



## **Submission in Response to Token Mapping by The Treasury**

*To whom this may concern,*

*The UNSW Crypto Clinic is the main blockchain and cryptocurrency body at the University of New South Wales in Sydney.*

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

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

*Q3) 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?*

*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?*

## **Preamble**

The role of the government in the crypto ecosystem at this stage of its development should optimally be that of a guardian and an overwatch. Some believe that the government should have a heavy hand in regulating the industry, while others believe that the industry should be left to regulate itself. However, it is widely agreed that the government's role in the crypto industry should be that of a guardian and a guide. Specifically, the government should be consulting with foundations of major cryptocurrencies networks to establish typologies, standards, and metrics upon which different cryptocurrencies could be categorized and measured against.

As the crypto industry is relatively new, there are a lot of uncertainties and risks involved. It is the government's responsibility to set standards and guidelines to protect consumers and investors from fraud, manipulation, and other malicious activities. In consultation with the industry, the government should also specify how each of these standards are measured, and the means by which crypto projects can seek to comply with these standards. This will help ensure that the crypto industry is transparent, secure, and trustworthy.

However, it is also important to note that over-regulation of the crypto industry can stifle innovation and growth. The crypto industry is constantly evolving - with new technologies being developed every day. If the government places too many restrictions and regulations on the industry, it could discourage entrepreneurs from taking the crypto industry to the next level. This could have a negative impact on the growth and development of the industry and could potentially limit its potential to revolutionize finance and commerce.

Therefore, the government must strike a delicate balance between protecting consumers and investors and allowing the crypto industry to flourish and grow. The government should not impose restrictions that are so onerous to discourage innovation and investment in the industry. Rather, they should seek to create an environment that is supportive and conducive to growth.

The route to regulation by the government of crypto is only as good as the weakest link. Unless there is full coordination and uniformity in how regulations could be implemented across all nations, crypto is always going to flow towards the friendliest jurisdictions. Therefore, unless the Australian government wants to miss out on potentially the next exponential economic growth with the advent of the web3 era, our recommendations would be for the Australian government to continue with the light touch framework that has permeated over the recent years. However, there is still a need for a way by which retail users and investors could be protected when they come into contact and interactions with this industry.

## **Challenges with government over-regulation in crypto industry:**

If the government attempts to regulate the crypto industry and force it to fit into one or more of its existing frameworks or paradigms, it is likely to run into massive regulatory overheads as each transaction made in the crypto industry is likely to fall across multiple legal domains to render them unique in configurations in every sense of the word. In other words, it could mean that every case brought against a potential "delinquent" would have to be treated as a unique case and such a practice cannot be effectively scaled when a government agency is dealing with millions or billions of transactions. Furthermore, these litigations would do little to provide the creation of case laws and precedents that could clarify the path forward for others due to the almost infinite ways by which each case could be configured.

For example, one single type of cryptocurrency should have multiple use cases such that it could at different points of time serve as a store of value, a commodity, a governance voting mechanism, a stake to secure the network, a collateral for synthetic assets etc. Conversely, if the government tries to treat cryptocurrencies as a uniform entity and force all crypto projects to fit under a single regulatory framework (e.g., financial security regulations), it will stifle innovations. At this rate, only a few categories of crypto projects would flourish.

Additionally, crypto projects that use the proof of work (PoW) consensus mechanism are not uniform, as the mining process depends on whether the mining machines are ASIC or non-ASIC in nature. The difference in the block sizes of the different blockchains is also important. Both have implications in whether the network will tend towards decentralization or centralization, which means that the token in

the former is likely to fit with the legal definition of a commodity and the latter that of a security. Similar legal implications could also be found in the numerous design differences in crypto projects that use the proof of stake (PoS) consensus mechanism. Some of these PoS protocols are custodial, and some are non-custodial and some of these protocols have bonding and lock up mechanisms that could affect the liquidity of the individual users, which translates to different types of risks for them. Some of these protocols could have a slashing mechanism for delinquent node validators and some do not. Again, such differences in design choices could have implications for whether individual stakers or validators have been subjected to proper disclosure if they have access to transparent due process when slashing occurs. Each of these design decisions and mixing and matching them would then have different legal implications and treating these protocols as a uniform entity would create a legislation nightmare for the government.

Also, the belief that crypto could be regulated is akin to China's attempt to regulate the Internet. Crypto protocols are mostly open sourced and existing networks are permissionless. Especially for PoS networks, as long as an individual has a phone and has internet access, they will be able to circumvent the technological restrictions and join the networks. Any technological or judicial surveillance will raise the shadows of totalitarianism. With these above challenges in mind, we have provided the following recommendations in response to the question of what we believe the role of the Government should be in the regulation of the crypto ecosystem.

### **Recommendations (Q1- Q3):**

1. First, there is an urgent need to specify the category to which different crypto projects could belong. For instance, there are store of value crypto networks, where the network exists purely to push or pull value across space and time and there are utility networks, where more complex computations could be conducted. The categories should not be too restrictive and overly narrow as many crypto projects are still evolving. The categories are meant to serve as an anchor for the standards to be derived for a set of similar crypto projects.

2. Subsequently, similar to how the ISO standards are implemented, governments can specify what are the different levels of the standard that could be awarded or attributed to the different crypto projects in each of the categories as specified in point 1. It could be a spectrum indicated by a score by which a crypto project could range between 1 to 10, with 1 being the lowest in the standard and 10 being the highest. As to how the score for the standard could be derived, different criteria would have to be utilized depending on the specific characteristics specific to each category of the crypto projects (e.g., Stablecoins, DeFis, Layer 1 Utility network, Store of value etc.).

For stablecoins, the criteria may consider the stability of the coin's value, the level of collateralisation, the transparency and auditability of the reserves, and the level of decentralisation of the stablecoin's governance. On the other hand, decentralised finance (DeFi) projects may be assessed with the level of decentralisation, the extent of security and auditability, as well as its functional parameters and liquidity pools.

3. Develop a library of relevant existing Australian regulations and laws that are implemented as codes or smart contracts that could be appended to any crypto protocols that will watermark every transaction that originates or intends to off-ramp within the Australian jurisdiction. This allows regulation to be applied at the transaction level instead of at the application level. This remains sufficiently autonomous to innovate without the burden of regulatory compliance at the technological stack.

4. Develop accreditation standards for educators or crypto advisers and also the demand for declaration of vested interest of the educators or advisers if they have invested in certain crypto. Provide guidelines and compliance framework of behaviour of the educators and advisers so that the general public can develop trust and seek education and advice from accredited advisers, rather than online influencers with potentially malicious self-interests and agendas. Accredited are the best defences for retail by equipping them with the knowledge of the principles of cryptocurrencies and how to recognize scams from legitimate projects evaluated against these principles.

Universities are the perfect facilitators for this - they present an impartial and independent setting, possess the latest research capabilities, and have established a plethora of courses across Australia for blockchain and cryptocurrency education (e.g., INFS4777 – Blockchain and Web 3 Innovations,

UNSW FINS3647 - Bitcoin and Decentralised Finance). This can be further explored in an academic and industry collaboration, focusing on: (1) research partnerships, (2) curriculum development, (3) professional development opportunities, (4) joint projects and (5) advisory boards.