



CRYPTO ASSET

SECONDARY SERVICE

PROVIDERS

**LICENSING AND CUSTODY
REQUIREMENTS**



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Dear Treasury,

Crypto asset secondary service providers: licensing and custody requirements

Introduction

Stirling & Rose welcomes the opportunity to comment on the Treasury Crypto asset secondary service providers: Licensing and custody requirements – Consultation Paper (Consultation Paper).

We first propose that any recommendations in respect of the Consultation Paper are appropriately contextualised as only one part of what will need to be the government's holistic response to new digital rights, obligations and responsibilities. Second, we make recommendations on key regulatory considerations surrounding the definition of crypto assets, and our proposal to bring crypto assets into the financial product regulatory regime.

Stirling & Rose advises a variety of clients who would fall under the definition of CASSPrs set out in the Consultation Paper.

Executive Summary

Responsible and innovative regulation of crypto assets by the Australian Government will only be effective if we understand that crypto assets belong to a new and increasingly ubiquitous global asset class that:

- (a) Is comprised of a broad church of programmable assets that are novel in that they can change in any number of parameters including state, size, data retention, transferability, integration with other parts of their underlying ‘tech stack’ (e.g., distributed ledger technology or DLT) and rights and obligations (Novel Features Problem). It *does not* however follow that just because crypto assets have Novel Features they should not be regulated.
- (b) Includes assets with autonomous elements that exist independently of a responsible person or ‘person in the loop’. This is problematic because all existing legislation is predicated on rights, responsibilities (custody) and penalties for non-compliance to ultimately be placed on or with a ‘person’ (not a machine or an algorithm). This problem (the Responsible Machine Problem) will need to be addressed by the Australian government many times over the next decade and will impact all areas of the law. For example, the notion of a ‘responsible person’ is difficult in the context of some crypto assets where the Responsible Machine Problem is already at play. It cannot be correct that where no responsible person can be identified, a crypto asset should not be regulated if the crypto asset would be considered a financial product or service, but for the substitution of an algorithm or a machine for a responsible person. A clear example of legislative decisions that will ultimately revolve around this problem, is the regulation of decentralised autonomous organisations or (DAOs);
- (c) Includes assets that are clearly financial products/services operating in financial markets, such that these assets should continue to be regulated as financial products but with greater clarity and nuance as to how to comply with regulation, particularly considering their Novel Features;
- (d) Includes assets that have meaningful and practical benefits beyond speculative trading. From carbon trading to DeFi applications, such assets may encourage technological innovation, efficiency, and greater productivity;
- (e) Will include the next iteration of digitised legal contracts (smart legal contracts or SLCs) which bring their own legal considerations to bear;
- (f) Includes features traditionally associated with Ponzi schemes and other undesirable or dishonest speculative behaviours; and

- (g) Has not been holistically well integrated into the existing regime of any jurisdiction – although some jurisdictions are now moving to better integrate these assets into their broader economic function, (e.g., Singapore and the US).

Recommendations

Stirling & Rose makes the following recommendations, as elaborated in the substantive discussion below:

- (a) **Crypto vs financial products (navigating the dichotomy):** Defining the concept of ‘crypto assets’ and its relation to ‘financial products’ is the first and most important question. The broad definition set out in the Consultation Paper does not square with the approach of defining these two categories as mutually exclusive and establishing a hierarchical relationship whereby blockchain-based digital assets that are also financial products are subject to the financial products/services/markets regime.
- (b) **Avoiding prescription:** Prescriptively defining crypto assets should be approached with caution. We do not support the use of naming systems that will sandbox the technology, as such legislation will likely become obsolete in the face of evolving technological developments.
- (c) **Principles based approach to address dynamic technology:** Tokens are dynamic and can change their nature over time so a principles-based definition system should be considered.
- (d) **Using the right legislation for the task:** The Corporations Act should govern the field with respect to its domain of financial products, services and related licensing; however, it is not the appropriate sole legislative repository for crypto assets.
- (e) **Crypto assets that are financial products should be regulated by the Corporations Act:** As a matter of fundamental principle, ‘crypto assets’ that are financial products should be regulated under the Corporations Act. Relevant provisions of the *Corporations Act* should be amended and updated to properly address and characterise crypto assets (and related services) and, insofar as necessary, effectively address any unique risks raised by blockchain-based financial products. We remain neutral at this stage as to whether a ‘lighter touch’ or any additional measures are needed.
- (f) **A holistic and dedicated regime:** Establish a new and holistic digital regime (potentially in a separate statute) addressing in a foundational way the Responsible Machine Problem.
- (g) **A moratorium for CASSPrs is reasonable and practical:** A moratorium for a reasonable period (e.g., 18 months) to allow ‘crypto asset secondary service providers’ (CASSPrs) entities to comply with Corporations Act requirements before any penalties apply.

- (h) Legislative audit to deal with crypto assets: A legislative audit should be conducted of State and Federal legislation to ensure that they properly recognise the characterisation of crypto assets (as defined in any new legislation). For example, the *Personal Property Securities Act 2001* (Cth) provides for a regime for security interests over personal property to be perfected. The only presently available means of perfection with respect to crypto assets is registration on the Personal Property Securities Register which may not be appropriate given the nature of crypto assets.
- (i) No action letters may be a helpful measure for this burgeoning space: If an appropriate regulatory mechanism can be established, we would recommend the use of “no-action” letters (in the style of the US Securities Exchange Commission). Without “no-action” style letters or appropriate enforcement of market participants acting without licences (particularly where financial products or services are being issued, dealt or traded in) the Australian government is setting a concerning precedent that has a punitive comparative impact on good actors engaging with regulators.

About Stirling & Rose

Stirling & Rose is a national law firm with offices in all major cities. We are market leaders and a first-of-a-kind legal practice specialising in crypto assets, Web 3.0, smart legal contracts and digital law. Our partner cohort have a long track record across some of the most complex transactions and applications of digital law in the market and have been influential in thought leadership, policy making, and regulation internationally.

We have advised Governments, Central Banks, platform providers, investors and financial institutions in blockchain platforms, the governance of Web 3.0, central bank digital currencies, smart legal contracts, NFTs and property law, digital ethics and human rights.

Our leadership team consists of a group of global experts in the field, who care deeply about justice in our technological future.

Accordingly, Stirling & Rose is uniquely positioned to advise on the Consultation Paper and can bring a global and local focus.

1. Responses to Consultation Questions

Stirling & Rose supports the overarching policy objectives set out on p. 14 of the Consultation Paper (consumer protection, AML/CFT, and greater regulatory certainty). We would also stress the importance of managing financial market integrity and financial stability risks. Crypto assets (broadly defined) are increasingly presenting financial stability risks, as the recent Terra/Luna episode has demonstrated. As mainstream investors and financial institutions continue to become exposed to this market, contagion between the 'crypto' and 'mainstream' economy grows.¹

However, we would qualify some of the assumptions adopted in the Consultation Paper. For example, the notion that crypto assets are 'distinct in character from financial products and are affected by different market dynamics, with features that create different risks and market failures' does not sit well with the broad definition adopted in the Consultation Paper (see below). Further, features of blockchain databases (such as decentralisation and

¹ See R.M. Lastra and J.G. Allen, 'Virtual Currencies in the Eurosystem: Challenges Ahead' (European Parliament ECON Committee Monetary Dialogue Briefing Paper, July 2018), 26, [Virtual currencies in the Eurosystem: challenges ahead \(europa.eu\)](https://www.europa.eu).

tamper-proofness) do not remove all the risks associated with this new asset class or reduce the need for product disclosure (for example). Nor do we think it is necessarily accurate that blockchain is a technology which reduces risk and therefore justifies ‘lighter regulation than existing products’ despite providing ‘the same service to the consumer’ consider the Responsible Machine Problem set out above.

Further, we would emphasise the importance of bringing decentralised finance (DeFi) into the picture at an appropriate stage of this process. Once an activity becomes regulated, entities have an incentive to move into the unregulated space to escape the costs of compliance.² Thus, there is a risk of shadow financial products proliferating in the DeFi space. Some of the developments characteristic of DeFi (such as DAOs, assets without identifiable issuers, and informal governance networks) are significant regulatory challenges. Again, the Responsible Machine Problem is relevant.

We are broadly supportive of many of the proposals set out in the Consultation paper, mindful of the early stage of the process. Below, we elaborate on the points that we regard as most essential at this preliminary stage of the law reform process.

There is a potential (though not necessarily insurmountable) constitutional question about decentralised platforms which do not involve corporations – and whether the *Corporations Act 2001 (Cth)* (Corporations Act) is the correct governing legislation for crypto assets (which we will not elaborate on at the current time.)

² See C.A.E. Goodhart and R.M. Lastra, ‘Border Problems’ (2010) 13(3) *Journal of International Economic Law* 705.

2. Proposed Definitions

The most crucial question is how one defines ‘crypto assets’ relative to other categories of asset. This is logically primary because it informs one’s answer to all following questions. At the outset, we are strongly averse to particular naming systems that will sandbox the technology. This is because such legislation will likely become obsolete in the face of evolving technological developments. We recommend further consultation on how to capture assets and activities with the most neutral language possible.

The Consultation Paper sets out an approach by which ‘crypto assets’ and ‘financial products’ are mutually exclusive categories, but on p. 10 adopts the ASIC definition of ‘crypto assets’ that is very broad, namely:

...a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof.

So defined, the category of ‘crypto assets’ doubtless contains many financial products as defined in s. 764A of the Corporations Act. In our view, many (even most) blockchain-based digital assets are, in fact, financial products.

We note, and agree with, the approach taken in the Consultation Paper at p. 12 that the “tokenisation” of an asset by putting it on-chain should not make an asset a financial product per se’. We also note, and agree with, the proposition that ‘[i]f a crypto asset is a representation of, or connected with, an underlying product, service, or asset, then the regime that already applies to the underlying product, service, or asset should apply as far as practical.’ This is consistent with the basic principle of regulating activities, not technologies.³

At base, distributed ledger technology (including blockchain) is a *type of database*; in most cases, it does not say anything necessarily about the *type of asset* that database is used to record, or the risks inherent to that asset (as opposed to risks of, e.g., database or intermediary failure). For example, a company that uses a blockchain data structure to record ownership of its shares (instead of a paper ledger book or an Excel spreadsheet) is still issuing ‘shares’, being rights in the company that gave participation and profit rights and limit their holders’ liability to the nominal value of the shareholding.

The definition of ‘crypto asset’ is not an easy task. The terminology used to define blockchain-based digital assets has evolved over the past decade and in our view, there is still no truly adequate definition in any jurisdiction. In the past, some of us have advocated

³ There may be specific circumstances in which technology-specific regulation is required, but we do not think it would be appropriate to remove blockchain-based financial products into a separate (and possibly more relaxed) regulatory environment in virtue of blockchain use alone.

a very narrow definition of the category ‘crypto assets’ to include only those issued on open, permissionless networks which do not represent any value external to themselves (e.g., Bitcoin).⁴ This distinguishes, at least, blockchain-based digital assets that have ‘digital commodity’ features from those that are more obviously ‘tokens’ with some external reference asset.

In light of this, we do not think that it is possible to combine (i) the broad definition of ‘crypto asset’ currently adopted by ASIC with (ii) two mutually exclusive categories of ‘crypto asset’ and ‘financial product’ and (iii) a hierarchical rather than cumulative legislative framework for governing ‘crypto assets’ (broadly defined) that are also financial products.⁵

In our view, the consultation process should be used to develop a satisfactory definition of ‘crypto assets’ that does what it is meant to do: identifying and excluding the sub-set of blockchain-based digital assets that are not ‘financial products’. Given the current market usage and legal definition of ‘crypto assets’ and related terms in other jurisdictions, ‘crypto assets’ may not be the best nomenclature for this subset. This then raises two questions:

First, do blockchain-based financial products require different treatment to other financial products? This is essentially a question of (i) the perceived desirability of fostering the nascent industry (that might justify a ‘lighter touch’) and (ii) the technical and Novel Features of blockchain-based financial products (that might justify additional requirements over and above those already found in Chapter 7). At this stage, we think it is most important to frame this question of regulatory design and policy correctly; we do not make any substantive submissions on the merits of either (i) or (ii) but again note the long-term impact of the Responsible Machine Problem.

Secondly, what is to be done with non-financial product crypto assets? Should they be (i) unregulated, (ii) regulated within Chapter 7 (for example, by deeming them to be ‘financial products’ as defined in the Corporations Act), or (iii) regulated within a parallel regime?

Beyond this framing of the policy decision-space, we think it is important at the present stage to highlight that tokens can change characterisation over time. For example, the analysis of whether a digital asset is offered or sold as a security is not necessarily static. Further, there is a great deal of overlap between classification categories; hybridity is a well-known issue in this space. Modifying a token’s function (or associated rights) may move a Digital Asset from one category into another, and/or dictate that it straddles more than one category. How a token should be classified and therefore regulated, is also a product of the

⁴ See J.G. Allen *et al*, ‘Legal and Regulatory Considerations for Digital Assets’ (Cambridge Centre for Alternative Finance 2020), 13, [Legal and Regulatory Considerations for Digital Assets - CCAF publications - Cambridge Judge Business School](#); J.G. Allen, ‘Cryptoassets in Private Law’ in Iris Chiu and Gudula Deipenbrock (eds), *Routledge Handbook of Financial Technology and Law* (Routledge 2021), Ch 17.

⁵ See the discussion in Apolline Blandin *et al*, ‘Global Cryptoasset Regulatory Landscape Study’ (Cambridge Centre for Alternative Finance 2019), 18, [2019-04-ccaf-global-cryptoasset-regulatory-landscape-study.pdf \(cam.ac.uk\)](#).

relationship that token has with other digital assets, or its milieu of operation. For example, an NFT in isolation is its own class... if however, it is wrapped or tethered to a security token, that will likely change the nature of the NFT such that it also should be a regulated token. We set out some further thoughts on this point in Appendix I.

3. Incorporation into Financial Services Regime

With the above considerations in mind, Stirling & Rose supports the proposal to bring crypto assets into the financial product regulatory regime through the incorporation of CASSPr licensing requirements into the Corporations Act. We believe this is unavoidable to the extent that many crypto assets are clearly financial products or could become financial products pending their future development and/or use, and that most CASSPrs are likely to want to provide services for cryptoassets that are and are not financial products under the definition in s. 764A(1).

In our experience, few secondary service providers want to provide services exclusively over 'crypto assets' (narrowly defined as blockchain-based assets that are not s. 764A financial products). Our clients generally want to list blockchain-based financial products alongside 'crypto assets'. In this context, it is also essential to remember the dynamic nature of crypto assets based on their empirical use. This being the case, it is important to consider whether the regulatory burden (and risk of regulatory overlap and duplication) would be eased or increased by the enactment of a parallel regime, which might resemble something like a Tier 3 market license, for non-financial product crypto asset service providers.

In our experience, it would cause duplication for most affected entities. This does not necessarily preclude the approach altogether, but it does flag the need for further consultation and careful consideration.

ASIC is required to assess all applications for an AFSL fairly based on whether applicants:

- 'display the competency required to provide the financial services specified in the application; and
- have ample financial resources to provide on the proposed business services; and
- can meet the other obligations of an AFS licensee (such as training, compliance, insurance and dispute resolution)'

Beyond this, the other main policy design consideration is to resolve the need for a primary and holistic piece of legislation (or regime) for crypto assets and broader digitisation requirements.

4. Conclusion

Stirling & Rose broadly supports the proposal to bring crypto assets into the financial product regulatory regime, through the incorporation of CASSPr licensing requirements into the current Corporations Act and also welcomes the introduction of a new holistic ‘Digital Act’ or regime that amongst other things address the Responsible Machine Problem. We welcome any further inquiries and look forward to participating in the next stages of the consultation process.

APPENDIX – INDICATIVE VIEWS ON TOKEN MAPPING

We note our first recommendation in the Executive Summary, which is to avoid defining crypto assets too narrowly, given (*inter alia*) their dynamic nature.

The inherent attributes of a crypto asset may or may not warrant their characterisation as financial products. However, subsequent usage may result in such assets being recognised (or not recognised) as financial products.

For instance, crypto assets which are digital representations of real-world collectible items (e.g., NFTs) should not by their inherent nature be financial products, but subsequent sale or resale may make them so. In other words, the indicia of a ‘financial product’ in Australian law depends on an object’s empirical use over time rather than (only) its design and intended use-case at time of launch. Use as a facility for non-cash payments, for example, may even occur without the intention of the issuer.

We welcome participation in the token mapping exercise and set out our initial comments below.

No.	Token	Position
1	Utility crypto assets which can only be redeemed for goods or services by the issuer. This includes loyalty schemes and digital vouchers represented with crypto assets. For example, crypto assets that are developed for storage and digital content and data	Likely not financial products
2	Collectable crypto assets that include digital representations of real-world collectible items like art, image, music, in-game items, promotional posters	Likely not financial products in themselves but capable on subsequent use / sale
3	Zero utility crypto assets that provide no promises, rights or other use case than the ability to transfer them via a network	Likely not financial products
4	Membership crypto assets that allow access to communities or loyalty schemes. This can include ‘social’ crypto assets	Likely not financial products

5	Asset-backed crypto assets used as a store of value, means of exchange and unit of account. These would include certain stablecoins and Central Bank Digital Currencies (CBDCs)	Financial products
6	Algorithmic stable crypto assets whether under-collateralised or over-collateralised	Likely financial products
7	Crypto assets used for fundraising similar to not-for-profits	Financial products but carved out as an exception
8	Crypto assets used for fundraising by performing artists, journalists, or similar publications as a form of income to offer their services	Financial products but carved out as an exception
9	Governance crypto assets that have no value accrual	Likely not financial products
10	Governance crypto assets that have value accrual (e.g. buy back and burn model)	Likely financial products
11	Crypto assets that replicate the functions of a financial product (whether they strictly meet the definition or not, for example, derivatives where technology is the intermediary instead of the issuer)	Financial products
12	Hybrid crypto assets that may perform multiple functions across several categories	Dominant purpose test should apply

Stirling & Rose is a national incorporated legal practice that specialises in the intersection of law and emerging technology.

