15 December 2023

Law Council
OF AUSTRALIA

Office of the President

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

By email: crypto@treasury.gov.au

Dear Director

Regulating digital asset platforms

1. The Law Council is grateful for the opportunity to respond to the Treasury's *Regulating Digital Asset Platforms* Proposal Paper.

2. This submission has been prepared by the Financial Services and Digital Commerce Committees of the Law Council's Business Law Section, with input from the Law Society of New South Wales (together, the **contributors** to this submission).

3. In addition to the comments contained in this letter, the contributors' responses to the Question Sets canvassed in the Proposal Paper are provided in Appendix A.

Preliminary observations

4. The contributors commend Treasury on the Proposal Paper. On balance, the contributors consider that the proposed legislative approach is reasonable and proportionate to the risk of consumer harm which digital asset platforms can present and can lay an appropriate foundation for future regulation.

5. The contributors agree with the Proposal Paper's statement that Australia should 'accommodate a future where an increasingly diverse range of entitlements are … tokenised'. This is consistent with the market experience of the Committees' members and the inevitable by-product of widespread global digitisation, increasing digitalisation and automation through adoption of emerging technologies (including artificial intelligence).

6. This submission, as well as responding to the Question Sets in the Proposal Paper, seeks to:

   (a) suggest some potential improvements to the proposed regime; and

   (b) raise other similarly important issues,

   with a view to ensuring any legislative framework is fit for purpose.

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The contributors' position

7. Overall, the contributors consider the regulatory perimeter of Chapter 7 of the *Corporations Act 2001* (Cth) should be maintained.

8. The contributors consider Chapter 7 of the Corporations Act will be a suitable tool to address a significant proportion of potential consumer harms that can arise for digital assets which are, or are functionally similar to, the current Corporations Act concept of 'financial products'.

9. A significant number of digital assets currently in circulation already meet the definition of financial product (or their global equivalents) at least for some point in their creation, issue, trade, etc. This appears well understood by many legal experts and some platform providers in Australia and is consistent with the position of major global regulators.

10. The contributors endorse an approach to regulation that is consistent with the Board of the International Organisation of Securities Commissions' *Policy Recommendations for Decentralized Finance Consultation Report* (September 2023)—particularly Recommendation 1, which outlines the principle 'same activity, same risk, same regulatory outcome'.[1] That is, the same substantive economic activity and risk profile should be regulated the same, irrespective of the technology used.

11. However, the contributors caution that:

    (a) the Corporations Act regime will not be the most suitable tool to address all scenarios where digital assets present a risk of consumer harm. As referenced on page 15 of the Proposal Paper, it will be important for government to consider whether certain consumer protections are best achieved through other legal frameworks, and the interaction between applicable laws. This will require multi-agency and multi-departmental collaboration;

    (b) there are aspects of the regulatory regime which, if they are to operate effectively, require a detailed investigation and understanding of the digital assets industry ecosystem. This is beyond the scope of the Proposal Paper and may appropriately sit within legislative instruments rather than the primary legislation (this design question is the subject of a current reference to the Australian Law Reform Commission);

    (c) the digital assets landscape is rapidly evolving and there may be future uses of digital assets that we are yet to contemplate or comprehend;

    (d) the legislative regime must be reviewed (and, where necessary, adjusted) on an ongoing basis to ensure it remains fit for purpose;

    (e) as Chapter 7 of the Corporations Act (as it currently stands) is complex and difficult to navigate, additions to the Chapter 7 framework should only be made where there is a strong policy rationale for doing so and in the absence of other viable alternatives;

    (f) these law reforms should not be considered in a vacuum. Other relevant regimes to consider, include privacy, broader consumer protection, tax, credit and payment system laws; and

[1] Board of the International Organisation of Securities Commissions, *Policy Recommendations for Decentralized Finance* (Consultation Report, September 2023) 19, rec 1.

(g) the importance of educating a newly regulated population cannot be underestimated and must not be under-funded.

Proposed regulation of digital asset facilities with a 'financialised function'

12. The proposed regulation of tokens with a 'financialised function' seeks to address industry concerns identified in the earlier Token Mapping consultation process that tokens are dynamic and may be used in different ways at different points in time. The contributors agree that tokenisation can create new 'pivotal points of vulnerability from a technology, counterparty, and fraud risk perspective', as the Proposal Paper rightly states. The question for law reform is: what is the best framework (or frameworks) for addressing those risks?

13. However, some members of the Committees are concerned that the concept of 'financialised function' will:

    (a) introduce unwanted complexity and be difficult to administer in practice; and

    (b) amount to regulatory overreach by regulating activities in respect of non-financial products within the regulatory perimeter of Chapter 7 of the Corporations Act.

14. Government will need a clearly articulated policy rationale for bringing regulation of activities in respect of non-financial products into the regulatory perimeter of financial services under Chapter 7. While the contributors appreciate the need to ensure consumer protection in respect of activities of intermediaries in the digital asset space, the contributors are not persuaded it is appropriate to bring digital assets with financialised functions (that are not financial products) into Chapter 7, nor to regulate the custody of digital assets that are not financial products by requiring the custody provider to hold an Australian financial services licence (**AFSL**). The contributors note that regulation of the holding of non-financial product digital assets could significantly increase the number of AFSL applications and enforcement actions. A proportionate increase in the funding of the Australian Securities and Investments Commission (**ASIC**) would be required to ensure that it can adequately respond to the additional workload. Regulatory resourcing is discussed further at paragraphs [24]-[26] below.

15. The contributors query whether the proposed approach will strike an appropriate balance between consumer protection (by regulating custody of non-financial product digital assets) and promoting innovation, namely tokenisation of real-world and virtual assets which are not financial products. The contributors also believe it is important to consider whether and to what extent this approach aligns with approaches taken in other jurisdictions.

16. Therefore, the contributors recommend Treasury conduct further industry consultation to:

    (a) test and confirm the policy objectives and rationale for imposing obligations on digital asset facility provider entities dealing in digital assets that are non-financial products (for example, gaming assets, real world tokenisation and smart contracts between layer 1 and layer 2 systems);

    (b) consider whether alternative approaches to treatment of financialised functions could be more appropriately tailored to the nature of the underlying asset and associated risks, whether through special purpose legislation or drawing on other existing legal frameworks; and

(c) if such regulatory approach is considered necessary, explore whether a staged regulatory approach could be adopted, and proceed to consider this issue once the new digital asset facilities regime has been implemented and tested.

Disclosure

17. Disclosure is an important aspect of consumer protection but is unlikely to achieve all the desired consumer protection outcomes on its own.

18. Appropriate disclosure by digital platforms providers can assist in informing consumers of the nature of some risks of accessing digital assets. However, the contributors query whether the product disclosure statement / prospectus regime used for financial products in the Corporations Act will produce the best disclosure outcomes.

19. It will be important to consider practically the level of disclosure and risk assessment required by the platform providers (as distinct from disclosure required by the issuer of digital assets). The contributors recommend a minimum standard of disclosure (possibly a template form disclosure) be required for each token. Standardisation of disclosure with the appropriate level of information would assist in consumer protection across platforms. The contributors consider that, at a minimum, platforms should be required to disclose:

    (a) publicly available information on the token (for example, links to whitepaper(s), information on token issuers);

    (b) key factual/historical information in relation to the token including trading history, technical features, etc; and

    (c) other information that the platform considers to be reasonably relevant to a customer's decision to access a digital asset.

20. These requirements should necessarily fall short of risk assessments that might stray into financial advice territory.

21. The contributors consider that the legislative regime for disclosure should be principles-based, with more tailored legislative instruments to be used to address the more detailed nuances.

22. The contributors note the reference to the design and distribution obligations (**DDO**) regime found in Part 7.7A of the Corporations Act in recent Treasury roundtables which some members of the Committees attended. Applying the DDO regime to the tokens as opposed to the digital asset facility appears to contradict the proposal to treat the digital asset facility (a financial product) as related but separate to the token it is applied to (which may or may not be a financial product), and significantly undercuts the clarity which the proposed framework hopes to establish.

23. The potential application of the DDO regime to the tokens has not been canvassed in the Proposal Paper. The contributors caution that it is critically important to conduct appropriate industry consultation before introducing such a reform. Failure to do so could have undesirable consequences.

Regulatory resourcing

24. The contributors believe that Australia has the potential to be a blockchain and digital assets success story. Whether this potential can be fulfilled depends upon both the

design of the regulatory framework and the effectiveness of ASIC as a conduct regulator.

25. Digital assets will increasingly become a key element to our national and global economies. Regulating digital assets and blockchain can be particularly challenging because of the flexibility, pace and scale of the industry.

26. If ASIC is given regulatory responsibility in this area, it will require access to:

    (a) additional financial resources to regulate this area of the market; and

    (b) technical capabilities (whether internal or through suitable expert advisors),

    in order to:

    (c) design its regulatory guidance appropriately (e.g., responsible manager qualifications for licensing);

    (d) engage with the industry on key issues in a constructive manner; and

    (e) target bad actors with suitable enforcement action.

Custody of financial assets

27. Members of the Committees have experience advising clients on custody arrangements for digital assets which constitute financial products. Based on their experience, members believe there are a number of complex matters in need of clarification, including:

    (a) how to ascertain whether a person is 'holding' a digital asset;

    (b) whether particular activities do or do not constitute the provision of custody; and

    (c) distinguishing between digital asset platforms and managed investment schemes.

    The contributors consider these matters should be further explored and, where necessary, captured in legislative instruments and/or regulatory guidance.

28. Another matter which the contributors wish to bring to Treasury's attention is that, as things currently stand, most custody services relating to digital assets are provided from outside Australia. At least in the short term, the contributors anticipate that this trend will continue, due to the lack of appropriate market infrastructure within Australia. This should be taken account in the design of the legislation.

Other regulatory issues

29. As the contributors have noted earlier in this submission, the regulation of digital asset platforms under Chapter 7 of the Corporations Act should not be considered in isolation from other issues in the digital assets eco-system, which warrant regulatory attention. Treasury will be aware of other legal frameworks that would benefit from detailed review to identify any areas of complementary regulatory reform.

30. With this in mind, the contributors have identified the following important considerations:

(a) there are numerous important issues relating to tax treatment of digital assets that need to be addressed as a priority to ensure consumer protection and promote innovation, one of them being to enshrine the status of digital assets as 'property' in the tax legislation;

(b) digital asset platform providers should have access to the Australian banking system (that is, be able to open bank accounts in Australia to conduct their Australian business);

(c) regulated entities should be incentivised to proactively collect and share intelligence about scams involving digital assets that target Australian consumers;

(d) digital asset exchanges should be required to provide information about their sources of liquidity in the public domain for the benefit of regulators, consumers and other stakeholders;

(e) decentralised autonomous organisations (**DAOs**) are being increasingly used for digital governance, and Australia should consider whether to follow in the footsteps of some other jurisdictions and recognise DAOs as legal entities; and

(f) the role of major digital asset platforms as critical infrastructure should be considered in the context of potential regulation under the *Security of Critical Infrastructure Act 2018* (Cth).

Contact

31. The Law Council would welcome the opportunity to continue to engage with Treasury in this important law reform process. Please contact John Farrell, Executive Policy Lawyer, on [redacted] or at [redacted] in the first instance.

Yours sincerely

Luke Murphy
President

Appendix A – Responses to Proposals Paper Question Sets

Question	Response
2. Regulating digital asset intermediaries	
2.4 Focus of the proposed framework	
Questions (Set 1) Prior consultation submissions have suggested the Corporations Act should be amended to include a specific 'safe harbour' from the regulatory remit of the financial services laws for networks and tokens that are used for a non-financial purpose by individuals and businesses. What are the benefits and risks that would be associated with this? What would be the practical outcome of a safe harbour?	It is noted that a safe harbour would lengthen the period of consumer and investor risk posed by the current lack of industry regulation. However, the contributors consider that it would be a pragmatic measure as the industry navigates required behavioural change and more importantly widespread appropriate levels of licensing (including appropriate authorisations). The design of any proposed safe harbour would require detailed consideration as to objectives, design, practical implementation and ways to promote adoption.
3. Licensing digital asset intermediaries	
3.1 Standard AFSL obligations	
Questions (Set 2) Does this proposed exemption appropriately balance the potential consumer harms, while allowing for innovation? Are the proposed thresholds appropriate? How should the threshold be monitored and implemented in the context of digital assets with high volatility or where illiquid markets may make it difficult to price tokens?	The contributors support the general proposition of a regulatory 'safe harbour' to foster innovation, promote certainty and prevent regulatory arbitrage. However, in recognising that digital assets are not a homogenous asset class and are used for a variety of financial and non-financial purposes, the contributors recommend that Treasury consider imposing conditions to be met by digital asset facility providers in order to access safe harbour protection, which may include: • appropriate disclosure requirements, regarding the nature of the assets held, and relevant tax information; and • adhering to best practice guidelines for consumer protection.

Question	Response
	It will be important to ensure a reasonableness standard is applied so as not to undermine the purpose of the safe harbour protections by imposing an overly onerous burden on the digital asset facility provider in meeting the conditions. Given the high volatility in prices of digital assets, the contributors suggest that Treasury consider applying safe harbour protections in the context of calculating the value of digital assets for the purposes of the exemption thresholds (Info Box 3 of the Proposal Paper—see response to the Set 2 questions below) and general net tangible assets (**NTA**) for the purposes of meeting the financial requirement threshold (Info Box 6—see response to the Set 4 questions below). It is noted that a safe harbour would lengthen the period of consumer and investor risk posed by the current lack of industry regulation. However, the contributors consider that it would be a pragmatic measure as the industry navigates required behavioural change and more importantly widespread appropriate levels of licensing (including appropriate authorisations).
Questions (Set 3) What would be the impact on existing brokers in the market? Does the proposed create additional risk or opportunities for regulatory arbitrage? How could these be mitigated?	The contributors agree that the regulatory perimeter should be maintained, and that therefore brokers who are providing financial services should be required to hold an AFSL.
Questions (Set 4) Are the financial requirements suitable for the purpose of addressing the cost of orderly winding up? Should NTA be tailored based on the activities performed by the platform provider? Does the distinction between total NTA needed for custodian and non-custodian make sense in the digital asset context?	The contributors consider that it is appropriate to impose financial / NTA requirements. As a general principle, the level of NTA required should be a reflection of the risk of potential consumer harm associated with a particular activity. The contributors consider that, rather than spelling out the detail of NTA requirements in the Corporations Act, the Corporations Act should allow for financial / NTA requirements to be prescribed by delegated legislation.

Question	Response
	For example, ASIC has used legislative instruments to impose licence conditions which require particular kinds of financial service providers to hold specified levels of NTA based on the financial services they are authorised to provide. The contributors recommend a similar approach for the regulation of the digital asset intermediaries.
Questions (Set 5) Should a form of the financial advice framework be expanded to digital assets that are not financial products? Is this appropriate? If so, please outline a suggested framework.	The contributors consider that the regulatory perimeter should be maintained. Therefore, the contributors see no need to expand the financial advice framework to digital assets which are not financial products. The contributors note that it is important to consider how other consumer protection laws apply to digital assets that are not financial products, and whether they should be enhanced or improved in order to achieve their intended purpose for digital assets.
3.2 Disclosure obligations	
Questions (Set 6) Automated systems are common in token marketplaces. Does this approach to pre-agreed and disclosed rules make it possible for the rules to be encoded in software so automated systems can be compliant? Should there be an ability for discretionary facilities dealing in digital assets to be licensed (using the managed investment scheme framework or similar)?	The contributors agree that non-discretionary rules and arrangements carry less risk of consumer harm that may be associated with human action and are likely to be easier to enforce. However, it is unlikely that all risks will be eliminated. Transparency, accessibility and explainability of non-discretionary rules will be critical to achieving regulatory outcomes. *Managed investment schemes* (**MIS**)—The contributors consider that the resolution of this policy issue would benefit from more detailed exploration, discussion and consultation. The contributors consider that if a facility with discretionary rules meets the MIS definition, then it should be regulated as a MIS. Where non-discretionary rules are applied, the scheme will have a different risk profile and will require a more tailored approach to regulation ensure regulatory objectives for consumer protection can be achieved. The contributors consider that digital asset facilities should also be considered in the broader context of proposed reforms to payment system

Question	Response
	regulation, which can to some extent overlap with the licensing regime of Chapter 7 of the Corporations Act.
4. Minimum standards for facility contracts	
4.1 Minimum standards for holding assets	
Questions (Set 7) Do you agree with the proposal to adopt the 'minimum standards for asset holders' for digital asset facilities? Do you agree with the proposal to tailor the minimum standards to permit 'bailment' arrangements and require currency to be held in limited types of cash equivalents? What parts (if any) of the minimum standards require further tailoring? The 'minimum standards for asset holders' would require tokens to be held on trust. Does this break any important security mechanisms or businesses models for existing token holders? What would be held on trust (e.g. the facility, the platform entitlements, the accounts, a physical record of 'private keys', or something else)?	The contributors consider that there should be minimum standards for asset holders for digital asset facilities. However, the contributors consider that the legislation should require the asset holders to adhere to minimum standards, which may be separately prescribed in a legislative instrument. There should be separate, more detailed consultation on the development of the minimum standards to ensure that they are fit for purpose.
Questions (Set 8) Do you agree with proposed additional standards for token holders? What should be included or removed?	In principle, the contributors consider that additional standards for token holders are appropriate. Again, the contributors consider that it would be more appropriate for the legislation to require token holders to meet minimum standards, but then prescribe the minimum standards in a legislative instrument after undertaking a suitable consultation process. The contributors note that there are existing arrangements in place which may not comply with the new standards and may not be able to do so without incurring significant expense. The contributors consider that the framework should recognise that it is easier for new entrants to design and structure their asset holding arrangements to meet the new standards than for existing businesses with established arrangements. The contributors envisage that

Question	Response
	compliance with new standards will be particularly challenging for smaller operators. Therefore, the contributors would welcome some provision for grandfathering in recognition of this difficulty.
4.3 Minimum standards for transactional functions	
Questions (Set 9) This proposal places the burden on all platform providers (rather than just those facilitating trading) to be the primary enforcement mechanism against market misconduct. Do you agree with this approach? Should failing to make reasonable efforts to identify, prevent, and disrupt market misconduct be an offence? Should market misconduct in respect of digital assets that are not financial products be an offence?	As a matter of principle, the contributors consider that it is appropriate and in the interests of systemic stability to require platform providers to, at a minimum, take reasonable steps to monitor trading activities. The contributors consider that this policy proposal needs to be developed in further detail with deeper analysis of existing financial market laws and how they might apply in a digital asset context. This would include, for example, articulating what 'reasonable efforts' would require of platform providers, noting for example that digital assets can be traded across multiple platforms and jurisdictions. The primary policy objective should be clarified. Is the desired outcome enforcement by platform providers to the best of their abilities or is the prevention of systemic harm better served through information gathering through measures such as mandatory reporting? Further careful consideration should also be given to the approach to offences/penalties to identify a fit for purpose regime that reflects the practical realities of the industry and provides enforcement outcomes commensurate to the harm in the circumstances rather than a one size fits all approach. The contributors do not consider that Chapter 7 market misconduct rules should apply to digital assets which are not financial products. However, it would be appropriate to consider how other consumer protection laws apply to such digital assets, and whether they would benefit from reform.

Question	Response
5. Minimum standards for "financialised functions"	
5.1 Token trading	
Questions (Set 10) The requirements for a token trading system could include rules that currently apply to 'crossing systems' in Australia and rules that apply to non-discretionary trading venues in other jurisdictions. Do you agree with suggested requirements outlined above? What additional requirements should also be considered? Are there any requirements listed above or that you are aware of that would need different settings due to the unique structure of token marketplaces?	As a matter of principle, the contributors consider that if a token trading system is performing similar functions to a financial market trading system, then similar rules should apply. The contributors consider that this policy proposal needs to be developed in further detail with deeper analysis of existing financial market laws and how they might apply in a digital asset context, including whether a light touch regime could offer valuable consumer protection and achieve regulatory policy objectives.
5.2 Token staking	
Questions (Set 11) What are the risks of the proposed approach? Do you agree with suggested requirements outlined above? What additional requirements should also be considered? Does the proposed approach for token staking systems achieve the intended regulatory outcomes? How can the requirements ensure Australian businesses are contributing positively to these public networks?	The contributors consider that it is appropriate to differentiate between 'staking' for the purpose of participating in a validating transaction on a public market (which may be essential for the orderly operation of the relevant network) and 'staking' in a more speculative sense with a view to generating an investment return. The contributors consider that the latter form of 'staking' should be regulated in a similar manner to a financial investment.
5.3 Asset tokenisation	
Questions (Set 12) How can the proposed approach be improved?	The contributors do not seek to comment on policy goals.

Question	Response
Do you agree with the stated policy goals and do you think this approach will satisfy them?	The contributors note that the proposed requirements are quite specific and are uncertain whether there is sufficient flexibility in the proposed regime to accommodate the full spectrum of digital asset platforms. The contributors are also conscious that digital asset platforms are rapidly evolving, and the proposed requirements may not be particularly 'future-proof'. Therefore, the contributors query whether the primary legislation should be more principles based, and for legislative instruments and/or guidance to be used to deal with specific and emerging issues.
5.4 Funding tokenisation	
Questions (Set 13) Is requiring digital asset facilities to be the intermediary for non-financial fundraising appropriate? If so, does the proposed approach strike the right balance between the rigorous processes for financial crowdsource funding and the status quo of having no formal regime? What requirements would you suggest be added or removed from the proposed approach? Can you provide an alternate set of requirements that would be more appropriate?	The contributors consider that activities which are, in substance, functionally similar to crowdsourced capital raising activities ought to be regulated in a similar manner. The contributors consider that this policy proposal should be developed in further detail and form the subject of a standalone consultation process (similar to the process that was used to introduce the current crowdsourced funding rules into the Corporations Act).
6. Other activities	
Questions (Set 14) Are there alternate approaches that should be considered which would enable a non-financial business to continue operating while using a regulated custodian?	Broadly, the contributors agree that the regulatory perimeter for businesses using tokens for reasons other than 'financialised functions' should be maintained. The contributors are comfortable with the proposal for the custodian to be regulated under the financial services laws.

Question	Response
	However, the contributors consider that it is important to consider how other consumer protection laws might apply to tokens which are used for non-financial purposes. The contributors are also conscious that the use of tokens is an evolving landscape, and it is critical that the legislative framework remains fit for purpose.
Questions (Set 15) Should these activities or other activities be added to the four financialised functions that apply to transactions involving digital assets that are not financial products? Why? What are the added risks and benefits?	The contributors note that the debenture-like arrangements and margin lending-like arrangements are not in scope for the proposal paper. The contributors would welcome greater clarity and consider that ideally the legislation should be designed to minimise the risk of regulatory arbitrage (that is, avoiding regulation by using digital assets rather than money to engage in activities which are functionally similar to regulated activities).
7. Next steps	
Questions (Set 16) Is this transitionary period appropriate? What should be considered in determining an appropriate transitionary period?	The contributors are concerned that a 12-month transitionary period may not allow sufficient time for affected entities to apply for licences and have their licences assessed by ASIC. The contributors note that the transition period for Chapter 7 of the Corporations Act was 24 months and considers that 24 months would be more reasonable than 12 months. It is critical that there is adequate resourcing dedicated to licensing and industry education to ensure that relevant entities become licensed and are able to comply with the relevant laws by the end of the transition period.