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Senate Standing Committees on Economics
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Dear Committee Secretariat

Inquiry into Digital Assets (Market Regulation) Bill 2023

1. Background

- 1.1. Thank you for the opportunity to provide a submission to the Senate Economics Legislation Committee inquiry into the *Digital Assets (Market Regulation) Bill 2023* (“**Bill**”).
- 1.2. As an opening comment, Australia must not lose sight of the guiding light underpinning the innovation in the blockchain ecosystem. Potts J, succinctly summarizes the network benefits of blockchain systems:

Production takes time. Production in time takes trust. Capital and trust are inputs into production. Larger capital structures require more secure property rights and institutional trust. Longer capital structures require greater trust owing to increased complexity of contracting. Changes in the cost of trust in consequences of new technologies of trust – e.g. blockchain, which industrialises trust (Berg et al 2018) – will therefore affect capital structure the same way as changes in interest rates.¹

- 1.3. Simply restated, blockchain systems afford reorganisation of our trust allocation in the economy. This should be forefront when legislating what is (or should) be encouraged to develop out of the maturing blockchain sector, in order to facilitate a deliberate societal reorganisation that promotes the increasing ability to connect, administer and engage in trade and social activities through emergent technology.

¹ Allen, DWE, Berg, C, Davidson, S and Potts, J, ‘*Blockchain and Investment: An Austrian Approach*’, Review of Austrian Economics, Forthcoming (2020), p 3.

- 1.4. The consumer protections are solved (in some sense), by the nature of the interaction layer inherent in blockchain systems.² Unfortunately, bad actors exist - so a regulatory or industry seal, confirming a project safe for consumers is desirable.³ We've seen projects like Signaller⁴ emerge, where crowd sourced warnings are sent to offending addresses/projects in an early attempt of engaged industry participants to protect consumers from bad actors. This Bill is a considered distillation of what pockets of industry have been attempting to address.
- 1.5. In light of the limited time available for submissions, Pier Two has concentrated on the custody and transition period aspects of the Bill.

2. About Pier Two

- 2.1. Pier Two is a technology company, based in Brisbane, Australia. We specialise in building and investing in blockchain technology, namely:
 - (a) Performing node and infrastructure services, that provide accurate and timely data and secure validation services, as part of a decentralised network, in order to enable blockchain-based transactions (with self-executing settlement);
 - (b) Building non-custodial platforms and applications with blockchain technology; and
 - (c) Researching and investing in applications of blockchain technology.
- 2.2. Pier Two is taking a considered approach to building with blockchain technology in Australia by ensuring that we: have strong partnerships and advisors within Australia; consistently interact with other teams building with blockchain technology in Australia and abroad; and keep a close eye on other progressive jurisdictions.

3. Custody

- 3.1. Care needs to be taken to avoid capturing non-custodial solutions.⁵
- 3.2. For example, consider the non-custodial ETH staking that occurs on the Ethereum Network's Beacon Chain. Staking participants deposit ETH into the deposit contract dictate what the

² Notwithstanding that centralised exchanges do not work into this ethos *per se*, yet it is inherent in how underlying blockchain systems operate and the digital assets that flow from them.

³ A stand alone regime is desired (such as this one). Digital Assets are not merely financial instruments and they will be used to interact in a variety of mediums.

⁴ <https://signaller.eth.limo/>

⁵ This could include validators, node service providers and many other industry participants.

withdrawal address will be, with that address being immutable linked to the legal and beneficial owner of the asset⁶ once the initial deposit is complete and assuming they either self custody or custody through an intermediary.

- 3.3. With regard to proof-of-stake (PoS) staking, it is typical that the attestations⁷ and the withdrawal capabilities are bifurcated, where:
- (a) service providers run and maintain nodes on behalf of users, which are required components of infrastructure for running validators that participate in consensus related for the network. On Ethereum, validators that perform these activities correctly receive rewards in ETH that are automatically streamed to the withdrawal address from the Beacon Chain; and
 - (b) the owner of the relevant asset retains control over the withdrawal rights and function. Ultimately maintaining control⁸ over whatever assets are in the possession of the particular withdrawal address.
- 3.4. In non-custodial ETH staking products, deposit and withdrawal address private keys will be retained by the user⁹ and stored either with a third party custodian, or self-custodied in a secure way by the customer irregardless of whether they are engaging a staking infrastructure provider.
- 3.5. Within this context, the definition of *digital asset custody service* is potentially problematic through the inclusion of the word “servicing” insofar as there are things done by service providers running validator-related infrastructure on behalf of users that impact the effectiveness of the digital asset being used to secure the broader function of the relevant network, without obtaining access to the underlying asset itself.
- 3.6. It is unclear whether non-custodial PoS service providers would inadvertently be captured by the “servicing” component of the definition of *digital asset custody service*, or whether this is intended.
- 3.7. The minimum capital requirements would not make sense for these types of businesses as customers retain the right to, and control of, their assets. Security audit reports, disclosable to

⁶ Which includes the control and legal ownership of the relevant private key to withdraw from a particular wallet.

⁷ Along with sync committee duties and block proposals.

⁸ Including legal and beneficial ownership.

⁹ Withdrawal address private keys are generated prior to, and without any, involvement of non-custodial staking providers.



third parties using the service would be appropriate, with industry working with ASIC to determine what is an acceptable outcome of a security audit to allow for use by third parties.

4. Transition Period

- 4.1. It is strongly encouraged to extend the transition period to no less than 12 months from the date of commencement of the Bill. This brings it in line with the lower end of the transition period afforded under the European Union's Markets in Crypto Assets ("**MiCA**") reforms.
- 4.2. There is a risk to market competition and the creation of an incumbent monopoly if smaller operations are not afforded time to work through the framework due to having limited resources when compared to larger exchanges.
- 4.3. Further, and with respect, it would be helpful to industry if ASIC prepared detailed compliance guidance in advance along with details regarding processing times for applications. This could include ASIC actively approaching and guiding market participants into compliance or recommending that applications be submitted.

5. Parting Comments

- 5.1. Thank you for the opportunity to engage on this important and well considered Bill. Pier Two looks forward to seeing a clear and helpful framework being implemented that promotes Australia as an advanced, considered and mature economy that engages with emergent technology.
- 5.2. Please reach out to us if you would like to discuss our submission further, we will assist without pause.

Yours Sincerely

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w. <https://piertwo.com>