Chandlers International Lawyers

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

3 March 2023

Your ref: Token Mapping

Our ref: MT/Treasury_Token_Mapping

By email: crypto@treasury.gov.au

Dear Sir/Madam

SUBMISSION IN RESPECT OF THE FEBRUARY 2023 CONSULTATION PAPER ENTITLED

"TOKEN MAPPING"

We refer to the above consultation paper.

Chandlers International Lawyers is a boutique corporate commercial law firm in Sydney with experience in providing a range of legal services to Australian and overseas participants in the crypto asset markets, including legal advice in relation to potential litigation for the recovery of assets and compensation for losses arising from its clients' involvement in the crypto ecosystem.

Our responses to the list of consultation questions in Annexure 4 to the above consultation paper are as follows.

Question 1

We believe the role of Government in the regulation of the crypto ecosystem should be to facilitate the growth and development of the crypto ecosystem for efficient, proper, and lawful purposes.

We think that the preferred Government approach is to facilitate the provision of sufficient information to enable an individual participant in the crypto ecosystem to effectively assess the value, legality, and financial and non-financial risks of a transaction involving the specific crypto asset or application.

After all, "*Sunlight is said to be the best of disinfectants; electric light the most efficient policeman*"[1].

Question 2

We believe there are currently insufficient safeguards for consumers and investors.

We suggest imposing minimum statutory obligations on the creator, issuer and transferor of a crypto token to help the consumer/investor/transferee judge the quality of, and risks associated with, the relevant crypto token.

We suggest that any individual who has the 'exclusive use or control' of a digital asset (ie. whether or not that individual has the use or control of a digital asset for that individual's own benefit, for the benefit of another person, or as agent for another person) be obliged to register an information statement with an Australian registry capable of public inspection, or otherwise ensure that one has been previously registered, prior to the issue or transfer of the digital asset to a person in Australia.

This suggested scheme is suggested to be a similar one to the disclosures presently required for food or pharmaceutical drugs that are marketed or consumed in Australia, regardless of their place of origin.

The minimum disclosures may include, for example –

1. details of the creator/issuer;

2. details of the originally intended use (ie. financial, social or other purpose);

3. whether the crypto token has been issued as a form of negotiable instrument (ie. embodying the legal rights which it evidences, capable of transfer by negotiation, etc) or otherwise has specified terms or restrictions on the transferability of the legal rights evidenced by it;

4. whether the crypto token is held on a public or intermediated network and, if held on an intermediated network, then by whom and on what terms;

5. other relevant terms, such as any restrictions on the further issue of the relevant digital asset.

[1] Brandeis, Louis D., "Other People's Money and how the Bankers use it", Frederick A Stokes Company, New York, 1913, Pg. 92

Question 3

The suggested registered information may assist to prevent scams in that a prudent consumer / investor would prefer dealing in 'registered' crypto tokens, meaning that the suggested information statement has been registered.

Question 4

We think that concepts of exclusive use or control of data (ie. whether public or private) could be used in a general definition of crypto token and crypto network for the purposes of future legislation.

Question 5

We think that a bespoke crypto taxonomy will not be able to account for the myriad forms and uses of crypto tokens.

The suggested disclosure framework will allow creators/issuers to nominate the intended purposes of the crypto token which will thereby attract the appropriate regulatory framework. For example, a crypto token which has been created/issued with the purpose of being a social token (such as proof of registration at an event) will not attract the regulatory framework applicable to a crypto token that is intended for non-cash settlement of transactions.

Question 6

The suggested disclosure framework is intended to enable the consumer/investor to make an informed decision whether there is sufficient 'backing' of a real world asset.

The suggested disclosure framework is intended to promote a self-regulating environment in which demand and pricing for poorly 'backed' intermediated crypto assets are adjusted according to normal economic principles (ie. to take into account the risk of a poorly 'backed' crypto asset relative to a well 'backed' crypto asset).

Question 7

We believe the suggested disclosure framework will identify arrangements underpinning the relevant crypto tokens.

Other initiatives that crypto asset service providers could take to promote good consumer outcomes lie in appropriate corporate governance frameworks of the providers themselves. As an example, we believe that a robust corporate governance

framework (such as those currently applicable to financial institutions) could have avoided the inter-group company transactions that led to the collapse of FTX.

Question 8

We believe that the functional parameter could be clarified to include those crypto assets which are disclosed by the creator/issuer/transferor as being intended for a financial purpose in the registered information statement suggested herein.

Question 9

We suggest that the criteria of a suitable specific public crypto network for hosting real world wrapped assets should be similar in nature to those of an Australian Market Licence which similarly hosts real world assets "wrapped" in the shared equity interests of a limited liability entity.

Question 10

If there is adoption of a suitable disclosure framework for the crypto tokens which is intended to enable consumers/investors to make informed decisions, and attract appropriate existing regulatory frameworks, then we would consider anything in addition to the existing financial services framework to unfairly discriminate against issuers (and innovators) of digital assets, and potentially result in a mispricing of that asset class.[2]

Question 11

We consider it would be suitable for Australia to adopt a regulatory framework which would prevent the marketing or promotion of crypto tokens to Australians or within Australia which have not complied with the suggested registration of an appropriate information statement on the suggested Australian register.

Question 12

The suggested publication of relevant information is intended to create accountability and a deterrence against smart contracts and smart contract applications which do not comply with existing regulatory frameworks.

[2] ie. additional regulation could have a consequential negative impact on the pricing of intermediated crypto tokens relative to the pricing of equivalent traditional intermediated financial products which are in some cases less efficient than the digital asset equivalent.

Question 13

We consider the key risk differences between a smart-contract and conventional pawn-broker lending is that the right of the conventional pawn-broker to enforce repayment of the loan from the sale proceeds of underlying assets arises as a collateral relationship to the loan itself. In many common-law countries, this is characterised as a possessory lien, whereas in many civil-law countries a similar right arises from a relevant civil code. The lender's right to a refund of any surplus proceeds of sale (ie. net of the discharge of the loan) varies from place to place. The De-Fi network spans several legal jurisdictions, and it is not clear which place would govern the lender's right to sell the borrower's assets and apply the proceeds in repayment of the loan. There are also questions whether the possession element of the possessory lien is satisfied.

Equitable defences to the automatic enforcement by a smart contract, such as unconscionable conduct, and other consumer protections are not necessarily available.

We are not aware of quantifiable data in this regard.

Question 14

Automated market makers (AMM) enable unstoppable, automated, and decentralized trading using algorithms to price assets in liquidity pools. We consider the key differences in risk between using an AMM and the services of a crypto exchange to be that an AMM may have an unforeseen issue with the pricing algorithm embedded in the smart contract, which may result in an over exaggeration of swings in pricing which a crypto exchange may avoid through dynamic trading intervention if required.

We are not aware of quantifiable data in this regard.