

Michael Tilley

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The Manager-Consultation Paper 343  
Australian Securities & Investment Commission

By Email: [REDACTED]

Dear Sir,

I am Chair and a founding shareholder of Latitude Group Holdings Limited, formerly a director of Orica Limited, Incitec Limited, Chief Executive Officer and Managing Director of Challenger Limited, Chairman and Chief Executive Officer of Merrill Lynch Australasia and Deputy Chairman of JP Morgan Australia.

Over the past seven years my family office has been a founding or early-stage investor in a large number of businesses in Australia and The United States of America engaged in the commercialization of block chain technologies and what might loosely be described as crypto asset related activities.

I sit on the advisory boards of several high net worth US based family offices which collectively have invested several billion US dollars into crypto assets and crypto service providers. In my view the value in developed economies, of widely traded crypto assets and the organisations providing services and technologies to the crypto markets, and services using crypto as a mechanism for delivery or reward materially exceed the combined value of all of the companies and funds listed on the Australian Stock Exchange in 2021.

The crypto related trading and business services market has for the past decade operated in a largely unregulated environment in most developed counties. As a consequence, the market has experienced the adverse consequences of inappropriate market participants, inadequate investment in protecting customer assets (custody), and a myriad of practises outlawed in equity and debt markets such as front running, insider trading, unreasonable risk taking and trading without appropriate terrorism or money laundering regulation. To this end the largest crypto currency exchange in the world does not have a legal country of residence, that is it is "stateless" making it almost if not totally impossible to enforce legal judgements against it, which has significant implications for Australian taxation, family law and insolvency claims.

There are however many myths about the crypto currency industry and markets which should be addressed by Australian regulators:

1. Crypto assets are the preferred method of money laundering the proceeds of crime because they are bearer in nature?

This is a complete myth. Cash, gold and silver, coins and bearer bonds are completely fungible and often incapable of having their ownership traced; they are easily transferable with no record. By their nature crypto are held on the blockchain and the crypto asset contains within its record of authenticity the ownership details of every owner who has ever held title of the asset. It is not possible to own a crypto currency unless the owner is registered as such on the blockchain. In countries with effective anti-money laundering and terrorism legislation the ownership of all Crypto assets is instantly and completely transparent.

Recommendation: The Australian Government should mandate that all Australians holding crypto currencies must hold them in Australian based custodial services, this would ensure that all Australians trading or owning crypto currencies participate in a full and properly governed anti-money laundering and terrorism process, that the ownership of all crypto currency assets is registered on the blockchain and that all crypto assets are available to the Australian Taxation Office, The Family Court and the Courts generally particularly for insolvency matters.

2. Mining crypto assets is damaging to the environment because it creates significant greenhouse gas emissions?

The University of Cambridge Judge Business School conducts an annual Global Crypto Asset Benchmarking Study. The 2020 study report found that 76% of the energy utilised globally by proof of work miners in 2019 was sourced from generators utilising renewable source material other than coal or gas.

3. There is no transparency or trusted sources for valuation purposes?

The Chicago Mercantile Exchange has traded crypto asset futures now for more than 3 years. The current and future market price of a wide range of crypto assets are freely available through the exchange. S&P provide index data on 30 crypto assets. NASDAQ listed Coinbase the largest exchange in the USA with a market capitalisation of US\$86 billion provides up to date, real time market-based values for more than 250 crypto assets. ICE, the holding company for the NYSE also provides real time market values for more than 200 crypto assets. In Australia Melbourne based BTC Markets with an annual market turnover exceeding A\$20 billion in crypto assets and Independent Reserve with an annual market turnover exceeding A\$10 billion both provide public real time access to up-to-date trade values. It is arguable that the large number of independent sources for data on crypto asset values enables a fairer and more independent source of asset values than the Australia Stock Exchange can provide for thinly traded Australian equities values at any point in time. The Toronto Stock Exchange allows and now trades crypto based Exchange Traded Funds with real time valuation reporting.

4. There is no methodology to classify crypto assets for regulatory, taxation or security purposes?

A one size fits all classification of crypto assets would misunderstand the essence of what constitutes a crypto asset. A crypto asset is a means to an end, a method of packaging something of value to enable low-cost commercial trade in that asset. All crypto assets are contained or held within the blockchain. In the crypto world the blockchain essentially holds a contract to deliver something of value, this may be a commodity, a currency, a service or a right. Markets and crypto coins for these needs are already well under way in development. Central Banks are considering the issuance of currency backed crypto assets. Large corporations are developing stable currency backed crypto assets for on line transactions. In the near future I anticipate that a wide range of debt instruments, currencies (stable-coins), commodities and other contractual rights will all be freely traded under the auspices of crypto coins. The motivation for these markets developing is the high cost of transacting these items through traditional channels in particular the heavily regulated inefficient banking system.

Recommendation: Bitcoin is already classified as a commodity in the USA and in many other markets. Where ever possible uniform classification of crypto assets by application between geographies is extremely important to ensure that jurisdictions do not compete for activity based upon seeking more favourable treatment for taxation, security or other purposes.

Crypto assets are being developed for many different applications and to meet demand for different service needs. Few of these are "investment" in nature, most have practical applications, a cheaper methodology for buying and selling debt instruments and currency, a method of payment for providing services (Bitcoin, Ethereum and Filecoin Mining), and many other applications as yet undiscovered. The regulatory regime requires the ability to be sufficiently flexible in its characterisation of applications so as not to unnecessarily burden market participants in a manner which would drive activity to more reasonably regulated jurisdictions. Such unnecessary burdens reduce employment, investment and taxation revenue in Australia and drive activity to often unregulated jurisdictions which frustrate the ability of the Australian Taxation Office, the Family Courts and insolvency recoveries.

The Australian Government should establish a process for classifying crypto assets by their purpose to ensure a reliable and consistent approach for taxation, family law, regulation of sales and custody and insolvency and security purposes.

5. Crypto Assets are not legitimate, they are not based on real applications or supported by physical assets which have value.

The concept of value is a widely misused in financial markets and the media. Fundamentally value is only established by the preparedness of two or more parties to conduct an exchange of title or rights for something in return. Stores of value, such as cash money, government bonds or gold are only worth what they are because enough people trust that there will be other people who will exchange them over time for something they value and that they will substantially retain their value over that time. Crypto assets are no different, the value ascribed to them is determined by the confidence of other people that there will be people who will

exchange them over time for something they value and that they will substantially retain that value over time.

Some Crypto assets such as Bitcoin are in fact no different to gold, cash or Government bonds they are accepted as a store of wealth, while others convey a contractual right to be exchanged for a product, a service, a security or a payment.

Recommendation: A one size fits all classification system for crypto assets will inhibit Australia's opportunity to be a global leader in new technology applications which are and will drive significant productivity and competitive advancements in financial markets, opening up new competition in banking, commodity and debt securities markets. Failure to create a flexible and informed fit for purpose regulatory classification of Crypto assets will drive employment, investment and taxation revenues to more enlightened markets such as Singapore or the USA.

#### 6. Crypto Assets are not suitable for retail investors?

The two largest Crypto exchanges in Australia have between them almost 500,000 retail customers undertaking more than \$15 billion of trades in Crypto assets each year. While there is no reliable data to support an estimate, based upon anecdotal feedback from executives of non-Australian based exchanges, it is likely that retail trading by Australia residents on exchanges based outside Australia is as much as 10 times this amount. Retail is engaged in Crypto asset trading and ownership and often on exchanges and in custody arrangements where there are few or no rules and limited safeguards. The largest Crypto exchange in the world does not have a country of residence since being forced to exit China, yet there are no enforceable legal rights or protections for Australians nor rights for Australian taxation authorities, family courts or the courts in matters of insolvency. Retail investors are being offered unregulated leverage by the exchanges well in excess of any responsible lending concepts and many of these exchanges do not comply with any money laundering or proceeds of crime checks or reporting regimes.

Recommendations: The national interest is best served by requiring Australians to trade on Australian platforms and to maintain custody of Crypto assets with appropriately licensed, robust and capitalised custodians. Retail investors should be able to trade managed Crypto assets in the same way they can trade funds which specialise in the management of equities, gold, currencies and other asset classes. The same regulations on insider trading, front running and unconscionable conduct should be applied to trading in Crypto assets as for any debt instrument, currency contract or commodity contract to ensure the maintenance of a fair and transparent market.

Globally regulators have been slow to respond to the rapid development of Crypto and Blockchain technologies. Australia is well placed to position itself as a safe haven for participants in Crypto markets by establishing clarity on the regulatory and taxation classification of Crypto assets, by creating a safe and secure regulatory environment for the trading and custody of Crypto assets, by enabling the establishment of exchange traded funds to enable retail investors to access industry expertise for their exposure to Crypto assets. Australians are awarded protections from unfair market practices such as insider trading, front running and inappropriate leverage in equity, debt, currency and commodity

markets but not for Crypto assets. Blockchain technology, primarily being commercialised via Crypto platforms is developing rapidly to bring about competition in financial markets to drive financial efficiency and productivity gains where current market participants rely on outdated technology or are seeking rents enabled by licensing or outdated practises. As a modern economy Australia deserves a regulatory environment which protects its citizens and allows its businesses and government agencies to take advantage of the investment and productivity opportunities available through the Blockchain and its primary commercialisation platform in Crypto.

Yours Sincerely

Michael Tilley

Response to specific questions

Question B1Q1: Crypto assets are already widely available to Australian retail investors both through local exchanges and through international exchanges. More than 500,000 Australian retail investors hold accounts with Australian based exchanges and trade more than A\$15 billion in Crypto assets annually within Australia and based upon anecdotal feedback as much as 10 times that amount on international exchanges. Currently none of that activity has any regulatory oversight or protections. The development of a regulated ETP can only be considered to be in the national interest.

Question B1Q2: All Crypto assets held by Australians should be settled, cleared and held in custody in Australia.

Question B1Q3: Not Applicable

Question B1Q4: Yes Neither I or my entities currently trade Crypto assets on exchanges. We do however trade Crypto ETF's on licensed foreign stock exchanges. This is complex, expensive to implement and involves unnecessary taxation and currency risk.

Question B1Q5: No it appears that ASIC is seeking to regulate the technology rather than activities. The potential purposes of Crypto assets vary enormously from the commodity like nature of a Bitcoin, to the contract for services type use of a Filecoin to the evolving use of Ethereum based assets for trading or settling debt securities or currency transactions.

Question B1Q6: In the absence of a desire to classify by use, then I would recommend that all assets are treated as commodities. However, taking this short cut would likely lead to an incorrect classification of many existing assets and even more future assets.

Question B1Q7: It is likely that a more detailed analysis of Crypto assets would show that current Crypto assets have a number of distinct features; a store of value (gold like or precious metal like in nature) thus a commodity, a stable based product backed by currency, a contract for the supply of services such as Filecoin for data storage or a contract for difference. In time I expect that Crypto assets will be created which themselves emulate managed investment scheme products because they are backed by or represent a share of assets such as real estate, equities, insurance rights or other financial or investment products. The classification scheme must be able to deliver a sensible, fair and level regulatory playing field for each use. The purpose of creating these uses is not to circumvent the regulatory environment but rather to deliver productivity gains through more efficient use of blockchain technology.

Question B2Q1: No. Current regulation is sufficient for creating an ETP. Not all Crypto assets are suitable for ETP's. The most logical Crypto asset for an ETOP today is Bitcoin, it is widely traded globally, it is already regulated as a commodity in a number of developed markets

and could be launched on Australian exchanges as an ETP with no requirement to make any regulatory changes. Australian retail investors are being penalised by delays.

Question B3Q1: Yes, there are many exchanges and reliable sources of data available from sources with much deeper and more liquid trading than is available for pricing ETF's currently traded on the ASX>

Question B3Q2: No there are no practical problems.

Question B3Q3: Major international markets have developed very quickly over the past 18 months. NYSE, S&P, Chicago Mercantile Exchange all provide indexes covering hundreds of Crypto assets. NYSE and Coin base are Crypto exchanges with a combined market capitalisation of more than US\$100 billion, both provide live real time asset pricing in deep liquid markets. These exchanges which are the base data providers for indexes are too large and too deep to allow manipulation.

Question B3Q4: See my answer to question B3Q3

Question B4Q1: INFO 230 should be expanded to establish custodial rules for Crypto assets, to include a requirement for custodians to be licensed and properly capitalised and located in Australia.

Question C1Q1: Yes subject to them being Australian based

Question C1Q2: Custody should not be permitted offshore to protect the national interest. ASIC has no power to regulate offshore custodians, Australian courts have limited if any jurisdictional rights or powers. Custodial services should be regulated, properly capitalised and within the regulatory power of ASIC and the jurisdictional power of Australian courts.

Question C1Q4: See answer above

Question C1Q5: See answer above

Question C1Q6: Sophisticated Australian custodians exist today, if licensed and properly capitalised, the role of market operators picking winners and losers is removed.

Question C2Q1: Yes

Question C2Q2: Subject to appropriate custody arrangements and the application of good practice rules on insider trading and front running, no.

Question C2Q3: None

Question C2Q4: Custody and legal redress to custodians

Question C2Q5: See answer to C1Q6

Question C3Q1: Yes in principal however, as demonstrated in my covering letter and in studies by Cambridge University, ASIC's information on the impact of Crypto mining on greenhouse gas emissions is incorrect.

Question C3Q2: Disclosure must be based in fact, not activist or political in nature

Question C3Q3: The primary risks are volatility, custodial reliability and security and the integrity of the underlying manager

Question C4Q1: Crypto assets which are comm oddity like in nature should be treated in precisely the same manner as other commodity like assets, gold, silver, pork bellies etc

Question D1Q1: Yes as is evidenced by the volume of global and trade by Australian retail investors and the success of Crypto ETF's in other markets

Question D1Q2: Yes

Question D1Q3: See answers above in relation to custody

Question D1Q4: None

Question D1Q5: Yes Crypto assets should be treated exactly the same as other investment assets, full disclosure and transparency should always be the objective

Question D1Q6: 5% is the most used materiality threshold in audit, prospectus due diligence and risk assessments. As such there are many precedents to support this level

Question E1Q1: No for the reasons discussed both in my covering letter and to the questions above. Existing asset classes (investment products, shares, currencies, commodities, contracts, debt securities) are sufficient to deal with all known activities in Crypto assets developed to date. Not all Crypto assets fill a similar function and risk profile just as shares have a different purpose than commodities and or currencies.

Question E1Q2: Yes please see my answer to question E1Q1

Question E2Q1: No this is a short cut approach which would if followed through drive activity offshore to unregulated markets.

Question E2Q2: The key to expanding access to Australian retail investors is to regulate and mandate Australian custody services. No managed investment scheme has to date been able to resolve this issue. It is unlikely that services will be able to be made available in a manner which protects retail investors until this issue is resolved.

F106 (a) Introducing a new asset class for Crypto assets will both delay and add material cost to the process of providing a safe and fairly regulated product to retail investors in Australia. Further it will not create a regulatory environment which will encourage



investment in Australia but rather drive even more investors offshore where markets are more responsive to need and flexible.

F106(b) Creating a new asset class for Crypto would be a retrograde step and out of step with other major jurisdictions. Rather than encouraging investment in Australia by creating a useable regulatory framework which encourages investment it would drive investment to countries with more flexible regimes

F106(c) The market for Crypto assets is evolving quickly, any decision to restrict the Australian market to a small number of assets should be avoided. The test should be one of liquidity, not what might seem to be material today. To manage an orderly introduction of Crypto assets ASIC might commence with commodity assets before expanding to assets which are more like financial instruments. Australia is already falling well behind other jurisdictions in protecting and preserving the rights and best interests of retail investors who are actively trading with exchanges or on line market participants who purport to be exchange like in nature but are rather front running transactions.