

Australia - Crypto asset secondary service providers: Licensing and custody requirements

Consultation paper



25 May 2022

Introduction

Thank you for the opportunity to provide input on the CASSPr consultation paper.

As Asia's leading Digital Asset custodian, Hex Trust is a fully-licensed and insured provider of bank-grade custody for digital assets. Through our proprietary platform Hex Safe™, we deliver custody, DeFi, brokerage, and financing solutions for financial institutions, digital asset organisations, corporate and professional clients. Hex Trust has offices in Hong Kong, Singapore, and Vietnam and is expanding across Europe, the Middle East and the Americas. Hex Trust does not currently operate within Australia but it is a jurisdiction we are looking at with interest for possible future expansion. Our responses to the consultation paper are from the perspective of a provider of services to institutional clients and professional investors - we do not provide services directly to retail clients - but many institutional clients hold retail assets and there is therefore a strong tendency for retail asset regulatory requirements to be cascaded through to institutional providers.

| # | Terminology - CASSPr (Consultation paper page 10) | Hex Trust comment |
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| 1 | Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'? | Yes - this better describes the proposed scope of the regulations than "digital currency exchange". Virtual Asset Service Provider (VASP) is a term commonly used in many regulatory jurisdictions to cover this area. If VASP is not preferred then we suggest to remove "Secondary" from CASSP and make it Crypto Asset Service Provider (CASP). Whilst the difference between primary and secondary markets is understood, the use of the term "secondary" in the context of a service provider could cause confusion, implying some form of indirect service provision. The Primary/Secondary distinction is academic for most service users - clients view us simply as a "service provider". We believe this would be particularly the case for retail clients. |
| 2 | Are there alternative terms which would better capture the functions and entities outlined above? | |
| Crypto asset definition (pages 10/11) | | |
| 3 | Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments. | We believe this is an appropriate definition. |
| 4 | Do you agree with the proposal that one definition for crypto assets be developed to apply across all Australian regulatory frameworks? | Yes - this makes absolute sense for clarity and consistency and it would be even better if one definition could be used across all regulatory jurisdictions globally. |
| 5 | 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)? | At this stage we don't see the rationale for excluding some crypto assets from the regulations and so would prefer all crypto assets to be treated equally. |
| Policy objectives (page 14) | | |
| 6 | Do you see these policy objectives as appropriate? | Yes The objective of the regulations in our view should be to strike a balance between regulating activities on the one hand, whilst on the other allowing CASSPrs the ability to differentiate services and provide flexibility of approach. The crypto asset industry is evolving rapidly and needs flexibility to allow continued evolution and innovation, without regulation becoming a hindrance to reasonable business activity. Regulation should therefore be directional and principles-based rather than highly prescriptive. |
| 7 | Are there policy objectives that should be expanded on, or others that should be included? | Regulations should also differentiate between providers of services to retail clients who need a stronger degree of protection compared with providers servicing institutional/professional clients which have the resources/knowledge/expertise to perform their own detailed due diligence. |
| Scope of the regulation, types of crypto assets, regulatory duplication (existing vs upcoming) (page 15) | | |
| 8 | Do you agree with the proposed scope detailed above? | As mentioned in the introduction, Hex Trust does not offer crypto asset services to retail consumers. From the perspective of providing crypto asset services to professional investors, the proposed scope detailed above seems appropriate. |
| 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? | As with Q5 we do not see the rationale for distinguishing between different crypto asset types. In principle it is better to have a level playing field with all crypto assets regulated in a similar manner. The NFT market is at an early stage of development, so flexible regulation would be the most appropriate. |
| 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)? | ASIC should be responsible for all aspects of crypto assets and service providers in a comprehensive regulatory environment, such that CASSPrs don't have to engage with multiple regulators or regulatory regimes. |

| Proposed obligations, airdrops, advice, cost of implementation (page 17) | | |
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| 11 | Are the proposed obligations appropriate? Are there any others that ought to apply? | These seem appropriate but the requirement for minimum financial requirements (Obligation no 5) should be discussed in more detail as to what is a fair and reasonable level of financial requirements. |
| 12 | Should there be a ban on CASSPrs airdropping crypto assets through the services they provide? | It is not clear to us why there should be a ban on airdrops which are a normal part of the crypto asset industry. Processing of airdrops is part of the service a crypto custodian provides. |
| 13 | 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)? | We assume this means "Should there be a ban on providing advice which doesn't take account of a person's... etc". We believe that service providers should be able to provide factual answers to clients' questions but should stop short of offering investment advice, especially to retail clients, unless they are appropriately licensed, in a similar way to financial products. |
| 14 | If you are a CASSPr, what do you estimate the cost of implementing this proposal to be? | The proposed regulations are largely in line with Hex Trust's existing practices and regulatory obligations in other locations. Therefore, if we were to become licensed in Australia we do not envisage any significant additional cost of complying with the regulations as outlined and providing they are implemented in a pragmatic manner. The main exception to this would be the financial requirements required by ASIC which would clearly be an incremental cost but cannot be quantified at this stage. |
| Alternative option 1 Regulating CASSPrs under the financial services regime (page 18) | | |
| 15 | 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? | On the face of it we would not support this. It could make regulation of crypto assets and service providers unnecessarily restrictive and complex. The dynamics of the crypto world are very different from the traditional financial services industry and the regulatory environment should recognise this rather than adopting a "one size fits all" approach. We should take care not to unnecessarily restrict crypto innovation. |
| 16 | If you are a CASSPr, what do you estimate the cost of implementing this proposal to be? | N/A |
| Alternative option 2 Self-regulation by the crypto industry (via a code of conduct for crypto asset services) (page 19) | | |
| 17 | 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? | Voluntary codes of conduct can be seen as ineffective and even self-serving and in our view wouldn't be conducive to strengthening the image and reputation of crypto. An external, objective but nurturing regulator seeking to establish best practice but encouraging innovation should be the best way forward. |
| 18 | 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. | N/A |
| Custody obligations to safeguard private keys (page 21) | | |
| 19 | Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets? | In principle these look reasonable, but the actual terms of some of the obligations, for example points 3 and 4, would be critical and would need to take account that this is a young industry without necessarily the financial resources, balance sheet strengths and depth of expertise of traditional financial service providers. For point 9 there could be some form of insurance requirement but again this would need to be pitched at a realistic level and commensurate with the ability to obtain insurance cover at commercially viable rates. |
| 20 | Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above? | Not in our opinion |
| 21 | 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? | It is a normal requirement to need to establish a minimal in-country presence, such as locally-incorporated company, office and resident senior executive. Without some form of local presence it is difficult to see how a service provider can be effectively regulated. |
| 22 | Are the principles detailed above sufficient to appropriately safekeep client crypto assets? | Yes - they appear appropriate. |
| 23 | Should further standards be prescribed? If so, please provide details | No |
| 24 | If you are a CASSPr, what do you estimate the cost of implementing this proposal to be? | For Hex Trust the marginal cost would be minimal as we believe we already conform to the practices outlined. See also our response to Q14. |
| Self-regulatory model for custodians (page 22) | | |
| 25 | Is an industry self-regulatory model appropriate for custodians of crypto assets in Australia? | Please see our response to Q17. In addition to these points, whilst a self-regulatory model might work for traditional custodians, we question if the crypto industry has the maturity to regulate itself at this time. A self-regulatory model also runs the risk of becoming a means to erect obstacles to newcomers into the industry. Furthermore it is not clear how self-regulation might work in such a fluid jurisdictional / legal environment that we find in the crypto world. |
| 26 | Are there clear examples that demonstrate the appropriateness, or lack thereof, of a self-regulatory regime? | No comment |
| 27 | Is there a failure with the current self-regulatory model being used by industry, and could this be improved? | We are not familiar with the current regulatory model and are therefore unable to comment. |
| 28 | If you are a CASSPr, what do you estimate the cost of implementing this proposal to be? | N/A |

Crypto classification (page 24)

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| 29 | 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. | For consistency purposes and to avoid the need to frequently revise the regulation, we believe this should be limited to two broad categories: (1) crypto asset (2) financial product This is in line with the classification used by other regulators, for example MAS in Singapore. |
| 30 | Are there any other descriptions of crypto assets that we should consider as part of the classification exercise? Please provide descriptions and examples. | No |
| 31 | Are there other examples of crypto asset that are financial products? | No comment |
| 32 | Are there any crypto assets that ought to be banned in Australia? If so which ones? | No comment |

Alessio Quaglino Chief Executive Officer

