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Commission
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# Hamilton Locke Submission – Consultation Paper 381 – February 2025

Dear ASIC

We welcome the opportunity to submit a response in relation to ASIC's *Consultation Paper 381: Updates to Info 225: Digital assets: Financial products and services* (**Consultation Paper**).

The application of the existing regulatory framework to digital assets and services is complex and mostly uncharted. While we have some recent case law following ASIC regulatory enforcement activity in the past 18 months or so, there is still regulatory uncertainty. Given this, ASIC guidance on the regulatory perimeter is critical and we appreciate the thinking that has informed the Consultation Paper and Draft INFO Sheet 225.

We, like many in the sector, welcome the opportunity this consultation affords to inform and provide feedback on the regulatory perimeter. In interpreting and clarifying the regulatory perimeter, it is critical that:

- A technological neutral approach is adopted;
- The approach is consistent with case law – both past and present (whether digital asset specific or not);
- It reflects the nature and features of the digital assets and services;
- It promotes a realistic and achievable pathway to regulation;
- It aligns (to the extent practicable) with proposed reforms; and
- It promotes innovation and competition.

We have deep expertise in financial services, specifically the regulation of digital assets and services. We regularly advise clients on the regulatory perimeter for digital assets and services and have engaged with ASIC and Treasury in roundtables and consultations on this topic. In the past few years, we have made submissions to:

- Treasury's token mapping consultation paper in February 2023;

- The Crypto asset secondary service providers: Licensing and custody requirements Consultation Paper in March 2022;
- The Senate Economics Committee inquiry into the draft Digital Assets (Market Regulation) Bill 2023 in May 2023; and
- Treasury's Regulating digital asset platforms Consultation Paper – October 2023.

We are delighted with the opportunity to continue to provide feedback on digital asset regulation.

We thank you in advance for considering the points we have raised in this submission and welcome any feedback you may have in respect of this submission. As always, we are happy to further engage with ASIC on this and we look forward to the outcome of this consultation process.

Yours faithfully

[redacted]

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# Submission Paper

## In response to ASIC's Consultation Paper 381 – February 2025

# About Hamilton Locke – Funds and Financial Services

Hamilton Locke is Australia's fastest growing law firm, which is focused on transforming the traditional approach to corporate and commercial legal services. Hamilton Locke is a full service corporate law firm, which is a part of the HPX Group, that delivers essential corporate services across legal, governance, risk and compliance helping businesses grow and thrive.

The Funds and Financial Services Team at Hamilton Locke (formerly, The Fold Legal) has become one of the go-to firms for digital asset, blockchain, fintech and insurtech businesses seeking legal and regulatory advice. Our Funds and Financial Services team is also one of Australia's largest as a result of the merger between The Fold Legal and Hamilton Locke.

We are known for our technical expertise and industry knowledge, which we use to provide practical solutions for our fintech and digital asset clients. Our expertise in financial and credit services is recognised by our ranking in Chambers and Partners Asia-Pacific and FinTech Legal Guides. Reflecting our commitment to client service, we also won Best Law & Related Services Firm (<$30mil) across several specialist categories based on direct feedback from our clients.

Collectively, we have been deeply steeped in the fintech space since early 2013 and we continue to deepen and strengthen this experience as one of Australia's largest and most diverse financial services practices.

We are technical specialists that have a broad and deep understanding of blockchain technology, digital assets, exchanges, Decentralised Autonomous Organisations (**DAO**), alternate platforms and digital asset products and service offerings. Our knowledge of digital assets and services, combined with our traditional financial services expertise, is market leading. We use our industry knowledge and expertise to deliver practical, compliant, and innovative solutions for our clients. We have worked with digital asset exchanges, miners, digital asset payment businesses, digital asset platforms, DAOs and token issuers to design innovative and compliant offerings.

We are a partner and member of the Digital Economy Council of Australia (**DECA**), FinTech Australia and InsurTech Australia.

This submission has been prepared by Jaime Lumsden, Michele Levine, Charmian Holmes, Nicholas Pavouris and Ruth Fesseha.

# Our Submission

We commend ASIC's efforts in providing updated guidance in Draft INFO Sheet 225, which seeks to provide industry with further transparency and clarity on ASIC's views on the regulatory perimeter, both based on recent case law developments where available and ASIC's own thinking in areas where case law has not yet developed.

The guidance in Draft INFO Sheet 225 provides a helpful springboard to tease out and finesse the interpretation and application of the current financial services regulatory framework to digital assets and services. To assist ASIC with this, our submission highlights a number of issues, challenges and gaps that we believe still need to be worked through before the updated guidance in Draft INFO Sheet 225 is finalised. It is critical that these points are considered and worked through with industry to ensure that the guidance appropriately demarcates the regulatory perimeter based on case law. To help inform ASIC with this, our submission is structured as follows:

- Section 1: This section outlines key issues, gaps and challenges with the updated guidance in Draft INFO Sheet 225 as well as any commentary and guidance in the Consultation Paper. To the extent we can, we have proposed potential solutions and included recommendations (which are shaded purple) for ASIC's consideration; and
- Section 2: This section provides a summary of our recommendations for convenience.

Unless specified otherwise, all references in this submission to:

- Sections are to sections of the *Corporations Act 2001* (Cth); and
- Regulations are to regulations of the *Corporations Regulations 2001* (Cth).

## 1. Issues and Challenges

Given the scope of the proposed updated guidance in the Consultation Paper, we believe it is critical that any issues, gaps and challenges are identified, considered and resolved before ASIC finalises its guidance in Draft INFO Sheet 225.

To help inform ASIC on these matters, this section of our submission details these issues, gaps and challenges at a conceptual level. It also outlines further questions or matters we believe need to be explored and, where possible, proposes potential solutions and recommendations for consideration.

### 1.1 No-action relief

*Reliance before release of final relief instrument*

We understand that the no-action proposal in the Consultation Paper is intended to ensure that digital asset businesses may access class order relief subject to a number of conditions, which includes applying for an Australian Financial Services Licence (**AFSL**) within six months of the final INFO Sheet 225 being published.

It is our view that the no-action position appears to have been designed to encourage businesses to apply for an AFSL expeditiously. While a clear pathway to regulation is essential for both ASIC and industry, the no-action relief as currently drafted may create more uncertainty and engender regulatory arbitrage opportunities. In our view, businesses will be less inclined to lodge an AFSL application sooner if the following issues are not addressed in updated guidance.

We outline the reasons for this as well as propose an alternative solution.

*Disadvantage to early applicants*

We note that no one currently has the benefit of any no-action relief. This is because the Consultation Paper only proposes ASIC's position, and relief will only apply (to the extent a business meets the required conditions) once ASIC issues a final relief instrument.

If a digital assets business lodges an AFSL application early, it is more likely that its application may have weak spots or deficiencies, especially given that ASIC's position in Draft INFO Sheet 225 on certain items may be unclear, untested or contentious.[1] This issue is likely to be more acute for businesses that applied for an AFSL or to vary an AFSL before the Consultation Paper was released. We note that ASIC is liaising with applicants in light of the Consultation Paper and Draft INFO Sheet 225. However, it is unclear how applicants best navigate the licensing process until such time that Draft INFO Sheet 225 is finalised.

We consider the disadvantage of early and existing applications as an issue that needs to be further considered especially given that a deficient application may be rejected and will lose the benefit of the proposed no-action relief.

It is also important to note that there can be a first mover disadvantage when it comes to lodging licence applications. There are certainly cost and time efficiencies in lodging a licence application later as you can draw on the learnings and experience of those who applied before. As currently proposed, the no-action relief does not encourage early applications, and we anticipate most businesses will wait the maximum timeframe to apply. Like with other new licensing regimes, this can impact ASIC resourcing and timeframes for granting licences.

*Market exits*

It is quite possible that a business may wish to exit the Australian market in light of the application of the existing regulatory regime to digital asset businesses. Such an exit may involve ceasing all operations in Australia, divesting the Australian business to other Australian participants (whether as a share or asset sale), or restructuring to eliminate the provision of financial services (for example, where financial services is only a small part of the operation).

On the current drafting, any exiting business would not have the benefit of the no-action relief for past conduct on the basis that such a business is unlikely to apply for licence. In our view, this is misguided, and businesses exiting the market (and any acquirers of those businesses) should have the benefit of the no-action relief for past conduct, given that the no-action relief is at least partially premised on the challenges historically faced by digital asset businesses in determining if they were providing a financial service. This remains a live issue for businesses that make a conscious decision to exit the market. Businesses that do not apply for a licence should only be exposed if they continue to provide financial services after a specified date, or if they commence new financial services after that date (assuming they are not financial services that are not completely excluded from the no-action relief in any case).

*Restructure*

We anticipate that many digital asset businesses may restructure their trading functionality in light of markets licensing. This is likely to involve businesses moving from an order book model to an OTC trading model or potentially a broker model.

On the current drafting, it appears these businesses will not have the benefit of the no-action relief in respect of any conduct that amounted to operating a market if they do not comply with the conditions of the relief. There are two key conditions that apply to markets licences, being:

- The business informs ASIC in writing of its intention to lodge a licence application or variation application to cover their digital asset products no later than six months from the date the updated INFO Sheet 225 is published; and
- The licence application or variation application is lodged within 12 months of the date the person informed ASIC in writing of its intention to apply for a markets licence.

Similarly to businesses that choose to exit the market, these businesses should still have the benefit of the no-action relief in relation to any conduct in breach of markets licensing rules, notwithstanding they choose to restructure to avoid the need for a markets licence. Only if new market operations are commenced after a specified date should such businesses be outside the no-action relief.

*Financial services v financial products*

[1] This is particularly important in light of ASIC's proposed position in relation to Responsible Managers which we consider in more detail in section 1.2.

The proposed current wording in the Consultation Paper seems to suggest that the no-action relief will only capture financial services that have been provided in relation to a digital asset that is a financial product. For example, if a digital asset is a security, then the no-action relief would cover any financial services provided in relation to that security i.e. advice, dealing, custody and market making.

We understand from discussions at ASIC roundtables that the no-action relief would not apply where a service offering is the financial product and that service offering involves the use of digital assets, which are not financial products. For example, ASIC has indicated that a traditional managed investment scheme investing in digital assets will not have the benefit of the no-action relief, on the basis that a managed investment scheme is well-understood to be a financial product and therefore no relief is merited.

While we agree that traditional financial products that merely overlay digital assets, such as ETFs investing in digital assets or derivatives over digital assets, do not need and should not benefit from the no-action position, we are concerned that there is a middle position that is not clearcut and does need the benefit of no-action relief. This middle position relates to complex financial services that have been developed and built in new ways around digital assets that do not have clear analogues in traditional finance, and where businesses have faced the same complexity in assessing the regulatory status of their offerings as businesses offering digital assets. Examples might include:

- **Stablecoins** – there is currently a debate in the industry about whether the “facility” that could be a financial product is the digital asset itself or some broader facility that sits above the stablecoin (and within which the stablecoin functions). If the final position is that the stablecoin is a non-cash payment facility, businesses will have relief – but if the facility exists as some higher level, such that the financial product is not itself the stablecoin, then businesses will not have relief. At the same time, the fact this debate exists at all demonstrates how this analysis is complex and that businesses should rightly have access to the no-action relief;
- **Staking** – staking, as an earn product[2], is to be carved out of the relief due to the fact that case law has already clarified this area. However, staking is an example of the type of financial service we are describing, where if a financial product exists, it is not the digital asset itself, but some other facility within which the digital asset operates. If this area had not been clarified by case law, off chain staking would be an example of a financial service that would not have the benefit of the no-action relief. The very fact that case law was necessary to clarify this area demonstrates that the complexity is such that relief may have been merited if clarity had not already been provided;
- **Wallets** – many wallets do not hold themselves out to facilitate transfers to third parties and prohibit such transfers, but at the same time cannot technologically enforce that these transfers do not occur, of which there is no direct analogue in the payments industry. Wallet providers have attempted to mitigate this risk without guidance to date and stand to be exposed without qualifying for no-action relief, because the wallet is not itself a digital asset. Additionally, there is still a lack of clarity around when a wallet is “custodial” or not, as this can also affect the characterisation as a non-cash payment facility.[3]

Provision needs to be made to include these challenging and non-traditional financial services within the ambit of the no-action relief.

*When is a business “operational”?*

The proposed no-action relief in the Consultation Paper does not provide any guidance on what ASIC considers is an existing business. Given the lifecycle of businesses, there is a continuum of what an existing business is, which includes:

- Business concept;
- Pre-pilot phase;
- Pilot phase;
- Soft business launch; or
- Full business launch.

[2] In addition, please see our separate commentary in relation to earn products below.
[3] In addition, please see our separate commentary in relation to custody and wallets below.

It is quite possible that a business may have a legal entity, website, market presence, engaged service providers or raised capital in stages 1 to 3. In our view, these businesses should be considered existing businesses for the purposes of the no-action relief.

In addition, there are businesses that have adopted a conservative and compliant approach to business launch based on ASIC's public statements and expectations. These businesses have delayed launch and instead expended upfront capital and time on:

- Engaging with ASIC in good faith in light of ASIC's public statements and expectations before launching their product and services to work through licensing requirements;
- Have met with ASIC and exchanged views of licensing requirements;
- Have lodged a licence application and not yet received a licence; and
- Have held off launching their product without a licence.

Invariably, these businesses have put themselves at a competitive disadvantage by engaging with ASIC early and in good faith. It would seem counter-intuitive and a poor regulatory outcome if a business that launched a product without engaging ASIC before the Consultation Paper would have the benefit of the no-action relief, whereas the above new businesses that engaged with ASIC early would not.

Additionally, there are further businesses that are waiting to complete their registrations with AUSTRAC in order to be able to launch.

In our view, any business should be considered operational if it has one or more of the following features:

- Has a market presence – either through a website, advertising, or engaging in its industry sector on a more bespoke basis;
- Has made a capital investment in regulatory compliance - for example, sought legal advice or submitted applications to regulators;
- Has designed and developed a product or service to at least concept phase – even if that product has not yet been launched or even publicly announced; or
- Has conducted capital raises to support the business launch.

It should also be clarified that if a business is "operational" that it will get the benefit of the no-action relief on all its financial services offerings, whether launched before or after the publication of the Draft INFO Sheet 225, including the listing of new tokens which might amount to a financial product (provided they are not financial services that are excluded from the ambit of the no action relief).

### *Timing issues*

Because the no-action relief is structured around incentivising businesses to apply for a licence, the end date of the relief will not be consistent – rather it will be staggered, with relief ending for each entity as its licence is granted or rejected.

This means it is quite possible that an issuer may have the benefit of the no-action relief, but an intermediary or service provider may not any longer because their licence has been granted. For example, a stablecoin issuer that launched a stablecoin before the Consultation Paper will have the benefit of the no action relief (subject to complying with the conditions), but a digital asset exchange or custodian that has already obtained its licence will not.

This creates real regulatory compliance issues for the licensed exchange. For example, if the stablecoin issuer continues to operate under relief, then:

- The exchange cannot provide a PDS to retail clients as required by the Act (because one does not yet exist); and
- The exchange cannot even engage in any retail distribution conduct because a TMD does not exist.

In these circumstances, the no-action relief is of little practical benefit to the issuer, as the stablecoin cannot be listed or held on custody by licensed providers. This is highly problematic and a poor market and consumer outcome as the issuers will not be able to facilitate trading of these digital assets, which will hinder growth and functionality.

*Lack of clarity on the scope or conditions for relief*

It is also unclear *when* ASIC may notify a business that it may not access the no-action relief, as there are not currently any conditions or qualifications that form the basis under which ASIC can withdraw relief. It is also unclear whether any current or future enforcement activity may preclude a business from relying on the no-action relief.

In our view, it is not appropriate that ASIC should be able to withdraw relief at any time for any reason, as this provides no certainty to any market participants. No-action relief granted on this basis is meaningless and offers no real protection.

*Derivative exclusion*

We note that ASIC is proposing to exclude derivatives from the no-action relief. As we understand from engagement with ASIC at the various roundtables, ASIC's view is that derivatives are complex products and people issuing or otherwise dealing in those products should be well aware of the licensing and regulatory requirements that apply to derivatives.

While we understand ASIC's rationale, the exclusion of derivatives at large in our view is misguided and different types of derivatives need to be considered in the context of the no-action position. We outline in the table below the different types of derivatives that we think are relevant and our view as to how they should be treated in terms of the proposed no-action relief.

| Derivative type | No-Action Relief | Rationale |
|---|---|---|
| Traditional derivatives (whether OTC or market traded) where the reference or underlying asset is a digital asset | No | We agree that issuers, brokers, market makers or operators of traditional derivatives should be well aware of their obligations in relation to derivatives with the only difference being the reference or underlying asset being digital assets. |
| Digital assets that may be derivatives | Yes | Based on the lack of clarity on the regulatory perimeter and the fact that ASIC has not undertaken any enforcement action in relation to a digital asset that may be a derivative, we think it is essential that no-action relief is provided. This is particularly the case given ASIC's newly held views on wrapped tokens that many in the industry (including us) do not agree with for the reasons detailed in section 1.7. |
| Broader facilities that may be derivatives other than traditional derivatives | Yes | While ASIC did raise derivatives in connection with *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd* [2024] FCA 64, the court held that the different products may have been derivatives but did not explore this in detail because the products had the benefit of the future services exemption in s761D(3)(b). At this stage, there is not much helpful judicial guidance on this, and we note that the decision is also subject to appeal and the outcome may change. |

*Earn products exclusion*

We note that ASIC is proposing to exclude earn products from the no-action relief. No specific reason for this has been included in the Consultation Paper or via any of the roundtables. We presume that ASIC is proposing this position in light of its recent regulatory enforcement action against both Finder and Block

Earner. However, given that both of these cases are at varying stages of an appeal process[4], we do not think it is appropriate to exclude earn products at large from the proposed no-action relief given the ongoing regulatory uncertainty.

Further, the Consultation Paper does not include any definition of an earn product for this purpose and this raises further ambiguity. This is because other platforms, products or services different to those considered in Block Earner or Finder may provide a return (in the form of capital appreciation) but are structurally different to the products considered in Block Earner and Finder. Given this, we think it is important that ASIC clarifies what would be caught by the earn product exclusion if it maintained that exclusion from the no-action relief is appropriate.

**Recommendation 1**

Given the issues detailed above, we strongly recommend that the no-action relief is redrafted to apply retrospectively with a fixed sunset date of two years. This approach is consistent with the foreign financial services providers (**FFSP**) exemption instruments and would avoid any regulatory arbitrage as between participants. This recommendation is consistent with our suggestions to ASIC both formally and informally in meetings and at various roundtables.

We do not recommend that the no-action relief completely sunset on receipt of a licence because of the issue identified above where licensed providers cannot themselves meet their own obligations while other participants continue to have the benefit of the relief. Once licensed, an entity should continue to have relief where their own compliance is dependent upon the actions of a third party who themselves are not yet licensed but have the benefit of the relief.

We also recommend that this relief should be from all obligations in Chapter 7 of the Corporations Act, with the exception that we consider it appropriate for the no-action relief to be subject to the condition of maintaining membership with an external dispute resolution scheme (to minimise consumer harm). We acknowledge that ASIC has specifically asked if the no-action relief should apply to obligations such as the one to produce a PDS, and we consider that it should. Producing a PDS is itself challenging when the product issuer is not licensed, for example:

- The licence details cannot be included;
- The entity is not required to maintain internal dispute resolution systems (yet), and so either this information cannot be included or the entity is forced to opt into additional requirements just to comply with the PDS obligation.

While ASIC could grant relief from any obligations that present a challenge, to comprehensively identify all such matters and appropriately provide relief would seem onerous and difficult to achieve without unintended consequences. We suggest that blanket relief in this case is effective and appropriate.

We acknowledge that this is a fundamentally different approach but will provide a more seamless and achievable pathway to regulation with greater certainty. It may be appropriate to add additional conditions to the relief – for example, businesses that are subject to regulatory enforcement commenced prior to the no-action relief taking effect will not ever have the benefit of the relief in respect of the matters that are the subject of the regulatory enforcement.

We also recommend that you adopt our suggested approach above in relation to both the derivatives and earn product exclusion.

## 1.2 Responsible Managers

*Unregulated experience in a regulated environment*

Nominating appropriately qualified responsible managers is critical for a successful licence application. Usually, new industries have the benefit of regulatory reform and transitional arrangements to deal with past unregulated experience. This approach was most recently adopted for debt management services

[4] *Australian Securities and Investments Commission v Finder Wallet Pty Ltd [2024] FCA 228* and *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd [2024] FCA 64.*

and insurance claims handling, which were new licence authorisations that were implemented in 2021 for credit licences and AFS licences respectfully.

However, as the updated guidance in Draft INFO Sheet 225 is not a consequence of regulatory reform, but rather a reinterpretation and / or clarification of the application of existing laws, ASIC has not, as yet, proposed to provide such transitional arrangements for prior unregulated experience.

At the present time, ASIC has confirmed in the Consultation Paper that its normal approach to the key AFS licensee and ongoing requirements will apply to digital asset firms, including but not limited to ensuring responsible managers have the organisational competence described in ASIC Regulatory Guide 105 (**RG 105**), unless during consultation other compelling views are put forward.

In our view, ASIC's proposed approach is unworkable and does not address the significant hurdles in sourcing appropriately qualified responsible managers for digital assets. These challenges exist because:

- Many of the people inside digital assets businesses who have prior traditional finance experience have now been inside those businesses for ten years, and any financial services experience gained in those businesses is unregulated (and in ASIC's view obtained in breach of the law) and, therefore, not usually considered by ASIC, meaning most digital assets businesses may need to source new staff for responsible manager roles who will not have the operational experience inside these businesses;
- The responsible manager pool for digital asset businesses is likely to be small, given that digital asset businesses are likely to have a high need for authorisations for which responsible managers have always been hard to find, such as custody, miscellaneous investment facilities and non-cash payments facilities (the latter of which is already subject to rising demand in anticipation of changes to payments regulations);
- While there is a small pool of responsible manager candidates that have obtained regulated experience in licensed digital asset businesses, these candidates often have limited or narrow regulated experience, which will not readily support all of the regulated activities for the digital asset business going forward. This is because these digital asset businesses often have very limited or narrow licence authorisations and, in our experience, these authorisations usually only cover non-cash payment facilities or wholesale funds;
- Only a small percentage of digital asset businesses have been appointed as corporate authorised representatives and will have staff who have met the minimum three-year experience to qualify as a responsible manager if that business wishes to transition to its own licence. Further, this experience is most often limited to dealing in, or advising on, non-cash payment facilities in relation to pre-paid cards, and will not be useful to support the breadth of authorisations required;
- A significant portion of the digital asset market will transition from unregulated to regulated in a relatively short timeframe. It is currently proposed that businesses will have 6 months from the date the final INFO Sheet 225 is published to lodge licence applications. We have suggested the transition period should be extended, which will help to alleviate this if adopted, but nevertheless there will be reasonably high demand on uncommon experience;
- ASIC's guidance as currently drafted may result in a need for new expertise that does not currently exist in the market, for example, making a market in non-cash payment facilities. Noting that we do not agree with ASIC's characterisation of stablecoins (see section 1.5), nevertheless this needs to be factored in. Another example is making a market in securities, an authorisation we have not (to date) been able to identify on any existing licence. If they exist, they are rare, and persons qualified to be responsible managers would also be exceedingly rare;
- There is a limit to the number of businesses a responsible manager can support given the time commitment involved. ASIC's current position is that a responsible manager should not be attached to more than three AFS licences (depending on time commitment to each and the relationship between them). Given the size and scale of many of these businesses, it would be uncommercial and not competitively realistic to have a responsible manager acting across multiple digital asset businesses; and
- ASIC takes a very limited and strict approach to Option 5 in RG 105 for responsible managers and our experience has been that ASIC does not accept unregulated experience (especially where obtained in breach) even under Option 5 (especially not for retail clients) for businesses that are not going through a formal transition to regulated status due to a change in the law.

On the basis of the above, we do not think it is appropriate for ASIC to maintain its standard position on responsible manager competency requirements as set out in RG 105. Instead, we recommend that ASIC provide transitional arrangements for digital assets on exactly the same terms that it does when Parliament has passed new laws to regulate a new sector, i.e. all persons who have been working in the business of the licence applicant (or another digital assets business) who have gained relevant experience through that business providing financial services in an unregulated fashion (whether lawfully or otherwise) should be accepted as having qualifying experience in those financial services.

As an alternative, if ASIC does not consider that such transitional arrangements are appropriate, we recommend that a bespoke approach is adopted for digital asset businesses, and we propose a number of recommendations in this regard. The approach we recommend below is consistent with and has regard to the approach that ASIC has adopted and continues to use now for responsible manager competency for carbon trading.[5]

In our view, our alternative approach will:

- Foster a realistic pathway to regulation;
- Recognise the valuable experience and expertise of current candidates; and
- Align with regulatory reform principles and mitigate any risk of regulatory arbitrage in relation to the payment reforms and the overlap with stablecoins.

This is particularly important given the impact suitably qualified responsible managers may have on the likelihood of applicants applying early and the success of earlier licence applications. This is compounded by the possibility that ASIC may update its guidance for responsible managers as it reviews licence applications, meaning early applicants may be disadvantaged in the event that ASIC relaxes or changes the guidance over time. This means that those businesses that do not have stock standard responsible manager candidates in their existing business, may be incentivised to wait until clearer guidance is released from ASIC.

On the other hand, the longer a business leaves its application, the more difficult it may be to source suitable responsible managers if it does not have candidates internally and ASIC does not relax the requirements.

We encourage ASIC to consider the impact of this as it may lead to an uneven playing field given the points we have highlighted above. The ability for a business to balance these risks is challenging and will ultimately be driven by its risk appetite and business strategy. Below we recommend some alternative approaches for ASIC to consider.

**Recommendation 2**

***Alternative approaches***

We recommend that ASIC reconsider its position on responsible managers and adopts a more facilitative approach for industry sooner rather than later. We have outlined below some suggested options for consideration. We outline our recommended approach below having regard to existing experience.

***Usual transitional arrangements***

We recommend that ASIC adopts the standard transitional approach it has when an unregulated industry is brought within the ambit of regulation. While we recognise that to the extent digital assets are currently regulated, it has always been regulated, the complexity of the sector means that both industry and ASIC have, for a long time, not necessarily held this view (or have not held it to the extent it is now held). Accordingly, the digital assets sector is presented with challenges similar to those of industries transitioning from unregulated to regulated status, and therefore it is appropriate to approach responsible managers the same way. That is, if persons have been operating within a digital assets business prior to the publication of updated INFO Sheet 225 (and up until the end of transitional relief), that experience should be recognised as sufficient (in accordance with the usual five options applied by ASIC),

[5] See ASIC Regulatory Guide 236: Do I need an AFS licence to participate in carbon markets? (September 2023) at para RG236.197 to RG236.201.

notwithstanding it was gained in an unregulated business, in respect of any financial services that person provided or of which they had oversight.

Although we strongly consider this to be the appropriate position, we have provided some alternative views below.

***Supplementary training***

Where ASIC is uncomfortable to accept unregulated experience gained by dealing in, and advising on, financial products in a digital assets business, it may be appropriate to require responsible managers to also undertake some training to provide a supplemental understanding of regulatory requirements. For example:

- Where responsible managers are supporting an authorisation for advising retail clients, that responsible manager will be required to undertake RG146 training. This training will help to provide the candidate with some understanding of regulatory requirements in connection with advice for retail clients; or
- Where a responsible manager is not supporting an authorisation for advising retail clients and will not undertake RG146 training, there are also industry-based courses run by a number of providers which are notionally dubbed “responsible manager” courses, workshops or masterclasses. These courses can be as short as 1 hour and as long as a whole day and are designed to assist existing or incoming responsible managers and compliance managers to better understand the AFS licensee’s general conduct obligations. Hamilton Locke runs a number of Responsible Manager Masterclasses, both publicly and privately (the latter of which can be tailored to the needs of the business), as do other providers such as Sophie Grace, Holley Nethercote, Kaplan and Financial Education Professionals.

***Paired responsible managers***

Alternatively, it may be appropriate to “pair” responsible managers so that two responsible managers together satisfy what would ordinarily be satisfied with one responsible manager. This might be the case where:

- Someone with traditional regulated financial services experience is paired with someone with digital assets experience but without financial services experience. This may be appropriate because digital asset technology operates differently to traditional finance (**TradFi**) and it is doubtful that a responsible manager with only TradFi experience would be competent to oversee the provision of financial services in the form of digital assets; or
- Someone with compliance experience (not specific to any particular financial service) is paired with someone with unregulated digital assets financial services experience – this would be an alternative way of supplementing a responsible manager’s unregulated financial services experience with someone well-versed in the regulatory requirements. This could also be used to supplement retail client experience, for example, a compliance person with an understanding of retail client requirements could supplement someone who otherwise only has wholesale client experience.

***Equivalent experience***

In the past, ASIC had accepted “equivalent” experience, for example, accepting unregulated reinsurance experience to support an application for general insurance, or accepting general insurance experience in personal accident to support an authorisation for life insurance. In our experience, the former of these has not often been accepted for 10+ years now, while the latter is still somewhat likely to succeed. ASIC has also used similar principles in how it accepts responsible managers for carbon trading.

Given that some of the authorisations likely to be necessary for digital assets are rare or non-existent, if ASIC will not provide full transitional arrangements for responsible managers, then we consider it appropriate to consider equivalent experience.

### 1.3 Identifying the Relevant Facility

*Lack of clarity on what a ‘facility’ is*

The updated guidance in Draft INFO Sheet 225 does not properly explain the importance of the concept of the “facility”, nor does it draw on the judgement in *Australian Securities and Investments Commission v BPS Financial Pty Ltd* [2024] FCA 457 (**Qoin case**) to explain how one determines what the relevant facility is and whether that facility is a financial product.

We also note that aspects of Draft INFO 225 seem to blur the lines and expand the definition of a facility. For example, the guidance provides that bundled arrangements may amount to a facility. The guidance also provides that a token cannot be separated from its associated bundle of rights, benefits, expectations and features, even if some of these rights, benefits, expectations and features do not strictly exist inside the token and depend on some other platform, technology, or terms and conditions.

Both of these ideas are problematic because they gloss over the importance of identifying the correct facility. In some instances, there are multiple possible “facilities” that might need to be considered, for example:

- The token;
- The blockchain;
- A wallet; or
- Some other product, platform, or arrangement between an entity and a person.

A more nuanced approach is required. We do not agree that the distinctions between these things can be glossed over to treat one, or more (or all) of these things as financial products just because one of them meets the definition of a financial product. Each facility needs to be identified and assessed against the relevant financial product definitions.

A “facility” is defined to include intangible property, an arrangement or a term of an arrangement (including a term that is implied by law or that is required by law to be included) or a combination of intangible property and an arrangement or term of an arrangement. In this context, an “arrangement” is very broadly defined to mean a contract, agreement, understanding, scheme or other arrangement (as existing from to time):[6]

- Whether formal or informal, or partly formal and partly informal;
- Whether written or oral, or partly written and partly oral; and
- Whether or not enforceable, or intended to be enforceable, by legal proceedings and whether or not based on legal or equitable rights.

The definition of facility is relevant to the general definition of a financial product in section 763A of the Corporations Act, which includes:

- A facility for making an investment;7
- A facility for managing risk; [8] and
- A facility for making a non-cash payment. [9]

Based on ASIC’s updated guidance in Draft INFO Sheet 225, there are a number of issues that arise from ASIC’s interpretation of a facility, and we consider these separately below. Some of these issues relate to specific financial products, others apply more broadly.

### *What are the relevant bundle of rights?*

The updated guidance provides that one needs to assess the “bundle of rights, benefits, expectations and product features” associated with a particular token to determine whether it is a financial product. In our view, the reference to “expectations” is misguided and should be replaced with “representations”. This is because anyone’s expectations should be reasonable and objectively determined based on representations made. The reference to “expectations” could raise issues as to “subjective” understanding, which may be unfounded and not reasonably held.

[6] Section 761B *Corporations Act 2001* (Cth).
[7] Section 763B *Corporations Act 2001* (Cth).
[8] Section 763C *Corporations Act 2001* (Cth).
[9] Section 763D *Corporations Act 2001* (Cth).

In addition, the assessment of the bundle of rights should not be limited to digital assets but should also be considered in connection with services, which may involve the provision of a broader facility. This is because, in our experience, most digital assets are unregulated but broader facilities may be regulated as a financial product and involve the provision of financial services. To make this clearer, we suggest that ASIC includes guidance on what is a facility and how to identify the relevant facility, along with one or more examples that assess both the digital asset and broader facility against different financial product definitions.

*Multiple financial products*

Based on Draft INFO Sheet 225, it is possible that a digital asset or some other broader facility may meet the definition of more than one financial product.

However, while this may be theoretically possible based on the satisfaction of more than one financial product definition, there are statutory rules that needs to be followed when determining what financial product applies for licensing purposes, which are not currently referenced in Draft INFO Sheet 225.

Essentially, these statutory rules require the following steps to be followed:[10]

- First, one needs to assess if the digital asset or service in question falls within the specific definition of a financial product in section 764A(1). If yes, then it is a financial product, whether it falls within the general definitions in Subdivision B or not. Note that something can only be a derivative if it does not meet any other definition;[11]
- Second, one needs to assess if the digital asset or service is specifically excluded from the definition of a financial product under section 765A(1). If yes, then it is not a financial product, even if it is falls within the specific definition in section 764A or the general definition in Subdivision B; and
- Third, if it is not within a specific definition in section 764A, or is not specifically excluded by section 765A, then one must consider if it falls within the general definition in Subdivision B.

It is important that the guidance in Draft INFO Sheet 225 addresses this, as it is possible that a particular digital asset or service could otherwise be more than one financial product but will not be when assessed in this way.

**Recommendation 3**

ASIC's guidance should be updated to include the following and be consistent with the Qoin Case:

- Make it clear that it is necessary to identify all the relevant facilities – which may include a digital asset and some broader facility based on a service offering or platform;
- Make it clear that, in assessing whether something is a financial product, regard should be had to the rights, benefits, features and representations; and
- Includes one or more examples that assess both the digital asset and broader facility against different financial product definitions. This is particularly important for managed investment schemes, a facility for making an investment, a facility for managing risk, a facility for making non-cash payments, derivatives and deposit-taking facilities. See our non-cash payment facility stablecoin example; and
- Make it clear that while a digital asset or broader facility may technically meet more than one definition of a financial product, from a licensing perspective, one needs to determine which financial product definition applies based on the statutory rules. An example should be provided to demonstrate this. Example 2 in Draft INFO Sheet 225 can be adapted for this purpose. See our suggested changes in mark-ups below.

*Proposed mark-up to Example 2 in Draft INFO Sheet 225*

Company B runs a digital asset exchange. It offers its customers the ability to 'natively stake' certain native digital assets to support verification of blockchain transactions, where the blockchain uses a 'proof of stake' consensus mechanism.

[10] Section 762A *Corporations Act 2001* (Cth).
[11] Section 761D(3)(c) *Corporations Act 2001* (Cth).

Company B markets its staking services as a way of earning a return on otherwise idle digital assets. Company B takes a small share of the staking revenue as a fee for providing the services. For all digital assets made available to stake, Company B allows customers to stake with no minimum balance, withdraw their staked assets instantaneously, and participate in staking at any time. However, the underlying processes for staking on the relevant blockchains have restrictions, such as:

- a minimum staking balance
- the digital assets must be locked for a minimum period of time, or there is an inbuilt delay in returning unstaked assets, and
- limits on the number of individuals who can participate in staking at one time.

Company B's facilities for staking these digital assets are likely to meet the definition of ~~be~~ facilities for making a financial investment ~~(~~and ~~potentially~~ managed investment schemes~~)~~. This is because in each staking facility there is a contribution of money's worth (being the digital asset) which is ~~pooled or~~ used ~~in a common enterprise~~ by Company B to generate a financial return or other benefit for the investor, and the investors do not have day-to-day control of the facilities.

Because Company B allows customers to stake with no minimum balance, and does not enforce minimum staking and unstaking periods, it is likely that customers' assets are pooled or used in common enterprise in order to facilitate this outcome. Where this is the case, the staking service is a managed investment scheme. If there is no pooling, then the staking service is a facility for the making of a financial investment. It cannot be both, because rules in the Act specify that something cannot meet the general definition of a facility, including being a facility for making a financial investment, if it meets the specific definition of a financial product, such as a managed investment scheme. ~~In each facility, the rights and benefits from Company B's facility differ from and exceed what the client would get if they undertook to stake the digital assets without the services of Company B. For example, Company B's facilities allow clients to stake digital asset balances below the minimum for that particular blockchain.~~

### *A facility for making an investment*

We think that ASIC's guidance on what is a facility for making an investment (**Investment Facility**) adopts a broader interpretation than the current case law and conflates the concept of "generating a return". This is best illustrated by assessing some of the examples in Draft INFO Sheet 225.

For instance, Example 1 in Draft INFO Sheet 225 provides:

> *Company A runs a digital asset exchange. They issue a digital asset where the relevant 'white paper' outlines it is to raise funds to assist in the development of the exchange. The token was marketed as a way of contributing to, supporting and potentially obtaining a financial return, or other benefit, by 'investing in' the project, and at least some consumers bought the tokens on that basis.*
>
> *The token's price on the exchange (and on any other exchange) was expected to and does go up and down based on the perceived success of, and general sentiment towards, Company A's exchange.*
>
> *The white paper stated that Company A intends to (but is not obliged to) buy back the tokens at a certain price if Company A's exchange achieves certain success metrics (e.g. based on revenue, trading volume and profit).*
>
> *Company A's digital asset is likely to be a facility for making a financial investment. It involves members of the public contributing money or money's worth which is used in a business project where both the business and the investors intend the money to be used to generate a financial return (e.g. the token increases in value and the token is intended to be bought back by the exchange if the project is successful). The investors do not have day-to-day control over how the funds are used (even if there is a voting mechanism to consider certain matters).*

The inclusion of capital appreciation as a return generated for investors by Company A in this example as the determining criterion for the first requirement of an Investment Facility is flawed, as it has wide implications and could, potentially, capture physical goods and commodities. If we suppose that car manufacturers, whisky distilleries, or wineries (among others, such as gold bullion etc.) did make similar representations, there is a question: "if car manufacturers made similar representations as in the token example, would a car (or other physical good) be a financial product?"

The answer would be yes – but also, in our opinion, this is an absurd outcome. It cannot have been intended that the definition of an Investment Facility could be interpreted in such a way as to capture to physical goods.

The reason that this example does not work is not because ASIC have said certain representations are made (as this was covered in the Block Earner case and is correct), but because ASIC has taken the view that capital appreciation in and of itself is a return that can be generated by a third party from a contribution made to them by an investor.

Section 763B alludes to this in the notes. Note 1 says that a share is financial investment because money is given to the issuer which generates dividends - note that this note does not reference any capital gain of the share, only the dividends (which are distributed company profits).

Note 2 says that real property and bullion are not a financial investment – because the capital gains earned on the property or bullion are not generated from the contribution. There is no qualification on this about how the money is used by the seller, for example, if the seller of the property is a property developer and they take the money and put it into further advertising of the estate, such that the value of houses in the estate go up, then under Note 2, this is still not a financial investment, because capital appreciation is not a return generated by the contribution.

The connection between the contribution, what might be done with it, and the capital appreciation on the market, is too tenuous in Example 1. For example, factors that the markets often react to (affecting price movements up or down) are not always closely linked to company performance. There is insufficient causality to call capital appreciation a return generated by the third party using the contribution.

The conclusion to be drawn between Note 1 and Note 2 is that capital appreciation is not a return generated by the contribution (no matter how that contribution was used or representations made).

The Explanatory Memorandum provides no further insight in addition to Notes 1 and 2. ASIC's *Regulatory Guide 2 AFS Licensing Kit: Part 2 – Preparing your AFS licence or variation application (June 2022)* does not explain or characterise an Investment Facility but provides managed discretionary accounts and warrants as examples of things that could be an Investment Facility.

However, there is some case law that has considered what is an Investment Facility and based on these cases it is clear that:

- A distinction exists between the giving of money or money's worth to a person to invest to generate a financial return versus merely engaging someone to purchase an asset on one's behalf.[12] That is, the mere purchasing of an asset on behalf of another did not amount to an Investment Facility.[13] Further, the court made the point that when a person purchases an asset in this way, the person was "….themselves using money or money's worth to generate a financial return or other benefit for themselves". This being the case, even if the asset has a capital appreciation, that is not a return generated by a third party, as is required for an Investment Facility, but a return generated by the person themselves in electing to purchase the asset;[14]
- A mere loan agreement with a borrower and lender, where money is lent in return for repayment together with interest, is unlikely to satisfy the requirement that it was intended that the contribution would be used by the borrower to generate a financial return for the lender;[15]
- Simply holding fiat currency on client instructions in connection with payment services does not constitute generating a return;[16] and
- Merely executing trades for a customer to buy or sell assets and holding those assets on bare trusts for the customer is not an Investment Facility.[17] Instead, it involves the customer generating

[12] *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd* [2024] FCA 64 at para [76].
[13] *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd* [2024] FCA 64 at para [76].
[14] *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd* [2024] FCA 64 at para [75].
[15] *Australian Securities and Investments Commission v Secure Investments Pty Ltd (No 2)* [2020] FCA 1463.
[16] *Australian Securities and Investments Commission v One Tech Media Ltd* [2020] FCA 46.
[17] *Australian Securities and Investments Commission v Monarch FX Group Pty Ltd, in the matter of Monarch FX Group Pty Ltd* [2014] FCA 1387; *Samuel Holdings Pty Ltd v Securities Exchange Guarantee Corporation Limited* [2010] QSC 450.

a return for themselves, and this is consistent with the notes to section 763A detailed above.[18] However, where additional functionality is provided with trading (e.g. automatic trade executions based on market signal) and representations are made that a return will be generated, then this is likely to constitute an Investment Facility.[19]

The new guidance in Draft INFO Sheet 225 is broad and not specific, or confined, to digital assets, and therefore if this is ASIC's view, it should have existed prior to the advent of digital assets as it could equally apply to other things, like commodities, if the correct representations are made. Digital assets as an emerging asset class should not be a driver of this view, and the fact that it appears to be is a demonstration of overreach.

It would be a different outcome if Company A committed to buying the token back, particularly at a higher price, or pays "interest". However, where the facility sits can also vary in these cases – sometimes it is at the token level and sometimes it is not. To illustrate how small changes can alter the outcome:

- If Company A commits to buying the token back at a certain point in time and / or at a certain price, the token is likely to be a derivative, or there might be a derivative as a separate facility to the token (depending on the specifics of the situation, for example, if the token is the thing to be bought back, the token is unlikely to be the derivative – rather, it is the intangible asset the subject of the derivative – the derivative exists off-chain as a separate arrangement as a result of contractual promises made);
- If Company A represents that they intend to buy back at higher than market value because they will have generated a return using the investor's money and can so afford to do so and reward the investor, this is arguably an Investment Facility. However, the Investment Facility is not the token – it is the wider arrangement in which Company A is representing that it will buy back (and at a higher price) that makes it a financial product. We note there may still be a financial services dealing activity associated with trading the token in this circumstance;
- Company A issues tokens where the token itself intrinsically pays a return, for example, every certain period of time each token earns a reward of a certain number of tokens. The money paid to token issuers by investors to acquire the tokens is used by the token issuer to generate the return. The token here is an Investment Facility;
- The previous example can be contrasted with a wallet that pays a return on tokens held in the wallet. If Company A offers a wallet for investors to hold their tokens, and while it is in the wallet it earns a return, in circumstances where Company A is entitled to use tokens held in the wallet to generate the return, then the arrangement that gives rise to the entitlement to earn a return while tokens are in the wallet (and not the token) is the Investment Facility.

**Recommendation 4**

We recommend that ASIC's draft guidance on this needs to be refined to ensure that the guidance on what is an Investment Facility better aligns with current case law on when a person generates a return for themselves versus when a contribution is made to a third party to generate a return for the person.

### *A facility for making non-cash payments*

Recent case law[20] (the **Qoin Case**) has confirmed that when assessing whether something is a non-cash payment facility, it is necessary to consider what is the product, facility or thing that enables customers to make a payment.[21]

In assessing this, it is important to distinguish between:[22]

- The unit of measure (i.e. fiat currency or digital assets) which may be used to make a payment;
- Third party systems that may be required to process payments, but which do not have any relationship with or direct nexus with the customer; and

[18] *Samuel Holdings Pty Ltd v Securities Exchange Guarantee Corporation Limited* [2010] QSC 450.
[19] *Australian Securities and Investments Commission v Monarch FX Group Pty Ltd, in the matter of Monarch FX Group Pty Ltd* [2014] FCA 1387.
[20] *Australian Securities and Investments Commission v BPS Financial Pty Ltd* [2024] FCA 457 (**Qoin Case**). We note that ASIC has appealed this case, but not in respect of any of the findings in relation to non-cash payment facilities.
[21] Qoin Case at para 108 to 112.
[22] Qoin Case at para 108 to 112.

- Products that do have a direct customer relationship that can initiate a payment or receive a payment.

It is also important to distinguish between what comprises a facility and a use of the facility. ASIC has issued guidance on this that provides as follows:[23]

> *The act of making a non-cash payment to the recipient is a 'use' of the NCP facility by the holder. For example:*
>
> *(a) an instruction by a client to make a non-cash payment to a particular payee is a 'use' of the NCP facility by the client;*
>
> *(b) for a cheque facility, the writing of a cheque to a particular payee is a 'use' of the facility by the client, while the arrangement giving the ability to write that cheque is the NCP facility;*
>
> *(c) for a stored value facility, the NCP facility is the arrangement (which may include a physical device) that gives a person the ability to make non-cash payments to various payees from time to time, while presentation of the device to make a purchase is a 'use' of that facility; and*
>
> *(d) for direct debits, the NCP facility is the arrangement between the client and a financial institution that gives the client the ability to make direct debit payments to various persons (payees) from time to time, while an order by the client to make a direct debit payment to a payee is a 'use' of the facility.*
>
> *Note: Telephone or computer equipment may be the means of giving instructions to make a payment using a particular NCP facility. However, while the underlying NCP facility may be the financial product (e.g., direct debit), the physical communication system is not: see s765A(1)(x).*

Draft INFO Sheet 225 does not address this in the guidance or any of the examples. Rather, the updated guidance provides that "Digital assets designed for use in payments may be a non-cash payment facility in themselves". In our view, this is misguided and conflates the token with a broader facility.

In our experience, digital assets in and of themselves do not facilitate payments as between two parties. Rather, digital assets are usually a unit of value that can be used within other facilities (which facilities may process payments). This is because digital assets do not include any functionality to automatically process a payment in and of itself and any payment processed occurs in some other facility. This is something that needs to be properly explained and different examples should be added to address this point. It also impacts the characterisation of stablecoins, which we consider in more detail below in section 1.5.

**Recommendation 5**

We recommend that ASIC's guidance is updated to distinguish between what is the facility and use of the facility for non-cash payment facilities consistent with case law and current guidance.

### 1.4 The relevance of an "issuer"

In addition to our points above, there are unresolved questions in relation to ASIC's view on the relevant requirements in relation to an "issuer" for the purposes of the different definition of a "financial product".

Given the significance of blockchain technology in relation to digital assets and services, it is necessary to consider whether a financial product requires an issuer and whether that issuer needs to be "person".

Generally, in determining whether a financial product requires an issuer, the first step is to consider the requirements of each financial product definition. Some financial product definitions specifically refer to an issuer or provider (e.g. a facility for making an investment), while others do not (e.g. a facility for making a non-cash payment or managed investment scheme).

Despite this, in our view, all financial products require an issuer, and that issuer must be a "person" (whether or not this is actually specified in the definition of a financial product). The fact that the drafting in

[23] ASIC Regulatory Guide 185: Non-cash payment facilities (November 2005) at RG 185.60.

the Corporations Act is both intentionally broad and technologically neutral does not change this. This is because the Corporations Act includes provisions for determining:

- when a financial product is issued: a financial product is "issued", when it is "acquired" by a client and "provided to" the client by the issuer; and
- who is the issuer of a financial product: the Corporations Act provides that an issuer of a product is the person who is responsible for the obligations owed to the client (or person nominated by the client) under the terms of the facility that is the product.

Collectively, these provisions strongly imply that there must be an issuer and client, and both must be a person, and obligations are owed by one to the other. Taking a different view would result in an absurd outcome where:

- Primary issuance or sale of financial products would not be regulated under the Corporations Act as there would not be an arrangement (which is required for a facility) or a person responsible for the product; but
- Intermediated services would be regulated under the Corporations Act, as intermediaries would be providing dealing activities to clients in respect of these products, even though these activities could never be provided as agent of the issuer (as there is no issuer). The fact that these activities may be artificially structured as dealing on behalf of clients (i.e. acting as a client's broker) to accommodate a situation where there is not an issuer does not change this absurd outcome. This is because if a person (e.g. a broker) provides financial services on behalf of a client where those services involve the acquisition of a financial product, there still needs to be a person who can actually issue that product to a customer following receipt of client money (e.g. broking of insurance products) and provide any other dealing activities in respect of that product (e.g., vary or dispose); and
- It may not actually be possible for some intermediaries to deal in the product where that dealing is prohibited in circumstances where a target market determination does not exist (and one cannot be created because there is no issuer).

While conceptually it is possible to conceive of a product that exists without an issuer on the blockchain, whether such a thing can be legally characterised as a financial product under the Corporations Act is another question entirely. To break this down further:

- "Issue" is defined to mean when a product is "acquired" by a person from an issuer and "provided" to that person by the issuer;
- If there is no issuer, then a financial product can never be "issued" to a person, and there is no one to owe to a client the obligations that exist under the terms of the product;
- If the product is never "issued", as defined in the Corporations Act, it is arguable that whatever that thing is, it is not a financial product as conceived of under the Corporations Act;
- If the product cannot be issued because there is no issuer, can it even be acquired – given that the first person must acquire it from the issuer. If there is no issuer, it is arguable that the first person cannot acquire it as contemplated by the Corporations Act;
- If the first person to interact with the "product" cannot "acquire" it under the Corporations Act, they also cannot vary or dispose of it; and
- If it is arguable that the product cannot be acquired or disposed of, then markets licensing (in respect of either making a market or operating a market) cannot apply, and also that financial product advice can never be given, because if no one can acquire, vary, or dispose of the product, then no opinion or recommendation can be made to influence a person to do these things.

That is, it may be the case that something that technically meets the definition of a financial product as set out in the Corporations Act, but which does not have an issuer, is not capable of being something in respect of which any financial service can be provided.

While the above arguments have not been specifically tested in case law, these arguments draw on the reasons and conclusions in the Qoin Case (see section on non-cash payment facilities above for more detail), where the court determined that the product had to sit at the wallet level, because only there was there a person with whom the client could have an arrangement, as well as the various challenges that exist in attempting to treat something as a financial product in circumstances where it has no issuer, because there are significant flow-on effects that affect the operation of the entire legislative regime.

Other examples include the application of the design and distribution obligations, the creation and issue of a product disclosure statement, and the complaints and compensation regime. If it is legitimately possible for a product to have no issuer, there is no one to create and publish a target market determination, no one to determine the target market, no limits on who a product can be distributed to, no one to create and distribute a product disclosure statement, no one for the holder to complain to and no one to compensate aggrieved clients.

Additionally, it is worth noting that if the issuer is the person responsible for the obligations owed to the client under the facility that is the financial product, it begs not only the question of who is responsible for those obligations if there is no issuer, but also, are there any obligations at all (because how can there be obligations if there is no one to owe them). This is a particularly pertinent question in relation to blockchains and digital assets, many parts of which are comprised of smart contracts. Despite the name "smart contracts", they are not legally enforceable contracts at all, because they are in fact self-executing software code that will automatically execute a particular transaction when certain pre-conditions are met. A smart contract will self-execute if the pre-conditions are met even if doing so does not align with the legal rights and entitlements of affected parties (because a smart contract is not a legal agreement and can therefore be set up to run counter to off-chain legal agreements). Such smart contracts often cannot be enforced by the courts, because there are no counterparties with a relationship that amounts to a legally enforceable contract.

This being the case, any so-called financial product which has no issuer and which is comprised only of smart contracts, cannot, in fact, be a financial product, because not only is there no one to whom the obligations are owed under the facility, but in fact there are no obligations owed – and in such circumstances, no one who "held" such a product, in any loose sense of the word, would have any legal recourse to pursue the enforcement of obligations to that holder. Such a thing cannot be construed as a financial product while retaining any sense of consistency and cohesiveness in not only the Corporations Act, but also the history of contract law.

The only sensible approach is to treat as a financial product some collection of rights, benefits, features and representations that exist between two persons[24]. A digital asset, therefore, may be a financial product where it has an issuer who owes some obligation to the tokenholder which may be embedded in the smart contract or reflected in some broader facility. Digital assets that do not feature such issuers and obligations cannot be financial products. Parts of the blockchain infrastructure that comprise smart contracts, without having a person who is accountable to users for the functioning (and failure to function) of that blockchain, cannot be a financial product.

We are aware that ASIC has expressed to us the view that a financial product need not have an issuer and that any resulting problems can be worked through. We note that this view has not currently been expressed in Draft INFO Sheet 225 or the Consultation Paper, and we note that many others in the legal profession have similarly expressed concerns about this view. If ASIC does wish to adopt this view, then we would respectfully request that the guidance explain the basis of this view having regard to recent case law (especially the Qoin case) and the operation of the Corporations Act. While we acknowledge that digital assets without issuers can cause harm, whether something causes harm is not the foundation for whether the Corporations Act applies, and the Corporations Act, in our view, did not contemplate and was not built to accommodate products without issuers. Respectfully, how to mitigate the harm of such products is a novel question for Parliament.

**Recommendation 6**

We recommend that ASIC's guidance be updated to make it clear that a financial product as currently defined in the Corporations Act requires an issuer and that the issuer must be a person.

[24] A reference to a person means a person as defined in section 2C of the *Acts Interpretation Act 1901* (Cth), which includes a natural person, body corporate or body politic.

## 1.5 Stablecoins

*Not all stablecoins meet the definition of a financial product*

In our experience, not all stablecoins are equal and it is possible that some stablecoins may be unregulated and others may meet the definition of a financial product (and there are often more than one possible financial product definitions to be considered).

Draft INFO Sheet 225 does not currently include any detailed guidance or examples (other than a yield bearing stablecoin which ASIC has characterised in Example 4 as likely to be an interest in a managed investment scheme) on the different types of stablecoins and what financial product definitions may apply.

It appears ASIC is still firming up its view on this and is asking industry for feedback based on ASIC's proposed approach in the Consultation Paper. We note that in the Consultation Paper, ASIC outlines its view that a stablecoin with the following features may be a financial product (specifically a non-cash payment facility):[25]

- The digital asset token is marketed as a non-interest-bearing "stablecoin";
- The token expected to maintain a stable price and value in Australian dollars (**AUD**), and the tokens are issued at par value (i.e. one token equals one AUD);
- The company will redeem, or buy back the tokens at par value in exchange for fiat money, on demand from any holder (subject to any relevant know-your-customer (**KYC)** requirements);
- The money received by the company is recorded as an asset, and the requirement to repay is recorded as a liability, on the company's balance sheet; and
- The company will either hold the money raised from token sales in a bank account or use it to purchase low-risk investments (e.g. Australian Government Securities).

Having regard to this commentary and more generic statements about bearer instruments in relation to non-cash payment facilities in Draft INFO Sheet 225, it is clear that ASIC is minded to treat a stablecoin (not the broader facility i.e. T&Cs and technology) as the non-cash payment facility.

There are some fundamental issues with this approach, as it brushes over what is the facility and the role of the digital asset, especially in light of the Qoin Case, and creates markets licensing and AFSL implications for any exchange that lists the token. Additionally, some stablecoins may meet one of the defined financial products in Section 764A of the Act, in which case it is not possible for it to be a non-cash payment facility (because of the order of precedence in which the various definitions are applied).

With respect to ASIC's position that stablecoins are non-cash payment facilities, we consider this approach is flawed for a variety of reasons, including the following:

- A properly structured stablecoin should be an on-chain representation of ownership of a dollar. If a dollar is not a non-cash payment facility, and a digital representation of a dollar in a bank account is not a non-cash payment facility, then an on-chain representation of that same dollar also cannot be a non-cash payment facility – to think otherwise would seriously call into question the nature of other things that might be put on the blockchain, for example, if an on-chain share certificate is created, this should not change the nature of the share. One of the predicted use cases of the blockchain is digital representations of many assets, and a mere digital analogue of an off-chain ownership certificate shouldn't change the characterisation of the thing;
- A stablecoin, in and of itself, does not facilitate a payment. Without a third party providing a payment service, to move the stablecoin from one party to the other, the stablecoin is static and remains with the person to whom it is issued. Alone and without more, a stablecoin just represents ownership of a dollar;
- A service such as a wallet can move a stablecoin. This is a non-cash payment facility offered by the wallet provider, and is analogous to a bank transfer which moves a digital representation of a dollar, which bank transfer service is also a non-cash payment facility;
- A direct sale by Party A to Party B of a stablecoin is not a non-cash payment facility as between Party A and Party B – because there is no third party "facilitating" the payment. For example, if Party A hands over a cold wallet USB storage in return for cash. This means that for on-chain

[25] Paragraph 21 of the Consultation Paper.

sales, any payments facilitated relate to other parts of the transaction e.g. transferring the fiat which is paying for the stablecoin, rather than the sale of the stablecoin itself. This has to be correct, otherwise the sale of any digital asset could be a non-cash payment facility, instead of an exchange service, because digital assets represent value.

Notwithstanding the above, we do consider that a stablecoin issuer may be operating a facility for the making of non-cash payments to the extent that the stablecoin facility (the broader arrangement between token holders and the stablecoin issuer) enables token holders to redeem the stablecoin for fiat, even if they are not the person to whom the stablecoin was issued. This facility can be considered analogous to a cheque account. In a cheque account arrangement:

- The holder of the cheque account draws a cheque. In RG 185, ASIC characterises the cheque account as the non-cash payment facility and the cheque as a use of that facility. Another way of considering it is that the cheque is an instruction to pay, that initiates the non-cash transfer from the cheque account, which is the non-cash payment facility. We note that if ASIC were to change its views, as they have been expressed in RG 185 since 2003, it could have far-reaching implications for the payments industry – we also note there has been no case precedent which would merit a change to those views;
- Having drawn the cheque, the cheque account holder gives the cheque to someone as payment;
- The recipient of the cheque may take the cheque to their bank to cash, or they may “endorse” the cheque and transfer it to someone else;
- Eventually, a holder of the cheque will take it to their bank, where their bank will deposit the funds to a bank account. The bank then makes arrangements with the bank with whom the cheque drawer holds their cheque account to have the funds paid. A hold is usually placed on the deposited funds until such time as they have cleared from the payer’s bank;

The cheque has face value, not in and of itself, but because it is understood to be backed by the cheque account facility, and the agreement that the drawing bank will transfer the funds from the cheque account.

A bearer instrument example is traveller’s cheques. However, similarly, traveller’s cheques operate inside the framework of a legal agreement which is how the traveller’s cheque derives value i.e. there is an issuer who has made certain promises to honour the traveller’s cheque when presented for payment. The traveller’s cheque itself is not a non-cash payment facility – the legal arrangement within which it can be presented and redeemed for cash, and which gives it its value, is the non-cash payment facility.

Neither cheques nor travellers’ cheques can do anything in and of their own right. Like a stablecoin, they are static. However, they are a representation of value, which can be transferred from person to person, and they can be redeemed for fiat inside the non-cash payment facility of which they form part.

Rewards points are another example. ASIC has long treated rewards programs as a non-cash payment facility (albeit one for which relief exists), but the rewards program has always been the facility – rewards points are merely representations of value that move around within the rewards point system. Rewards points are accepted as payment because they are backed by real value in the form of dollars under the terms and conditions of the loyalty program. Rewards points have never been treated as a non-cash payment facility in and of themselves – and if they were, it would have had had market implications for websites that facilitate the buying and selling of rewards point.

Cheques, traveller’s cheques, rewards points and stablecoins are all merely representations of dollars – whether on-chain, off-chain, digital, or otherwise, they are the dollars being moved around inside a non-cash payment facility which enables the ultimate delivery of fiat to the person who presents the cheque, travellers’ cheque, reward point or stablecoin for redemption.

To treat stablecoins differently to the historical treatment of other, analogous facilities would have radical implications for the payment industry and, respectfully, would amount to a misapplication of the law.

**Recommendation 7**

We recommend that ASIC clarifies the different available structures for stablecoins, including clarifying that even where a stablecoin facility is a non-cash payment facility, the token itself is just a digital representation of dollars.

We recommend that ASIC include additional examples of stablecoins to reflect the common structures in the market, which will provide more instructional guidance on what stablecoins may be regulated and, if so, how. We have provided some examples for illustrational purposes.

***Non-cash payment facility example***

Company N is the issuer of a stablecoin. Company N issues a stablecoin upon the receipt of 1 AUD from a customer. The stablecoin is transferred to the customer and Company N holds the 1 AUD in a bank account on trust for the customer.

The customer must enter into a legal agreement with Company N in order to mint stablecoins. Under those terms and conditions:

- The customer is permitted to transfer the stablecoin to any person it wishes;
- Company N promises to deliver the 1 AUD to the holder of the stablecoin, on presentation of the stablecoin, whether that holder is the original customer or otherwise;
- Company N promises to hold the 1 AUD on trust for the benefit of the customer, or any person to whom they transfer their stablecoin;
- The customer agrees that Company N may retain all interest on the AUD held in trust; and
- Anyone who takes receipt of the stablecoin is deemed to agree to the terms and conditions by virtue of their conduct in accepting the stablecoin.

Upon redemption of a stablecoin, the token holder must expressly accept the terms and conditions of the arrangement with Company N. Company N will then take the stablecoin and either burn it or, if appropriate, re-issue it on receipt of 1 AUD from a new customer. Company N will pay 1 AUD to the token holders whose stablecoin has been redeemed.

Company N is likely to be issuing a non-cash payment facility. That facility is the wider arrangement between Company N and the customer that comprises the terms and conditions of the facility. This is because the stablecoin, in and of itself, is inert and does nothing. Only because of the wider arrangement between tokenholders and Company N is the token holder able to transfer value via the stablecoin because:

- Company N promises to hold 1 AUD on trust for the benefit of the token holder; and
- Company N promises to deliver 1 AUD to whoever holds the stablecoin.

These rights are not embedded in the stablecoin smart contract, and therefore the stablecoin itself is not a non-cash payment facility – it is merely an on-chain digital representation of the ownership of 1 AUD.

Company N may need an AFS licence to issue the non-cash payment facility. There are no markets licence implications for any exchange that trades the stablecoin.

***Debenture example***

Company N is the issuer of a stablecoin. Under Company N’s terms and conditions, Company N will mint stablecoins for customers who open an account with Company N and pay 1 AUD. Only persons who meet certain qualifying criteria are eligible to open an account.

Token holders who have an account with Company N may redeem their stablecoins for AUD. Persons who do not qualify to open an account may still hold the stablecoins, but they may not mint or redeem them with Company N.

Company N commits to ensure all issued stablecoins are fully backed by an equivalent amount of AUD denominated assets held by Company N with regulated financial institutions in segregated accounts apart from Company N’s corporate funds. Company N retains all interest earned, or capital gains made, on any assets backing the stablecoins and the assets are not held on trust for, or for the benefit of, token holders.

Account holders may only redeem stablecoins with 14 days’ notice.

The stablecoin may be a debenture, which is a security, because:

- Funds are provided to Company N for the purpose of investment and generating a return for Company N;
- Token holders do not have a legal or beneficial entitlement to AUD or assets backing the stablecoin;
- Funds are repayable to the holder of the token holder, but funds are not “at call”.

Company N may need an AFS licence for an issue of securities.

***Managed investment scheme example***

Company N is the issuer of a stablecoin. Under Company N’s terms and conditions, Company N will mint stablecoins for customers who pay 1 AUD. Token holders may redeem their stablecoins for AUD. There are no restrictions on which customers may use the service.

Company N commits to ensure all issued stablecoins are fully backed by an equivalent amount of AUD denominated assets held by Company N with regulated financial institutions in segregated accounts apart from Company N’s corporate funds. Company N retains all interest earned, or capital gains made, on any assets backing the stablecoins but the assets are held on trust for, and for the benefit of, token holders.

The stablecoin may be a managed investment scheme, because:

- Accountholder token holders have made a contribution to Company N;
- That contribution has been pooled to acquire assets;
- Assets backing the stablecoin are held beneficially for token holders;
- Those assets generate a return, to which token holders are entitled as a matter of trust law – that the returns are never paid is because token holders have agreed that it will be paid to Company N. Nevertheless, this was a return generated by the contributions for the benefit of token holders, which has then been paid to a third party with consent.

Company N may need an AFS licence to operate a registered managed investment scheme.

## 1.6 Asset-backed Tokens

*Insufficient guidance*

Example 5 in Draft INFO 225 covers a gold backed token issued and promoted by a company, which uses the sale proceeds to buy gold and holds the gold beneficially for tokenholders. We tend to agree with ASIC’s view that this token is likely to represent an interest in a managed investment scheme. However, there are several ways to structure an asset-backed token that are not financial products. For example, a bailment structure or exempt derivative structure.

We think it is important that ASIC’s guidance acknowledges these other structures and provides examples of them, particularly more fringe cases and examples so that industry has clearer guidance.

**Recommendation 8**

We recommend that ASIC include a bailment example and derivative example for asset-backed tokens. We have included a bailment and derivative example for consideration.

***Bailment example***

Company E owns gold reserves and holds them in a vault. Company E issues a gold-backed digital asset token. Each token records ownership of a specified quantity of gold held in Company E’s vault on bailment for the token holder. In practice, the price of the tokens in the secondary market does seem to generally track the price of gold.

The gold is stored in bulk, including in large bars, in Company E’s vault. The bulk storage is for the benefit of Company E and no benefit is derived by token holders from this storage method.

Each token holder is able to present their token to Company E, in return for which the token holder may take possession of the amount of bullion in the vault denoted by the tokens presented. If the gold is bulk stored, Company E will arrange for the token holder's amount of gold to be minted into an appropriately sized bar and delivered.

Company E's digital asset token is unlikely to be a financial product. This is because the token represents ownership of the physical asset (the bullion) which is bailed into Company E's possession. The token is no different to an off-chain paper or digital certificate of ownership. Although Company E stores the gold in bulk, there is no benefit derived by token holders from this form of storage, and token holders have no common purpose in storing it in this way, and accordingly it is unlikely to be an interest in a managed investment scheme.

***Exempt derivative example***

Company E issues a gold-backed digital asset token. Company E holds some gold reserves but does not hold gold reserves equivalent to the tokens on issue, has not promised to hold gold reserves equal to the tokens on issue, and buys and sells its gold reserves as it sees fit, and according to the market, without regard for the tokens on issue.

Each token gives the token holder a right to present their token and redeem it for a certain amount of gold (subject to the payment of certain redemption fees). Company E may fulfil a redemption from its own gold reserves, or it may source gold reserves on the gold market or via options that it holds. Company E may not cash settle instead of delivering the gold. None of the gold reserves or the gold options are held on bailment or beneficially for the benefit of token holders and the existence of gold options is not promoted to, or known by, token holders. In practice, the price of the tokens in the secondary market does seem to generally track the price of gold.

Company E's digital asset token is likely to be a derivative, because it requires consideration (the redemption fees) to be paid at a future time (which is likely to be more than 1 business day in the future), and the value of the token is derived by reference to the value of gold. However, it is an exempt derivative and not regulated as a financial product, because the derivative requires physical delivery of the gold and cannot be cash settled.

## 1.7 Wrapped Tokens

It is also our view that wrapped tokens need to be considered more closely, because typically wrapped tokens facilitate the creation of the same token on a different chain. Similar to our comments about the creation of an on-chain share certificate not changing the nature of the share (i.e. the token that is a digital representation of share ownership is a share, not a derivative over a share), wrapped tokens are typically just evidence of ownership of the original token, on a new chain. This means that, often, a wrapped token is not a derivative.

A derivative is defined in section 761D as an arrangement where:[26]

- A party to the arrangement must, or may be required to, provide at some future time consideration to someone;
- That future time is not less than 1 business day,[27] after the day on which the arrangement is entered into; and
- The amount of consideration, or the value of the arrangement, is determined, derived from, or varied by reference to the value or amount of something else, including, for example, an asset, a rate (including an interest rate or exchange rate), an index or a commodity.

We note that in Consultation Paper ASIC states that its considers that a wrapped token with the following features may be a financial product (specifically a derivative):[28]

- A company offers a product that enables a digital asset (normally only available on its "native" blockchain) to be represented on a different blockchain;
- The version that is on the different blockchain has added functionality and lower fees;

[26] Section 761D(1) *Corporations Act 2001* (Cth).
[27] Reg 7.1.04(1)(a) *Corporations Regulations 2001* (Cth).
[28] Paragraph 20 of ASIC Consultation Paper 381: Updates to INFO 225: Digital assets: Financial products and services, December 2024.

- The price of the wrapped token changes in line with the price of the native token, but the prices are not identical; and
- Any subsequent holder of the wrapped token can redeem it for the native token.

Some of the above features that ASIC calls out as indicators of a derivative (particularly, the second and third bullet points above) are not specifically included in the definition of a derivative in section 761D. Accordingly, we are of the view that these features are neither instructive nor determinative as to whether a wrapped token is a derivative. For this reason, we respectfully disagree with ASIC's draft guidance and are of the view that regard should only be had to the requirements specified in the definition of a derivative and any relevant case law in determining whether a wrapped token (or the broader facility, as the case may be) is a derivative.

Also, we have recently considered a number of wrapped tokens. Some wrapped tokens are backed on a 1:1 basis and others have a floating conversion rate. In our experience, wrapped tokens are not derivatives. This is because a wrapped token usually works as follows:

- The customer provides a digital asset (**Native Token**) to a centralised party (**Issuer**) to custody;
- The customer requests the Issuer to mint a wrapped token that is compatible with other blockchains (**Wrapped Token**);
- The Issuer mints the Wrapped Token and treats the Wrapped Token as evidence of the customer's beneficial ownership of the Native Token that is custodied with the Issuer. If the Wrapped Token is pegged on a 1:1 basis with the Native Token, then the number of Wrapped Tokens on issue will always be equal to the number of Wrapped Tokens in the Issuer's custody. If the Wrapped Token is minted using a floating conversion rate, then the number of Wrapped Tokens minted will be determined by applying the applicable conversion rate at the time the request is made;
- The Wrapped Token represents an on-chain record of the customer's beneficial ownership of the Native Token custodied with the Issuer;
- A holder of a Wrapped Token remains (for so long as they hold the token) entitled to all of the economic value and risk of the Native Token but cannot exercise any rights in respect of the Native Token until the Wrapped Token is redeemed for the Native Token;
- The customer may redeem the Wrapped Token for the Native Token on request subject to complying with the Issuer's terms and conditions. If the Wrapped Token is pegged on a 1:1 basis with the Native Token, then the customer will receive an equal number of Native Tokens to the number of Wrapped Tokens redeemed. If a floating conversion rate applies to the Wrapped Token, then the number of Native Tokens a customer will receive will be determined by applying the applicable conversion rate at the time the Wrapped Tokens are redeemed;
- The customer may transfer the Wrapped Token or otherwise use, or transact with, the Wrapped Token on the supported blockchains or protocols. Selling or otherwise transferring the Wrapped Tokens automatically transfers ownership of the Native Token (including entitlement to the economic value and risk of the Native Token) and the right to redeem to the recipient (;
- The customer may pay fees for minting or redeeming the Wrapped Token; and
- The price for the Wrapped Token may vary from the price of the Native Token.

In our view, a Wrapped Token will not meet the definition of a derivative as either the first requirement of the definition of derivative will never be met or an exemption will apply. We explain this in more detail below.

*First requirement*

For this requirement, it is necessary to consider what is the relevant arrangement and whether any relevant consideration may be paid by either the Issuer or customer who requested the minting of the Wrapped Token (**Minting Customer**).

In our experience, the relevant arrangement is the terms and conditions that apply to minting, use and redemption of the Wrapped Token (**Wrapping Terms**).

In working out consideration, "consideration" is generally understood to mean the exchange of mutual promises or, more simply, consideration can be understood as the thing that Party A gives to Party B in return for the thing that Party B will give Party A (this is also, itself, consideration).

For a Wrapped Token, the potential types of consideration will be:

- The delivery of the Native Token to the Issuer to custody when making a wrapping request. In our view, this cannot amount to consideration because the Minting Customer does not pay the Native Token to the Issuer by way of consideration – it is beneficially owned by the customer, and that beneficial ownership does not change. All that changes is that the Wrapped Token represents an on-chain record of Minting Customer's beneficial ownership
- The provision of custody services in respect of the Native Token when the Wrapped Token is minted. While consideration, this service is provided from the time of minting until redemption, which is not at a future time;
- Any fees charged for redemption may amount to consideration, but will have the benefit of the future provision of services exemption in 761D(3)(b);
- The return of the Native Token after the Wrapped Token is redeemed. While this superficially looks like consideration, it is not. This is because the Issuer is merely returning to the customer what already belongs to them upon the customer presenting evidence of ownership (i.e. redeeming the Wrapped Token). The correct interpretation of the consideration in the arrangement is that Issuer promises to keep the Native Token on trust for customers and to return it on presentation of the Wrapped Token. Note that the consideration here is the promise to do the thing (which is made upfront), not the act itself (which is done later).
- The amount paid to a token holder by a person buying the Wrapped Token on an exchange (centralised or decentralised) or another marketplace. In our view, this cannot be consideration as any amount paid is by a third party who is not a party to the Wrapping Terms (which is the relevant "arrangement" being assessed as a possible derivative).

Accordingly, if there is no payment of consideration at a future time which meets the first requirement of the definition of a derivative, a wrapped token cannot be a derivative.

However, it is possible that the Native Token itself may be a financial product and, accordingly, any minting, transfer or redemption of the Wrapped Token is likely to involve a dealing in the financial product. In saying this, we want to stress that most digital assets are not financial products, but it is conceivable that some digital assets may be a financial product or represent an interest in a financial product, and on that basis, if the Wrapped Token represents ownership of a Native Token that is a financial product, then the Wrapped Product will also be the same type of financial product (exactly as would be the case if an on-chain share ownership certificate were created).

**Recommendation 9**

We strongly recommend that ASIC reconsiders its position on Wrapped Tokens and provides more detailed guidance as to when and why a Wrapped Token may be a derivative given that most of the features ASIC refers to are not relevant to the assessment of whether a digital asset is a derivative. In particular, ASIC needs to have reference to what consideration is being paid at a future time in a Wrapped Token arrangement.

## 1.8 Market licence

We understand that ASIC has been working through market and clearing and settlement facility (**CS Facility**) licensing in light of its view that many digital assets may be financial products.

Before market and CS Facility licensing can be worked through, it is fundamental to have clarity and agreement on what is a financial product. This is because the potential impact of market and CS Facility licensing can only be determined once there is a clearer understanding of the nature and type of digital assets that are regulated financial products. In our experience, many digital assets are not themselves financial products.

It is also important to understand how exchanges current facilitate trading of digital assets. There are three potential models, which we outline in the table below:

| Model Type | Description | Licensing |
|---|---|---|
| **Brokerage** | Acting as a broker that merely arranges for the purchase or sale of a digital asset on behalf of a customer on another trading venue or platform (e.g. global DCE). That is, an order is simply passed through and there isn't any back-to-back trade. This is not a common model in the market at present, but we suspect this may become more prevalent over time. | If any of the digital assets are financial products, the broker will need an AFSL that includes advice and dealing authorisations in respect of the relevant financial product. It is possible that a custody authorisation may also be required if wallet functionality is provided (see section 1.9 below for more detail). |
| **OTC** | Acting as the counter party to each buy or sell trade on an exchange. This may involve placing a back-to-back order on another trading venue or platform to source liquidity or using existing stock. | If any of the digital assets are financial products, the exchange will need an AFSL that included advice, dealing and make the market authorisations in respect of the relevant financial products. It is possible that a custody authorisation may also be required to wallet functionality is provided (see section 1.9 below for more detail). |
| **Order Book** | Operating an order book and matching trades between two parties. | If any of the digital assets are financial products, the exchange will need a markets licence and may also need a CS Facility licence. A custody authorisation should not be required if wallet is provided in connection with or incidentally to the market as market operators are exempt from AFS licensing. |

Given the complexity, timeframes and obligations associated with market and CS Facility licences, we anticipate that many exchanges that operate order books will either switch entirely to an OTC model or will only broker or provide OTC trading for digital assets that are financial products. The ability to restructure is very much predicated on the number of digital assets that are financial products and the ability to readily and consistently source liquidity. There is also a risk that some businesses move offshore, given preferential treatment in other geographies. This would be a poor consumer outcome as it would reduce consumer protection.

To help prevent this, it is critical that we get the appropriate regulatory settings in place. We acknowledge that the current markets and CS Facility licensing framework was designed to be flexible and to be tailored based on the particular market in question. To date, there are two tiers of market licences:

- Tier 1 – Retail; and
- Tier 2 – Wholesale.

While conceptually a digital asset market could be designed to operate within either tier, in our view, it is preferable to create a Tier 3 licence for markets that trade native digital assets (as opposed to tokenised financial products). We detail in the table below our recommended approach for market licensing. Of course, CS Facility licensing requirements will depend on the market in question, whether an outsourced CS Facility provider and whether the market infrastructure is critical.

| Tier | Description | Coverage |
|---|---|---|
| **1** | Retail market for financial products | This should apply to traditional markets offered to retail clients as well as any markets that merely tokenised existing financial products. |

| Tier | Description | Coverage |
|---|---|---|
| | | However, in designing the licensing conditions regard should be had to the nature of the market (e.g. trading window, availability on other trading venues etc), technology used and operational risk in designing appropriate licence conditions. It is quite feasible that the licence conditions may vary as between traditional and tokenised markets. |
| **2** | Wholesale market for financial products | This should apply to traditional markets offered to wholesale clients as well as any markets that merely tokenised existing financial products.<br><br>However, in designing the licensing conditions regard should be had to the nature of the market (e.g. trading window, availability on other trading venues etc), technology used and operational risk in designing appropriate licence conditions. It is quite feasible that the licence conditions may vary as between traditional and tokenised markets. |
| **3** | Native digital asset markets | This should apply to any platform that provides an order book for native digital assets that so happen to meet the definition of a financial product.<br><br>However, in designing the licensing conditions regard should be had to the client base (retail v wholesale), nature of the market (e.g. traded 24/7 on numerous trading venues locally and globally), technology used and operational risk in designing appropriate licence conditions. It is quite feasible that the licence conditions may vary as between traditional and tokenised markets. |

We understand that ASIC's preference is to work through market licensing with one or two particular candidates. In our experience, this can be challenging as there is definitely a first mover disadvantage especially when it involves upskilling in a new area without any clear pathway to licensing.

In our view, industry would be more inclined to engage if ASIC did some groundwork and prepared a basic Tier 3 licence based on an order book model. This would then provide industry with an idea of the expectations and pathway to licensing. Of course, each market licence would need to be tailored to the market in question.

In relation to how the market is operated, we conceptually do not have any major concerns in relation to applying the fair, orderly and transparent market obligation in section 792A(1)(a) provided that the obligations are contextualised for the digital asset market in question. This would include designing appropriate pre and post trading surveillance that recognised the 24/7 nature of the market and the many trading venues locally and globally on which native digital assets may be traded. While blockchain technology does provide an immutable record, any surveillance obligations would need to recognise the inherit limitations, including:

- Identifying the person behind a wallet address;
- The trading volume on other exchanges;
- The use of tools that mask, mix or convolute transactions;
- The functionality of surveillance and reporting tools; and
- The numerous exchanges involved and the impact this has on communication and cooperation.

Regard will also need to be had as to how to manage liquidity and trading volume particularly for exchanges that source liquidity from third parties or also run OTC trades that may provide liquidity for order books.

**Recommendation 10**

Develop a baseline new Tier 3 model to capture native digital asset markets that operate order books, which can be augmented for specific markets.

## 1.9 Custody

It is important to understand that there are different custodial solutions available in the market and the applicable licensing and regulatory obligations will vary depending on the model in question. We detail the different custodial arrangements in the table below.

| Tier | Description | Licensing |
|---|---|---|
| **Custodial wallet** | This is a wallet that may be offered by an exchange or other service provider that enables customers to store and hold their digital assets | If the digital asset is a financial product, this will involve the provision of custodial and depository services |
| **Non-custodial wallet with sharding** | This is a wallet that may be marketed as a non-custodial wallet but the private keys are sharded so the exchange or provider must sign each transaction together with the customer. | If the digital asset is a financial product, this will involve the provision of custodial and depository services because the provider also holds a private key essential for a transaction to be processed. |
| **Non-custodial wallet** | This may be a hot, warm or cool wallet that the customer solely controls, and the provider does not hold any private keys (in full or sharded). | If the digital asset is a financial product, this will not involve the provision of custodial and depository services. |

In light of the different models above, we recommend that ASIC provides guidance on what it means to control the private key and, in what circumstances an entity will provide custodial and depository services. See section 1.10 below for more detail.

**Recommendation 11**

ASIC should provide further guidance in relation to the different types of wallets and what ASIC considers constitutes control of a private key and will result in the provision of custodial and depository services when a digital asset is a financial product.

## 1.10 Wallets

Wallets present a related issue to custody. While we agree that, in general, a wallet could be a non-cash payment facility. However, whether it is at least partly turns on whether the wallet is "custodial" is not, which will hinge on the concept of "control" we mentioned in the previous section. Therefore, it is critical to define when an entity "controls" the private keys in order to identify when the wallet provider is facilitating a non-cash payment versus when a token holder is transferring their assets themselves. Some work was done by Treasury in this respect as part of the Digital Asset Facility reforms that could be leveraged by ASIC.

Additionally, it would be useful for ASIC to give guidance on when a wallet is a facility for making non-cash payments, with reference to wallets that are not intended to, and may even prohibit, third party payments, and the application of the incidental financial product exemption.

For example, many wallet providers offer their wallet on the basis that users are only allowed to transfer tokens to other digital wallets they own and third party payments are prohibited. However, due to the nature of the blockchain, wallet providers cannot check the ownership of a wallet address, so third party payments are in fact possible.

It would be useful for ASIC to provide guidance on:

- Whether a wallet that provides incidental third party payment functionality but contractually prohibits such payments in the terms is a non-cash payment facility at all; and
- If ASIC thinks it is, when and to what extent the incidental financial product exemption applies because is reasonable to assume (under section 763E) that the main purpose of the wallet is not a financial product purpose.

We also recommend Example 13 of the Consultation Paper be rewritten to provide clarity as it currently references both stablecoins and wallets.

**Recommendation 12**

ASIC provide further guidance in relation to the different types of wallets and what ASIC considers constitutes control of a private key and will result in the provision of custodial and depository services when a digital asset is a financial product.

***Example 13***

Company M offers a non-custodial digital asset wallet service ~~and issues their own proprietary stablecoin token on a public blockchain.~~ The digital asset wallet service allows a client to instruct Company M to transfer their token to another address or digital asset wallet issued by Company M. The service can also be used to transfer the token to any other address or digital asset wallet that accepts these tokens. Company M markets this service as a convenient way for its clients to make payments to third parties and the terms and conditions reflect the provision of this functionality.

Company M's digital asset wallet service itself is likely to be a non-cash payment facility. It is a facility through which clients can and do make payments to third parties~~, using Company M's token or other tokens,~~ and Company M's marketing promotes the wallet as having that functionality.

### 1.11 Client Money

Client money rules apply where money is paid to a financial services licensee in connection with a financial service that has been provided, or that will be provided, and the money is paid by the client (among other situations). Where a digital assets service provider obtains a financial services licence, it is likely that any fiat currency paid to that provider by way of pre-funding, such as fiat currency that sits in a wallet on an exchange, will be client money.

Client money must be held in a designated trust account opened with an ADI. At present, an overwhelming proportion of the digital assets industry has been debanked and currently operate their banking arrangements through alternative payment service providers who are not ADIs. Accordingly, it is highly probable that virtually no digital assets businesses that obtain a financial services licence will be capable of complying with the client money rules because they cannot access bank accounts with ADIs. At present, there is no reason to believe that these businesses will be able to access such accounts merely by virtue of obtaining a licence.

Accordingly, we consider that ASIC should consider granting relief to digital assets businesses that obtain a financial services licence until such time as debanking is resolved for the digital assets sector. That relief will likely need to:

- Allow digital assets businesses to hold client monies either:
  - With alternative payment service providers who are not ADIs;
  - Hold client money in liquid stablecoins that are either pegged 1:1 to the AUD or pegged to another currency with FX hedging; and
- Consider what alternative protections can be conferred, for example:

- Require any alternative payment provider to hold (or require the digital assets licensee to procure that the alternative payment services provider holds) client monies in a designated trust account with an ADI;
- Require any alternative payment provider to hold (or require the digital assets licensee to procure that the alternative payment services provider holds) client monies in a segregated client monies account i.e. separate to all other funds for all other clients of the provider and separate to the payment services provider's corporate funds; or
- Require any stablecoins representing client monies to be held in a segregated digital wallet;
- Whether the Financial Claims Scheme can extend to payment providers that are providing client money services as otherwise only the payment provider has the benefit of the scheme with each ADI and it is not passed on to customers on a look through basis.

**Recommendation 13**

ASIC should consider granting relief to digital assets businesses that hold a financial services licence from the requirement to hold client money in a bank account with an ADI, subject to appropriate conditions.

## 1.12 RG 166

Digital assets businesses with financial services licences will find them subject to the requirements in *Regulatory Guide 166 AFS licensing: Financial requirements* (**RG 166**) where applicable. Digital assets businesses are likely to hold large volumes of assets on their balance sheet that are, in fact, digital assets, which may pose challenges at financial audit stage. This is because auditors, by nature, are conservative, and there can be a general reluctance to make a call on whether digital assets on the balance sheet can be included to meet certain financial requirements, with digital assets being excluded completely from all calculations in some cases.

In this regard, the definitions of "liquid assets" and "cash and cash equivalents" in RG 166 are relevant and we consider that ASIC can make some amendments to clarify the treatment of certain digital assets.

The current definition of liquid assets is:

- Cash or cash equivalents other than a commitment of the kind specified in RG 166.170(d); and
- Assets of the licensee that the licensee can reasonably expect to realise for their market value within 6 months.

It would be useful to clarify if digital assets are considered to be liquid assets and if there are certain features of digital assets that would not make them liquid assets.

The current definition of cash or cash equivalents is:

| Licensee | Description |
|---|---|
| For responsible entities, IDPS operators, corporate directors of retail CCIVs and licensed custodial or depository service providers | (a) assets of the licensee that are cash on hand, demand deposits and money deposited with an Australian ADI that is available for immediate withdrawal;<br>(b) assets of the licensee that are short-term, highly liquid investments that are readily convertible to known amounts of cash that are subject to an insignificant risk of changes in value;<br>(c) the value of any eligible undertaking provided by an eligible provider that is an asset of the licensee; and assets of the licensee that are committed by an eligible provider to provide cash on request within 5 business days: |

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| | | (i) which will not expire within the next 6 months and which cannot be withdrawn by the provider without giving at least 6 months written notice to the person to whom the commitment is made; and<br><br>(ii) in relation to which any cash provided is not repayable for at least 6 months. Cash or cash equivalents RG 166.186 |
| For an AFS licensee with an authorisation to make a market in derivatives to retail clients and that owes liabilities or contingent liabilities by entering into derivatives with retail clients | (a)<br><br>(b)<br><br>(c) | cash on hand, demand deposits and money deposited with an Australian ADI that is available for immediate withdrawal;<br><br>short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value; the value of any eligible undertaking provided by an eligible provider; and<br><br>a commitment by an eligible provider to provide cash on request within 5 business days:<br><br>(i) that will not expire within the next 6 months and that cannot be withdrawn by the provider without giving at least 6 months written notice to the person to whom the commitment is made; and<br><br>(ii) in relation to which any cash provided is not repayable for at least 6 months. |

It would be useful for ASIC to include guidance on whether:

- Stablecoins specifically would count as a short-term, highly liquid investment that is readily convertible to cash and that is subject to an insignificant risk of changes in value, and the features or circumstances where this would not be the case; and
- Other digital assets would count as a short-term, highly liquid investment that is readily convertible to cash and that is subject to an insignificant risk of changes in value, and if yes, in what circumstances, for example, whether a gold-backed digital asset should qualify under this criteria.

**Recommendation 14**

ASIC should consider appropriate updates to RG 166 where necessary to clarify how digital assets should be treated for the purpose of the definitions of liquid assets and cash or cash equivalents.

### 1.13 Professional Indemnity Insurance

Licensees are required to hold professional indemnity (**PI**) insurance if they provide financial services to retail clients. Digital asset businesses are unlikely to find insurance arrangements that will allow them to fulfil this AFSL condition due to the risks and appetite of APRA-regulated insurers. Whilst there are insurance products for digital currency businesses, including custody risk, director's and officer's insurance, kidnap and ransom, cyber risk, crime and errors and omissions coverage, the insurance markets supporting these lines of insurance tend to be overseas insurers and reinsurers.

Errors and omissions coverage may not provide professional indemnity coverage, which is the customary requirement for other financial services licensees, including compensation for customer claims and funding for AFCA claims.

Businesses who cannot secure compliant PI insurance with an APRA regulated insurer should be permitted to use safe alternatives to insurance. Digital asset businesses are well capitalised and, as an industry, they could contribute to a statutory indemnity fund to compensate customers for errors and omissions, including determinations made through AFCA.

Treasury could explore establishing a new statutory fund for this purpose – perhaps as part of the proposed Digital Asset Facility reforms. This has been done previously for hard-to-place risks, including where clients / consumers need to access compensation for their claims. For example, the Australian Reinsurance Pool Corporation is used to fund terrorism and cyclone risk pools for the insurance industry, and historically PI insurance risks have been funded in some states and territories (including New South Wales) by establishing an insurance fund for high-risk professions including lawyers and doctors. This model is also used overseas in the United Kingdom and the US.

However, such a statutory fund will take to establish, and in the meantime, any digital assets business that holds an Australian financial services licence for retail clients will need relief from PI insurance where they cannot reasonably obtain this cover.

**Recommendation 15**

ASIC should consider relief for digital asset businesses that hold AFSL, such as:

- Permitting PI insurance to be held with overseas insurers instead of only APRA regulated insurers;
- Relaxing some requirements for PI insurance where it is placed overseas, including strict requirements that the policy cover all liability under Chapter 7 and AFCA determinations, as this may not be achievable for overseas cover; and
- Allowing digital assets businesses that are sufficiently well-capitalised to self-insure – this could include rules for how capital needs to be held, segregated, or available for consumer claims.

ASIC should also liaise with Treasury in regards to the proposed Digital Asset Facility reforms to explore the possibility of establishing a statutory fund for any digital assets business that holds an AFSL in lieu of holding PI insurance.

Hamilton Locke

## 2. Summary of Recommendations

<table>
<tr><th>Item</th><th>Recommendation</th></tr>
<tr><td>1</td><td>We strongly recommend that the no-action relief is redrafted to apply retrospectively with a fixed sunset date of 2 years. This approach is consistent with the FFSP exemption instruments and would avoid any regulatory arbitrage as between participants. This recommendation is consistent with our suggestions to ASIC both formally and informally in meetings and at various roundtables.<br><br>We do not recommend that the no-action relief completely sunset on receipt of a licence because of the issue identified above where licensed providers cannot themselves meet their own obligations while other participants continue to have the benefit of the relief. Once licensed, an entity should continue to have relief where their own compliance is dependent upon the actions of a third party who themselves are not yet licensed but have the benefit of the relief.<br><br>We also recommend that this relief should be from all obligations in Chapter 7 of the Corporations Act, with the exception that we consider it appropriate for the no-action relief to be subject to the condition of maintaining membership with an external dispute resolution scheme(to minimise consumer harm). We acknowledge that ASIC has specifically asked if the no-action relief should apply to obligations such as the one to produce a PDS, and we consider that it should. Producing a PDS is itself challenging when the product issuer is not licensed, for example:<br><br>• The licence details cannot be included;<br>• The entity is not required to maintain internal dispute resolution systems (yet), and so either this information cannot be included or the entity is forced to opt into additional requirements just to comply with the PDS obligation.<br><br>While ASIC could grant relief from any obligations that present a challenge, to comprehensively identify all such matters and appropriately provide relief would seem onerous and difficult to achieve without unintended consequences. We suggest that blanket relief in this case is effective and appropriate.<br><br>We acknowledge that this is a fundamentally different approach but will provide a more seamless and achievable pathway to regulation with greater certainty. It may be appropriate to add additional conditions to the relief – for example, businesses that are subject to regulatory enforcement commenced prior to the no action relief taking effect will not ever have the benefit of the relief in respect of the matters that are the subject of the regulatory enforcement.<br><br>We also recommend that you adopt our suggested approach above in relation to both the derivatives and earn product exclusion.</td></tr>
<tr><td>2</td><td>Alternative approaches on responsible managers<br><br>We recommend that ASIC reconsider its position on responsible managers and adopts a more facilitative approach for industry sooner rather than later. We have outlined below some suggested options for consideration. We outline our recommended approach below having regard to existing experience.<br><br>Usual transitional arrangements<br><br>We recommend that ASIC adopts the standard transitional approach it has when an unregulated industry is brought within the ambit of regulation. While we recognise that to the extent digital assets is currently regulated, it has always been regulated, the complexity of the sector means that both industry and ASIC have, for a long time, not necessarily held this view (or have not held it to the extent it is now held). Accordingly, the digital assets</td></tr>
</table>

sector is presented with challenges similar to those of industries transitioning from unregulated to regulated status, and therefore it is appropriate to approach responsible managers the same way. That is, if persons have been operating within a digital assets business prior to the publication of updated INFO Sheet 225 (and up until the end of transitional relief), that experience should be recognised as sufficient (in accordance with the usual five options applied by ASIC), notwithstanding it was gained in an unregulated business, in respect of any financial services that person provided or of which they had oversight.

Although we strongly consider this to be the appropriate position, we have provided some alternative views below.

***Supplementary training***

Where ASIC is uncomfortable to accept unregulated experience gained by dealing in, and advising on, financial products in a digital assets business, it may be appropriate to require responsible managers to also undertake some training to provide a supplemental understanding of regulatory requirements. For example:

- Where responsible managers are supporting an authorisation for advising retail clients, that responsible manager will be required to undertake RG146 training. This training will help to provide the candidate with some understanding of regulatory requirements in connection with advice for retail clients; or
- Where a responsible manager is not supporting an authorisation for advising retail clients and will not undertake RG146 training, there are also industry-based courses run by a number of providers which are notionally dubbed “responsible manager” courses, workshops or masterclasses. These courses can be as short as 1 hour and as long as a whole day and are designed to assist existing or incoming responsible managers and compliance managers to better understand the licensee’s general conduct obligations. Hamilton Locke runs a number of Responsible Manager Masterclasses, both publicly and privately (the latter of which can be tailored to the needs of the businesses), as do other providers such as Sophie Grace, Holley Nethercote, Kaplan, and Financial Education Professionals.

***Paired responsible managers***

Alternatively, it may be appropriate to “pair” responsible managers so that two responsible managers together satisfy what would ordinarily be satisfied with one responsible manager. This might be the case where:

- Someone with traditional regulated financial services experience is paired with someone with digital assets experience but without financial services experience. This may be appropriate because digital asset technology operates differently to TradFi and it is doubtful that a responsible manager with only TradFi experience would be competent to oversee the provision of financial services in the form of digital assets; or
- Someone with compliance experience (not specific to any particular financial service) is paired with someone with unregulated digital assets financial services experience – this would be an alternative way of supplementing a responsible manager’s unregulated financial services experience with someone well-versed in the regulatory requirements. This could also be used to supplement retail client experience e.g. a compliance person with an understanding of retail client requirements could supplement someone who otherwise only has wholesale client experience.

***Equivalent experience***

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| | In the past, ASIC had accepted “equivalent” experience, for example, accepting unregulated reinsurance experience to support an application for general insurance, or accepting general insurance experience in personal accident to support an authorisation for life insurance. In our experience, the former of these has not often been accepted for 10+ years now, while the latter is still somewhat likely to succeed. ASIC has also used similar principles in how it accepts responsible managers for carbon trading.<br><br>Given that some of the authorisations likely to be necessary for digital assets are rare or non-existent, if ASIC will not provide full transitional arrangements for responsible managers, then we consider it appropriate to consider equivalent experience. |
| **3** | ASIC’s guidance should be updated to include the following and be consistent with the Qoin Case:<br><br>• Make it clear that it is necessary to identify all the relevant facilities – which may include a digital asset and some broader facility based on a service offering or platform;<br>• Make it clear that, in assessing whether something is a financial product, regard should be had to the rights, benefits, features and representations; and<br>• Includes one or more examples that assess both the digital asset and broader facility against different financial product definitions. This is particularly important for managed investment schemes, a facility for making an investment, a facility for managing risk, a facility for making non-cash payments, derivatives and deposit-taking facilities. See our non-cash payment facility stablecoin example;<br>• Make it clear that while a digital asset or broader facility may technically meet more than one definition of a financial product, from a licensing perspective one needs to determine which financial product definition applies based on the statutory rules. An example should be provided to demonstrate this. Example 2 in Draft INFO Sheet 225 can be adapted for this purpose. See our suggested changes in mark-ups below. |
| **4** | We recommend that ASIC’s draft guidance on this needs to be refined to ensure that the guidance on what is an Investment Facility better aligns with current case law on when a person generates a return for themselves versus when a contribution is made to a third party to generate a return for the person. |
| **5** | We recommend that ASIC’s guidance is updated to distinguish between what is the facility and use of the facility for non-cash payment facilities consistent with case law and current guidance. |
| **6** | We recommend that ASIC’s guidance be updated to make it clear that a financial product as currently defined in the Corporations Act requires an issuer and that the issuer must be a person. |
| **7** | We recommend that ASIC include additional examples of stablecoins to reflect the common structures in the market, which will provide more instructional guidance on what stablecoins may be regulated and, if so, how. We have provided some examples for illustrational purposes.<br><br>***Non-cash payment facility example***<br><br>Company N is the issuer of a stablecoin. Company N issues a stablecoin upon the receipt of 1 AUD from a customer. The stablecoin is transferred to the customer and Company N holds the 1 AUD in a bank account on trust for the customer.<br><br>The customer must enter into a legal agreement with Company N in order to mint stablecoins. Under those terms and conditions:<br><br>• The customer is permitted to transfer the stablecoin to any person it wishes; |

- Company N promises to deliver the 1 AUD to the holder of the stablecoin, on presentation of the stablecoin, whether that holder is the original customer or otherwise;
- Company N promises to hold the 1 AUD on trust for the benefit of the customer, or any person to whom they transfer their stablecoin;
- The customer agrees that Company N may retain all interest on the AUD held in trust; and
- Anyone who takes receipt of the stablecoin is deemed to agree to the terms and conditions by virtue of their conduct in accepting the stablecoin.

Upon redemption of a stablecoin, the token holder must expressly accept the terms and conditions of the arrangement with Company N. Company N will then take the stablecoin and either burn it or, if appropriate, re-issue it on receipt of 1 AUD from a new customer. Company N will pay 1 AUD to the token holders whose stablecoin has been redeemed.

Company N is likely to be issuing a non-cash payment facility. That facility is the wider arrangement between Company N and the customer that comprises the terms and conditions of the facility. This is because the stablecoin, in and of itself, is inert and does nothing. Only because of the wider arrangement between tokenholders and Company N is the token holder able to transfer value via the stablecoin because:

- Company N promises to hold 1 AUD on trust for the benefit of the token holder; and
- Company N promises to deliver 1 AUD to whoever holds the stablecoin.

These rights are not embedded in the stablecoin smart contract, and therefore the stablecoin itself is not a non-cash payment facility – it is merely an on-chain digital representation of the ownership of 1 AUD.

Company N may need an AFS licence to issue the non-cash payment facility. There are no markets licence implications for any exchange that trades the stablecoin.

***Debenture example***

Company N is the issuer of a stablecoin. Under Company N's terms and conditions, Company N will mint stablecoins for customers who open an account with Company N and pay 1 AUD. Only persons who meet certain qualifying criteria are eligible to open an account.

Token holders who have an account with Company N may redeem their stablecoins for AUD. Persons who do not qualify to open an account may still hold the stablecoins, but they may not mint or redeem them with Company N.

Company N commits to ensure all issued stablecoins are fully backed by an equivalent amount of AUD denominated assets held by Company N with regulated financial institutions in segregated accounts apart from Company N's corporate funds. Company N retains all interest earned, or capital gains made, on any assets backing the stablecoins and the assets are not held on trust for, or for the benefit of, token holders.

Account holders may only redeem stablecoins with 14 days' notice.

The stablecoin may be a debenture, which is a security, because:

- Funds are provided to Company N for the purpose of investment and generating a return for Company N;
- Token holders do not have a legal or beneficial entitlement to AUD or assets backing the stablecoin;
- Funds are repayable to the holder of the token holder, but funds are not "at call".

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| | Company N may need an AFS licence for an issue of securities.<br><br>***Managed investment scheme example***<br><br>Company N is the issuer of a stablecoin. Under Company N's terms and conditions, Company N will mint stablecoins for customers who pay 1 AUD. Token holders may redeem their stablecoins for AUD. There are no restrictions on which customers may use the service.<br><br>Company N commits to ensure all issued stablecoins are fully backed by an equivalent amount of AUD denominated assets held by Company N with regulated financial institutions in segregated accounts apart from Company N's corporate funds. Company N retains all interest earned, or capital gains made, on any assets backing the stablecoins but the assets are held on trust for, and for the benefit of, token holders.<br><br>The stablecoin may be a managed investment scheme, because:<br><br>• Accountholder token holders have made a contribution to Company N;<br>• That contribution has been pooled to acquire assets;<br>• Assets backing the stablecoin are held beneficially for token holders;<br>• Those assets generate a return, to which token holders are entitled as a matter of trust law – that the returns are never paid is because token holders have agreed that it will be paid to Company N. Nevertheless, this was a return generated by the contributions for the benefit of token holders, which has then been paid to a third party with consent.<br><br>Company N may need an AFS licence to operate a registered managed investment scheme. |
| **8** | We recommend that ASIC include a bailment example and derivative example for asset-backed tokens. We have included a bailment and derivative example for consideration.<br><br>***Bailment example***<br><br>Company E owns gold reserves and holds them in a vault. Company E issues a gold-backed digital asset token. Each token records ownership of a specified quantity of gold held in Company E's vault on bailment for the token holder. In practice, the price of the tokens in the secondary market does seem to generally track the price of gold.<br><br>The gold is stored in bulk, including in large bars, in Company E's vault. The bulk storage is for the benefit of Company E and no benefit is derived by token holders from this storage method.<br><br>Each token holder is able to present their token to Company E, in return for which the token holder may take possession of the amount of bullion in the vault denoted by the tokens presented. If the gold is bulk stored, Company E will arrange for the token holder's amount of gold to be minted into an appropriately sized bar and delivered.<br><br>Company E's digital asset token is unlikely to be a financial product. This is because the token represents ownership of the physical asset (the bullion) which is bailed into Company E's possession. The token is no different to an off-chain paper or digital certificate of ownership. Although Company E stores the gold in bulk, there is no benefit derived by token holders from this form of storage, and token holders have no common purpose in storing it in this way, and accordingly it is unlikely to be an interest in a managed investment scheme.<br><br>***Exempt derivative example***<br><br>Company E issues a gold-backed digital asset token. Company E holds some gold reserves but does not hold gold reserves equivalent to the tokens on issue, has not |

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| | promised to hold gold reserves equal to the tokens on issue, and buys and sells its gold reserves as it sees fit, and according to the market, without regard for the tokens on issue.<br><br>Each token gives the token holder a right to present their token and redeem it for a certain amount of gold (subject to the payment of certain redemption fees). Company E may fulfil a redemption from its own gold reserves, or it may source gold reserves on the gold market or via options that it holds. Company E may not cash settle instead of delivering the gold. None of the gold reserves or the gold options are held on bailment or beneficially for the benefit of token holders and the existence of gold options is not promoted to, or known by, token holders. In practice, the price of the tokens in the secondary market does seem to generally track the price of gold.<br><br>Company E's digital asset token is likely to be a derivative, because it requires consideration (the redemption fees) to be paid at a future time (which is likely to be more than 1 business day in the future), and the value of the token is derived by reference to the value of gold. However, it is an exempt derivative and not regulated as a financial product, because the derivative requires physical delivery of the gold and cannot be cash settled. |
| **9** | We strongly recommend that ASIC reconsiders its position on wrapped tokens and provides more detailed guidance as to when and why a wrapped token may be a derivative given that most of the features ASIC refers to are not relevant to the assessment of whether a digital asset is a derivative. In particular, ASIC needs to have reference to what consideration is being paid at a future time in a wrapped token arrangement. |
| **10** | We recommend that ASIC develop a baseline new Tier 3 model to capture native digital asset markets that operate order books, which can be augmented for specific markets. |
| **11** | ASIC should provide further guidance in relation to the different types of wallets and what ASIC considers constitutes control of a private key and will result in the provision of custodial and depository services when a digital asset is a financial product. |
| **12** | ASIC should provide further guidance in relation to the different types of wallets and what ASIC considers constitutes control of a private key and will result in the provision of custodial and depository services when a digital asset is a financial product.<br><br>***Example 13***<br><br>Company M offers a non-custodial digital asset wallet service and issues their own proprietary stablecoin token on a public blockchain. The digital asset wallet service allows a client to instruct Company M to transfer their token to another address or digital asset wallet issued by Company M. The service can also be used to transfer the token to any other address or digital asset wallet that accepts these tokens. Company M markets this service as a convenient way for its clients to make payments to third parties and the terms and conditions reflect the provision of this functionality.<br><br>Company M's digital asset wallet service itself is likely to be a non-cash payment facility. It is a facility through which clients can and do make payments to third parties, using Company M's token or other tokens, and Company M's marketing promotes the wallet as having that functionality. |
| **13** | ASIC should consider granting relief to digital assets businesses that hold a financial services licence from the requirement to hold client money in a bank account with an ADI, subject to appropriate conditions. |
| **14** | ASIC should consider appropriate updates to RG 166 where necessary to clarify how digital assets should be treated for the purpose of the definitions of liquid assets and cash or cash equivalents. |

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| **15** | ASIC should consider relief for digital asset businesses that hold AFSLs, such as:<br><br>• Permitting PI insurance to be held with overseas insurers instead of only APRA regulated insurers;<br>• Relaxing some requirements for professional indemnity insurance where it is placed overseas, including strict requirements that the policy cover all liability under Chapter 7 and AFCA determinations, as this may not be achievable for overseas cover; and<br>• Allowing digital assets businesses that are sufficiently well-capitalised to self-insure – this could include rules for how capital needs to be held, segregated, or available for consumer claims.<br><br>ASIC should also liaise with Treasury in regards to the proposed Digital Asset Facility reforms to explore the possibility of establishing a statutory fund for any digital assets business that holds an AFSL in lieu of holding PI insurance. |