Submission to Treasury on Initial Coin Offerings

March 2019

This Submission was prepared by FinTech Australia working with and on behalf of its Members; over 300 FinTech Startups, VCs, Accelerators and Incubators across Australia.
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About this Submission

This document was created by FinTech Australia in consultation with its Blockchain Working Group, which consists of over 64 company representatives. In particular, the submission has been compiled with the support of our Working Group Co-leads:

- Alan Tsen of Stone & Chalk
- Rory Manchee of Brave New Coin.

This Submission has also been formally endorsed by FinTech Australia members.

Submission Process

In developing this submission, our Blockchain Working Group held a Member teleconference to discuss key issues relating to the Initial Coin Offerings Issues Paper.

We also particularly acknowledge the support and contribution of Claire Wivell Plater of The Fold Legal Pty Ltd, John Bassilios of Hall & Wilcox and Hannah Glass of King & Wood Mallesons to the topics explored in this submission.
Context: Initial Coin Offerings

Fintech Australia FinTech Australia has been a consistent advocate for policy and regulatory clarity for ICOs to provide certainty to innovative blockchain businesses wishing to raise capital through this new mechanism and use tokens to develop, grow and drive distributed ledger organisations.

We met with ASIC’s Cryptocurrency Working Group on a number of occasions in 2017 to provide information and insight into the nature and likely significance of distributed ledger technology, the token economy and ICOs.

FinTech Australia welcomes the opportunity to put forward its position on behalf of members in relation to Treasury’s Consultation on ICOs.

In preparing this submission, we have had the benefit of reading drafts of the submissions prepared by BlockChain Australian and the Australian Digital, Commerce Association (ADCA). To avoid duplication, we will refer to, but not replicate material in those submissions.

In this submission, we use “tokens” to describe tokens of all types and “ICO” to describe the initial issuance of tokens.

Definitions and Token Categories

1.1. What is the clearest way to define ICOs and different categories of tokens?

Initial Coin Offerings

ICO(s) take a variety of forms. While they are commonly used for fundraising, they may also be used to seed networks of users for the underlying technology protocol.

Not all ICOs require recipients to provide value in exchange for token issuance. For example, token airdrops, where no consideration is required to particulate, are common methods of ICOs. There is considerable innovation underway in this area.

It is important that any definition of ICO is sufficiently flexible to cater for the different methods
and purposes for in which ICOs are conducted and, while the distributed ledger technology is at such an early stage of its evolution, does not constrain future innovation in this area.

**Tokens**

Fintech Australia agrees in general terms with the three categories of token identified by Treasury and notes the additional types of tokens identified by BlockChain Australia (collectibles, sovereign and privacy tokens). ADCA’s submission provides compelling insight into the current speed and creativity associated with token development.

For similar reasons as ICOs, any definition of tokens needs to be sufficiently flexible to cater for different types of tokens, different uses of tokens, including combinations of uses, and to facilitate future innovation.

A considerable amount of work has been undertaken on developing token taxonomies. Fintech Australia commends Treasury to the work of Global Digital Finance and Brave New Coin in this area. Please contact us if you require copies.

**Drivers of the ICO Market**

2.1. **What is the effect and importance of secondary trading in the ICO market?**

Fintech Australia considers that the ability to trade cryptographic tokens in an orderly fashion is essential to facilitate the growth of network economies based on distributed ledger technologies for the reasons identified by Treasury and additional reasons described by Blockchain Australia.

2.2. **What will be the key drivers of the ICO market going forward?**

Liquidity and security are the key drivers of any market.

Fintech Australia agrees with ADCA and Blockchain Australia that a clear regulatory framework for issuance and secondary trading of tokens is essential to the growth of distributed ledger technology organisations and network economies based on distributed ledger technologies.

Current regulation poses challenges for token issuers and traders. It has historically developed sequentially, in response to financial product innovation, leading to the result that it recognises a number of categories of financial product to which an instrument may belong, e.g. managed
investment schemes, shares, derivatives and the like. It does not currently recognise or readily cater for hybrid instruments, to which a number of categories, and therefore overlapping and potentially conflicting, regulatory requirements might apply.

The categorisation of the financial product determines its structure and governance requirements such as regulatory approvals, disclosure, distribution, and reporting and management obligations.

Even at this early stage of token development, it is apparent that these categories are insufficiently technologically neutral. They are constraining innovation, by in effect requiring token issuers to design their tokens for the regulatory environment, rather than the reverse.

Fintech Australia urges Treasury to incorporate maximum flexibility into the design of any regulatory framework for tokens in order to facilitate further development.

Opportunities and Risks

3.1. How can ICOs contribute to innovation that is socially and economically valuable?

Fintech Australia broadly agrees with Treasury’s description of the opportunities and risks associated with ICOs for industry, consumers, investors and the economy and the contributions to innovation enumerated by Blockchain Australia.

However, these appear to be premised on an assumption that ICOs occur primarily for fundraising. Fintech Australia urges Treasury to consider and take into account the other purposes for which tokens and ICOs are used, to ensure that the economic and social potential of this innovation is fully recognised.

Fintech Australia endorses ADCA observations regarding the social and economic potential of tokens and distributed ledger technology development.
3.2. What do ICOs offer that existing funding mechanisms do not?

3.3. Are there other opportunities for consumers, industry or the economy that ICOs offer?

In relation to issues 3.2 and 3.3, Fintech Australia agrees with the observations made by ADCA and BlockChain Australia regarding the opportunities offered by ICOs.

3.4. How important are ICOs to Australia’s capability to being a global leader in FinTech?

As stated above, the development of an accessible secondary market for tokens is essential for the development of distributed ledger technology.

Distributed ledger technologies have the potential to radically reshape economies by altering the way in which asset ownership, deployment, management and exchange occurs. Early developers have a one-time opportunity to dominate these technologies, which can be equated to the way Google, Facebook and Amazon have taken over and now dominate so many sectors of the marketplace economy.

If Australia does not facilitate domestic innovation in this area, it will necessarily become a follower and price taker, with implications for our balance of trade.

3.5. Are there other risks associated with ICOs that policymakers and regulators should be aware of?

Fintech Australia endorses the observations made by ADCA and BlockChain Australia regarding the risks associated with ICOs and distributed ledger organisations.

Regulatory Frameworks in Australia
4.1. Is there ICO activity that may be outside the current regulatory framework for financial products and services that should be brought inside?

As Treasury sets out, ICOs are governed either by the Australian Consumer Law or by the financial services provisions of the Corporations Act 2001 (Cth). There do not appear to be any ICOs that fall outside these categories.

We applaud the transfer of the ACCC’s responsibilities to ASIC so that distributed ledger technology organisations only need to deal with one regulator and to facilitate the development of a consistent regulatory approach.

There will necessarily be uncertainty in some circumstances regarding which regime should apply. More specific guidance in this area would assist to create greater certainty and encourage distributed ledger technology organisations to remain in or move to Australia.

In this regard, a considerable number of distributed ledger technology organisations have already relocated to other jurisdictions due to regulatory uncertainty.

4.2. Do current regulatory frameworks enable ICOs and the creation of a legitimate ICO market? If not, why and how could the regulatory framework be changed to support the ICO market?

While not ideal for the reasons described earlier in this submission, subject to the remarks in 4.3, at this time, Australia’s regulatory frameworks are generally suitable for ICOs and the creation of a legitimate ICO market.

FinTech Australia does not recommend significant structural change, or a purpose built regulatory framework for ICOs and an ICO market at this time. This would pose a significant risk of fettering innovation, not the least because it is too early to predict the ultimate outcome for this technology.

However, we would welcome an ICO registration requirement for all ICOs, loosely based on the IPO regime, including appropriate scaling for the complexity and size of the distributed ledger organisation, technology, the rights associated with the token and the type of investor.
4.3. What, if any, adjustments to the existing regulatory frameworks would better address the risks posed by ICOs?

Fintech Australia welcomes ASIC’s initiative in creating a Cryptocurrency Working Group and the proactive work undertaken by the Group. However, it believes it is as important for Treasury and ASIC to facilitate the development of distributed ledger technology organisations, as it is to understand and manage risk and to identify and penalise bad conduct.

Fintech Australia urges the empowerment of ASIC’s Cryptocurrency Working Group to provide detailed and specific guidance on its regulatory approach in order to provide greater clarity to distributed ledger technology organisations.

Areas where guidance (and in some cases adjustment to current legislation) is currently required include:

- The types of tokens that constitute securities (and those which do not);
- The application of the managed investment scheme regime to token structures – Fintech Australia agrees with BlockChain Australia that this regime is inappropriate for most types of ICO;
- How hybrid tokens should be treated - Fintech Australia recommends that this encompass the potential for a myriad of usages and combinations of tokens characteristics;
- An appropriate disclosure regime for tokens which are not securities – Fintech Australia recommends that it be scalable, having regard to the complexity and size of the distributed ledger organisation, technology and the rights associated with the token.
- The application of the AML-CTF regime to ICOs of all types – Fintech Australia recommends that it be extended to apply to non-security tokens.
- The post ICO governance obligations of distributed ledger technology organisations - Fintech Australia considers that these organisations should have similar obligations and duties to token holders as companies have to their shareholders.

4.4. What role could a code of conduct play in building confidence in the ICO industry? Should any such code of conduct be subject to regulator approval?

Fintech Australia believes that a self-regulating Code of Conduct is an important initiative to assist to bring stability and security to the distributed ledger technology sector.
A Code could be adapted to changes in the sector as the technology develops, thereby providing sufficient flexibility to facilitate innovation. Regulatory approval is desirable, but not essential at this nascent stage of the evolution of the sector.

Global Digital Finance has undertaken considerable work in developing wide-ranging Code/s of Conduct relating to a number of areas of financial services activity. It has obtained input from many global jurisdictions, as well as international bodies including the OECD and IOSCO. Global Digital Financial’s objective is for the Code/s to form a framework for consistent global regulatory approach to ICOs and related services.

Fintech Australia believes that ASIC should consider adopting Global Digital Finance’s Code/s in Australia.

4.5. Are there other measures that could be taken to promote a well-functioning ICO market in Australia?
As above.

Conclusion

Fintech Australia welcomes Treasury’s Issues Paper and looks forward to participating in its Roundtables to further expand and elucidate the points raised in this submission.

About FinTech Australia

FinTech Australia is the peak industry body for the Australian fintech Industry, representing over 300 fintech Startups, Hubs, Accelerators and Venture Capital Funds across the nation.

Our vision is to make Australia one of the world’s leading markets for fintech innovation and investment. This submission has been compiled by FinTech Australia and its members in an effort to drive cultural, policy and regulatory change toward realising this vision.

FinTech Australia would like to recognise the support of our Policy Partners, who provide guidance and advice to the association and its members in the development of our submissions:

- DLA Piper
- Hall & Wilcox
• King & Wood Mallesons
• K&L Gates
• The Fold Legal