DIGITAL LAW ASSOCIATION

SUBMISSION

Digital Assets (Market Regulation) Bill 2023

May 2023

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ABOUT THIS SUBMISSION

The Digital Law Association is an organisation dedicated to the promotion of a fairer, more inclusive, and democratic voice at the intersection of law and technology.

Our mission is to encourage leadership, innovation, and diversity in the areas of technology and law by:

- bringing together the brightest legal minds in the profession and in academia to collaborate; and
- developing a network that promotes digital law, and particularly female leaders in digital law.

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Submission Process

In developing this submission, our members have engaged through email correspondence, regular video calls, and worked in teams to conduct research and prepare briefing papers about the issues dealt with in the third issues paper.

Recommendation #1	*Tiered licensing regime to allow licence obligations to be applied taking into account the nature and risks of the market and digital assets traded on the platform.*
Recommendation #2	*Consolidation of licensing powers into a single regulatory authority.*
Recommendation #3	*Clearly identify the jurisdictional nexus that must exist for foreign businesses to determine whether they are subject to the foreign licencing status requirements.*
Recommendation #4	*Government to pursue a multi agency working taxonomy on digital assets and take into account likely impacts of emerging technologies with consistency across different legislative frameworks.*
Recommendation #5	*Replace the term 'digital asset' with 'token' to ensure that the Bill, once legislated, is technology neutral, and suitably flexible to accommodate a wide range of digital asset use cases.*
Recommendation #6	*Limit application of the Bill to centralised entities.*
Recommendation #7	*Carry out further consultation on legal issues relating to decentralised autonomous organisations and their members. Noting that a key aspect of this consultation will be to identify the deterministic characteristics and potential regulatory perimeter between centralised and decentralised.*

1 Licencing regime: Digital Asset Exchange authorisation, Digital Asset Custody authorisation and Stablecoin Issuance authorisation

Recommendation #1: Tiered licensing regime to allow licence obligations to be applied taking into account the nature and risks of the market and digital assets traded on the platform.

The *Digital Assets (Market Regulation) Bill 2023* (the **Bill**) proposes a licencing regime that resembles the Australian Financial Services License (**AFSL**) administered by the Australian Securities and Investments Commission (**ASIC**) under Chapter 7 of the *Corporations Act 2001* (Cth), as well as the Australian credit licence (**ACL**) under Chapter 2 of the *National Consumer Credit Protection Act 2009* (Cth).

However, the very nature of digital assets and the broader web3 ecosystem necessitates a level of flexibility. This is in order to accommodate the fact that digital assets can evolve rapidly. A digital asset that was not previously considered a *regulated* digital asset under the Bill's definition (i.e. an asset-referenced token, an electronic money token or an exchange token) may evolve into a *regulated* digital asset, and vice versa. That is to say that any regime will need to be dynamic enough to address the evolving nature of digital assets.[1]

Digital assets represent the present and future of economic growth for Australia, but they could also pose a potential risk to society if left entirely unchecked. It is important to navigate the delicate balance between promoting innovations in the digital economy, and mitigating the risks they might pose to Australian consumers.[2] Poor regulatory choices risks stifling innovation and the digital economy in Australia. It is important to avoid unnecessary regulatory burdens and instead balance required guardrails with the need to continue promoting innovation to allow the emerging Australian tech industry to grow. The DLA believes this step is critical to recognising the important nuances that arise in relation to digital assets.

In light of this, the DLA is of the view that a 'one size fits all' licensing regime could create unnecessary regulatory burden for low-risk digital asset products.

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[1] Herbet Smith Freehills submission, *'Treasury's consultation paper on crypto asset secondary service providers'* 3 June 2022, page 5.

[2] Cornelius Kalenzi, 'Artificial Intelligence and Blockchain: How should emerging technologies be governed?' *Frontiers in Research Metrics and Analytics* (Feb 2022) (doi: 10.3389/frma.2022.801549. PMID: 35224423; PMCID: PMC8874265.).

The DLA recommends that the Bill encompass a tiered licensing regime.[3] A tiered regime would allow licence obligations to be applied in a way that takes into account the nature and risks of the market and digital assets traded on the platform.

Similar to the existing licencing regime in Parts 7.2 and 7.2A of the *Corporations Act 2001* (Cth), the applicable licence obligations to tiers of market venues would allow regulators to:

- maintain a fair, orderly and transparent market and undertake appropriate supervision of the market;
- exempt tier 2 venues from obligations that are not appropriate or unnecessarily burdensome; and
- adapt additional obligations to the nature, size and complexity of venues, which could be achieved through specific exemptions, licence conditions or both.[4]

Recommendation #2: Consolidation of licensing powers into a single regulatory authority.

Section 7 provides a simplified outline of Part 2 of the Bill ('Licensing for certain digital asset activities'). Section 7 provides that a person is required to hold a licence granted by ASIC, or a recognised foreign licence, to operate a digital asset exchange, provide a digital asset custody service or issue stablecoins in Australia. Further, the Minister may, by legislative instrument, approve a foreign licensing scheme.

Throughout the Bill, ASIC is given the function and authority of supervising digital asset exchanges,[5] granting licences,[6] imposing conditions on licences,[7] and varying, suspending, or cancelling a licence.[8] However, the Minister has the power to deem whether a person is taken to have a licence if the person has had their licence suspended.[9] Further, the Minister must cause to be maintained a register that sets out information prescribed by the rules relating to licenses.[10] The rules in Part 2 must also set out matters that must be considered by the Minister in deciding licences.[11]

The DLA recommends clarification and consistency in the delegation of powers, functions and duties of the Minister and relevant authorities throughout the Bill.

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[3] Endorsing the Law Council of Australia's submission to Treasury, Response to Crypto Asset Secondary Service Providers (CASSPrs) Consultation Paper (3 June 2022).
[4] Guidance taken from ASIC Regulatory Guide 172, Financial Markets: Domestic and overseas operators (July 2017) (https://download.asic.gov.au/media/4396002/attachment-1-to-cp293-published-20-july-2017-1.pdf)
[5] *Digital Assets (Market Regulation) Bill 2023*, s 12.
[6] Ibid, s 23.
[7] Ibid, s 24.
[8] Ibid, ss 25, 27.
[9] Ibid, s 26(2).
[10] Ibid, s 30.
[11] Ibid, s 28.

A lack of clarity in this delegation may result in practical and administrative difficulties. Further, APRA and ASIC, as statutory authorities, and the Minister, have varying jurisdictional limitations. Inconsistency in the delegation to authorities may contribute to complexity in compliance for stakeholders.

2 Cross-jurisdictional harmony

Recommendation #3: Clearly identify the jurisdictional nexus that must exist for foreign businesses to determine whether they are subject to the foreign licencing status requirements.

The Bill requires that a person hold a licence granted by ASIC, or a recognised foreign licence, to operate a digital asset exchange, provide a digital asset custody service or issue stablecoins in Australia (emphasis added).[12] However, the DLA considers that this does not clearly identify the jurisdictional nexus that must exist for foreign businesses to identify whether they are subject to the proposed legislation. A clear jurisdictional test is essential in order to attain both certainty for businesses and adequate consumer protection.[13]

Ambiguities arise when a foreign business either may not operate a permanent establishment in Australia, and/ or may not be required to hold a licence in its home country. In such a case, it is unclear whether the proposed Bill would require the foreign business to attain a licence under the regime.

This is particularly important in the context of the increasing adoption of digital assets by Australian consumers. Recent surveys indicate that in 2022, 25.6% of the Australian population owned a form of crypto-currency.[14] This is a significant increase from 16.8% in 2019.[15] With 90.8% of the Australian population having a general awareness of Bitcoin, the adoption of digital assets is likely to increase.[16] In recognising the increasing demand by Australian-based consumers to access digital exchanges, which may be foreign digital exchanges and custodians, the Bill ought to address:[17]

- whether foreign businesses (who are deemed not to hold a recognised foreign licence) will be prohibited as unlicensed digital exchanges and custodians from providing, and/or promoting, their services in Australia;

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[12] Ibid, s 4.
[13] Endorsing the Law Council of Australia's submission to Treasury, Response to Crypto Asset Secondary Service Providers (CASSPrs) Consultation Paper (3 June 2022).
[14] Statista, 'Share of people who own cryptocurrency in Australia from 2019 - 2922' <https://www.statista.com/statistics/1244739/australia-cryptocurrency-ownership/>.
[15] Ibid.
[16] Statista, 'Awareness of cryptocurrency in Australia in 2022' <https://www.statista.com/statistics/1244702/australia-cryptocurrency-awareness-by-type/>.
[17] Endorsing the Law Council of Australia's submission to Treasury, Response to Crypto Asset Secondary Service Providers (CASSPrs) Consultation Paper (3 June 2022).

- in the case that they will be prohibited, whether the Australian government ought to take steps to prevent foreign digital exchanges and custodians from providing, and/or promoting, their services to customers in Australia;
- whether a licensee will need to be a registered Australian company;
- whether Australian based consumers will have the ability to decide between use of a licenced or unlicensed digital asset exchange or custodian.

The DLA recommends that guidance should be taken from the amendments made to the *Privacy Act 1998* (Cth) by the *Privacy Legislation Amendment (Enforcement and Other Measures) Bill 2022* which was passed and commenced on 13 December 2022. That is, the DLA proposes that the sole requirement for the proposed Bill to apply to overseas companies is that the entity "carries on business in Australia." The term "carries on business" has been interpreted by the courts to mean either commercial in character or engaged in a continuous or repetitive basis.[18] By way of example, in the case of *Facebook Inc v Australian Commissioner*,[19] the Full Federal Court found that installing and managing cookies on the devices of Australian users and managing a login system for Australian developers were sufficient to constitute *"carrying on business"*.[20]

Indeed, the cross-border nature of digital assets limits the effectiveness of uncoordinated national approaches. That is, without regulatory consistency, a multi-jurisdictional stablecoin or digital asset might need to comply with securities regulations in country A, derivatives regulations in country B, banking regulations in country C and perhaps no regulations at all in country D. Without international coordination, such potential gaps could create regulatory arbitrage. While in a common law country like Australia, these gaps could be addressed through the evolution of case law as digital currencies evolve, this is a lengthy process. Instead, any regulatory approach to digital assets should be guided by interagency and international coordination in order to best bridge the gap between innovation and regulation.[21] A globally consistent and comprehensive regulatory response is vital to achieve effective digital asset regulation and supervision.

[18] Facebook Inc v Australian Information Commissioner (2022) 402 ALR 445.
[19] Ibid.
[20] Ibid, [168].
[21] World Economic Forum, 'Digital Currency Governance Consortium White Paper Series' (Compendium Report, November 2021), pp 43 - 51.

3 Proposed scope & policy objectives

Recommendation #4: Government to pursue a multi agency working taxonomy on digital assets and take into account likely impacts of emerging technologies with consistency across different legislative frameworks.

The ultimate purpose of the proposed legislation is to provide consumer protection in the digital assets market.[22] The Bill provides licence requirements for digital asset exchange and custody services, and stablecoin issuers. As such, DLA commends the Bill's regulatory focus on digital asset activity rather than technologies. Whilst this relatively technology neutral approach safeguards some industry and market change, further categories of digital assets (or an expanded definition) may be required to accommodate the dynamic digital financial market. DLA reiterates its recommendation from previous submissions to the Treasury[23] and Senate[24] that a critical measure in developing digital asset policy is a multiagency working taxonomy of crypto assets within the broader category of 'data structure' and 'data activities'.

To protect consumers in the long term, and in a time of emerging and changing technology, government should ensure that all regulatory reforms take into account likely impacts of emerging technologies with consistency across different legislative frameworks.

DLA notes that there has been a lack of regulatory attention to the interactions between artificial intelligence, quantum computing and the emerging digital assets market. DLA is of the view that these technologies have the potential to radically change how people, systems and regulatory bodies interact with digital assets and their underlying technologies.[25] For example, classical cryptography based currencies are considered relatively secure due to their encryption protocols. However, the future application of quantum computing

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[22] Explanatory Memorandum, https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/s1376_ems_66ab60ef-6c9d-4a00-a5a5-ca0c31a60fa0/upload_pdf/EM_23S012.pdf;fileType=application%2Fpdf

[23] Digital Law Association, Submission to Crypto asset secondary service providers: Licensing and custody requirements, May 2022.

[24] Digital Law Association, Submission to Third Issues Paper (Senate Select Committee on Australia as a Technology and Financial Centre), July 2021.

[25] See generally Department of Industry, Science and Resources, 'National Quantum Strategy' (Report, 2023) https://www.industry.gov.au/sites/default/files/2023-05/national-quantum-strategy.pdf; See Jose Deadoro, 'Quantum Computing and the Financial System: Spooky Action at a Distance?' (Working Paper, 2021) available via https://www.imf.org/en/Publications/WP/Issues/2021/03/12/Quantum-Computing-and-the-Financial-System-Spooky-Action-at-a-Distance-50159.

may threaten this security,[26] with quantum encryption likely being necessary. DLA recommends further research and policy consideration be done to ensure the stability, legitimacy and safety of the digital assets market. Ultimately legislation considering any digitisation of financial markets should embed flexibility in its operation to adapt to these approaching changes.

4 Proposed definitions and terminologies

Recommendation #5: Replace the term 'digital asset' with 'token' to ensure that the Bill, once legislated, is technology neutral, and suitably flexible to accommodate a wide range of digital asset use cases.

Intended outcomes

- **Technology neutrality**: the term 'token' is more neutral in terms of technology. This allows for flexibility in accommodating other use cases that may emerge in the future.
- **Consumer protection**: Technology-neutral laws are crucial for ensuring consumer protection. By focusing on the underlying principles and objectives rather than specific technologies, consumer protection can be maintained consistently, regardless of the technology used - this approach will enable regulators to address the potential risks associated with the tokens while safeguarding the interests of consumers and investors.
- **Future-readiness**: the term 'token' is less limited than 'asset' in the sense that it has the potential to encompass innovative features and characteristics distinct from economic value. It has the potential to remain more relevant and adaptable as technology evolves, avoiding potential confusion or outdated terminology.

Reasons

The DLA previously made a submission in response to the Treasury's consultation paper, 'Crypto asset secondary service providers: Licensing and custody requirements', dated May 2022 (t**he CASSPr Consultation Paper**). Consistent with that submission, the DLA reiterates its support in favour of the foundational principles for the regulation of crypto assets and (data activities) set out in the CASSPr Consultation Paper. In particular, the DLA recommends that any proposed regulation should be technology neutral and the

[26] See generally Peter Rohde et al, 'Quantum crypto-economics: Blockchain prediction markets for the evolution of quantum technology' (2021) https://dx.doi.org/10.2139/ssrn.3777706; See generally Jon Lindsay, 'Demystifying the Quantum Threat: Infrastructure, Institutions, and Intelligence Advantage' (2020) 29(2) *Security Studies* 335 https://doi.org/10.1080/09636412.2020.1722853.

overarching approach to the regulation of technology should promote, as far as possible, principles of technology neutrality.[27]

'Asset' is an economic notion and it may not fully encompass the innovative features, functionalities, and potential use cases that may emerge in the future.

Under the current architecture of the proposed Bill, a 'regulated digital asset' is defined by reference to three types of tokens.[28] We recommend replacing 'digital asset' with 'token'. Each 'digital asset' could potentially be understood to be a 'token', however, generally tokens have a broader application and a token may not necessarily be an 'asset'.

We refer to the submission of Joni Pirovich of Blockchain & Digital Assets – Services + Law (**BADASL Submission**), which states that a technology neutral definition would have to focus on defining a 'data structure'.[29] The term 'token' would be a form of a 'data structure'. The Bill would then seek to regulate the activities and behaviours associated with the 'token' (under the proposed Bill, this will be called the 'regulated token'), such as 'token exchange' and 'token custody service' (rather than the current proposed activities: 'digital asset exchange' and 'digital asset custody service').

Using a more specific and comprehensive term can better reflect the evolving nature of these 'data structures'. We refer to, and agree, with the Law Council of Australia's submission to the CASSPr Consultation Paper, which stated that:

> "*'Token' is arguably a better term than 'asset' as it is value neutral. Tokens have a broad application and may have zero or negative financial value.*"[30]

We also refer to the BADASL Submission which, in relation to the definition proposed in the CASSPr Consultation Paper, recommended:

> "*No reference to value (either positive or negative), and reference to attributes in addition to rights and obligations, so as to capture identity and credential token 'data structures' that may not have a value when at rest or in transit.*"

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[27] Digital Law Association, Submission to the 'Crypto asset secondary service providers: Licensing and custody requirements' consultation paper (May 2022) (**CASSPr Consultation Paper**), Recommendation #1.
[28] Draft *Digital Assets (Market regulation) Bill 2023*, section 5.
[29] Blockchain & Digital Assets – Services + Law, Submission to the CASSPr Consultation Paper, pages 10 -12.
[30] Law Council of Australia, Submission to the CASSPr Consultation Paper, responses to questions 1 and 3.

The BADASL Submission demonstrates concepts that have not yet been explored, and accounted for, under the proposed Bill. We agree with BADASL's recommendation on this issue.

5 Clear policy rationale for regulating 'centralised' entities

Recommendation #6: Limit application of the Bill to centralised entities.

The proposed licensing regime seeks to promote consumer protection by licensing people/entities carrying out activities in relation to regulated digital assets. We agree that there is a clear policy rationale for regulating activities for certain digital asset activities particularly where intermediaries introduce consumer or market risks and disrupt the actual (or perceived) advantages of 'trustless' DLT/blockchain based systems.

The DLA notes that the policy rationale for digital asset activities on decentralised protocols requires different assessment criteria and further consideration. As such, the DLA recommends that the Bill be limited in scope to activities of people or entities that are centralised.

Decentralised Autonomous Organisations

Recommendation #7: Carry out further consultation on legal issues relating to decentralised autonomous organisations and their members. Noting a key aspect of this consultation will be to identify the deterministic characteristics and potential regulatory perimeter between centralised and decentralised.

In our previous submission to the Senate Select Committee on Australia as a Technology and Financial Centre[31], the DLA noted that decentralised autonomous organisations (DAOs) will increasingly feature as a business model in the digital economy through digital assets and decentralised business models, and merit some form of legal recognition to bring conduct into legal frameworks.

The DLA also acknowledges that convergence of DLT, artificial intelligence and automation will increasingly require the law to consider questions of accountability and legal status of machines, algorithms and computer protocols. Not doing so will create significant legal loop-holes.

[31] Digital Law Association, Submission to Third Issues Paper (Senate Select Committee on Australia as a Technology and Financial Centre), July 2021

It is unclear where decentralised autonomous organisations, and relevantly, their members, sit in the policy framework for regulation of digital assets. The DLA recommends further regulatory consideration be given to treatment of decentralised and/or autonomous organisations and their members.

DAOs do not currently have incorporated personalities or recognition of legal status under Australian law, and therefore legal position on liability of DAO members is uncertain. The Senate Select Committee on Australia as a Technology and Financial Centre (the **Committee**) recognised this fact and have stated that Australia's legal system is incompatible with DAO structures.[32] The Committee made that statement under the assumption that DAOs are incompatible with and cannot be introduced under the *Corporations Act*[33].

The DLA queries the policy rationale for regulating, and cost benefit analysis of enforcing regulation against, genuinely decentralised DAO structures. DAOs are intended to operate on a blockchain without the permission of a centralised entity. This means that users can access services created by a DAO, such as a decentralised exchange, without asking for the DAO's permission. The user maintains custody of their digital assets when they use the service, and they must approve and sign all transactions which occur, removing some of the consumer protection harms of centralised exchanges.

DAOs which have built or intend to build a decentralised exchange and/or custody service could be captured under the Bill if offering a service which satisfies the definition of *digital asset exchange and digital asset custody service* (eg sections 11 and section 16 of the Bill).

Bringing DAOs into the licensing regime may have unintended consequences. Firstly, general public members of DAOs may not be aware of licensing obligations for which DAO members could potentially be held liable.

DAO members could be penalised when they do not have practical control over a DAO's service offerings or how users interact with a DAO's smart contract.

<u>Section 11 of the Bill</u>

Further consideration should be given to whether and how the following provisions under the Bill might apply to DAOs including individual members:

- the regulation of the conduct of the exchange's participants and protections for the exchange's participants in relation to their participation;[34]

[32] The Senate, *Select Committee on Australia as a Technology and Financial Centre* (Final Report, October 2021).
[33] *Corporations Act 2001* (Cth).
[34] Ibid, s11(2)(b).

- procedures relating to the exchange, and monitoring activity facilitated by the exchange;[35]
- the segregation of the exchange participants' funds (including digital assets) from those of the licensee, and management of those funds, including reporting on participants' holdings;[36]
- record-keeping and other reporting;[37]
- the obtaining, use and disclosure of information, including the disclosure of information to ASIC, APRA or another authority of the Commonwealth.[38]

Section 16 - Digital Asset Custody Requirements

It may not be practical, nor necessary, for truly decentralised DAOs to comply with the following requirements:

- the designation of key personnel in Australia to be responsible for provision of digital asset custody services by the licensee in Australia;[39] and
- the segregation of the exchange participants' funds (including digital assets) from those of the licensee, and management of those funds, including reporting on participants' holdings.[40]

[35] Ibid, s11(2)(c).
[36] Ibid, s11(2)(d)(i).
[37] Ibid, s11(2)(g).
[38] Ibid, s11(2)(h).
[39] Ibid, s16(2)(a).
[40] Ibid, s16(2)(c)(ii).

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