coinbase

To:
Director – Crypto Policy Unit
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

Date:
1 December 2023

Re: Regulating digital asset platforms

Coinbase Global, Inc. and its subsidiary Coinbase Australia Pty Ltd (together, **Coinbase**) welcome the opportunity to comment on the Australian Treasury's proposal paper on *Regulating digital asset platforms* (**Consultation Paper**).

Coinbase Australia Pty Ltd is registered with the Australian Transaction Reports and Analysis Centre (**AUSTRAC**) as a Digital Currency Exchange (**DCE**). The Coinbase group holds licences in multiple jurisdictions, and is the only publicly listed digital asset platform in the United States (**US**). We are committed to ensuring appropriate consumer protection, governance, and risk management practices on our platform and support the creation of regulatory frameworks with those outcomes at the forefront.

We commend the Australian Treasury's work to develop regulatory clarity for the digital assets sector in Australia. We share the mutual imperative of ensuring the future framework for digital assets regulation provides effective protections for consumers while recognising the multiplicity of use cases for digital assets, the broader benefits to society in promoting a modern, innovative digital economy.

The Consultation Paper rightly focuses on outcomes, recognises the critical differences between financial and non financial uses of digital assets, and prudently identifies the centralised custody of assets as a regulatory anchor. We also appreciate Treasury's recognition of the role staking plays in securing Proof of Stake blockchains, and the substantive differences between certain staking activities and those that may constitute a Managed Investment Scheme. We further recognise Treasury's objective of aligning to international regulatory approaches given the global nature of this industry.

In our submission, we would draw your attention in particular to our recommendations to affirm certain global

digital asset facility arrangements (e.g. use of omnibus accounts and offshore models) within the legislative text, and to ensure balanced prudential requirements for digital asset facility providers. We believe that consideration of these issues will ensure Australia is able to attract mature, global players, leading to the responsible development of a vibrant digital assets industry while protecting Australian consumers. In order for Australia to leverage its presence on the international stage, we encourage further consideration with respect to the harmonisation of concepts and definitions throughout the Consultation Paper.

We are pleased to provide our comments to Treasury and look forward to engaging throughout the legislative process.

Sincerely,

Tom Duff Gordon
VP, International Policy
Coinbase Global, Inc.

John O'Loghlen
Country Director
Coinbase Australia Pty Ltd

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Introduction

Since our Australian launch in October 2022, Coinbase has sought to actively engage with the Australian Government and broader ecosystem to realise the potential of blockchain technology and Australia's digital transformation. We serve as a board member of Blockchain Australia, have partnered with web3 players such as Zepto and CryptoTaxCalculator, and collaborated with university blockchain departments and web3 innovation centres to provide thoughtful analysis on the potential role of digital assets in the future of the Australian economy.

We most recently responded to the Australian Attorney-General Department's consultation on *Modernising Australia's anti-money laundering and counter-terrorisim financing regime*,[1] and prior to that engaged with Treasury on the *Token mapping* consultation.[2] We are pleased to have another opportunity to share our views with the Australian Government in pursuit of a workable regulatory regime for digital assets.

In our previous response to the *Token mapping* consultation, we outlined key principles for a regulatory framework for digital assets. Coinbase has further advocated for the adoption, and the benefits, of international consistency related to these principles across jurisdictions including international standard setting bodies, such as the Financial Stability Board (**FSB**) and the International Organisation of Securities Commissions (**IOSCO**), as well as other Commonwealth jurisdictions such as the United Kingdom (**UK**) and Singapore.

We appreciate that Treasury has reiterated many of those principles in its Consultation Paper, and has noted that a fit-for-purpose regulatory regime must focus on outcomes. We concur with Minister Jones' remarks in October on the importance of a pragmatic approach to regulation that seeks to strike the right balance between encouraging innovation, providing consumer protection, and system stability.[3] The Consultation Paper endeavours to achieve those outcomes and sets Australia on the right path to doing so.

Coinbase Supports Treasury's Policy Principles

We support Treasury's policy principles and in some instances have included additional recommendations on how to best achieve these outcomes.

Treasury should continue to apply the following principles in the development of Australia's digital asset regulatory framework.

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[1] Coinbase, Response to Australian Attorney-General Department's consultation (16 June 2023).
[2] Coinbase, Response to Treasury's Token Mapping consultation (March 2023).
[3] The Hon Stephen Jones MP, Address to the Australian Financial Review Crypto Summit (16 October 2023).

1. Focusing on regulatory outcomes

'Given the unique structure of token marketplaces, wholly applying the existing frameworks may target the wrong risks and fail to accommodate potential benefits.'[4]

We commend Treasury for recognising the importance of applying an outcomes-focused approach to regulation, as the proposed framework adopts the principle of 'similar activity, similar risk, same regulatory outcome.'[5] This approach is aligned with international standards and will help to position Australia as a leader in the development of blockchain technology.[6]

2. Aligning with international jurisdictions

'The objectives of the proposed framework include: [...] aligning Australia's digital asset regulatory framework with international jurisdictions, where appropriate.'[7]

We agree that Treasury should adopt, where possible, standards and practices that are already internationally recognised. Digital assets are a global phenomenon, and they travel across jurisdictional lines with greater ease than traditional assets. Global alignment on the treatment of digital asset products and services is critical to a workable and interoperable regulatory framework. Where differences emerge, they should be clearly understandable and provide for treatment that can reasonably be implemented by market participants that operate in multiple jurisdictions.

3. Pursuing regulatory priorities while supporting innovation

'While the evolving landscape of digital assets may present new challenges, overextending financial regulations to non-financial products could inadvertently stifle growth in emerging sectors and deter the integration of digital technology into various non-financial industries.'[8]

Coinbase wholeheartedly supports Treasury's objective of promoting innovation through regulatory clarity. The Consultation Paper gives careful consideration to the challenges of regulating token-based systems[9] in a manner akin to traditional financial (**TradFi**) services, and we appreciate that Treasury has included 'providing agility and flexibility'[10] as a policy objective in regulatory treatment of this sector. We also appreciate the aim to support market structures and forms of vertical integration that are natural for blockchain-based ecosystems.[11] As we will outline in this submission, providing industry

[4] Treasury, Consultation Paper, p.10 (October 2023).
[5] Treasury, Consultation Paper, p.9 (October 2023).
[6] IOSCO, Policy Recommendations for Crypto and Digital Asset Markets Final Report (16 November 2023).
[7] Treasury, Consultation Paper, p.3 (October 2023).
[8] Treasury, Consultation Paper, p.19 (October 2023).

clarity – in particular in defining the regulatory perimeter – will be key to facilitating future innovation in Australia.

4. Acknowledging differences between financial and non-financial uses

'Financial investments and non-financial investments are distinguished by their inherent characteristics and risk profiles, particularly in terms of their impact on consumer protection.'[12]

We are encouraged that Treasury has rightfully identified that 'non-financial investments such as those made in real estate, gold, baseball cards, art, and domain names derive their value primarily from intrinsic attributes and the prevailing balance of market demand and supply.'[13] This recognition of consumptive uses for digital assets is a necessary first step to a sensible and workable regulatory framework, and avoids the pitfalls of jurisdictional approaches that exclusively and inappropriately rely on investor protection frameworks (to the detriment of product use and consumer protection).

5. Using asset holdings as the regulatory anchor point

'In the context of digital assets, the loss of access to tokens (via theft of private keys, loss of private keys, transaction errors, or damage to the systems storing private keys) can mean the irreversible loss of the entitlements linked to the tokens.'[14]

Coinbase agrees with an approach to regulation that focuses first on centralised digital asset intermediaries that engage in custody activities, as opposed to those that engage solely in decentralised finance (**DeFi**) activities that do not entail third party control of private keys. We believe this approach also most effectively accomplishes the key, mutual imperative of protecting consumers participating in the digital assets space. In service of this principle, it will be crucial to ensure the scope of legislation is clearly defined to capture centralised custodians.

6. Managing conflicts of interest within the natural market structure

'The regulatory model proposed in this paper aims to accommodate the natural market structure and emerging technologies used for token marketplaces.'[15]

We appreciate the Consultation Paper's recognition that the digital asset ecosystem – because of the instant settlement benefits enabled by blockchain technology – has

[9] Treasury, Consultation Paper, p.6 (October 2023).
[10] Treasury, Consultation Paper, p.3 (October 2023).
[11] Treasury, Consultation Paper, p.8 (October 2023).
[12] Treasury, Consultation Paper, p.19 (October 2023).
[13] Treasury, Consultation Paper, p.19 (October 2023).
[14] Treasury, Consultation Paper, p.31 (October 2023).
[15] Treasury, Consultation Paper, p.8 (October 2023).

naturally evolved to combine custody and token trading, which can be safely performed by a single intermediary and in a manner that aligns with the regulatory objectives of consumer protection and market integrity. Of course, like with TradFi market intermediaries, conflicts of interest can emerge, and where they do, they should be mitigated through fit-for-purpose regulation designed to preserve the efficiencies and risk mitigating benefits of instant settlement and while providing robust consumer protection.

High level summary of Coinbase recommendations

As Treasury considers next steps in this consultative process, we want to highlight four opportunities for further consideration and refinement.

1. Extend permissible custodial activities

As explained in more detail below, we recommend further clarity around the treatment of digital asset custody **within the legislative text, as opposed to relying on the process of seeking certain exemptions** (e.g. Australian Securities and Investments Commission (**ASIC**) instrument relief).[16] Such recognition would provide clarity and confidence to global operators investing in the Australian market, as well as to local entities that may benefit from the technological infrastructure and sophistication of global custodians. This includes legislative recognition that digital asset facility providers should be permitted to:

- appoint a sub-custodian without requiring that ultimate custodian to be Australia based, provided the sub-custodian adheres to the obligations set forth for Australian financial services licence (**AFSL**) holders operating digital asset facilities;
- hold customer assets in omnibus wallets (whereby customer assets are segregated on books and ledgers), which should extend to both custodians and sub-custodian asset holders; and
- maintain de minimis house-origin funds in the omnibus wallet in order to facilitate the timely and efficient execution of customer orders and support operation of the market.

2. Do not unduly focus on concentration risk among custodians

We strongly caution against a policy approach that prioritises protecting against concentration risk above all other concerns. These services entail significant fixed costs to ensure appropriate customer protections and there are large economies of scale in providing institutional grade services as Coinbase does. Taking regulatory measures that encourage a larger number of smaller custodians will expand potential attack vectors,

[16] ASIC, *ASIC Regulatory Guide - Funds management and custodial services: Holding assets* (**RG 133**), p. 39 (23 June 2022).

particularly among custodians that are unable to invest in industry-standard security practices because they have not achieved the necessary economies of scale.

Rather, we encourage Treasury to ensure minimum standards for custodians regardless of their scope and size, and to also recognise that institutional market participants will favour leading custodians with strong track records, as they do today.

In comparable jurisdictions, there is no requirement for TradFi market participants to incur the proposed 50 basis point capital buffer on the amount of entitlements under custody. Similarly, we don't think it is appropriate to impose such a requirement absent an appropriate cap given the economic reality that custodial services incur predominantly fixed and not variable costs. The proposed, uncapped capital buffer could materially undermine natural efficiencies that will otherwise develop for highly secure and safe custodial services and practices.

3. Adopt a regulatory lexicon consistent with international approaches

We encourage Treasury to adopt, where possible, terms and definitions that are already internationally recognised. This will ultimately help provide global businesses the confidence to invest and operate in Australia.

We appreciate Treasury's decision to follow IOSCO's approach to defining the regulatory perimeter by reference to functions and outcomes rather than specific technologies or applications (i.e. 'function over form'). However, we have concerns that the introduction of new terminology could unintentionally undermine regulatory alignment with other jurisdictions. To this end, we highlight six definitional issues below.

- **Digital asset definition:** The Consultation Paper refers to a digital asset (token) as a bearer instrument.[17] While digital assets operating on blockchains are transferable peer-to-peer without need for a recordkeeper beyond the blockchain itself, that does not mean ownership cannot be reversed or adjusted by a third party following a transfer. For example, smart contracts on permissionless chains can be designed to whitelist, blacklist, and burn/re-mint digital assets in ways that replicate TradFi market practices. This is an important definitional property to recognise in any regulatory framework.
- **The term 'entitlement' has no legal definition**: As the Consultation Paper states, entitlement is not a legally defined term. While using such a term has appeal from a principled or colloquial sense, there is danger in introducing ambiguous terminology into a regulatory framework where clear lines and definitions will matter. As we describe in more detail below, we recommend that Treasury refrain

[17] Treasury, Consultation Paper, p.5 (October 2023).

from using this term with respect to any legally binding regulatory requirements; it will unnecessarily introduce unclear and potentially stifling compliance burdens.

We believe a more useful approach would be describing obligations in reference to 'customer assets', 'customer rights' and 'intermediary processes'. This will allow Treasury to target regulation in a manner that better reflects the associated risk.

- **Custody is generally viewed as a service, not a financial product:** We understand the motivation for Treasury's proposed approach to include potentially risky activity involving non-financial products in scope of the proposed regulatory perimeter. By defining a custodial arrangement involving non-financial products to itself be a new financial product, a licensing regime for such facilities can be enacted under existing financial services law to regulate the activity. While convenient in the Australian context, however, pursuing such a definition is unlikely to conform with the approaches of other jurisdictions, and risks placing Australia out of step with international interoperability and harmonisation.

- **'Digital asset facility' vs 'digital asset platform':** One thematic concern relates to whether custody is also the regulatory anchor for minimum standards (not just licensure). We believe this should be clarified so as not to unintentionally and prematurely capture technology such as DeFi. More generally, the Consultation Paper uses multiple terms for regulatory concepts that are similar but not the same: its formal title refers to 'Regulating digital asset *platforms*,' Part 2 refers to 'Regulating digital asset *intermediaries*,' and the proposal would create a new financial product called a 'digital asset *facility*' (emphasis added). The resulting assortment of terms is confusing even to those who are well-versed in Australia's existing regulatory framework for financial services.

- **Minimum standards for facility contracts:** Another thematic concern relates to minimum standards being set by reference to facility contract content, when in practice they should relate to internal processes and procedures. To avoid misalignment of compliance arrangements and consumer outcomes, we encourage Treasury to refer to internal processes and procedures in order to categorise minimum standards.

4. Provide clarity and certainty for innovators

Clear definitions are important to determining the regulatory perimeter. We strongly encourage Treasury to make clear that pure coding – e.g. software development activity that does not involve holding assets in custody for others – is not in scope of financial regulation, and to provide this clarity in a form that innovators are able to access and rely on without the need to rely on lawyers or make nuanced legal judgments. This will help ensure that Australia serves as an innovation where innovators can build and startup activity is not unnecessarily chilled.

Response to Questions and Associated Topics

In this section, we respond to select Consultation Paper questions, with additional commentary on certain topics that we view as important for Treasury to consider.

Consultation Part 2 - Regulating Digital Asset Facility Providers

Coinbase agrees with Treasury's approach of anchoring the regulatory perimeter on centralised custody arrangements. This is fundamental to ensuring consumer assets are protected on an ongoing basis, especially during periods of economic stress or operational shock.

The Consultation Paper uses the terms 'digital asset facility' and 'digital asset platform' interchangeably[18] and both concepts utilise custody as the regulatory anchor. While 'digital asset facility' is the licensable activity, requiring a non-discretionary holding arrangement, the Consultation Paper's use of 'digital asset platform' in the context of minimum standards for financialised functions makes it unclear whether these obligations only apply to AFSL-holding platform intermediaries that also provide custody, or if they also apply to centralised intermediaries that provide such activities without custody (i.e. platforms which do not trigger the AFSL requirement).

We commend recent comments by Treasury crypto portfolio team members (including at the Crypto Assembly on 24 November 2023), indicating that Treasury does not intend to capture DeFi arrangements at this time. We encourage Treasury to make this distinction clear in the legislation.

As discussed in Coinbase's response to IOSCO's proposed policy recommendations for DeFi,[19] the development of the internet – an open source collection of protocols used by billions of people – provides an excellent framework for how regulators can and should think about DeFi. Decentralised protocols with community-based governance are the backbone of the internet as it exists today. DeFi can remove the need for financial intermediaries and enable new types of activities and economic relationships, with potentially transformative benefits for people and businesses. We encourage Treasury and other policy makers to take the time to understand DeFi protocols and the process of decentralisation before proposing rules that could adversely affect their development.

[18] For example, section 3.1(c) of the Consultation Paper states that a digital asset facility may have more than one platform provider, each of which takes responsibility for a part of the facility. This creates ambiguity as to whether Treasury considers a platform and a facility to be the same thing, despite providing a different definition for each in the Consultation Paper.
[19] Coinbase, Response to IOSCO's policy recommendations for DeFi (19 Oct 2023).

<u>Question Set 1:</u> 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?

The practical and appropriate outcome of a safe harbour would be to provide certainty to builders of digital asset infrastructure and services that they will not be scoped into a financial regulatory regime. This would allow innovators to focus on fundamentals – developing products, and getting a project off the ground. Provided that the safe harbour is well drawn, we believe the benefits greatly outweigh the risks.

To that end, Coinbase suggests that Treasury consider the following safe harbours.

1. Custody software

The Consultation Paper notes that creating or selling software used by others to hold or deal in assets (**custody software**) would not be an asset holding arrangement, and the AFSL obligation accordingly would not apply to this activity.[20] We interpret this language to mean that Treasury does not intend to regulate self-hosted wallets (also known as non-custodial wallets). If so, we agree. A self-hosted wallet application is a software product, not a financial product. Excluding custody software would also be consistent with comparable jurisdictions.[21]

However, we are concerned with the Consultation Paper's ambiguous distinction between custody software (which is not in scope) and a 'business that controls customer tokens using custody software, such as smart contracts'[22] (which would be in scope). As such, we strongly encourage Treasury to define the 'necessary level of control,'[23] where the AFSL obligation is triggered, because the lack of clarity on this may otherwise have unintended consequences.

One area of control consideration relates to decentralised arrangements, as discussed below. Another relates to custody software providers. For example, custody software may come with a password recovery function, enabling a customer's access to be restored in the event that they lose or forget their password or seed phrase. Providing consumer protection in this manner should not be deemed factual control over customer assets for the purpose of licensing.

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[20] Treasury, Consultation Paper, p.12 (October 2023).
[21] HM Treasury, Future financial services regulatory regime for crypto assets: Response to the consultation and call for evidence, p.59, 8.13 'Self-hosted wallets' (October 2023).
[22] Treasury, Consultation Paper, p.12 (October 2023).
[23] Treasury, Consultation Paper, p.12 (October 2023).

2. Decentralised arrangements

Although licensing can only practically apply to centralised entities, Coinbase submits that Treasury should be explicit that decentralised arrangements (e.g. DeFi protocols) are not included in the definition of 'digital asset facility.' Decentralised protocols and pure software development activities should not be subject to the licensing regime or obligations under transactional and financialised functions until such time as that is the intention. This approach would be consistent with both comparable jurisdictions[24] and Treasury's previous commentary on decentralised structures.

3. Global operating models

Many businesses use global operating models to improve the quality and efficiency of their services to customers around the world. These businesses are often headquartered outside Australia and either support Australian customers indirectly through local entities (e.g. providing back-end custody services behind an Australian provider) or provide services directly to Australian customers. The *Corporations Act 2001* (Cth) and Corporations Regulations 2001 (Cth) (**Corporations Regulations**) set out various AFSL exemptions that support such offshore structures. Coinbase encourages Treasury to include digital asset facilities within these exemptions.

For example, this would be consistent with Corporations Regulation 7.6.01(na), which exempts offshore entities providing certain financial services where its Australian related body corporate that is an AFSL holder arranges for the service and is responsible for their conduct. This exemption should be extended to include digital asset facility providers. Further, comparable jurisdictional relief (as those implemented for foreign financial service providers) would be a useful mechanism to achieve global regulatory harmony.

Consultation Part 3 - Licensing Digital Asset Facility Providers

The Consultation Paper uses the term 'platform entitlement' to refer to contractual rights in some contexts[25] (e.g. a customer's right to withdraw assets in the future) and to assets themselves in other contexts[26] (e.g. in the proposed low value exemption). As we explain in more detail below, we encourage Treasury to clarify concepts relating to *assets* as opposed to *rights* in relation to those assets.

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[24] HM Treasury, Future financial services regulatory regime for crypto assets: Response to the consultation and call for evidence, p.82, 11.28 '... HM Treasury recognises it would be premature and ineffective for the UK to regulate DeFi activities' (October 2023).
[25] Treasury, Consultation Paper, p.10 (October 2023).
[26] Treasury, Consultation Paper, p.21 (October 2023).

3.1 Standard AFSL Obligations

We broadly support the recommendation that digital asset facility providers be subject to the same AFSL standards as other licensees. However, in some instances, the Australian Government will need to take additional actions to ensure industry participants are able to comply with certain obligations due to existing constraints in the Australian market. For example:

1. Client money and bank relationships

We strongly support industry's ability to hold client money in an authorised deposit-taking institution, and believe that any obligation to do so would need to take into account real frictions that digital asset facility providers would face. Today, many Australian digital asset intermediaries have difficulty obtaining (or maintaining) a banking relationship, or may feel at risk of de-banking. We recommend that Treasury work with industry and the banking sector to encourage responsible banking relationships.

A good example of advancing further bank integration into the digital asset ecosystem is the roundtables held by the Hong Kong Securities and Futures Commission and the Hong Kong Monetary Authority to encourage banking relationships between digital asset intermediaries and financial institutions in parallel to the release of their new Virtual Assets licensing regime.[27] While the AFSL regime may alleviate this issue by providing a standard by which banks can understand a customer's regulatory profile, the nature of AFSL obligations also requires the resolution of this issue before the new licensing regime comes into force.

2. Availability of insurance products

Providing financial services to retail clients requires AFSL holders to have appropriate compensation and insurance arrangements in place, including implementing alternative compensation arrangements if insurance cannot be sourced (in line with ASIC relief and ASIC Regulatory Guide 126).

We commend Treasury for recognising that non-insurance arrangements are also appropriate. In particular, insurance is not a substitute for effective risk management practices, the latter of which should be the primary focus of any customer protection regime.

We agree and believe it is important that Treasury not impose strict insurance requirements, particularly because there is not yet a widely accessible and cost efficient insurance market in place. Similar to banking relationships, many digital asset intermediaries will struggle to secure policies from insurance providers, or otherwise be

[27] Bloomberg, HK Regulators to Host Meeting to Help Crypto Firms With Banking (28 March 2023).

subject to cost-prohibitive premiums. Insurance providers, in turn, will need more time to learn how best to price the risks associated with digital asset products and services to create a viable insurance market. As indemnification markets evolve, the prudent course forward is to recognise and permit suitable alternative indemnification arrangements – e.g. tied to current industry practices that target specific threats like cyber and theft – to help ensure appropriate customer protection in a manner that does not require individual ASIC relief applications. We recommend that the Corporations Regulations be amended to recognise such market arrangements as sufficient.

Question 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?

We appreciate the parallel this exemption draws as against comparable exemptions (e.g. low value non-cash payments) and strongly support its implementation. We make the following recommendations.

1. Remove entitlement terminology

The Consultation Paper uses the term 'platform entitlement' for a per client monetary threshold but uses the term 'assets' for the overall platform monetary threshold.[28] In our view, 'assets' is the correct designation, and to remove any ambiguity, should be the only designation in the exemption.

2. Use average client holding

Linking exemption reliance to platform asset valuations will pose an ongoing challenge to platforms because asset prices are beyond their control. A platform that restricts customers onboarding to less than $1,500 in assets to stay within the exemption could nevertheless face a licensing requirement if the assets increase in value. And given that even a single client crossing the threshold would trigger a licensing requirement, the exemption as written would likely be unworkable; it will inadvertently cause smaller intermediaries to trigger the AFSL requirement before they are operationally ready.

We suggest Treasury change the threshold to average client holding. Doing so would avoid unduly triggering registration based on a single client account while keeping with the spirit of being a low value exemption. The total amount threshold trigger in part 3.1(b)(ii) would protect against any potential manipulation of average account balances.

[28] Treasury, Consultation Paper, p.21 (October 2023).

3. **Set a higher threshold of $15 million AUD**

As Treasury has set the per client limit for the digital asset facility exemption at $1,500, the aggregate threshold should be increased to $15 million AUD to maintain parity with the ratios applied to the low value non-cash payment facility exemption.

4. **Include a transitional grace period**

We suggest implementing a grace period for continued AFSL exemption reliance if valuation thresholds are exceeded by a digital asset facility provider. During this time, the intermediary can either offboard customer assets to bring them below threshold requirements or apply for an AFSL. The grace period should be consistent with a reasonable expectation of securing a licence, particularly to the extent the licensing application assessment period is outside the control of the intermediary.

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

We have not responded to this question.

Question 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?

We believe the proposed Net Tangible Asset (**NTA**) requirements for digital asset facilities should align with the NTA requirements for comparable financial services (e.g. custodial and depository services). We make the following recommendations.

- **0.5%:** NTA requirements for comparable services outsourcing custody (i.e. as 0.5% of assets), such as operating an investor directed portfolio service (**IDPS**), are capped at $5 million AUD. The same cap should apply to digital asset facilities, in the interest of regulatory parity. To the extent Treasury believes the level should be higher, a graduated schedule of charges should be used – with smaller percentages as the amount of assets under custody increases – and with lower capital charges for cold storage than hot. This would be responsive to both the fixed cost nature of custodial activities (due to scale economies in achieving security) and the level of risk incurred.
- **Value of the facility:** Treasury should clarify that this term refers specifically to customer assets. Further, many digital asset businesses (like Coinbase) operate

global platforms that support a broad range of customers in multiple jurisdictions that each have their own regulatory regimes. Treasury should expressly clarify the value of in scope assets should be limited to the portion of the platform that relates to Australian customers served by the Australian entity. For instance, those related to Coinbase Australia Pty Ltd – and not Coinbase's global assets – to avoid the risk of inadvertent miscalibration.

We do not believe that NTA measures should be adopted to 'balance the need to avoid concentration of digital assets among a small number of custodians.'[29] Custodial services incur significant fixed costs to ensure appropriate safety and security of assets, and as such, confers economies of scale benefits. Instead of providing economic disincentives to the contrary, which could result in the underinvestment of security standards if custodial services are forced across a larger number of smaller custodians, Treasury should focus on appropriate security standards.

Question 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.

No, this framework should not be expanded to cover digital assets that are not financial products. Doing so would create significant operational and legal burdens for digital asset intermediaries without commensurate benefits for consumers.

Unlike with financial products, purchasers of non-financial digital assets are making decisions based on consumption preferences. Even when non-financial digital assets are purchased for investment purposes, for example based on their potential future utility, such decisions are no different from trading baseball cards, art, or real estate (as the Consultation Paper already acknowledges). There would be little reasonable basis with which to measure the appropriateness of any advice given. Instead, we firmly believe that the minimum standards applicable to listing criteria and disclosure requirements provide sufficient consumer protection.

3.2 Disclosure Obligations

Customers benefit when information relevant to their purchase decisions are made available by digital asset intermediaries, including information about supported digital assets. This could come in the form of information about customer rights, terms of use, how a service is operated, as well as key characteristics associated with digital assets made available – e.g. for trading – on a digital asset platform.

However, disclosure requirements need to accommodate for the unique and evolving nature of the digital asset ecosystem. For example, in the US, Coinbase has petitioned for rules covering digital asset disclosure requirements that focus on the asset-specific

[29] Treasury, Consultation Paper, p.24 (October 2023).

rather than issuer-specific information.[30] In our proposed framework, we highlighted where disclosure requirements from existing financial service frameworks made sense, and where they were not relevant given the inherent difference between financial and non financial digital assets.

For services offered on a digital asset platform or facility, it is important for the intermediary to have an ability to structure liability attribution and disclaimers in relation to facilities where there are multiple participants or intermediaries that are 'plugged in', as well as third parties listing assets on the facility. Concepts of clear, concise and effective disclosure in relation to 'full disclosure' should also provide scope for digitally native methods of communication delivery (e.g. through timely placed disclosures within the customer journey rather than a standalone document that is provided out of context).

Question 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?

We broadly consider the approach to pre-agreed and disclosed rules to be consistent with the implementation of automated systems, however we stress that this should not imply intermediaries should be required to use automated systems. Moreover, there should be a distinction between the (a) pre-agreed and disclosed rules, and (b) how those rules are chosen to be implemented and enforced (having regard to the size, nature, and complexity of the business). For example, some operating procedures are simple to automate (e.g. ensuring platform entitlements can only be exercised once), while others require discretionary input and considerations (e.g. listing criteria) that require manual implementation. Requirements regarding implementation should be left to industry and should not be prescriptive.

Question Set 6 (Cont.) Should there be an ability for discretionary facilities dealing in digital assets to be licensed (using the managed investment scheme framework or similar)?

Discretionary arrangements should be permitted, particularly if they are subject to certain criteria or guardrails agreed with customers prior to entering the arrangement. Discretionary arrangements relating to purchasing digital assets for financial or investment purposes are already picked up by the existing licensing regime (e.g. managed investment schemes, managed discretionary accounts). Discretionary arrangements for non-financial or investment purposes should also be permitted. For example, digital asset intermediaries may provide services that require a level of management for participation at an infrastructure level or otherwise require discretionary decisions that correspond to a customer's preferences and profile. While

[30] Coinbase, Petition for Rulemaking – Digital Asset Issuer Registration and Reporting (6 December 2022).

core entitlements should remain non-discretionary, Treasury should not unnecessarily prohibit discretionary arrangements that support the operation of a regulated platform.

Consultation Part 4 - Minimum Standards for Facility Contracts

We broadly support Treasury's approach to requiring minimum standards for facility contracts. However, some of the minimum standards relate to operational requirements rather than contractual content. For example, the minimum standards requiring that assets be held through an arrangement that meets minimum standards for financial product asset holders is an operational and not contractual requirement. We nevertheless agree that such minimum standards should be in place for all digital asset facilities.

4.1 Minimum Standards for Holding Assets

Question 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?

We broadly agree with this benchmarked proposal, however submit that appropriate alterations are required to address specific features of blockchain technology. We recommend the following.

1. Operational requirements

We agree that Treasury should apply the existing minimum standards for asset holdings set forth in RG 133 to digital asset custodians. For example, there should be clear operational requirements with respect to adequate organisational structure, staffing, and capacity and resources. Coinbase is proud to implement the latest and best in class technology arrangements to secure client assets. That said, best practices continuously evolve. In line with its stated goal of remaining technology-neutral, Treasury should not codify prescriptive requirements regarding technological implementation. Such requirements may quickly become outdated and could impose operational burdens without commensurate benefit. Instead, there should be guiding principles that allow custodians to implement technological solutions flexibly, with a focus on ultimate objectives of information security and consumer protection.

2. Fallacy of localisation

Coinbase strongly supports the approach Australia takes with respect to the sufficiency of offshore asset holders of financial products. We recognise that some jurisdictions are considering or have already imposed operationally prohibitive localisation requirements on

custodians. This can include requiring storage of digital assets (keys) and/or custodial personnel within a jurisdiction. We believe the better approach is for jurisdictions to accommodate global models for custody with the appropriate guardrails. The ultimate outcome should be the same but at a lower cost and with enhanced customer protection. Customers should have priority over all other creditors in the insolvency of the relevant intermediary or platform.[31]

Having a separate local custodian would undermine efficiency and customer protection by opening up additional attack vectors due to lower economies of scale to enable superior levels of security. More generally, as we previously explained, any requirement or incentive to limit the ability of a custodian to realise economies of scale (e.g. by pursuing an unbalanced objective of limiting concentration risk) could result in the underinvestment in security technology and practices.

Alternatively, permitting the appointment of a sub-custodian that is not Australian-based can strengthen the regulatory objectives of preventing misuse of client assets and making sure that client funds remain protected at all times, including in an event of insolvency (provided the sub-custodian adheres to the obligations set forth by the AFSL regime for digital asset facilities and are otherwise supervised by a regulator with similar guidelines and equally high standards). Offshore sub-custodians are widely used in TradFi markets, and this practice is expressly permissible under the existing financial services framework for financial product custody arrangements.[32]

3. Limited commingling of funds is appropriate

In digital asset markets a digital asset facility provider may add a de minimis amount of funds to omnibus wallets maintained for customers to facilitate the fulfilment of customer order instructions (e.g. paying network or gas fees and meeting pre-funding requirements for brokers that route orders to multiple exchanges). These assets serve as a buffer to ensure that one customer's assets are never used to fund another customer's trading activity and to ensure proper books and records segregation.

To this end, Treasury should make clear that a de minimis amount of house-origin funds should be permitted to be added to customer omnibus wallets. Such assets should be treated as customer assets and, in the event of an insolvency of the digital asset facility provider, should be distributed to customers to the extent that assets in the customer omnibus wallet are insufficient to meet customer claims. Leading digital asset regulators,

[31] A good example of this is the 'legal segregation with operational commingling' regime for cleared swaps adopted by the U.S. Commodity Futures Trading Commission.
[32] ASIC, RG 133 (23 June 2022). ASIC, ASIC Class Order [CO 13/1410] (18 September 2018).

including the New York Department of Financial Services,[33] understand that such a buffer is necessary and expressly permit it in their regulations.

Their approach is not only protective of customers, it is also consistent with established practices in US TradFi markets. Futures commision merchants (**FCMs**) regulated by the US Commodity Futures Trading Commission are required by regulation to add such a buffer to customer accounts, and this buffer is required to be treated as belonging to customers. This means it cannot be freely used by the FCM in the ordinary course of business and may be used to satisfy customer claims in the FCM's insolvency to the extent of any shortfall in the customer account. A similar outcome is also provided for by Article 8 of the Uniform Commercial Code (**UCC**), which governs how securities intermediaries (including clearing agencies, banks and brokers) hold financial assets for other persons.[34]

4. Omnibus wallets

The use of omnibus wallets is common practice in both digital asset and TradFi industries, and is entirely appropriate, provided it is accompanied by a robust internal ledger that tracks client-by-client asset ownership in real-time.

Digital asset custodians (as well as sub-custodian asset holders) should not be required to use entirely separate wallets for each individual customer, as doing so would be operationally prohibitive and lead to inappropriate customer outcomes regarding trading, staking, and withdrawals. Permitting the use of omnibus accounts would support Treasury's objective of reasonably balancing security and the timely processing of requests to exercise platform entitlements.

The effectiveness of the omnibus segregation approach has been tested in insolvencies of both commodity brokers and securities broker-dealers. Customers are protected under this model, and operational commingling of customer assets does not threaten this protection. Coinbase strongly recommends that Treasury expressly permit the use of omnibus accounts by digital asset custodians (and sub-custodian asset holders) in meeting these minimum standards.

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[33] See New York Department of Financial Services, Guidance on Custodial Structures for Customer Protection in the Event of Insolvency**,** FN 7, permitting Virtual Currency Entities (**VCE**s) that act as custodians to fund transaction fees for customers, provided such funds are treated as customer funds by the VCE.

[34] Among other things, UCC Article 8 governs property rights in financial assets held by or through a securities intermediary for another person, known as an entitlement holder. Consistent with Article 8, a securities intermediary may hold financial assets on an omnibus basis and may even include its own assets in that account, subject to accurate books and records. All financial assets held by a securities intermediary are customer property to the extent needed to satisfy customer entitlements.

More generally, omnibus accounts are critical for commercial relationships. In particular, intermediaries that participate on unaffiliated digital asset platforms are typically unwilling to disclose their client information, both for security and competitive reasons. Omnibus accounts that are appropriately ledgered and legally protected within a jurisdiction help to facilitate necessary and productive economic activity.

As stated in the introduction of our submission, we recommend that Treasury codify the above arrangements as permissible for digital asset custody services in the legislative text itself for the avoidance of doubt and for consistency with the existing framework.

Question Set 7 (cont.) 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)?

We recognise that different jurisdictions take different approaches regarding the legal basis on which digital assets can be held (whether on trust, under bailment or otherwise). We appreciate that Treasury has articulated its intention to take an approach that allows for flexibility in arrangements on the condition that they remain bankruptcy remote. Under RG 133, custody arrangements (for traditional assets) are deemed to be sufficient if held in an offshore jurisdiction where such custody is held in accordance with foreign law and gives protection in the case of insolvency (irrespective of whether trust structures are recognised). A similarly flexible approach should be taken with respect to how digital assets are held by custodians. Further, this would not break existing security mechanisms or impede current business models.

We note the phrasing of the question as to 'what' is held on trust highlights the need for greater clarity regarding terms used in the Consultation Paper. We suggest that the focus on trust arrangements - or similar, commensurate protections - should pertain to the assets themselves. If the term 'platform entitlements' in the Consultation Paper relates to contractual rights against a facility provider, it would be inappropriate for such rights to be held on trust (notwithstanding that such rights may be exercised in an event of insolvency). Similarly, if omnibus structures are permissible, private keys would not be held on trust.

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

We broadly support the requirements for facility contracts, particularly to ensure appropriate security practices, and most crucially in attesting that third party custody arrangements meet similarly high standards as would be expected of the facility itself.

As noted in Question Set 7, technology continues to evolve and we caution against overly prescriptive thresholds or requirements. Nevertheless, best in class practices to which Treasury may consider referring include the following.

1. **Globally distributed and secure storage of assets**

A significant percentage of digital assets should be stored offline in secure, guarded 'cold storage' facilities. This storage should be globally distributed in order to best protect assets from theft and natural disasters, as well as ensuring intermediaries can securely support customer demands across time zones. By contrast, narrowing the number of human or technical resources to a particular location would multiply potential vulnerabilities of a cyber attack, potentially leading to a loss of funds.

2. **Globally distributed and secure storage of private key materials**

Similarly, private key materials should be separated and stored across different locations, time zones, and functions. Centralising these materials could impair system resiliency and security protection. Requiring strict reliance on a single geographic location (whether for technical materials or personnel) would put core operations and timely withdrawals under additional risk in the case of a natural disaster or public health emergency. And as we explained above, localisation can increase the attack vectors for bad actors, particularly to the extent that a system is compromised solely through local infrastructure.

3. **Ensuring the security of assets and information stored online**

Traditionally, a significantly smaller portion of assets would be stored online in 'hot wallets'. This practice, combined with multi-factor authentication and the ability to utilise enhanced security for assets stored in hot wallets, provides significant protection. We also see areas of technological innovation maturing to a point where a suitable combination of wallet technologies can provide a high level of security while offering faster access to stored digital assets, thereby better balancing the security versus availability trade-off.

4. **Deploying new technology solutions to augment security, such as multiparty computation (MPC)**

MPC is the leading technology for generating, storing, and using private keys. Keys constructed and used in MPC are never in any single place at one time. Rather, MPC enables the intermediary to split the key between the customer's wallet and the intermediary's server, and to generate signatures on transactions without ever bringing the two shares of the key together. As a result, the customer's key cannot be stolen if the part of the key used to sign transactions is taken from their device, since a single share is meaningless without the other. In the same way, the intermediary cannot generate a

signature without the customer, which means that the intermediary cannot control the customer's keys or funds without the customer's involvement.

4.2 Minimum Standards for Intermediating Platform Entitlements

We broadly support the proposed minimum standards for digital asset platform providers intermediating platform entitlements (e.g. trading, transferring, or withdrawing assets). The proposed approach also aligns with comparable IDPS arrangements regarding customer control of assets and decision making. As noted throughout this submission, Treasury should clarify the definition of 'platform entitlements' and how that interrelates with assets over which such entitlements exist.

In relation to the minimum standard that platform entitlements must be processed in a timely manner,[35] we believe this standard should depend on the contractual nature of the entitlement. For example, if customers have provided assets in the context of collateralised transactions, a digital asset platform provider should not be obligated to return such assets except in accordance with the terms of the contract giving rise to the collateral interest.

The Consultation Paper also notes an intention to prohibit complex platform entitlements.[36] It is difficult to provide feedback on this prohibition without clarity on what constitutes a 'complex platform entitlement'. Definitional clarity would help industry understand the policy rationale for prohibiting them, and also determine whether the prohibition would unnecessarily stifle innovative product offerings for certain customer classes. We strongly encourage Treasury to refine the meaning of platform entitlements and further consult on the proposed complex entitlements prohibition before enshrining this in legislation. We are happy to work with Treasury in setting this structure.

4.3 Minimum Standards for Transactional Functions

We broadly support the proposed minimum standards for transactional functions. However, there is ambiguity regarding 'transactional function', which complicates our understanding of its application. This is particularly the case when set against seemingly comparable activities like 'token trading' under 'financialised functions'. Again, we strongly suggest Treasury clarify its use of novel terminology as it directly applies to prospective market participants. The context in which it is used in the Consultation Paper suggests this is any exercise of platform entitlements (either in relation to the intermediary or other account holders), rather than in relation to purely entering into token transactions (which the minimum standards suggest). In this context, we submit the following points.

[35] Treasury, Consultation Paper, p.32 (October 2023).
[36] Treasury, Consultation Paper, p.13 (October 2023).

1. Listing criteria

We believe that requiring certain listing criteria is an important requirement for centralised exchanges. Coinbase evaluates a variety of listing criteria for new assets in its Asset Listing process[37] led by our Digital Asset Support Group. Before making an asset available on our platform, Coinbase carefully considers the local regulatory context and thoroughly evaluates each asset, any associated platform or blockchain, the individuals developing or promoting the asset, and Coinbase's own ability to maintain safety and integrity of trading activity involving that asset on our platform.

2. Token disclosure

Disclosures are critical to the quality and integrity of digital asset markets. Throughout the Consultation Paper, Treasury proposes obligations around disclosures for digital asset facility providers, entities providing financialised functions, as well as additional services and activities. These requirements appear to take the form of 'facility contracts', 'facility guides', disclosures related to token entitlements as well as platform entitlements, and more. Across this spectrum of disclosure requirements, we emphasise the following principles:

- Disclosures should be clear and easy to understand
- Any disclosure requirements on intermediaries (as opposed to token issuers) should apply only on a reasonable efforts basis, and should only include information that is publicly available.

For digital assets that have an identifiable central token issuer, that issuer should be primarily responsible for disclosing the key features and risks of the crypto-asset, and digital asset platforms should be able to rely on that information.

As projects become decentralised over time, to address the need to provide customers with appropriate disclosures, we encourage Treasury to strike a balance between imposing obligations on platforms to publicly maintain certain information on digital assets that they list, and the practical reality that much of the required data will already be publicly available in different forums and formats. And, provided that the information is publicly available, a digital asset platform's liability for maintaining such information should be limited to material errors or omissions caused by the exchange's own gross negligence.

3. No entitlements except factual control

We encourage Treasury to consider the policy objectives relating to the minimum standards for tokens attaching no entitlements except factual control, and how this differs

[37] Coinbase, Asset Listing Process (2023)

from the approach intermediaries should take with other tokens. For example, we expect all customers would be required to confirm they have read the relevant disclosure documents or information summary, and it is unclear how 'no entitlement tokens' are different.

We appreciate the need to obtain express confirmation from customers regarding the understanding of non-financial purpose of certain token classes (e.g. meme tokens that may be subject to dramatic valuation swings through cultural or momentum trading), however as drafted this could also apply to high grade assets like Bitcoin (which has a fundamentally different profile to meme tokens). We suggest Treasury clarify the distinction for these tokens and the customer risk that is being managed.

Question 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?

We are generally supportive of proposed measures to enhance market integrity, many of which have been implemented by intermediaries via their own market trading rules.[38] While the top level challenges are common across TradFi and digital asset markets, there may be different methods of perpetrating market misconduct. We therefore believe that the ideal approach to addressing digital asset market misconduct will combine learning from TradFi with the tools capable of addressing digital asset markets' particular characteristics, including 24/7 trading across multiple jurisdictions.

We have invested substantial resources in developing sophisticated capabilities to monitor, identify, and control market misconduct in digital asset markets, using trusted third party software as well as tools and enhancements developed in-house. Our cutting-edge surveillance technology enables real time market monitoring by leveraging machine learning techniques. This is an advancement over current equity market surveillance practices, and a reflection of the 24/7/365 operational attributes of digital asset trading platforms.

Similar to the most advanced surveillance systems today, we monitor for manipulations like spoofing, layering, wash-trading etc. and also to detect crypto-specific strategies and events. We have strong confidence in our tools for policing manipulative behaviour – which are also integrated with our systems for anti-money laundering compliance and the

[38] Coinbase, Trading Rules (2023).

prevention of financial crimes – and we believe they are as effective as the tools used in the TradFi system for the same purposes.

We generally agree that trading intermediaries should be the first line of defence against abusive behaviour and that requirements should be put in place to enable the identification of potential market misconduct that is carried out across platforms, which would necessarily require coordination across intermediaries. To this end, any imposed surveillance requirements should be associated with clear and readily implementable standards, so that intermediaries can easily comply and manage their responsibilities under the regime.

Coinbase is supportive of a general licensing obligation for digital asset facility providers to have a framework (e.g. market trading rules) in place to reasonably identify, prevent and disrupt market misconduct through their facility. This should be done through a consultation process with industry to help ensure the adoption of best practices across platforms, which could include enhancements over current practices in equity markets today.

Treasury should also be mindful that there is not a one-to-one mapping of what constitutes potential 'market misconduct' between financial and non-financial products. In particular, traditional securities markets will not always be a relevant benchmark. For example, prevention of misconduct in securities markets often centres on prohibitions related to insider trading (e.g., taking advantage of asymmetric information between issuers and investors), which may not exist for digital assets that do not offer a financial return or have a residual claim on an issuer's assets or balance sheet. As such, using the phrase 'financialised functions' to denote a comparability of digital asset transactions with financial market transactions may not always be appropriate.

Consultation Part 5 - Minimum Standards for Financialised Functions

As noted, the Consultation Paper's use of the term 'digital asset platform' makes it unclear whether the minimum standards for financialised functions would apply to non-custodial participants in the market, or whether they are intended as an extension of obligations for regulated custody exchanges (e.g. digital asset exchanges licensed as a digital asset facility). Some of Coinbase's comments and requests for clarity stem from this ambiguity.

5.1 Token Trading

Question 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 above? 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?

Subject to our comments above regarding the scope of application and the need to not be overly prescriptive regarding how technological processes are to be implemented, we broadly support Treasury's approach to token trading functions.

In addition, the Consultation Paper characterises token trading as 'intermediating the exchange of platform entitlements between account holders'[39] and applicable requirements under the proposed approach apply specifically to a 'digital asset platform' (being a multi-function platform that is also a digital asset facility). Based on this language, we understand Treasury's intention with respect to token trading is not to include a decentralised exchange (**DEX**) in scope of regulatory requirements. That is, a DEX does not deal in platform entitlements or hold digital assets in custody and therefore is not a digital asset facility to which the token trading minimum standards would apply. We once again suggest Treasury confirm that DEXes and other non-custodial DeFi protocols are not in scope of these requirements in the legislative text.

We also make the following comments.

1. Token recovery

Sub-point (d)(v)[40] proposes measures for recovering tokens sent by account holders to the intermediary's correct address on the wrong network. In some instances, recovering tokens that have been erroneously sent to the wrong network would be technically infeasible. This is particularly the case on open, permissionless networks. We encourage Treasury to include an appropriate caveat in any legislative requirement specifying that such measures would only be applicable 'where technically possible.'[41]

[39] Treasury, Consultation Paper, p.37 (October 2023).
[40] Treasury, Consultation Paper, p.38 (October 2023).
[41] Treasury, Consultation Paper, p.38 (October 2023).

2. Public trading disclosures

Sub-points (f) and (g) propose obligations regarding pre-and post-trade disclosures.[42] We agree that such transparency is critical to the efficiency of any market trading activity and should be a principal characteristic of regulatory requirements related to digital asset trading. Pre-trade price transparency helps purchasers to decide on a trading venue. Post-trade transparency allows market participants to evaluate the efficiency of services provided. We welcome the opportunity to discuss best practices with Treasury.

5.2 Token Staking

We agree with Treasury's assessments on both the value of staking services, as well as the need to carve out obligations for staking services in order to distinguish from services which could be considered a managed investment scheme. On this matter, we believe Treasury has an opportunity to set an example for other jurisdictions on how to manage the technical risks of staking, while recognising the benefits in securing public network infrastructure through staking activity.

Question 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?

We commend Treasury for recognising the importance of staking to validate and secure networks. We also appreciate that Treasury has defined a specific archetype for staking.[43] Pragmatic obligations for staking services that enable the activity, and mitigate financial and technological risks help accomplish this policy objective. We broadly agree with Treasury's proposed approach to token staking functions, and make the following comments.

1. Unstaking

The Consultation Paper states that account holders must be provided with a direct entitlement to 'unstake' any staked asset from the facility.[44] We believe this should relate to a general unstaking entitlement conditioned on the parameters of the relevant protocol. There are many protocols in the market that are subject to time-based lockups at the protocol layer, which are reflected in the terms of the arrangement in which customers participate. In these instances, it would be operationally prohibitive to implement a direct

[42] Treasury, Consultation Paper, p.38 (October 2023).
[43] Treasury, Consultation Paper, p.41 (October 2023).
[44] Treasury, Consultation Paper, p.40 (October 2023).

entitlement to unstake at any time. Protocol staking arrangements should be regulated as a passthrough intermediation (i.e. the terms of the protocol layer apply at the intermediation layer, cognisant of any technical requirements, such as time required to prepare and sign the unstaking request for the blockchain).

2. Sanctions screening

The best means of accomplishing appropriate screening of anti-money laundering and counter-terrorism financing activity as well as activities related to sanctioned actors would be during the onboarding process onto a centralised platform, as well as through continuous transaction monitoring. Coinbase has offered more detailed perspectives on this matter in our response to the recent consultation on *Modernising Australia's AML regime* within the Attorney-General's Department.[45]

5.3 Asset Tokenisation

Question 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?

Asset tokenisation is a vital, emerging technology that has the potential to offer increased transparency, enhanced liquidity,[46] and more inclusive and global access to investment. We commend Treasury for considering which policy goals can best support asset tokenisation. In particular, we support Treasury's commitment to facilitating 'a transparent and trustworthy framework,'[47] given that public, decentralised blockchain technology has the potential to introduce much-needed transparency into markets, including into supply and demand dynamics. Coinbase also appreciates Treasury's endorsement of token standards, as the adoption of ERC standards can ensure that legal and regulatory requirements are enforced automatically, thereby enabling trading that is more efficient and less intermediated.

The recommendations could add greater value by more explicitly defining regulatory intent and scope. For instance, tokenisation operates on a spectrum, from minting NFTs to tokenising real world assets (**RWAs**). It is unclear where, across this spectrum, Treasury intends to apply such obligations.

Coinbase also has concerns regarding the infeasibility of sub-point (h)[48] requiring reversibility. As with the requirements under *Section 5.1 Token Trading*, reversibility is not necessarily technological feasible in the context of all digital assets due to the open and permissionless nature of the underlying network. Coinbase encourages Treasury to define

[45] Coinbase, Response to Australian Attorney-General Department's consultation (16 June 2023).
[46] Nasdaq, What tokenization is and how it can unlock illiquid and opaque markets (6 March 2023).
[47] Treasury, Consultation Paper, p.42 (October 2023).
[48] Treasury, Consultation Paper, p.42 (October 2023).

the parameters of the asset tokenisation financialised function and clearly state how this is to apply to various actors in the space.

Finally, it is important to recognise the significant innovation taking place with respect to tokenised assets, including in the areas of ownership, custody, identity, and smart contracts. Treasury should make clear that regulatory requirements should be technology agnostic and designed to support, rather than stifle, innovation in this area.

5.3 Funding Tokenisation

Question 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?

We are still in the early stages of understanding how digital asset facilities and platforms can intermediate capital raising for non-financial assets. There are tremendous opportunities for blockchain-based enhancements to traditional crowdfunding, and we urge caution with respect to establishing rules governing such activities. We agree that the existing Australian approach for equity crowdfunding platforms provides an appropriate starting point by placing a regulated entity as the central funding facilitator, subject to adjustment as appropriate to address the non-financial nature of some projects. That said, we recognise that blockchain-based crowdfunding is at a very early stage in its development, and the establishment of rules in this area may still be premature. To that end, we recommend the use of regulatory sandboxes as a constructive path forward, to permit industry experimentation subject to appropriate monitoring.

Consultation Part 6 - Other Activities

Question 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?

We generally agree with Treasury's approach to engaging custody only providers, noting our comments above regarding custody requirements for digital assets.

<u>Question Set 15:</u> 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?

We have not responded to this question.

<u>Question Set 16:</u> Is this transitory period appropriate? What should be considered in determining an appropriate transitionary period?

We agree with the 12 month transition period to commence following the full legislative process. We note that (as with any new regime) sufficient time is crucial not only for industry, but also to ensure the appropriate staffing accommodations at regulators. It is crucial during this period that industry can continue to innovate and responsibly serve the Australian market. To that end, we recommend that Treasury explicitly state that no enforcement action can be taken against an entity that has filed an AFSL application for services related to their application, provided that such providers should comply in principle with applicable financial services laws during this time. This will provide sufficient time for the regulator to process applications while not impeding the ongoing operation of businesses.