



# **Crypto asset secondary service providers: Licensing and custody requirements**

May 2022

---

**[www.digitalx.com](http://www.digitalx.com)**



Copyright 2021 DigitalX Ltd (ABN 59 009 575 035). All Rights Reserved. This has been prepared by DigitalX Ltd and DigitalX Asset Management Pty Ltd (ABN 59 629 653 121) a subsidiary of DigitalX Limited, an Authorised Representative of Boutique Capital Pty Ltd (ABN 33 621 697 621) which holds AFSL 508011.

Director – Crypto Policy Unit  
Email: [crypto@treasury.gov.au](mailto:crypto@treasury.gov.au)

## **Crypto asset secondary service providers: Licensing and custody requirements**

DigitalX Limited is pleased to comment on the above consultation paper. We welcome the opportunity to contribute to The Treasury's efforts to regulate crypto asset secondary service providers.

Our detailed responses to the questions raised in the consultation paper are provided in the appendix to this letter. We would be pleased to discuss our comments further with you or your wider team. If you wish to do so, please contact Alex Nagorskii on

 Jonathon Carley on 

Yours Sincerely

DigitalX Limited  
(ASX:DCC)

## Introduction: DigitalX

DigitalX Limited (ASX: DCC) is a technology and investment company focused on growing the blockchain economy through its digital asset funds management business, digital fintech and regtech products, and blockchain ventures.

DigitalX's product team designs and develops blockchain technology applications for business and enterprise organisations.

Through its asset management division (DigitalX Asset Management), DigitalX provides low-cost traditional asset management products for qualified investors looking to gain exposure to the growing alternative asset class of digital assets, including Bitcoin.

DigitalX is currently commercialising Drawbridge, the Company's first regtech solution which is supporting listed companies to better manage their compliance and corporate governance policies. With Drawbridge, companies can manage employee and director share trading approvals in order to safeguard their reputations.

[www.digitalx.com](http://www.digitalx.com) | <https://digitalx.fund/> | [www.opendrawbridge.io](http://www.opendrawbridge.io) | [www.sellmyshares.com.au](http://www.sellmyshares.com.au)

## Appendix

Q #	Question	DigitalX Response
1	<p><b>Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'?</b></p>	<p>DigitalX focuses on crypto asset funds management for institutional investors and development of blockchain enabled products for capital markets applications. As an Asset Manager specialising in crypto assets, we are responding to the consultation paper as a user of CASSPrs, as well as a secondary service provider as illustrated on page 3, figure 1.</p> <p>We agree that the CASSPr terminology is appropriate. However as an Asset Manager working exclusively in this asset class we provide some feedback about the potential scope of this licencing regime in question 8.</p> <p>Digital currency exchange is too narrow a definition as it doesn't capture a variety of operators in this space.</p> <p>Future regulation (outside current scope) should expand to blockchain native service providers. The current decentralised finance market holds</p>

		<p>around \$150B in this total value locked on-chain. Critical infrastructure like Chainlink's Oracle service provides pricing information for over 50% of the DeFi ecosystem. There are other examples of crypto native critical infrastructure service providers underpinning crypto asset markets, these should be explored in the future as they carry significant systematic risks.</p>
<p><b>2</b></p>	<p><b>Are there alternative terms which would better capture the functions and entities outlined above?</b></p>	<p>The term is appropriate.</p>
<p><b>3</b></p>	<p><b>Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments.</b></p>	<p>The definition should be expanded to "...a digital representation of value or contractual rights that can be transferred, stored or traded electronically via distributed ledger technology". This is a key feature of the crypto assets.</p> <p>Additionally the term contractual right in the definition will need to be clarified in the context of crypto assets in the regulation.</p>

<p><b>4</b></p>	<p><b>Do you agree with the proposal that one definition for crypto assets be developed to apply across all Australian regulatory frameworks?</b></p>	<p>One definition across all regulatory frameworks would be preferable. However this requires the token mapping exercise to be completed in close consultation with industry.</p> <p>Not all crypto assets should have the same tax implications, as an example stablecoins should be treated as currencies for legal and tax purposes. There are many different types of existing and potential future types of crypto assets, with the potential categorisation of the asset being either financial or non-financial products may be inadequate.</p> <p>There should be clear definitions of tokens and clear differentiations between different types of tokens.</p> <p>For example;</p> <ul style="list-style-type: none"> <li>● Digital Assets - real asset backed tokens</li> <li>● Crypto - there are many different types</li> <li>● Digital Securities - representing programmable financial instruments both over real asset</li> </ul>
-----------------	---	---

		<p>tokens and crypto tokens</p> <ul style="list-style-type: none"> <li>● Stablecoins - there are four types: <ul style="list-style-type: none"> <li>○ Crypto back Algorithmic</li> <li>○ Crypto backed non-Algorithmic</li> <li>○ Real asset backed algorithmic</li> <li>○ Real asset backed non Algorithmic</li> </ul> </li> </ul> <p>We believe only real asset backed “stable” should be called stable CBDC (Central Bank Digital Currencies]. We would recommend an industry working group to formulate this definition / token taxonomy.</p>
<p><b>5</b></p>	<p><b>Should CASSPrs who provide services for all types of crypto assets be included in the licencing regime, or should specific types of crypto assets be carved out (e.g. NFTs)?</b></p>	<p>Yes, all should be included in the licencing regime. The NFT sector is evolving and growing rapidly, this sector has attracted significant investment from retail and institutional investors. Investors should be able to identify quality NFT exchanges and service providers that abide by the obligations proposed under this licensing regime.</p> <p>However, similar to DeFi services, the most popular NFT exchanges work with Web3 style wallet connectivity. These</p>

		<p>sites provide peer-to-peer marketplaces for exchanging NFTs, and do not have fiat gateways. The obligations described in this consultation paper would be largely irrelevant for these types of marketplaces as the protections are largely baked into the code. A different approach would be required to satisfy the policy objectives in this case.</p>
6	<p><b>Do you see these policy objectives as appropriate?</b></p>	<p>The policy objectives are well formulated and appropriate.</p>
7	<p><b>Are there policy objectives that should be expanded on, or others that should be included?</b></p>	<p>A number of exchange and broking services dealing with crypto assets currently offer a variety of yield products. Oftentimes these are labeled as ‘savings’ accounts without disclosing the methods used for generating yield on the depositor’s crypto assets.</p> <p>The regulation should seek to define the various types of yield generating activities which exist in the market and oblige service providers to properly label their products and disclose the underlying risks.</p> <p>Three distinct activities are currently used</p>



	<p>to generate yield, however service providers often mislabel and misrepresent the risks associated with the activities.</p> <ol style="list-style-type: none"> <li>1. <b>Staking:</b> Considered one of the safest ways to generate yield applies to blockchains with a Proof-of-Stake consensus mechanism. The tokens locked in validator nodes help to secure and propagate the network and are rewarded for this activity.</li> <li>2. <b>Lending:</b> Similar to securities lending arrangements in traditional finance, assets are lent out to Funds or exchanges to finance speculative activities, exposing investors to counterparty risks.</li> <li>3. <b>DeFi:</b> Most commonly refers to committing crypto assets to liquidity pools to facilitate trading on decentralised exchanges.</li> </ol> <p>The associated risks should be clearly disclosed to consumers and products labeled correctly.</p>
--	--

<p><b>8</b></p>	<p><b>Do you agree with the proposed scope detailed above?</b></p>	<p>As an asset manager, we are already compliant with existing regulations. However due to unique risks and challenges associated specifically with this asset class, we think the scope of the licencing regime should be expanded to include asset managers who operate with this crypto assets.</p> <p>Further fact finding should be conducted with relation to DAOs, stablecoins and decentralised on-chain activities and services for potential future regulation which may be outside the scope of the proposed CASSPrs regime.</p>
<p><b>9</b></p>	<p><b>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?</b></p>	<p>The final subset of crypto assets to be covered by the regime should be decided once the token mapping exercise is completed and the CASSPrs regime should only be applied to specific subsets of crypto assets.</p> <p>Certain activities undertaken by service providers might also require supervision under the licencing regime, regardless of the subset of crypto assets they are dealing with. For instance if a carve-out for stablecoins is created, operators in</p>

	<p>that space should not fall through the cracks.</p> <p>NFTs have been created to represent non fungible ownership of assets such as art, collectibles, domain names, music, photography, trading cards, utility within applications/games and services. The nature and application of NFT technology is just as varied as crypto assets and this category requires a separate mapping exercise itself.</p> <p>For example, a video game with an internal marketplace might offer an in-game character in the form of an NFT, should the game then be subject to the CASSPrs regime? As games integrating NFTs or tokens become more popular there has to be a definition or a hurdle rate for assets to be included in the regime.</p> <p>There are several other subsets in the crypto assets space that present unique challenges which deal with, some of these relate to data/file storage, compute power and stablecoins.</p>
--	--

		<p>New categories of crypto assets and NFTs are constantly being developed which shows the importance of working closely with industry to determine which assets are appropriate for inclusion in the regime.</p>
10	<p><b>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)?</b></p>	<p>The new licensing regime could be comprehensive in detailing obligations in other regulatory regimes. Duplication could be a feature, not a fault if CASSPrs can assess all of their obligations in one place as part of the new legislation.</p> <p>Regulatory body coordination with industry through a permanent channel or scheduled consultations might be required to maintain relevance.</p>
11	<p><b>Are the proposed obligations appropriate? Are there any others that ought to apply?</b></p>	<p>The proposed obligations are largely appropriate from our view as an asset manager.</p> <p>Additionally the obligations can be expanded to define the regularity of audits and reporting mechanisms.</p>
12	<p><b>Should there be a ban on CASSPrs airdropping crypto assets through the services they provide?</b></p>	<p>No, in fact investors rights to certain airdrops should be protected by the licensing regime. Legitimate airdrops can</p>

		<p>be used for a variety of purposes and represent a significant value add for holders of certain tokens. Service providers should not deprive investors of airdrops entitled to them where operationally possible.</p> <p>Regulation should investigate airdrops in more detail and provide guidance to CASSPRs in determining which airdrops are appropriate to pass down to investors. Some airdrops are vectors for attack on token wallets, these are known as dusting attacks. Others are hugely beneficial and valuable to investors.</p>
<p><b>13</b></p>	<p><b>Should there be a ban on not providing advice which takes into account a person's personal circumstances in respect of crypto assets available on a licensee's platform or service? That is, should the CASSPRs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto asset)?</b></p>	<p>Yes, CASSPRs should not be influencing investment decisions through advice, with a carve out for providing necessary information. Necessary information can include upcoming development changes, distributions through airdrops, and other relevant information.</p> <p>Regulation relating to the provision of personal advice requires immediate revision. Due to the lack of regulation in crypto assets many financial advisers are unable to serve investors interested in this</p>

		asset class.
<b>14</b>	<b>If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?</b>	In the case of our asset management business this could be roughly estimated at \$100K AUD. As we already satisfy similar obligations under existing regulatory regimes, this cost would be attributed to external compliance audits.
<b>15</b>	<b>Do you support bringing all crypto assets into the financial product regulatory regime? What benefits or drawbacks would this option present compared to other options in this paper?</b>	<p>No, this will stifle competition and progress. As discussed in question 9, the variety of crypto assets and NFTs make a one size fits all approach not workable.</p> <p>There are various subtypes of crypto assets and NFTs like gaming tokens, liquid staking/yield bearing tokens, file storage tokens, tokenised gold and real assets and many others.</p> <p>Working closely with the industry is required to determine assets appropriate for the regulatory regime which should be reviewed after the token mapping exercise is completed.</p>
<b>16</b>	<b>If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?</b>	Not applicable.

<p><b>17</b></p>	<p><b>Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia?</b></p>	<p>Yes. This industry moves fast and it makes a lot of sense for an industry body to develop a code of conduct so as to not stifle innovation and lose Australian talent to overseas competitors. Industry leaders and working groups are also able to adapt to changes to protect investors a lot quicker than regulatory bodies.</p> <p>However, a minimum standard must be enforced by a regulatory body. Indeed an external dispute resolution body would provide confidence and also keep industry more compliant. Making sure the dispute resolution body also has the power to compel action and penalise is important for enforcement.</p>
<p><b>18</b></p>	<p><b>If you are a CASSPr, what do you estimate the cost and benefits of implementing this proposal would be? Please quantify monetary amounts where possible to aid the regulatory impact assessment process.</b></p>	<p>Not applicable.</p>
<p><b>19</b></p>	<p><b>Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets?</b></p>	<p>The proposed obligations are appropriate from our view as an asset manager.</p>

<p><b>20</b></p>	<p><b>Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above?</b></p>	<p>Minimum insurance requirements per wallet should be considered, especially as this becomes more practical with wider adoption.</p> <p>Point 8 dealing with independent verification of cyber practices should have an ongoing component as a one off review may not be sufficient as technology changes.</p> <p>SLAs (service level agreements) on withdrawals should be considered like T+2 settlement in traditional finance. Crypto asset transfers can be completed within minutes or hours, service providers should not be unnecessarily delaying any investor withdrawal requests.</p>
<p><b>21</b></p>	<p><b>There are no specific domestic location requirements for custodians. Do you think this is something that needs to be mandated? If so, what would this requirement consist of?</b></p>	<p>No, crypto assets are decentralised by nature. Some of the best custody providers are located offshore. The nature of digital assets does not necessitate domestic location requirements. However these providers should be able to register under the licencing regime if they are servicing Australian customers.</p>
<p><b>22</b></p>	<p><b>Are the principles detailed above</b></p>	<p>Yes, the principles are sufficient.</p>



	<b>sufficient to appropriately safekeep client crypto assets?</b>	
<b>23</b>	<b>Should further standards be prescribed? If so, please provide details</b>	Custodians in this space will be better placed to answer this, from our point of view and experience with custody arrangement of crypto assets, the standards are comprehensive.
<b>24</b>	<b>If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?</b>	Not applicable.
<b>25</b>	<b>Is an industry self-regulatory model appropriate for custodians of crypto assets in Australia?</b>	No, in the case of custody providers the proposed obligations would be more appropriate and preferred over self-regulation.
<b>26</b>	<b>Are there clear examples that demonstrate the appropriateness, or lack thereof, a self-regulatory regime?</b>	Since 2012, at least 46 crypto asset exchanges have lost an estimated \$2.6B in assets through major security breaches. There is a clear need for prescribed best-practice obligations for custody providers.
<b>27</b>	<b>Is there a failure with the current self-regulatory model being used by industry, and could this be improved?</b>	Under the current regime certain industry participants can be too opaque to determine if the self-regulatory model is working. Although, we have not experienced a failure under the current model with our custody providers.

28	<b>If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?</b>	Not applicable.
29	<b>Do you have any views on how the non-exhaustive list of crypto asset categories described ought to be classified as (1) crypto assets, (2) financial products or (3) other product services or asset type? Please provide your reasons.</b>	DigitalX has views on the appropriate classification of the assets provided in the non-exhaustive list, and we aim to participate in the token mapping exercise in the further consultation that will follow on this subject.
30	<b>Are there any other descriptions of crypto assets that we should consider as part of the classification exercise? Please provide descriptions and examples.</b>	Refer to question 29.
31	<b>Are there other examples of crypto asset that are financial products?</b>	Refer to question 29.
32	<b>Are there any crypto assets that ought to be banned in Australia? If so which ones?</b>	There are certain classes of non-productive crypto assets that attract significant retail investment that need further investigation. Much like traditional ponzi schemes, these assets serve no purpose other than enriching founders/early investors at the expense of late entrants. The model of these tokens usually has three components:

		<ul style="list-style-type: none"><li>• Token lock up periods in exchange for promised yield.</li><li>• Promises of unrealistic rates of interest, often in the thousands of % p.a.</li><li>• Unlimited supply of tokens which appears as hyperinflation, this debases existing investments to pay the extremely high rates of return.</li></ul> <p>These assets often perform very well early on, attracting a lot of retail investment before eventually collapsing as early investors begin redeeming their investments. We suspect the following tokens require further scrutiny by regulators, in particular to study their structures and tokenomics in order to identify other copying this model:</p> <ul style="list-style-type: none"><li>• OHM - Olympus</li><li>• HEX</li></ul> <p>Privacy coins - coins that allow users to obfuscate origin/movement are a direct threat to the current AML/CTF regime and should also be banned.</p>
--	--	---