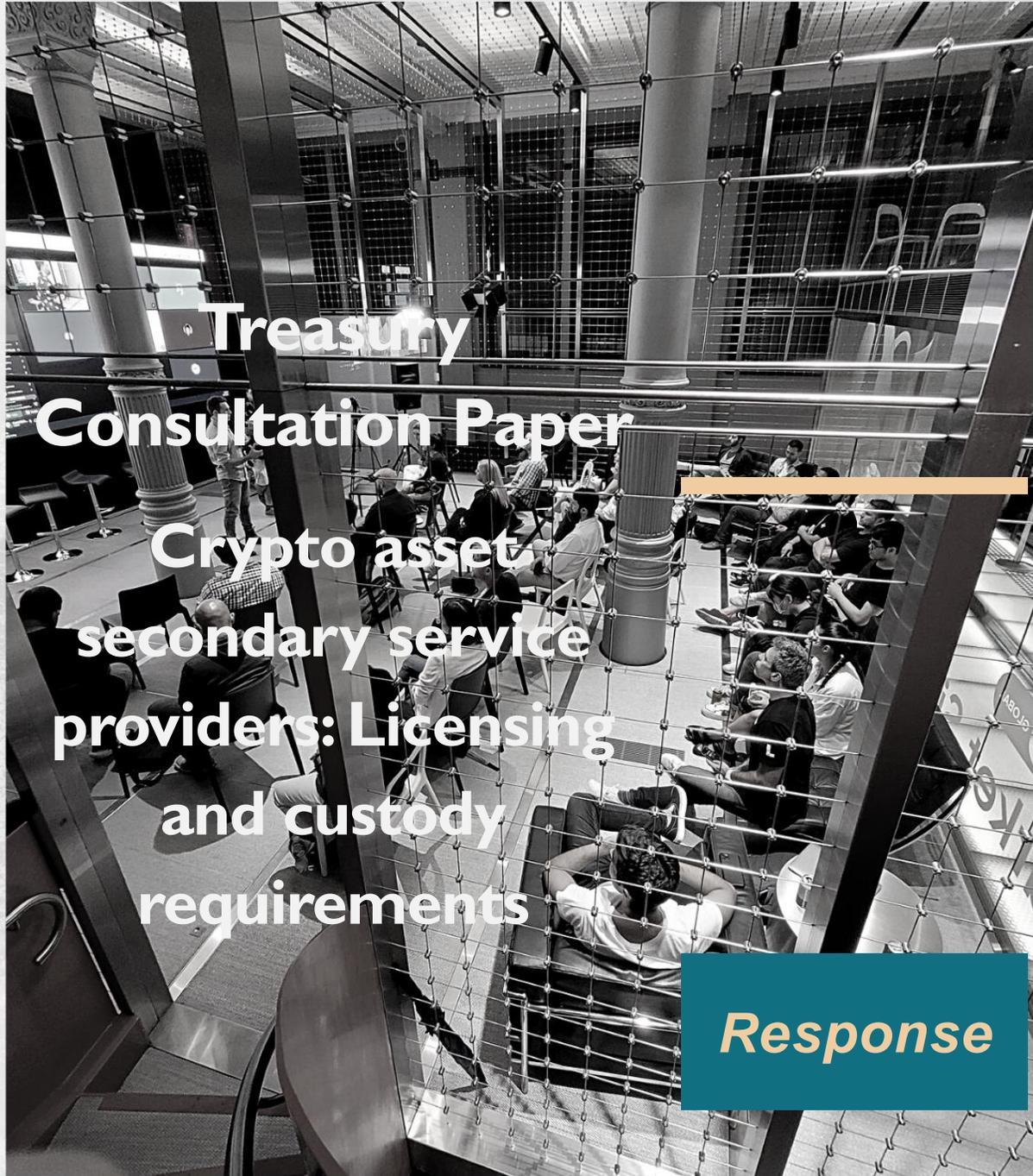




**AUSTRALIAN DEFI
ASSOCIATION**



**Treasury
Consultation Paper
Crypto asset
secondary service
providers: Licensing
and custody
requirements**

Response

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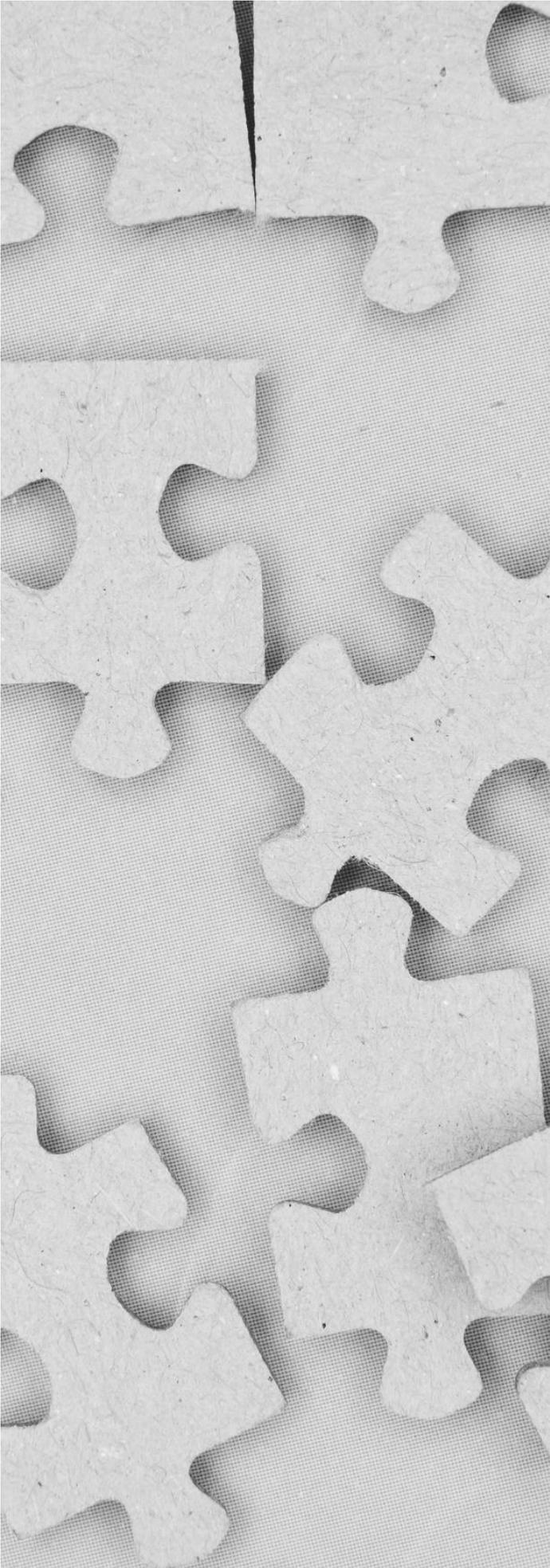


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EXECUTIVE SUMMARY

The Director
Crypto Policy Unit - Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600
By email only: crypto@treasury.gov.au

Dear Director,
Crypto asset secondary service providers: Licensing and custody requirements

Thank you for the opportunity to provide feedback on the proposed regulation of crypto asset secondary service providers (CASSPrs).

The Australian DeFi Association provides our submission which is split into 3 parts. The first provides specific answers to questions posed in the consultation paper (CP). Secondly, we add further responses to the second draft (dated 20 May 2022) BADASL CASSPrs submission:

<https://mirror.xyz/jpirovich.eth/E3pj0QFFBsYTvKN2VVI48TTuw2SG8RtE2MFmdsi2U1q>.

Finally, we add our own observations to be considered by the Treasury.

Historical Context

Before we begin, a bit of historical context. Context is important because our view is that the Australian government is at the precipice of a modern renaissance, and we believe it should think carefully about the amazing opportunity we all face as we proceed towards crypto asset regulation. The disparity between the upper and lower classes in society right now mirrors human history going back to when monarchies and monasteries (church and state) ruled with their access to information and resources.

We saw this change with the invention of the ledger (double entry bookkeeping) and the printing press which both helped move humanity from the dark ages into the first renaissance. The Medici whilst not inventing the ledger, pioneered its usage and were able to use it to support the arts and architecture. With the printing press, we saw communication becoming more of a mass market product and with this easier ability to form and share ideas, we saw the age of enlightenment. Mankind found freedom beyond the farmlands of our ancestors and into the mercantile age that led to global exploration.

We are facing this again and the explosion of new ideas and the positive outcome for humanity is exactly what we expect to come from this. It is very important.

Furthermore, our response expands on the following ideas:

- This moment presents an unprecedented opportunity for the government to work more closely with industry and community, especially when it comes to monitoring and potential auditing crypto assets & protocols.
- We should avoid bringing different types of crypto assets & protocols under a single umbrella, especially as they provide different types of benefits to those who use them.
- We should avoid definitions that paint broad brushstrokes over crypto assets that differ in their usage and application (for example, not all NFTs perform the same function and have identical characteristics and some tokens merely embody governance, and not financial utility).
- There is also the need to specify definitions in crypto regulation and important in this is the need to distinguish between centralised and decentralised activities
- We should establish a regulatory framework that actively promotes (rather than avoid hindering) innovation and increases investor protection and confidence.
- We should foster an agile mindset as the technology and its use cases change rapidly.
- We should use this opportunity to create an ecosystem that brings in new investors and ventures that have the capacity to expand the national tax base.

AUSTRALIAN DEFI ASSOCIATION

RESPONSES TO CASSPRS

In this section we add our answers to specific CASSPr questions.

Response to Question 1 - “Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of ‘digital currency exchange’?”

No. The term CASSPr is intended in this CP to refer to centralised exchanges but it will be fairly limited as decentralised exchanges and providers can also issue tokens. Even if this was intended to focus on centralised entities first and decentralised entities at a later stage, it would be a difficult task to apply the same sort of regulation on centralised groups as you would with decentralised ones. The former may be geographically bound to Australia, but the latter is not and with the free flowing 24/7 nature of the markets, the centre of gravity for decentralised entities can move from place to place.

Using the term CASSPr is not well known globally and introduces additional definitions to a market and product that is becoming more used to specific terms globally such as decentralised exchanges (DEX), centralised exchanges (CEX) or other popular crypto vernacular.

As our friends at Crypto Law Group state, “one size fits all” definitions in this space are impossible to maintain due to the rapidly evolving nature of the technology and the community surrounding it. The currently proposed “CASSPrs” term is likely to be rejected or amended in the future due to the fact that it fails to take into consideration the systemic and operational differences between centralised CASSPrs and decentralised CASSPr (or the entities behind them).

Recommendation 1 - We propose Treasury adopt commonly used terms to classify different emerging crypto assets, for example “NFTs”, “decentralised exchanges” (DEX), “centralised exchanges” (CEX), utility tokens, governance tokens and other terms, whilst leaving a broad definition for an emerging class of assets yet to be created.

Response to Question 2 - “Are there alternative terms which would better capture the functions and entities outlined above?”

As per our response to question 5, we believe that due to the different use cases for tokens, having all of these fall under a single licensing regime may not be fit for purpose.

We should, where possible, adopt common crypto parlance used globally. This is to avoid confusion especially as DAOs (Decentralised Autonomous Organisations) become more prominent and founders and users of tokens from these entities become more situationally aware of the evolving regulatory landscape globally.

If CASSPrs must be used in terminology, we recommend the consideration of centralised and decentralised CASSPrs, but this is not recommended.

Recommendation 2 - We support the adoption of commonly known and used global crypto terminology as regulations are shaped.

Response to Question 5 - “Should CASSPrs who provide services for all types of crypto assets be included in the licencing regime, or should specify types of crypto assets be carved out (e.g., NFTs)?”

Just as this CP highlights, there were issues using old terminology to define crypto (e.g., section 763a of the Corporations Act). We need to avoid creating a similar situation with a definition that is not fit for purpose.

First and foremost, we believe that the Treasury should avoid adopting a broad definition of crypto assets and should instead adopt separate definitions for each type of digital asset (e.g., NFTs, DeFi and other various platform/utility tokens).

We believe this because currently, we are at the initial stages of the digital infrastructure we know as crypto. Right now, we mainly have DeFi (decentralised finance) and NFT tokens. These often use ERC-20 and ERC-721 smart contracts and are the most common contract types. There are, however, other token types such as ERC-777, ERC-1155 and ERC-4626 which provide different features (for example, the latter auto-compounds yield). Creating definitions that categorise all assets under a single category may unwillingly stifle future innovation.

Additionally, in the world of web3 and effectively our digital future, we should consider that much of what we will interact with is yet to be built. These new protocols will almost be their own digital “nation states” and each will have a native token.

Even here, the definition and use of NFTs is still in its infancy with most use cases centring on them as profile pictures and artworks. If, for example, the definition of NFTs is too narrow, the continued innovations in the NFT space such as them being used for new forms of utility (e.g., streaming payments) may not happen.

Whilst most of the popular standards are currently being derived from the main Layer 1 chains (e.g., Ethereum, Solana, Cardano), we will see many new standards emerge as more of these are developed and adopted across the crypto asset ecosystem.

Recommendation 5 - We propose that certain types of crypto assets ought to be carved out of the regulatory perimeter altogether if the value of the is merely for record keeping or governance purposes (e.g., governance tokens, social tokens).

Additionally, we add that “new policies have to keep in mind the global nature of the cryptocurrency industry” and that whilst minimising risks for consumers will be difficult, these should be “acknowledged and communicated”.

Response to Questions 8, 9, 10

8. Do you agree with the proposed scope detailed above?

9. Should CASSPrs that engage with any crypto assets be required to be licenced, or should the requirement be specific to subsets of crypto assets? For example, how should the regime treat non-fungible token (NFT) platforms?

10. How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g., in financial services)?

We believe that the licensing regime should take into consideration the specific nature of each asset and should not be imposed on platforms that do not provide access to financial products. The definition of what constitutes financial products must be considered as crypto assets, depending on their usage can be considered as both financial and non-financial or have elements of both. The focus should be on how the assets are used rather than the assets themselves.

Regulatory duplication can be avoided by ASIC and AUSTRAC working together in order to create a separate regulatory body that issues CASSPr licences and ensures compliance with AML/CTF regulations.

Recommendation - we recommend that the imposition of regulation should not be on platforms that do not provide access to financial products but also, careful we should be careful when considering which of those crypto asset products are regulated as some are not clear cut as to when they are a financial product versus when they are not.

Response to Question 11 - “Are the proposed obligations appropriate? Are there any others that ought to apply?”

In addition to the existing proposed obligations, we consider that a materiality threshold should be applied based on market capitalisation, number of tokens minted, or wallet holders registered that is similar to the concessions provided for small businesses in Australia on their payment and reporting obligations or whether a private company with less than 50 members is subject to the public disclosure regime.

Requiring all entities regardless of size to adhere to the same obligations may end up creating compliance and reporting obligations that are not appropriate for the size of the project, thereby unfavourably stifling innovation.

Recommendation 11 - We propose a materiality threshold be applied in determining whether a project is included or excluded from the regulatory perimeter. Such threshold should be based either on a minimum market capitalisation, minimum number of tokens or minimum number of wallet addresses registered with the project.

Response to Question 12 - “Should there be a ban on CASSPrs airdropping crypto assets through the services they provide?”

Airdrops should not be banned by CASSPrs as these are commonly used ways to reward and incentivise users of crypto communities. Whilst there may be a concern regarding the taxable nature of these airdrops, the use of tokens does not always have to be for monetary gains. There are social tokens and non-transferrable NFTs that will be used as forms of reputation and identification. Blanket banning of CASSPrs airdropping crypto assets would capture these sorts of assets and stifle innovation.

Recommendation 12 - We propose that airdrops of crypto assets by CASSPrs be permitted under any proposed regime.

ADDITIONS TO BADASL RESPONSE TO CASSPRS

In this section we add thoughts and opinions to some of the BADASL observations. At an overall level we agree with the focus on foundational policy issues before a CASSPr regime as setting the right level of foundation is by far, more important.

BADASL Observation 1

To this point we add that the nature of this regulation is akin to setting regulation rules (and ultimately penalties) to a game before we have had a chance to design how the game works.

- It's very different to well established industries such as banking where their features, services, products and capabilities are more well-established.
- We cannot predict the future and creating infrastructure that will be used to write future rules of crypto activity in Australia will be like writing the instruction manual for a car which is being built as we are driving it.

Additionally, we would add to the concept of analytics as being useful in KYC and AML activities. Our view is similar to that of TradeFlows (their response is here: "[TradeFlows Response to Crypto asset secondary service providers: Licensing and custody requirements](#)") in their CASSPrs CP response where they highlight that due to the "unprecedented transparency and integrity" of blockchain data, "regulators now have the ability to have real-time and comprehensive oversight". There are a variety of tools available to trace, track and ultimately understand and analyse activity. These types of analyses are conducted to review the viability of certain projects by analysing their token economics (tokenomics for short). Blockchain analytics have proven useful in highlighting projects that have the potential to be scams because they detect characteristics seen in previous scams (pattern analysis) and because of their high level of availability and transparency which allow anyone with the tools to analyse these events and patterns.

Recommendation - we recommend prioritising working closely with companies and analysts that understand how to analyse and gain insights from the various tokens and token activities. This means that rather than retroactive, after-the-fact regulation, Treasury and other entities

have an opportunity to be proactive monitors that ensure crypto-related activities are safe for retail consumers.

Treasury and related agencies then have the job of becoming partners with industry and community rather than corporate watchdogs and should consider incentivising organisations to be open to this sort of monitoring.

BADASL Observation 2

In addition to agreeing with these points we would add that scaling up the resources should be done in partnership with industry and community. Just like the Audit Office of NSW partners with accounting firms on a rotating basis to provide audit services to its entities (e.g. local councils), so should Treasury do so with regards to increasing its policy resources.

The world of blockchain technology and cryptocurrencies is built on an ethos of collaboration and creating stronger ties with industry, community and those who build in this space. Establishing the right level of regulatory oversight is an opportunity that can be far stronger than in any other area of regulation in Australia.

Treasury and related agencies will also need to consider how they can educate users and leverage the gatekeepers to separate the crypto asset industry from the gambling industry.

BADASL Observation 3

The BADASL proposed concept of a minimum standard for DAOs to publish analysis of why existing laws are not fit for purpose for their protocol is a good idea in premise but delivery of this may prove difficult for DAOs which have smaller communities. This leads to a question of materiality for DAOs where the requirements for reporting are only for those entities above a specific level. This could be market cap, number of tokens minted or wallet holders or other measures. Smaller DAOs could see similar concessions that small businesses receive from the ATO for payment and reporting. This would encourage innovation and not have smaller groups caught up in undue admin as they grow.

We also agree with the concept of token mapping to map token “data activities” rather than characterising the token for legal and tax purposes. There are various aspects of how tokens

are used in DeFi protocols and whilst utility and governance are the most typical there are also platform, security and transactional tokens. They all provide different benefits to the user so mapping the activity they are used for will be better than the blunt force approach.

On the point of legal recognition of DAOs, we agree with the proposal to create limited legal liability structure for DAOs as well as some sort of continuous market disclosure by the entity formed rather than register the individual token holders in the DAO.

The proposed protocol audits could be conducted in conjunction with industry just like state government works with private enterprise (as highlighted in the state audit office example in observation 2 above).

BADASL Observation 6

We agree that an allowance of two (2) years or longer is necessary for the review of what an appropriate tax regime should be for digital asset transactions and DAOs. The space is still very nascent and what capabilities are available to improve the efficiency of how we transact with one another are still being discovered. We also agree that double taxing on the same transaction can occur if legislation is unclear so should be avoided.

GENERAL OBSERVATIONS

The following are additional observations that the Australian DeFi Association believes are necessary to add as responses to this CP.

Definitions

We add to the conversation around definitions needing to be defined better by reference to the CASSPrs submission by TradeFlows. They highlight that the CP uses terms like “*centralisation, decentralisation, custody and exchange without explicit definition*”. They highlight when they believe it is appropriate that

Furthermore, we would like to contend that crypto assets are financial products or securities if and only if:

- The crypto asset is a token, whether fungible or non-fungible, that is linked to a smart contract or a set of smart contracts where the balance of these smart contracts is not fully controlled by owners of the crypto asset through an on-chain voting mechanism but instead is controlled by another person or distinct group of people to which the crypto asset owner is not part of.
- Or the crypto asset is linked to an off-chain financial product or off-chain security.

On the one hand, the consultation paper loosely defines custody of a crypto asset as an entity having control of private keys while at the same time the consultation paper aims for a technology agnostic approach. All blockchain technology is not dependent on private keys due to recent technological advances, therefore, as stated above, the concept of custody should refer to the technological ability of another person other than the owner of the crypto asset to execute transactions that transfer the asset to a digital location outside of the control of the original owner.

Scams

Whilst we are aware that regulation is needed to help avoid the scams that have occurred (and will continue to occur), we also highlight that a swift and heavy-handed approach should be avoided when we consider that illicit activity has made up less than 1% of crypto-related activity in 2020 and 2021 and has been decreasing (see Chainalysis Crypto Crime report: <https://blog.chainalysis.com/reports/2022-crypto-crime-report-introduction/>).

Whilst we agree that scams and criminal activity needs to be addressed, we would advise that despite the headlines, this is not what is going on in the majority of the industry.

Crypto is built on rails which are transparent, and we are afforded an ability to make data decisions when it comes to creating new regulations.

Fit for purpose

Unlike the traditional financial markets, retail investors are left mostly to their own devices when it comes to the decision of what constitutes sound financial investments and management of their portfolios. There are no financial advisers to guide them and even then, though surveys show demand from financial adviser clients for crypto guidance, the response back from advisers was that they would be “fairly or extremely unlikely” to recommend crypto investments over the next 12 months.(see AFR article [“Wealth advisers crypto-averse despite growing inquiries”](#)).

Presently, there is an opportunity for CASSPrs to provide users with education in respect of their tokens, to ensure that these users understand the various operational, custodial and financial risks involved with owning their crypto assets. This is a way to proactively increase the education of users, whilst also not limiting the capabilities of CASSPrs by simply mandating minimum standards of conduct.

In considering how to design a regulatory regime that is “fit for purpose”, Treasury should consider the shifting attitudes, needs and will of the community (many of which comprise retail investors). As foreshadowed in our Historical Context above, our society locally and globally is undergoing a period of modern renaissance. The advent of crypto, NFTs, web3 and the metaverse points to a society yearning for economic, societal, environmental, political and cultural reform. Crypto technology merely happens to be the vehicle of expression for this collective desire to create more equitable, accessible and fair systems that promote the socioeconomic flourishing of many, not just a few. From such collective will has emerged distributed and decentralised technologies. Therefore, an acknowledgement of this and willingness to work collaboratively with - and be earnestly advised by industry and community - will be an important feature of an effective, coherent and pragmatic regulatory regime that is adaptable and “fit for purpose”.

Trustlessness

The CP acknowledges the ongoing debate as to the true “trustlessness” of crypto assets (as noted on page 13 of the CP). The argument advanced is that crypto assets require an order of magnitude less trust than other assets including financial products and should be considered differently. This is not entirely accurate. Notwithstanding the lack of conventional issuer and seller, we submit that trust has simply been transferred. Instead of trust existing between the issuer and seller, trust in a crypto environment exists between the user and the protocol giving rise to the crypto asset. The term “trustless” is a misnomer and does more harm than good for the development and public understanding of the crypto landscape. The term “trustlessness” should be phased out in favour of a more accurate description - that in a crypto environment, there is a transfer of trust from people to protocols.

CLOSING REMARKS

The move towards regulation is highly important and we support the endeavours of the Commonwealth Treasury to steer us there. Our response highlights the opportunity for supportive partnerships between the Australian government, industry and the overall crypto community here in a way that is symbolic of the collaborative nature of the crypto community.

Whilst our response highlights some critiques of the CP, we offer these as positive ones whereby we view this as an open discussion between regulators and industry advocates who are after the right type of regulation.

We want to see this space evolve and mature in a way that is safe for people to enter, transact, share value and more. We look forward to the response back from the Treasury and we are open to any and all discussions on these matters.

Finally, we thank the team at Treasury for the time it has taken to pull this CP together. We have enjoyed reviewing it as well as responding to it. We also thank Joni Pirovich and team at BADASL through which we were able to review their draft responses to the CP and add additional insights. Finally, we thank our various members who contributed to this response.

CONTRIBUTORS

Contributors to this response include

- **Mark Monfort** - Australian DeFi Association / NotCentralised / TradeFlows
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Contributor organisations include:

- **Australian DeFi Association** - advocacy group promoting the education and discussion of various topics on DeFi, web3, blockchain across our meetups, podcasts, newsletters and other communications.
- **NotCentralised** - venture studio for web3 projects helping startups and scale-ups with a variety of services from smart contract development, tokenomics, tax, capital advisory and more.
- **BADASL** - Building digital skills and literacy for professionals and executives through guided workshops, starting with blockchain and digital assets.
- **TradeFlows** - is a web3 powered payments protocol enabling streamlined transactions across a variety of industries
- **Aviatrix** - an impact advisory and commercialisation firm that educates and supports on-chain and off-chain organisations to develop and implement their impact strategy and reporting capability while they scale and grow.

- **Bishop & Fang** - We are an independent capital advisory firm founded in 2020 and based in Sydney. We are trusted advisors to fintechs, impact businesses, the Federal Government, investors and lenders
- **Cadena Legal** - Australia's top tax and crypto lawyers · Australian based lawyers who consult locally and internationally · General tax advice and consulting on income tax, capital gains tax and international tax planning as well as specialist tax services.
- **Geminio** - Geminio is an administration service for your Crypto finance investments, its mission is to provide exposure to crypto finance without complexity.
- **Crypto Law Group** - Crypto Law Group is a Sydney-based law practice and legal consultancy firm advising web3 projects in relation to regulatory compliance, legal documentation, and entity formation.