



**ASIC**  
Australian Securities &  
Investments Commission

CONSULTATION PAPER 343

# Crypto-assets as underlying assets for ETPs and other investment products

June 2021

## About this paper

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. The paper sets out our proposals on good practice for market operators and product issuers so that these products can be facilitated in a way that maintains Australia's fair, orderly and transparent markets.

It also sets out our proposals on good practice that apply to other investment products that could provide retail investors with exposure to crypto-assets so that similar financial products are subject to similar good practice expectations. These other investment products are listed investment companies, listed investment trusts and unlisted registered managed investment schemes.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Document history

This paper was issued on 30 June 2021 and is based on the legislation as at the date of issue.

### Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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## The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final position.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also keen to hear from you on any other issues you consider important.

Your comments will help us develop our position on ETPs and other investment vehicles that propose to invest in, or provide exposure to, crypto-assets. In particular, any information about compliance costs, impacts on competition and other impacts, costs and benefits will be taken into account if we prepare a Regulation Impact Statement: see Section F, 'Regulatory and financial impact'.

### Making a submission

You may choose to remain anonymous or use an alias when making a submission. However, if you do remain anonymous we will not be able to contact you to discuss your submission should we need to.

Please note we will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any personal or financial information) as confidential.

Please refer to our [privacy policy](#) for more information on how we handle personal information, your rights to seek access to and correct personal information, and your right to complain about breaches of privacy by ASIC.

Comments should be sent by 27 July 2021 to [marketsregulation@asic.gov.au](mailto:marketsregulation@asic.gov.au) with the subject heading 'CP 343 Submission—[Entity Name]'.

## What will happen next?

<b>Stage 1</b>	30 June 2021	ASIC consultation paper released
<b>Stage 2</b>	27 July 2021	Comments due on the consultation paper
<b>Stage 3</b>	Q3 2021	ASIC good practice information published

## A Background to the proposals

### Key points

ASIC is aware of interest in the Australian market for exchange traded products (ETPs) that invest in, or provide exposure to, crypto-assets (crypto-asset ETPs), particularly exchange traded funds (ETFs).

Along with Australian market licensees, we have responsibility for ensuring that the admission and monitoring standards for ETPs continue to support fair, orderly and transparent markets, particularly in the context of ETPs that have unique or novel features. We are also responsible for regulating registered managed investment schemes and listed companies.

We consider that crypto-asset ETPs have unique features and risks which need to be recognised by market operators and product issuers in performing their functions and meeting existing regulatory obligations. We also consider that there needs to be consistency in how these existing regulatory obligations are met by ETPs and other investment vehicles regulated by ASIC that may also invest in, or provide exposure to, crypto-assets.

In this consultation paper, we seek feedback on proposed good practices for market operators and product issuers regarding crypto-asset ETPs and other investment vehicles that provide retail investors with exposure to crypto-assets.

## Introduction

### Background

- 1 Crypto-asset ETPs have attracted significant attention globally, particularly with the launch of bitcoin-based ETFs on the Toronto Stock Exchange.
 

Note: The crypto-asset, bitcoin, and the network it trades on are both referred to by the same term. In this consultation paper we use the term 'bitcoin' with a lower case 'b' to refer to the crypto-asset and 'Bitcoin' with the upper case 'B' to refer to the network.
- 2 In Australia, we are aware of interest in, and demand for, domestic crypto-asset ETPs. However, we are also aware of the real risk of harm to consumers and markets if these products are not developed and operated properly.
- 3 We have the function of monitoring and promoting market integrity and consumer protection in relation to the Australian financial system: s12A of the *Australian Securities and Investments Commission Act 2001* (ASIC Act). In performing this function, ASIC, along with Australian market licensees,

have the responsibility for ensuring that the admission and monitoring standards for ETPs continue to support fair, orderly and transparent markets: s792A(a) of the *Corporations Act 2001* (Corporations Act). Good practices to support fair, orderly and transparent markets, particularly in the context of ETPs that have unique or novel features are set out in in [Information Sheet 230 Exchange traded products: Admission guidelines](#) (INFO 230).

- 4 We consider that crypto-asset ETPs have novel and unique features that require consideration of whether such products can support fair, orderly and transparent markets and comply with our regulatory framework. Given the unique, ever evolving characteristics and risks involved with crypto-assets, we consider it appropriate to consult widely on our understanding of crypto-assets and the proposals in this consultation paper.

### Key issues

- 5 In our view, the key issues raised by crypto-asset ETPs that need to be considered include:
- (a) whether these products can meet existing expectations for ETPs, including whether crypto-assets are appropriate underlying assets, whether crypto-assets can be reliably priced, and how crypto-assets should be classified with respect to underlying asset rules; and
  - (b) how product issuers can ensure these products are compliant with our regulatory framework, including with respect to custody, risk management and disclosure.
- 6 We note that similar issues have been, or are being, actively considered by other jurisdictions in the context of their regulatory frameworks. See, for example, [SEC Staff Letter: Engaging On Fund Innovation and Cryptocurrency-related Holdings](#) (18 Jan 2018) and [CSA Staff Notice 51-363 – Observations on Disclosure by Crypto Assets Reporting Issuers](#) (11 March 2021).
- 7 We seek your feedback on the proposals set out in this consultation paper for market operators and product issuers regarding good practices and expectations for crypto-asset ETPs and other investment products.

## Important concepts and context

### What are crypto-assets?

- 8 For the purposes of this consultation paper, a crypto-asset can be understood to be a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof. A

crypto-asset may or may not have identifiable economic features that reflect fundamental or intrinsic value.

Note: This is ASIC's working understanding of crypto-assets and may evolve over time. We may craft a different description of crypto-assets as needed in performing our legislative functions in line with government policy at that time. We use the term 'crypto-assets' but recognise that they may also be commonly referred to as digital assets, virtual assets, tokens or coins. We are not aware of a universally accepted name for, or definition of, 'crypto-assets'.

- 9 Crypto-assets are not a homogenous asset class. The rights and features of each crypto-asset can raise different considerations for consumers, product issuers and regulators. Crypto-assets are commonly referred to as speculative assets with volatile prices and minimal to no regulatory oversight.

### **How are crypto-assets regulated?**

- 10 Crypto-assets are available directly to retail investors in Australia through local digital currency exchanges and overseas-based crypto-asset trading platforms.
- 11 We regulate crypto-assets and related products and services to the extent they fall within the existing regulatory perimeter of financial products and services: see [Information Sheet 225](#) *Initial coin offerings and crypto-assets* (INFO 225). Crypto-assets that do not fall within the existing regulatory perimeter of financial products and services are generally unregulated by ASIC. They may be subject to other Australian laws.
- 12 The Senate Select Committee on Australia as a Technology and Financial Centre will be assessing options for the development of a comprehensive regulatory framework for crypto-assets which could change how crypto-assets are regulated in Australia.

Note: For further information, see the Senate Select Committee on Australia as a Technology and Financial Centre's [Third Issues Paper](#).

### **Retail investor interest and crypto scams**

- 13 The rise in value of crypto-assets globally has seen a sharp increase in retail investor interest in investing in crypto-assets. In parallel, we have seen an exponential rise in the number of crypto investment scam reports received this year compared to previous years, and we continue to publish scam warnings like our overseas regulatory counterparts. The crypto-asset marketplace is technologically complex, online and global. These features lend themselves to unscrupulous operators seeking to defraud consumers.
- 14 We also note and share the concerns of international standard-setting bodies and regulators globally regarding the use of crypto-assets in criminal activity, such as money laundering schemes.



- 15 In these circumstances, we understand there is demand for crypto-asset ETPs from retail investors seeking exposure to crypto-assets who:
- (a) are unfamiliar with the processes involved for investing, trading and safe-keeping crypto-assets; and
  - (b) prefer to gain exposure to crypto-assets through a regulated financial market where a regulated investment vehicle (providing some protections) holds the crypto-assets.

Note: We do not, and cannot, guarantee the profitability or the ongoing feasibility of any financial product or investment vehicle—whether listed or unlisted. We administer regulatory requirements and controls that seek to promote market integrity and consumer protection.

### **What are ETPs?**

16 ETPs are open ended investment products that are traded on a financial market and invest in, or give exposure to, various assets or asset classes.

17 In Australia, there are three broad categories of ETP:

- (a) Exchange traded funds (ETFs): Collective investment vehicles that generally aim to track the performance of an index, a currency or a commodity.
- (b) Managed funds (MFs): Collective investment vehicles that generally follow an active investment strategy that seeks to outperform an index or benchmark, or targets another specified objective. This category includes hedge funds.
- (c) Structured products (SPs): A security or derivative which gives financial exposure to the performance of underlying instruments. Types of structured products include exchange traded commodities (ETCs) and exchange traded notes (ETNs).

### **How are ETPs regulated?**

18 All ETPs are financial products and are regulated by ASIC under the Corporations Act. ETFs and MFs are registered managed investment schemes. SPs are generally classified as securities or derivatives.

19 Australian market licensees ensure that market activity of ETPs takes place within a fair, orderly and transparent environment. They are the primary gatekeeper for the product admission process and they monitor the compliance of ETPs under the market licensee's rules.

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

## Other investment vehicles

- 21 ETPs are not the only means by which retail investors can obtain exposure to various assets or asset classes. Retail investors can also invest in listed investment trusts (LITs), listed investment companies (LICs) and unlisted registered managed investment schemes. These investment products are also regulated by ASIC under the Corporations Act. We must consider the effects that the performance of our functions will have on competition in the financial system: s1(2A) of the ASIC Act. As such, to ensure a level playing field and minimise opportunities for regulatory arbitrage, we propose that relevant good practices and expectations set out below apply to similar investment products offering to provide retail investors with exposure to crypto-assets.
- 22 The ‘Key points’ at the beginning of each section of this paper set out which types of investment products the proposals in the section apply to.

## Classification of crypto-assets

- 23 How crypto-assets are classified and regulated in Australia is a matter for government decision. As noted above, the Senate Select Committee on Australia as a Technology and Financial Centre is considering these questions.
- 24 The proposals in this paper do not seek to pre-determine or pre-empt any government decision on how crypto-assets ought to be classified or regulated in Australia; nor do we express any opinion on how crypto-assets ought to be classified or regulated in Australia.
- 25 The proposals in this consultation paper have been developed on the basis that ETPs and other investment products that invest in, or provide exposure to, crypto-assets are financial products under the Corporations Act, and therefore fall within ASIC’s regulatory responsibility. The proposals have been developed because we consider there is a need to identify good practice in complying with existing regulatory obligations for such products.

## B Meeting INFO 230 expectations

### Key points

[INFO 230](#) sets out good practices to help ensure that admission and monitoring standards for ETPs continue to support fair, orderly and transparent markets, particularly in the context of ETPs that have unique or novel features. Market operators implement these good practices through their regulatory framework.

We are seeking feedback on proposed good practices for product issuers and Australian market licensees about how crypto-asset ETPs can meet the expectations for ETPs that are set out in INFO 230.

This section applies only to ETPs.

## Suitability of crypto-assets and identifying features

### Proposal

- B1** We propose to work with Australian market licensees to establish the following factors as the basis to identify particular crypto-assets that may be appropriate underlying assets for an ETP:
- (a) a high level of institutional support and acceptance of the crypto-asset being used for investment purposes;
  - (b) the availability and willingness of service providers (including custodians, fund administrators, market makers and index providers) to support ETPs that invest in, or provide exposure to, the crypto-asset;
  - (c) a mature spot market for the crypto-asset;
  - (d) a regulated futures market for trading derivatives linked to the crypto-asset; and
  - (e) the availability of robust and transparent pricing mechanisms for the crypto-asset, both throughout the trading day and to strike a daily net asset valuation (NAV) price.

### Your feedback

**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.

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

- B1Q3 If you are a clearing participant, would you be willing to clear crypto-asset ETPs? Please provide your reasons.
- B1Q4 If you are a trading participant, would you be willing to trade crypto-asset ETPs? Please provide your reasons.
- 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?
- B1Q6 Do you have any suggestions for additions or modifications to the factors in proposal B1? Please provide details.
- 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.

- B2** We propose to work with Australian market licensees to establish a new category of permissible underlying asset for crypto-assets in their regulatory frameworks that, at a minimum, is consistent with the factors set out in proposal B1.

*Your feedback*

- 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?

## Rationale

- 26 It is a requirement of quotation that an ETP be a suitable product for admission. This includes considering whether it is appropriate to offer retail investors exposure to the ETP's underlying assets through a licensed Australian market.
- 27 Australian market licensees, as the primary gatekeepers for product admission, are responsible for making this assessment. ASIC's role is to supervise the conduct of Australian market licensees, including in this context, ensuring that market innovation is appropriately balanced against maintaining fair and efficient markets.
- 28 We do not consider that all crypto-assets are currently capable of being appropriate underlying assets for an ETP. We consider a principles-based approach ought to be used to determine whether a crypto-asset is capable of being an appropriate underlying asset for an ETP to support the fair, orderly and transparent operation of a licensed financial market. In proposal B1, we have set out our views on the factors that ought to be considered in making this determination. Further information in relation to some of these factors is set out below.
- 29 *Mature spot market*—This should involve a holistic assessment of the state of the spot market for the crypto-asset, considering factors such as:
- (a) the value and frequency of trading activity across platforms;
  - (b) the level of trading fees and bid–offer spreads;

- (c) the diversity of buyers and sellers;
- (d) the extent to which trading activity takes place on platforms that have policies and procedures to promote fair, orderly and transparent trading activity and address manipulation and other market integrity risks; and
- (e) the effectiveness of arbitrage activity and consistency of pricing across major platforms.

30 *Regulated futures market*—The standard of regulation should be that of a licensed derivatives market, which is required to maintain a fair, orderly and transparent market, or equivalent standard in a comparable jurisdiction, for trading in the crypto-asset futures and which is subject to oversight by a financial markets regulator.

31 We propose to work with Australian market licensees to establish these factors as the criteria by which licensees determine whether a given crypto-asset is an appropriate underlying asset for ETPs on their market. This could be included in [INFO 230](#) and/or the market operator rules, procedures or guidance.

32 Under this approach, market operators could determine that a particular crypto-asset is an appropriate underlying asset for ETPs on their market. We would not object to that determination, provided the licensee can demonstrate that the crypto-asset satisfies all of the factors in proposal B1.

33 At this point in time, in our view, the only crypto-assets that are likely to satisfy these factors are bitcoin (BTC) and ether (ETH).

34 The licensee's framework for facilitating crypto-asset ETPs should also address the other issues in this consultation paper. Specifically, we consider it good practice that the market operator assesses whether the ETP's custody solution is consistent with proposal C1 and that its risk management system is consistent with proposal C2 as part of the admission process, and that these are ongoing requirements of quotation.

### **Permissible underlying assets**

35 An important aspect of an Australian market licensee's framework is how assets are categorised with respect to its permissible underlying asset rules. While permissible underlying asset rules are specific to each market, they generally provide that the underlying assets of an ETP must comprise of securities, derivatives, debentures, bonds, currencies, or commodities that can be reliably priced.

36 In our view, a new category of permissible assets is warranted to adequately capture the unique characteristics of crypto-assets. In this respect, we note:

- (a) crypto-assets are categorised differently for different purposes and there is no consensus internationally or among industry on how certain crypto-asset ought to be categorised;

- (b) crypto-assets can evolve in how they are structured and used over time so any categorisation at a point in time could change in the future; and
- (c) to the extent these categories overlap with types of assets set out in the Corporations Act, any categorisation by Australian market licensees could influence how these assets ought to be considered for the purposes of the Corporations Act before a policy decision by Government.

37 Accordingly, we consider that the establishment of a new category of permissible underlying asset for appropriate crypto-assets is the most appropriate way to facilitate ETPs that invest in these assets, for example, by way of an ‘eligible crypto-asset’ category. This category could be defined by reference to the factors above, or it could set out the specific crypto-assets which satisfy the factors.

38 We expect this would require market operators to change their operating rules and we propose to work with Australian market licensees to establish the precise parameters of the category.

## Robust and transparent pricing mechanisms

### Proposal

**B3** For crypto-assets, we propose the following good practices in relation to demonstrating a robust and transparent pricing mechanism:

- (a) The basis of the pricing mechanism for crypto-assets held by an ETP should be an index published by a widely regarded provider that:
  - (i) reflects a substantial proportion of trading activity in the relevant pair(s), in a representative and unbiased manner;
  - (ii) is designed to be resistant to manipulation;
  - (iii) complies with recognised index selection principles such as the International Organization of Securities Commission (IOSCO) Principles for financial benchmarks, the EU Benchmarks Regulation, or other internationally recognised index selection principles; and
- (b) Pricing mechanisms which rely on a single crypto-asset spot market would be unable to achieve robust and transparent pricing.

#### *Your feedback*

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?

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

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

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.

## Rationale

39 As set out in [INFO 230](#), the underlying assets of an ETP are expected to have robust and transparent pricing mechanisms. This supports market liquidity and gives retail investors confidence that they can transact in the ETP units at a price at, or closely resembling, the NAV of the underlying investment portfolio.

40 There are unique challenges when pricing crypto-assets:

- (a) Crypto-assets trade on numerous trading platforms around the world simultaneously and continuously; they trade in multiple trading pairs with other crypto-assets or fiat currency; and prices may diverge across these markets and trading pairs.
- (b) Market quality is also an issue as crypto-asset trading platforms are generally not required to have rules and practices to maintain fair, orderly and transparent markets, such as pre- and post-trade transparency rules and market surveillance systems. Trading on these markets is generally not subject to oversight by a financial markets regulator.

Note: We understand that, in a limited number of jurisdictions, crypto-asset trading platforms are required to have rules and practices to detect, prevent and respond to fraud or manipulation. We are also aware that some crypto-asset trading platforms have chosen to implement such rules and practices of their own accord. However, we are not aware of any jurisdiction where these requirements or implementations are to the same standard, and subject to the same regulatory oversight, as a licensed financial market in that jurisdiction.

- (c) These two factors, combined with the fact that it can be difficult to value crypto-assets based on fundamentals that are commonly applied to other types of investment assets, mean that crypto-asset trading platforms are more susceptible to price manipulation risk than most other markets.

41 A significant amount of research has been conducted on the relative contribution of different crypto-asset trading platforms to the price formation process. While no consensus has been established, most studies find that price discovery is led by unregulated futures, perpetual swap and spot markets for crypto-assets, rather than regulated futures markets. Many studies find that platforms with higher trading activity have a larger

contribution to price discovery. Most of the research in this area examines data prior to the large increase in bitcoin futures trading activity on the CME market in late 2020, so it is plausible that this regulated trading venue now has a larger contribution to bitcoin price discovery. Nevertheless, we are still concerned that if price discovery mainly occurs on unregulated markets, the price formation process is likely to be less resistant to manipulation.

- 42 Additionally, research examining statistical anomalies in trading activity has identified evidence of market integrity concerns in crypto-asset trading platforms, including manipulation. The most common type of manipulation identified is wash trading, whereby trades that do not reflect genuine buying and selling activity occur between related entities to inflate the reported trading volumes on a particular venue. Although estimates about its prevalence vary widely, studies have found that this conduct is more prevalent on less established exchanges, as well as those with lower levels of self-regulation, compliance and transparency. Studies also identify ‘pump and dump’ activity in crypto-asset trading platforms, whereby market prices are boosted using false or misleading information to enable perpetrators to sell their holdings at inflated prices. These market integrity concerns highlight the importance of developing a robust and transparent pricing mechanism for crypto-assets which is resistant to these issues.

Note: References for the research considered above are set out in the Appendix.

- 43 We note that the pricing mechanisms for crypto-assets may not be as robust and transparent as pricing mechanisms for existing permissible underlying assets for ETPs such as securities and derivatives. Nevertheless, we consider that a pricing mechanism for crypto-assets that is sufficiently robust and transparent to meet the expectations set out in [INFO 230](#) could be demonstrated by using an appropriate index to strike a daily NAV price, and provide an intraday indicative net asset value (iNAV) where a product issuer decides to make this available.

- 44 The product issuer should be satisfied that the index is calculated by reference to constituent crypto-asset trading platforms that reflect a substantial proportion of trading activity in the relevant pair(s) in a representative and unbiased manner. The issuer should be satisfied that the index methodology sets out a robust framework for selecting constituent crypto-asset trading platforms, and that the index provider reviews their list of constituent crypto-asset trading platforms on a regular basis.

Note: Relevant pair means the crypto-asset versus fiat currency pair that is relevant to the ETP, for example BTC-USD or ETH-AUD.

- 45 The issuer should be satisfied that the index is designed in a way that is resistant to manipulation. This should be demonstrated both in the way constituent crypto-asset trading platforms are selected and retained, and in the way the index is calculated.



- 46 The issuer should also be satisfied that the index is published by a widely regarded benchmark provider and complies with recognised index selection principles such as the IOSCO Principles for financial benchmarks, the EU Benchmarks Regulation or other internationally recognised index selection principles, as noted in INFO 230. ‘Widely regarded’ should be understood in the same manner it is currently used in market operator regulatory frameworks.
- 47 We do not consider that pricing mechanisms which rely on a single crypto-asset spot market would generally meet an appropriate standard for a robust and transparent pricing mechanism for crypto-assets. This is because:
- (a) the pricing mechanism would be subject to a greater level of operational risk and would not be able to function if the relevant crypto-asset spot market were to cease operating, either temporarily or permanently;
  - (b) the pricing mechanism would be less resistant to manipulation; and
  - (c) the pricing generated by the mechanism would be reflective of trading in the crypto-asset on that single crypto-asset spot market, rather than of the crypto-asset generally.
- 48 We are conscious there are pricing mechanisms used by existing ETPs which rely on a single spot market. We consider those can be distinguished from a crypto-asset spot market because those markets are regulated financial markets that are subject to significant regulatory oversight and monitoring to promote fair, orderly and transparent markets.

## No other INFO-230-related guidance

### Proposal

- B4** We propose not to include any further expectations in INFO 230 in relation to crypto-asset ETPs.

#### *Your feedback*

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

### Rationale

- 49 [INFO 230](#) sets out our good practices for the admission and monitoring standards of ETPs. Aside from confirming that certain crypto-assets may be capable of being appropriate underlying assets for an ETP, and providing good practice information on how a robust and transparent pricing mechanism can be demonstrated, we do not consider that any other clarifications or modifications to INFO 230 are necessary to accommodate crypto-asset ETPs.

## C Responsible entity obligations

### Key points

We regulate responsible entities and managed investment schemes under Ch 5C of the Corporations Act. Responsible entities (REs) play a crucial role in ensuring the health of, and confidence in, the financial system. They are entrusted with the funds of their investors and must comply with their legal obligations as REs, including to act in the best interests of members of the scheme.

There are certain key matters that REs must consider when investing the funds of their investors into crypto-assets, particularly in relation to custody, risk management and disclosure. REs must also consider their obligations under the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (DDO obligations), particularly in creating a target market determination (TMD) and taking reasonable steps that will or are reasonably likely to result in distribution being consistent with this TMD.

We are seeking feedback on proposed good practices for REs about how they can meet certain existing obligations when investing in, or providing exposure to, crypto-assets.

This section applies to any investment product that is operated by a responsible entity, including certain ETPs, LITs and unlisted registered managed investment schemes.

### Custody

- 50 There are several obligations that apply to REs in relation to custody of the crypto-asset schemes:
- (a) REs must comply with [Regulatory Guide 133](#) *Fund management and custodial services: Holding assets* (RG 133) and [Class Order \[CO 13/1409\]](#) *Holding assets: Standards for responsible entities*. The ‘scheme property’ includes underlying crypto-assets held by the scheme.
  - (b) Asset holders need to comply with financial requirements set out in [Regulatory Guide 166](#) *Licensing: Financial requirements* and [Class Order \[CO 13/760\]](#) *Financial requirements for responsible entities and operators of investor directed services*. Generally, this will mean that the RE, or its custodian engaged to hold the scheme property, will be required to hold minimum net tangible assets of \$10 million.

51 We consider that the unique characteristics of crypto-assets mean that specialised infrastructure and expertise is required by custodians to hold crypto-assets in safe and secure custody, and we propose to set out good practices in relation to the custody of crypto-assets. We recognise that custody offerings continue to evolve in line with developments in technology and changes in risks.

### Proposal

- c1** We propose the following good practices for REs in relation to the custody of crypto-assets:
- (a) The chosen custodian has specialist expertise and infrastructure relating to crypto-asset custody.
  - (b) The crypto-assets are segregated on the blockchain. This means that unique public and private key(s) are maintained on behalf of the RE so that the scheme assets are not intermingled with other crypto-asset holdings.
  - (c) The private keys used to access the scheme's crypto-assets are generated and stored in a way that minimises the risk of unauthorised access. For example:
    - (i) solutions that hold private keys in hardware devices that are physically isolated with no connection to the internet (cold storage) are preferred. Private keys should not be held on internet-connected systems or networked hardware (hot storage) beyond what is strictly necessary for the operation of the product; and
    - (ii) the hardware devices used to hold private keys should be subject to robust physical security practices.
  - (d) Multi-signature or sharding-based signing approaches are used, rather than 'single private key' approaches.
  - (e) Custodians have robust systems and practices for the receipt, validation, review, reporting and execution of instructions from the RE.
  - (f) REs and custodians have robust cyber and physical security practices with respect to their operations, including appropriate internal governance and controls, risk management and business continuity practices.
  - (g) The systems and organisational controls of the custodian are independently verified to an appropriate standard—for example, through a SOC 2 Type II or equivalent report.
  - (h) REs and custodians have an appropriate compensation system in place in the event a crypto-asset held in custody for REs is lost.
  - (i) If an external or sub-custodian is used, REs should have the appropriate competencies to assess the custodian's compliance with RG 133.

*Your feedback*

- 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.
- C1Q2 Are there any practical problems associated with this approach? If so, please provide details.
- C1Q3 Do you consider there should be any modifications to the set of good practices? Please provide details.
- C1Q4 Do you consider that crypto-assets can be held in custody, safely and securely? Please provide your reasons.
- 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.
- 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.

**Rationale**

- 52 The custody—or safekeeping—of assets is a critical function. Without appropriate safeguards by the asset holder, which can be a responsible entity or separate custodian, there is a potential threat to client assets. Custody can also involve complex functions, such as pricing and reporting. Adequate resources and an appropriate risk management framework are therefore necessary for asset holders to ensure that their safekeeping of assets and related functions are satisfactorily performed.
- 53 The existing obligations that apply to responsible entities are set out above. However, we consider that additional safeguards are appropriate in the context of schemes which hold crypto-assets and we propose to set these out as good practices for REs.
- 54 The security of private keys is of critical importance. Private keys are necessary to sign transactions that assign crypto-assets to new addresses. If private keys are compromised, unauthorised parties can use them to transfer the scheme's crypto-assets to addresses (and parties) that are outside the control of the RE.
- 55 Accordingly, custodians should ensure that the private keys used by the scheme are protected from unauthorised access—both online and offline.
- 56 With respect to transaction signing, we consider that multi-signature or sharding-based signing approaches should be preferred to 'single private key' approaches. In a multi-signature approach, there is a set of distinct,

independent private keys in existence, as opposed to one single private key. A certain quorum of keys out of the total set is required to sign a given transaction. This approach helps avoid a single point of failure and makes it substantially more difficult for the assets of the scheme to be compromised by theft or fraudulent activity.

- 57 *Sharding* is an alternative approach by which a single private key is split into multiple pieces and some subset of the pieces is recombined to recover and use the key to sign a transaction. While sharding has similarities with multi-signature, a key difference is that a single point of failure still exists at certain points in the process—a single private key exists on a single device at creation and it is reconstructed onto a single device to sign transactions. However, we recognise that sharding may have other benefits, including scalability and flexibility, so it is a matter for the RE to determine which approach is in the best interests of the members of the scheme.
- 58 With respect to the receipt, validation, review and execution of customer instructions, these processes should include appropriate permissioning so that no one party has control of the entire process. If the structure of the product is such that it only needs to interact with a pre-defined set of addresses—for example, particular dealers, markets or authorised participants—the custodian should consider a *whitelist* approach, so that transfers can only be made to those pre-defined addresses.
- 59 In respect of compensation systems, we consider this could take a variety of forms (such as insurance, an asset protection plan or compensation fund). The RE should be satisfied that a custodian’s compensation system is appropriate and in the best interest of the members of the scheme.

## Risk management

- 60 There are a number of obligations that apply to an Australian financial services (AFS) licensee and additionally to an RE under the Corporations Act. Relevantly, under s912A(1)(a) of the Corporations Act, an AFS licensee is required to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly. Further, under s912A(1)(h), an AFS licensee is required to have adequate risk management systems. We have published guidance on how REs may comply with this obligation in [Regulatory Guide 259](#) *Risk management systems of responsible entities* (RG 259).
- 61 We consider the unique characteristics and risks of crypto-assets must be recognised in the provision of financial services and the risk management system of an RE, and we propose good practices in relation to this.

## Proposal

- C2** We propose the following good practices in relation to the risk management systems of REs that hold crypto-assets:
- (a) If the RE undertakes trading activity in crypto-assets, it should do so on legally compliant and regulated crypto-asset trading platforms. For this proposal, we consider an appropriate baseline level of regulation to be know your customer (KYC) and anti-money laundering and counter-terrorism financing (AML/CTF) obligations.
  - (b) The RE should ensure that authorised participants, market makers and other service providers that trade crypto-assets in connection with the product do so on crypto-asset trading platforms that meet the same standard as in proposal C2(a).
  - (c) The RE is responsible for ensuring its risk management systems appropriately manage all other risks posed by crypto-assets.

### *Your feedback*

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

## Rationale

- 62 Crypto-asset trading platforms are distributed around the world and vary greatly in terms of how they operate and how they comply with regulatory obligations that may apply to them in relevant jurisdictions.
- 63 We are not yet aware of any crypto-asset trading platform that is subject to the same level of regulatory oversight as a licensed financial market in its jurisdiction. We are, however, aware that most crypto-asset trading platforms, as service providers, are subject to applicable KYC and AML/CTF obligations and there may be varying degrees of compliance with

these obligations. Depending on the nature of the crypto-assets traded on the platforms they may be subject to other regulatory requirements as well.

Note: The Australian Transaction Reports and Analysis Centre (AUSTRAC) is the Australian Government agency responsible for ensuring compliance with Australia's AML/CTF laws. Crypto-asset trading platforms that are *digital currency exchange providers* are required to be registered with AUSTRAC.

- 64 ASIC considers that REs should have systems in place to ensure that any crypto-asset trading activity they engage in takes place on legally compliant and regulated crypto-asset trading platforms. REs should ensure that service providers who are involved with the product and may be trading crypto-assets, such as authorised participants and market makers, also meet this standard.
- 65 At a minimum, we consider this should involve ensuring that any crypto-asset trading activity undertaken in connection to the fund is done on crypto-asset trading platforms that:
- (a) are based in jurisdictions with KYC and AML/CTF laws; and
  - (b) comply with those obligations.
- 66 These obligations play a key role in being able to identify traders of crypto-assets and aim to reduce the risk of crypto-assets being used to support criminal activity.
- 67 As noted in paragraph 42, market integrity issues are more prevalent on crypto-asset markets with lower levels of regulation, compliance and transparency.
- 68 While this section is focused on trading on crypto-asset trading platforms, we note the RE is responsible for ensuring its risk management systems appropriately manage all other risks posed by crypto-assets.

## Disclosure

- 69 Part 7.9 of the Corporations Act sets out the obligations that apply to an RE, as issuer of a product disclosure statement (PDS). Further guidance about disclosure is set out in [Regulatory Guide 168](#) *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (RG 168) and issuers should have regard to the 'Good Disclosure Principles' outlined in Section C of RG 168.
- 70 Relevantly, s1013D of the Corporations Act requires that a PDS must include information—about any significant risks associated with holding the product—that a retail client would reasonably require to make a decision whether to buy the financial product.

- 71 We consider the unique characteristics and risks of crypto-assets must be reflected in the disclosure documents of investment products, and we propose the following good practices in identifying areas that the RE should consider in the context of their disclosure obligations.

### Proposal

- c3** We propose the following good practices regarding the RE's disclosure obligations in relation to a PDS for a registered managed investment scheme that holds crypto-assets:
- (a) The RE should consider disclosing information about the unique characteristics of crypto-assets. This may include:
    - (i) the technologies that underpin crypto-assets, such as blockchains, distributed ledger technology, cryptography and others;
    - (ii) how crypto-assets are created, transferred and destroyed;
    - (iii) how crypto-assets are valued and traded; and
    - (iv) how crypto-assets are held in custody.
  - (b) The RE should consider providing appropriate disclosure of the following and other risks:
    - (i) market risk—historically, crypto-assets have demonstrated that their investment performance can be highly volatile and there is a risk that they could have little to no value in the future;
    - (ii) pricing risk—it may be difficult to value crypto-assets accurately and reliably given the nature of their trading and difficulty in identifying fundamentals;
    - (iii) immutability—most crypto-assets are built on immutable blockchains, meaning that an incorrect or unauthorised transfer cannot be reversed and can only be undone by the recipient agreeing to return the crypto-assets in a separate transaction;
    - (iv) increased regulation risk—both crypto-assets and their spot markets are largely unregulated at this moment. This may change in the future;
    - (v) custody risk—the private keys may be lost or compromised, resulting in crypto-assets being inaccessible or accessed by unknown third parties without authorisation;
    - (vi) cyber risk—the nature of crypto-assets may mean they are more susceptible to cyber risks; and
    - (vii) environmental risk—crypto-assets, especially those based on proof-of-work consensus mechanisms, by design require significant amounts of energy to operate.



*Your feedback*

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

**Rationale**

- 72 A PDS must contain sufficient information so that a retail client may make an informed decision about whether to purchase a financial product.
- 73 In the context of investment products that invest in, or provide exposure to, certain crypto-assets, we consider there must be sufficient information about the characteristics and risks of those crypto-assets in the PDS. There must also be sufficient information about how the product involving crypto-assets is intended to operate and how it is expected to generate a return for investors.
- 74 We do not propose to mandate certain disclosures or provide examples of 'correct' disclosure with respect to crypto-assets. Instead, the purpose of the proposed good practices is to highlight certain areas which REs should consider in the context of their disclosure obligations.
- 75 The list is not exhaustive and REs must determine what is appropriate disclosure in the context of the characteristics and operations of their product.

**Design and distribution obligations****Proposal**

- c4 We propose not to issue any additional expectations about how the design and distribution obligations (DDO) can be met for investment products that invest in, or provide exposure to, crypto-assets.

*Your feedback*

- 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?

- 76 The DDO in Pt 7.8A of the Corporations Act are intended to help consumers obtain appropriate financial products by requiring issuers and distributors to have a consumer-centric approach to designing and distributing products. Specifically, under s994B, an issuer must prepare a TMD for the financial product. Each TMD must comply with the content requirements of s994B(5). This includes describing the target market for the product (s994B(5)(b)) and specifying any distribution conditions and restrictions on distribution (s994B(5)(c)).
- 77 The TMD must also meet the appropriateness requirements in s994B(8) such that it would be reasonable to conclude that, if the product were issued:
- (a) to a consumer in keeping with the distribution conditions, it would be likely that the consumer is in the target market; and
  - (b) to a consumer in the target market, it would likely be consistent with the likely objectives, financial situation and needs of the consumer.
- 78 We have provided guidance to issuers and distributors generally in [Regulatory Guide 274: Product design and distribution obligations \(RG 274\)](#).
- 79 The Corporations Regulations 2001 clarify that an issuer of an ETP is required to make a TMD, whether or not the product uses internal market making or external market making: see RG 274.256 to RG 274.263. However, we have issued [ASIC Corporations \(Design and Distribution Obligations—Exchange Traded Products\) Instrument 2020/1090](#) to:
- (a) clarify that an issuer is not required to cease on-market distribution where a TMD is no longer appropriate;
  - (b) provide that distributors are only required to comply with the obligation to keep records of complaint information and information that an issuer specifies in the TMD and report this to the issuer.
- 80 Issuers and distributors of crypto-asset-related investment products will need to comply with the DDO from 5 October 2021. We expect issuers to carefully consider the DDO regime when designing new crypto-asset-related products.
- 81 We do not propose to issue any further guidance about how the DDO can be met for investment products that invest in, or provide exposure to, crypto-assets. We consider that existing guidance is suitable and applicable.

## D Listed investment entities

### Key points

Listed investment entities are closed-ended investment vehicles which are listed on licensed financial markets and available to retail investors.

Listed investment entities can be listed investment trusts (LITs), which are regulated as registered managed investment schemes by ASIC, or listed investment companies (LICs), which are regulated as public companies by ASIC.

We are seeking feedback on the proposal that if listed investment entities invest in crypto-assets, they should be subject to minimum admission criteria overseen by market operators that are equivalent to those proposed for ETPs in Sections B and C. This will help to ensure the fair, orderly and transparent operation of Australian financial markets and to minimise opportunities for regulatory arbitrage through the choice of investment vehicle used to offer investors exposure to crypto-assets.

This section discusses good practices for market operators to implement as part of their oversight of LICs and LITs.

## Settings for investment entities

### Proposal

- D1 We propose to work with market operators to establish that:
- (a) the approach used to determine and classify appropriate crypto-assets for investment entities is the same as that set out in Section B for ETPs;
  - (b) in respect of the admission process, to be considered to have a structure and operations that are appropriate for a listed entity, a LIC that invests a material amount in crypto-assets is expected to:
    - (i) have a custody solution for its crypto-assets that is consistent with the expectations for custody set out in proposal C1;
    - (ii) ensure it only trades crypto-assets on crypto-asset markets that are regulated in a manner consistent with proposal C2; and
    - (iii) value crypto-assets held by the LIC using an approach that is consistent with expectations for pricing set out in proposal B3;
  - (c) in respect of the admission process, to be considered to have a structure and operations that are appropriate for a listed entity, a LIT that invests a material amount in crypto-assets should value crypto-assets held by the LIT using an approach that is consistent with expectations for pricing set out in proposal B3; and

- (d) the expectations for the admission of LICs and LITs set out in subparagraphs (b) and (c) above should also be ongoing requirements of listing (e.g. they should be imposed as a condition of listing).

Note: Listed investment entities must also provide adequate disclosure at the time of listing (see paragraphs 69–75) and will be subject to DDO (see paragraphs 76–81).

#### *Your feedback*

- D1Q1 Do you agree that crypto-assets are capable of being appropriate assets for listed investment entities on Australian markets? If not, why not?
- 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?
- D1Q3 Are there any practical problems associated with this approach? If so, please provide details.
- 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?
- 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?
- 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?

## Rationale

### Background

- 82 LICs and LITs are closed-ended investment vehicles that provide investors with exposure to a range of investment strategies and assets. A LIC or LIT is admitted to a market's official list if the entity meets certain minimum admission criteria. This includes consideration of whether the entity has a structure and operations that are appropriate for a listed entity. These minimum admission criteria safeguard the reputation and integrity of the market, and the market licensee may choose to impose conditions on the entity's admission.

Note: For example, ASX Listing Rule 1.1, condition 1 requires the entity to have a structure and operations that are appropriate for a listed entity.

- 83 Once admitted to the market's official list, the entity must comply with the listing rules, including some rules specific to listed investment entities, such

as the requirement to report net tangible assets (NTA) within 14 days of the month end. LICs and LITs are also subject to statutory financial reporting requirements under Ch 2M of the Corporations Act and continuous disclosure obligations under s674. The entity's other statutory duties depend on its legal structure:

- (a) LICs are public companies incorporated under the Corporations Act and are subject to the law relating to such companies, including Ch 2D (directors' duties). The LIC will appoint an investment manager with an AFS licence but does not generally have its own AFS licence.
- (b) LITs are managed investment schemes registered under Ch 5C of the Corporations Act with a responsible entity that has an AFS licence. LITs are therefore subject to the requirements set out in Section C.

### **Minimum standards for LICs and LITs that invest in crypto-assets**

- 84 To date, LICs and LITs have not been able to invest significant funds directly in crypto-assets. However, LICs and LITs could be seen as another way of providing investors with exposure to crypto-assets.
- 85 We consider that LICs and LITs should only be able to invest in crypto-assets that meet the factors set out in proposal B1. We propose to work with market operators to ensure that the framework for determining permissible crypto-assets for listed investment entities is consistent with the framework for determining permissible underlying crypto-assets for ETPs, as set out in Section B.
- 86 We also consider that minimum standards as to pricing, risk management and custody should apply regardless of an entity's legal structure to prevent regulatory arbitrage and foster a level playing field for competition between different types of investment entities—for example, ETPs that invest in crypto-assets should not be at a competitive disadvantage to LICs.
- 87 The following proposed minimum standards are consistent with, or complement, existing requirements:
- (a) responsible entities of LITs would be required to comply with the expectations set out in Section C;
  - (b) the directors of a LIC need to ensure they act in shareholders' best interests with important issues like the safekeeping of assets;
  - (c) reliable pricing and valuation of crypto-assets are also important for investment entities' NTA and statutory financial reporting obligations;
  - (d) all products, regardless of legal structure, should ensure that any crypto-asset trading is done on crypto-asset markets that are regulated to an appropriate level; and
  - (e) the matters in proposal C3 regarding effective PDS disclosure are also relevant to prospectus disclosure under s710 of the Corporations Act.

88 We propose to work with market licensees to ensure the relevant minimum standards proposed in Sections B and C are imposed under the market's listing rules, procedures and/or guidance if an investment entity invests material amounts in crypto-assets.

Note: We consider a material investment is where an entity invests or plans to invest more than 5% of its funds in crypto-assets.

89 We consider these minimum standards reflect the structure and operations that are appropriate for listed entities that invest in crypto-assets and should be imposed as an ongoing condition of the entity's admission.

#### **Changing an investment mandate to extend to crypto-assets**

90 LICs and LITs explain their investment mandate and the potential risks to investors in their listing disclosure document. This allows investors to assess the entity's prospects and the extent to which the investor's funds are at risk. It is also important for the market licensee's assessment of the entity's suitability for listing.

91 Existing LICs and LITs are unlikely to have an investment mandate that clearly extends to crypto-assets. An investment in crypto-assets is a fundamentally different proposition to more traditional investments. We consider that investment entities should seek member approval with sufficient disclosure before investing in crypto-assets.

92 Market licensees may also consider that the entity should re-comply with the admission requirements on the basis that crypto-asset investment constitutes a significant change to the entity's activities.

## E AFS licensing

### Key points

When applying for a new AFS licence, or a variation to an existing AFS licence, to operate a registered managed investment scheme the applicant is required to select what kind(s) of assets the scheme will hold. Scheme assets do not have to be financial products.

We consider that crypto-assets do not fall within any existing asset kind that can be selected by an applicant.

We are seeking feedback on proposals to establish a new asset kind that will cover crypto-assets.

This section is relevant to registered managed investment schemes and will therefore affect certain ETPs, LITs and unlisted registered managed investment schemes.

### New asset kind

#### Proposal

- E1** We propose to establish a new asset kind that can be selected when applying for a new AFS licence, or a variation to an existing AFS licence, to operate a registered managed investment scheme which holds a particular kind of asset. This asset kind will cover crypto-assets.

#### *Your feedback*

- E1Q1** Do you agree with our proposal to establish a new asset kind that will cover crypto-assets?
- E1Q2** Do you consider that crypto-assets may be captured by the existing asset kinds? If so, please explain.

- E2** When granting an AFS licensee's authorisation to operate a registered managed investment scheme which holds crypto-assets, we will restrict the crypto-assets the registered managed investment scheme can hold by reference to the factors set out in proposal B1. Accordingly, at this point in time, we consider that such authorisations could only be given to operate registered managed investment schemes that hold bitcoin or ether.

#### *Your feedback*

- 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)?

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?

## Rationale

- 93 A person who carries on a financial services business in Australia must hold an AFS licence covering the provision of the financial services or be exempt: s911A. We are responsible for administering the AFS licensing requirements under the Corporations Act. When applying for or varying an AFS licence to operate a registered managed investment scheme, the applicant is required to select what kind(s) of assets the scheme will hold. [Regulatory Guide 2 AFS Licensing Kit: Part 2—Preparing your AFS licence or variation application \(RG 2\)](#) provides guidance in this area, including describing the existing asset kinds that an applicant can select.
- 94 In our view, crypto-assets do not fall within any existing asset kind that can be selected by an applicant. Accordingly, a registered managed investment scheme cannot currently be authorised to directly hold crypto-assets.
- 95 We propose to establish a new asset kind that will cover crypto-assets so entities with the appropriate authorisation can hold these assets directly.
- 96 We consider a new asset kind is required given the unique features and characteristics of crypto-assets such as bitcoin and ether. We do not consider it appropriate to modify any existing asset kind to include these assets.
- 97 For reference, a possible formulation of this asset kind set out in a form that is consistent with how asset kinds are set out at RG 2.89 could be:
- Crypto-asset scheme—this covers schemes that hold *crypto-assets*.
- 98 We intend to define crypto-asset broadly for the purposes of this asset kind. However, the description used in this consultation paper should only be taken as an indication of a possible approach. As set out at paragraph 8, our working understanding of crypto-assets may evolve over time and we may craft a different description of crypto-assets as needed in performing our legislative functions in line with government policy at that time.
- 99 While this asset kind will be defined broadly, we also propose to restrict the AFS licence authorisations to operate a ‘crypto-asset scheme’ to specified crypto-assets. This is because we recognise that crypto-assets vary greatly in their features, characteristics, and how they operate. As such, we consider that only some may be appropriate to be held by a registered managed investment scheme.



- 100 The factors we propose to use in assessing whether a crypto-asset is appropriate to be held by a registered managed investment scheme are the same factors we have set out in proposal B1.
- 101 As set out in Section B, we consider that bitcoin and ether are the only crypto-assets that could satisfy these factors at this point in time. Accordingly, we consider that authorisations could only be given to operate registered managed investment schemes that hold bitcoin and ether at this time.
- 102 Over time, when we consider it is appropriate, we may allow other crypto-assets that meet the factors in Section B to be specified.

## F Regulatory and financial impact

103 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

- (a) innovation; and
- (b) investor protection and maintaining fair, orderly and transparent markets.

104 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

- (a) considering all feasible options, including examining the likely impacts of the range of alternative options that could meet our policy objectives;
- (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
- (c) if our proposed option has more than a minor or machinery impact on business or on the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

105 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.

106 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:

- (a) the likely compliance costs;
- (b) the likely effect on competition; and
- (c) other impacts, costs and benefits.

See 'The consultation process', p. 4.

## Appendix—Research references

107 References for the research considered at paragraphs 41 and 42 are set out below.

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## Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services  Note: This is a definition contained in s761A of the Corporations Act.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act  Note: This is a definition contained in s761A.
AML/CTF laws	Anti-money laundering and counter-terrorism financing laws
ASIC	Australian Securities and Investments Commission
ASIC Act	<i>Australian Securities and Investments Commission Act 2001</i> , including regulations made for the purposes of that Act
AUSTRAC	Australian Transaction Reports and Analysis Centre
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
bitcoin	The unit of account of Bitcoin
Bitcoin	The network of computers running the software protocol governs the creation of bitcoin and the cryptographic operations that verify and secure bitcoin transactions
Ch 5C	A chapter of the Corporations Act (in this example numbered 5C), unless otherwise specified
[CO 13/1409] (for example)	An ASIC class order (in this example numbered 13/1409)
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of the Act
crypto-asset	A digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof
crypto-asset ETP	An ETP that invests in, or provides exposure to, crypto-assets
DDO (design and distribution obligations)	The obligations contained in Pt 7.8A of the Corporations Act

<b>Term</b>	<b>Meaning in this document</b>
ETC	Exchange traded commodities
ETF	Exchange traded fund
ether	The unit of account of Ethereum
Ethereum	The network of computers running the software protocol that governs the creation of ether and the cryptographic operations that verify and secure ether transactions
ETN	Exchange traded note
ETP	Exchange traded product
iNAV	Indicative net asset value
INFO 230 (for example)	An ASIC information sheet (in this example numbered 230)
IOSCO	International Organization of Securities Commissions
LIC	A listed investment company
LIT	A listed investment trust
managed investment scheme	Has the meaning given in s9 of the Corporations Act
market licensee	The holder of an Australian market licence Note: This is a definition contained in s761A of the Corporations Act.
NAV	Net asset value
NTA	Net tangible assets
PDS	Product disclosure statement
Pt 7.8A (for example)	A part of the Corporations Act (in this example numbered 7.8A), unless otherwise specified
RE	Responsible entity
RG 257 (for example)	An ASIC regulatory guide (in this example numbered 257)
s1013D	A section of the Corporations Act (in this example numbered 1013D)
SOC Report	A system and organisation controls audit report. There are various categories and types of SOC report. They generally serve to assesses the internal control environment of a service provider
TMD	Means a target market determination document

## List of proposals and questions

Proposal	Your feedback
<p>B1 We propose to work with Australian market licensees to establish the following factors as the basis to identify particular crypto-assets that may be appropriate underlying assets for an ETP:</p> <ul style="list-style-type: none"> <li>(a) a high level of institutional support and acceptance of the crypto-asset being used for investment purposes;</li> <li>(b) the availability and willingness of service providers (including custodians, fund administrators, market makers and index providers) to support ETPs that invest in, or provide exposure to, the crypto-asset;</li> <li>(c) a mature spot market for the crypto-asset;</li> <li>(d) a regulated futures market for trading derivatives linked to the crypto-asset; and</li> <li>(e) the availability of robust and transparent pricing mechanisms for the crypto-asset, both throughout the trading day and to strike a daily net asset valuation (NAV) price.</li> </ul>	<p>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.</p> <p>B1Q2 Do you consider that crypto-asset ETPs should be cleared and settled through licensed Australian clearing and settlement facilities? Please provide details.</p> <p>B1Q3 If you are a clearing participant, would you be willing to clear crypto-asset ETPs? Please provide your reasons.</p> <p>B1Q4 If you are a trading participant, would you be willing to trade crypto-asset ETPs? Please provide your reasons.</p> <p>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?</p> <p>B1Q6 Do you have any suggestions for additions or modifications to the factors in proposal B1? Please provide details.</p> <p>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.</p>
<p>B2 We propose to work with Australian market licensees to establish a new category of permissible underlying asset for crypto-assets in their regulatory frameworks that, at a minimum, is consistent with the factors set out in proposal B1.</p>	<p>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?</p>

Proposal	Your feedback
<p>B3 For crypto-assets, we propose the following good practices in relation to demonstrating a robust and transparent pricing mechanism:</p> <p>(a) The basis of the pricing mechanism for crypto-assets held by an ETP should be an index published by a widely regarded provider that:</p> <p>(i) reflects a substantial proportion of trading activity in the relevant pair(s), in a representative and unbiased manner;</p> <p>(ii) is designed to be resistant to manipulation;</p> <p>(iii) complies with recognised index selection principles such as the International Organization of Securities Commission (IOSCO) Principles for financial benchmarks, the EU Benchmarks Regulation, or other internationally recognised index selection principles; and</p> <p>(b) Pricing mechanisms which rely on a single crypto-asset spot market would be unable to achieve robust and transparent pricing.</p>	<p>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?</p> <p>B3Q2 Are there any practical problems associated with this approach? If so, please provide details.</p> <p>B3Q3 Do you think crypto-assets can be priced to a robust and transparent standard? Please explain your views.</p> <p>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.</p>
<p>B4 We propose not to include any further expectations in INFO 230 in relation to crypto-asset ETPs.</p>	<p>B4Q1 Are there any other good practice expectations in INFO 230 that need to be clarified or modified to accommodate crypto-asset ETPs?</p>



Proposal	Your feedback
<p>C1 We propose the following good practices for REs in relation to the custody of crypto-assets:</p> <ul style="list-style-type: none"> <li>(a) The chosen custodian has specialist expertise and infrastructure relating to crypto-asset custody.</li> <li>(b) The crypto-assets are segregated on the blockchain. This means that unique public and private key(s) are maintained on behalf of the RE so that the scheme assets are not intermingled with other crypto-asset holdings.</li> <li>(c) The private keys used to access the scheme's crypto-assets are generated and stored in a way that minimises the risk of unauthorised access. For example: <ul style="list-style-type: none"> <li>(i) solutions that hold private keys in hardware devices that are physically isolated with no connection to the internet (cold storage) are preferred. Private keys should not be held on internet-connected systems or networked hardware (hot storage) beyond what is strictly necessary for the operation of the product; and</li> <li>(ii) the hardware devices used to hold private keys should be subject to robust physical security practices.</li> </ul> </li> <li>(d) Multi-signature or sharding-based signing approaches are used, rather than 'single private key' approaches.</li> <li>(e) Custodians have robust systems and practices for the receipt, validation, review, reporting and execution of instructions from the RE.</li> <li>(f) REs and custodians have robust cyber and physical security practices with respect to their operations, including appropriate internal governance and controls, risk management and business continuity practices.</li> <li>(g) The systems and organisational controls of the custodian are independently verified to an appropriate standard—for example, through a SOC 2 Type II or equivalent report.</li> </ul>	<p>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.</p> <p>C1Q2 Are there any practical problems associated with this approach? If so, please provide details.</p> <p>C1Q3 Do you consider there should be any modifications to the set of good practices? Please provide details.</p> <p>C1Q4 Do you consider that crypto-assets can be held in custody, safely and securely? Please provide your reasons.</p> <p>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.</p> <p>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.</p>

Proposal	Your feedback
<p>(h) REs and custodians have an appropriate compensation system in place in the event a crypto-asset held in custody for REs is lost.</p> <p>(i) If an external or sub-custodian is used, REs should have the appropriate competencies to assess the custodian's compliance with RG 133.</p>	
<p>C2 We propose the following good practices in relation to the risk management systems of REs that hold crypto-assets:</p> <p>(a) If the RE undertakes trading activity in crypto-assets, it should do so on legally compliant and regulated crypto-asset trading platforms. For this proposal, we consider an appropriate baseline level of regulation to be know your customer (KYC) and anti-money laundering and counter-terrorism financing (AML/CTF) obligations.</p> <p>(b) The RE should ensure that authorised participants, market makers and other service providers that trade crypto-assets in connection with the product do so on crypto-asset trading platforms that meet the same standard as in proposal C2(a).</p> <p>(c) The RE is responsible for ensuring its risk management systems appropriately manage all other risks posed by crypto-assets.</p>	<p>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?</p> <p>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.</p> <p>C2Q3 Are there any practical problems associated with this approach? If so, please provide details.</p> <p>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.</p> <p>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.</p>

Proposal	Your feedback
<p>C3 We propose the following good practices regarding the RE's disclosure obligations in relation to a PDS for a registered managed investment scheme that holds crypto-assets:</p> <p>(a) The RE should consider disclosing information about the unique characteristics of crypto-assets. This may include:</p> <ul style="list-style-type: none"> <li>(i) the technologies that underpin crypto-assets, such as blockchains, distributed ledger technology, cryptography and others;</li> <li>(ii) how crypto-assets are created, transferred and destroyed;</li> <li>(iii) how crypto-assets are valued and traded; and</li> <li>(iv) how crypto-assets are held in custody.</li> </ul> <p>(b) The RE should consider providing appropriate disclosure of the following and other risks:</p> <ul style="list-style-type: none"> <li>(i) market risk—historically, crypto-assets have demonstrated that their investment performance can be highly volatile and there is a risk that they could have little to no value in the future;</li> <li>(ii) pricing risk—it may be difficult to value crypto-assets accurately and reliably given the nature of their trading and difficulty in identifying fundamentals;</li> <li>(iii) immutability—most crypto-assets are built on immutable blockchains, meaning that an incorrect or unauthorised transfer cannot be reversed and can only be undone by the recipient agreeing to return the crypto-assets in a separate transaction;</li> <li>(iv) increased regulation risk—both crypto-assets and their spot markets are largely unregulated at this moment. This may change in the future;</li> </ul>	<p>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.</p> <p>C3Q2 Are there any practical problems associated with this approach? If so, please provide details.</p> <p>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?</p>

Proposal	Your feedback
<ul style="list-style-type: none"> <li>(v) custody risk—the private keys may be lost or compromised, resulting in crypto-assets being inaccessible or accessed by unknown third parties without authorisation;</li> <li>(vi) cyber risk—the nature of crypto-assets may mean they are more susceptible to cyber risks; and</li> <li>(vii) environmental risk—crypto-assets, especially those based on proof-of-work consensus mechanisms, by design require significant amounts of energy to operate.</li> </ul>	
<p>C4 We propose not to issue any additional expectations about how the design and distribution obligations (DDO) can be met for investment products that invest in, or provide exposure to, crypto-assets.</p>	<p>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?</p>

Proposal	Your feedback
<p>D1 We propose to work with market operators to establish that:</p> <ul style="list-style-type: none"> <li>(a) the approach used to determine and classify appropriate crypto-assets for investment entities is the same as that set out in Section B for ETPs;</li> <li>(b) in respect of the admission process, to be considered to have a structure and operations that are appropriate for a listed entity, a LIC that invests a material amount in crypto-assets is expected to: <ul style="list-style-type: none"> <li>(i) have a custody solution for its crypto-assets that is consistent with the expectations for custody set out in proposal C1;</li> <li>(ii) ensure it only trades crypto-assets on crypto-asset markets that are regulated in a manner consistent with proposal C2; and</li> <li>(iii) value crypto-assets held by the LIC using an approach that is consistent with expectations for pricing set out in proposal B3;</li> </ul> </li> <li>(c) in respect of the admission process, to be considered to have a structure and operations that are appropriate for a listed entity, a LIT that invests a material amount in crypto-assets should value crypto-assets held by the LIT using an approach that is consistent with expectations for pricing set out in proposal B3; and</li> <li>(d) the expectations for the admission of LICs and LITs set out in subparagraphs (b) and (c) above should also be ongoing requirements of listing (e.g. they should be imposed as a condition of listing).</li> </ul> <p>Note: Listed investment entities must also provide adequate disclosure at the time of listing (see paragraphs 69–75) and will be subject to DDO (see paragraphs 76–81).</p>	<p>D1Q1 Do you agree that crypto-assets are capable of being appropriate assets for listed investment entities on Australian markets? If not, why not?</p> <p>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?</p> <p>D1Q3 Are there any practical problems associated with this approach? If so, please provide details.</p> <p>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?</p> <p>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?</p> <p>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?</p>
<p>E1 We propose to establish a new asset kind that can be selected when applying for a new AFS licence, or a variation to an existing AFS licence, to operate a registered managed investment scheme which holds a particular kind of asset. This asset kind will cover crypto-assets.</p>	<p>E1Q1 Do you agree with our proposal to establish a new asset kind that will cover crypto-assets?</p> <p>E1Q2 Do you consider that crypto-assets may be captured by the existing asset kinds? If so, please explain.</p>

Proposal	Your feedback
<p>E2 When granting an AFS licensee's authorisation to operate a registered managed investment scheme which holds crypto-assets, we will restrict the crypto-assets the registered managed investment scheme can hold by reference to the factors set out in proposal B1. Accordingly, at this point in time, we consider that such authorisations could only be given to operate registered managed investment schemes that hold bitcoin or ether.</p>	<p>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)?</p> <p>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?</p>