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## RE: Submission to Third Issues Paper

Dear Committee,

### Introduction

Thank you for the opportunity for us to provide a submission in response to the third issues paper published by the Senate Select Committee on Australia as a Technology and Financial Centre.

Independent Reserve Pty Ltd ([Independent Reserve](http://www.independentreserve.com)) is a Digital Currency Exchange (DCE) that has been operating in Australia since 2013 and has been a proponent of regulation in the digital asset and cryptocurrency sector. Independent Reserve services hundreds of thousands of Australian customers each year and in the financial year ending 2021, Independent Reserve estimates that total turnover on its platform alone will exceed AUD\$5 billion; and total assets in custody is in the hundreds of millions. We welcome the focus on regulation in this industry to provide certainty for service providers such as independent Reserve and to enhance consumer protection mechanisms.

Independent Reserve is a member of Blockchain Australia and our CEO Adrian Przelozny sits on the Board of Blockchain Australia. Independent Reserve are actively involved with Blockchain Australia on their submission to the committee and fully endorse the Blockchain Australia recommendations in addition to the recommendations contained in this submission.

### Summary

Independent Reserve is making four recommendations in response to the Third issues Paper and are summarised below:

1. Minimum standards for custody of digital assets  
Independent Reserve recommends the introduction of **minimum standards for digital asset custody service providers** to ensure security of customer assets, assets are stored in Australia and businesses offering services are financially viable.
2. Licensing of digital assets custody service providers  
Holding customer assets should be limited only to businesses able and willing to adhere to the minimum standards and these should be tested independently. Independent Reserve recommends a **licensing program** for all digital asset custody service providers.



3. De-coupling custody licensing from token classification  
Requiring a comprehensive token classification system to introduce any regulation and security into digital asset custody management will greatly delay any implementation and will require international agreement. Independent Reserve recommends to **de-couple custody legislation from token classification**.
4. No direct action on the de-banking issue  
Independent Reserve recommends **no direct intervention by government to alleviate the de-banking issue**. It is the responsibility of government and the industry to ensure digital asset and cryptocurrency service providers are a sound business to provide services to.

## Recommendations

### 1. Minimum standards for Custody of Digital Assets:

There have been numerous examples in the past of digital asset custody providers and exchanges losing millions of dollars of customer assets. This has created a perception that using a professional company to house digital assets is a risky proposition. This has had the flow-on effect of making insurance for reputable custody service providers either prohibitively expensive or simply not available.

Independent Reserve recommends that the Australian Government defines a set of minimum standards for any company offering digital currency custodial services. The minimum standards must cover:

- Minimum net capital requirements for all custodial service providers
- IT security arrangements
- Redundancy arrangements (to eliminate key person risk)
- Segregation of customer/house assets
- Record keeping/holder entitlement
- Reconciliations/proof of ownership
- Regular external audit of security procedures

Businesses seeking to provide custodial services to retail and/or institutional customers must be granted authority to do so by Government (see Recommendation 2 below) and be subject to regular renewals of this authority.

#### Benefits:

Customers: The single largest issue facing individual customers in the digital asset and cryptocurrency industry is the security of their digital assets with their chosen service provider. Defining minimum standards ensures customers know they are dealing with a business that has in place a comprehensive set of controls that are regularly scrutinised by an independent third party and have the required financial capital backing their ongoing operation.



With customers having assurance that assets can be held securely by a business, it has the added benefit that Australian-owned assets are kept in Australia, by Australian businesses and customers are then protected under existing consumer protection laws. Currently the largest providers of custody services globally are not domiciled in Australia. Should customers of these offshore businesses have a dispute with the provider, the individual customer must negotiate international laws and jurisdictions to try and resolve the dispute and recover their assets. Providing a custody standard and requiring businesses to be financially viable, domiciled in Australia and adhering to minimum standards would ensure Australian assets stay in Australia and customers are afforded the range of consumer protections already in place for Australian consumers.

Service providers: Published standards by the Governments give support service providers (auditors, insurance companies, underwriters, consultants, etc.) confidence that all businesses holding the appropriate authority to operate are adhering to a high standard of security and regular assurance activities. This will translate into more support services being made available to the service providers. This will eventually allow insurance, audit and controls assurance services to be made available at reasonable prices.

Financial Product innovation: There are many digital asset and cryptocurrency funds in existence around the world and Independent Reserve is aware of at least two Australian funds that are in the process of listing on the Australian Securities Exchange. Funds provide an easy way for customers to gain exposure to digital asset and cryptocurrency asset classes. To provide assurance to Australian investors, Independent Reserve recommends that Australian funds maintain custody of all assets in Australia. Introducing licensing (see recommendation 2 below) and minimum standard for custody of digital assets and cryptocurrency would allow this industry to operate safely and would encourage investments and innovation in digital asset and cryptocurrency backed products in Australia.

Australia: Increased use of audit and assurance services locally boosts the professional services industry and brings more money and more expertise into Australia to service the regulated custody industry. It will also encourage overseas investment and encourage foreign service providers to establish operations in Australia to take advantage of the regulation. This will also increase demand for local insurance, assurance and audit services and create jobs in the digital asset and cryptocurrency sector in Australia.

## **2. Licence to operate a digital asset/cryptocurrency custodial service:**

For all financial products in Australia, any business providing a custodial or depository service must hold an Australian Financial Services licence. Applying for an AFSL is a non-trivial matter and carries a range of responsibilities for licensees.

Independent Reserve **does not** recommend that an AFSL be required to provide a custodial service for digital assets and cryptocurrency (see recommendation 3 below). Holding an AFSL carries many requirements that are not appropriate or relevant to the digital currency sector as it currently stands.

Independent Reserve welcomed AUSTRAC bringing Digital Currency Exchanges (DCEs) under the AML/CTF Act as it was a positive step forward for Australia and the sector. However, registration with AUSTRAC is quite a simple process and it is available to almost all service providers regardless of size, business maturity and financial backing. For this reason, Independent Reserve **does not** recommend this type of arrangement for providers of custodial services.



Independent Reserve **recommends that businesses that want to provide a custodial service for digital assets and cryptocurrencies must be issued an authority/licence** to do so prior to offering services to customers. Requirements to be issued with an authority/licence:

- Minimum capital requirements (net tangible assets) – at least AUD\$5m
- Audit certificate/external assurance of custodial procedures
- Redundancy procedures
- Segregation of customer and operational funds/assets
- Annual compliance requirements for audit/external assurance
- A Responsible Person with adequate experience

Benefits: Setting a high bar for the storage and security of customer assets elevates consumer protection from unscrupulous operators and businesses that do not invest adequately in security. It will also serve as an incentive to reputable operators to sufficiently invest in security and systems and to have these systems regularly tested by external firms.

### **3. Custody licensing decoupled from token classification**

Token and coin classification is a complex issue that has yet to be solved in an elegant manner in any jurisdiction around the world. For example: the recent licensing developments in Singapore require a legal opinion from every participant seeking to list each token and all stable coins are treated as e-money and fall under a prohibitive section of legislation.

If any near-term solution requires a comprehensive token classification mechanism to enable the digital currency and cryptocurrency sector to slot into the existing Corporations Act, then it is unlikely to happen prior to an established international standard.

For this reason, it is important that the Committee focuses on what can deliver meaningful improvements to the Australian industry and consumer protection. Independent Reserve recommends that any licensing of custody services to the digital asset and cryptocurrency industry should be token neutral and allow any licensed business to offer custody for any digital asset and cryptocurrency.

### **4. Banking / De-Banking Legislative Changes**

A pervasive issue for the digital asset and cryptocurrency sector is de-banking where businesses in the industry cannot secure the most basic of banking services. Independent Reserve understands that Australian Banks are heavily regulated and are encouraged by the applicable legislation to operate in a risk averse manner. For this reason, Independent Reserve **does not** recommend attempting to create a legislative exception that would require banks to deal with the digital asset and cryptocurrency sector.



The Australian Banking sector will continue to operate in a risk averse manner, so it is the responsibility of the digital asset and cryptocurrency industry and law makers to design the industry such that banks want to do business with the sector.

Independent Reserve recommends as a first step in this process, to put in place minimum requirements and licensing for the custody of digital assets and cryptocurrency. AUSTRAC already ensures that all DCEs must adhere to the AML/CTF Act 2006. If we can add a licence and minimum standards to the custody and security of customer assets, there is a demonstration of clear and comprehensive consumer protections in place.

## Conclusion

The digital asset and cryptocurrency industry in Australia is growing rapidly and it is extensively used by hundreds of thousands of Australians each week. Annual turnover across the industry is in the billions of dollars and billions in digital assets are held by Australian customers. An industry of this size and scope requires regulation to:

- Keep consumers safe.
- Support Australian service providers to the industry.
- Ensure growth of the industry locally.

The issue of token classification and the impact they have on legislation is a global discussion and a discussion that does not look like being resolved soon. Attempting to legislate tokens by classification will be difficult and may put Australia at odds with any global standard. Independent Reserve recommends putting in place regulations that can be enacted quickly and will provide benefits to customers through enhanced protections and assurance; and provide local industries and support services to continue to grow and attract investment.

Independent Reserve recommends **focusing on minimum standards and licensing of digital asset and cryptocurrency custody services**. This ensures custody services are provided by financially sound, well-run and secure local businesses and Australian assets will remain in Australia. This will also provide assurance to the financial product innovators who are already trying to grow their size and scope in Australia.

Safe, secure and financially backed custody will support the growth of local industry, provide consumer protection and will not require token classification.

Sincerely,

**Duncan Tebb**  
Head of Operations + Risk