

Submission of Morgan Mac Lawyers to the Token Mapping Consultation Paper February 2023

Morgan Mac Lawyers makes this submission in response to questions 1, 2 and 5 of the Token Mapping Consultation Paper 2023.

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

The role of the Government is to regulate the crypto ecosystem in a way that fosters innovation and protects consumers from fraud, rug pulls and scams, and avoid the inertia apparent in some other jurisdictions that has seen regulators focus on regulation by enforcement in the absence of developing a crypto specific regulatory framework or improving existing regulatory frameworks in a way that protects consumers, fosters innovation and provides certainty to industry participants.

We favour the approach of the European Union of drafting crypto specific legislation. The risk of seeking to apply the existing financial services regulatory framework without any modernisation to the technical and economic complexity of the crypto ecosystem and crypto assets, both of which the Token Mapping Consultation Paper acknowledges are not homogenous, will uncertainty about how that existing framework applies to crypto networks and crypto tokens, which may stifle innovation and drive it offshore¹. Many crypto tokens may attract speculative investment but also exhibit attributes of money and commodities. Some cryptos are uniquely designed be used for cross border payments² or solve some other real problem and should not be subjected to regulation that prevents or hinders that utility.

Even if products and services offered by persons or companies to consumers fall functionally within the ambit of financial products or financial services the current financial services

¹ The approach of the Securities Exchange Commission in the USA that has seen it commence multiple enforcement proceedings in the last few years against crypto companies in a crypto market that has existed for over a decade, while claiming the application of current securities laws to cryptos is clear, has not protected investors from many of the significant failures of participants, especially intermediaries, in the crypto market such as FTX, Celsius, Voyager. This approach included a lawsuit commenced by the SEC against Ripple Labs in December 2020, in which no fraud is alleged. The commencement of the lawsuit against Ripple caused many exchanges to delist XRP, which at the time was a top five crypto by market volume, causing its price to fall, billions of dollars to be wiped off the market value of XRP and financial harm to investors. Subsequently, there was an extraordinary intervention of Amici Curiae in the Sec v Ripple Labs lawsuit on behalf of 75,978 XRP holders who essentially oppose the SEC's case.

² For example, XRP and XLM are capable of seconds fast and cheap cross border payments.

framework may not sufficiently regulate the crypto industry in a way that does not stifle innovation and sufficiently protect consumers.

We consider that if a crypto specific regulatory framework is developed and adopted by the Government the principle of technology neutrality remains important and should inform a crypto specific framework.

Further, functionally equivalent crypto assets should be treated equivalently. This ensures consistency and that certain cryptos are not given a regulatory advantage over other cryptos because of arbitrary factors. For example. It would be unhelpful and inconsistent if Bitcoin was treated as a commodity because Satoshi, the pseudonymous person or persons who developed Bitcoin, is unknown, but all other crypto assets are considered financial products because the creator or issuer of the token is known, despite Bitcoin's functional similarities with other tokens such as Bitcoin Cash, or Litecoin.

Q2) What are your views on potential safeguards for consumers and investors?

Although we consider the existing financial services framework has a continuing role in regulating those crypto products that are obviously financial products (form example arrangements that fall within the definition of managed investment schemes), we believe it is necessary for the government to implement a crypto specific regulatory framework that better protects consumers, especially in relation to disclosure of information relevant to investors and the safe custody of investors' assets.

For example, in respect of the disclosure, investors may expect disclosure of information such as how many tokens are reserved to developers and creators, whether there are escrow arrangements or restrictions on developers and creators selling (dumping) tokens, whether the crypto is inflationary or deflationary, whether the issuer has blackholed the crypto³, whether the creator or issuer intends to buyback and burn part of the supply⁴, security risks, availability and terms of on chain staking and restrictions on unstaking tokens. Crypto asset white papers are published by many projects but often lack clarity, and the technological complexities and hype can make crypto assets difficult to understand for consumers.⁵

³ Blackholing is a measure taken that makes it impossible to issue further tokens and which fixes the total number of tokens that can be issued.

⁴ In November 2019, the Stellar Development Foundation burned 55 billion XLM tokens.

⁵ Bains, Parma, Arif Ismail, Fabiana Melo, and Nobuyasa Sugimoto.

2022. "Regulating the Crypto Ecosystem: The Case of Unbacked Crypto Assets." IMF Fintech Note 2022/007, International Monetary Fund, Washington, DC. at p.16.

Due to a tendency towards a lack of transparency of crypto intermediaries such as exchanges and wallet providers there should be a particular, although not exclusive, focus on the disclosure obligations of crypto intermediaries. Exchanges for example, should disclose how they are dealing with and investing the crypto assets of investors who use the exchange, and the nature and terms of the custody arrangements.

Exchanges should also disclose the risks to investors, and rights or loss of rights to investors, in their crypto assets, if the exchange fails, or the company that runs the exchange becomes insolvent. There should be consideration about the whether custodial arrangements that may be unknown or not adequately disclosed to investors who keep their crypto assets on exchanges when the nature of those arrangement determines whether or not the investors' assets on the exchange become available to creditors of the company that operates the exchange in the event of the company's insolvency.

Morgan Mac Lawyers are preparing specific recommendations for desirable changes to consumer protection legislation such as the *Australian Consumer Law* to safeguard consumers from specific risks that have become apparent from failures and problems in the crypto ecosystem over the last 2 years.

Q5) 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?

In the absence of an internationally agreed taxonomy, for what are essentially globally traded assets, a crypto specific regulatory framework should not be based on an exhaustive bespoke crypto asset taxonomy but on a high level taxonomy. This taxonomy should not be grouped in terms of intermediated and public tokens systems but on the four broad categories that have been adopted by many financial regulators globally⁶ being:

1. Unbacked crypto assets such as Bitcoin, Ether and XRP;
2. Utility tokens;

⁶ Bains, Parma, Arif Ismail, Fabiana Melo, and Nobuyasa Sugimoto. 2022. "Regulating the Crypto Ecosystem: The Case of Unbacked Crypto Assets." IMF Fintech Note 2022/007, International Monetary Fund, Washington, DC. p. 11-12.

3. Security tokens;
4. Stablecoins.

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

The creation of a standalone regulatory framework that is complemented by the *Australian Consumer Law* and the existing financial services regulatory framework is the option most likely to protect consumers, foster innovation and provide certainty to participants in the crypto ecosystem. The confusion or lack of crypto specific legislation in other jurisdictions where there have been attempts to apply existing securities laws to the crypto ecosystem, has caused a reaction by crypto industry participants⁷ that points to the need to create a standalone regulatory framework to provide certainty and avoid innovation moving offshore.

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?

The creation of a standalone regulatory framework that excludes from the financial services regulatory framework, but not from consumer protection laws, products and services that are not clearly financial products or financial services is desirable.

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3 March 2023

⁷ In December 2022, crypto lender Nexo announced it would phase out its U.S. products and services due to clashes with U.S. regulators after what it described were 18 months of good-faith dialogue with U.S. state and federal regulators which had come to a dead end. U.S. investors being deprived of these products and services can hardly be described as consumer protection.