creo

Contact: David Chung
Email: david@creolegal.com.au
Phone: +61 414 700 599
Our Ref: 1

19 May 2023

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

By way of lodgment

Dear Committee,

SUBMISSION BY CREO LEGAL TO DIGITAL ASSETS (MARKET REGULATION) BILL 2023

About Creo Legal

Creo Legal is a boutique commercial law firm which has serviced clients in the web3, crypto, and digital assets (**Crypto**) space since 2017. On average, 75% of our clients are startups or early-stage ventures, and half of those have a connection with Crypto. We act for digital asset exchanges, Crypto project founders, investors, and service providers.

In the absence of Crypto-specific legislation (other than in relation to anti-money laundering and counter-terrorism financing) and a historical body of case law, the advice we have given to our clients has relied heavily on a methodology involving reasoning from first principles. We continue to adopt this approach to this day.

We consider ourselves to be a Crypto-native law firm. In our approach to advising Crypto-related clients, we give due consideration to, but are ultimately unrestrained by, the unwritten customs or norms of established industries such as financial and professional services, real estate, retail goods and services, gaming and wagering, and others. This touches on the essence of the Crypto industry which breaks boundaries in all directions, legally, socially, politically, and technologically.

Submission

We wish to avoid diluting our message and accordingly we comment only on the following provisions of the Digital Assets (Market Regulation) Bill 2023 (the **Bill**):

1. **Part 1, section 5 (Definitions)**

   (a) **Regulated digital assets**

   The definition of 'regulated digital asset' excludes financial products within the meaning of the *Corporations Act 2001* (Cth) (the **Corporations Act**). However, in our

view, many tokens which might fall under the definitions of 'asset-referenced token', 'electronic money token', and 'exchange token' have the potential (in many cases a high potential) to be financial products under the Corporations Act.

This does nothing to dispense with the current uncertainty about the application of the Corporations Act to any Crypto-related business.

The number of tokens which would clearly fall under the Bill would be a relatively small proportion of existing tokens. Due to the composability of Crypto-related products and the advent of decentralised finance, the Crypto space is highly financialised and is likely to remain as such. Consequently, the tokens captured by the Bill relative to the total number of tokens available in the market is likely to diminish over time.

Whether this is a problem depends on the intended approach. Do we want the Bill to regulate Crypto as a whole, or do we want the Bill to regulate a diminishing proportion of Crypto? We prefer the former, as the latter would ensure the obsolescence of the Bill within a relatively short timeframe (perhaps as short as 5 years).

(b) **Exchange tokens**

The term 'exchange token' is commonly used in the Crypto space to refer to tokens released by centralised Crypto exchanges. This is likely to cause public confusion about the application of the Bill.

In our view, the definition of 'exchange token' excludes the following token types, even though such tokens are commonly traded (in Crypto-to-Crypto or Crypto-to-fiat transactions on both centralised and decentralised digital asset exchanges) and used as means of exchange:

(i) non-fungible tokens (NFTs), which currently primarily consist of digital art and collectibles, but will eventually extend in application to digital representations of any non-fungible right or property, including contractual rights (e.g. a right to enforce an obligation on a third party) or proprietary rights (e.g. an interest in real estate);

(ii) governance / voting / membership tokens, which are intended to allow holders to participate in voting or community events;

(iii) utility tokens, which are intended to have utility in online products, services, or ecosystems (e.g. loyalty tokens giving users early access to products offered by a retailer).

These are incredibly large categories of tokens which are excluded from the application of the Bill by virtue of not having the 'main purpose' of being used as a means of exchange, which the definition of 'exchange token' currently requires.

We speculate that the number of tokens which will have the main purpose of being a means of exchange will diminish over time. Most tokens in the future will have

other main or predominant purposes, but most (if not all) of them will also be capable of being used as means of exchange (such as on decentralised digital asset exchanges).

Similar to our comment above, this goes to the issue of whether this Bill is intended to regulate Crypto as a whole, or only a small proportion of it. It also raises the question of legislative obsolescence and what timeframe would be acceptable considering the speed of legislative reform as compared to technological development in the marketplace.

(c) **Digital asset custody services**

The definition of digital asset custody services should expressly include escrow services to avoid doubt.

It is also not clear to us whether smart contract-based services are intended to be caught by this definition. For example, staking services involve a smart contract holding or locking the staked assets. Is a staking service provider providing a digital asset custody service?

We consider it prudent to expressly exclude services based on smart contracts.

2. **Part 2, section 11 (Digital Asset Exchange Requirements)**

Consider adding the following to the Digital Asset Exchange Requirements:

(a) maximum debt to asset ratios – to preclude high risk commercial activities; and

(b) disclosure requirements for arrangements with third parties for market making, liquidity provision, and related services – to ensure that such arrangements to not pose a risk to consumers.

3. **Part 2, section 13 (When an exchange is taken to be operated in Australia)**

This provision is likely to result in all digital asset exchanges around the world geo-blocking Australia. Australians will then be cut off from accessing the world of Crypto, even where the intended activity may not pose an undue risk to them.

Given Australia's relatively small market size on the global scale, we do not think it is likely that this will encourage overseas digital asset exchanges to become licensed in Australia. Indeed, it is likely that the provision will discourage:

(a) Crypto-related businesses (small and large) from entering the Australian market, or continuing to conduct business in Australia;

(b) foreign investors from investing in Australia; and

(c) skilled workers in the Crypto industry from migrating to Australia.

In our view, a digital asset exchange should only be considered to operate in Australia if it has a permanent place of business in Australia, or exceeds a threshold of say five percent (5%) of its total users being Australian residents.

4. **Part 2, section 17 (When a digital asset custody service is taken to be operated in Australia)**

We repeat our comments in relation to Part 2, section 13, which also apply to digital asset custody services.

5. **Part 2, section 21 (When stablecoins are taken to be issued in Australia)**

We repeat our comments in relation to Part 2, section 13, which also apply to stablecoins.

6. **Part 7, section 51 (Transition period)**

A three (3) month transitionary period is an unreasonably short a period of time to expect businesses who currently operate legitimately to comply with a new regulatory and licensing framework.

In our estimation, most businesses in the Crypto space are still in startup phase and operate with limited capital and tight budgeting. Such businesses are likely to require additional funding to obtain the required professional advice and assistance to move into compliance with a licensing framework. Some businesses, such as digital asset exchanges, may require all three licences required by the Bill.

To allow Crypto businesses to fully understand and prepare to comply with a licensing framework, and raise the additional funding required to do so, in our view a twelve (12) month transitionary period would be more appropriate and reasonable.

We are open to engaging in further discussions with government and industry participants on a public or private basis.

Yours faithfully
Creo Legal

David Chung
Founding Director