

Submission of Piper Alderman to Treasury Initial Coin Offering Issues Paper

Introduction and summary

1. The Australian government was an early mover in investigating blockchain and cryptocurrencies, with the Australian Taxation Office (**ATO**) issuing guidance in 2014 and the Joint Parliamentary Report into Digital Currency being issued in late 2015.¹ Since that time, the rise (and fall) of “Initial Coin Offerings” as a new form of transferring value digitally, including by early stage companies seeking to raise funds for growth and expansion, has posed new regulatory challenges.
2. Despite this early start by Australia, policymakers and regulators globally have been forced to play ‘catch up’ and decide how existing laws and regulation should (or could) be applied to such token offerings, cryptocurrencies more generally, cryptoassets and blockchain technology as the space continues to evolve and expand.
3. ICOs were popular in 2017 - 2018, correlating broadly with a significant increase in the price of Bitcoin and other cryptocurrencies. During those years two of Australia’s top ten ICOs sold upwards of AUD\$30 million worth of tokens², while globally, other ICOs have sold over USD\$4 billion of tokens.³
4. With projects (including start-ups) selling tokens for such large sums, policymakers and regulators are seeking to balance incentives which promote innovation and protect consumers, speculators or investors who are purchasing tokens.

¹ Parliamentary Joint Committee on Corporations and Financial Services, *Statutory Oversight of the Australian Securities and Investments Commission, the Takeovers Panel and the Corporations Legislation Report No. 1 of the 44th Parliament*, November 2014 (**Parliamentary Report**).

² Powell, D, ‘Ten Australian companies raising millions and disrupting industries’, *Smart Company*, 23 April 2018, <<https://www.smartcompany.com.au/startupsmart/news/ten-australian-blockchain-companies-raising-millions-and-disrupting-industries/>>.

³ Iadeluca, J, ‘Who is Block.one: The Company Behind the World’s Largest ICO’, *BTCManager*, 5 January 2019, <<https://btcmanager.com/block-one-eos-background-biggest-ico/>>.

5. As noted in the Issues Paper, some countries such as China⁴ and South Korea,⁵ have opted to ban token offerings all together. Other countries such as Singapore and Switzerland have adopted a more collaborative approach in their regulation to increase certainty around cryptocurrency activities while protecting consumers, enhancing market integrity and promoting effective competition and innovation.⁶ Those countries which have taken the latter approach have attracted significant projects to their jurisdictions, generating employment, investment and building a reputation for innovation.
6. If Australia wishes to play a significant role in the increasing use of blockchain in the global economy, and continue to retain Australian talent and projects, we suggest the following be given consideration:
 - 6.1. Australia following the UK, Swiss and Singapore approach to token categorisation and regulation;
 - 6.2. the implementation of a specific regulatory sandbox for blockchain projects separate to (or as an adjunct to) the existing Fintech regulatory sandbox;⁷ and
 - 6.3. the provision of clear regulatory guidance for:
 - 6.3.1. information sheets and “how to” guides, including examples, in the same style and clarity as the recent Financial Conduct Authority (**FCA**) Consultation Paper ‘Guidance on Cryptoassets’ (**FCA Guidance**);⁸ and
 - 6.3.2. the regulatory view on existing projects and tokens.

⁴ Maura, N, ‘China Prohibits Crypto Again This time Banning all Commercial Ventures’, CoinGape, <<https://coingape.com/china-prohibits-cryptos-again-banning-all-commercial-venues/>>

⁵ The Financial Services Commission (FSC), ‘ICO Survey Results and Future Direction’ <http://www.fsc.go.kr/info/ntc_news_view.jsp?bbsid=BBS0030&page=1&sch1=&sword=&r_url=&menu=7210100&no=32932>.

⁶ The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>, page 5.

⁷ Australian Securities Investments Commission, *Regulatory Sandbox* <<https://asic.gov.au/for-business/your-business/innovation-hub/regulatory-sandbox/>>.

⁸ The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>.

7. We submit that the above approach will help position Australia to develop and retain quality talent in STEM fields, promote job creation and enable Australia to stay closer to the forefront of innovation and technology.
8. Blockchain technology is transformative and represents a paradigm shift in how value can be moved in a decentralised manner as well as within permissioned environments. A recent survey by KPMG revealed 41% of global leaders in 12 countries planned to implement blockchain in their businesses in the next 3 years.⁹ Blockchain has been described as the “new internet” or the “new email” for the reason that blockchain will likely be a disruptor to each industry and reach into almost every aspect of our economy over the long term.¹⁰
9. The policy positions adopted within the next 12 months, including how different elements of blockchain and cryptocurrency are defined and treated, will have a lasting impact on the growth and speed of this almost brand new industry in Australia. Currently the size of the industry is estimated at USD\$1.2 billion per annum and is expected to grow to USD\$23.3 billion per annum by 2023.¹¹
10. Anecdotally, we are seeing projects move out of Australia and towards jurisdictions which:
 - 10.1. provide clearer regulatory guidance;
 - 10.2. provide easily understood and available paths to compliance; and
 - 10.3. embrace and support blockchain technology.

⁹ KPMG LLP ‘KPMG Technology Innovation Survey: Blockchain’
<<https://assets.kpmg/content/dam/kpmg/us/pdf/2019/02/blockchain-tech-survey-2019-infographic.pdf>>.

¹⁰ Adam Tepper, ‘The People’s Money Bitcoin’
<<https://www.independentreserve.com/education/download>>.

¹¹ Blockchain Market by Provider, Application (Payments, Exchanges, Smart Contracts, Documentation, Digital Identity, Supply Chain Management, and GRC Management) - Global Forecast to 2023, Markets Research Report, December 2018. <<https://www.marketsandmarkets.com/Market-Reports/blockchain-technology-market-90100890.html>>.

11. While the Treasury Issues Paper focuses on the use of “Initial Coin Offerings” to denote the sale of a cryptographic token, given the recent shift away from that language in the blockchain industry, we will use the more neutral name, “token offering” or “token sale”.

Definitions and Token Categories

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

12. A meaningful definition of a token sale is difficult without first considering the elements of the tokens and the rights attaching to those tokens which are offered for sale. As such, we suggest the clearest way to define token sales is to start by categorising the tokens.
13. In contrast, an approach which considers the offer of tokens for sale in isolation, without reference to the possible categorisation of tokens, for example the *Howey* test in the US appears to be overly broad and likely to lead to unintended outcomes. For example the offer of cryptographic tokens which entitle purchasers to attend a concert, with discounts for early purchase, operates functionally the same as a token offering for a so-called “utility token” yet the real world nature of these transactions may be quite different.
14. It does not appear to be the case that regulators wish to regulate under existing securities laws the presale of products, software or event tickets which move to using a cryptographic token to represent that sale, even if there is speculation occurring and a secondary market in existence for the tokens sold.
15. Given this, we approach responding to Question 1.1 by addressing two questions:
 - 15.1. what are the different broad categories of tokens (noting they could overlap); and
 - 15.2. how can token sales be defined in a meaningful way given the different categories.
16. The FCA in the United Kingdom, the Securities and Exchange Commission (**SEC**) in the United States, the Monetary Authority of Singapore (**MAS**) and the Swiss Financial Market Supervisory Authority (**FINMA**) each provide different approaches to establishing categories and defining token sales. We consider each of these approaches below and note that the FCA, MAS and FINMA categories broadly align with the categories already set out in the Issues Paper.

United Kingdom

17. The FCA Guidance correctly states that cryptoassets vary significantly in the rights that they grant to holders, as well as actual and potential users. The FCA Guidance states at paragraph 2.6:

“Given the variety and complexity of applications, the Taskforce developed a framework which takes into account the different uses of the three types of cryptoassets identified above. Cryptoassets are typically used:

***As a means of exchange**, usually functioning as a decentralised tool to enable the buying and selling of goods and services, or to facilitate regulated payment services.*

***For investment**, with firms and consumers gaining direct exposure by holding and trading cryptoassets, or indirect exposure by holding or trading financial instruments that reference cryptoassets.*

***To support capital raising and/or the creation of decentralised networks** through ICOs or other distribution mechanisms.”¹²*

18. These three categories identified by the FCA are thus:¹³

18.1. Exchange tokens;

18.2. Security tokens; and

18.3. Utility tokens,

(collectively, the **FCA Categories**).

¹² The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>, 9.

¹³ Ibid 7.

Exchange Tokens

19. An exchange token (also referred to as a “currency token”) is intended and designed to be a form of cryptoasset that is used as a means of exchange for goods or services.¹⁴ Exchange tokens are generally exchanged on a peer-to-peer basis and are usually decentralised.¹⁵

20. The FCA considers that:¹⁶

“Exchange tokens currently fall outside the regulatory perimeter. This means that the transferring, buying and selling of these tokens, including commercial operation of cryptoassets exchanges for exchange tokens, are activities not currently regulated by the FCA.”

21. Importantly, exchange tokens can be acquired for the purpose of speculation rather than exchange, but this alone is not sufficient for the FCA to consider exchange tokens to become ‘Specified Investments’.¹⁷ Similar comments concerning speculation occurring in relation to Bitcoin was present in comments quoted in the Parliamentary Report.¹⁸

22. The FCA position matches that which appears to have been adopted to date in Australia. The Australian Securities Investment Commission (**ASIC**) submitted to Parliament in 2014 that Bitcoin is not a financial product¹⁹ and appears to consider that Ether is not a financial product.²⁰

23. Given the breadth of the definition of a managed investment scheme (**MIS**) in the *Corporations Act 2001* (Cth) (**Corporations Act**) and the present wording of ASIC

¹⁴ The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>, 7.

¹⁵ Ibid 22.

¹⁶ Ibid.

¹⁷ The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>, 22.

¹⁸ See Chapter 5 of the Parliamentary Report.

¹⁹ Australian Securities Investments Commission, ‘Senate inquiry into digital currency, Submission by the Australian Securities and Investments Commission’ December 2014.

²⁰ Stephanie Rickard of Australian Securities and Investments Commission, (Speech delivered at the ADCA Financial Reporting for Cryptoassets Information Session, EY Sydney Office, 200 George Street Sydney, 15 February 2019) not published.

Information Sheet 225 (**INFO225**),²¹ clear guidance from ASIC would be welcomed as to why Ether (and other tokens offered for sale prior to a functional network being available) would not be considered to be financial products or interests in a MIS.

Security Tokens

24. The FCA defines security tokens as tokens that have specific characteristics akin to “Specified Investments” stating that:

“Security tokens includes tokens that grant holders some, or all, of the rights conferred on shareholders or debt-holders, as well as those tokens that give rights to other tokens that are themselves Specified Investments.

*We consider a security to refer broadly to an instrument (i.e. a record, whether written or not) which indicates an ownership position in an entity, or other rights to ownership or profit. **Security tokens are securities because they grant certain rights associated with traditional securities.**”²² (emphasis added)*

25. Security tokens, in our submission, should be defined as a tokenised form of a security or a tokenised financial product where, for example, a certificate of a share or unit entitlement is replaced by a cryptographic token.
26. Others have suggested utility tokens should be treated as securities. Adjunct Professor Hinkes of NYU Law School has recently suggested that “utility tokens” could be offered in compliance with securities laws, what he calls “SICOs” or Security wrapped ICO.²³ This is what has occurred in the USA with utility tokens being sold to accredited investors only under the “Reg D” exemption.

²¹ Australian Securities and Investment Commission, ‘Initial Coin Offerings and Cryptocurrency’, <<https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-cryptocurrency/>>.

²² Ibid 23.

²³ Hinkes, A, ‘The Security Token Market Needs Better Lingo’, Coindesk <<https://www.coindesk.com/the-security-token-market-needs-better-lingo>>.

27. We do not believe that tokens which lack asset backing or features associated with shares or debt instruments should be sold under financial services regulation for several reasons.
28. Firstly, it is conceptually problematic for the sale of a token which explicitly has no asset or revenue backing to be sold in a manner similar to a token which does have asset or revenue backing.
29. Second, it raises the concern that purchasers may mistakenly believe they are in fact purchasing something with asset or income backing when the tokens have none.

Utility Tokens

30. The final category of the FCA Categories is the utility token, which is a token that does not have any entitlement to share in an asset or revenue/dividend.²⁴ It may be sold as a future right to interact with a planned platform or may be usable in a platform which is already live and operating or be a pre-sale of a good or service to be delivered in the future. It may also function as an exchange token if buyers and sellers exist for the token.
31. A utility token can be considered analogous to the pre-sale of a concert ticket or the sale of a collectible or trading card in many respects, with the funds received from the sale used to fund delivery of the concert (in the first example) or to promote a peer-to-peer marketplace for trading and collecting cards (in the second example).
32. An important distinction between many of the utility tokens sales in 2017-2018 and pre-sales of goods and services is that the sale of utility tokens to date have almost always included disclaimers to the effect that a project may never be developed and that the token sold may have no future value. Hence utility tokens might be seen as the pre-purchase of the *opportunity to redeem* the token in the future for a good or service, contingent upon the issuer making the product or service available for redemption.

²⁴ The Financial Conduct Authority, 'Guidance on Cryptoassets' (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>, 28.

Example: CryptoWallaby

The Issues Paper provides an example of CryptoWallaby by PouchTech as an example of issues arising in a project selling tokens (**WBY tokens**).

It seems that there would be two main ways of characterising this offering in Australia:

1. The offer of WBY tokens is a financial product.

Since purchasers would be providing money which would be pooled by PouchTech for development costs of a platform, and the users would presumably have an implicit right to use their tokens on the platform and to trade, the broad definition of an MIS would be met. However, since PouchTech is not representing that they will be investing any person's money, there is a risk of regulatory mismatch in that PouchTech's business model is unlikely to have the features of a fund, and so the existing regulatory guidance will not be fit for purpose. Further PouchTech will have licensing obligations, which may not provide any substantive investor protection.

We consider it likely PouchTech will quickly hop offshore to a jurisdiction such as Switzerland, UK, Singapore or Malta.

2. The offer of WBY token is not a financial product

If the sale of the WBY token is considered to be the sale of a 'collectible' akin to a trading or collector card, or a presale of the usage of the gaming platform akin to a concert or event ticket, then the token would not meet the definition of an MIS anymore than the sale of collector cards or event tickets.

Buyers of the token will hope, just as with real world collectibles, that the issuer will help create enough excitement or use around the product that a flock of users will gather, enabling peer-to-peer trading opportunities in a secondary market.

It is our view that the second characterisation more accurately reflects the transaction being proposed (based on the limited facts concerning PouchTech's business model).

33. The FCA also provides an example to elucidate the distinction between Security and Utility Tokens:

“Firm MN issues a token that grants the holder early access to a new line of clothing to be released by the firm, at a discounted rate. This would be similar to rewards-based crowdfunding where consumers have contributed to a project in exchange for early access to items from the new firm’s new clothing line. This token will be considered a utility token, and not considered a Specified investment... nor a ... Financial Instrument.”²⁵

United States of America

34. SEC Commissioners have defined ICOs as “a way to raise capital or participate in investment opportunities”²⁶ and regard ICOs as an “efficient means for carrying out financial transactions.”²⁷
35. In 2017 and 2018, a document known as the Simple Agreement for Future Tokens (**SAFT**) became a popular method for many projects seeking to sell tokens. The SAFT originated in the USA and is in appearance very similar to the Simple Agreement for Future Equity (**SAFE**) which has been a popular fundraising document.
36. The SAFT was designed to facilitate the pre-sale of tokens for a network which did not yet exist. SAFTs were designed to be an offer of securities under US law, without reference to the nature of the tokens offered for sale under a SAFT. The SAFT concept was that the *sale* of the future tokens would be the offer of a security, but once those tokens were

²⁵ The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>.

²⁶ United States Securities and Exchange Commission, ‘Spotlight on Initial Coin Offerings’, <<https://www.sec.gov/ICO>>.

²⁷ Commissioner Hester M. Peirce, ‘Regulation: A View from Inside the Machine’, (Speech, Remarks at Protecting the Public While Fostering Innovation and Entrepreneurship: First Principles for Optimal Regulation, 8 February 2019). <<https://www.sec.gov/news/speech/peirce-regulation-view-inside-machine>>.

issued on a functioning and “sufficiently decentralised” network, the tokens themselves would not be securities.²⁸

37. This approach to token sales in the USA appears to have been adopted by the SEC. Director William Hinman of the SEC stated in 2018 that Ether is not considered a security now that it has become “sufficiently decentralised”,²⁹ and SEC Commissioner Hester Peirce said in February 2019 that the offer for sale of a token in a functioning network is no longer to be treated as a security.³⁰

38. At least one SEC Commissioner has taken the view that whether an ICO can fit within the definition of a securities offering does not hold any bearing against the question of how ICOs should be regulated.³¹ Commissioner Hester M. Peirce stated that:

“Changes to the blockchain may have outsized effects on certain tokens that depend on it. An investor may need to understand, for example, how the blockchain can be changed, and how those changes would affect the relevant token before she could fully appreciate the risks of investing in that crypto asset.”³²

39. A key problem with the US approach is that there is no way to know what “sufficient decentralisation” means and the consequences of a token not being “sufficiently decentralised” are highly problematic.

²⁸ See the SAFT Whitepaper <<https://saftproject.com/>>.

²⁹ Director Hinman, W. ‘Digital Asset Transactions: When Howey Met Gary (Plastics) (Speech, Remarks at the Yahoo Finance All Markets Summit: Crypto, 14 June 2018) <<https://www.sec.gov/news/speech/speech-hinman-061418>>.

³⁰ Commissioner Hester M. Peirce, ‘Regulation: A View from Inside the Machine’, (Speech, Remarks at Protecting the Public While Fostering Innovation and Entrepreneurship: First Principles for Optimal Regulation, 8 February 2019).< <https://www.sec.gov/news/speech/peirce-regulation-view-inside-machine>>.

³¹ Ibid.

³² Ibid.

Swiss Categories

40. The Issue Paper already provides, in Box 3, a summary of the Swiss approach, citing FINMA's ICO guidelines, published in February 2018.³³
41. FINMA's token categorisation is broadly in line with that proposed by the FCA with payment tokens aligning to exchange tokens and asset tokens aligning to security tokens. For the reasons set out above, these categories appear well considered and have been in use in the Swiss marketplace, seen as a global hub for token sale activity, for a year now.

Singapore Token Categorisation

42. The MAS has published a guide to digital token offerings which contains a number of examples, the first of which describes the sale of a token to raise funds to develop a platform to enable sharing and rental of computing power with the token being used to access and use the platform and pay for rental of computing power,³⁴ The token in that example is identified as one which would seem to also meet the "utility token" definition set out by FINMA or the FCA. MAS considers the sale of such a token to be not subject to any requirement of Singapore securities laws but still subject to all general Singaporean law.
43. MAS includes a further example noting that a token which meets the *Howey* test, and hence would be the offer of a security in the USA, may **not** be a security when sold to Singaporean residents.³⁵

³³ FINMA publishes ICO guidelines, Press Release 16 February 2018
<<https://www.finma.ch/en/news/2018/02/20180216-mm-ico-wegleitung/>>.

³⁴ Monetary Authority of Singapore, 'A Guide to Digital Token Offerings' last updated 31 November 2018
<<http://www.mas.gov.sg/~media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Securities%20Futures%20and%20Fund%20Management/Regulations%20Guidance%20and%20Licensing/Guidelines/A%20Guide%20to%20Digital%20Token%20Offerings%20last%20updated%20on%2030%20Nov%202018.pdf>> p10.

³⁵ Ibid, p.15-16.

Token Categories - Conclusions

44. Australian policymakers will need to decide if Australia should take a new and novel approach to categorisation and definition of token sales, or follow the conceptual approach of:
 - 44.1. the UK, Swiss and Singaporean Regulators in defining categories of tokens (**the Global Approach**) as an integral part of determining whether a sale of tokens is the offer of a security or not; or
 - 44.2. the USA approach of treating the sale of all tokens entirely as a separate matter to the category of token sold and considering whether the decentralisation of the tokens is determinative in whether a token is a security or not (**the US Approach**); or
 - 44.3. an approach similar to the Isle of Man, deciding that all token sales are outside of the regulatory framework (**the Island Approach**).
45. Given that the *Howey* test is not law in Australia; Australian law draws on a deep and rich tradition of UK law; and that the Global Approach is plainly more attractive to token offering projects, we respectfully submit that this approach represents a more easily understood and deployable categorisation of tokens for the purposes of considering token sales.
46. It follows that once a category for a token is identified the regulatory treatment may be determined. Should the Global Approach be preferred, then categories, such as of exchange and utility tokens which are usable upon issue but which do not contain features of ownership or dividend/revenue entitlement, can be recognised as falling outside the regulatory framework while still remaining subject to the Australian Consumer Law.
47. Security tokens can then be regulated through compliance with existing Corporations Act requirements, or alternatively with a specialised sandbox permitting an approach which might blend a code of conduct with more limited disclosure/licensing requirements while the benefits and risks of the use of blockchain tokens to represent asset backed securities is tested and better understood.

48. Should the US Approach be preferred, then the importance of very clear guidance beyond that published to date is critical. It is worth noting that we are not aware of any exchange or utility style token being offered to purchasers as an interest in a managed investment scheme to Australians.

Drivers of the ICO Market

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

49. Secondary markets permit asset holders to exchange property with each other rather than the party which first sold the asset and have been described as more important than primary markets as a determinant of economic growth.³⁶
50. In Australia, facilitators of secondary trading of cryptocurrencies are predominantly digital currency exchanges (**DCE**) which are required to be registered with AUSTRAC under the *the Anti-Money Laundering and Counter- Terrorism Financing (AML/CTF Act) Act 2006* but are not required to hold an Australian Financial Services Licence (**AFSL**) unless a cryptoasset listed on a particular exchange is a financial product.
51. DCE's attract and retain highly skilled employees and institutional investment.³⁷ Given that "*[e]mbracing innovation, technology and science is critical to powering our economy to provide jobs and high living standards for all Australians*"³⁸ is a government priority, we submit that enabling DCE's to continue to operate effectively and with certainty over the tokens they are listing is important.
52. The existing regulatory framework for DCE operators under the AML/CTF Act appears well understood. However, the lack of certainty around the regulation of categories of

³⁶ Messinis, G and Andriansyah, 'Equity Markets and economic development: Does the primary market matter?' Australian Conference of Economists, Murdoch University <<https://www.murdoch.edu.au/School-of-Business-and-Governance/document/Australian-Conference-of-Economists/Equity-markets-and-economic-development.pdf>>.

³⁷ Chanticleer, 'Mike Tilley backs cryptocurrency exchange Independent Reserve', *The Australian Financial Review* (Sydney), 14 March 2018.

³⁸ Australian Government: Department of Industry, Innovation and Science, 'Boosting Innovation and Science' < <https://www.industry.gov.au/strategies-for-the-future/boosting-innovation-and-science>>.

tokens has left DCE operators unsure of whether there is an effective and practical way of providing a secondary market for certain tokens.

53. Ultimately, any further regulation of token offerings should consider the economic effect on DCE's and the risk that further uncertainty will drive the operators of secondary markets to jurisdictions which provide such certainty.

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

54. Internationally, the market for token offerings, and the blockchain market more broadly will continue to develop regardless of the regulatory position taken in Australia, but the "rapid growth in the popularity of ICOs"³⁹ in 2017-2018 has passed.
55. While there may be entities undertaking token offerings (other than for Security Tokens) in Australia, most appear to have relocated offshore, or restructured in response to regulatory uncertainty.⁴⁰
56. We submit a key driver of the token sale market in Australia will be the extent to which considered and informative regulatory guidance provides certainty to business and purchasers of tokens.

Opportunities and Risks

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

57. Appropriately regulated token offerings can facilitate:
 - 57.1. a more accessible business model for small and medium sized entities, usually with a technology and innovation focus testing new and innovative business ideas;

³⁹ Australian Government: The Treasury, 'Initial Coin Offerings Issues Paper', *Commonwealth of Australia*, 2019, 1, <https://static.treasury.gov.au/uploads/sites/1/2019/02/c2019-t353604-Issues_Paper-1.pdf>.

⁴⁰ See the list of projects assembled by the Australian Digital Commerce Association at Appendix 1 to their submission.

- 57.2. greater efficiency and automation of existing and future innovative financial products, including the potential to provide “regulator view” into shared ledgers; and
- 57.3. greater employment and investment in the Australian economy.

Question 3.2. What do ICOs offer that existing funding mechanisms do not?

- 58. Token sales offer a natively digital experience to participants and a global accessibility which existing funding mechanisms cannot. For example, a project planning on launching beyond Australia may be able to test markets (subject to the regulatory environment in that market) with a pre-sale of a utility token redeemable for their product, giving them greater confidence in expanding. Innovative business models might be able to be founded and operated from Australia, with global reach and benefits flowing to users over a broad and decentralised network.
- 59. The shared nature of blockchain technology opens up great potential for further reducing compliance costs by providing a “regulator view” into shared ledgers for offerings, to permit oversight by regulators into the holdings or trading of a token which previously has not been available (if for example an unlisted unit trust’s units were being traded privately).

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

- 60. The opportunities offered by blockchain are likely to be comparable to that of the internet, and history has shown the opportunities for consumers, industry and the economy from that technology are still being discovered.
- 61. A strong Australian blockchain industry, including token issuers acting in a well informed way with appropriate regulation and guidance carries the promise of very significant benefits both in direct employment and investment as well as secondary economic benefits and the offer of innovative products and ways of doing business.

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

62. The Hon Scott Morrison, when Treasurer, stated that the Australian Government wanted to help create an environment for Australia’s FinTech sector where it can be both internationally competitive, and play a central role in aiding the positive transformation of the economy.⁴¹
63. Distributed ledger technology remains at the forefront of FinTech development and investment internationally, and jurisdictions with favourable conditions are seeing the benefit of FinTech firms and innovative individuals seeking out those jurisdictions.
64. Australia’s strong financial and banking reputation is well positioned, with clear guidance and sensible treatment, to be enhanced by a growing blockchain industry, in particular with the current movement towards tokenised securities.

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

65. Policymakers and regulators are cognisant of the risks involved with token offerings, and there have been numerous concerns around possible scams in the past two years, as well as concerns over misleading and deceptive conduct occurring in token sales.
66. Much as many online businesses failed during the early days of the internet, many early blockchain token projects have similarly failed. Cryptoassets can often involve substantial risks to consumers if inadequate information is provided to those inexperienced in technology, who can purchase unsuitable products.⁴² Examples include misleading or deceptive representations in documents which do not provide the level of detail required for an ordinary consumer to be properly informed of the nature of transactions in the token sale or which contain incorrect or exaggerated statements.

⁴¹ Australian Government: The Treasury, ‘Backing Australian FinTech’ by Hon Scott Morrison, <<http://fintech.treasury.gov.au/>>.

⁴² The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>.

67. A well-defined and established regulatory framework with clear guidance can help encourage greater transparency for consumers to be better prepared and make informed decisions during a token offering.⁴³

Regulatory Frameworks in Australia

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

68. We refer to our response to Question 1.1 in relation to the different categories of tokens and defining token offerings.
69. The current regulatory framework under the Corporations Act applies to cryptoassets if the cryptoasset is a financial product. However, it is often difficult and expensive for a project to conduct an analysis as to whether an offering is a financial product due to the broad nature of how a financial product is defined. While part of this flexibility in the definition is by design, to enable regulators to respond to new products, guidance in the form of a clear “regulatory perimeter” (to use the FCA’s language), is valuable to help both token issuers and purchasers to understand what is “in” and what is “out” of the regulatory framework.
70. We submit that Treasury should consider:
- 70.1. explicitly bringing security tokens within the regulatory landscape by providing specific guidance as to how tokens can be issued and traded within the existing financial product definition and the specific compliance requirements which will apply to those offerings; and
 - 70.2. providing more detailed and specific guidance by regulators to token issuers regarding the circumstances when a utility token or an exchange token will be considered to be a security and what, if any, compliance will be required as a result.

⁴³The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>.

Question 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?

71. We refer to our response to Questions 1.1 and 4.1 above in relation to the current regulatory framework and the issues with the current regulatory framework in Australia. In short, the exodus of projects from Australia should be seen as an indicator that the current regulatory framework is not enabling ICOs or the creation of a legitimate ICO market.
72. Box 3 of the Issues Paper states, in relation to managed investment schemes, that *“ASIC has released a suite of regulatory guides to provide comprehensive guidance to the industry”*.
73. These guides are no doubt of great use to security offerings which are seeking to tokenise financial products and gain efficiencies via the use of Blockchain, but as they focus on funds which take investors money and invest in a project with a view to providing a capital or income return *from the invested money* they do not align with an exchange or utility token offering where there is no capital or income return.
74. The existing guidance does not appear to reference any kind of tokenised security or the unique features of blockchain. An update of those guides (or ideally a separate guide) would be valuable.
75. It appears that tokens which are analogous to share offerings or which involve non-cash payment facilities are less problematic under the existing regulatory framework. We note, however, that the US states of Wyoming and Delaware have made legislative amendments to permit blockchain enabled shares in their registers, which provide another “regulator view” which may assist future compliance. Those jurisdictions may provide useful guidance to Treasury to consider how to proceed at a legislative level.

76. The comments of Mr Michael Saadat of ASIC to Parliament in 2015 remain true today:

“...it is not straightforward to regulate digital currencies like financial products. You would have to solve a number of unique issues associated with digital currencies, and also the industry would probably look for a more tailored regulatory regime that makes the industry still commercially feasible in this country.”⁴⁴

77. Question 4.2 asks for a response to whether the current regulatory framework creates of a “legitimate” token offering market. We take legitimate to have the ordinary meaning of “according to law; in accordance with established rules, principles, or standards”.⁴⁵ This means that the current token offering market is “legitimate” if they are in accordance existing laws and regulations. The token offering market will become competitive, efficient and consumer friendly with specific regulation that allows for the growth of blockchain projects across Australia.

78. The current regulatory framework and the position taken by ASIC is set out in the INFO225, which provides guidance as to the potential application of the Corporations Act, in regulating entities considering raising funds through a token offering. In regards to whether a crypto-asset is considered a financial product, the guidance does not prescribe that a token issued in a token offering will be a financial product, but goes as far as to state that:

“the mere existence of a statement that the ICO or the token is not a financial product also does not mean it is not a financial product.”⁴⁶

⁴⁴ Parliamentary Report, para 5.23 citing *Committee Hansard* 7 April 2015, p.36.

⁴⁵ Pan Macmillan Australia, *Macquarie Concise Dictionary Sixth Edition* (online ed, Macquarie Publishing Pty Ltd, 2013).

⁴⁶ Australian Securities and Investment Commission, ‘Initial Coin Offerings and Cryptocurrency’, <<https://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings-and-cryptocurrency/>>.

79. The FCA Guidance is written in plain English and provides a model followed by the FCA which may be of assistance in future guidance published by Australian regulators:

“Step 1: Listing investments set out in the [law] that a cryptocurrency might constitute.

Step 2: Guidance on how these apply to cryptoassets for the areas where we have observed greater market development.

Step 3: Case studies to give practical examples of how the Guidance works in practice.

Step 4: An indicative list of market participants that carry on cryptoassets activities, and the types of permissions they may need if they are using tokens that are within our perimeter.

Step 5: Q&A section to give guidance on more nuanced, complex, or frequently asked questions.”⁴⁷

80. In addition, Treasury should consider expanding the existing FinTech regulatory sandbox, or consider a separate regulatory sandbox model for cryptoasset businesses to operate in.
81. This would allow firms to *“test their innovative propositions in the market, with real consumers, within the confines of a controlled environment.”⁴⁸* In regards to the effectiveness of the sandbox regulations, it was illustrated in the below case study provided by the FCA whereby a firm within the FCA’s Sandbox could use a permissionless DLT network to mimic the traditional issuance process for a short-term debt instrument:

⁴⁷ The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>, 18.

⁴⁸ The Financial Conduct Authority, ‘Guidance on Cryptoassets’ (Consultation Paper CP19/3* January 2019) <<https://www.fca.org.uk/publication/consultation/cp19-03.pdf>>, 44.

“Due to the permissionless DLT network, ownership of an asset is recorded publicly which increases transparency for investors who do not rely on the registrar/custodian to hold the record of ownership anymore. This eliminates the need for reconciliation between network participants because they share the same record of ownership, supporting more efficient settlement operations.”⁴⁹

Question 4.3. What, if any, adjustments to the existing regulatory frameworks would better address the risks posed by ICOs?

82. We refer to our response to Questions 1.1, 4.1, 4.2 and 4.4.

Question 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?

83. Currently, the ADCA have put in place an Australian Digital Currency Industry Code of Conduct which must be complied by all ADCA Certified Digital Currency Businesses.⁵⁰

84. This Code of Conduct sets the ‘Best Practice Standards’ whereby under rule 4.1.2,⁵¹ all certified businesses are to act with “integrity, transparency, competency, diligence, respect and in an ethical manner with its customers, employees, members of the public, government regulators and agencies and other members of the digital currency industry.”⁵²

85. Other standards ensure consumer protection, whereby it is required that under rule 4.2.2, the ADCA certified business “apply data security systems and processes to protect customer data including any IP addresses, digital currency identifiers or credit card information.”⁵³

⁴⁹ Ibid.

⁵⁰ The Australian Digital Currency Industry Code of Conduct <<https://adca.asn.au/wp-content/uploads/2019/02/Australian-Digital-Currency-Industry-Code-of-Conduct-Board-Approved-Text-30-Nov-2016.pdf>>.

⁵¹ The Australian Digital Currency Industry Code of Conduct, Rule 4.1.2.

⁵² Ibid Rule 4.2.2.

⁵³ Ibid.

86. We submit that a Code of Conduct should have regulator input to gain additional standing in the community in which it is to operate and to ensure that the Code aligns with the goals of the regulator.

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

87. We refer to our response to Questions 1.1, 4.1, 4.2 and 4.4.