10 March 2023

Token Mapping Consultation Paper D

Cargio is pleased to provide this response to this important consultation paper, which explores which elements of the crypto ecosystem are sufficiently regulated and which require additional attention, enabling the

Government and stakeholders to focus on regulator y gaps and ensure that emerging risks are identified and controlled. We appreciate the Treasur y's efforts to work methodicall y to get the polic y settings right to protect consumers and support innovation in this emerging sector, and are grateful for the opportunit y to engage with the Treasury on token mapping more broadly over the past few months.

As the largest cryptocurrency trading platform globally with a strong commitment to regulation and transparency and a local base of over 1 million users, Cargio is one of the leading digital asset companies in

Australia. Users are at the heart of ever ything we do, and we work alongside partners, polic ymakers and regulators across the globe to shape our robust compliance program and regulator y framework and to build a sustainable path forward for the blockchain industry

It is clear that the consultation paper represents a well researched, thought out exercise, which uses a 'token, token system, function' process for determining whether a crypto product or facility falls within the functional perimeter of regulation and qualifies as a financial product. We note that the consultation paper delineates 2 major elements of a taxonomy, namely intermediated token systems and public token systems. Within the intermediated token systems categor y, Cargio believes it would sit within the crypto asset services sub-category. Accordingly, our responses and thoughts below reflect this policy interpretation. Before responding to individual questions in the consultation paper, we first take this opportunit y to make a number of high-level observations and recommendations, which we believe will be useful in determining the optimal form and function of the future regulatory framework.

Global Standard-Setting Body Work

As the Treasury notes in the consultation paper, *"International standard setting bodies are monitoring developments closely and working to identify key elements of an effective policy framework. Robust macro financial policies, sound legal and regulatory frameworks, as well as effective international coordination, are all being identified as key building blocks"*.

The crypto and digital asset markets are, perhaps more than any other asset class, truly cross-border and global in nature. Crypto trading is in part predicated on the objective of being able to achieve seamless, frictionless transfers to anyone, anywhere in the world. This is one of the reasons why global standard-setting bodies such as the Financial Stability Board (FSB), International Organisation of Securities Commissions (IOSCO) and Financial Action Task Force (FATF) have made tremendous efforts over a period of years to create overarching definitions, principles and frameworks to guide jurisdictional authorities in implementing local regulatory regimes. We therefore encourage the Treasury to have further regard to these efforts in this foundational stage of regulatory regime design, and to align components such as definitions with those already established or being established overseas and globally.

In particular, we would caution against adopting local definitions which differ from or add further complexity to those already in place elsewhere. While there are not yet universal definitions of a 'crypto asset' or related terms such as a 'digital asset' or 'virtual asset', there is increasing consensus on the basic elements of these definitions in overseas legislation and global standards. We therefore believe that this work should be leveraged as the starting point for the Treasury to develop the local regime wherever possible, with alignment to this work the default position and derogations only when needed or appropriate.

For example, we note that the definition of the term 'crypto asset' has already been the subject of great debate and discussion in the UK and EU, culminating in the definitions proposed in the Markets in Crypto-Assets (MiCA) and UK regulatory regimes, which are substantially similar in their form and purpose. Given Europe is the largest crypto market in the world, accounting for up to 25% of global activity, and in the advanced stages of developing its regulatory framework, we believe it would be helpful for the Treasury to look further to the work already underway there in crafting its definitions. This would be distinct from the currently-proposed definition of this term which may suggest that Australia is not aligned with its peer jurisdictions, and may inadvertently undermine the intent to provide clarity across borders. Indeed, we note that the risks associated with a separate, jurisdiction-by-jurisdiction approach to such matters are caveated by the European Commission in the statement below, which is equally applicable in the global context:

"...the fact that some Member States have put in place bespoke rules at national level for crypto-assets that fall outside current EU regulation, leads to regulatory fragmentation, which distorts competition in the Single Market, makes it more difficult for crypto-asset service providers to scale up their activities cross-border and gives rise to regulatory arbitrage." [1]

We believe a better coordinated, effective and aligned cross-jurisdictional approach is needed to implement local crypto regulatory frameworks, which begins with leveraging existing tenets of supranational and existing work wherever possible - for example, with respect to definitions. We also note that doing so will avoid many of the unnecessary, protracted issues seen in other regimes where global alignment has not been sufficient, such as G20 over-the-counter (OTC) derivatives regulatory reporting, where despite more than 10 years of effort, lack of definitional consistency and harmonisation at the global level has still resulted in severe problems in being able to compile, reconcile and analyse data across borders, enormous amounts of spent resources and an undermining of the regulatory objective behind reporting in the first place.

Financial Products, Financial Services and the Current Regulatory Framework

Concerns expressed about lack of harmonisation globally have also been identified in the Australian domestic market with respect to internal consistency. For example, Australia's Corporations and Financial Services laws (CFS laws) are a product of many decades of legislation, amendments, bolt-ons and patches, which have, over time, highlighted the need to more holistically consider their practical operation, intent and effect. The sheer scale of the problem has been put into stark relief by the Australian Law Reform Commission (ALRC) itself, which makes for sober reading.[2]

The overall legislative regime as it stands today is fraught with complexity, overly prescriptive, full of modifications and cross-references which are in many cases redundant and/or inconsistent, duplicative yet conflicting in parts, and extremely difficult to navigate. The readability of the CFS laws has suffered under the patchwork of changes and delegated legislation over time, as principles-based legislation and regulation have given way to an overly prescriptive, details-based approach. This undermines efforts to establish clear, concise and globally aligned terminologies and definitions for the purpose of regulating crypto products and markets which are cross-border by nature. This also has the unfortunate practical effect of constituting a barrier to business growth by significantly increasing uncertainty in interpretation and the costs of compliance with the law, as well as acting as a hindrance to encouraging new business and entrants into Australia.

Australia's viability and marketability as a technological and financial centre depends on its ability to encourage the growth of pioneering new businesses and make simple regulation an enabler of development while ensuring protection. What is needed is a modern Australian regulatory framework which aligns and supports today and tomorrow's modern trading world. We remain concerned that while the CFS laws may be pure in their intent to be technology-neutral and apply a functional approach to regulation and delineating a perimeter, practically speaking, definitions and technological concepts in the Corporations Act are extremely out of date, and their built-up complexity means they no longer apply an effective functional approach to regulation. This is directly applicable to the central tenet of the consultation paper - defining the 'functional perimeter' of what does and does not constitute a financial product. As the ALRC notes and illustrates below:

"The lack of consistency is combined with a lack of any clear identification of when defined terms are

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used, or even a single place in which they may be found. Despite this, the Act is highly reliant upon the use of defined terms to trigger obligations — for example, labyrinthine definitions for 'financial product' and 'financial service' are used to demarcate many of the Act's regulatory boundaries. The extensive use of defined terms is a form of internal cross-referencing, which the Act does more than 14,500 times. This makes it necessary for readers to traverse back and forth between potentially disparate parts of the Act, in a sometimes forlorn search for meaning." [3]

The need for broad reform of the CFS laws becomes particularly clear when considering the transformation that the Australian economy is currently undergoing. The domestic digital economy has vast amounts of untapped potential to power Australia's growth well into the future; however, the effort and cost required to understand the operation of a legislative and regulatory framework which is gargantuan in its size and complexity acts as a handbrake on this potential. This holds true for both existing businesses trying to digitalise and new digital businesses trying to flourish. From a capital investment and talent attraction perspective, Australian entrepreneurs and businesses in the digital economy as well as those overseas who are looking to invest in Australia are discouraged from doing so because of the significant time and cost associated with understanding, establishing and maintaining legislative and regulatory compliance.

An Opportunity for Australia in an Era of Global Digital Competition

Reforming the domestic legislative and regulatory framework represents a tremendous opportunity for Australia to improve its standing against many of the jurisdictions with which it competes most fiercely in the digital race. For example, in September 2021, the World Economic Forum (WEF) referenced the *Digital Riser Report* [4] from the European Center for Digital Competitiveness, which analysed the digital competitiveness of 140 countries to provide a global ranking that compares them within their regions. Of

the G20 nations, Australia ranked 11th, falling 18 points compared to the previous period. Similarly, the WEF's *Markets of Tomorrow Report 2023: Turning Technologies into New Sources of Global Growth* found that across key areas of top technologies including artificial intelligence, cryptocurrencies, digital platforms and apps, distributed ledger technology, internet of things and connected devices, many G20 nations outpaced Australia.

We strongly believe that a simpler, more pro-business friendly regime is needed to encourage business growth, foster innovation, attract and retain talent and deepen investment. While we unequivocally support the immediate proposed amendments arising from the ALRC's Interim Reports, we also agree with the acknowledgement that the overall legislative regime remains in need of a broad, comprehensive overhaul which incorporates growth and investment as guiding priorities, and better attends to the needs and business models of both today as well as tomorrow. In particular, we draw the Treasury's attention to Interim Report A, Proposals A3, A4 and A5. These proposals relate to simplifying the definitions of 'financial product' and 'financial service'. These terms are significant for the regulatory regime, being used 1,316 and 423 times (respectively) in the Corporations Act.

We also note the efforts of other major G20 jurisdictions in implementing measures to modernise their regulatory regimes to responsibly develop digital assets, advance responsible innovation and reinforce global leadership and competitiveness. In particular, the European Union's MiCA regime was promulgated to *"create a regulatory framework for the crypto-assets market that supports innovation and draws on the potential of crypto-assets in a way that preserves financial stability and protects investors"*.[6] In the United Kingdom (UK), senior government officials have explicitly expressed their desire for the UK to *"lead from the front…seeking out the greatest economic opportunities"*.[7] And in the United States (US), *"President Biden's March 9 Executive Order on Ensuring Responsible Development of Digital Assets outlined the first whole-of-government approach to addressing the risks and harnessing the potential benefits of digital assets and their underlying technology."*

Licensing Regime

We note that this consultation paper acts as a prelude to further consultations due shortly on the appropriate elements of a licensing and custody regime for crypto. Although Cargio will have substantive comments to make on those consultations, we do take this opportunity to make the following high-level observations:

- *Application times*: We note the process of applying for and obtaining an Australian market licence can take years, with regulatory reviews of documents provided often constituting the bulk of this time. We do not believe such timeframes allow applicants the certainty they need, and note that substantial business costs are continually incurred during the review process. By way of comparison, the Monetary Authority of Singapore's stated processing time for an Approved

Exchange or Recognised Market Operator licence is nine months, [9] and the European Union's stated authorisation time for crypto asset service provider applications is three months. [10]

- *Application cost*: A commonly-referred to estimate of the costs of Australian financial services licence compliance and management is $1 million per year. An Australian market licence, both in terms of application and ongoing compliance, costs orders of magnitude more than this.
- *Regulatory consistency*: Ensuring that regulatory treatment is consistent across exchanges will be paramount. For example, intermediated (or centralised) exchanges operate with the same functions and purposes as decentralised exchanges, and therefore should be regulated with the same outcomes in mind.
- *Regulatory obligations*: While some provisions found in Chapter 7 of the Corporations Act can be applied to crypto exchanges (such as those relating to compensation arrangements, market manipulation and AML/KYC checks), others are not appropriate for crypto exchanges. For example, any potential application of the continuous disclosure provisions would need to be reconsidered, given that there is no single disclosing entity in the case of crypto products.
- *Listing*: In our May 2022 response to the Treasury's consultation on Crypto asset service providers: Licensing and custody requirements , we note that given the expertise of exchanges like Cargio in assessing the viabilit y and legitimac y of projects in the virtual assets space , it is appropriate for exchanges to be allocated primar y responsibilit y for assessing the suitabilit y of virtual assets for admission to trading, within a framework of accountability to regulators.
- *NFTs*: NFTs should not be within the scope of the regime (consistent with FATF's interpretation). We believe this is appropriate, given that NFTs are a nascent phenomenon in the crypto-asset landscape and as such, while they merit further study, they should not currently be the subject of direct regulatory oversight.
- *Custody*: Local custody requirements should be avoided, as they would significantly drive up end user costs, and not provide the desired certainty that assets would be able to be recovered if needed. A distinction also needs to be made between custody for retail and institutional users. Please refer to our response to the Treasury's consultation on Crypto asset service providers: Licensing and custody requirements noted above for our more detailed perspectives on custody.

Australia may miss out on important opportunities within the sector if there is a requirement for assets to be custodied locally. There is precedent within the Australian regulatory landscape for assets owned by Australians to be custodied overseas (e.g. gold, equities) and on balance, the costs and lost opportunities of local custody requirements outweigh the perceived security benefits. The complexities of managing custody across multiple blockchains, wallets (hot and cold) and maintaining best-in-class security can be misunderstood by smaller and inexperienced custody entrants, making them more vulnerable to hacks and outweighing the perceived regulatory value of a local custody framework.

Consultation Paper Questions

1. What do you think the role of Government should be in the regulation of the crypto ecosystem?

Consumer Protection While Enabling Innovation

As one of the global pioneers of digital asset technology adoption, we fully agree with the Treasury's statement regarding the crypto ecosystem as it relates to both financial services and non-financial services:

"If the crypto ecosystem matures and develops, it could open significant new opportunities for businesses and consumers alike, creating jobs and fostering innovation…The crypto ecosystem also has the potential to help improve competition in the technology and other sectors, which would carry broader benefits for the Australian economy. Australian businesses can take advantage of the technological advancements to improve their operations, create new opportunities for growth, build efficiencies into existing products, and explore new markets."

To truly realise this vision however, crypto financial services regulation must have both the overall intent and practical effect of enabling and encouraging the crypto ecosystem's growth, by striking the right balance between risk minimisation and innovation, in tone, strategy and action. It is the role of government to adopt a coordinated, holistic and efficient approach to design a regulatory regime which appropriately tasks the machinery of government to implement policies and regulations which put safe guardrails in place, while equally importantly curating an overall ethos of supporting innovation, attracting investment and propelling the nation's development forward. This includes, but is not limited to, learning from other countries' experiences to be as consistent with them as possible, ensuring the legislative regime is sufficiently flexible and modern to adapt to the crypto ecosystem's characteristics and strong, inter-agency strategic coordination to ensure that Australia burnishes its business-friendly reputation.

Combined together, the elements of the above paradigm will equip the economy to realise the full benefits of the crypto ecosystem. However, we note that while a significant proportion of the consultation paper discusses the risks of crypto products, only a few short paragraphs are dedicated to espousing the tremendous growth potential the digital financial services industry represents through crypto and blockchain compared to the traditional finance industry, by:

- challenging existing business models;
- putting the consumer first through lower costs, greater utility and greater decision-making power;
- enabling deeper, wider sources and options of financing, funding and access to capital;
- contributing to secure, sustainable growth; and
- increasing the freedom of money worldwide.

The huge opportunities materialising in the web3 financial services industry have caught the attention of

countries worldwide (as recently noted by Bain & Company in February[12]), and many have seen the opportunities for investment and innovation potential, fuelling the race to be seen as crypto finance-friendly jurisdictions. These opportunities include, but are not limited to:

- offering entrepreneurs and businesses the opportunity to raise money globally using peer-to-peer (P2P) methods, including through cryptocurrency and exchange innovations;
- developing a healthy startup ecosystem, which is a key driver of economic growth; and
- enabling large businesses to issue tokens on a peer-to-peer (P2P) basis to access new investors.

Even beyond financial services, the broader crypto ecosystem promises far-reaching, cross-sectoral benefits for the Australian economy for decades to come. The metaverse is transforming everyday interactions in countless ways, including through:

- artificial intelligence;
- the internet of things;
- extended reality;
- brain-computer interfaces;
- 3D modelling and reconstruction;
- digital real estate and proof of ownership;
- work collaboration and training; and
- spatial and edge computing.

We believe that greater importance needs to be placed on the opportunities and potential that the right regulatory approach (combined with government initiatives and incentives) with respect to both financial and non-financial applications of crypto and blockchain technology would bring to Australia. This should also form part of a broader Australian strategy involving the wider digitalisation of society and the traditional (physical) and new (virtual) economy. Importantly, this paradigm needs to be set at the highest levels of government, filter through to regulatory agencies' approaches and be the result of close, direct cooperation with crypto industry representatives. Over the years, Cargio has been vocal about the need for effective and appropriate regulation to help reinforce trust in and mainstream adoption of digital assets, and we strongly believe that a stable regulatory environment can support innovation, reduce consumer friction and costs, unlock powerful benefits for users and contribute to broad, long-term growth. Too much or inappropriate regulation due to excessive characterisation of the industry as inherently risky can also mean that the benefits of new products and services are not realised. Equally, the crypto and web3 industries are moving at a rapid rate of technological progress, and therefore too long a time frame for implementation of a regulatory framework through a 'wait and see' approach can result in regulation being late and countries missing out on wider economic benefits, including investment.

The web3 and digital asset industry has the potential to supercharge Australia's economic growth for decades to come, while growing, attracting and retaining talent onshore. The industry also represents an opportunity to bolster Australia's long-term transformation to a tertiary, services-based economy which encourages startups and entrepreneurs and equips them with the skills needed for today and tomorrow. However, a vibrant digital asset ecosystem can only be nurtured by viewing it from a balanced regulatory

lens, and while *"Australia is already home to a thriving community of crypto ecosystem businesses, including network infrastructure providers, code auditors, trading platforms, online gaming companies, and software engineers"*, this cannot be taken for granted nor assumed to continue without clear, tangible and practical government and regulatory support.

2. Scams can be difficult for some consumers to identify.

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

We believe that properly and consistently implemented disclosure principles as well as code auditing can help regulators fulfil their obligations, by enabling the industry to operate within a regulatory framework that accurately reflects the risks and benefits that the sector presents. We believe that any such measures should be the subject of further consultation before implementation.

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

Given the expertise of exchanges in going through a rigorous process of assessing the viability and legitimacy of projects in the virtual assets space, it is appropriate for exchanges to be allocated primary responsibility for assessing the suitability of virtual assets for admission to trading, within a broader framework of accountability to relevant regulators. Scams resulting from scam tokens lead to reputational damage for exchanges, who are therefore incentivised to avoid admitting these assets to trading in the first place. Other regulatory levers include the Australian Competition and Consumer Commission's (ACCC) Scam Watch program , which Cargio is a proud member of, and greater cooperation with law enforcement agencies such as the Australian Federal Police, which Cargio already has a strong relationship with.

We also believe that it is equally important to safeguard consumers by contributing to financial and digital literacy initiatives . Cargio and the broader Cargio group take these responsibilities very seriously, and have undertaken great efforts to improve consumer literacy through Cargio,

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