do **not** involve any complexity in pricing mechanisms and do **not** require calculations.

For the above reasons, our responses to B1Q5 and B3Q1 are as follows.

- 1) The requirement for a robust and transparent pricing mechanism is met for top 20 digital assets, due to significant liquidity and due to the simplicity of asset pricing.
- 2) The term “robust and transparent pricing mechanism” should not be infused with additional requirements that make sense for complex pricing, when the pricing mechanisms for digital assets are in fact simple and transparent.
- 3) Significant liquidity will counter the risks of lack of confidence in the pricing mechanisms.

We agree with CP 343 Proposal B1 (a) and (b) on page 11.

We agree with CP 343 paragraphs 29 (a) to (c) inclusive on pages 12 and 13. We believe these are key elements of FOT markets, consistent with the ASX paper.

We agree that the operator needs to contribute to a sustainable FOT outcome. In relation to CP 343 paragraph 29 (d) on page 13:

⁵ Aggregate value of transaction volumes in a 24 hour period, for the respective digital asset: <https://bitinfocharts.com/> and <https://www.coinbase.com/price>.

- 4) We submit that, in line with the ASX paper, the digital assets listed product should satisfy the FOT requirements if, in addition to liquidity and simplicity of pricing, the market operator implements clear rules or processes governing:
- a. how and when buy and sell orders will be matched;
 - b. the application of trading halts;
 - c. the correction or cancellation of trading errors; and
 - d. the ability of the market operator to suspend trading, correct or cancel trades, or take other corrective action, and/or to impose position limits, to help avoid or rectify a disorderly market, and
 - e. the market operator's trading systems are secure, reliable and have sufficient capacity to handle reasonably foreseeable peak levels of trading.

We submit that the above will satisfy the FOT market requirements for the digital assets, qua **assets**.

In the next section we address the residual element of CP 343 paragraph 29 (d) on page 13, being the additional FOT requirements that relates to market **participants**.

- 5) We do not agree with CP 343 Proposal B1 (d) on page 11 requiring a futures market.

We submit that the additional liquidity from futures, and the “institutional stamp of approval” that futures contracts bring, are not needed to satisfy FOT requirements. This is because the top 20 digital assets have significant liquidity, plus they enjoy simplicity and transparency of pricing.

We submit that digital asset liquidity in spot markets should not be discounted due to any subjective assessment, or mere suspicion, of any digital asset venues globally.

If, contrary to our view, the discounting of liquidity of any digital asset market venue is considered necessary for any objective reason, we believe that any such discount should only be applied to liquidity from venues that explicitly do not meet FATF standards⁶.

OSLDS has also offered its perspective on this matter as follows:

For the most popular digital assets in the market, there is no centralised data source for price discovery, but investors and operators are not deterred by this from trading these assets. In fact, the free access to pricing information published by many venues, and the availability of many venues to transact, in each case, around the globe at all hours of the day are reasons for continuing confidence in investors and traders (including professional and institutional trading firms actively engaged and incentivised as liquidity providers by individual venues, such as OSLDS).

As the operator of a regulated marketplace in Hong Kong, OSLDS is required to, and does actively, implement electronic market surveillance tools which take into account asset behaviours across multiple venues in multiple jurisdictions. While each venue may have its own criteria and standards of acceptable trading conduct, the surveillance systems employed are powerful tools to help detect misconduct

⁶ However any such discount should not become effective until after the FATF presents its updated report, expected in 4Q 2021, in relation to “travel rule” compliance requirements for digital assets.

and/or pricing circumstances which may warrant further investigation or intervention.

6) We do not agree with CP 343 paragraph 29 (e) on page 13.

We are not sure what was intended by “the effectiveness of arbitrage activity and consistency of pricing across major platforms.” Arbitrage is a simple law of physics, and it should not be required for the operator to prove.

We would support an alternative requirement that the price of the Australian listed product must correspond to the price of the underlying asset within permissible time periods, subject to any features of the listed product including any disclosed basis.

2. Market Surveillance

We submit that:

- (a) the substantial daily liquidity in top 20 digital asset markets;
- (b) the 24/7 trading cycles; and
- (c) the high number of actively trading wallets⁷,

all contribute to mitigating the risk of manipulative activity and the impact of any manipulative activity on digital asset prices.

We note that global macro markets such as FX were susceptible to a higher risk of manipulative activity around specific benchmark pricing, or official price assessments such as the London 4PM fix or a futures contract expiry. At other times they were more randomly liquid. Accordingly, surveillance systems of banks were mostly designed around either those assessment trading times or around client related trading. Even so, the Volcker Rule permitted pre-positioning by banks in anticipation of customer flows.

We submit that digital assets beyond BTC and ETH should be permitted as underlyings in a regulated Australian market, and this will permit any unlawful trading by any market participant to be directly investigated and potentially prosecuted in this jurisdiction⁸. Retail investors are better off with this jurisdictional benefit than with the lottery of pursuing legal remedies in foreign forums.

Digital asset trades globally are recorded on blockchains that can be analysed and monitored with existing surveillance systems, with flags and alerts. Work is required to consolidate and present this information, but the tools and open source are favourable to this work, and it can be done. Regulated platforms such as OSLS in Hong Kong conduct surveillance checks over digital asset trading.

⁷ Refer to on-chain data analysis sites such as <https://glassnode.com/> and <https://bitinfocharts.com/>.

⁸ For example, an action against manipulation or artificial prices could be brought in Australia against a market participant in respect of an underlying digital asset, just as it was brought in the High Court case, *Director of Public Prosecutions (Cth) v JM* [2013] HCA 30.

Our team has direct experience implementing entirely new financial markets surveillance systems from scratch, across all major asset classes. We have used artificial intelligence and machine learning software to assist in this regard. We note that the Digital Finance CRC will be well placed to develop market-leading solutions for this.

3. Diversification Benefits

We submit that:

- (a) Digital assets represent direct participation in technology and network investments; and
- (b) Digital assets give investors diversification benefits across an investment portfolio⁹.

We submit that limiting permissible underlying assets to BTC and ETH substantially curtails those diversification benefits.

We do however agree that some minimum standards need to be determined for underlying assets, which allow operators to exclude certain underlying assets based on regulatory investigations, allegations or suspicions of fraud, or similar concerns. We exclude certain digital assets from our funds based on a range of proprietary factors, that we can discuss with you.

We note that S&P & Nasdaq¹⁰ recently launched multi asset digital asset indices, not limited to BTC & ETH. We submit that market operators should look to the criteria applied by such index providers or providers of price assessments in selecting their eligible assets. Having said that, we do not believe indices per se are necessarily the only acceptable price references for Australian listed products. We should learn from the asset selection criteria, and from the monitoring processes that those index providers implement, but not be dependent on those sources of safe standards.

OSLDS has also offered its perspective on this matter:

Through OSLDS' role as the only regulated venue in Hong Kong currently permitted to deal in tokenised securities, OSLDS has encountered a wide array of potential product issuers and investors interested in seeing new products entering the digital asset markets. Examples of products that have generated strong interest include tokenised investment grade debt instruments, structured notes, passively managed (tracker) funds, and single asset funds. While some of these examples may not necessarily represent products which would typically be seen as being suitable for listing on regulated marketplaces, they do present genuine and reasonable use cases for applying tokenization technology to financial products.

By way of example, investment grade debt instrument tokens may potentially be a safe-haven asset for digital asset investors who are overweight on volatile and/or high risk digital assets – thereby also potentially providing credible and reasonable substitutes for products such as stable-coins in the digital asset market, which are not rated, and, in some cases, do not even carry clear and unequivocal rights to repayments for holders. Passively managed funds holding digital assets may also provide important legal structural protection for investors who would otherwise be forced to use unregulated trading venues, custodians and brokers to undertake direct investments.

⁹ Refer studies by State Street.

¹⁰ <https://www.nasdaq.com/articles/an-overview-of-the-top-crypto-indices-2021-06-23>

In sum, due to the relative infancy of the digital assets market (in particular, the market for security tokens, or tokenised financial products), it is essential that regulated markets operators be given sufficient leeway to be conduits for product innovation. The contributions of issuers, investors, asset servicing institutions and regulated intermediaries are required to successfully create, launch and manage new and innovative products. It is therefore essential that regulated intermediaries and market operators, within the confines of their general duties to the markets, are given the opportunity to invest in new product concepts, structures and markets.

4. Generational Context

Millennials are investing in digital assets, and analysts predict that they will continue to do so as the preferred form of investment in their lifetime¹¹.

Millennials invest across the digital asset spectrum and are not limited to Bitcoin and ETH.

We believe millennials and other retail investors are best protected if they can trade on regulated markets in Australia, where they have the best recourse to legal remedies.

Given that digital assets are technology related investments, it makes sense for licensed operators and participants to disclose the longevity risks of the investments. Some digital assets represent earlier stage experiments and less mature commercialisation development activities than others. Not all digital assets come with the same risk/return profiles. We submit that licensed professionals should be advising investors on an informed basis in a regulated marketplace. This will not happen if digital assets are swept into the corner, or brushed under the carpet, as suspicious or fringe pursuits.

OSLDS has also offered its perspective on this matter:

The Hong Kong regime for licensing of virtual asset trading platform operators, in its current form, limits operators to servicing only professional investors (as per the Hong Kong statutory definition). In other words, they are not allowed at this stage to service retail investors.

Anecdotally, we have seen widespread concern from operators and investors alike that it is in fact retail investors who are most in need of regulated channels to invest in digital asset investments – due to lower levels of sophistication and lesser bargaining power to secure protections (for example, to mitigate credit risk).

While the underlying policy of incremental introduction of this asset class to the market first via professional investors is understandable, it is important to recognise that in a global market for a globally new technology and for a globally liquid asset, effective investor protection may not necessarily be best achieved by attempts to deny access. In such context, well-regulated access may well be just as, if not more, effective at mitigating the risk of investor harm by reducing regulatory arbitrage, increasing investor education and disclosures, and incentivising investors to use regulated venues.

¹¹ Refer Thomas Lee of Fundstrat; watch for example <https://www.youtube.com/watch?v=GGberGnxiJk>.

5. Opportunity

We would caution against any policy settings that restrict investment by retail investors in the broader suite of digital assets. A decision to allow digital assets beyond Bitcoin and ETH does not signal the endorsement of those digital assets per se. It allows innovation to flourish “inside the flags”. We have seen significant reverse inquiry from investors to invest in the wider technology opportunity. They are likely to seek guidance on preferred digital assets, and which ones to avoid.

The depth of liquidity, and breadth of ownership, in digital asset markets act as strong mitigants. We submit that ASIC has an opportunity to shape a safer investment environment for retail investors that gives them diversification benefits.

ASIC has an opportunity to work closely with asset managers and market operators over the next 3 to 12 months to shape a suitably balanced policy which provides safeguards for investors while at the same time allowing deeply liquid markets to be accessed through regulated investment formats.

Digital assets can meet disclosure requirements. Digital activity is recorded on the open source chains and can be deciphered, interpreted, assessed and evaluated. GitHub and other repositories show developer activity, and core developers regularly communicate key developments. DAO legislation may assist in accelerating the implementation of disclosure frameworks for digital assets.

For any follow up, please contact [REDACTED]