Law Council
OF AUSTRALIA

Business Law Section

10 March 2023

Director, Crypto Policy Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: crypto@treasury.gov.au

Dear Sir or Madam

Token Mapping—Consultation Paper

1. The Financial Services Committee and the Digital Commerce Committee of the Business Law Section of the Law Council of Australia (the **Committees**) have prepared this submission in response to the Consultation Paper dated February 2023 issued by Treasury and titled "Token Mapping" (the **Consultation Paper**). The Committees thank Treasury for this opportunity to respond to the Consultation Paper, and for agreeing to a short extension of time to provide this submission.

Overall position of the Committees

2. The Committees support:

   (a) the comprehensive token mapping exercise undertaken by Treasury and set out in the Consultation Paper; and

   (b) a regulatory approach that balances the opportunities of the crypto ecosystem alongside prudent risk management, while being informed by international approaches to crypto ecosystem regulation.

3. The Committees acknowledge and agree that:

   (a) the Consultation Paper does not address all the risks of investing in crypto assets, but maps the ecosystem against specific portions of the financial services regulatory framework; and

   (b) a complete overview of the crypto ecosystem is beyond the scope of this submission.

4. The Committees support and agree with the application of the functional perimeter i.e, which captures any 'facility' through which, or through the acquisition of which, a person does one or more of:

(a) makes a financial investment;

(b) manages financial risk; and

(c) makes non-cash payments

(together, the 'general financial functions').

Responses to questions in the Consultation Paper

5. The Committees' responses to some of the questions asked in the Consultation Paper are set out below. Some hyperlinks to relevant external resources have been included.

Q1) What do you think the role of Government should be in the regulation of the crypto ecosystem?

Dynamism

6. The Committees submit that:

(a) Government, through the Australian Securities and Investments Commission (**ASIC**), should enforce the functional perimeter in respect of crypto assets in a technology agnostic way; and

(b) this enforcement should be timely, appropriate and take account of the dynamic nature of tokens—i.e., that they may change in function, form, rights and obligations over time.

7. Relevantly, crypto assets, by virtue of their digital nature, may fall in and out of the functional perimeter more quickly than conventional assets.

Future proofing

8. The Committees submit that the Government should exercise caution in providing responses or mappings that over-emphasise status quo public, permissionless infrastructure terminology and smart contract methodologies that are highly simplistic "generation one" products.

9. This is because crypto asset development is rapid, and crypto assets can be any form of digitalised autonomous and often programmable assets—they are not just Ethereum-based speculative tokens or non-fungible tokens.

10. The Committees submit that the regulatory framework should be agnostic on a forward-looking basis to avoid having to solve the same problem in the near future for the same (but more evolved) asset class.

Tax leakage

11. The Committees submit that the Government should, through the Australian Taxation Office, the Department of Social Services and the Department of the Prime Minister and Cabinet (and other relevant departments), recognise the significant impact on the money supply and leakage of taxation revenues and hidden revenues that is possible

through the use of cold wallet solutions, as well as platforms like Ethereum and popular decentralised "peer to peer" exchanges.

Critical digital infrastructure

12. The Committees submit that the Government, through the Attorney General's Department, should consider whether legislation is required to support the digitisation of legal contracts (smart legal contracts) and what impact this will have on a need for critical digital infrastructure.

13. The Committees consider that national digital infrastructure is likely to become a matter of national security and competitive advantage, as data and smart legal contracts increasingly represent a digital twin of the national economy.

Decentralised autonomous organisations (**DAOs**) and autonomous organisations (**AOs**)

14. The Consultation Paper sets out a clear explanation of DAOs in paragraphs 177 to 183. In furtherance of this, the Committees submit that the Government should follow the token mapping exercise with a follow-on consultation by Treasury that considers the responsible machine problem (see here), and whether appropriate legislation/regulation is required to give machines / AI / algorithms legal status as a "person" under the law (see here). It is noted that neither the Law Council nor the Business Law Section has adopted a position on this significant latter issue, which would require careful consideration.

15. This latter point is, however, directly relevant to the question whether the more agnostic artificial intelligence concept of AOs is preferable to DAOs as the concept which is to be captured in the law. That is, going beyond the "crypto" specific context, the "D" in DAO may be less significant from a technological, market and regulatory perspective, than the existence of organisations that operate autonomously in general: AOs.

Licensing

16. The Committees submit that the Government, through ASIC (and appropriate legislation / regulation if required), should consider the introduction of a third-tier style market licence which involves lighter touch regulation and can be applied for in a similar manner to a "fill in a form" Australian Financial Services Licence (**AFSL**). The Committees believe that a form (which currently does not exist) would help guide market participants to satisfy their regulatory obligations, and avoid incurring unnecessary legal and other costs which may not necessarily reduce the fundamental risk exposure.

17. The Committees consider that it will be critical for the Government to allocate sufficient resources to:

    (a) provide public education for the benefit of all stakeholders in the crypto assets space about the scope of the regulatory perimeter;

    (b) appropriately address misconceptions about whether or not particular tokens and/or token related activities sit within or outside the regulatory perimeter; and

    (c) improve public awareness of the serious consequences of failing to adhere to regulatory requirements.

Regulator resourcing

18. The Committees submit that the Government should resource ASIC appropriately to moderate new and emerging users of platforms and markets catalysed by the digitalisation of traditional assets by non-traditional financial market participants and stakeholders, who may lack familiarity when consuming ASIC services. This increase in digitalised property is only expected to increase and to be used as "complex money" (see here). The Committees consider that adequate resourcing, to ensure appropriately quick regulatory response times, will be critical in responding to the fast pace of these businesses if Australia seeks to be a favourable jurisdiction for fostering innovation in this significant sector of economic activity.

Regulatory equivalence

19. The Committees submit that the Government should work with other global regulators to ensure maximum regulatory equivalence consistent with the approach taken by the International Organisation of Securities Commissions. The Committees believe that this may be the largest on-the-ground change that would encourage innovation in Australia and inflow of innovative companies.

20. If a financial market or AFSL could be obtained in Australia and that licence(s) could assist innovators in more easily securing equivalent licences in other foreign markets, this would be expected to reduce the costs of operating in multiple jurisdictions. The Committees also consider that adopting such an approach in Australia would encourage prudent foreign entities to provide services to Australian users within the tolerance range of Australian regulations rather than avoiding Australia as a "too hard and too small" market.

4. 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?

21. The Committees do not favour the use of the concept of "exclusive use or control" of public data in a definition of "crypto token" for the purposes of Australian financial services law or consumer protection law. This is because of the risk of conflation of the needs and aims of financial services and consumer protection law, on the one hand, with the needs and aims of property law, including in the context of insolvency, on the other.

22. There is a separate issue as to how existing custody (or safekeeping) frameworks in the Australian financial services industry should be adapted for service providers for intermediated token systems. In that context:

    (a) the Committees agree that it would be desirable for existing custody frameworks to be supplemented by specific controls and safeguards for the safekeeping of private keys; and

    (b) the concept of exclusive use or control may be relevant.

23. The Committees submit that the Government should also be mindful that:

    (a) technical solutions may emerge to solve some of the challenges consumers currently face; and

(b) any regulatory response will need to be sufficiently technology agnostic and flexible.

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

24. Although the Committees do not believe that "crypto token" should be defined by reference to the concept of "exclusive use or control", the Committees consider that the concept would be helpful to distinguish between intermediated token systems (where the service provider rather than the user will have use and control of the applicable crypto tokens) and public token systems (where users will have self-custody—i.e., exclusive use or control—of the crypto tokens in connection with the public token system).

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

25. The Committees agree that a bespoke crypto asset taxonomy would have minimal regulatory value.

    However, a consistent terminology for key crypto asset related concepts should be used across the various legislative frameworks and Government agencies to ensure clarity and consistency.

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

26. As noted above, the Committees consider that this would have minimal regulatory value.

5. 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?

27. The Committees suggest that section 765A of the *Corporations Act 2001* (Cth) should be amended to include a specific "safe harbour" from the regulatory remit of Chapter 7 for crypto networks and crypto assets that are used for a non-financial purpose by individuals and businesses. The Committees consider that this would provide a degree of certainty for non-financial uses.

28. Given that the technology and business cases are both evolving rapidly, the Committees envisage that this could be accompanied by an additional legislative lever to enhance ASIC's ability to make declarations under section 765A(2) to specifically exclude additional non-financial uses from time to time. See the comments in paragraph 18 above in relation to adequate funding required for this to be viable and fit for purpose.

Other comments

29. The Committees note that a framework for custody and licensing is to be released for public comment in mid-2023. The Committees look forward to making a contribution to this consultation process.