swyftx

Digital Assets: Financial products and services in Australia

Submission to Consultation Paper 381

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Digital Assets Team
Australian Securities and Investments Commission
GPO Box 9827
Melbourne VIC 3001

By email: digital.assets@asic.gov.au

Dear ASIC

Swyftx's submission to Consultation Paper 381

Introduction

Thank you for the opportunity to provide this submission in response to Consultation Paper 381 Updates to INFO 225: Digital assets: Financial products and services (**Consultation**). Our submission continues a long-running dialogue we have had with Government and its related bodies over the past several years, and we do not take for granted ASIC's willingness to continually engage with our industry and hear our respective voices.[1]

The Australian digital asset industry has rapidly expanded over the last five years in response to increasing demand among Australians. As of our August 2024 YouGov Survey, approximately 3.9 million Australians, or 29% of Australian adults have ever owned cryptocurrency (crypto).[2] It is therefore time for a regulatory framework that both protects Australian digital asset consumers and allows the industry to innovate and contribute to the national economy.

Swyftx has consistently advocated for the sector to be regulated under the existing Australian Financial Services Licence (**AFSL**) framework.[3] Whilst the digital asset trading has similarities and differences to existing traditional equity and OTC trading Infrastructure, we submit that bringing crypto under the AFSL regime supports the principle of regulating based on the nature of a risk rather than the type of institution.

Swyftx is supportive and appreciates the current approach of seeking to provide clarity for the regulatory environment for service providers and consumers. We view the implementation of a regulatory regime as an important opportunity both for market participants and consumers for what is a complex and relatively untested area.

Approach to regulating digital asset platforms

While certain aspects of the Web3 ecosystem are novel and do not align with the existing regulatory framework, the concept of a centralised platform that either holds or does not hold other peoples' assets and facilitates token trading (whether by way of operating an order book exchange or facilitating transactions among multiple exchanges) is consistent with the operating model of many other TradFi businesses.

The mechanics of digital asset trading operate much faster than traditional share trading infrastructure with a common 'T+2' pace. Digital assets are trading globally 24/7 with largely autonomous settlement. The traditional legislation did not anticipate this model of global peer to peer interoperability for tradable financial assets. However, the potential risks to investors are similar, and on the basis of "same activity same risks" we submit that any proposed regulatory regime should provide appropriately similar protections. We strongly

[1] Senate Select Committee on Australia as a Technology and Financial Centre (Submission 21), Treasury's Crypto Asset Secondary Service Providers: Licensing and Custody Requirements Consultation Paper (Swyftx Submission), Treasury's Token Mapping Consultation Paper (Swyftx Submission), and Treasury's Regulating Digital Asset Platforms Proposal Paper (presently unpublished).
[2] Swyftx's YouGov Survey 2024.
[3] See footnote 1.

endorse enhanced rules around governance, custody, capital adequacy and disclosure, and wholeheartedly agree with ASIC on the requirement for appropriate consumer protections.

However, where our views diverge in part is in relation to whether certain digital asset types are financial products under existing laws or not.

Financial products

ASIC has outlined in the Consultation that it considers "many digital assets (whether alone or in combination with other products or services) are financial products under the Corporations Act".[4]

Our view is that digital assets are far from homogenous, with diverse features, rights, and contexts for issuance or acquisition, some of which change over time. Each asset requires a detailed, nuanced case-by-case analysis to determine whether it qualifies as a financial product. This task has significant complexity and the review of the same assets by differing parties may result in varied legal opinions. This lack of consensus underscores the challenge of applying traditional financial laws to the unique nature of digital assets.

The Government, led by Treasury, has recognised these challenges and taken steps to develop a tailored regulatory framework. Treasury's token mapping consultation in 2023 emphasised a functional approach, focusing on the token system rather than the token itself, to determine its regulatory categorisation. In addition, the European Union's Markets in Crypto-Assets Regulation (MiCA) focuses on a broad categorisation of tokens, rather than an individualised approach. These nuanced perspectives contrast with ASIC's proposed approach which appears to be more broad based. Treasury has acknowledged the ambiguity in existing laws and the difficulties faced by the industry, advocating for a more precise and functional framework, focusing on the services provided, rather than the individual digital assets. Treasury acknowledge that digital assets that are financial products will be regulated under existing laws. Considering this in light of ASIC's views that many digital assets are financial products, does it then follow that Treasury's digital asset platforms regime will for the most part be regulating memecoins?

Although the financial product definitions are written into legislation in a broad way, the Federal Court has taken more of a narrow view when looking in the context of digital assets. Specifically:

1. In the Block Earner case, found that although pooling occurred, that pooling was not and did not 'produce financial benefits'[5]; and
2. In the Qoin case, found that the Qoin wallet, but not the Qoin blockchain was a financial product.[6]

In light of this, our view is that the proposed descriptions of digital assets that may be financial products in INFO 225, particularly in relation to the general descriptions of non-cash payment facilities and managed investment schemes, should be narrowed to more closely align with these decisions.

Further, is it truly beneficial and in the best interests of all Australians to have a situation where we are shaping the future of this industry through enforcement and case law? Surely, we are at the precipice of being able to introduce clear and well considered legislation that will significantly reduce uncertainty and costs for all stakeholders.

Differing legal opinions

We are supportive of IOSCO's principle of "same activities, same risks, same regulation/regulatory outcomes" in relation to digital asset regulation.[7] We understand that ASIC are also supportive of this objective.[8]

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[4] CP 381, paragraph 27.

[5] *Australian Securities and Investments Commission v Web3 Ventures Pty Ltd* [2024] FCA 64 [71].

[6] *Australian Securities and Investments Commission v BPS Financial Pty Ltd* [2024] FCA 457 [108].

[7] IOSCO Policy Recommendations for Crypto and Digital Asset Markets (including DeFi), Umbrella Note.

[8] Address by ASIC Commissioner Alan Kirkland at Blockchain APAC's Policy Week, 20 March 2024.

We are concerned that even with the helpful guidance set out in the Consultation that there will remain the high likelihood of differing legal opinions in relation to the financial product categorisation of whether a particular asset, or service, is a financial product. For example, your draft example 2 outlines that your view is the example is likely a facility for making a financial investment, but that it could potentially also be a managed investment scheme. This variability will only broaden where ASIC have not published guidance in relation to a particular type of asset. Our concern stems from the differing legal opinion that may then result in different businesses treating the same digital asset, or service, differently. This may result in the same digital asset, or service, being offered by two businesses that are the same activities, same risks, with different regulatory outcomes.

There is a need for synergy between this interpretation to mitigate this risk. We would appreciate ASIC publishing more guidance around individual assets, for example the top 100 digital assets by market capitalisation even if these are point in time assessments.

Submissions in response to the Consultation

The following section provides our submissions on several aspects of the Consultation, as well as responding directly to certain feedback requests. Our submissions are organised in chronological order as they correspond with the Consultation.

A1Q1 & A1Q3

Our views on staking as part of custodial and depository services

We submit that it would be helpful to have clear guidance whether or not staking as part of custodial and depository services constitutes a financial service. Swyftx was founded on the basis of 'democratisation of financial freedom' and sharing more of the rewards from the financial system with our customers, therefore from a customer perspective, we wish to ensure that we are able to continue to deliver a quality, regulatory compliant custody service to our customers at a reasonable price in the same way that TradFi custodians also look for ways to reduce costs to their customers through the generation of ancillary income and, with appropriate AFS licensing in place, the ability to share a portion of this income with our customers.

We submit that this can be best achieved through a native, on-chain staking arrangement. Our reasoning is two-fold:

a) we have long viewed native, on-chain staking as a true innovation of digital assets in the financial landscape. It is also critical to securing the network in many proof-of-stake protocols. In the context of custody service provision, we consider staking (in its classic sense, rather than other forms of 'liquid' staking) to be an innovative way to generate revenue for the provision of custody services, without adding financial burden on customers, provided it is always done in a risk-controlled manner; and

b) the delegation of assets within native proof-of-stake protocols is an incidental part of custody arrangements for assets on such networks, that provide a number of benefits to the network and participants of the network, including improved network security, increased transaction efficiency and enhanced governance over the network; and

c) such delegation does not materially increase the custodial risk of holding the asset; it is important to note that delegating assets as part of a proof-of-stake protocol does not have inherent financial counterparty risk / exposure in the same way that lending arrangements do.

We are supportive of obtaining approval for this purpose through our facility agreement with clear consent and disclosure for relevant custodial assets to be staked as a means of being remunerated for offering our custodial services. To be clear, we are not in favour of Digital Currency Exchange (**DCE**) providers being able to lend or otherwise rehypothecate custodially held assets, as is the case in stock lending arrangements. Staking is truly an innovation in this sense, as legal title does not transfer simply because a token is delegated to a validator node – by retaining the corresponding private keys, title and control are both retained by the custodian even though rewards generated are as a result of the staking delegation via a smart contract.

We therefore think an innovative way to be remunerated for providing custodial services as a DCE would be to permit native, on-chain staking activity by a custodian, provided consent is provided and any additional risks to the staked digital assets can be effectively mitigated and disclosed. In our view, this is a clear example of balancing consumer protection and risks with innovation.

Considering this, we submit that ASIC should include guidance in its INFO 225 to clarify how it sees staking held as part of custodial and depository services.

Incidental exemption

We submit that there would be benefit in ASIC including how it considers the incidental financial product exemption, as outlined in section 763E of the *Corporations Act*, interacts with its views on financial product, in particular in relation to the functional definitions of non-cash payment facilities and facilities for making a financial investment.

A1Q2

We do not have any specific comments in relation to this question.

A2Q1

We make the following comments in relation to some of the proposed worked examples:

- Example 2: We submit that it would be helpful for the industry if ASIC could include its views on the relevant trigger for a facility that offers staking to be making a financial investment (and potentially managed investment schemes). For example, in the case of Solana delegation, holders of Solana can delegate their tokens with practically no minimum[9] and earn a return of around 7%. Would offering Solana delegation as a service, where the rights and benefits under the facility did not "differ from and exceed what the client would get if they undertook to stake the digital assets without the services"[10] of the facility, amount to a facility of making a financial investment. Would the view of ASIC vary if the digital asset exchange didn't take a small share of the staking revenue as a fee?
- Example 4: Whilst we are aware of yield-bearing stablecoins in the market, consistent with our response to A3Q1 below, our view is that the industry would benefit from guidance on whether non-yield bearing stablecoins (noting that they make up the vast majority of value by market capitalisation) are a financial product.

A2Q2

Outside wrapped tokens and non-yield bearing stablecoins, which we discuss in more detail in response to question A3Q1 below, we are of the view that including ASIC's interpretation of the following examples would be helpful:

- Bitcoin (BTC): We note that ASIC have previously expressed the following views: "Digital currencies are not a facility through which a person makes a financial investment.", "ASIC considers that it is unlikely that a digital currency is a facility

[9] There is a minimum account balance on Solana of approximately 0.002 SOL, worth less than $1 at the time of writing.

[10] Consultation attachment, Example 2.

through which a person makes non-cash payments. It follows that digital currencies are themselves not financial products.", and "Digital currencies such as bitcoins are more akin to a commodity."[11] While we appreciate that these statements were expressed by ASIC in 2014, it would nonetheless be helpful, to the extent that ASIC's views have changed, that these be made publicly to allow much needed clarity for our industry.

- DAOs and voting rights: We submit there is benefit in including an example in relation to ASIC's views on a governance token that either represents a portion of a DAO and/or has the ability to cast voting rights in respect of certain matters. We note that the statutory definition of "body" is a broad one, and includes "… for example, a society or association".[12] That being said, the technological and structural characteristics of a DAO are novel (DAO's rules are programmed, function autonomously, and are coordinated through a consensual protocol) and, unlike corporations, DAOs rarely share similar structures and operating models (i.e., the programmed rules may differ significantly between different DAOs). In this respect, we note that Treasury outlined in its Token mapping consultation paper that:

  > *They are not 'equity' in any traditional sense and they do not necessarily entitle holders to legal 'ownership' of the DAO controlled funds. However, DAOs can generate revenue for their token holders and many DAOs control 'treasuries' of crypto token valued in the hundreds of millions or billions of dollars.*[13]

- Decentralised Physical Infrastructure Network (DePIN): DePINs leverage blockchain technology and token rewards to incentivise individuals to develop real-world physical and digital infrastructure networks. Participants in these networks contribute underutilised resources or financial capital and, in return, earn rewards in the form of project-specific tokens. An example of a DePIN is the Hivemapper (HONEY) project. Users attach specialised cameras to their cars, which automatically capture images and data. This data is then sent to the Hivemapper network to create up-to-date 3D maps. In exchange for providing this data, drivers earn HONEY tokens. While we anticipate that ASIC may view this contribution to the network as a form of money's worth, being the data provided, along with the other characteristics of a managed investment scheme, we would appreciate guidance around these nuances being included in the Consultation.

- AI Agents: AI Agents are a relatively new novel concept that we think will continue to evolve particularly in our industry. AI agents are AI-powered applications designed to perform tasks autonomously or assist users in completing them. We are seeing an increasing amount of AI agents enter the market. These projects often do not have any 'team' or 'personnel', save for an initial deployer or developer. An example of a novel AI Agent is H4CK Terminal (H4CK). H4CK Terminal is a 'white hat' AI Agent that seeks vulnerabilities of projects that offer a 'bug bounty'. Organisations will then pay these bug bounties to the H4CK Terminal, which in turn distributes these bounties to H4CK holders that stake their tokens. Similar to DePIN, while we anticipate that ASIC may view this project as a facility for making a financial investment (and potentially managed investment schemes), we would appreciate guidance being included in the Consultation.

A2Q3

We do not have any specific comments in relation to this question.

A3Q1

[11] ASIC's 'Submission to the Senate inquiry into digital currency', December 2014.

[12] Corporations Act s 9.

[13] Treasury's Token Mapping Consultation paper [180].

Yes, we think there is benefit in including ASIC's views on a wrapped token and a 'stablecoin' (non-yield bearing) in its INFO 225. We provide some further views on each description as outlined in paragraphs 20 and 21 of the Consultation below.

In relation to a wrapped token, we think that a token in the form described in paragraph 20 of the Consultation could be excluded from the definition of a derivative, by virtue of the redemption arrangement as described in paragraph 20(d), being a contract for the future provision of services.[14] As an example, in the case of Wrapped Ether (WETH), the tokens "Ownership of WETH is managed by the WETH token smart contract, secured by the Ethereum protocol".[15] In our view, even though the WETH token may meet elements of a derivative, it could be excluded on the basis of the future provision of services, namely the redemption rights. If you disagree with this assessment, we think the guidance could set out your views on when a wrapped token, that you consider a derivative, may be an exempt future provision of services.

In relation to a stablecoin, we appreciate the intersection with the proposed reforms in relation to stored value facilities currently under review by Treasury. We nonetheless submit that it would be helpful to the industry if guidance could be included in INFO 225 as to your interpretation of existing laws. Given the prevalence in our industry of stablecoins denominated in foreign currencies, in particular USD and Euro, we also submit that the guidance should be expanded in INFO 225 to cover both non-Australian dollar and Australian dollar denominated 'fiat' government issued currencies.

A3Q2

We do not have any specific comments in relation to this question.

A3Q3

We understand from paragraph 30(b) of the Consultation that wrapped tokens that ASIC consider are derivatives would be included in the no-action position proposed. Accordingly, to the extent not already envisaged, that the no-action position would also apply to stablecoins that ASIC consider to be non-cash payment facilities.

Should the Government's proposed payment service licensing and DAF/DAP reforms be introduced we would expect that would be include a transitional period, given the statements made by Treasury in those consultations.[16] Should these transitional arrangements be enacted, we do not presently see a need for any further transitional provisions, outside the no-action proposed in the Consultation.

B1Q1 & B1Q2

We are appreciative of the consideration being given to a no-action approach in the Consultation. We consider this to be very helpful to the digital asset industry. We however do not believe that this proposal goes far enough given the current circumstances.

We are of the view that the following modifications or clarifications to the proposed no-action would benefit the industry:

- Group coverage: Allows for group coverage of no-action position, where a related entity has applied for an AFSL, and its related entity was operating in Australia before the date of the Consultation.
- Revocation of the no-action position: It would be helpful if ASIC could set out the circumstances or triggers that would cause it to revoke its no-action position to specific individuals as contemplated in paragraph 27, sub-paragraph B1 (i).

[14] *Corporations Act 2001* (Cth) s 7.6.01(1)(e).

[15] Wrapped ETH website.

[16] Treasury in its 'Regulating Digital Asset Platforms' Proposal paper proposed a 12-month transitionary period and 'Payments System Modernisation: Regulation of payment service providers' Consultation paper proposed a 18-month transitional relief, subject to a rage of conditions.

- Custody: We note that ASIC has recently updated its RG133 to include guidance in relation to holding crypto assets that are financial products, which we discuss in more detail in response to question B2Q3. To the extent not already envisaged in its no-action approach, we would strongly advocate for relief as part of the no-action for custodial obligations as outlined in RG133.

We also think it is prudent that the below considerations are factored into the licensing approach for the industry.

Insurance

The lack of accessible Professional Indemnity Insurance presents a significant barrier to licensing and regulatory compliance for digital asset businesses. Many insurers remain hesitant to provide coverage due to perceived risks, including regulatory uncertainty, evolving compliance obligations, and the unique characteristics of digital assets. This has resulted in limited policy availability, high premiums, and restrictive exclusions that often do not align with the operational needs of licensed entities.

Given that insurance is a core requirement under an AFSL, the absence of viable coverage options creates a structural challenge for businesses seeking to meet licensing conditions. We encourage ASIC to consider this issue in its regulatory approach, including engaging with insurers to explore risk-based solutions or alternative mechanisms that allow compliant operators to meet their obligations while maintaining adequate consumer protections.

Banking

As ASIC is no doubt aware, as part of obtaining an AFSL as anticipated in the Consultation, platform providers will need to operate client money account infrastructure. The challenges of many digital asset and FinTech companies to obtain sufficient banking services (due to risks related to fraudulent activity or AML/CTF risks) is well documented. Accordingly, consideration ought to be given to expanding the list of service providers (such as payment service providers or foreign banks) who might be able to step in and fill this need in the market. In particular, for those businesses that have a mature approach to AML, financial crime and illicit activity on their platforms, we would encourage ASIC to set expectations that such responsible actors receive support from banking partners and payment service providers, similar to that issued by Hong Kong's Monetary Authority in 2023.[17]

Additionally and respectfully, the traditional banking sector is preparing to enter the digital assets space and it is in their self-interest to make it create barriers for new entrants seeking access to banking infrastructure. We believe this economic choke point should be acknowledged and recognised by ASIC and the Government.

B1Q3 & B1Q4

We support the implementation of a class no action position and are of the view that this would greatly benefit the industry and its consumers. We support that class no-action position should be dependent on lodging an AFS licence application or the other suggested triggers.

However, we submit that:

- Given the amount of time that is involved in the preparation and submission of a licensing application, particularly if it is more complex, a longer submission time frame than 6 months should be considered.

- The no-action relief should also extend to any group entities of the applicant given that it is common for one entity in a group to hold the licence and then subsequently appoint other entities as an authorised representative.

[17] Reuters article.

The no action relief should also clearly address and include a reasonable timeframe for an application to be re-submitted to the extent there are minor deficiencies in the original application in the no-action period.

B1Q5

While this does not apply directly to Swyftx's business, as we do not issue any products that are financial products, we think there is benefit in extending the no-action relief to other licensing obligations, including the obligation to provide a Product Disclosure Statement (**PDS**). Many crypto brokers, for example, if such obligation arises relating to a product issued by a third party, that obligation to provide a PDS would similarly apply to a digital asset exchange or crypto broker facilitating the acquisition, where the client is a retail client.[18]

We note that existing disclosure and continuous disclosure obligations may be unworkable for DCEs to comply with in respect of the crypto assets they list. DCEs are rarely the token issuers, and have no control over the token and its associated rights changing over time or new rights being added.

B2Q1

We thought it would be beneficial to briefly set out the order execution model for crypto brokers before setting out our views on potential modifications to the regulatory framework for digital asset businesses.

Crypto broker model

As is well understood, the digital asset markets operate on an instantaneous, 24/7 basis (colloquially referred to as 'T+0', given trades settle instantly as opposed to the permitted 2-3 days which is common in traditional securities markets). For crypto brokers that rely on multiple third-party liquidity providers to facilitate trades, a certain percentage of digital assets are currently needed to be held in wallet infrastructure controlled by these liquidity providers, with an account-based system recording ownership. In our case, the percentage of digital assets held in these 'hot wallets' is small. The vast majority of assets under our control are custodied within institutional grade multi-party computational (MPC) security solutions. While it may be the case that technology will continue to evolve, such that we no longer require the use of any 'hot wallet' infrastructure, that is not the case today for many crypto brokers and we cannot reasonably predict a timeline for that to be the case. Specifically in relation to order execution custody, we are currently constrained by the limitations of available technology/products at this point in time.

Accordingly, to continue being able to service instantaneous trades of the wide array of digital assets offered through our platform, in a cost-effective manner for our customers, we think the trust arrangements under which digital assets are held by a DCE should come with express powers for the trustee to utilise those digital assets in a risk-controlled manner. For example, the trustee should be given the discretion as to how it manages its wallet infrastructure, including where and how digital assets are stored, along with when they are transferred, provided it does so in a mature, risk-controlled manner.

Potential modifications to regulatory obligations

In light of the above, we submit that the following factors be considered in relation to a DCE's regulatory obligations:

[18] *Corporations Act 2001* (Cth) s 1012IA.

- Difficulty of segregation of platform to non-financial products and financial products: There may be difficulties in the approach to offering non-financial products and financial products digital assets in the same offering. For example, with respect to client money obligations, in relation to the treatment of fiat currency deposited with the platform. While we accept that the obligations around client money are well established for financial products, the application of these rules to a platform offering both financial and non-financial digital assets may create complexity.

- As outlined in response to questions A1Q1 & A1Q3 above, we submit that DCE's be permitted to stake funds held under trust, provided sufficient customer consent is obtained, and the staking is managed with appropriate controls.

B2Q2

We do not have any specific comments in relation to this question.

B2Q3

The proposed guidance in updated INFO 225 regarding custodial requirements for financial products will be helpful to the industry. That said, the crypto industry operates differently to the traditional securities and banking industry. The proposed operating processes need to adopt the relief already available to Traditional Finance (or 'TradFi') whilst also reflecting the nuances necessary in the digital asset industry.

We are supportive of extending the omnibus client accounts class order relief to digital assets that are financial products. This support is on the basis that if individual client wallets are required to be segregated on the blockchain that this will result in a substantial increase to the costs associated to run a DCE. The result would be that the costs of these services would need to be passed onto clients and will not result in any greater consumer protection.

B2Q4

In relation to organisational competence demonstrated through a firm's responsible managers (**RM**), we are supportive of technological experience in relation to digital assets be taken into account when assessing under Option 5 of RG105. We appreciate that ASIC outlines in its Example 3 of RG105 that it will take into account an RM with substantial experience in developing systems that support services, when combined with another RM with financial services experience. We strongly believe it is important to emphasise the point that there are a number of members within the industry with a substantial level of experience developing trading platforms or have significant traditional financial services experience, have significant organisational management and governance experience and have been involved with the digital assets industry for a number of years. For such individuals, we believe that ASIC should give consideration to approving such individuals as RM's for this emerging industry. that are critical to the offering of services. These individuals should be considered suitable RMs, when combined with appropriate traditional financial services experience.

B3Q1

We do not have any specific comments in relation to this question.

B3Q2

We do not have any specific comments in relation to this question.

We want to emphasise our earlier point that providing broad guidance on the classification of specific crypto tokens will likely lead to inconsistent interpretations across platforms. As a result, some platforms may treat certain assets as financial products, while others may not. This inconsistency arises from ASIC's apparent approach of regulating the asset itself rather than the activity in offering it, which carries significant risks.

It is clear that Australians want to and are actively investing in crypto assets. The longer Australia delays the implementation of clear regulation, the more Australians (soon to be 40% of Australians who are projected to be invested in crypto by 2027) who will be unable to receive financial planning advice from regulated financial planners,

Additionally, as observed in the U.S. prior to the Trump administration's policy shift, intellectual capital and investment in the Australian digital assets industry will likely remain low. If Australia can swiftly enact well-considered legislation, blockchain and digital assets have the potential to become the nation's fifth major economic pillar, alongside mining, agriculture, education, and tourism.

We appreciate the opportunity to provide this submission and would welcome the opportunity to discuss any aspect of it with you in greater detail. We look forward to our continued engagement with ASIC on these critical issues.

Yours faithfully,

Jason Titman
CEO & Executive Chair
Swyftx