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Regulating Digital Asset Platforms – Exposure Draft

The Australian Financial Markets Association (AFMA) welcomes the opportunity to make comment on the *Regulating digital asset platforms – exposure draft legislation* consultation.

We note given the complexity of scale of the proposals that 4 weeks has been insufficient to progress a fully considered response.

We find that the novel differences in construction in relation to the regulation of digital assets are generally well formed and technically interesting but as a result it is also challenging to see how they will play out over time as they are utilised for new business applications.

As such, our main recommendation is that Treasury adjust the Exposure Draft to extend the deeming powers of the Minister proposed under 767B to bring types of products and platforms into, or carve them out of, the regime as needed from time to time. This should go to the definitions of Digital Object, Digital Token, but it should also grant more general powers in relation to types of Digital Asset Platforms and Tokenised Custody Platform. Gaining post-legislation flexibility would de-risk the project for Treasury and increase the potential for the arrangements to evolve with sometimes fast changing international developments.

AFMA supports the general approach of continuing the application of financial services law unless expressly exempted by the legislation. Where both regimes apply, the outcome should seek to avoid additional obligations where firms are already complying with financial product relevant requirements. These might arise when assets traditionally regulated under other regimes (e.g., cash, securities) are held or transacted via digital tokens. It may be difficult to foresee and resolve all of these issues in advance of the

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schemes getting underway. We therefore suggest that flexibility be built into the scheme to allow obligations imposed by the new regime to be switched off by legislative instrument.

In relation to “digital token” and “digital object” the definitions in the draft legislation are notably broad. The term “digital object” encompasses any electronic record, including documents, images, or other intangible items recorded electronically. A “digital token” is defined as a digital object over which one or more persons can exercise control, with possession generally equated to the ability to control the object.

We suggest a list of specific exclusions that can be expanded by the Minister over time, might reduce unnecessary considerations of unintended crossover of the new regime with existing arrangements. For example, a bank account password might be stored on a cloud storage file system, the bank account qualifying as a Digital object, the password as a token, and the cloud storage provider as a Digital Asset Platform. We understand there may be other examples that might appear to satisfy the control requirements while seemingly best to keep out of the regime.

Members have also noted that the control test should be limited to factual control in accordance with the law.

We also support the regime’s regulatory neutrality and agree with the underlying view that ‘same risk, same regulation’ is appropriate given the same risks are present in different forms in schemes implemented with different technologies.

We also support the technological neutral approach which is silent on the underlying technology and seeks instead to work from the basis of legal rights.

AFMA is keen to understand more about the relationship between central securities depository (CSD) services, traditional custodial services, and the new categories of DAP and TCP. Specifically, to understand the substantive differences between the regulatory regime for DAP/TCP and the existing frameworks for central depositories and custodians. And how will the new rules apply in practice to platforms that perform similar functions to CSDs.

Relatedly, the explanatory materials state that “dealing in a digital asset platform, or the possessing of digital tokens under such a platform; and dealing in a tokenized custody platform, or the holding of assets or digital tokens under such a platform” does not constitute providing a custodial or depository service for the purposes of the Act. We request further elaboration on the meaning of “dealing in” DAP/TCP, and how these activities will be distinguished from traditional custodial or depository services.

We thank you for considering our comments in relation to this consultation.

Yours sincerely

A handwritten signature in dark ink, appearing to read 'Damian Jeffree', written in a cursive style.

Damian Jeffree

Head of Financial Markets, Exchanges and Digital

Tokens and Digital Assets

1. The component parts of the ‘digital token’ definition used in the draft Bill have been informed by international work including the UK Law Commission’s Final Report on Digital Assets, the UNIDROIT Principles on Digital Assets and Private Law, and the US Uniform Law Commission’s Uniform Code Amendments 2022.

1.1. Is the concept of “control” in section 761GB sufficiently clear to allow stakeholders and courts to determine the circumstances in which: (i) a digital object is a digital token; and (ii) a person is issuing a digital asset platform (DAP) or tokenised custody platform (TCP)? If not, how can it be improved?

1.2. Is the concept of “control” in section 761GB sufficiently flexible to enable the law to develop and apply to various technologies in future? If not, how can it be improved?

1.3. Does the definition of digital token properly capture the types of digital objects that are intended to be captured (i.e. digital tokens that exist on decentralised networks such as bitcoin) and avoid capturing digital objects that are not intended to be covered (e.g. company shares recorded on digital registries)?

Members advise us that the ‘control’ concept has some risk of circularity as determinations are dependent on the exclusion abilities of other parties.

Control might apply in ways that are likely not intended to be captured such as where a provider of systems or storage to a digital asset inadvertently has the ability to exclude others including the owner of the asset.

3. The draft Bill focuses on circumstances in which a person *in fact* possesses or transfers a digital token. It does not change the way that the existing law applies to determining whether a person – by possessing or transferring a digital token – is holding or transferring a financial product.

3.1. Is it clear that a facility where ‘offers to acquire or dispose of *digital tokens* are regularly made’ may constitute a financial market, if those transactions effect (i.e. result in) the acquisition or disposal of financial products?

3.2. Is it clear that a person (including a DAP or TCP operator) who arranges for another person to ‘acquire or dispose of a digital token’ may be providing a financial service of dealing in a financial product, if those transactions effect (i.e. result in) the acquisition or disposal of a financial product?

Members have suggested that factual control might be better framed as factual control in accordance with the law.

6. Under the draft Bill, a “client” of a TCP is a person who has entered into an agreement with the operator. Merely possessing a TCP token does not make a person a client – a TCP token holder must onboard with the operator and become a client before being able to exercise rights in relation to the underlying assets.

6.1. Is the draft Bill sufficiently clear on this distinction between TCP client and TCP token holder? If not, how could this be clarified?

6.2. Does the draft Bill need to make specific provision for operators to hold underlying assets on trust for TCP token holders, including those who may be unknown to the operator? If so, how could such a provision be implemented?

We acknowledge the tension here in that the bearer bond type nature of tokens means that a TCP could find itself without any clients despite holding tokens effectively for unknown persons.

Priority rules and safe harbour test

9. The draft Bill does not alter the priority between facilities that are financial products and facilities that are financial markets or clearing and settlement facilities.

9.1. Is it clear that a facility (or part of a facility) that meets both: (i) the definition of a DAP; and (ii) the definition of a financial market or clearing and settlement facility, will be a financial market or clearing and settlement facility (and not a DAP)? If not, how could this be clarified?

While the logic of the final Act utilising s765A(1)(l)(i) works, and the Note 2 that is added after 768A(1) is helpful, it does take some decoding of the structure given the way it is drafted.

13. Section 1020AR of the Bill would empower the Corporations Regulations to prescribe a disclosure regime for non-financial product digital tokens offered through a DAP or TCP.

13.1. Would addressing disclosure for non-financial product digital tokens in this way cause any concerns, or would a different approach (e.g. standards prepared by ASIC) be preferable?

13.2. If the approach in the draft Bill is appropriate, what disclosure obligations should apply to operators of DAPs and TCPs in respect of non-financial product digital tokens, and what information should be disclosed?

13.3. Are there any obligations that should not be imposed on operators (i.e. obligations that would be impossible to comply with or disproportionate for non-financial product assets)?

AFMA would prefer the power be kept with the Minister and run through a Treasury consultation.

Regulatory clarity and flexibility

14. The draft Bill attempts to provide regulatory clarity with targeted exemptions and flexible powers that can be exercised by the Minister or ASIC.

14.1. Do the exemptions for wrapped tokens, public digital token infrastructure, and intermediary staking arrangements adequately address the regulatory uncertainties that arise in each context? If not, how could they be improved?

14.2. Is the power for the Minister to declare that specific digital tokens are not treated as financial products for the purposes of the financial markets or clearing and settlement regime an appropriate way to provide flexibility to “right-size” regulation in future?

As noted in our letter, while the settings appear broadly appropriate, additional flexibility should be built into the design due to the high potential for unseen developments. This is our main recommendation in response to this consultation.

While the industry has been actively considering the proposals the four week consultation period is insufficient to maximise the utility of this process.

15. The appendix to the Explanatory Memorandum includes a series of worked examples covering the application of the definitions and exemptions in the Bill. These examples are intended to show at a high level how the statutory tests are intended to apply in practice.

15.1. Do the examples illustrate the intended application of the Bill clearly and accurately? If not, how could they be improved?

15.2. Are there additional examples or clarifications that would assist stakeholders in understanding how the regime applies in practice?

The examples are helpful, but as per our response to question 14 there are a large number of potential edge cases that might be expected to emerge over time.

19. Issuers of margin lending facilities and similar products cannot rely on the intermediary authorisation exemption due to regulation 7.6.01AAA of the Corporations Regulations.

19.1. Should this intermediary authorisation exemption also be disappplied to DAPs and TCPs under regulation 7.6.01AAA?

Margin lending facilities should not be put at a disadvantage to DAPs and TCPs effecting the same activity.