FinTech Australia

# Token Mapping consultation paper response

**March 2023**

***This Submission Paper was prepared by FinTech Australia working with and on behalf of its 420+ Members***

## About this Submission

This document was created by FinTech Australia in consultation with its members.

In developing this Submission, interested members participated in roundtables and individual meetings to discuss key issues and provided feedback to inform our response to the consultation paper.

## About FinTech Australia

FinTech Australia is the peak industry body for the Australian fintech sector, representing over 420 fintech companies and startups across Australia. As part of this, we represent a range of businesses in the crypto, blockchain and Web3 space, which is one of the fastest growing sectors in Australia's fintech ecosystem, as well as fintechs spanning payments, consumer and SME lending, wealthtech and neobanking, and the consumer data right.

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 assist in the development of our submissions:

- Cornwalls;
- DLA Piper;
- Gadens;
- Hamilton Locke;
- King & Wood Mallesons; and
- K&L Gates.

# Key Recommendations

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| **Recommendation 1.** | ***Establish a web 3 advisory council to assist with the continued development of regulatory frameworks and guidance for crypto assets and blockchain technology.*** |
| **Recommendation 2.** | ***Consider how practical compliance obligations such as design and distribution obligations, product disclosure statements and custody can be met for crypto asset products and services and the underlying technology.*** |
| **Recommendation 3.** | ***Consider whether the Australian markets licensing regime is fit for purpose for crypto asset service providers.*** |
| **Recommendation 4.** | ***Evaluate whether the types of financial services in the existing regime sufficiently capture the types of services provided by crypto asset service providers.*** |
| **Recommendation 5.** | ***Ensure ASIC has sufficient capacity to process relevant licenses and oversee the industry.*** |
| **Recommendation 6.** | ***Encourage early guidance and communication from ASIC on their regulatory approach as the Government's multi-stage reform agenda progresses.*** |
| **Recommendation 7.** | ***Engage in targeted consultation on custody and licensing requirements, in advance of formal consultation, with the entities likely to be most affected by regulatory changes (e.g. exchanges).*** |
| **Recommendation 8.** | ***Provide transitional periods which may include to allow industry the opportunity to comply with the appropriate licensing or regulatory regime.*** |
| **Recommendation 9.** | ***Consult with industry regarding the legal treatment of DAOs under Australian law.*** |

# Summary

FinTech Australia welcomes token mapping as the foundational stage in the Government's multi-stage reform agenda to support innovation and implement appropriate regulatory settings. We appreciate the paper's forward-looking approach, and its recognition of the great opportunities digital assets innovation can provide for the Australian economy.

As the paper notes, Australia is already home to a thriving community of crypto ecosystem businesses – including many fintechs. The success of fintech in Australia has been fostered by Australia's track record of taking a considered, proportionate approach to regulating emerging products and technologies.

With token mapping as the foundation, we hope this approach can continue for digital assets regulation to ensure Australia continues to punch above its weight in financial innovation. Without this, there is a risk that fast-growing crypto, blockchain and web 3 businesses, both home-grown and international, will look elsewhere to jurisdictions that support innovation and provide regulatory certainty.

FinTech Australia Members broadly support Treasury's token mapping consultation paper and its approach to determining whether a crypto asset is regulated as a financial product under Chapter 7 of the *Corporations Act 2001* (Cth) ("**Corporations Act**"). Members support a regime that protects consumers, is technology neutral, principles based, encourages industry coordination and supports innovation.

In discussions regarding developing such a regime Members have highlighted a number of key issues, including:

1. ***Token mapping definitions.*** Members acknowledge that the definitions used by the token mapping framework are not indicative of any legislative definitions. However, Members cautioned against adopting these definitions to assist with amendments to laws in the future.

2. ***Token mapping framework.*** While FinTech Australia Members are generally supportive of the token mapping framework and its approach, Members note that the framework's focus on whether the "token system" is a financial product, rather than the facility which includes the token, and any other arrangement, may result in confusion and unintended outcomes.

3. ***Financial services.*** The token mapping process and future licensing and custody consultations should focus both on whether a crypto asset is a financial product and whether the services provided by crypto asset service providers are covered by the types of financial services in the existing regime. This approach may also inform Treasury as to whether any new financial services need to be included in the regime.

4. ***Markets licences.*** Members hold mixed views as to whether the Australian markets licensing regime is suitable for crypto assets. Some Members consider that imposing a regime on crypto exchanges which recognises their role as markets and complying with the obligations of a markets licence may offer some operational benefits. For example, Members have suggested a general authorisation could be included in a markets licence which would relieve the exchange of conducting as assessment on each crypto token it offers. Other Members raised concerns that the markets licensing framework may not be fit for purpose, and that many exchanges would not be able to afford the related costs or be able to comply with its obligations. Members also made clear in discussions that whether an exchange is operating a market should be evaluated on the basis of that exchange's structure.

5. ***Practical compliance with existing regime.*** Members raised a number of concerns that it is often difficult, or impossible, to comply with some obligations under the existing regime where a crypto asset is a financial product. These obligations include registration of a managed investment scheme, design and distribution obligations, disclosure obligations including product disclosure statements and custody.

6. ***ASIC's capacity to assess and grant licences.*** Several Members have raised concerns with ASIC's capacity to assess and issue AFSLs and Australian markets licences. New licensing requirements will likely result in an influx of applicants and will put pressure on ASIC's service levels.

7. ***ASIC guidance and communication.*** Members support early and ongoing communication and guidance from ASIC on their regulatory approach as the reform agenda progresses. Regulatory guides from ASIC will be critical to the industry's practical understanding of any new, modified, or existing requirements and obligations.

8. ***Transition periods.*** The crypto industry requires clarity on the details of any transition or grandfathering provisions.

9. ***Decentralised autonomous organisations.*** Members consider that further consultation with industry is required regarding the legal treatment of decentralised autonomous organisations under Australian law.

# Questions

### Question 1. What do you think the role of Government should be in the regulation of the crypto ecosystem?

***Members support the Government's continued role in regulating the crypto ecosystem***

FinTech Australia Members consider that Government has a crucial role in facilitating practical regulatory frameworks that promote innovation while protecting consumers. Members encourage Treasury to continue engaging with industry broadly throughout this and future consultations, and to continue to enable constructive industry discourse.

In supporting the growth and innovation of the crypto asset industry in Australia, Members are also of the view that Government should work with and encourage private industry to innovate. Particularly as central bank digital currencies develop and gain adoption in the market. Members encourage Government to ensure its activities do not stifle private innovation.

***Members recommend the establishment of a specialised web 3 advisory council***

In respect of next steps, several Members recommended that Government establish a web 3 advisory council to assist with the continued development of regulatory frameworks and guidance for crypto assets and blockchain technology. Members appreciate the difficulties in navigating the nuances of the industry and its technology, and consider that a web 3 advisory council could assist Government and regulators with specialist areas such as smart contracts and cybersecurity. Please see our response to question 12(a) for further Member views.

***Members support greater communication and early guidance from ASIC***

As the Government's multi-stage reform agenda progresses, it will be important for the industry to understand ASIC's expectations and approach to interpreting and enforcing any new obligations. Key to this will be early consultation on any forthcoming ASIC regulatory guidance (RG). Although the typical sequencing of ASIC's RG development would require regulatory changes to already be in place, we encourage early consultation in tandem with any draft regulation from Government. This approach will provide more certainty and greater understanding of how obligations will apply in practice.

**Question 2. What are your views on potential safeguards for consumers and investors?**

***Existing safeguards under the ASIC Act and Australian Consumer Law are sufficiently robust***

FinTech Australia's Members consider consumer safeguards to be among the highest priorities for the development of a robust and safe crypto industry in Australia. The crypto ecosystem is made up of particularly complex products, services and systems. Australia is known for having a robust consumer protection regime under both the *Australian Securities Investment Commission Act 2001* (Cth) ("**ASIC Act**") and Australian Consumer Law. These existing safeguards already apply to crypto products & services whether captured under Chapter 7 or not respectively.

Members also caution against imposing new safeguards solely on the basis that the service involves a crypto asset or distributed ledger technology. Instead, Members have made clear that safeguards for services involving crypto assets should not go beyond those imposed where the service is currently provided without the involvement of crypto assets or distributed ledger technology. Such an approach aligns with the principles of technology neutrality which ensures the use of the technology, not the technology used, is regulated.

***Consumer education, disclosure obligations and AFCA membership are key consumer safeguards***

Members highlighted several key consumer safeguards, such as:

- ***Consumer Education.*** Consumers may need to have a greater general financial literacy including of investment products. Consumer education may assist consumers to understand how products may work, and any relevant risks.

- ***Disclosure.*** Several Members have suggested that disclosure materials, such as documentation required under the existing regime could be replaced with simpler video, or tutorial-based content which may increase financial literacy generally and understanding of complex products. Please see our responses to questions 3, 7 and 11.

- ***AFCA membership.*** The Australian Financial Complaints Authority ("**AFCA**") should also receive support so that the complaints process is able to properly handle and react to the complexities of crypto assets and blockchain systems. We note AFCA's remit as an external dispute resolution 'one stop shop' has expanded rapidly over recent years to new technologies, regulated entities and types of complaints.

- ***Availability of professional indemnity insurance.*** The cost or availability of professional indemnity insurance is also a considerable concern of Members that provide crypto asset services or issue crypto asset financial products. In most cases, the cost is either prohibitively high, or it is not possible to get insurance at all. While it is possible to have alternative arrangements instead of professional indemnity insurance, many in the industry are finding it difficult to receive approval from ASIC. Some Members suggested that if an entity is not able to acquire insurance, this may be met through other means, such as by a compensation scheme.

### *Guidance on practical compliance with consumer safeguards is necessary*

Members also encouraged regulators to provide clarity on practical measures to comply with consumer safeguard mechanisms and the Australian Consumer Law (ACL) broadly. Clear guidance from regulators and Government that responds to the way the crypto ecosystem operates is essential to fostering an industry that protects consumers, encourages innovation, and ensures stability and integrity. Any guidance should be forward looking and be made in consultation with industry and an advisory council, as suggested in our response to questions 1, 2 and 12(a). We also note the ACL is jointly regulated with the states and territories and encourage ASIC and the ACCC to support state agencies in the development of uniform guidance. This is particularly important in the context of applying these general, principles-based ACL obligations to innovative and technically complex products and services.

Without this guidance, confusion for businesses and consumers is likely to remain which may prompt otherwise unnecessary regulatory action that may stifle innovation.

**Question 3. Scams can be difficult for some consumers to identify.**

**a) Are there solutions (e.g. disclosure, code auditing or other requirements) that could be applied to safeguard consumers that choose to use crypto assets?**

***FinTech Australia's Members consider that existing compliance obligations under Australia's financial services laws are generally suitable but that several additional obligations may assist.***

In addition to the matters identified in response to question 2 above, Members also considered that:

- ***Technology audits.*** Technology risks including those presented by smart contract technology require technological expertise to mitigate. For example, if a smart contract contains a bug that cannot be fixed, a new smart contract must be deployed which may require network approval. Also, the functions or nature of an upgradable smart contract can change. To mitigate some of these risks, Members considered it may be reasonable to recommend smart contract audits be conducted. This may form part of reasonable steps taken to mitigate technology risk.

- ***Custody.*** Members consider that custody requirements under the existing regime are not suitable for crypto assets. Members consider that the implementation of fit for purpose custody obligations that respond to the unique aspects of crypto asset products and services, and the technology that underpins them, would be key consumer safeguards.

- ***Foster a regulatory environment that attracts crypto asset service providers.*** Some Members also considered that appropriately regulated and responsible crypto service providers, such as exchanges, provide a consumer safeguard function in the market by having the resources to conduct technology and smart contract audits, transaction monitoring, fraud detection, and are financially incentivised to not list scams. Some Members expressed concern that should the Australian regulatory regime restrict the operation of exchanges or limit the types of crypto assets they are able to support, consumers may instead access decentralised structures or offshore exchanges, which may not meet the same, if any, consumer or product safeguards.

- ***Broader initiatives to prevent scams.*** Members are supportive of the Government's broader initiatives to restrict and prevent the promotion of scams, particularly the role digital platforms and telecommunications providers can play to block and restrict advertisement of scams. Strengthening the ACCC's capacity and the new National Anti-Scams Centre will ensure there is a more coordinated response to this multifaceted, economywide issue.

**b) What policy or regulatory levers could be used to ensure crypto token exchanges do not offer scam tokens or more broadly, prevent consumers from being exposed to scams involving crypto assets?**

***Members have mixed views regarding the application of the Australian markets licensing framework on crypto asset service providers***

In addition to our response to question 3, we also note that the application of the Australian markets licensing regime may be a possible to mitigate consumers being exposed to scams involving crypto assets.

One suggested mechanism is to require crypto asset exchanges apply for, obtain and comply with the Australian markets licensing regime under Chapter 7 of the Corporations Act. Members have mixed views in relation to the fitness for purpose of this regime to crypto assets. Several members noted that imposing a regime on crypto exchanges which recognises their role as markets and allows them to implement rules to ensure a fair, orderly and transparent market is able to operate, may be a possible solution. As part of this, the exchange may establish rules for its operation. Were regulation to be imposed, for example because some or all products were financial products, some Members have suggested a general authorisation may be granted, regardless of the legal classification of the asset, provided the market can meet overarching principles, and requirements, including in relation to collateral, capital and systems, as well as in relation to participants and products.

In particular, other Members were concerned that the markets licence framework may not be suitable for crypto asset exchanges particularly when their activities do not amount to "operating a financial market". While the Australian markets license is a flexible framework that may suit some participants in the market, it is important to understand that not all entities that provide exchange services are operating a financial market. An entity should be evaluated on basis of the products and services they provide to establish whether it is operating a market or providing financial services that would require an AFSL.

Further, others may not be able to afford the costs involved in acquiring a licence or comply with its obligations. Those Members argued that this may negatively impact consumers if exchanges were unable to provide services within this framework as they would leave Australia in favour of other jurisdictions due to the compliance burden. Of course, we note that the obligation to hold an Australian market licence applies where the market is wholly operated from off shore and there are limited Australian participants (may apply if there is only one Australian participant). As a result, foreign markets may also be caught meaning practically there may be little, if any, benefit from offshoring a business.

To date, many crypto asset service providers which provide exchanges conduct token by token assessments to determine their nature. This is an onerous process and does not necessarily alleviate consumer harm as much of this harm has resulted from technological exploits.

As a broader issue, several Members also raised concerns with ASIC's capacity to assess and issue AFSLs and Australian markets licences. New requirements are likely to result in an influx of new applicants and will put pressure on ASIC's already lengthy licensing service levels. We have considered this issue further in our response to question 11 in the context of the significant delays experienced by industry in Singapore.

Members also seek clarity on how the ASIC Industry Funding Model (IFM) would apply, noting a separate review of the IFM is ongoing.

**Question 4. The concept of 'exclusive use or control' of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records.**

**a) How do you think the concepts could be used in a general definition of crypto token and crypto network for the purposes of future legislation?**

***Members do not consider the concept of "exclusive use or control" relevant to future legislation***

Members are broadly of the view that the current regulatory framework which imposes obligations on persons providing financial services, operating financial markets and operating clearing and settlement facilities in respect of financial products is appropriate provided this remains technology neutral. Technology neutrality must extend to the nature of products, activities which are regulated, and the obligations imposed on regulated entities.

Fintech Australia supports the functional perimeter of our financial regulation, as it is supplemented with general definitions of financial product. Members have broadly expressed concern that there may be a risk with including technological concepts in definitions for things like crypto tokens and crypto networks in future legislation. Members generally did not see the relevance of establishing whether a product is a crypto token or a crypto network in the context of the Australian financial services regime. A general definition of "crypto asset" may result in a different regulatory treatment where novel technology is used for an existing function. In response to regulating on the basis of technology, developers may simply create new products to circumvent regulatory obligations. Were these to have reduced obligations, traditional financial services providers might also restructure products to take advantage of the reduced regulatory burden.

When applying a technology neutral approach, the relevant test as to whether it falls within the ambit of the Australian financial services regime is whether the product is a financial product. This analysis should not hinge on concepts such as whether the product is able to be exclusively used or controlled. Doing so may inadvertently capture products or services that were not intended to be captured by the financial services regime.

Further, it appears unclear how a definition of crypto network might assist future legislation. Such a definition runs the risk of being contrary to the policy of technology neutrality which focuses on the use of the technology, and not on the technology used.

***Regulatory obligations should be as technology neutral as reasonably possible to allow for practical compliance***

On the other hand, technology neutrality may not be supported by practical compliance obligations which implicitly require the use of certain technologies, such as for the delivery of documents, or custody requirements with respect to technological structures such as private keys. This may prove a practical barrier to compliance. Again, these would not necessarily be overcome with general definitions of crypto asset or crypto network. Please see our response to questions 6(b) and 11 in relation to compliance obligations.

On the topic of custody, Members are of the view that any assessment as to the relevance of "exclusive use or control" to the definition of a crypto asset should be considered in the context of custody and property law. Namely, the exclusive use and control of a crypto token is not indicative of ownership.

**b) What are the benefits and disadvantages of adopting this approach to define crypto tokens and crypto networks?**

Please see our response to question 4(a).

**Question 5. This paper sets out some reasons for why a bespoke 'crypto asset' taxonomy may have minimal regulatory value.**

**a) What are additional supporting reasons or alternative views on the value of a bespoke taxonomy?**

***FinTech Australia Members generally do not support a bespoke crypto asset taxonomy. FinTech Australia Members support the existing functional perimeter of financial products in Chapter 7 of the Corporations Act.***

Members broadly support a taxonomy that is designed to assist Members to determine the application of the existing Australian financial services regime to crypto assets such as the one suggested by Treasury. In particular, Members appreciate that applying a functional definition to crypto assets enables the Australian financial services regimes to adapt to an industry in which technologies and product change at a rapid pace.

While Members acknowledge that the token mapping framework is merely a method by which Treasury explains its understanding of the existing regime's application to crypto assets, Members are of the view that the token mapping framework's focus on whether the token system is a financial product, rather than the token, along with any other arrangements, may result in confusion and unintended outcomes, for example the application of the framework on a crypto network may result in that crypto network itself being considered a financial product, despite having many features and uses, many of which are not financial in nature. Members consider that stablecoins warrant further consideration in light of the review of Australia's payment systems and regulation.

We acknowledge that these may be edge cases, however, Members consider that it is still important to examine these outcomes and any intended effects on the market. With respect to DAOs, please see our response to question 12(b) for further details.

Members have noted that statements that are made in consultation papers may have an impact on interpretation of existing laws. In this context we consider statements how to interpret tokens where there is no intention to amend existing laws should be considered in this light.

***Token mapping framework definitions***

While Members understand that the Paper's definitions are not indicative of any intended legislative definitions, Members considered that the definition of a "crypto asset" may cause confusion to industry as the term has been generally understood to be an umbrella term for the types of assets and tokens that exist in a distributed ledger system. For example, a native cryptocurrency, such as BTC, an ERC-20 token and ERC-721 non-fungible token would all be types of crypto assets, not all of which should be caught. Members are also of the view that (to the extent possible) the taxonomy should be aligned across different regimes, such as anti-money laundering and counter-terrorism financing, payments and taxation.

Some members have expressed concern that much of the Paper's focus on broad technological definitions of "intermediated token systems" and "public token systems" may imply to the market that these are relevant to determining whether a crypto asset is a financial product, rather than focusing on the definitions of a financial product.

**b) What are your views on the creation of a standalone regulatory framework that relies on a bespoke taxonomy?**

The preferred approach of FinTech Australia's Members is that crypto assets are not excluded or 'carved out' from Chapter 7 of the Corporations Act and a bespoke regime is not adopted. Members broadly agree that where a crypto asset falls under the definition of a financial product, activities related to that asset which fall under the existing regime should be regulated in the same way regardless of the technology that underpins it. This approach allows a person to only be subject to regulation under Chapter 7 where they are carrying on a financial services business, operating a financial market or operating a clearing and settlement facility in relation to a crypto asset that is a financial product and are not otherwise exempt.

Whilst compliance obligations may change depending on the nature of the asset, activities undertaken and clients, broadly speaking, by applying the existing regime, the regulatory burden reflects the activities undertaken, not the financial product. This also provides consistent consumer protections for the same activities.

**c) In the absence of a bespoke taxonomy, what are your views on how to provide regulatory certainty to individuals and businesses using crypto networks and crypto assets in a non-financial manner?**

FinTech Australia's Members consider that further guidance from regulators may assist individuals and businesses to comply. This guidance may relate to the nature of each financial product (including crypto assets), whether activities amount to providing a financial service or not, when certain exemptions may be relied on and factors relevant to whether use of crypto networks and crypto assets may not be captured.

Members have noted practical issues complying with existing regulatory obligations. This includes the cost or availability of professional indemnity insurance for crypto asset service providers or issuers of crypto asset financial products. In most cases, the cost is either prohibitively high, or it is not possible to get insurance at all. While it is possible to have alternative arrangements instead of professional indemnity insurance, many in the industry are finding it difficult to receive approval from ASIC. Some Members suggested that if an entity is not able to acquire insurance, this may be met through other means, such as by a compensation scheme.

**Question 6. Some intermediated crypto assets are 'backed' by existing items, goods, or assets. These crypto assets can be broadly described as 'wrapped' real world assets.**

**a) Are reforms necessary to ensure a wrapped real-world asset gets the same regulatory treatment as that of the asset backing it? Why? What reforms are needed?**

Not all wrapped assets are the same. There are many different structures, with a myriad of underlying instruments (both real world assets and crypto assets) which may all be called "wrapped" assets. With this in mind, Members generally considered it may be more appropriate to apply Treasury's proposed 'token/token system/function' framework to consider the features of the wrapped crypto asset as to whether it is a financial product, rather than relying on the characterisation of the underlying or solely relying on the "function". Members have identified the following five issues to consider in relation to a wrapped asset:

1. ***The use of "wrapped crypto asset" may be confusing.*** The use of "wrapped crypto asset" to refer to crypto assets that relate or are connected to real world assets may be confusing to industry. FinTech Australia Members note that "wrapping" already has an accepted meaning

as it refers to where crypto assets are tokenised by smart contracts to provide a crypto asset with new features or enable compatibility or interoperability with other systems. FinTech Australia Members highlighted that "real world asset" may be more suitable.

In some circumstances, it may be appropriate for a real-world asset token to receive the same regulatory treatment as its underlying. In other cases, it may not.

For example, a real-world asset token for grain could be a grain receipt stored on a distributed ledger. This may indicate legal title to the grain, provided it is structured to meet all relevant requirements of the instrument. As a grain receipt is not a financial product, nor should the distributed ledger-based receipt, being the real-world asset token be a financial product. The law should continue to recognise that distributed ledger-based assets are not necessarily distinct from the underlying. On the other hand, if the real-world asset is a token which tracks the price of grain, this may be more akin to another instrument separate from the receipt which may be a financial product.

2. ***A wrapped asset may have different risks to its underlying.*** The structure of the crypto asset and the risks associated with it should be considered. It may be the case that the real world asset token presents risks that the underlying does not. For example, the risks presented by cash may not be the same as those presented by an Australian dollar stablecoin. These risks may well depend on its structure and the nature of the issuer. We also note that stablecoins will be subject to the current review of Australia's payments system, which may affect how they are treated under the regime.

3. ***Wrapped assets take many forms.*** They may involve a crypto asset, intangible property, other financial product or something else entirely. The regulatory treatment should follow from the nature of their arrangement.

4. ***Not all wrapped assets are the same.*** Wrapped assets that are not connected to a real world asset are not homogenous either, even when they involve the same underlying. Accordingly, the risks differ, and so too may the necessary regulatory treatment. For example, the risks inherent in Ether may be different to those of wrapped Ether issued by the wETH smart contract and to those of a version of wrapped Ether issued by a smart contract bridge on another blockchain. There may also be different risks in relation to Ether that exists on an Ethereum layer 2 protocol depending on how that protocol functions.

5. ***Regulatory arbitrage risk.*** There may be a risk of regulatory arbitrage were wrapped crypto assets to receive the same regulatory treatment as its underlying without examining the arrangements that govern the wrapped asset.

**b) Are reforms necessary to ensure issuers of wrapped real-world assets can meet their obligations to redeem the relevant crypto tokens for the underlying good, product, or asset?**

FinTech Australia Members largely consider that provided a wrapped asset is treated according to its legal structure and not according to the fact that it is "wrapped" the current regime and its obligations should be sufficient to ensure that these issuers are able to meet their obligations to redeem the underlying asset, where that is a feature of the asset. This will arise where the terms provide a right to redeem the underlying asset which may not be present in many wrapped real world or crypto assets. More broadly, it is important to note that compliance with these, and indeed all, terms should be both legally enforceable and technologically feasible. Both are matters for the issuer to consider. Assistance could be provided by Treasury in relation to describing how this may be legally and technologically feasible.

Nevertheless, other compliance issues may arise in relation to practical compliance, for example, it may be difficult for a broker to meet design and distribution obligations for disposal and acquisition of crypto assets that are financial products. In particular this may be an issue where the issuer may not be in Australia and so does not comply with the Australian regime, or where there are no documents provided by the issuer in respect of that crypto asset.

One Member considered that where the issuer of a wrapped asset, such as a stablecoin, makes a statement in relation to how that asset is backed and how assets are held, there should be obligations on the issuer to provide evidence, including audits and mark to market evaluations, to verify these statements.

**Question 7. It can be difficult to identify the arrangements that constitute an intermediated token system.**

**a) Should crypto asset service providers be required to ensure their users are able to access information that allows them to identify arrangements underpinning crypto tokens? How might this be achieved?**

***Crypto asset service providers should be required to provide certain information to users where that crypto asset is a financial product***

Yes. Where a crypto asset is a financial product, it is important that users are able to access information in relation to that product, as they would for any financial product. Members do not consider that additional burden beyond those imposed by the current regime should be placed on issuers or other service providers where a crypto asset is a financial product, nor should such requirements apply purely on the basis that the product or service involves a crypto asset. As discussed in our response to question 6(b), there are concerns that it may be difficult to satisfy these requirements where issuers that may not be in Australia, and therefore may not comply with the Australian regime, do not provide documents in relation to a crypto asset.

In many cases, a detailed analysis of underlying arrangements and technological analysis would simply cause confusion and act as a barrier to adoption of new technology to deliver existing products. That being said, it may at times be necessary to conduct an analysis of the arrangements and technology where relevant to its risks. In relation to this, Members expressed concern that due to the composable nature of crypto assets many risks manifest externally and may be difficult or impossible to account for.

***Type and form of disclosure documentation***

It is also important to consider the type and format of information that is necessary to assist in making a decision in relation to a financial product, for example, there have been suggestions that disclaimer documents may not meet the desired consumer protection outcomes. As this is a broad issue, we suggest this may be considered in light of the broader reform to Chapter 7 of the Corporations Act.

One Member considered that a standardised framework for crypto asset disclosures would be beneficial to the industry. It could form part of discrete voluntary industry standards to which

crypto service providers could adhere. Guidance with respect to the application of the Australian Consumer Law was also flagged as something that would be beneficial to crypto asset service providers and consumers.

Please also see our response to question 3(a).

**b) What are some other initiatives that crypto asset service providers could take to promote good consumer outcomes?**

Members consider that the following can promote good consumer outcomes:

- ***Due diligence and disclosure.*** Undertaking due diligence may assist to ensure products are able to meet stated requirements. Imposing disclosure obligations which already exist under the regime may assist consumers to understand products providing consumers with clear information about how a crypto asset product functions, and if relevant, where and how crypto assets are held. For example, in a staking product, consumers should be informed where crypto assets are held and how rewards are generated and distributed. As noted above, Members consider that disclosure obligations under the existing regime are sufficiently robust for crypto assets.

- ***Consumer education.*** General education programs promote greater awareness and understanding of the functionality and risks that exist in relation to crypto assets. This can be provided by third parties, regulators and certain intermediaries such as exchanges.

However, other members raised concerns that consumer outcomes could be negatively affected where these obligations become too onerous such that they impact the service.

Please also see our response to question 3(a) in respect of scams.

**Question 8. In addition to the functional perimeter, the Corporations Act lists specific products that are financial products. The inclusion of specific financial products is intended to both: (i) provide guidance on the functional perimeter; (ii) add products that do not fall within the general financial functions.**

**a) Are there any kinds of intermediated crypto assets that ought to be specifically defined as financial products? Why?**

FinTech Australia Members consider it to be inappropriate to specifically define intermediated crypto assets as financial products where they are not otherwise financial products. Such an approach would be contrary to the principle of technology neutrality and may have the following consequences:

- ***technological arbitrage*:** developers would be able to create products which do not meet certain technological features and so are not caught;
- ***future proofing*:** a definition that depends on current technology may not work into the future;
- ***inadvertently capturing assets that should not be caught*:** products which have certain technological features but are not intended to be financial products, such as cryptographic tokens which are used to grant access to information which is not a function that is regulated, loyalty points, or in game assets, or artwork, which may have some form of 'economic function' but should not be caught as they are not under current financial services laws and there is no intention to depart from this;
- ***inconsistent policy*:** it also sets a precedent for legislating based on technology used rather than the use of the technology. This is contrary to current regulatory principles and recommendations by the ALRC to amend Chapter 7 of the Corporations Act; and
- ***net increase in legislation*:** if all crypto assets were brought into the definition, subject to exemptions, both a general definition of crypto asset and a myriad of exemptions would be required. This would likely result in a net increase to legislative provisions, which is contrary to policy and risks lack of clarity. Further, such a list would require frequent updating, resulting in an increase in burden for legislators and regulators.
- ***inadvertently capturing services that should not be caught:*** those providing adjacent services who are not holding or undertake any activities in relation to the crypto assets themselves should remain subject to existing laws but not be caught by any crypto asset

specific regime. To do so would be contrary to the current structure of Australia's financial services laws. For example, a payments providers who provides payment services to crypto asset service providers should be subject to the relevant laws regarding payments, but not in relation to crypto assets where they do not interact with crypto assets.

A Member noted that it may be suitable to capture a crypto asset which is a governance token that has the capacity to control large pools of money in a DAO treasury.

**b) Are there any kinds of crypto asset services that ought to be specifically defined as financial products? Why?**

***Members consider that there should be more focus on financial services***

Treasury's consultation paper largely focuses on establishing a framework that helps determine whether a crypto asset is a financial product. FinTech Australia Members emphasise the importance of focusing on whether the service provided with respect to a crypto asset that is a financial product constitutes a financial service under Chapter 7 of the Corporations Act.

Rather than defining specific types of crypto asset services as financial products, some Members consider that it may be more effective to focus on whether crypto asset services are already covered by the existing regime, or whether a new type of financial service is necessary.

One Member also noted that there should be a focus on whether particular services involving crypto assets which are financial products should be subject to financial service regulation, rather than focusing on whether that product fits within current financial product definitions. Treasury has the opportunity to amend the definitions of financial products and financial services where necessary to ensure they operate appropriately in the context of the products and services in the market as a whole.

Please also see our response to question 8(a).

**Question 9. Some regulatory frameworks in other jurisdictions have placed restrictions on the issuance of intermediated crypto assets to specific public crypto networks. What (if any) are appropriate measures for assessing the suitability of a specific public crypto network to host wrapped real world assets?**

***Members do not support restrictions on the basis of technology***

FinTech Australia Members caution following the lead of other jurisdictions to legislate on the basis of technology used. This includes to restrict issuance of tokens or use of certain public crypto networks. Such an approach is contrary to existing principles of technology neutrality.

In relation to whether there are appropriate measures for assessing the suitability of specific public crypto asset networks, including to host wrapped crypto assets, Members did not consider it appropriate for Government to legislate or make rules regarding the technology that should be used for a crypto asset or service. As discussed in this response, the risks associated with a crypto asset and a crypto network depend on, among other things, its technological features and implementation, structure and legal architecture. Applying our financial services laws means that the regulatory burden flows from the services provided in relation to those products, not the technology used. Instead, this is a matter for service providers to consider in the context of the asset and services, as well as for regulators to consider when granting licenses as there are existing obligations to have appropriate technological systems and procedures.

***Members do not support restricting access to privacy-focused crypto networks***

FinTech Australia Members also cautioned against any approach by regulators to attempt to restrict the access of any crypto networks whose core features centred around privacy technologies. In an environment where security of information in the digital age is becoming increasingly important, preventing the use of such technologies may be contrary to other overarching principles regarding cybersecurity, access to and the use of data, and may even risk consumer harm. Instead, Members considered that compliance could focus on the use of those technologies, such as imposing obligations under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) ("**AML CTF Act**") to capture nefarious actors, or allowing market participants to comply with KYC obligations using novel technologies such as zero knowledge proofs.

Further, Members noted that practical enforcement of any such ban on open-source technology itself would be difficult.

**Question 10. Intermediated crypto assets involve crypto tokens linked to intangible property or other arrangements. Should there be limits, restrictions or frictions on the investment by consumers in relation to any arrangements not covered already by the financial services framework? Why?**

FinTech Australia Members generally did not consider that there should be limits, restrictions or frictions on the investment by consumers in relation to arrangements not covered by the financial services framework. Please see our response to question 8 for further detail.

**Question 11. Some jurisdictions have implemented regulatory frameworks that address the marketing and promotion of products within the crypto ecosystem (including network tokens and public smart contracts). Would a similar solution be suitable for Australia? If so, how might this be implemented?**

***Members consider that crypto assets should be subject to the same existing laws as currently apply to guard against regulators arbitrage, and duplicating laws***

Broadly, Members were of the view that crypto assets should be subject to the same framework as financial products where it falls within our existing legislation. In relation to marketing, those obligations should align with existing obligations where a product is not caught under the ASIC Act, and where other obligations to consumers under the Australian Consumer Law would apply. Members do not see any reason to depart from these existing obligations when the only difference is the underlying technology. For example, both protections under the ASIC Act and consumer laws apply when a product is and is not a financial product respectively.

***Members caution looking to regime implementations of international jurisdiction***

Some Members note that while consumer protections are vital to supporting a thriving industry, regulations that over-prioritise and over-protect consumers can result in a market that is untenable to operate in. Such was the case in Singapore where one Member notes they saw many market participants either switch to servicing only wholesale clients or leave the Singapore market entirely.

Another considerable issue in the Singapore market was wait time for licensing, and appropriate transitional periods and grandfathering provisions. This Member considered that the implementation of these measures was inadequate for the crypto ecosystem in Singapore and led to some entities waiting 3 years to receive a licence. Many companies were not able to justify

continuing to operate and closed their doors. This Member also noted that among the over 150 companies covered by the grandfathering period, only 11 were able to receive a licence.

***Members consider that the current regulatory frameworks for marketing and promotion are sufficient and caution following international approaches that unduly restrict marketing and promotion***

Members broadly considered that obligations under both the ASIC Act and Corporations Act, and otherwise under the Australian Consumer Law were sufficient. Looking internationally, one Member considered the UK financial promotion regime's requirements to be overly restrictive and, as a result, stifle innovation. They were particularly concerned by the requirement for a promotion to be communicated by, or made with the approval of, an authorised person or registered crypto asset business.

***Changes in the nature of a crypto assets may make compliance with disclosure obligations difficult***

Some Members have raised concerns that the fast nature of the crypto ecosystem may make it difficult to comply with continuous disclosure obligations where crypto assets undergo changes or upgrades that require disclosure documentation to be updated. Members have expressed concerns about circumstances where a crypto asset undergoes a change that alters its regulatory treatment, particularly where elements of the technology are open-source and queried how crypto service providers would practically respond. In this situation, Members considered that it may be appropriate to implement a safe harbour period in which a crypto asset service provider is able to update disclosure documentation or comply with any new or changed obligations. Guidance may also clarify the kind of information that would be appropriate to provide to meet these obligations, including whether crypto asset service providers should and, if so, how they are able to cease supporting certain assets and the implications in those circumstances.

**Question 12. Smart contracts are commonly developed as 'free open-source software'. They are often published and republished by entities other than their original authors.**

**a) What are the regulatory and policy levers available to encourage the development of smart contracts that comply with existing regulatory frameworks?**

***Members support establishing of a web 3 advisory council and recommend audit requirements***

Some of the regulatory and policy levers that several Members considered may encourage the development of smart contracts that comply with existing regulatory frameworks include:

- ***A web 3 advisory council.*** As discussed in our responses to questions 1, 2 and 12(a), a web 3 advisory council would be able to assist with the continued development of regulatory frameworks and guidance for crypto assets and blockchain technology. This body could assist Government and regulators with technical issues related to smart contracts and cyber security as it related to the continued development of guidance. Members broadly agreed that any cybersecurity requirements need to suit how blockchain systems and smart contracts function, as well as the businesses that operate them. We welcome further consultation on the appropriate composition of this advisory council.

- ***Auditing requirements.*** As discussed in our response to question 3(a), due to the increased risk of consumer harm that arises from the immutability of smart contracts, Members considered it may be reasonable to recommend smart contract audits be conducted. This may form part of reasonable steps taken to mitigate technology risk.

**b) What are the regulatory and policy levers available to ensure smart contract applications comply with existing regulatory frameworks?**

***Members consider DAOs fundamental to the crypto asset ecosystem and recommend that Treasury provide industry with the opportunity to consider these issues in further detail.***

FinTech Australia acknowledges the difficulties around regulating smart contract applications on public crypto networks that do not involve a promise provided by an agent or intermediary. Relevant to this question is the role of decentralisation and whether decentralisation should be a factor in determining whether a product is excluded from the regime. For example, where a public token system is controlled by a DAO and provides a financial service in relation to a crypto

asset, Members queried whether there was a certain point at which the DAO may be considered to be sufficiently "in control" of the crypto asset, and therefore an intermediary subject to requirements to hold and comply with the obligations of an AFSL. In these circumstances a number of important considerations arise. Some of them are as follows:

1. ***How is decentralisation defined and quantified?*** Members noted that drawing on existing control tests in the Corporations Act may assist in developing a test. However, this may not address the practical realities of public token systems, where persons may be able to design complex technological implementations to structure around these traditional indicators of control.

2. ***What is a DAO under Australian law?*** Among the numerous issues surrounding DAOs, FinTech Australia Members noted that DAO is a broad term. It can be a structure, a means for organising, not a legal entity, or an entity such as a company if structured in that way. When no conscious decision as to form is made, it can be difficult for a DAO to enter into contractual relationships. The liability of a DAO's members is also unclear, as is to whom that liability extends, whether it be a core group of members, its active participants or all DAO token holders.

   Members considered that any definition adopted under Australian law should, so far as is possible, follow the principles of technology neutrality discussed in the Paper such that it looks through the technology of a DAO. FinTech Australia Members caution against defining legal concepts with reference to technology as it may unnecessarily restrict market use of certain systems or affect systems in unintended ways. For example, COALA's definition as set out in the ALRC's recent report does not appear to capture a DAO that is created on a permissioned or private blockchain:

   > "*'Decentralized Autonomous Organization' (DAO) refers to smart contracts (i.e. blockchain-based software) deployed on a public Permissionless Blockchain, which implements specific decision-making or governance rules enabling a multiplicity of actors to coordinate themselves in a decentralized fashion. These governance rules must be technically, although not necessarily operationally, decentralized.*"[1]

It also requires decentralisation to be quantified. The definitions of 'Permissionless Blockchain' and 'Smart Contract' present similar issues, such as only capturing blockchains or smart contracts that are designed in a particular way. Accordingly, FinTech Australia Members do not support the COALA definition.

3. ***What types of arrangements are captured by a DAO definition?*** Consideration should also be had as to the types of arrangements that should be captured. While coordination mechanisms may be captured, the use of those mechanisms by a company should not change its nature. Also, a blockchain's "governance mechanisms", such as consensus rules enforced by nodes, miners, and validators, are considered by many to be a type of DAO and may be inadvertently captured.

4. ***How do other regulatory regimes apply to DAOs?*** While outside of the scope of the Paper, Members also noted that aspects of the current anti-money laundering and counter-terrorism financing regime are incompatible with how DAOs and much of the crypto ecosystem functions.

FinTech Australia Members consider that these issues need to be discussed in further detail, particularly where Treasury and regulators are considering the application of existing regimes to an ecosystem that very often relies on DAOs to operate or coordinate.

**Question 13. Some smart contract applications assist users to connect to smart contracts that implement a pawn-broker style of collateralised lending (i.e. only recourse in the event of default is the collateral).**

**a) What are the key risk differences between smart-contract and conventional pawn-broker lending?**

***Members do not consider that regulatory relief provided to pawn-brokers should be provided to smart contract lending protocols***

There are two primary similarities between pawn broking and the types of collateralised lending arrangements that occur on blockchains through smart contracts ("**lending protocols**"). The first, as Treasury has identified, is that in many cases the primary recourse in the event of default is the lender taking possession of the collateral. Given the limited exposures to loss

from pawnbroking the policy has been to exempt pawn brokers from the National Credit Code and all applicable obligations.

Instead, we consider this to be more akin to a mortgage, margin loan or loan against other secured property, as this provides recourse against "collateral" but carries a significant risk of financial detriment. Accordingly, we do not consider the relief provided to pawnbrokers should apply to collateral loan providers.

**b) Is there quantifiable data on the consumer outcomes in conventional pawn-broker lending compared with user outcomes for analogous services provided through smart contract applications?**

FinTech Australia has not received feedback from its Members on this question.

**Question 14. Some smart contract applications assist users to connect to automated market makers (AMM).**

**a) What are the key differences in risk between using an AMM and using the services of a crypto asset exchange?**

***Risks of AMMs and exchanges***

Exchanges and AMMs share many of the same risks but may manifest in different ways. For example, both may be subject to different technological risks. Users of an AMM may be exposed to:

- ***smart contract risk***, such as where the smart contracts that underpin the AMM do not work as intended, or are manipulated;
- ***oracle risk***, such as where supply of price feeds or other external data is disrupted or manipulated;
- ***protocol governance or control risk***. The way an AMM protocol is designed may provide certain participants with control or an ability to upgrade or manipulate the protocol in unexpected ways; and

- ***network risk***. Users are exposed to any issues or failures of the underlying crypto network.

The technological risks that impact an exchange are more concerned around the technological performance and uptime of its own systems. However, due to the interoperable nature of blockchain systems, and the reliance that exchanges may have on crypto networks, some of the technological risks that impact AMMs inevitably impact people who interact with those systems, including exchanges who use them to provide liquidity for transactions.

Similarly, each may be subject to other risks in different ways, such as custody risk, price, liquidity and volatility risk, and broader market and contagion risks.

***Difference in user experience between AMMs and exchanges***

FinTech Australia Members also highlighted the difference in user experience between an AMM and an exchange. One of the primary differences is that an exchange provides customer service, consumer safety and education resources and as discussed above, which act as a safeguard to protect consumers from harms, such as scams.

On the other hand, a decentralised exchange typically provides consumers with access to a wider range of crypto assets and allows them to exchange crypto assets on a peer-to-peer basis from their own wallets. However, consumers require a higher level of technical knowledge and expertise to navigate a decentralised exchange, which we have detailed above. This may provide a practical barrier to entry and thus consumer protection.

**b) Is there quantifiable data on consumer outcomes in trading on conventional crypto asset exchanges compared with user outcomes in trading on AMMs?**

FinTech Australia has not received feedback from its Members on this question.

# Conclusion

FinTech Australia and its Members thank Treasury for the opportunity to provide their views on such an important suite of issues, and greatly appreciates the work that Treasury has put into the Paper and past consultations. The token mapping project can set the course for progress towards a proportionate, fit-for-purpose regulatory regime for crypto assets, blockchain and web3 that supports innovation and protects consumers. These technologies will be key to the future of fintech, as well as the broader digital economy in Australia.

We look forward to engaging in the future on further industry consultations, including forthcoming consultation on custody and licensing requirements.