



To:

Director, Crypto Policy Unit
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

Date:

27 May 2022

**Re: Crypto asset secondary service providers:
Licensing and custody requirements**

Coinbase Global, Inc. and its subsidiary Coinbase Australia Pty Ltd (together, **Coinbase**) welcome the opportunity to comment on the Australian Government's consultation paper on licensing and custody requirements for crypto asset secondary service providers.

We appreciate your thoughtful efforts to develop a regulatory framework for crypto assets, and we look forward to continued engagement.

Sincerely,

A handwritten signature in black ink, appearing to read "Faryar Shirzad".

Faryar Shirzad
Chief Policy Officer
Coinbase Global, Inc.

Introduction

Coinbase started in 2012 with the radical idea that anyone, anywhere, should be able to easily and securely send and receive Bitcoin, the first digital asset. Coinbase built a trusted platform for accessing Bitcoin and the broader crypto economy by reducing the complexity of buying and selling through a simple and intuitive user experience. Today, Coinbase is a leading provider of end-to-end financial infrastructure and technology for the crypto economy. Coinbase's platform enables more than 98 million verified users, 13,000 institutions, and 230,000 ecosystem partners in more than 100 countries to participate in the crypto economy. Coinbase incorporated an entity in Australia in October 2021, with a view to establishing a fully localized on-shore service offering to Australians. The entity secured its registration with AUSTRAC in May 2022.

We appreciate the efforts of the Australian Government and Treasury in developing this consultation paper. We agree wholeheartedly with many of the paper's observations about the appropriate approach to regulation and the need to protect innovation and flexibility while also providing sound regulation. We applaud the Government and Treasury for engaging with many of the most important questions around crypto assets and their proper regulation. As discussed below, we support a majority of the proposals and believe they provide a foundation for an approach to regulating crypto and crypto markets that can serve as a model for other jurisdictions.

We would be delighted to work with the Government and Treasury further as it continues to seek public input in developing this framework.

Proposed terminology and definitions

- 1. Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'?**
- 2. Are there alternative terms which would better capture the functions and entities outlined above?**

Answer to Questions 1-2:

We support the use of this term. We note, however, that there may be a need for subcategories to ensure that regulation is appropriately tailored to the specific risks presented by different types of service providers. The consultation paper includes a non-exhaustive list of activities in which CASSPrs may engage. While some risks may be similar across various offerings, there may be differences. For example, while protections against cyber attacks may require similar cybersecurity measures regardless of the kind of services a CASSPr provides, the types of fraud customers may face may be different in the

case of an exchange versus a custodian, and therefore the anti-fraud measures each type of business should undertake may be different.

3. Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments.

The Treasury has proposed the following definition for a crypto asset: “a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof.”

We believe this definition is adequate, however the definition adopted by the Australian Securities & Investments Commission (**ASIC**) set out in *Information Sheet 225: Crypto Assets* (INFO 225) may be clearer in that it incorporates the concept of distributed ledger technology, which is currently integral to cryptocurrency. This definition defines a crypto asset as: “a digital representation of value or rights (including rights to property), the ownership of which is evidenced cryptographically and that is held and transferred electronically by a type of distributed ledger technology, or another distributed cryptographically verifiable data structure”.¹

If the Treasury were to adopt the proposed definition, it should clarify what the term “substantially affected” means, as this term is not entirely clear in context.

Regardless of what definition is used, we believe that the assets described in our responses to questions 5, 9, and 15 should be explicitly excluded. Additionally, we would encourage the inclusion of flexible language to ensure the definition will be durable as technology develops, and to provide for convergence internationally on a consistent definition across jurisdictions.

4. Do you agree with the proposal that one definition for crypto assets be developed to apply across all Australian regulatory frameworks?

We support consistent definitions across all Australian regulatory frameworks. Depending on the specific features of various assets, and the risks applicable regulation is designed to address, it may be appropriate to use slightly different definitions in different contexts to highlight the specific features to be addressed. These definitions, however, should remain consistent with one another so as to reduce confusion.

¹ ASIC, INFO 225: Available here: <https://asic.gov.au/regulatory-resources/digital-transformation/crypto-assets/>

5. Should CASSPrs who provide services for all types of crypto assets be included in the licencing regime, or should specific types of crypto assets be carved out (e.g. NFTs)?

The Treasury has stated in the paper its view that “products and services should be regulated according to the risks they could present.” We agree with this approach and would recommend the application of this principle here. There are some risks that apply across all types of crypto. For example, all crypto custodians should most likely provide protection against cyber attacks. Therefore, certain requirements relevant to cybersecurity may reasonably be applied to all CASSPrs, regardless of the type of assets for which they provide services.

On the other hand, it is not clear that, for example, NFTs present the same risks with respect to trading - as buyers and sellers may have different trading patterns than those trading other types of crypto assets (e.g. buyers of NFTs making trading decisions based on aesthetics or lifestyle factors, rather than for investment or solely financial gain). Similarly, the types of fraud potentially present in NFT markets may be different than the types that may appear in other crypto markets.

Additionally, other types of crypto may develop and the regulation should not preemptively apply to these developing or not-yet-thought-of uses. Application of the licensing regime to new types of crypto should be considered individually to ensure that the application is appropriate.

Proposed principles, scope and policy objectives of the new regime

6. Do you see these policy objectives as appropriate?

7. Are there policy objectives that should be expanded on, or others that should be included?

Answer to Questions 6-7:

We support the listed policy objectives and believe they are reasonable and appropriate goals of the proposed regulation. In addition, we would support a fourth goal: *“promoting responsible innovation that supports the development and growth of fair, orderly and competitive markets in crypto assets.”*

It should be noted, however, that some of the listed objectives are actually methods. For example, “minimise the risks to consumers from the operational, custodial, and financial risks facing the use of CASSPr” is an objective while noting that this will be achieved “through mandating minimum standards of conduct for business operations and for dealing with retail consumers to act as policy guardrails”, which is a method. The methods listed

provide insufficient detail for us to opine on their advisability. What kinds of “standards of conduct” are being considered and what would be the “minimum”? What activities does “dealing with retail consumers” include and what would constitute “policy guardrails”?

Given the range of possible methods to achieve the stated goals, we would encourage the Treasury to seek additional public comment on potential methods before their adoption.

8. Do you agree with the proposed scope detailed above?

We are concerned that the scope as proposed may be overbroad. We support ASIC overseeing crypto assets that serve as investments or a store of value, albeit under a regulatory regime tailored to the specific risks and regulatory requirements of crypto assets and crypto markets. These assets are routinely traded on exchanges and other trading venues that have features similar to those typically overseen by market regulators. We believe that ASIC is therefore best positioned to provide effective oversight to ensure market integrity, prevent fraud and manipulation, and protect investors.

Our support for ASIC’s oversight has one caveat: we believe that ASIC should be provided the necessary pecuniary and human resources required to ensure that it can provide effective oversight, which includes reasonable processing time for applications.

We would, however, caution against including other types of crypto assets in this regulatory regime. NFTs, for example, have different features and are used differently by buyers than other types of crypto. Additionally, there may be crypto assets that develop that would similarly be suitable for a carve out.

We do wish to commend the Treasury for the express statement in the consultation paper that the regime would not apply to decentralized platforms or protocols. We agree with the Australian Government that it is much more sensible to develop a regulatory approach focused on secondary service providers and not on protocols or platforms directly.

9. Should CASSPrs that engage with any crypto assets be required to be licenced, or should the requirement be specific to subsets of crypto assets? For example, how should the regime treat non-fungible token (NFT) platforms?

Please see our response to question 5.

10. How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g. in financial services)?

We appreciate the Treasury’s recognition of the difficulties presented by overlapping and potentially conflicting regulatory regimes. We support the creation of a separate regulatory regime for CASSPrs providing services in relation to crypto assets that are *not* financial products, recognizing that this regime may share certain features with the Australian financial services (**AFS**) regime for financial products. We agree with the proposal that, as far as practicable, CASSPrs should not be subject to multiple regulatory regimes.

Accordingly, a CASSPr that chooses to obtain an AFS License to provide services in relation to financial products should be permitted to provide services for all crypto assets – including both financial products and non-financial products – without the need to be separately licensed as a CASSPr.

We also note that CASSPrs will be subject to multiple regulatory regimes by virtue of operating in other jurisdictions, and we encourage the Government to make passporting or its equivalent available to CASSPrs on the same terms as for traditional financial services firms.

Proposed obligations on crypto asset secondary service providers - a CASSPr licensing regime

11. Are the proposed obligations appropriate? Are there any others that ought to apply?

We believe these requirements are, in general, reasonable and appropriate, with a few exceptions and clarifications, discussed below. We note, however, that the details of how performance with these obligations will be defined and measured will significantly affect their impact on CASSPrs and the crypto markets. The requirements include several words that, while providing flexibility, may also result in very different outcomes depending on how they are interpreted.

For example, item 1 requires that the CASSPr ensure that services are provided “efficiently, honestly, and fairly” and that “any market for crypto assets is operated in a fair, transparent and orderly manner.” The terms “efficiently, honestly, and fairly” can be subject to highly variable interpretations. The terms “fair, transparent, and orderly” have been highlighted by the Financial Services Legislation: Interim Report A (ALRC Report 37) published by the Australian Law Reform Commission as presenting interpretation difficulties.

Additionally, several items include the qualifier “adequate.” While such terms may provide valuable regulatory flexibility in well-established regimes, where the terms have acquired predictable definitions over time, in a developing market such as the crypto market, such

norms have not yet been established. To provide for needed flexibility while also providing predictability for the industry, we recommend adding guidance for regulators to ensure any requirements are proportional, and not overly burdensome for CASSPrs.

We also believe that item 5 is not exactly right. We do not see the need for capital requirements for the services contemplated and believe that the financial resiliency sought here would be better addressed through margin and collateral requirements – commensurate with market rather than prudential regulation. These requirements should be tailored based on appropriate and careful evaluation of the actual risks posed by various services.

12. Should there be a ban on CASSPrs airdropping crypto assets through the services they provide?

We do not support such a ban. So long as CASSPrs are subject to clear standards in respect of the services they provide, and the crypto assets that are airdropped are subject to the same standards as any other crypto asset, there is no reason to prohibit airdrops. Many kinds of businesses have used “free gifts” as a promotion, and it is unclear why airdrops should be subject to different treatment.

13. Should there be a ban on not providing advice which takes into account a person’s personal circumstances in respect of crypto assets available on a licensee’s platform or service? That is, should the CASSPrs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto asset)?

We see no reason to have a ban on the provision of such advice, with appropriate protections to mitigate conflicts of interest and other risks.

14. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

Although Coinbase is a CASSPr, it would be difficult for us to undertake the significant work required to quantify the costs of implementing the proposal before its details are clearly established. That said, we welcome further engagement and can provide more information on the anticipated costs of implementing the proposed regime as its details are developed. In addition, we note that any meaningful consideration of the costs of implementation should consider the cost to all participants, including the Treasury itself in providing the additional resources that will be necessary for it (and ASIC, assuming ASIC is the ultimate

administrator of the regime) to develop sound regulations and to conduct any regulatory review or approvals in a timely manner.

Alternative option 1: Regulating CASSPrs under the financial services regime

15. Do you support bringing all crypto assets into the financial product regulatory regime? What benefits or drawbacks would this option present compared to other options in this paper?

We do not support an approach that would simply overlay an existing regime onto crypto assets. The AFSL regime is not designed to address the risks presented by crypto assets and would likely prove to be unduly burdensome, resulting in stifling innovation and overall less crypto market activity in Australia.

Furthermore, given the careful attention that the Government and Treasury have paid to crypto, applying an existing regime to crypto in a blanket fashion would be a wasted opportunity. The proposal acknowledges that, in applying this regime, carve-outs may be needed and yet the provision for carve-outs could take time to implement, impeding innovation. As the consultation paper also recognizes, there are specific features present in many crypto assets that may merit lighter or different regulation. If the Government is taking the time to think through regulation of crypto and to solicit comment, this is the time to appropriately tailor regulation.

16. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

Please see our answer to Question 14.

Alternative option 2: Self-regulation by the crypto industry

17. Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia?

We support the development of a voluntary code of conduct, but we believe it would be most beneficial as a complement to, rather than a substitute for, the proposed regulatory regime for CASSPrs. As a general matter, we support market innovation and the opportunity for new technologies and new markets to develop best practices. At this point, more than a decade has passed since the emergence of crypto assets, and market standards and best

practices have already been established in many areas, which can now serve as a blueprint for sound, market tested regulation. Accordingly, in our view, market participants would benefit more from the certainty of a regime that is expressly codified in legislation and regulations than from a code of conduct developed entirely on a voluntary and industry-led basis.

18. If you are a CASSPr, what do you estimate the cost and benefits of implementing this proposal would be? Please quantify monetary amounts where possible to aid the regulatory impact assessment process.

Please see our answer to Question 14.

Proposed custody obligations to safeguard private keys

19. Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets?

We agree with the principle behind these requirements, namely that the security of customers' assets is of paramount importance, and that CASSPrs should be responsible for safekeeping these assets in a reliable and trustworthy manner to support consumer confidence. We generally support the obligations proposed in the consultation paper, and in particular we appreciate the proposal's recognition that consumers can be afforded the protections they need and deserve without custodians being restricted to specific technology or prescribed requirements. The consultation paper states that principles-based obligations will be applied in a manner that is proportionate to the nature, scale, and complexity of each custodian's operations – we believe this view reflects strong leadership by the Australian Government and Treasury and that other jurisdictions would do well to adopt similar positions.

Additionally, to the extent that technological changes may affect the way in which assets can be safeguarded, any obligations should be flexible enough to accommodate emerging practices. Given the rate of change, it is plausible that technological developments and breakthroughs may at any time render current custody practices outdated. There might also be potential divergences in security or custody practices in relation to different crypto assets arising from variations in the underlying blockchain technology. The regulatory framework should remain flexible and open to an ever-changing technological landscape, and CASSPrs should ultimately retain the discretion to select an appropriate custody solution based on prevailing knowledge. This is especially true to the extent that new technologies provide better protection. For example, obligation 6 as proposed would require signing approaches that minimize single point of failure, but increasingly custodians are using multiparty computation and sharding for the same purpose.

With regards to specific requirements, we note the following:

- Obligation (1) would require assets to be held in trust. While we agree that custodians should hold assets in a manner that provides a legal distinction between its own assets and each of its client's assets, other arrangements for specific assets, such as bailment, may provide sufficient protection and should be permitted.
- Obligation (2) would require that assets be "appropriately segregated." We agree that custodians should take care to ensure that client assets are appropriately documented, with clear ledgering practices to record client holdings, and to keep client asset records separate from the custodian's own asset records. We note, however, that it is standard practice within traditional finance for custodians to keep client assets in omnibus accounts and to rely on such ledgering practices as described to record client holdings and to segregate them legally from the custodian's assets.
- Obligation (3) would require custodians to meet minimum financial requirements, including capital requirements. In principle, we support this obligation and agree that a CASSPr should maintain sufficient financial resources to conduct its business in a prudent manner, taking account of the risks to which it is exposed. To that end, we believe that any requirements relating to financial resources and capital should be tailored to a CASSPr's specific business model and risk profile. For example, such requirements could include a fixed minimum capital requirement plus an additional amount based on a proportion of the CASSPr's annual operating costs, similar to the European Commission's MiCA proposal. Care should be taken to ensure that capital requirements are not overly onerous, thus becoming a barrier to entry for smaller and newer operators.
- We agree with obligation (4), and add that, in addition to the requisite infrastructure, the existence of a culture of security can improve custodial outcomes. To the extent that a self-regulatory model is developed alongside a government regulatory regime, that model might encourage the presence of a dedicated Head of Security and recommended levels of staffing. A dedicated Chief Security Officer enables the creation of a clear line of reporting and responsibility on cybersecurity matters which in turn facilitates effective supervision by the board of directors and the relevant regulator(s).
- At obligation (5), it may be worth specifying that private key management practices should include the maintenance of key backup and recovery plans for disaster recovery purposes.

20. Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above?

We believe the proposed obligations are adequate. If new assets develop that present new custodial risks, it would be appropriate to revisit the requirements at that time. Similarly, if new assets develop that mitigate some of the risks currently presented, we would encourage the Treasury to revisit any requirements at that time to ensure that the regulatory requirements remain appropriate to the risks presented.

21. There are no specific domestic location requirements for custodians. Do you think this is something that needs to be mandated? If so, what would this requirement consist of?

We do not believe that this requirement is necessary to ensure proper custodial practices.

22. Are the principles detailed above sufficient to appropriately safekeep client crypto assets?

We believe they are sufficient.

23. Should further standards be prescribed? If so, please provide details

Please see our answer to question 20.

24. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

Please see our answer to question 14.

Alternate option: Industry self-regulation

25. Is an industry self-regulatory model appropriate for custodians of crypto assets in Australia?

26. Are there clear examples that demonstrate the appropriateness, or lack thereof, a self-regulatory regime?

27. Is there a failure with the current self-regulatory model being used by industry, and could this be improved?

Answer to Questions 25-27:

Please see our answer to question 17.

28. If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

Please see our answer to question 14.

Early views sought on token mapping

29. Do you have any views on how the non-exhaustive list of crypto asset categories described ought to be classified as (1) crypto assets, (2) financial products or (3) other product services or asset type? Please provide your reasons.

At this point, although it is helpful to perform a token mapping exercise and create an accurate taxonomy of crypto assets, it is important to understand what the implications of that exercise are—is it envisaged that utility assets, collectible assets, membership assets, asset-backed assets, fundraising assets and others will all come with a different regulatory treatment? Understanding the consequences of including an asset in a particular category will be crucial. It may also be helpful, if the purpose is to consider regulation, to start from the paper's view that assets should be regulated according to the risks presented, considering first the risks presented by various types of assets, and then determining how they should best be categorized.

While many of these risks may exist in other types of assets, there are many that are unique to crypto. At the same time, crypto assets may be designed to mitigate risks that other assets may present, by, for example, embedding disclosures within the asset. Therefore, while existing regulatory frameworks can provide useful starting points for determining the best way to regulate crypto assets, simply mapping crypto to one regime or another may result in regulation that is both under- and over-inclusive.

We support the Treasury's ongoing efforts to find the right regulatory approach to crypto and look forward to commenting on future consultation in this area.

30. Are there any other descriptions of crypto assets that we should consider as part of the classification exercise? Please provide descriptions and examples.

31. Are there other examples of crypto asset that are financial products?

Answer to Questions 30-31:

There are no other assets we recommend adding at this time.

32. Are there any crypto assets that ought to be banned in Australia? If so which ones?

We do not advocate banning any specific assets, but instead encourage robust and appropriate regulation to prevent and punish fraud, and to ensure that buyers are informed of the features of any assets they are buying.