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Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

The Committee

Digital Assets (Market Regulation) Bill 2023

Thank you for the opportunity to submit a response to the consultation regarding the draft *Digital Assets (Market Regulation) Bill 2023* (**Digital Assets Bill**).

Our submission and comments are set out in the enclosed Appendix. This submission has been prepared by Michael Bacina, Partner and Steven Pettigrove, Special Counsel of the Blockchain Group and Financial Services and FinTech team at Piper Alderman. The comments within are the authors' own and do not necessarily represent the views of the Piper Alderman partnership.

Please do not hesitate to contact us if you have any queries concerning any aspects of this submission.

Yours faithfully
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Appendix

Executive Summary

Advancements in blockchain, digital assets and distributed ledger technology continue to gather pace, opening pathways for innovation in a wide range of fields including finance, real estate, supply chain, entertainment and ticketing, social media, music and the arts. The development of a bespoke legislative framework is necessary to enhance consumer protection and support innovation to enable Australians to fully grasp the opportunities and efficiencies unlocked by blockchain technology.

Many jurisdictions around the world including the European Union (**EU**), United States (**US**), the United Kingdom, Singapore, and Hong Kong are actively exploring and implementing new regulatory frameworks for the issuance and trading of digital assets. By moving in step with other jurisdictions in establishing a broadly based legislative regime, Australia can retain and attract young and highly skilled workers to support domestic innovation and industry in Web3 technology.

We welcome the Australian Government's Token Mapping Consultation Paper and the Government's efforts to progress a legislative framework for licensing and custody of digital assets. We also appreciate the Committee's and Senator Bragg's continued leadership and effort in pushing forward an Australian digital asset regulatory framework. The Digital Assets Bill is a welcome step in seeking to formulate draft legislation.

The current focus of the Digital Assets Bill is to establish a licensing and regulatory framework for digital asset exchanges, custody providers and stablecoin issuers. While these are important aspects of a digital asset licensing regime, we encourage policymakers to consider a more ambitious and comprehensive regime which would cover a broader range of digital asset services and intermediaries, such as market makers, brokers, underwriters and digital asset advisors. A comprehensive framework should also offer a regulated pathway for start-ups and token issuers who will otherwise leave Australia to establish operations in other jurisdictions such as the EU or Singapore.

The EU's Markets in Crypto-Asset Regulation (**MiCA**) offers a workable model for a comprehensive framework for regulating digital assets which sits alongside and complements existing financial services laws. MiCA covers a wide range of crypto-asset service providers and crypto-asset and stablecoin issuers and includes market integrity provisions.[1] The full text of MiCA was formally ratified and adopted by the European Parliament on 20 April 2023, and has since been approved by the European Commission. It will enter into force after 18 months from the date of official publication. MiCA is the most comprehensive international precedent and standard currently available for digital assets regulation.

[1] https://data.consilium.europa.eu/doc/document/PE-54-2022-INIT/en/pdf.

Given the likely impacts of MiCA, we recommend that consideration be given to implementing a more ambitious regime that embraces certain concepts in MiCA in formulating Australia's own digital asset services licensing and regulatory regime.

To provide practical suggestions for the next draft of the Bill, this submission outlines a few key areas that we believe could be addressed by reference to regulatory developments in other jurisdictions.

As further discussed below, we recommend that the Digital Assets Bill explicitly exclude non-fungible tokens (**NFTs**), tokenised financial instruments and decentralised platforms. This would follow the EU's approach under MiCA, which excludes NFTs from its scope for separate review in due course.

We also recommend that the Digital Assets Bill:

1. Narrow the definition of "regulated digital asset" to exclude unique NFTs to exclude assets such as digital art, collectibles, in-game items and tickets and ensure technology neutral regulatory treatment;

2. Narrow the definition of stablecoins to address core risks relating to redemption and reserve requirements and encourage adoption and usage;

3. Create a regulated pathway for token issuance that is not limited to stablecoins;

4. Expand the scope of the licensing regime to cover a range of digital asset service providers consistent with the MiCA regime and address regulatory arbitrage;

5. Implement basic prohibitions on market misconduct, including insider dealing and market manipulation in relation to digital assets to promote fair, orderly and transparent markets;

6. Narrow the scope of the proposed recognition of foreign licences to foster the domestic digital asset industry, ensure consistent regulatory standards and enhance consumer protection; and

7. Extend the transition period to allow the regulator sufficient time to process licensing applications having regard to recent experience in the United Kingdom and Singapore.

Recommendation 1: Definition of digital assets

In the draft Bill, the term "digital assets" could potentially capture a wide range of assets, including cryptocurrencies, digital securities, and digital representations of tickets, art or music. The scope of the licensing and custody regime in the draft Bill is appropriately confined to a more limited subset of digital assets falling within the definition of "regulated digital asset".

However, the definition of "regulated digital asset" includes "exchange token". "Exchange token" means a kind of digital asset (other than asset-referenced tokens or electronic money tokens) the main purpose of which is to be used as a means of exchange. This is potentially very broad and is liable to catch a wide variety of tokens, including NFTs. That definition flows through to

the core sections of the Digital Assets Bill including the operation of a digital asset exchange and provision of digital asset custody services.

NFTs to be carved-out

To further aid regulatory clarity, we propose to specifically exclude unique and non-fungible tokens which do not otherwise qualify as financial products (e.g. digital art, collectibles, in-game items, tickets, proof of attendance, music) from the definition of digital assets, consistent with the EU's approach under MiCA. Many of these use cases bear little resemblance to the features of other more financial-like crypto assets. NFTs are more closely akin to digital goods, and issuers are already subject to a comprehensive consumer protection regime under the Australian Consumer Law.

The underlying analogue versions of these assets (e.g. a physical piece of art, a physical Pokémon/basketball trading card or a concert ticket) are not treated as regulated assets similar to financial products. Equally, marketplaces that sell these underlying assets (e.g. eBay, Amazon, etc) are not licensed platforms. We submit that the law should adopt a technologically neutral approach in relation to digital versions of these underlying assets.

Absent this clarity, a marketplace for art-based NFTs, collectible NFTs, or gaming NFTs (to name a few NFT use cases) could be required to comply with the same standards expected of persons carrying on a regulated financial services business. This would include minimum capital requirements, custody, record-keeping and reporting obligations.

Exclusion of financial products

The definition of "regulated digital asset" also excludes digital assets which fall within the definition of a financial product under the Corporations Act (i.e. tokenised securities would be regulated under existing laws). This is appropriate. The fact that a security is issued on a blockchain rather than on paper or in dematerialised form should not impact its regulatory treatment.

Such an approach would recognise the principle of "same risk, same regulation" while acknowledging the differences between cryptocurrencies and traditional financial products. Certain laws that apply to financial products are not readily applicable to cryptocurrencies. For example, continuous disclosure obligations do not make sense in the context of a cryptocurrency where its features are encoded upon issuance.

The Digital Assets Bill does not address the complexity of assessing whether a crypto-asset is a financial product. This is something that is difficult to effectively address in legislation. Further regulatory guidance will be necessary to define the boundaries of the financial product and digital assets regimes respectively.

Recommendation 2: Definition of stablecoins

The current definition of stablecoins is broad and would cover a wide variety of digital assets, including wrapped tokens as well as algorithmic stablecoins. The current stablecoin definition includes an "asset-referenced token" which purports to maintain a stable value by reference to one or more fiat currencies, commodities, digital assets or some combination of the same and

an “electronic money token” which purports to reference the value of a single fiat currency. Both definitions are potentially very broad.

At this time, it is appropriate to limit the definition to stablecoins which purport to be pegged to a single fiat currency to address the specific risks relating to these assets (e.g. redemption and reserve requirements) and to encourage the adoption and usage of stablecoins as a means of payment. This approach would effectively ban algorithmic “stablecoins” (e.g. TerraUSD, the stablecoin behind the Luna collapse) which purport to be pegged to a single currency but which do not meet reserve requirements under legislation. Consideration may also be given to identifying systemically important stablecoins which are subject to enhanced regulatory oversight.

This approach would be consistent with global regulatory trends. MiCA seeks to regulate fiat-backed and collateralised stablecoins and imposes additional requirements on significant e-money and asset referenced tokens. The proposed *Responsible Financial Innovation Act* (**RFI**) in the US focuses on payment stablecoins which are redeemable for US dollars. Singapore’s proposed amendments to its *Payment Services Act* would regulate so-called single currency pegged stablecoins (**SCS**), which have a stronger use case for payment and settlement.[2] Late last year, the Monetary Authority of Singapore undertook a consultation seeking comment on whether systemic stablecoin arrangements should be subject to higher regulatory and supervisory standards.[3]

Recommendation 3: Token issuance

We propose a more ambitious draft of the Digital Assets Bill which provides a pathway for regulated token offerings in addition to stablecoin offerings.

In our view, the token issuance provisions under MiCA represent a potential game changer by establishing a regulated pathway for token issuance and basic consumer protections for consumers. The relevant protections include professional obligations for issuers, minimum disclosure and notification requirements for Whitepapers, and restrictions on misleading marketing and promotions. Token issuers will also need to provide an explanation of why the relevant crypto-asset is not a financial instrument or other regulated product.

In the absence of a regulated pathway for token issuance, entrepreneurs and software developers will leave Australia to build blockchain startups and applications where there is greater regulatory clarity in relation to token issuance. The regulation of intermediaries represents a partial solution only. Creating a minimum set of standards for token issuance in Australia will serve to provide regulatory clarity and is likely to encourage a new wave of product innovation in a range of fields.

In the absence of a regulated pathway, token issuance will take place overseas under local laws. Paradoxically, tokens issued overseas may nevertheless trade as regulated tokens on secondary markets in Australia.

2 https://www.mas.gov.sg/-/media/MAS-Media-Library/publications/consultations/PD/2022/Consultation-on-stablecoin-regulatory-approach_PUBLISHED.pdf.
3 Ibid.

Recommendation 4: Digital asset and custody services

The Digital Assets Bill should be extended to cover other types of crypto asset intermediaries consistent with the MiCA regime (e.g. market makers, brokers, underwriters and those providing advice in relation to digital assets).

A broadly based regime is likely to promote the growth of the domestic digital asset industry in Australia which otherwise risks being substantially based offshore. A limited regime which focuses only on exchanges may encourage regulatory arbitrage and inadvertently encourage the establishment of unregulated digital asset brokers and other intermediaries.

Minimum requirements should be specified relating to the admission of digital assets to trading on an exchange. For example, issuance should be in accordance with a regulated token offering regime, subject to appropriate grandfathering provisions.

It would be beneficial to clarify what constitutes “operating” for the purposes of the Digital Assets Bill insofar as it pertains to the operation of a digital asset exchange and licensing requirements. Decentralised digital asset exchanges generally operate by virtue of user interaction with smart contracts and typically do not involve a centralised intermediary having custody of assets. For this reason, decentralised exchanges do not present the same risks to consumers as centralised platforms. Further, a number of the Digital Asset Exchange Requirements in Section 11 do not readily apply to decentralised platforms, such as minimum capital requirements or segregation of assets.

Development and deployment of smart contract code does not necessarily constitute operation of a digital asset exchange. Where a person or group of people are able to augment or upgrade the underlying smart contract software, this action should, in our opinion, be considered separately to the management and control of a centralised exchange. Development and deployment of code, including through upgrades, tweaks and patches, should not trigger a raft of regulatory requirements akin to that imposed upon centralised exchanges.

It may be appropriate to consider alternate licensing requirements which are specifically tailored to decentralised platforms, including code/security audits, in future in line with the development of this technology. For the time being, crypto asset services that operate in a fully decentralised manner should fall outside the framework, consistent with MiCA.

We would encourage the adoption of a licensing regime which applies to all digital asset intermediaries to ensure consistent regulatory standards. The fact that an intermediary already holds an Australian Financial Services Licence does not necessarily mean that it will have the necessary expertise and experience to provide digital asset services. A single licensing standard for digital assets is also likely to be more readily understood by Australian consumers.

Finally, we submit that the definition of “digital asset custody service” should be clarified such that the licensing requirements only cover intermediaries who have the ability to initiate a transaction in respect of client assets without reference to a client. This would exclude from the definition non-custodial software wallet applications which generally do not permit the software developer to control customer assets or initiate transactions on their behalf.

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Recommendation 5: Market Integrity

Consideration should be given to implementing basic market integrity rules which would enable regulators to target misconduct in digital asset markets such as insider dealing and market manipulation. While these activities may be restricted under state-based fraud laws, there is currently substantial uncertainty as to whether they are covered by market conduct provisions under the Corporations Act. Crypto intermediaries should also be required to implement appropriate conflicts rules to curb proprietary trading which may adversely impact consumers.

MiCA contains specific prohibitions on insider dealing and market abuse. Singapore and Hong Kong have proposed or are in the process of implementing similar prohibitions on these types of behaviours which undermine fair, orderly and transparent markets.

Recommendation 6: Foreign licences & passporting

Foreign digital asset exchanges and custodians which offer services to Australian retail investors should be obliged to seek a domestic licence in order to promote full compliance with Australian regulatory standards and facilitate domestic recourse for consumers.

The MiCA regime requires Crypto-Asset Service Providers to establish an EU presence, have at least one local director and imposes strict reverse solicitation requirements. A similar regime would serve to foster the domestic digital assets industry and ensure minimum compliance standards across the sector.

Section 21 of the Digital Assets Bill contemplates that foreign stablecoin issuers may be taken to be issuing the stablecoin in this jurisdiction where the person issuing the stablecoin engages in conduct that is intended to induce people in Australia to use the stablecoin or is likely to have that effect. In that context, consideration should be given to whether it is appropriate to permit foreign stablecoin issuers to issue and offer stablecoins (in particular, Australia dollar-backed stablecoins) under a recognised foreign licence in accordance with Section 31.

It is likely to be more difficult for Australian consumers to assess the risks of purchasing stablecoins regulated under overseas regulatory regimes and seek recourse against foreign issuers.

In the context of globally available stablecoins, Singapore is considering a passporting regime whereby the regulator would need to be satisfied that a fiat-pegged stablecoin offered in multiple jurisdictions is appropriately regulated in each jurisdiction in order to become licensed for issuance in Singapore.[4]

Recommendation 7: Transition period

It is our view that a three-month transition period is likely too short based on past experience in other jurisdictions, such as the UK and Singapore, where there have been lengthy delays in processing applications to register with financial conduct regulators. It is likely that additional time will be required after legislation is enacted for the preparation of appropriate regulations

4 https://www.mas.gov.sg/-/media/MAS-Media-Library/publications/consultations/PD/2022/Consultation-on-stablecoin-regulatory-approach_PUBLISHED.pdf.

and guidance in advance of the regime coming into force. ASIC will also need to be allocated sufficient resources to deal with licensing applications.

The EU is proposing a 12 to 18 month transition period under MiCA. Article 123 of MiCA provides for grandfathering arrangements in respect of existing crypto-assets and transitional arrangements for existing crypto-asset service providers. Hong Kong is proposing a 12 month transition under its licensing regime.

Regulated businesses will also need to develop new infrastructure and processes to comply with the new law once the details of the new regime become clear. Implementation takes time. Compliance frameworks will need to be built, technology will need to be sourced, implemented and integrated, staffing and resourcing requirements will need to be addressed and training will need to occur.

We recommend a 12 to 18 month transition period to allow new and existing entities the chance to comply with legislation consistent with the MiCA regime. Providing for a sufficient transition period will be key to ensuring that the new protections are properly implemented and that the necessary regulatory resource and supervisory arrangements are in place.

Thank you for considering our submission.