gadens

ABN 30 326 150 968

ONE ONE ONE
Level 11
111 Eagle Street
Brisbane QLD 4000
Australia

GPO Box 129
Brisbane QLD 4000

T +61 7 3231 1666
F +61 7 3229 5850

gadens.com

31 October 2022

Senator Andrew James Bragg
Chair of Economics References Committee
Deputy Chair of Economics Legislation Committee
GPO Box 5411
Sydney NSW 2001

By email: senator.bragg@aph.gov.au

Dear Senator Bragg

Digital Assets (Market Regulation) Bill 2022 – Consultation Paper

Gadens Lawyers appreciates the opportunity to make a submission in relation to the *Digital Assets (Market Regulation) Bill 2022* (**Digital Assets Bill**) released on 19 September 2022.

Gadens is a leading law firm which advises Australian and global financial institutions, exchanges, funds, token issuers, financial intermediaries and fintechs on digital assets and financial services regulation. Liam Hennessy, Partner, is a leading specialist in financial services regulation and academic at Griffith University.

The need for effective regulation

1. The digital assets landscape needs effective regulation. For firms, to conduct their businesses and compete globally with certainty. For increasing numbers of retail and institutional consumers, to invest with greater understanding and protections.

2. The *idea* behind the Digital Assets Bill is well placed. That is, that there needs to be some form of licensing certainty regarding digital assets. We commend you for advancing the needs of an industry which will be fundamental to the Australian economy in the coming decade. Blockchain technology's potential far exceeds the confines of the financial services industry, though it is within this industry that the first rules will be created. It is critically important that they are good ones.

3. The *execution* of Digital Assets Bill in its current form needs work. We acknowledge that you have said that the Digital Assets Bill is very much a draft, the purpose of which is to push the Government along in the regulation of digital assets - which we wholly agree with. We have set out areas the bill can be improved and, with key industry firms themselves, would be delighted to contribute to the further development of the Digital Assets Bill.

'Crypto asset' definition is far too broad

4. The Digital Assets Bill's definition of Digital Asset[1] in its present form would give Australia one of the most onerous forms of digital asset licensing in the world.

5. While the US's Lummis-Gillibrand legislation effectively divides digital assets into three categories (i.e. those which are commodities, securities and ancillary assets), and the EU's Markets in Crypto-Assets Regulation effectively divides digital assets into four categories (i.e. securities, electronic money tokens, asset referenced tokens and utility tokens), the Digital Assets Bill makes no such distinction.

6. Every digital asset which falls within the broad definition in the Digital Assets Bill would be subject to onerous licensing, which largely frames them as quasi financial products to be regulated by ASIC. It would capture NFTs for artwork or music, for example, which hardly need ASIC's expertise!

7. This is especially true due to the fact that in the coming future we could start seeing these digital assets switching from standard art based to online game based items all the way up to ownership of real world asset based e.g. gold bullion, real estate, fractionalized collectables while also being able to earn rewards via staking or voting on proposals through a DAO, which is why we need defined granularity as crypto assets are not a one size fits all asset class. They are exceedingly variable.

8. Far more granularity is needed with the definition, following in footsteps of overseas jurisdictions, lest unnecessary regulatory weight be placed on the Australian firms. This, of course, will decrease their global competitiveness and create the barrier to entry for overseas businesses.

9. We suggest a functional approach to classification of digital assets, as has been adopted in other jurisdictions. The test could be whether the crypto token functions as a "financial product", a commodity, a service (utility), money or service another function at the time of the relevant transaction. Based on the function served, the form of regulation should follow.

10. The Digital Assets Bill should be limit the type of crypto assets which warrant regulation as quasi financial products. Right now, that is all the Digital Assets Bill does i.e. regulate them all as such.

The legislation lacks detail

11. The US's Lummis-Gillibrand bill is 168 pages when printed. The EU's Markets in Crypto-Assets Regulation is 380 pages when printed. The Digital Assets Bill is a mere 35 pages when printed.

12. Brevity in policymaking is commendable, though not where the heavy lifting is deferred to future regulations to the extent the Digital Assets Bill often provides mediocre guidance at best. For example, under s. 10(2), the "*Digital Asset Exchange Requirements"* to be set in the future for crypto

[1] *"**Digital Asset** means a digital representation of value or rights (including rights to property), the ownership of which is evidenced cryptographically and that is held and transferred electronically by:*

- *a type of distributed ledger technology; or*
- *another distributed cryptographically verifiable data structure."*

exchanges are to cover *"…the regulation of the conduct of the exchange's participants and protections for the exchange's participants in relation to their participation".* These words offer little insight to readers.

13. Another example under s. 10(1) is that there needs to be the "*fair, orderly and transparent operation of digital asset exchanges"* what does this mean in the context of an emerging asset class? This is a traditional ASIC market operator requirement, and there are only a bare handful of those in Australia such as the ASX and SSX. Imposing this requirement on private exchanges, which are more comparable to FX money remittance businesses, seems unnecessary and onerous.

14. The same issue crops up again throughout the legislation, including under section 14 which relates to "Digital Asset Custody Requirements", and section 17 which relates to "Stablecoin Issue Requirements". The content of these future regulations is set in similarly vague terms.

15. Legislation is cumbersome to change, so secondary rules in the form of regulations are a necessary feature of policymaking. They shouldn't usurp the primacy of legislation though, as the ALRC's work in relation to the *Corporations Act 2001* (Cth) shows. In the case of the Digital Assets Bill they clearly will, with the result that Australian digital assets business and consumers will potentially have greater uncertainty than their international peers.

Previous consultation points missed?

16. It seems there are some fundamental structural issues raised during the past consultation which have not been addressed. For example, does Australia *really* need a brand-new regulatory licence which essentially mutates the existing Australian Financial Services Licence? That will potentially cause confusion, and complexity.

17. Instead, we could take the path of modifying the familiar AFSL regime for crypto assets which require regulation. For example, scaling some of the regime's more onerous conditions back for simple crypto assets and keeping them in full for some of the more complex ones e.g. OTC products.

18. As stated above, this is not to suggest that all crypto assets require additional regulation – many do not, and arguably the US's Lummis-Gillibrand bill and EU's Markets in Crypto-Assets rules do not have enough definitional granularity. The Digital Assets Bill has none at all, but this is critical. An NFT for art or music or utility token should clearly not require a licence, whether a modified AFSL or otherwise. Many – perhaps most - other digital assets should not require a license to trade or issue.

Other ideas

<u>Property</u>

19. The question of whether digital assets area property or information/data in a legal sense needs to be addressed in the legislation. It is arguable at common law, and there are no *Australian* cases on point. The UK has entrusted an independent body made up of high court judges, lawyers and law professors to study the digital assets space and recommend ways to govern it. In that context, Prof. Sarah Green, the commissioner for commercial and common law, has recommended creating a new

category (i.e. in addition to “things in possession” like a copy of the Fin Review and “things in action” like a negligence claim) that would enable digital assets to be treated like personal property.

20. It is fraught for Australian policymakers to proceed to make financial services regulations on the assumption that digital assets are property at common law (as the ATO would, arguably mistakenly, have things). The Digital Assets Bill needs to contain a short legislative piece of guidance which judges can then develop.

Incentives

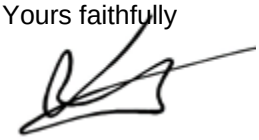
21. The Lummis-Gillibrand legislation also removes small-scale purchases of goods and services from tax implications by making it tax-free on crypto transactions with a value of less $USD 200. Naturally, this assists digital assets that act more like a currency, and is something that should be strongly considered being adopted in Australia for that reason. It, together with other tax incentives reposed in the Lummis-Gillibrand legislation, should also be considered from a macro-economic perspective of attracting business to Australia.

The idea behind the Digital Assets Bill is a commendable one, but the rules themselves require more detail. Specifically, with an eye to the developments in the US, EU and UK. Given the importance of the digital asset industry to Australia, we cannot afford to have a lack of rules. We can even less afford to have ones which are not on the cutting edge compared to our global economic peers.

We would be delighted to provide any further comment, or assistance in contributing to the further development of the Digital Assets Bill on a *pro bono* basis. The legislation is important to Australia, and we are here to fully assist.

Please contact the writer on at liam.hennessy@gadens.com or on (07) 3114 0291 if you wish to discuss our submission.

Yours faithfully



Liam Hennessy
Partner