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**Submission on Regulating digital asset platforms: Proposal Paper**

MinterEllison appreciates the opportunity to make a submission in relation to the Proposal Paper on 'Regulating digital asset platforms' released on 16 October 2023 (**Proposal Paper**).

MinterEllison is a leading Australian Law firm. We advise major financial institutions, fintechs and other financial intermediaries in Australia and overseas.

The views expressed in our submissions are ours alone and do not necessarily reflect the views of our clients.

**Overview**

We agree that digital asset platform providers (**platform providers**) should be the primary subject of regulation as they act as the main gateway between most consumers and the digital asset industry. We also agree with Treasury's proposal to include platform providers in the existing Australian financial services licensing (**AFSL**) regime.

Our detailed submissions in response to the proposals and questions raised in the Proposal Paper are set out below.

**1. Maintaining the distinction between investments and financial investments**

*Questions (Set 1): Prior consultation submissions have suggested the Corporations Act should be amended to include a specific 'safe harbour' from the regulatory remit of the financial services laws for networks and tokens that are used for a non-financial purpose by individuals and businesses.*

*What are the benefits and risks that would be associated with this? What would be the practical outcome of a safe harbour?*

1.1 Providing a 'safe harbour' to clearly identify where networks and tokens are not subject to financial services regulation could be beneficial. The current regime relies on general concepts, such as managed investment schemes, securities, derivatives and non-cash payment facilities, to determine whether a particular token or network is regulated. The application of these concepts to different types of tokens and networks is inherently uncertain. The benefits of specifying when a token or network is not caught by the financial services regime therefore include:

(a) encouraging innovation – a safe harbour will provide an environment for new technologies products and services to be created without unnecessary regulatory uncertainty and cost;

(b) reducing compliance burdens – allowing providers to focus resources on growth and development; and

(c) creating an attractive location for investment in Australia.

1.2 The main risk associated with providing a safe harbour would be how to identify and characterise whether particular tokens and networks should or should not be regulated as financial products. However, we believe that this risk could be addressed by giving ASIC, as the regulator, a broad power to designate whether particular tokens or networks are or are not regulated as financial products.

**2. Low value exemption**

2.1 We support the proposal that a platform provider would be required to hold an AFSL authorising them to issue and deal in digital asset facilities. We also support the proposed exemption for low value facilities.

*Questions (Set 2): Does this proposed exemption appropriately balance the potential consumer harms, while allowing for innovation? Are the proposed thresholds appropriate?*

*How should the threshold be monitored and implemented in the context of digital assets with high volatility or where illiquid markets may make it difficult to price tokens?*

2.2 We believe that the thresholds are reasonable. We note that they differ from other similar thresholds:

(a) as noted in the Proposal Paper, the low value exemption for non-cash payment facilities is $1,000 per customer and $10 million in total; and

(b) exemptions under the *Payment Systems (Regulation Act 1998* (Cth) where the total amount of obligations to make payments is no more than $10 million in total or the number of people to whom payments may be made does not exceed 50 people.[1]

2.3 The Proposal Paper does not provide any explanation for applying different thresholds to digital asset facilities.

2.4 We believe it is appropriate to increase the per customer threshold. The original threshold was proposed by ASIC in 2004[2] and an increase to $1,500 is broadly consistent with the rate of inflation. Consideration could however be given to automatically increasing the threshold by the rate of inflation or other appropriate index to ensure that it remains appropriate in a similar manner to the automatic adjustment of concessional contributions cap for superannuation.

2.5 We also suggest excluding wholesale clients from the per customer limit. This would facilitate innovation by allowing platform providers to develop their product in a more limited wholesale context.

2.6 We are unsure why a lower total value threshold has been proposed in the Proposal Paper. An inflation adjusted figure based on the low value exemption for non-cash payment facilities would be over $15 million.

2.7 It may be appropriate to consider an alternative threshold for the total size of the facility based on the number of customers. This would prevent the threshold needing to be adjusted periodically to reflect changes in value based on inflation or another appropriate measure. A limit of $1,500 per customer and a total value of $5 million would suggest a customer limit of around 3,500. On the other hand, a total value threshold of $15 million would suggest a customer limit of 10,000. We suggest a limit of 5,000 customers as an alternative to the total value threshold.

2.8 We agree that the volatile nature of digital assets may cause difficulties with the proposed thresholds. Using a customer number threshold would address this difficulty. In relation to the per customer limit, an alternative to calculating the value at any time could be to base the limit on the amount invested by the customer at the time they made the investment. This would have the effect that the most at risk for any customer using an exempt platform would be $1,500. A significant increase in the value of a customer's digital assets on the platform would not affect the amount that they had risked in the first place.

[1] Reserve Bank of Australia, Declaration No. 2, 2006 regarding Purchased Payment Facilities.
[2] ASIC Consultation Paper 59: Non-cash payment facilities, December 2004.

2.9 Alternatively, the thresholds could be determined by reference to an average value over a period of time, e.g. three months. However, this could still pose challenges where asset values are very volatile.

2.10 Where the market for a digital asset is illiquid, we suggest that platform providers be required to have a reasonable basis for the valuation of the tokens and this be certified by the directors periodically. ASIC could also be given the power to require platform providers to seek an external valuation of assets where appropriate.

**3. Brokers and other dealers**

3.1 We agree that intermediaries who deal in, or arrange for another person to use, a digital asset facility should be required to hold an AFSL authorising them to provide that service. We also believe that it would be appropriate to provide an exemption for businesses that are not primarily engaged in a financial services business where a licensed platform provider is involved.

*Questions (Set 3): What would be the impact on existing brokers in the market? Does the proposed create additional risk or opportunities for regulatory arbitrage? How could these be mitigated?*

3.2 We believe it is appropriate to have an exemption where there is a licensee involved and the exemption is limited to dealing in digital assets. It should not extend to advice or holding digital assets. It should only apply where the activity is the only financial service the business is engaged in and it should be an activity which is incidental to other non-financial service business activities.

**4. Financial requirements**

*Questions (Set 4): Are the financial requirements suitable for the purpose of addressing the cost of orderly winding up? Should NTA be tailored based on the activities performed by the platform provider?*

*Does the distinction between total NTA needed for custodian and non-custodian make sense in the digital asset context?*

4.1 We are unable to comment on the cost of an orderly winding up of a digital asset platform.

4.2 We note that the NTA requirements are different to and lower than similar requirements applying to other financial service providers. However, we acknowledge the purpose of the NTA requirement is not to prevent failure so the lower level requirement may be appropriate if it reflects relevant winding up costs. However, we do suggest that a minimum level of NTA be required. For example, the minimum required for responsible entities is $150,000. A lower minimum may be appropriate here but there should be one.

4.3 Applying a higher NTA requirement where there is no external custodian is consistent with existing requirements for other providers and is therefore appropriate.

**5. Financial product advice**

*Questions (Set 5): Should a form of the financial advice framework be expanded to digital assets that are not financial products? Is this appropriate? If so, please outline a suggested framework.*

5.1 We agree that the general licensing and conduct obligations, including advice related obligations, should apply to digital asset platforms, providers and intermediaries.

5.2 Where a token is available through a platform, the current definition of financial product advice should capture any advice given in relation to the token where the advice also relates to the platform, i.e. because it is given in the context of the platform. If the advice does not relate to the platform and only relates to the token, it would only be regulated as financial product advice if the token is itself a financial product. This seems to be an appropriate outcome.

5.3 The question is whether the token should be treated as a financial product. If not, then there should not be any reason to regulate advice given in relation to the token under the financial services regime. General consumer protection laws would apply and there may be specific regulation at Federal or State level for the type of token in question.

## 6. Disclosure obligations and facility contract

6.1 We agree with the proposed approach to disclosure which is broadly consistent with the approach adopted for investor directed portfolio services (IDPSs).

6.2 The specific disclosure requirements proposed seem appropriate with one exception. The 'full disclosure' requirement requires platform providers to providing information required to 'understand rights to disclosure in relation to assets and tokens the subject of platform entitlements'. We would expect that platform providers would be required to do more than this. Surely they should be required to provide or provide links to the available information assets and tokens available through the platform.

*Questions (Set 6): Automated systems are common in token marketplaces. Does this approach to pre-agreed and disclosed rules make it possible for the rules to be encoded in software so automated systems can be compliant?*

*Should there be an ability for discretionary facilities dealing in digital assets to be licensed (using the managed investment scheme framework or similar)?*

6.3 We agree that it is appropriate for rules to be reflected in the contract in a manner that is technology neutral.

6.4 We do not believe there is any reason to prevent discretionary facilities provided they are subject to appropriate regulation and controls. We would expect that this would need specific licence authorisation.

## 7. Minimum standards for asset holders

*Questions (Set 7): Do you agree with the proposal to adopt the 'minimum standards for asset holders' for digital asset facilities? Do you agree with the proposal to tailor the minimum standards to permit 'bailment' arrangements and require currency to be held in limited types of cash equivalents? What parts (if any) of the minimum standards require further tailoring?*

*The 'minimum standards for asset holders' would require tokens to be held on trust. Does this break any important security mechanisms or businesses models for existing token holders? What would be held on trust (e.g. the facility, the platform entitlements, the accounts, a physical record of 'private keys', or something else)?*

7.1 We believe it is appropriate to have minimum standards for asset holders and that bailment arrangements could be used where appropriate.

7.2 The nature of what is held on trust may vary depending on the nature of the token. The nature of the ownership and trust arrangements should be required to be disclosed to clients and ASIC should have the ability to require platform providers to provide information about these arrangements and to impose specific requirements where required to protect clients against significant detriment.

## 8. Additional standards for token holders

*Questions (Set 8): Do you agree with proposed additional standards for token holders? What should be included or removed?*

8.1 We agree in principle with imposing obligations on token holders. Security of token holding arrangements is critical. As noted in our previous response, ASIC should also have the power to impose or tailor requirements where appropriate.

8.2 We note that some of the proposed additional standards could be very difficult to apply in practice. For example, identify the highest level of safety which balances security and timely processing of requests is a difficult standard to meet.

## 9. Minimum standards for transactional functions

*Questions (Set 9): This proposal places the burden on all platform providers (rather than just those facilitating trading) to be the primary enforcement mechanism against market misconduct.*

*Do you agree with this approach? Should failing to make reasonable efforts to identify, prevent, and disrupt market misconduct be an offence?*

*Should market misconduct in respect of digital assets that are not financial products be an offence?*

9.1 We agree that the platform provider should be subject to the obligations proposed. However, some of the proposed standards for transactional functions, specifically items (iv) and (v), relate more to standards of conduct rather than matters to be included in the client contract. We suggest that platform providers be required to comply with these standards and would expect non-compliance to give rise to civil penalties.

9.2 We would not expect failure to comply with these standards to be a criminal offence unless a criminal element is introduced, e.g. knowingly or recklessly failing to comply with the standard.

## 10. Token trading

*Questions (Set 10): The requirements for a token trading system could include rules that currently apply to 'crossing systems' in Australia and rules that apply to non-discretionary trading venues in other jurisdictions.*

*Do you agree with suggested requirements outlined? What additional requirements should also be considered?*

*Are there any requirements listed above or that you are aware of that would need different settings due to the unique structure of token marketplaces?*

10.1 We believe the proposed approach is appropriate.

## 11. Token staking

*Questions (Set 11): What are the risks of the proposed approach? Do you agree with suggested requirements outlined above? What additional requirements should also be considered?*

*Does the proposed approach for token staking systems achieve the intended regulatory outcomes? How can the requirements ensure Australian businesses are contributing positively to these public networks?*

11.1 We believe the proposed approach is appropriate.

## 12. Asset tokenisation

*Questions (Set 12): How can the proposed approach be improved?*

*Do you agree with the stated policy goals and do you think this approach will satisfy them?*

12.1 We believe the proposed approach is appropriate.

## 13. Funding tokenisation

*Questions (Set 13): Is requiring digital asset facilities to be the intermediary for non-financial fundraising appropriate? If so, does the proposed approach strike the right balance between the rigorous processes for financial crowdsource funding and the status quo of having no formal regime?*

*What requirements would you suggest be added or removed from the proposed approach? Can you provide an alternate set of requirements that would be more appropriate?*

13.1 We believe the proposed approach is appropriate in principle.

## 14. Other activities

*Questions (Set 14): Do you agree with this proposed approach? Are there alternate approaches that should be considered which would enable a non-financial business to continue operating while using a regulated custodian?*

14.1 The proposed approach seems more complex than it needs to be. The simplest approach would be to require all persons holding digital assets to be licensed to undertake that activity (subject to the low value exemption) unless the assets are held by a person authorised to hold digital assets. No other requirements should be needed.

## 15. Activities for future consideration

15.1 We agree that lending to businesses in the form of tokens should be permitted subject to appropriate regulation. The simplest solution would seem to be to amend the definition of 'money' to include stablecoins for this purpose.

15.2 We also agree that margin lending involving digital assets should be regulated under the Corporations Act margin lending regime whether or not the digital assets are financial products.

*Questions (Set 15): Should these activities or other activities be added to the four financialised functions that apply to transactions involving digital assets that are not financial products? Why? What are the added risks and benefits?*

15.3 Based on our observations above, we do not believe this is necessary. The proposed solutions would address the issues.

## 16. Implementation

*Questions (Set 16): Is this transitionary period appropriate? What should be considered in determining an appropriate transitionary period?*

16.1 We are concerned the proposed 12 month transition period may not be sufficient given the amount of work required not only to apply for and obtain a licence but also to implement systems to comply with the proposed requirements and standards.

16.2 We suggest that the transition period be extended as follows. Platform providers and others requiring an AFSL relating to digital asset facilities (**applicants**) should have 12 months to lodge an application for the relevant licence authorisations. Applicants should be able to continue to engage in relevant activities until ASIC grants or refuses to grant the licence authorisations sought. Once ASIC grants an application, the provider should be required to opt into the new regime within 12 months and the new obligations should only apply from that time.

Please contact us if you have any questions about any aspect of our submission. We have a strong commitment to working with Treasury and the industry to establish a regulatory framework for platform providers that is both fit for purpose and appropriate balances the need for innovation and consumer protection.

Yours faithfully
**MinterEllison**

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