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GPO Box 129
Brisbane QLD 4001

Director - Crypto Policy Unit
Financial System Division
Treasury
Langton Cres
Parkes ACT 2600

T +61 7 3231 1666
F +61 7 3229 5850

gadens.com

By email: crypto@treasury.gov.au

Dear Director - Crypto Policy Unit

Token Mapping – Consultation Paper

Gadens appreciates the opportunity to make a submission in relation to Treasury's [Token Mapping Consultation paper](#) released on 3 February 2023.

Our financial services regulatory team is experienced in the crypto assets space. We advise Australian and international financial institutions, exchanges, funds, token issuers, financial intermediaries and fintechs on crypto assets, including crypto currencies, and regulation.

We are recognised leaders in the policy space, including through our multiple submissions on the CASSPr regime, to the Senate Economics Committee on the treatment of crypto assets (where we have been called to give evidence).¹²³

Our submission is brief by design. We wish only to make several pertinent points:

1. **Overview:** The crypto assets landscape needs effective regulation. For firms, to conduct their businesses and compete globally with certainty. For increasing numbers of retail and institutional consumers, to invest with greater understanding and protections. Treasury's work is commendable, rightly globally praised and will go a long way to achieving this end.
2. **Token system concept:** While the proposed "token, token system, function framework" is conceptually helpful, focusing on token systems as the "crypto asset" is the wrong way, in our respectful submission, of viewing regulation. Rights attach to tokens, which make them either financial products or not. By extension, those who provide services in respect of tokens which are financial products, eg derivatives, should be licenced, and those who do not should be unregulated.

The token system concept is somewhat of a shortcut, but is ultimately unworkable and at odds with how financial services are regulated in Australia and abroad. It is difficult to reconcile such a taxonomy with other well-understood financial products such as shares and derivatives. It also doesn't take into account the dynamism of crypto assets – they can morph from a non-financial product to one quickly, depending on their architecture e.g. turning on pooling features, reward features, etc. In addition, the crypto asset landscape is quickly evolving to include DAOs and smart legal contracts. If financial services regulation is to remain technology-neutral, from the services

¹ Submission: [Digital Assets \(Marketing Regulation Bill 2022\) – Consultation Paper](#).

² Further Submission: [Digital Assets \(Marketing Regulation Bill 2022\) – Consultation Paper](#).

³ Submission: [Inquiry into Treasury Laws Amendment \(2022 Measures No.4\) Bill 2022](#).

and products regulated to the obligations imposed on the entities regulated, regulating “token systems” is at odds with that approach. References to “systems” as part of technologically-neutral approach to regulation simply creates more confusion. Focusing on only regulating the current climate of tokens systems will quickly result in obsolete categorisations as new forms of crypto assets continue to emerge.

3. **Safe harbour:** Crypto assets do not come with disclosure documents. There are no “issuers” per se, save for developers (who are rarely concerned with legal disclosure documents!). Unlike derivatives, equities, bonds and other financial products, there is not the same level of information to test for DCEs. All of which makes the job of the issuer of the token that much harder in defining their characteristics – there should be a “safe harbour” for token distributors which may come in the form of establishing certain legislative requirements, which if they comply with, will see the regulatory risk reduced for merely offering tokens. This would have the desired outcome of token issuers not being faced with the same regulatory due diligence that would typically be required when offering a financial product. Otherwise, the regulatory risk is disproportionate to the role of DCE provider. We have this for PDS issuers – the same should exist for DCEs.

Similarly, there needs to be a developer liability safe harbour. Interesting arguments about “code as law” aside, holding developers accountable for creating financial products is practically unworkable and overly punitive. We cannot stifle development and create a law that is defective and unenforceable, and will send innovators overseas.

4. **Definition of “crypto assets”:** While we agree with the long-standing concept of a “functional perimeter” for financial product regulation, we simply need to create a definition of crypto assets which is fit for purpose and overlay licensing on those assets which are financial products. The UK’s model is most appropriate, and we suggest adopting granular definition categories, being:
 - a. security tokens eg financial products such as derivatives, MIS or NCP products;
 - b. e-money tokens eg digital payment instruments that store value, can be redeemed at par value, at any time and offer holders a direct claim on the issuer, such as tokens linked to fiat currencies, also known as stablecoins;
 - c. exchange tokens eg Bitcoin, Ether, XRP, etc; and
 - d. utility token eg governance rights for a DAO.

Regulatory guidance can then be developed to provide examples and clarification of the functional perimeter that applies to tokens in each of these categories – in essence providing the “map” that is necessary in order to be clearly understood by consumers, distributors and regulators alike, here and abroad. Adopting this approach avoids issues where tokens, which are not remotely like financial products, are subject to the licensing regime and ASIC’s oversight e.g. the 14 year old minting a token of an image of a monkey. It also limits jurisdictional arbitrage, which is important given the global reach of our clients in this space. In the UK model, the FCA only has security tokens and e-money tokens within its regulatory oversight.

You can see the detailed comparative analysis we provided to Senator Bragg in our submissions on the [Digital Assets \(Marketing Regulation\) Bill 2022](#). He too should be commended for his work in this space. Together, we think that there is an excellent framework for advancement for Australia.

5. **Market Licences:** A market licence is not needed, and hard to justify from a regulatory, commercial and benefits perspective. There are few domestic market licences in Australia at present (under 20), so why having such an onerous form of licensing applied to the crypto landscape is needed is unclear. It also does not fit the broker model which is how most consumers obtain crypto assets in Australia (and financial products and credit products for that matter), and would create an unjustifiable barrier to entry. The also mooted quasi-markets based AFSL authorisation, being the “operating a crypto trading platform” authorisation, is not necessary either – the financial regulation needs to stem from products alone as we set out below.

Carefully modify the existing AFSL regime, and starting by adopting the UK definition of digital assets to determine what the regulatory perimeter is required (see above). We do need to resist the odder proposals in the CASSPr paper as well, insofar as it proposed to combine market licence obligations on AFSL regime licensing e.g. operating a “fair, orderly and transparent” market. A broker model is

fundamentally not set up to be able to comply with this obligation, which is hard to conceive of how it will work in practice in any event. What is an orderly market in a new token whose value is spiking?

Otherwise, we are agnostic as to whether a new agency is required – ASIC can do the job, but is chronically stretched with its responsibilities as both immediate and past Chairs have recently said. A new, targeted agency could be a sensible idea, though it would need to work closely with ASIC. The easiest solution is to properly resource ASIC, and have a specialist and independent industry committee which it can consult with on technical matters and anything else Parliament deems appropriate e.g. delegated regulations. Responsible regulation and compliance is a whole of market obligation – policymakers, regulators and the regulated alike, so we think that Treasury should create a framework which facilitates ASIC achieving its role successfully in a proportionate, nuanced and calibrated manner. To do less is to set it up to fail, which is not fair on ASIC's people, the industry or consumers.

6. **Custody:** Custody in and of itself is fine, though first Australia needs to define crypto assets as legal property instead of data. See footnote, in which our Partner Liam Hennessy advised the Senate of these issues.⁴ Cold custody, segregation of assets under the existing Chapter 7 rules, and external custodians (with fewer requirements, so it can be profitable for them – it is not currently profitable) can all be made to fit within the crypto assets space. A compensation scheme is a bad idea; why tax a new industry in this way, and leave out, say, buy-now, pay-later or any other new industry?

Critically, Treasury needs to understand that it can't apply normal NTA and SLSF requirements on digital exchanges. Stringent capital costs, which are not calibrated to the emerging market, will see all local businesses go to Dubai. Australia is not regulating in a vacuum; we are competing for the best and brightest entrepreneurs, tax revenue and consumer experience. Over regulation, or badly calibrated regulation is harmful to us all. The same applies for insurance and banking arrangements. Specifying traditional finance requirements that can't be met will stifle the industry. Further, over-regulation of digital exchanges runs the risk of restricting the operation of these bodies and/or the crypto assets they support – which in turn risks increasing consumer harm, where consumers turn to more unstable or decentralised products and services.

7. **DAOs:** the legislation needs to recognise legal personhood for DAOs. The model adopted in Utah in the USA this week, is a starting point. Otherwise, there is considerable potential for confusion.
8. **Tax:** regulatory policy making moves in waves; we are at the zenith of a wave of policymaking, coinciding with a heavy consumer focus. Recalling that consumers want access to crypto assets, however, given ASIC research (it is the second most held product after shares), what is the Government going to do outside licensing to assist the industry?

Regan said that *"Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."*⁵ Let's avoid that, and give basic tax concessions and facilitations to an industry whose innovators Australian can be proud of and who will generate largescale economic activity for us. It is not a novel idea – the US [Responsible Financial Innovation Bill 2022](#), contains various clever tax concessions for Americans eg cryptocurrencies will be taxed under capital gains and not as personal income, and crypto asset lending agreements are not taxable events. Let's do that work in Australia as well, to support a large future tax revenue base, and investable asset class.

Treasury must also be mindful in this review that any legislative regime in respect of crypto-assets cannot be undertaken in a vacuum. Ongoing efforts in relation to the [Payment Systems Review](#), the [Consumer Data Rights Regime](#), the *Privacy Act 1988* Reforms and other key reforms impacting financial services providers in Australia must be aligned to ensure consistency and harmonisation across the market.

⁴ Submission: [Inquiry into Treasury Laws Amendment \(2022 Measures No.4\) Bill 2022](#).

⁵ Ronald Reagan Presidential Library & Museum, *Remarks to State Chairpersons of the National White House Conference on Small Business* (August 1986) < <https://www.reaganlibrary.gov/archives/speech/remarks-state-chairpersons-national-white-house-conference-small-business> >.

Our first point is the most important; we need certainty in Australia to compete globally, and Treasury is to be commended for doing the hard work here. It has been recognised globally, and is appreciated deeply locally – in a big year for the crypto assets space. We are ready to assist in any way we can.

Yours faithfully _____