

Annexure 4. List of consultation questions

<https://treasury.gov.au/consultation/c2023-341659>

I am responding to this consultation on behalf of the London Stock Exchange group, for which there exists a digital assets taxonomy build with Digital Assets Research.

The taxonomy is unique in its transparent methodology for screening assets and exchanges, necessary to comply with EU and UK regulations for building indices, as part of our FTSE Russell Index products

The screening process and taxonomy may be useful for the Australian government when considering a bespoke taxonomy. DAR continue to maintain our taxonomy with other industry partners

[https://research.ftserussell.com/products/downloads/Guide to the Vetting of Digital Assets and Digital Asset Exchanges.pdf](https://research.ftserussell.com/products/downloads/Guide%20to%20the%20Vetting%20of%20Digital%20Assets%20and%20Digital%20Asset%20Exchanges.pdf)

All the consultation questions, posed in this paper, are listed below. Please provide your responses to the following consultation questions and include examples where relevant.

Q1) What do you think the role of Government should be in the regulation of the crypto ecosystem?

Personal View of Alex Johnston

digital assets are a technology with the potential to transform multiple industries including but not limited to the financial services. Governments should not stifle innovation by imposing strict standards associated with the financial services, rather provide guidance for users in a similar way to the adoption of telecommunications, the internet and public services like email

Q2) What are your views on potential safeguards for consumers and investors?

Personal View of Alex Johnston

Consumers and investors should be informed and reminded of potential loss of funds entering digital asset networks. This can be done at the interface of banks into digital asset exchanges (i.e. payments), during onboarding to exchanges as well as transacting within the exchange. Beyond this point it is the responsibility of investors and consumers to conduct themselves accordingly.

The government may restrict digital asset exchanges to a set range of products, as in Japan, however this may limit innovation beyond 'crypto' assets today towards real world assets (RWA) and other new forms of technology

Public View of LSEG

A screening process can be used - like how we screen digital asset protocols for inclusion in FTSE Russell Indices. Further information is available at <https://www.ftserussell.com/digitalasset> specifically the digital asset vetting process applied to comply with EU and UK Benchmark Regulations.

https://research.ftserussell.com/products/downloads/Guide_to_the_Vetting_of_Digital_Assets_and_Digital_Asset_Exchanges.pdf

In summary, a benchmarked digital asset must meet criteria that includes:

- Pricing Assessment - trading activity, availability on multiple (screened) exchanges, convertible to fiat whitelist e.g. USD, JPY), wash trading checks, and other price comparisons
- Custody Assessment - custodied by institution, HSM hardware/software supporting air gapped cold storage and offline wallet generation/tx signing
- Codebase Qualitative Assessment - codebase and repository checks: 8 criteria including open source, version control, vulnerabilities
- Codebase Quantitative Assessment - digital asset project developer activity and effectiveness: 4 criteria including commit-to-contributor threshold requirements
- Network Security Assessment - security of the underlying network: 3 criteria including Byzantine Fault-Tolerant Consensus, Validator Diversity
- Protocol Security Assessment - security of the cryptographic tools used: 3 criteria including BIP32, BIP44, BIP39 and other signatory compliance
- Liquidity Assessment - measuring relationships between price sold for and speed of sale
- Regulatory Assessment - not subject to extraordinary surveillance or legal action by regulatory bodies

Q3) Scams can be difficult for some consumers to identify.

- a) Are there solutions (e.g. disclosure, code auditing or other requirements) that could be applied to safeguard consumers that choose to use crypto assets?

Personal View of Alex Johnston

Government or affiliated services may provide guidance on protocol quality using a scoring system similar to described in

consumer watchdog services may be useful for websites that accept digital assets as payment or facilitate the use of digital assets in the services, e.g. games. Note that digitized value has been used in the gaming and retail industries for many years in the form of gift cards tokenizing fiat value.

- b) What policy or regulatory levers could be used to ensure crypto token exchanges do not offer scam tokens or more broadly, prevent consumers from being exposed to scams involving crypto assets?

Confidential View of LSEG

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Using a screening process or service similar to the FTSE Russell Digital Asset Screening described in Q2. We at London Stock Exchange Group (LSEG) are interested in providing this service to the Australian Government as well as for digital asset exchanges domiciled in Australia. We already provide KYC, AML, ATF screening services to the government, special services and most digital asset exchanges in Australia & Asia.

Q4) The concept of ‘exclusive use or control’ of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records.

- a) How do you think the concepts could be used in a general definition of crypto token and crypto network for the purposes of future legislation?
- b) What are the benefits and disadvantages of adopting this approach to define crypto tokens and crypto networks?

Q5) This paper sets out some reasons for why a bespoke ‘crypto asset’ taxonomy may have minimal regulatory value.

- a) What are additional supporting reasons or alternative views on the value of a bespoke taxonomy?

Confidential View of LSEG

A taxonomy is necessary for the financial services to build investable products for the regulated financial community - subject to more stringent controls and mandates. Taxonomies enable development of investment strategies and risk policies, creation of index-linked products based on sector themes (gaming, defi, medical, infrastructure, energy, etc). Categories enable performance attribution to be conducted with portfolios, portfolio construction and comparison through benchmarking.

- b) What are your views on the creation of a standalone regulatory framework that relies on a bespoke taxonomy?

Personal View of Alex Johnston

Digital Assets built on blockchain technology are a technical innovation and therefore need different considerations to equities - code can reflect a range of behaviour and though may have overlap with investable products requires separate consideration. A taxonomy supports separation of concerns in code and may form a path to more considerate policy for each use case.

- c) In the absence of a bespoke taxonomy, what are your views on how to provide regulatory certainty to individuals and businesses using crypto networks and crypto assets in a non-financial manner?

Personal View of Alex Johnston

If regulation had been applied to the growth of the internet, or the growth of mobile applications over the mobile net, then we would not have the productivity gains and disinflationary results from these two technologies over the past few decades.

Value is already passed today in the gaming sector, for example, through the purchase of in game money tokens and prepaid credits, with low touch regulation. Similar approaches to self-regulation enable innovation to proceed whilst ensuring scrutiny from peers.

Consumers may be protected from scams and fraudulent token activity through an industry body responsible for vetting tokens, providing a gold/AAA rating similar to S&P, and use external tools like

the DAR vetting process and others resources such as OpenZeppelin for smart contract quality and the many contract audit companies that exist today. These companies can be registered and regulated for providing quality guidance.

Q6) Some intermediated crypto assets are ‘backed’ by existing items, goods, or assets. These crypto assets can be broadly described as ‘wrapped’ real world assets.

- a) Are reforms necessary to ensure a wrapped real-world asset gets the same regulatory treatment as that of the asset backing it? Why? What reforms are needed?

Confidential View of LSEG

I would look to the work by MAS for regulating 1-2-1 asset backing of currencies. Circle have a prudent approach for backing and proving 1-2-1 backing of USDC approach for . For precious metals like Gold then the approach by Perth Mint to prove 100% backing of their PMGT token provides a model for other precious metals and physically custodial property.

- b) Are reforms necessary to ensure issuers of wrapped real-world assets can meet their obligations to redeem the relevant crypto tokens for the underlying good, product, or asset?

Q7) It can be difficult to identify the arrangements that constitute an intermediated token system.


- a) Should crypto asset service providers be required to ensure their users are able to access information that allows them to identify arrangements underpinning crypto tokens? How might this be achieved?
- b) What are some other initiatives that crypto asset service providers could take to promote good consumer outcomes?

Q8) In addition to the functional perimeter, the *Corporations Act* lists specific products that are financial products. The inclusion of specific financial products is intended to both: (i) provide guidance on the functional perimeter; (ii) add products that do not fall within the general financial functions.

- a) Are there any kinds of intermediated crypto assets that ought to be specifically defined as financial products? Why?
- b) Are there any kinds of crypto asset services that ought to be specifically defined as financial products? Why?

Q9) Some regulatory frameworks in other jurisdictions have placed restrictions on the issuance of intermediated crypto assets to specific public crypto networks. What (if any) are appropriate measures for assessing the suitability of a specific public crypto network to host wrapped real world assets?

Q10) Intermediated crypto assets involve crypto tokens linked to intangible property or other arrangements. Should there be limits, restrictions or frictions on the investment by consumers in relation to any arrangements not covered already by the financial services framework? Why?

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- Q11) Some jurisdictions have implemented regulatory frameworks that address the marketing and promotion of products within the crypto ecosystem (including network tokens and public smart contracts). Would a similar solution be suitable for Australia? If so, how might this be implemented?**
- Q12) Smart contracts are commonly developed as ‘free open-source software’. They are often published and republished by entities other than their original authors.**
- a) What are the regulatory and policy levers available to encourage the development of smart contracts that comply with existing regulatory frameworks?
 - b) What are the regulatory and policy levers available to ensure smart contract *applications* comply with existing regulatory frameworks?
- Q13) Some smart contract applications assist users to connect to smart contracts that implement a pawn-broker style of collateralised lending (i.e. only recourse in the event of default is the collateral).**
- a) What are the key risk differences between smart-contract and conventional pawn-broker lending?
 - b) Is there quantifiable data on the consumer outcomes in conventional pawn-broker lending compared with user outcomes for analogous services provided through smart contract applications?
- Q14) Some smart contract applications assist users to connect to automated market makers (AMM).**
- a) What are the key differences in risk between using an AMM and using the services of a crypto asset exchange?
 - b) Is there quantifiable data on consumer outcomes in trading on conventional crypto asset exchanges compared with user outcomes in trading on AMMs?