Cosmos Asset Management Pty Ltd
[redacted]

18 July 2021

The Manager Consultation Paper 343
Australian Securities & Investments Commission

By Email: [redacted]

ASIC has clearly put considerable resources and considered thought into CP343 and this engagement with crypto-assets is most welcome by both the financial services industry and the cryptocurrency / blockchain industry.

Cosmos Asset Management Pty Ltd ("Cosmos") is Australia's thought-leading digital asset manager with a wide range of expertise in cryptocurrency. Dedicated to delivering financial innovation investments to investors and is supported by an experienced team with expertise to bring relevant and timely products that can enhance investor's portfolios. Cosmos Asset Management is a majority owned subsidiary of Mawson Infrastructure Group Inc. — Australia's largest Bitcoin mining company, a digital asset infrastructure business with its securities being listed in the USA with the code MIGI. We have prepared these comments in collaboration with Michael Bacina, Partner of Piper Alderman's Blockchain Group, who will also be providing his comments separately to ASIC which may have cross-over with our comments.

Cosmos in early 2020 worked with the staff at ASIC on establishment of a Bitcoin Managed Investment Scheme (retail scheme) and made original submission for a Bitcoin ETF in mid 2020. In or around the same period, it established a Bitcoin wholesale managed investment scheme. The wholesale MIS for Bitcoin has been live since early last year as a scheme for sophisticated and professional investors.

Unfortunately, for the moment, Australian retail investors can only access Bitcoin through digital currency exchanges (DCEs are mostly offshore) or by offshore CFD providers. These means of access are not cost-effective and they lack convenience and consumer protection layers.

Cosmos deeply believes that, under the Australian legal system, the best consumer protections for access to Bitcoin and other crypto-assets is by use of a Bitcoin ETP (either an ETF or a Structured Product).

Four brief highlights we wish to draw to your attention are below:

- ASIC should categorise **Bitcoin (and like crypto-assets) as a commodity**, consistent with the submission ASIC made in 2014 to the Senate Inquiry into Digital Currency and **not introduce a new asset category**. Bitcoin has been recognised as a commodity by major regulators in the US and UK and by the ATO and ASIC previously. ASICs suggestion that it belong in a special asset class risks creating a whole series of unintended consequences and complications that may make Australia less competitive internationally and further erode Australia consumer protections. There is a sound legal basis and movement internationally for the treatment of crypto-assets as commodities/a type of property.[1] Under this approach crypto-assets which have indicia making them financial

[1] See UK Jurisdiction Taskforce, "Legal Statement on Cryptoassets and Smart Contracts" (November 2019) and Slide 11, Commodities Futures Trading Commision, LabCFTC, "A CFTC Primer on Virtual Currencies" (17 October 2017) and the

products or something other than commodities are also then more easily categorised separately outside of a commodity category.

- **Custody and sub-custody of Bitcoin and crypto-assets should be in Australia where possible and clear guidance should be issued so licensed custodians know they can offer custody for crypto-assets**. Consumer protections are without doubt best served with local custody to streamline access for Australian compliance/auditors, Australian law enforcement, the ATO and ease of taxation and to ensure jurisdictional control by the Australian Courts, which will have jurisdiction over the ETPs listed by Australian market licensees.

- ETP structures which are well known and have been in use for many years can accommodate crypto-assets which are commodities and should be utilised to **avoid the need for additional layers of regulation with the attendant cost and complexity that brings, ultimately to the detriment of the Australian investor**. Such an approach would be consistent with the Canadian path, which ASIC has previously identified in responding to the Senate Inquiry into Australia as Technology and Financial Centre,[2] and with the European approach in permitting ETPs with crypto backing.

- The creation of a new asset-class, and the suggested involvement by ASIC in pre-determining that only Bitcoin and Ether are suitable crypto-assets for inclusion in ETPs **risks ASIC being seen to be engaging both in policy making** as well as choosing which specific crypto-currencies Australians should have access to, rather than permitting market operators and government to set clear definitions and principles for licence holders to meet.

Below are comments provided in response to each of the questions set out in ASIC Consultation Paper 343 "Crypto-assets as underlying assets for ETPs and other investment products" (**CP343**) which seeks feedback on how crypto-assets can meet existing regulatory expectations for ETPs and proposals ASIC is presently considering.

The Cosmos team has considerable expertise across a broad range of crypto-asset investments and companies and are available to the team at ASIC for any further information or enquiries. We welcome ASICs open and consultative approach to this financial innovation sector which we believe will provide large growing economic and societal benefit to Australian citizens broadly.

Yours sincerely,

[redacted]

Martin Rogers
Director
Cosmos Asset Management Pty Ltd
Investment Manager

judgment of the High Court of New Zealand in *Ruscoe & Ors v Cryptopia Limited (in liq)* Judgment of Gendall J (8 April 2020) at [21] citing the UK Taskforce report with approval as a definition

[2] Paragraph 93, Senate Select Committee on Australia as a Technology and Financial Centre: Third Issues Paper - Submission by ASIC, Submission 61, Appendix 3 to CP343

Summary Comment 1: Important definitions and concepts around crypto-assets

Defining crypto-assets

1. Paragraph 8 CP343 defines crypto-asset in a technologically focused and broad way that is functionally identical to the definition used by UK regulators.[3]

2. However, UK regulators (including the Financial Conduct Authority) have for several years adopted a further categorisation of crypto-assets along functional grounds within the perimeter of a broad definition, including e-money tokens, security tokens, unregulated tokens (utility tokens and exchange tokens) and are considering including a new stable tokens category,[4] ASIC has chosen to proceed only with a very broad definition and no further categorisation.

3. Definitions in relation to new and innovative matters are important. However, by adopting a very broad initial definition, without further categorisation, challenges arise. Most immediately is the statement at paragraph 68 CP343 that *"crypto-assets are not a homogenous asset class"* which is true by virtue of the definition which has been adopted.

4. However, as INFO225 and paragraph 69 CP343 makes clear, when a particular crypto-asset has features of a financial product, it will be treated as such, so that there are at least 2 categories of crypto-assets proposed by ASIC, those which are "financial products and services" and those which are not.

5. We submit that ASIC's leadership in promoting a like-for-like treatment of tokens in a manner similar to the FCA approach, with adoption of functional categorisation, would be useful and welcomed, both for ETP issuers and the blockchain / cryptocurrency industry more broadly as well as their service providers.

6. In the absence of specific functional categorisation beyond the two categories (in or outside of ASIC's regulatory perimeter), we submit that the starting point for any crypto-asset in the second category to be treated as a commodity for most purposes, for reasons including:

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[3] UK HM Treasury, "UK Regulatory approach to cryptoassets and stablecoins: Consultation and call for evidence" (January 2021)

[4] As above n.1

a. These crypto-assets meet the definition of being commodities;[5]

b. ASIC suggested this view in 2014 for Bitcoin-like crypto-assets;[6] and

c. There is a sound legal basis and movement internationally for treatment of crypto-assets as commodities/a type of property.[7]

7. The crypto-assets which are presently represented in overseas ETPs meet the definition of being commodities, and, lacking any feature which would render them something else in addition to being a commodity, should be accepted by ASIC as such.

8. Addressing crypto-assets in this framework turns consideration towards whether ETP structures in Australia presently in use for commodities can accommodate crypto-assets which are commodities and avoid the need for a further, new, category of asset.

Summary Comment 2: Existing ETP frameworks for commodities accommodate crypto-assets

9. The cover of CP343 states:

> *This consultation paper is about how exchange traded products (ETPs) that invest in, or provide exposure to, crypto-assets* ***can meet existing regulatory expectations for ETPs.*** (our emphasis)

10. ASIC identifies specific features of crypto-assets which need to be addressed in relation to any commodity backing an ETPs:

a. The requirements for careful custody of crypto-assets;

b. The need for reliable pricing of crypto-assets included in ETPs; and

c. The possibility that certain crypto-assets could change in nature over time.

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[5] See for example the definition of "commodity" in the Oxford Dictionary or Black's Law Dictionary

[6] Paragraph 50, Senate inquiry into digital currency - Submission by ASIC, December 2014, Submission 44

[7] See UK Jurisdiction Taskforce, "Legal Statement on Cryptoassets and Smart Contracts" (November 2019) and Slide 11, Commodities Futures Trading Commision, LabCFTC, "A CFTC Primer on Virtual Currencies" (17 October 2017)

11. The first two features are dealt with regularly by ETPs holding commodities, as commodities will need to be custodied and will often have special requirements, such as high security for gold for instance.

12. These ETP structures which are well known and have been in use for many years, if they can accommodate crypto-assets, they should be utilised to obviate the need for additional layers of regulation with the attendant cost and complexity that brings. Such an approach would be consistent with the Canadian path, which ASIC has previously taken note of in responding to the Senate Inquiry into Australia as Technology and Financial Centre.[8]

ETP structures are appropriate for crypto-asset commodities

13. Existing ETP structures used for gold and other physical commodities are also appropriate in the context of crypto-asset commodities, specifically structured products and exchange traded funds.

14. Structured products such as exchange-traded commodities are a current and suitable holding structure for crypto-assets which are commodities, such as Bitcoin, Ether and most other major crypto-assets traded globally. In such a model, the underlying commodity for a structured product is held in custody until it is required to be delivered.

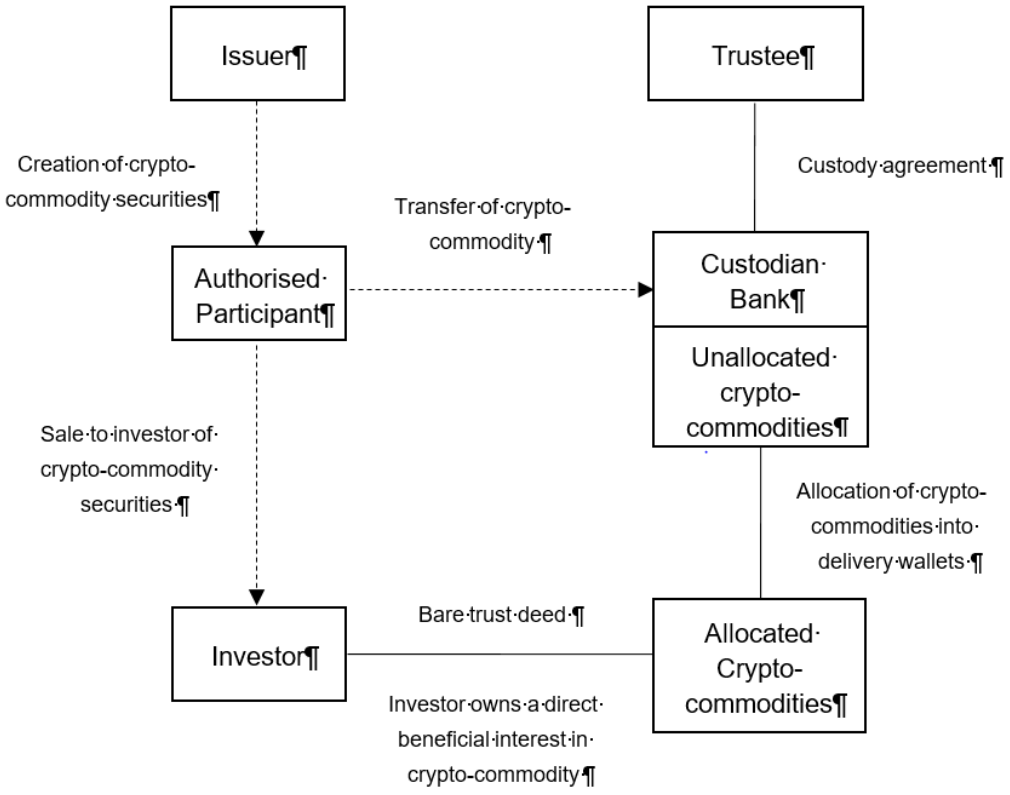
15. A crypto-asset ETP could operate by storing a unique private key in one or more cold wallets that are kept in line with the good practice for custody set out in CP343.

16. The ownership of assets held under such a custody arrangement is verifiable at any given time on the public blockchain relating to the asset held. In this respect, an ETP for crypto-commodities would be inherently more transparent than a similar structure for a physical commodity where vaulted assets must be the subject of audits.

17. Real-time monitoring of crypto-asset wallets is available to further enhance security with trusted companies such as Chainalysis, Ellipsis and Merkle Science already providing monitoring services to wholesale funds and DCEs (Digital Currency Exchanges).

[8] Paragraph 93, Senate Select Committee on Australia as a Technology and Financial Centre: Third Issues Paper - Submission by ASIC, Submission 61, Appendix 3 to CP343

18. A structured product for an exchange traded crypto-commodity could use a similar design to an existing, and analogous gold product:



19. Similarly, a crypto-commodity ETF could be structured using a structure typical for an asset backed ETF:-

    a. Investors would be offered units in a registered managed investment scheme.

    b. The Responsible Entity of the ETF would invest the funds assets into the purchase of crypto commodities from an approved vendor.

    c. The contract to purchase crypto-commodities would be on a deferred delivery basis.

    d. Rather than immediate delivery, the crypto-commodities purchased from the approved vendor would be held securely by an appropriately insured third party custodian.

    e. The vendor would secure its obligation to deliver crypto-commodities to the responsible entity by granting security over the relevant assets.

Summary Comment 3: Crypto-asset custody

20. We applaud ASIC's well considered crypto-asset custody best practices, and agree with the practices proposed by ASIC. We suggest a number of minor changes to improve those practices, considering the investor protection intent of assets underlying ETPs, principally that custody and sub-custody should be located within Australia where available for products seeking listing on Australian markets to enhance consumer protection and monitoring.

21. Given the absence of any licensed custodians offering custody of crypto-assets, whether custody is preferred or mandated for Australia, we ask that ASIC give clear guidance that licensed custodians are able to offer, and should consider offering, custody of crypto-assets immediately. While we do not believe RG133 needs amending for that to occur, a statement or amendment to RG133 to make this position clear would encourage the provision of an important service needed for the issue of ETPs or registered MIS with crypto-asset backing.

Summary Comment 4: Myths of money-laundering and illicit use of crypto-assets

22. ASIC makes a reference to "concerns of international standard-setting bodies and regulators globally regarding the use of crypto-assets in criminal activity, such as money laundering schemes" without further elaboration.

23. Given the ongoing and pervasive myth that crypto-assets are used for criminal activity, we request that ASIC ensure published material concerning the use of crypto-assets in illicit activity be properly researched and supported by evidence.

24. Outdated research[9] continues to be referenced which does not properly inform the public or industry or service providers ASIC can play a key role in ensuring that accurate information is disseminated as media plays catch up on reporting the correct position.[10]

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[9] See for example Foley S, Karlsen J and Putnins T, "Sex, Drugs and Bitcoin: How Much Illegal Activity is Financed through Cryptocurrencies?" The Review of Financial Studies Vol 32 May 2019 (https://academic.oup.com/rfs/article/32/5/1798/5427781) (accessed 18 July 2021) and see comments of J Yellen, speech to US Senate, 19 Jan 2021

[10] See for example Lennon H, "The False Narrative of Bitcoin's Role in Illicit Activity" Forbes 19 Jan 2021 (https://www.forbes.com/sites/haileylennon/2021/01/19/the-false-narrative-of-bitcoins-role-in-illicit-activity/?sh=61acbc663432) (accessed 18 July 2021)

25. The Chainalysis Crypto Crime report for 2021[11] reported that in 2020, **illicit activity was 0.34% of crypto-asset transactions**, down from 2019's figure of 2.1%, half of which was made up of a particular scam (PlusToken) that year.

26. Australia remains a low-risk destination for funds leaving illicit crypto-services, according to Chainalysis, and only 270 unique wallet addresses globally account for more than half of all illicit crypto-activity.

27. Chainalysis has been involved in a number of significant crypto-crime operations with law enforcement[12] and assisting banks in preventing financial crime using "crypto intelligence".[13]

28. The radical openness of crypto-asset platforms makes them uniquely poor tools for crime as they leave an immutable trail of where transactions have flowed. We hope that ASIC will take this and the above into consideration both in future publications and guidance generally. Specifically in relation to ETPs involving crypto-assets, it is quite probable that product issuer submissions will be made that repeating the myth of crypto-crime, including as a reason why crypto-assets should not be available as part of an ETP.

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[11] Chainalysis, "The 2021 Crypto Crime Report" (February 16, 2021) (https://go.chainalysis.com/rs/503-FAP-074/images/Chainalysis-Crypto-Crime-2021.pdf) (accessed 16 February 2021)

[12] See for example Chainalysis "Case Study: Welcome to Video, October 2019" (https://go.chainalysis.com/welcome-to-video-case-study.html) (accessed 18 July 2021)

[13] Chainalysis "Case Study – How a Traditional Bank Uses Crypto Intelligence to Stop FinCrime" April 2021 (https://www.acfcs.org/wp-content/uploads/2021/04/Case-Study-Chainalysis-Role-in-FinCrime-Investigations-Nov2020.pdf) (accessed 18 July 2021)

B. Meeting INFO 230 expectations

Suitability of crypto-assets and identifying features

B1Q1	**Do you consider that crypto-asset ETPs should be available to retail investors through licensed Australian markets? Please provide details, including data on investor demand where available.**

29. Bitcoin and other crypto-assets purchased on Australian digital currency exchanges (**DCEs**) may serve as a meaningful proxy for investor demand for crypto-assets, as wholesale investors already have a range of existing wholesale managed investment scheme offerings available which hold crypto-assets (including those offered by Apollo Capital, Cosmos Asset Management, Digital X, Monochrome Asset Management and others) in addition to direct holdings of crypto-asset commodities via DCEs.

30. Recent research indicates that 4 million Australians are likely to purchase digital currencies in the next 12 months and that 47% of Australians earning over AUD$100,000 per annum have some exposure to crypto-assets.[14] Australian investment round-up platform Raiz has included direct access to Bitcoin for up to 5% of portfolios and recently SelfWealth announced cryptocurrency trading would become available alongside SelfWealth share trading features, after a survey showed 30% of their customers already traded cryptocurrencies and 38% were interested in cryptocurrencies.[15]

31. In Europe, mutual funds, Exchange Traded Notes, Exchange Traded Contracts and ETPs investing in crypto-assets increased assets under management five-fold in 2020, to €2.3B.[16] Three funds held over €100 million each at the end of 2020.[17]

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[14] Vickovich, A, "Four million Aussies set to buy into crypto", Australian Financial Review, accessed 8 June 2021, (https://www.afr.com/companies/financial-services/four-million-aussies-set-to-buy-into-crypto-20210608-p57z2g) (Accessed 7 July 2021)

[15] Mourya, Ekta "Australian broker to offer real-time cryptocurrency trading" Fx Street (https://www.fxstreet.com/cryptocurrencies/news/australian-broker-to-offer-real-time-cryptocurrency-trading-202107121641) (accessed 17 July 2021)

[16] Moisson, "Fund managers speak out after crypto funds crackdown" FT.com 21 Janaury 2021 https://www.ft.com/content/052a58c7-632f-4f84-a567-f31be617cd4e (accessed 17 July 2021)

[17] Bloomberg Intelligence, "Europe's crypto ETPs show they're for real with 1 billion Euros" 9 December 2020 https://www.bloomberg.com/professional/blog/europes-crypto-etps-show-theyre-for-real-with-1-billion-euros/ (accessed 17 July 2021)

32. The experience of ETPs in Canada, which now has 19 crypto-asset backed ETPs listed on the Toronto Stock Exchange as noted in your paragraph 1, has shown there is a high level of demand for these products, including amongst retail investors. A notable example is 3iQ's Bitcoin ETF which increased by USD$823M within 3 weeks of trading publicly.[18]

33. A list of the current Canadian ETFs and data on their market cap and recent volume is below:[19]

Symbol	Name	Market Cap ($CAD)	24 hour Volume
1. ETHQ	3iQ CoinShares Ether ETF	$222,755,500	$18,918
2. QETH.UN	The Ether Fund	$487,317,167	$40,647
3. QETH.U	The Ether Fund	$387,817,773	$54,166
4. ETHQ.U	3iQ CoinShares Ether ETF	$177,6443,000	$1,0003
5. ETHR.U	Ether ETF	$4,619,901	$2,233
6. ETHQ.U	CI Galaxy Ethereum ETF	$999,000	$378,856
7. ETHR	Ether ETF	$35,352,000	$43,091
8. ETHX.U	CI Galaxy Ethereum ETF	$90,727,000	$51,321
9. ETHH.B	Purpose Ether ETF	$54,057,000	$128,063
10. ETHH	Purpose Ether ETF	$66,171,000	$163,967
11. ETHH.U	Purpose Ether ETF	$33,496,500	$57,468
12. BTCG.U	CI Galaxy Bitcoin Fund	$191,545,936	0
13. BTCG.UN	CI Galaxy Bitcoin Fund	$231,22,734	0
14. BTCQ.U	3iQ CoinShares Bitcoin ETF	$663,197,161	$1,100
15. BTCX.B	CI Galaxy Bitcoin ETF	$627,000	$177,470
16. BITC	Ninepoint Bitcoin ETF	$231,477,541	$13,555
17. BTCQ	3iQ CoinShares Bitcoin ETF	$839,566.533	$9,197

[18] Graffeo, E, "A Canadian bitcoin ETF has attracted $823 million in just 3 weeks since launching as crypto demand remains strong", Business Insider, accessed 7 May 2021 (https://markets.businessinsider.com/news/stocks/bitcoin-etf-3iq-coinshares-exchange-traded-fund-canadian-tsx-aum-2021-5)

[19] TMX, *Bitcoin and Crypto Funds* (8 July 2021) <https://money.tmx.com/en/stock-list/CRYPTO_FUNDS_LIST>.

18. EBIT	Bitcoin ETF	$56,524,516	$42,459
19. BTCC.B	Purpose Bitcoin ETF	$549,455,625	$934,941
20. EBIT.U	Bitcoin ETF	$11,370,620	$6,611
21.BTCC.U	Purpose Bitcoin ETF	$185,312,500	$157,487
22. BITC.U	Ninepoint Bitcoin ETF	$183,814,967	$1,255
23. BTCX.U	CI Galaxy Bitcoin ETF	$105,126,244	$45,888
24. QBTC	Bitcoin Fund (The)	$599,936,398	$44,050
25. QBTC.U	Bitcoin Fund (The)	$478,346,341	$24,582
	Total	**$6,417,330,257**	**$2,407,328**

34. The Greyscale Bitcoin Trust, while not a true ETF or Structured Product, remains the largest US based wholesale fund with over US$20B in assets as at 31 December 2020.

Investor protection would be enhanced by the availability of crypto-commodity ETPs

35. Presently, if a retail investor wishes to gain access to crypto-assets their only option is to open an account with a DCE or CFD provider, pass KYC checks, fund their account and purchase crypto-assets. There are inherent risks involved in the loss of private keys, and the heightened technological barrier to dealing with a sign up process as well as using private keys and public wallet addresses. This path therefore carries a heightened level of IT security risk in addition to market volatility and other risks which may be exchange specific.

36. ASIC has noted[20] that scams which in some way prey upon individuals seeking to be involved in crypto-asset ownership have risen considerably, and that DCE offerings do not automatically gain the benefit from any safeguards under the Australian financial regulatory framework ASIC administers.[21]

37. To the extent those scams involve tricking investors into believing they are making an *investment* into crypto-assets, such as a ponzi scheme, a regulated offering would provide a safer alternative to investors.

[20] Paragraph 13 of CP343

[21] Paragraph 81 Senate Select Committee on Australia as a Technology and Financial Centre: Third Issues Paper - Submission by ASIC, Submission 61, Appendix 3 to CP343

38. To the extent those scams involve victims being tricked into using crypto-assets as a means of *payment*, education appears to be a better approach together with enforcement from the appropriate government agencies (likely the Police and/or ACCC).

39. Further, financial planners and advisors are reportedly unable or unwilling to provide advice to their clients concerning exposure to crypto-assets, but will be better placed to include consideration of a regulated listed product which holds crypto-assets.[22]

40. We have set out direct answers to the questions posted in CP343 below on a question by question basis.

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

41. We submit that crypto-asset ETPs should be cleared and settled in the same manner as other commodity based ETPs where the crypto-assets held are analogous to a commodity.

42. We understand that in order for some products to be eligible for quotation they must be approved for clearing by a designated central counterparty, with similar rules applying for settlement. For example, under the Chi-X Procedures[23] only ASX Clear is approved to operate as that designated central counterparty.

43. It may well be prohibitive for parties looking to quote new products if clearing and settlement participants are not willing to support ETPs that are backed by crypto-assets. We suggest that ASIC should consider these potentially prohibitive features of the listing rules in conjunction with this consultation and the stated aims of encouraging innovation while protecting investors.

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

44. Not applicable.

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[22] Mickey News "Broker says financial advisors loading up on Bitcoin", Mickey accessed 9 July 2021 (https://micky.com.au/broker-says-financial-advisors-loading-up-on-bitcoin/)

[23] Chi-x Procedures, s 6.2; Chi-X Investment Products Information Pack, Attachment One, 7.4.

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

45. Not applicable.

B1Q5	**Do you agree with our approach to determining whether certain crypto-assets are appropriate underlying assets for ETPs on Australian markets? If not, why not?**

46. Proposal B1 contains excellent elements to help identify particular crypto-assets which may be suitable for an ETP. These would expand on and provide useful context for licence holders who are obliged to consider the suitability of new listings on their market. We do note that some of the items raised in B1, particularly around service provider availability, pose challenges and appear to place a high level of prescriptiveness around crypto-assets.

Institutional Support

47. In relation to B1(a) it is unclear just what level of support, and from what institutions, would be considered by ASIC to be acceptance of a crypto-asset being seen to be used for investment purposes. We suggest an adjustment to this, below.

Service providers

48. In relation to B1(b), as ASIC would be aware, and as is well set out in submissions made to the Senate Select Committee into Australia as a Technology and Financial Centre, there is a "chicken and egg" problem in the digital asset industry concerning service providers.

49. For a variety of factors, including prevailing myths concerning money-laundering or illegal use of crypto-assets and the absence of clear guidance from regulators globally, has left a landscape where service providers are hesitant about servicing the industry, a matter most identifiable in there being no licensed custody providers in Australia presently offering custody for crypto-assets of any kind.

50. As such, seeking to identify crypto-assets on the basis of whether service providers will support an ETP investing in those crypto-assets may invite a foregone conclusion, if it is the case that service providers are awaiting clarity from ASIC as to the status of those crypto-assets and that is is acceptable to hold them.

51. We suggest clear support from ASIC and guidance to custody providers in particular to the effect proposed below, would be of great assistance in enabling the very benchmarks to be met which ASIC is proposing to use to consider whether a crypto-commodity may be a suitable basis for an ETP.

52. We also note that there is a challenge in service providers being involved in Bitcoin or Eth ETPs at present, we submit, for the reasons set out above.

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

53. In relation to B1(a) we suggest ASIC make clear that ETP products using the same underlying crypto-asset listed on comparable overseas markets will be seen to demonstrate institutional support and acceptance of the crypto-asset under consideration.

54. In relation to B1(b) we suggest that ASIC provide immediate and clear guidance that:

    a. Licensed custodians may, under their existing authorisations, offer custody services for crypto-commodities;

    b. Service providers will find ASIC supportive of innovation to support any novel issues arising from their involvement in crypto-asset (i.e. commodity) backed ETPs;

    c. Applications for licensing of crypto-derivative markets will be granted to suitable applicants.

55. In relation to B1(c) we suggest that this be clarified to include major DCEs in Australia and globally, as these businesses provide the spot markets for crypto-commodities at this time.

B1Q7	**Do you have any suggestions for alternative mechanisms or principles that could achieve a similar outcome to the approach set out in proposal B1? Please provide details.**

56. We refer to our suggestions above concerning clear guidance and support from ASIC to assist service providers in particular to be confident they can engage in support for crypto-commodities.

57. We suggest that ASIC further consider providing alternative compliance means, for example if insurance is unavailable, that a bond regime be accepted in lieu of an insurance product.

B2Q1	**Do you agree that a new category of permissible underlying asset ought to be established by market operators for crypto-assets? If not, why not?**

58. As set out above, we propose that a crypto-asset definition starting from a commodity position be adopted and that this be used in lieu of a new category of permissible underlying asset, and that prevailing principles applicable to commodity backed ETPs apply to crypto-asset backed ETPs absent a compelling reason not to adopt this approach.

59. In relation to the comments at para 36 of CP343:

    a. We submit that there is growing consensus on different categories for cryptographic tokens which are broadly organised around the intended functions for tokens as stated by their issuers or as embodied in a cryptographic token's source code (see for example the FCA's categories).

    b. The ability for crypto-assets to evolve is in practice limited once a crypto-asset is minted, and can take a considerable period of time. The mere capability of a crypto-asset to evolve in structuring should not be considered any differently to a commodity which changes in nature, for example gold is held in ETPs and can be converted to coins etc. Crypto-assets differ only in that an outside change is possible, but is not likely to occur without substantial warning and time passing.

    c. It is unclear just what categories ASIC is referring to in paragraph 36(c), and we note that treating crypto-commodities as commodities again addresses and resolves an overlap concern. We submit that cryptographic tokens which are financial products (specifically those which are not crypto-commodities) are and will remain subject to the requirements of the Corporations Act.

60. We submit that the technology neutral and "regulation of activities" approach in Australian financial services regulation appears inconsistent with the suggested approach in paragraph 36(c), being a crypto-asset categorisation exercise by Australian market licensees being used to inform treatment more generally under the Corporations Act.

Robust and transparent pricing mechanisms

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

61. We consider the good practices in proposal B3 are well considered and should be adopted. As noted below in our comment on B3Q3, there are a number of major indices in operation for crypto-assets at present which have been operating for years and provide compliant pricing information.

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

62. We consider the good practices in proposal B3 are well considered and should be adopted.

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

63. Yes, the open nature of public blockchain ledgers permits unparalleled tracking and fraud / manipulation detection as well as flows between exchanges at costs and in ways previously not possible in relation to commodities or financial products.

64. We agree with the suggestion at para 43 of CP343 that the use of a major crypto-asset index to demonstrate robust pricing of crypto-assets, where appropriate governance and oversight of those indices are already in place, is suitable.

65. For completeness we note:

a. Since 2016, the CME Group has been operating a Bitcoin Reference Rate (**BRR**) and Bitcoin Real-Time Index (**BRTI**) with both the BRR and BRTI being registered benchmarks under the European Benchmarks Regulation (EU BMR).[24]

b. Since 2018, NYSE has hosted the NYSE Bitcoin Index (NYXBT).[25]

c. Earlier this year S&P Dow Jones Indices launched a Cryptocurrency Index Series including S&P Bitcoin Index, S&P Ethereum Index and S&P Cryptocurrency MegaCap Index (measuring Bitcoin and Ethereum).[26] S&P has also recently introduced a further 5 indices covering hundreds of crypto-assets.[27]

d. Regretfully no Australian crypto-commodity or crypto-asset benchmark or index exists at this time and we hope that this changes in the future as crypto-assets and crypto-commodities gain wider acceptance.

66. We further submit that the 25 Canadian crypto ETP products are a live example of pricing being robust and transparent to standards required for listing on regulated markets in Canada. We would expect the concerns in paragraph 40 of CP343 have been considered as part of those ETPs applications and admissions to listing.

67. We would not expect trading platforms which exhibit evidence of manipulation (including wash trading), hacks or interference in natural price discovery to be permissible as a basis to determine the price of crypto-assets, in the same way that small and untrustworthy commodity markets should not be a part of price discovery for commodity ETPs. The research cited in CP343 identifies this same problem, but it is not a problem faced by the major indicies referenced above.

68. We agree with the matters at para 47 and 48 that a single crypto-asset spot market would not be appropriate for pricing of an ETP.

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[24] https://www.cmegroup.com/trading/cryptocurrency-indices/cf-bitcoin-reference-rate.html#

[25] https://www.theice.com/publicdocs/data/NYSE_Bitcoin_Index_Methodology.pdf

[26] S&P Dow Jones Indices Launches Cryptocurrency Index Series Including S&P Bitcoin Index https://www.spglobal.com/spdji/en/index-launches/article/sp-dow-jones-indices-launches-cryptocurrency-index-series-including-sp-bitcoin-index/

[27] S&P Dow Jones Indicies Launches S&P Cryptocurrency Broad Digital Market Index https://www.spglobal.com/spdji/en/index-launches/article/sp-dow-jones-indices-launches-sp-cryptocurrency-broad-digital-market-index/

B3Q4	**Do you consider that a more robust and transparent pricing standard is achievable in relation to crypto-assets? For example, by using quoted derivatives on a regulated market. Please explain and provide examples where possible.**

69. We support ASIC's proposed approach and the use of existing, high quality indices as part of ensuring pricing at NAV of the ETP is close to the underlying asset.

No other INFO-230-related guidance

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

70. We submit that a new paragraph addressing crypto assets within INFO230 would assist the market participants to understand and have confidence in dealing with crypto-asset ETPs including:
    a. That crypto-assets which are commodities should be offered in ETPs in the same manner as existing commodity ETPs;
    b. That crypto-assets require specialised custody and the good practices should be linked or identified, including an Australia first approach to custody; and
    c. That licensed custodians may custody crypto-assets.

C. Responsible Entity Obligations

Custody

C1Q1	**Do you agree with our proposed good practices in relation to the custody of crypto-assets? If not, why not? Please provide any suggestions for good practice in the custody of crypto-assets.**

71. We applaud ASIC's excellent proposed good practices in relation to the custody of crypto-assets (including crypto-commodities) and recognising that:

    a. Segregated client assets;

    b. Cold storage of crypto-assets;

    c. Multi-signature wallets and specialised infrastructure and expertise is required by custodians;

    d. Physical security over the password and wallet systems,

    are all critical best practices for secure storage of crypto-assets.

    We suggest that ASIC's good practice also include the matters suggested in our response to C1Q3 below.

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

72. See below our comment regarding C1Q3.

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

73. We submit that modifications to encourage the growth of Australian custody providers would enhance consumer protection.

74. The use of GS-007 (the applicable Australian Standard) as the example of controls would be preferred in our submission to SOC 2 Type II (the applicable US Standard).

75. We submit that the "appropriate compensation system" should be considered in greater detail given the practical difficulties of obtaining sufficient insurance in relation to even the largest overseas crypto custodians.[28]

76. We submit there would be benefits in mandating Australian soil custody and sub-custody (if available) for most or the majority of RE held crypto-assets in an ETP to enhance investor protection by improving:

    a. Ease of compliance / auditing of physical control (which is an important part of verification of wallet control / wallet rotation); and

    b. Jurisdictional control by the Australian Courts, which will have jurisdiction over the ETPs listed by Australian market licensees.

77. We submit that the ease with which crypto-assets move without regard to international borders supports a stronger "Australia first" approach to custody to minimise the potential for risks of overseas jurisdictional risk for investors, with an option for an RE to utilise overseas custody if custody in Australia is not commercially available.

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

78. Yes. The nature of private / public key pairs utilised in crypto-asset wallets means that the security of custody is dependent upon high physical and IT security during:

    a. Key / wallet generation in an air-gapped and secure environment with the private keys never being stored on an internet-connected device; and

[28] For example BitGo has over US$16 billion in assets under custody buy has only been able to secure USD$700 million of insurance coverage (see https://au.finance.yahoo.com/news/bitgo-announces-16-billion-assets-204900065.html and https://www.theblockcrypto.com/post/102420/bitgo-700-million-insurance-crypto-custody) but only offers USD$100 million of insurance coverage as a standard offering (https://www.bitgo.com/services/custody/qualified-custody). Coinbase holds a commercial crime policy with a $320 million limit (https://custody.coinbase.com/faq) and holds over USD$90 billion in assets (https://www.coindesk.com/coinbase-now-has-over-90b-in-assets-on-platform)

b. Transaction signing processes which require transactions to be signed using air-gapped equipment, again so the private keys are never exposed to a risk of theft.

79. Further security methods include:-

a. The sharding, or splitting, of private keys. This provides for an N of M to sign system which enables redundancy as well as security against a rogue employee being able to transact.

b. Wallet rotation, so that any risk of compromised private keys is further mitigated with new wallets being used.

c. "Whitelist" or approved wallet addresses being deployed to further protect against theft or "man in the middle" attacks.

d. The ability for constant monitoring of cold storage wallet addresses via public blockchains in near-real time.

80. In many respects crypto-asset custody can provide superior protection compared to traditional custody systems due to their constantly monitorable state and ease of sharding private keys and restricting access to sign transactions without the need for any particular proprietary or compiled software.

C1Q5	**Do you have any suggestions for alternative mechanisms or principles that could replace some or all of the good practices set out in proposal C1? Please provide details.**

81. A simple alternative may be to provide a good practice guideline requiring regular auditing of appropriate controls to provide flexibility in any future technological developments concerning crypto-asset custody.

82. We submit that, due to the need for further education and confidence in the industry, a set of sound good practices issued by ASIC would be more beneficial at this time (as suggested) than a more general principles based approach.

C1Q6	**Should similar requirements to proposal C1 also be imposed through a market operator's regulatory framework for ETPs? If so, please provide reasons and how it could work in practice**

83. Listing applications at present must explain the custody proposed when the application is made.

84. Market operators are increasingly sophisticated and knowledgeable of crypto-assets and are aware of the special needs for crypto-asset custody, which can be reviewed at the time of listing and via regular audit of the custody used.

Risk Management

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

85. Yes, custody of crypto-assets is key to investor protection, and this could involve a regular audit of custody and processes by a suitably qualified service provider being put in place to protect the crypto-assets.

C2Q2	**Are there any other regulations (other than KYC and AML/CTF) that should form part of an appropriate baseline level of regulation for crypto-asset trading platforms used by REs and connected service providers? Please provide details.**

86. No, we submit that the KYC, AML/CTF regulations applicable to digital currency exchanges are a suitable baseline and the principles proposed by ASIC give REs flexibility to adopt best practice solutions as they emerge and develop.

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

87. We do not have a comment on this question.

C2Q4	**Are there any other matters related to holding crypto-assets that ought to be recognised in the risk management systems of REs and highlighted through ASIC good practice information? Please provide details and any specific proposals.**

88. We submit that suitable crypto-asset custody is the key risk management for REs to be carefully met, and that ensuring a suitable level of in-house expertise in crypto-assets should be demonstrated by REs wishing to issue ETPs.

89. The following examples of digital currency exchange hacks all have common feature, being a compromise of private keys:

    a. The collapse of Japanese exchange Mt. Gox;[29]

    b. The failure of Canadian exchange QuadrigaCX; and

    c. The failure of New Zealand exchange Cryptopia and theft of Bitcoin during the Cryptopia liquidation by an employee.[30]

90. While the above are examples of digital currency exchanges and not ETPs, the principle still holds that if segregated custody was used, the owners of assets held by those parties would have been better protected. In an ETP scenario, this is an unacceptable risk which can be avoided with sensible custody solutions.

91. We submit good practice set out for custody in proposal C1 with the amendments suggested above are a sensible approach.

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

92. We do not have a comment on this question.

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[29] Bacina, M "The Long Shadow of My. Gox" 7 March 2019 (https://piperalderman.com.au/insight/the-long-shadow-of-mt-gox/) (accessed 18 July 2021

[30] Bacina M and McGlynn J "Unnamed employee sprung stealing from liquidated exchange Cryptopia" BitsofBlocks.io (https://www.bitsofblocks.io/post/misdirection-gone-wrong-unnamed-employee-sprung-for-theft-from-liquidated-exchange-cryptopia) (accessed 18 July 2021)

Disclosure

C3Q1	**Do you agree with our proposed expectations regarding disclosure obligations for registered managed investment schemes that hold crypto-assets? If not, please explain why not.**

93. We agree with these expectations broadly, but we suggest that the appropriate disclosure point concerning environmental risk could be or amended to read as follows:-

> *"Environmental risk - REs should include the latest and reliable information on energy use by the underlying assets used in the ETP."*

94. This would better address:

a. The difference between proof-of-work and other systems (such as proof-of-stake or algorithmic random and other consensus mechanisms which do not burn considerable amounts of energy). The present wording risks leads readers to infer that crypto-assets generally are always heavily energy dependent by design, which is not correct.

b. The movement towards increasing levels of renewable energy / carbon dioxide emission free in proof-of-work blockchains and the use of 'stranded' energy (particularly those created by renewables such as hydroelectric power, wind, solar power or gas flaring on oil fields) which would otherwise be lost, acting like a "monetary battery" .[31]

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

95. Given the ongoing myths prevalent around crypto-assets, we suggest that where there are mitigating factors to the risks to be disclosed, those factors should also be required to be the subject of disclosure to better inform investors.

[31] Bendiksen, C, "A Closer Look at the Environmental Impact of Bitcoin Mining", CoinShares (accessed 17 July 2021) https://coinshares.com/research/closer-look-environmental-impact-of-bitcoin-mining

C3Q3	**Are there any additional categories of risks that ought to be specified by ASIC as good practice for disclosure in relation to registered managed investment schemes that hold crypto-assets?**

96. We submit that custody and cyber risk are the major risk factors outside of the well understood price volatility which registered managed investment schemes that hold crypto-assets should highlight.

97. ASIC should consider carefully any mandated risk warnings which could continue myths surrounding crypto-assets, including in relation to illicit/criminal use of crypto-assets or that they are creating environmental damage.

Design and distribution obligations

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

98. We have no comment in response to this question.

D. Listed investment entities

Settings for investment entities

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

99. Yes for the reasons set out above in answer to B1Q1 and our high level comments.

D1Q2	**Do you agree with our proposed expectations for LICs and LITs that invest in crypto-assets to ensure equivalent standards are applied by market operators? If not, why not?**

100. We repeat our comments set out in relation to proposal C1, C2 and B3 above.

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

101. We do not have a comment in response to this question.

D1Q4	**Are there additional standards which ought to apply via market operators to LICs or LITs that invest in crypto-assets? If so, what are these expectations and why should they apply?**

102. We do not have a comment in response to this question.

D1Q5	**Should LICs and LITs only be able to invest significant funds in crypto-assets if this is either set out in their investment mandate or with member approval? If not, why not?**

103. No, as set out above, where a LIC or LIT has a mandate to invest in commodities then crypto-commodities should be seen to be falling within that scope already and should not need to be the subject of further approval.

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

104. We do not have a comment in response to this question.

E. AFS Licensing

New asset kind

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

105. No, as set out above, crypto-assets which are commodities should be dealt with under the existing treatment of commodities.

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

106. As we set out above, many if not most crypto-assets are best dealt with as commodities which may be traded digitally.

E2Q1	**Do you agree with our approach to restrict the crypto-assets a registered managed investment scheme is authorised to hold (e.g. to bitcoin or ether)?**

107. No. As we set out above, many if not most crypto-assets are best dealt with as commodities which may be traded digitally, we submit ASIC would be making policy decisions as to the kinds of investments which Australian investors should access it if adopts this approach.

108. As such, we submit that crypto-assets which are commodities should be permitted under existing authorisations as occurs presently. If ASIC wishes to adopt a specific "commodities" or "property (other than real property)" category of authorisation for an AFSL holder to select for a registered managed investment scheme this would better serve both existing products and crypto-asset products.

109. We respectfully submit that while there may be very sensible reasons for ASIC to seek to restrict registered managed investment schemes to holding Bitcoin and Ether, ASIC would be, entering into the area of policy formulation in doing so.

110. We would be pleased to understand ASIC's considered and no doubt detailed rationale in stating in paragraph 94 CP343 that "*crypto-assets do not fall within any existing asset kind*" or that any asset kind would need to be modified, noting the matters we set out above.

111. We submit that the creation of a specific asset kind and AFS authorisation could be viewed as inconsistent with a technologically neutral approach to regulation and risks, and also creates uncertainty for digital currency exchanges which presently deal in crypto-commodities directly. It may risk expanding the scope of what a registered managed investment scheme is understood to comprise to include digital currency exchanges.

112. If it is not ASICs intention to create a licensing obligation on digital currency exchanges in this way, ASIC should make this very clear as digital currency exchanges already face numerous challenges from prevailing myths around crypto-assets without introducing a further licensing uncertainty to their operations.

E2Q2	**Do you consider there are any other aspects of the AFS licensing regime that need to be clarified or modified to accommodate investment products that invest in, or provide exposure to, crypto-assets?**

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

114. There is nothing in RG133 which prevents crypto-asset custody and we submit that clear and supportive guidance should be provided by ASIC to custody providers. An update to RG133 to clarify that licensed custodians can provide custody for crypto-assets would support and accommodate investment products which invest in or provide exposure to crypto-assets. This support may also assist in dispelling myths and misunderstandings around crypto-assets.

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

116. The absence of a single registered managed investment scheme holding crypto-assets being permitted to date in Australia also contrasts sharply with comments made during digital currency events by ASIC representatives. These comments have been supportive of encouraging innovation and have implied that licensing should be sought by those involved in digital assets and in crypto-asset businesses where crypto-assets are a financial product. However there is no

guidance issued by ASIC as to how any of those crypto-assets which are financial products can be the subject of licensing within a business model.

117. Clarification of the regulatory perimeter for the AFS licensing regime around crypto-assets, to make clear what characteristics of token would place them within, or outside, the regulatory perimeter or within, or outside, a particular category would greatly benefit both investment products and the crypto-currency and blockchain industry more broadly.

118. Investment product issuers would enjoy clarity over products which are holding, in effect, digital commodities, and ensure there is no inadvertent extension of licensing obligations to the growing and innovative digital currency exchange industry or those who are otherwise involved in the digital currencies.

F106 (a)	**Regulatory and financial impact - ASIC request for information on proposals or alternative approaches including likely compliance costs**

119. Significant compliance costs and delay will be required to accommodate a new category of crypto-asset including the need for a Regulation Impact Statement and further delay in the amendment of laws, instruments or regulations as well as the engagement of professional services for licence variation applications to accommodate the new asset category.

F106 (a)	**Regulatory and financial impact - ASIC request for information on proposals or alternative approaches including likely compliance costs**

120. We submit that a new category of crypto-asset will place Australia at odds with the rest of the world in how crypto-assets are treated for the purposes of investment vehicles and that this will raise a barrier to competition from offshore providers of investment products backed by crypto-assets.

121. It may also impact the ability of Australian investment managers to expand their offerings overseas if those jurisdictions do not have comparable methods for crypto-backed investment products.

122. The present time for processing of AFSL applications or variations is not insignificant, and there will be a flood of applications or variations to existing licences if a new category of crypto-

asset is created. ASIC should consider the internal cost and time-cost in processing these applications, which will delay and increase costs for new products being made available to Australian retail investors.

F106 (c)	**Regulatory and financial impact - ASIC request for information on proposals or alternative approaches including likely other impacts, costs and benefits**

123. The suggestion to restrict suitable crypto-assets to Bitcoin and Ether at this time, and a collaborative process with market operators to set a prescriptive formula to even consider crypto-assets has an immediate cost to businesses wishing to offer crypto-assets.

124. Australia has fallen behind Canada in launching crypto-asset ETPs and the proposed 2 crypto-assets, with an unknown path to more "permissioned" crypto-assets is, we submit, inconsistent with a principles based regulatory approach.

125. An approach which fully adopts the FCA's categories of tokens, if ASIC wishes to proceed with the crypto-asset definition in CP343, should be adopted to avoid the costs of ongoing uncertainty in relation to crypto-asset classification.

126. As suggested above, an alternative would be recognising crypto-assets as commodities unless a particular crypto-asset has an identifiable feature which renders it the subject of additional regulatory compliance such that it is better characterised as, for example, a derivative or share. This approach would fit better with INFO225, require less amendment to guidance and permit a faster time to market for ETPs which seek to include crypto-assets.