



Australian Securities and Investment Commission - Consultation Paper 343

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Introduction and Summary

Blockchain Assets Pty Ltd is the trustee and manager (the Manager) of the Blockchain Early Opportunities Fund. This submission draws on the experience the Manager has researching and investing in blockchain technology for more than 5 years.

We have over the years watched with interest the development of regulations across the world as they have evolved. Back in 2016 there was very little interest shown by regulators and this matched their level of knowledge. Today the global regulatory environment is a mixed bag, there are some examples of outright failure (the New York Bitlicense being one such example) and some of success (the Wyoming crypto bank and regulatory laws being a good example).

Aside from ASIC Information Sheet 225 and the AUSTRAC requirements for crypto exchange registration, there has been regulatory uncertainty in Australia. Consultation Paper 343 (CP 343) is most welcome.

Our understanding of the proposals in CP 343 is as follows.

1. At the moment ASIC are of the view that only ETH and BTC would be able to meet existing and proposed regulatory requirements for : ETP's; LIT/LIC and registered MIS investments.
2. Unregistered MIS are able to offer all types of crypto-assets.
3. AFSL holders are able to offer products as outlined in #1 and #2 above.

The net result, from an investors point of view, is that Section 708(8) Sophisticated investors could have the whole range of crypto assets offered to them via an unregistered MIS operated by an AFSL holder, whereas retail investors only have regulated access to ETH and BTC.

This is a compromise between ASIC's consumer protection role and it's responsibility for supporting orderly and transparent markets. However, as we outline in this feedback, this technology removes the technical barriers (to entry) to early stage investment by retail investors. The democratisation of finance and the potential reduction of wealth inequality are two of the most encouraging social reforming aspects of this technology. Australia is one of the most socially forward countries ¹ in the world and there is an opportunity to build on this with this technology.

With the technical barriers removed there is really now a moral question around, **to what extent should regulators exclude retail investors from the very same opportunities that have previously only been open to the wealthy and well connected?** Or perhaps the better question is how can regulators fulfill their

¹ <https://www.globalcitizen.org/en/content/social-progress-index-2020/?template=next>

consumer protection mandate without denying retail investors the opportunity for wealth betterment and reduced wealth inequality for society as a whole?

There are no easy answers to this question, but our philosophical view is that creating a financial system which facilitates inclusion and equality of opportunity is more important than consumer protection. At the very least, consumer protection regulations should not increase wealth inequality and exclusion. In our feedback we set out some suggestions which may be part of the answer to this question. In summary they are :

Suggestion 1 : Create principles based crypto specific regulations;

Suggestion 2 : Create a wiki for crypto scams;

Suggestion 3 : Create a cross-industry crypto regulatory working group to advise ASIC and the Government of crypto-asset regulations;

Suggestion 4 : Partner with crypto asset businesses (on and off shore) to develop a principles based approach to consumer protection and how such an approach can be demonstrated; and

Suggestion 5 : Allow 'crypto-certified' AFS licence holders (new and existing) to offer multi crypto-asset registered managed investment schemes.

Overall we feel that the proposed regulations are positive news for the industry and ASIC should be congratulated for this paper, it is one of the best we have seen in our global coverage of regulatory developments. We hope our feedback can move the proposed regulations in a positive direction and we would be happy to engage with ASIC at any stage and in any way.

Crypto-Asset Definition

Paragraph 8 reads :

For the purposes of this consultation paper, a crypto-asset can be understood to be a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof. A crypto-asset may or may not have identifiable economic features that reflect fundamental or intrinsic value.

Everyone is struggling to define crypto-assets. The definition proposed is as good as any I have seen as it allows for flexibility and is not prescriptive. However, eventually all assets will be crypto and so it is helpful to also think of crypto as a wrapper and as a trading/record keeping infrastructure.

Take for example, Perth Mint Gold Token (PMGT). PMGT is gold backed 1oz of gold = 1 PMGT, this is issued by the Perth Mint a Government owned enterprise. PMGT is currently tradable on [Independent Reserve](#) and can be sent peer to peer to anyone with a crypto-wallet. Another example is a tokenized work of art ², or a non-fungible token issued by a major sporting league ³, eventually all equities will be tokenized. These are all crypto-assets.

eftpos is currently working on a payment infrastructure project involving Hedera Hashgraph whose native currency is Hbars. Once implemented Hbars will be used by members of eftpos for real time settlement of transactions. Hbar is a crypto-asset and is likely to be a key part of Australia's payments infrastructure. ⁴ Why would Hbars not also be included as an 'approved' asset at this stage? There are many others in the same situation.

The reality is that crypto/blockchain/distributed ledger technology is a number of things :

1. Ether, bitcoin and Hbars are native crypto-assets;
2. PMGT is an existing analogue asset that has been tokenised, anything can be tokenized; and
3. Non-fungible tokens are digitally scarce assets that can be anything.

² <https://medium.com/security-token-offering/art-tokenization-what-is-it-how-does-it-work-fb2e31bfb822>

³ <https://nbatopshot.com/>

⁴ <https://www.ledgerinsights.com/australia-payments-eftpos-hedera-token-hbar/>

I feel that this Consultation Paper is aimed at #1 and if that is the case the definition should be tightened accordingly. But what then for an ETP that wishes to hold say a portfolio of vintage cars, fine art or one off sporting moments? These and many more investment portfolios will be put together for retail investors, and why not, retail investors should have the same opportunity to invest in fine art as the ultra wealthy.

There are no easy answers to these questions. In the very short term the proposed regulations are on the whole adequate for bitcoin and ethereum but not for other assets.

How are Cryptoassets regulated?

The objective of regulation is to protect consumers and to promote open markets for free exchange of assets. This objective does not change with the advent of new technology, however the way the objective is achieved must inevitably change.

I feel that crypto should not be made to fit within existing prescriptive regulations but that the way regulations are designed should change to fit crypto. Specifically, regulations should move away from a prescriptive 'checked box' approach to a principles based approach.

Our society is facing some very big changes in other areas, not the least of which is the transition of the economy from high to low emissions. I believe the change in financial markets technology is as significant and also as complicated.

Typically regulations have built up around asset classes or types. Broadly speaking ASIC regulates securities and other investments that are financial products. They do not regulate direct real estate investment or direct commodity investments. In the US the siloing of regulations around asset types and specific markets is even more specialised, their so called 'alphabet soup' of Federal and State regulators.

Eventually there will need to be a one-stop-shop for regulatory control and oversight. Even APRA will need to consider crypto-assets, for example, what is the nature of a ['staking-as-a-service'](#) business? Is it an investment scheme, is it a custody business, is it a deposit taking business, or is it simply a data center business?

These questions are beyond the scope of this paper, but they are interesting to consider as ETH will become a staking asset in the early part of 2022 (actually it is possible to stake ETH now) and there are businesses offering staking-as-a-service. Will they need an AFSL or will they be covered by APRA or are they outside existing regulatory frameworks and therefore perfectly legal but not specifically regulated?

A further complication to the regulatory environment is the emergence of smart contracts generally and fund management platforms that automatically perform the Administration and Custody roles that have traditionally been performed by third parties. These platforms reduce the barrier to entry for fund managers because the

cost of Administration and Custody is essentially reduced to under 1% of Fund Under Management (FUM) and there is no minimum amount of FUM needed to run an investment fund profitably. Under these models the institutional trust layer of Administration and Custody is replaced by a code/software trust layer which automatically handles Administration and Custody. The replacement of independent third parties with self executing software increases the efficiency of the industry significantly and promotes financial inclusion and competition. This is a very good thing for society.

One such platform is [Iconomi](#). I discuss Iconomi later in this paper under the heading of C Responsible Entity Obligations.

Suggestion 1 : Create principles based crypto specific regulations

These regulations should be a constant work in progress, constantly updated and progressive in their nature. They should adopt the democratisation of finance and reduction of financial in-equality (which is what this technology facilitates) as a core principle.

Retail Investors and Crypto Scams

There is a difference between a scam, a bad business model and incompetence. Like any other markets all three exist in the crypto world. However the word scam gets used a lot to describe projects that were honest and well intentioned but badly put together and have failed. There are a lot of bad projects out there that fall into this category, however, I feel it is important to use the word scam only in the context of criminally fraudulent or deceptive conduct.

True crypto scams like [OneCoin](#) and [Bitconnect](#) are egregious and there are many of these. It is shameful if even one Australian falls victim to these scams, which sadly they have. Even today the OneCoin scam continues in Australia despite regulatory agencies knowing about it, something needs to be done on that front. The proposed regulations will not stop this type of scam and others like it. For those who know crypto the red flags are easy to spot and a quick google search of the project name will lead to copious amounts of data setting out why the community views this or that project as a scam.

The ASIC (and other government agencies) general warnings are not sufficient. We need to find a way where the collective knowledge of responsible market participants can be collated into a traffic light style list of possible scam projects that is endorsed by ASIC and others. This could be done by way of a crypto wiki scam site where members of the public can post scams that are reviewed and ranged by approved oracles. This is something the Australian Govt could fund/launch for the global crypto ecosystem. But also I feel the industry should be a part of this, in a self-regulatory

partnership. Blockchain Assets Pty Ltd would be happy to be a part of a team putting together such a wiki if there is government support.

One thing the crypto community is very good at is open decentralised projects that farm the collective 'hive mind' of the internet. A global wiki scam site, kick started by ASIC, would be picked up by responsible players in the global marketplace and could become an important part of the consumer protection tool box for all global regulators.

Suggestion 2 : Create a wiki for crypto scams

ASIC and Consumer Protection agencies at State and Federal level should initiate an open source wiki site (working name 'crypto scam watch') and work with volunteers from industry to bring the site to a global level list of crypto scams.

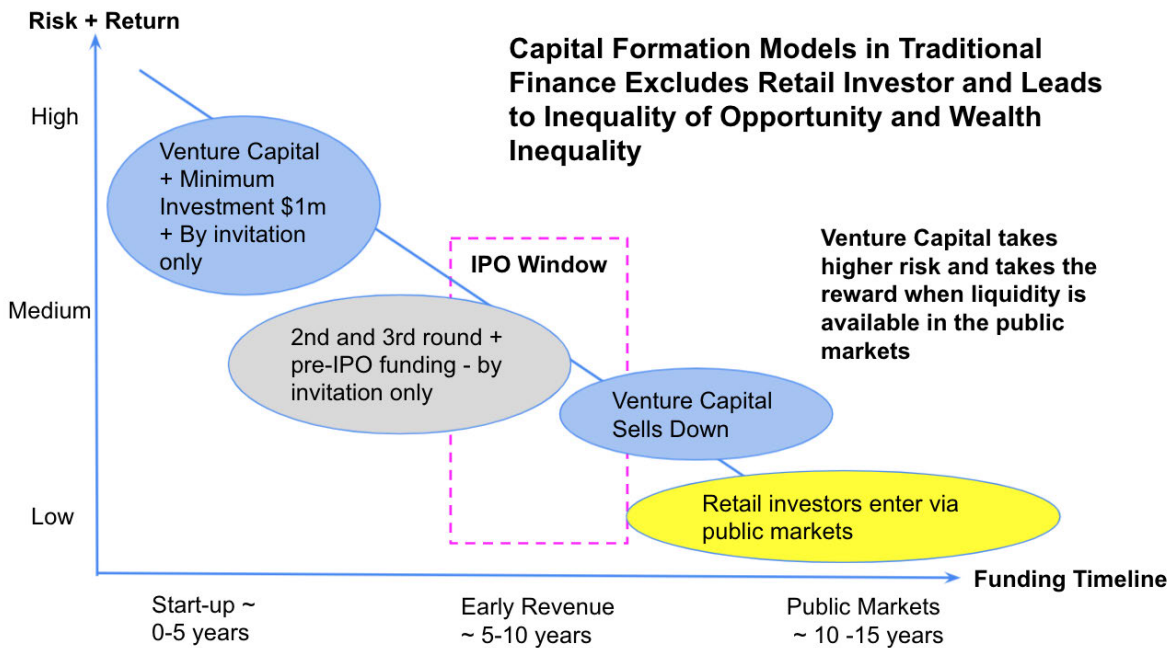
B Meeting INFO 230 expectations

The standards set out in INFO 230 were developed before the invention of distributed ledger technology. Not unsurprisingly they do not recognise the most important characteristic of crypto-assets and markets that have been enabled by this technology. And that is the change to the trust model for the financial services sector. Centralised human based trust institutions (subjective trust) is replaced with decentralised software based trust (objective trust). The existing manual systems with bolt on technology are being replaced with completely new blockchain native systems built from the ground up. The human elements of trust will be replaced with trust in software.

This new trust model and the crypto infrastructure aspect of this emerging asset class facilitates the tradability of the assets at an early stage that is not practically possible with existing market infrastructure.

Capital Formation Model - Traditional Markets

The traditional method for capital formation is through venture capital/private equity structures until the point the project is ready for listing on a public exchange. The traditional method generally excludes 'retail' level investors, this reduces their risk but also excludes them from early stage investment exposure to growing enterprises. By the time an enterprise is able to comply with the good practices of INFO 230 and ready to list, a lot of the value has already been captured by the wholesale investors. Indeed at the time of listing it is not unusual for early stage investors to (subject to vesting schedules) exit part or all of the investment.



It is fair criticism of the existing system that it is not inclusive. The opportunity for retail investors to participate in early stage capital opportunities (for example to invest early in a Facebook of the future) is non-existent. Instead only closed groups of people with the right contacts and access to large amounts of capital can participate. This no doubt has contributed to wealth inequality.⁵

Capital Formation Model - Crypto Markets

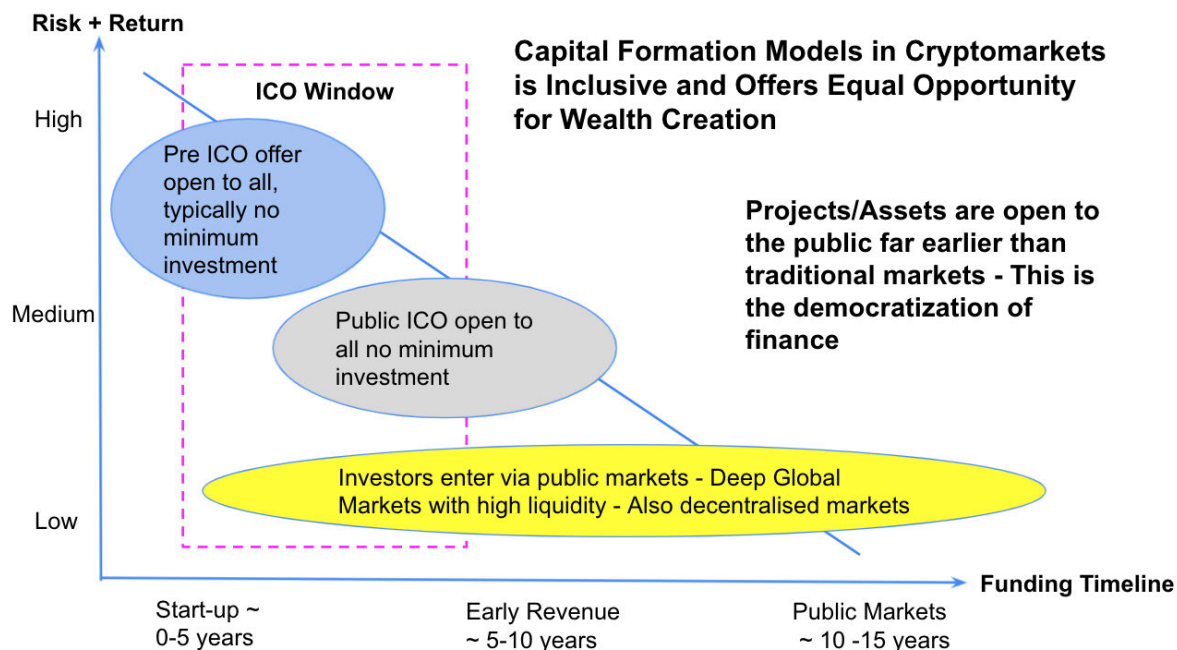
It has been recognised that blockchain technology provides open access to investment opportunities regardless of where people sit within the social structure and regardless of their wealth. We witnessed this with the creation of the Initial Coin Offering (ICO) market. For the first time in history retail level investors can for as little as AUD 100 make an investment in a start-up project, they could do this without obtaining permission and if they did not like the investment they could subsequently liquidate it via one of the hundreds of markets that formed around ICO's and these projects. This technology allows anyone on the planet with a smart phone to invest in any asset, from fine art to gold to currencies and stocks. There is a plethora of research into the 'democratisation of capital' and how blockchain technology and the ICO/crypto markets are reducing wealth inequality.⁶

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https://scholar.google.com.au/scholar?q=research+on+venture+capital+and+wealth+inequality&hl=en&as_sdt=0&as_vis=1&oi=scholar

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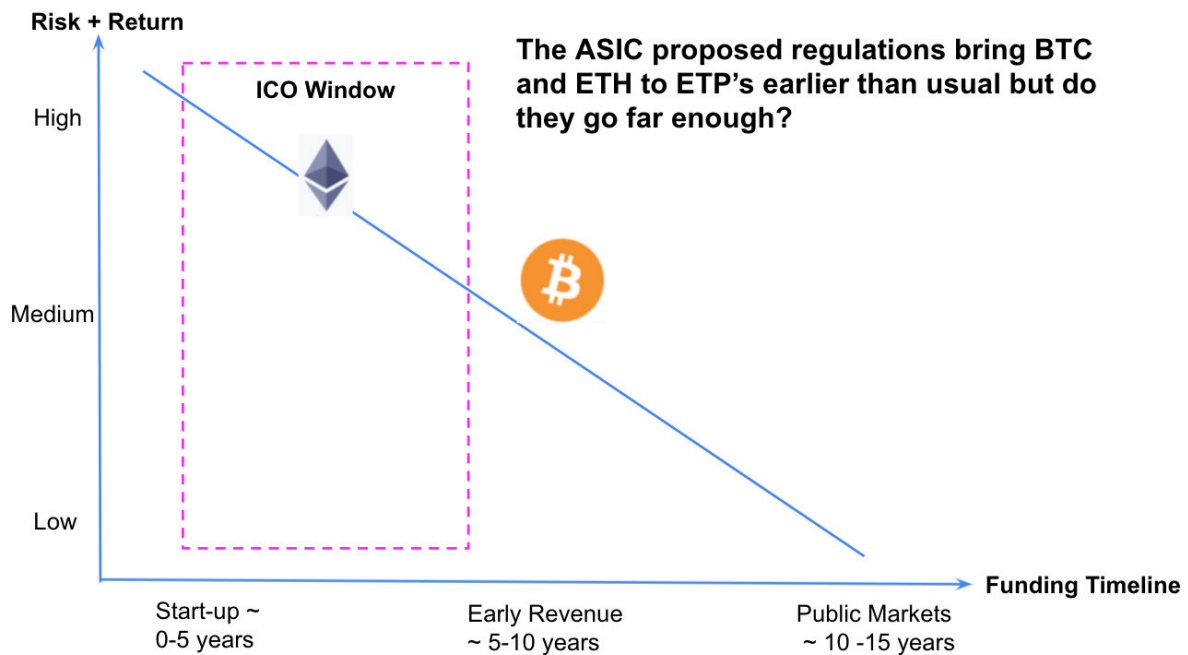
https://scholar.google.com.au/scholar?q=blockchain+technology+and+democratisation+of+capital&hl=en&as_sdt=0&as_vis=1&oi=scholar



This is not just theoretical. Most of the investment in the crypto space to date has come from the retail sector and this investment has funded a cambrian explosion of new projects and innovations that collectively are valued by the market at over AUD 1.8 trillion. This happened mainly through the three year period 2017-2020, yet still today many new projects are being developed. This is the free market at work.

Traditional institutional investors have been absent from this market mainly because of regulatory restraints. For the first time in the history of finance, retail investors have had access to high risk high return assets before the wealthy and connected incumbents. This is a wonderful thing.

The proposed regulations could in theory 'approve' Ethereum and Bitcoin as institutional grade ETP's. This is a great step forward as it will open up these assets to an even wider retail base, albeit via a third party institution. But the proposed regulations should not close down this evolution of capital markets from a closed exclusive system to one that is open and inclusive to all.



With technical barriers to early stage investment removed (thanks to blockchain technology) there is really now a moral question around, to what extent should regulators exclude retail investors from the very same opportunities that have previously only been open to the wealthy and well connected? Or perhaps the better question is how can regulators fulfill their consumer protection mandate without denying retail investors the opportunity for wealth betterment and reduced wealth inequality for society as a whole?

The responses we set out below seek to provide some answers to this complex question.

Suitability of crypto-assets and identifying features

In summary, the effect of ASIC CP 343 will be to exclude retail investors from participating (via ETP's/LIC/LIT and registered MIS) in crypto investments unless existing licensees support and accept that the asset is an investable asset and there are service providers willing to provide trust layer support services to investors.

With respect, this approach is like asking Cannon/Nikon/Leica in 2005 if they believe that it is a good idea to make a telephone with an inbuilt camera. The innovation that has developed over the past 5-10 years has not come from existing licensees, indeed many participants and service providers are hostile to the technology. Even the ASX, while adopting blockchain technology have done it in a closed permissioned environment which seeks to create an even stronger walled garden/moat around their

business.⁷ Book stores, video stores, the Post Office and others have all had to adjust their businesses dramatically with the evolution of the internet and Web 2.0. The evolution of blockchain technology and Web 3.0 will have a disrupting effect on existing licensees and those third party trust layer businesses that support (Administration and Custody etc.). There are strong incentives for existing licensees to maintain the status quo.

This said, if crypto is to become regulated, as it should, then of course existing licensees and service providers have to have input. But I do not feel that a lack of willingness to participate or innovate on their part should in any way hinder the development of regulations that support the growth of the crypto ecosystem and the benefits that this technology brings to society.

Suggestion 3 : Create a cross-industry crypto regulatory working group to advise ASIC and the Government of crypto-asset regulations

With regard to proposal B1, B2 and B3 a suggestion is that a specialist and focused group be formed to advise ASIC on the type of assets that are appropriate for an ETP. This group should be designed to ensure that the widest possible group of crypto-assets projects are available to retail investors at the earliest possible stage of their development, as this is what the technology enables. I attach as an appendix a suggested membership and governance structure.

C Responsible entity obligations

The purpose and function of Responsible Entities in the crypto markets should be the same as traditional markets. However, again, because the technology enables vastly different business models and different trust models, the way Responsible Entities fulfill their responsibilities will be quite different.

To illustrate this point I refer you to the business model of [Iconomi](#).

Iconomi is a fund management platform where all the Administration (calculation of unit value, maintenance of unit holders register, issuance of units etc.) is done by way of self executing contracts embedded in computer code (so called 'smart contracts') and Custody is also taken care of by the platform software.

As a fund manager on Iconomi platform, the only responsibility is to market the fund to clients and set the portfolio allocation, even the re-balancing is done via computer

⁷ <https://which-50.com/conflict-of-interest-and-bad-faith-negotiation-accusations-fly-over-the-asx-chess-replacement/>

code. In fact the clients are not even known to the fund manager, clients can enter the site via a sign-on (including AML/KYC) and select a fund manager from a menu, they then transfer in their funds and allocate to one or more of their preferred fund managers. Australian retail investors today can access Iconomi and enjoy their service. Iconomi has no legal footprint in Australia, it is a piece of software in the same way that Facebook is software.

How would the Iconomi software line-up against the regulatory requirements proposed by CP 343? I think for a start operators like Iconomi should be encouraged to have a legal footprint in Australia and they should be regulated by ASIC. I believe Iconomi would welcome the opportunity to do this if they can find a willing and senior enough partner at ASIC to work with their team.

But it is not just offshore software based fund management platforms that have this issue. There are many offshore crypto-exchanges, open to Australians, that are not registered with AUSTRAC and have no legal footprint in Australia. In some ways compliant Australian Responsible Entities and licensees holders are at a huge competitive disadvantage when it comes to competing with these platforms because of the regulatory gap.

The proposals in section C set out the prescriptive criteria ASIC will consider as minimum good practice to meet it's consumer protection/free markets mandate. However, there are other ways of demonstrating that the mandate can be met. Instead of being prescriptive about what needs to be done to prove that consumers are protected, why not ask the operators/developers of this new technology to prove in their own way how consumers are protected. A principled based approach instead of a prescriptive approach. I am sure local and overseas crypto businesses would be happy to be involved with this process.

Suggestion 4 : Partner with crypto asset businesses (on and off shore) to develop a principles based approach to consumer protection and how such an approach can be demonstrated.

D Listed investment entities

The comment we made in section B about working just with existing market operators potentially excludes new crypto native firms from bringing their services to the wider market. Our suggestion regarding the formation of a cross industry crypto regulatory working group is relevant here also.

E AFS Licensing

This section of the proposed regulations is the most challenging but may also present some answers to the *consumer protection v financial inclusion* dilemma.

As I understand it the proposals have the effect of restricting AFS licence holders from establishing multi asset crypto funds in all forms except for unregistered (wholesale only) managed investment schemes. I feel that this is a missed opportunity and would like to see at least registered managed investment schemes made available to retail investors.

The holders of AFS licence have an important responsibility within the financial services sector and they should have the professional experience to inform themselves and their clients of the risks and opportunities of investing in all types of assets, including crypto-assets.

Crypto-assets and markets, as pointed out in CP 343, have some unique features and complications and no doubt there are very few AFS licensees who have the relevant experience in crypto-assets to advise their clients with confidence. Allowing only wholesale investors to participate via AFS license holders is one way to limit the consumer protection risk. Another way would be to increase the restrictions on AFS licensees with regard to experience relative to crypto-assets.

Suggestion 5 : Allow ‘crypto-certified’ AFS licence holders (new and existing) to offer multi asset crypto registered managed investment schemes.

There are many self-trained crypto educators and communicators who are ‘not financial advisors’ operating on social media platforms. If AFS licence holders do not offer crypto-asset services to retail clients others will, this will add to the undesirable position of retail investors being exposed to potential fraudsters.

I believe ASIC could work with existing AFS licence holders as well as crypto experts (who currently do not have such licences) to develop a process whereby AFS licence holders and new applicants can be designated ‘crypto-certified’ by ASIC to provide multi asset registered managed investment schemes.

- END -

Appendix - Crypto Regulatory Advisory Group

Governance Structure

1. Members should be nominated/self-nominated.
2. ASIC should have authority on the member selection process.
3. Members should be for a maximum of 3 years.
4. The initial chairperson should be ASIC, subsequently the chairperson should be elected by members by ballot for a period of 12 months, maximum 2 terms.
5. Members should include people from :
 - a. Academia (computer science/blockchain technology experts (eg RMIT)
 - b. Crypto native business on-shore and off-shore (crypto exchanges, fund managers and staking service providers etc.)
 - c. Crypto educators/bloggers/podcasters
 - d. Crypto start-ups
 - e. Federal Government
 - f. ASIC
 - g. Reserve Bank of Australia
 - h. APRA
 - i. Stockbrokers and Financial Advisors Association
 - j. Financial Planning Association of Australia
 - k. Australian Financial Markets Association
 - l. Australian Investors Association
 - m. Australian Human Rights Association
 - n. Blockchain Australia
6. The group should be open, meetings open to the public (like parliament) and minutes published.