

**Submission to
Senate Select Committee on Financial Technology and Regulatory Technology
Parliament of Australia**

This submission provides a case study of FinTech as a ‘related matter’ falling within the terms of reference of the Committee. It is made by Dr **Kate Galloway**, Dr **Louise Parsons**, and Dr **Francina Cantatore**.¹

1. Summary

- 1.1. Blockchain systems are currently under consideration to register and trade in physical assets, that will likely integrate with FinTech or have implications for it.
- 1.2. Fractionalisation of land that is traded via blockchain will require widespread interoperability of land registries and land administration infrastructure, financiers, insurance companies, bodies corporate and local authorities.
- 1.3. The creation and use of ‘coins’ on a blockchain representing a proportion of a registered lot of real property creates two parallel registries: blockchain and land titles.
- 1.4. The existence of a coin and the land it is attached to, is likely to constitute two different types of property at the same time: real and personal property. The personal property may be best characterised as a financial product.
- 1.5. Inevitably, rendering land ‘liquid’² through blockchain (or other) technologies, has implications for FinTech: necessarily integrated financial technologies.
- 1.6. Potentially global capital movement in support of the trade in fractionalised interests in land raises multiple issues for regulators.
- 1.7. Although Australia has not implemented a system of fractionalised interests,³ regulators should be contemplating their place in the overarching ecosystem of FinTech.

2. We are each lawyers and legal academics whose research interests include the digital contexts of law.
 - 2.1. Dr Kate Galloway’s expertise lies in real property theory, and the implications for legal concepts and the practice of law wrought by new technologies.
 - 2.2. Dr Louise Parsons’ expertise lies in financial regulation and the deployment of blockchain and distributed ledger technologies.
 - 2.3. Dr Francina Cantatore’s expertise lies in property law, including the management of intellectual property through new technologies.

3. Scope and definitions

3.1. *Scope*

This submission focuses on contemporary proposals for the fractionalisation of real property through integration of a blockchain platform with the land register.⁴ Public discussion about such proposals embraces both FinTech and real property. Our analysis is that such systems are likely to create a hybrid form of property that is both

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² See, eg, Sarah Keenan, ‘Making Land Liquid: On Time and Title Registration’ in Sian Beynon-Jones and Emily Grabham (eds), *Law and Time* (Routledge, 2018).

³ Except for the recently announced release of bricklets at Bricklet Pty Ltd for Lanterne Fund Services Pty Ltd, ‘Bricklet’, *Bricklet* (Webpage, 7 November 2019) <<https://portal.bricklet.com.au/home>>.

⁴ Such as that announced by the SA Premier: David Ridgway MLC, ‘SA-based Innovation to Revolutionise Property Investment Bricklet by Bricklet’ Media Release (23 September 2019)

<https://premier.sa.gov.au/news/sa-based-innovation-to-revolutionise-property-investment-bricklet-by-bricklet>.

The current website of Bricklet states that ‘[b]ricklet is a fragment of Torrens Title. When you buy a Bricklet you will be registered on title with the relevant state Land Title’s Office’: Bricklet Pty Ltd for Lanterne Fund Services Pty Ltd, ‘What is Bricklet’, *Bricklet* (Webpage, 7 November 2019)

<<https://bricklet.freshdesk.com/support/solutions/articles/47000727368-what-is-bricklet->>.

real (land) and personal (financial product), that poses significant challenges for regulators.

3.2. Definitions

In this submission:

- ‘Coin’ means a digital asset that is native to its own blockchain;
- ‘FinTech’ means ‘the application of new digital technologies to financial services ... [and] the development of business models and products which rely on these technologies and more generally on digital platforms and processes’;⁵
- ‘Fractionalised ownership’ means a method of sharing ownership of a high-value tangible asset between several unrelated parties to mitigate costs and risks of sole ownership;
- ‘RegTech’ means information technologies that enhance regulatory processes principally pertaining to the financial sector; and
- ‘Token’ means a digital asset that is created to be used on an existing blockchain, often through a decentralised application.

4. Land as a Financial Product

4.1. As real property prices in Australia have increased, fewer people are able to afford to buy land. This has implications for the distribution of wealth. Traditionally, a high proportion of Australians owned their home, and this asset was the principal source of wealth.

4.2. There has been increasing interest in the prospect of breaking up a single land title into multiple components to facilitate a secure interest in real property through minimal (and therefore affordable) investment.

4.3. There are two ways to achieve this outcome: tokenisation and fractionalised ownership. Although the terms are sometimes used interchangeably, we distinguish between them.

4.3.1. Tokenisation involves establishing a proxy for a part interest in nominated land, but does not involve a registered interest in that land. Instead, it results in an investment in a land owning company or other legal entity that pays dividends to each investor equating to rent, and a capital return based on their nominated property’s capital gain.⁶ Such schemes are managed investments in terms of the *Corporations Act 2001* (Cth).⁷ Tokenisation can be achieved without FinTech.

4.3.2. Fractionalised ownership involves a direct interest in land, recorded in the land register, held in common with multiple other co-owners. Fractionalisation can also be achieved without the need for any technological intervention or FinTech and is governed either by the agreement of the co-owners between each other, or by common law and property law statutes.

4.3.3. Both of tokenisation and fractionalised ownership create the possibility for investment in land through FinTech.

4.3.3.1. Tokenisation can occur through the issue of tokens on a blockchain platform.

4.3.3.2. Fractional ownership using blockchain is more complex and is the focus of this submission.

5. Fractionalised Land Title on Blockchain

5.1. In a recent media release, the South Australian Premier announced the advent of fractionalised land title in South Australia to be undertaken with a technology firm,

⁵ OECD, *Financial Markets, Insurance and Pensions: Digitalisation and Finance*, 2018, 10.

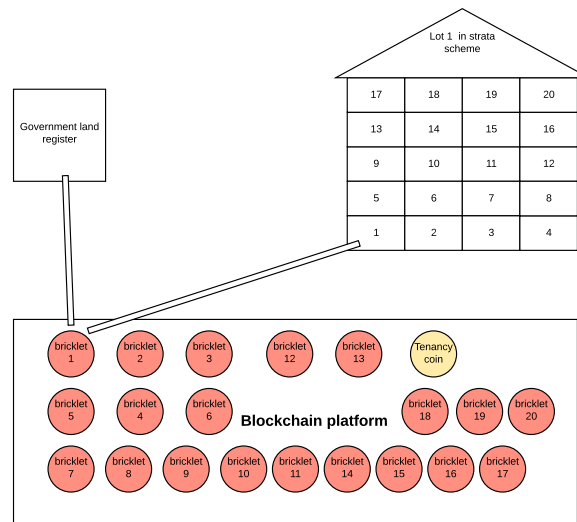
⁶ See, eg, BrickX Financial Services Limited, ‘How investing with BrickX works’, *BrickX* (Webpage, 2018) <<https://www.brickx.com/>>.

⁷ Section 9 *Corporations Act 2001* (Cth), ‘managed investment scheme’.

raising both FinTech and potentially Regtech related issues. Details are scant, except for these key features:

- 5.1.1. Breaking up of a registered land title into 20 ‘bricklets’;
 - 5.1.2. Trading of bricklets on blockchain;
 - 5.1.3. Registration of each bricklet on the land register;
 - 5.1.4. Bricklet owners would share rental income and capital gain, as well as costs and outgoings, proportionate to their interest;
 - 5.1.5. The bricklet platform owner will take a commission from all transactions conducted on the platform.
- 5.2. At its most basic, we envisage that the scheme as depicted in Figure 1.

Figure 1



- 5.3. Of note, and not addressed by the Premier’s statement, this scheme would depend upon interoperability of the blockchain platform and the land register as a minimum requirement for the proposal to function.
- 5.4. The blockchain platform would inevitably regulate the relationships between bricklet owners and the tenant through smart contracts. The blockchain platform also provides advantages including allowing for ‘tokenization in the sense of “the digital securitization of real estate properties”⁸ as well as ease in the processing of transactions, especially by making it easier to buy and sell bricklets.

6. Blockchain Interoperability

- 6.1. The system outlined in Figure 1 is limited to management of relationships between owners and the tenant, and those parties and the register. All other dealings would need to be undertaken ‘off-blockchain’. For example, payment of rates and insurance, dealings with the body corporate, dealings with banks/financiers, and engagement with all other aspects of land administration infrastructure, unless multiple third parties also participated in the blockchain. This is possible but has not yet been publicly mooted.
- 6.2. Each time a transaction occurs ‘off-blockchain’, the use case for blockchain is weakened. Any benefits arising from automation of low-friction transactions are lost as soon as a person needs to intervene to undertake a transaction.

⁸ Bastiaan Don, Dharma Rajah, Stephan Ott, Ken Fromm, ‘Real Estate Use Cases for Blockchain Technology’, Enterprise Ethereum Alliance, (Webpage, Volume 1, 1 March 2019) <<https://entethalliance.org/wp-content/uploads/2019/05/EEA-Real-Estate-SIG-Use-Cases-May-2019.pdf>>.

- 6.3. To fully gain the benefits of this proposal, the blockchain platform therefore requires far more extensive interoperability to develop a comprehensive or ‘full service’ land administration and financial infrastructure.
- 6.4. Inevitably, therefore, if fractionalisation of real property is to become a reality mediated by technologies, it must necessarily engage with FinTech and potentially RegTech.

7. Bricklets: Financial Product or Real Property?

- 7.1. Despite fractional ownership of real property comprising a registered interest in land, we submit that it confounds a traditional demarcation between real and personal property. We suggest that it comprises both real and personal property.
- 7.2. The implications of holding a registered estate in land include a legal right to possession of the whole of the land in common with all other co-owners, right of alienation of the interest including giving the land as security, and joint and several liability for outgoings and other liabilities associated with the land. These collective rights raise multiple challenges for management of co-owners’ rights and responsibilities. These are beyond the scope of this submission, relating principally to the State Government responsibility for land titles.
- 7.3. Relevantly to this inquiry, we consider it likely that despite the issue of a registered interest in real property, the rights and responsibilities generated through the issue of a bricklet, recorded, traded, and managed via the blockchain platform, comprise a differential right that is more properly characterised as personal property and possibly in the form of a financial product. The challenge is to explain the link between the obligations encoded into smart contracts on the blockchain, and the real property interest recorded on the register. Both of these registration processes generate a discrete set of rights and liabilities without a clear integration of those rights and liabilities as between the two registers. We see three key ways to analyse the connection.
 - 7.3.1. First, real property law has the capability of characterising covenants attached to land dealings as ‘personal covenants’⁹ or covenants that ‘touch and concern the land’.¹⁰ These are promises that are considered to be integral to the nature of the interest held. However, such covenants arise in interests less than freehold: for example, mortgages, leases, and easements. The characterisation relates to questions of whether such promises bind successors in title, and the rights of the owner of the freehold estate to enforce such rights. Relevantly, the bricklets are proposed as a fractionalised *freehold estate*, and so comprehend the largest estate known to the law. This raises the question of whether there is an intention of burdening the freehold estate with some kind of condition.
 - 7.3.2. Secondly, the common law recognises the capacity of a grantor of an estate to impose conditions on that grant. There are limits to what the courts will accept as a binding conditional grant but within those boundaries the consequences of such a grant are the reversion of the title to the grantor if the condition is breached. The nature of the obligations between the bricklet owners—to the extent that they form a set of obligations running alongside the real property interest—do not involve the reversion of the interest to the original transferor.
 - 7.3.3. Thirdly, and in our view the most likely explanation according to the law as it currently exists, is that there are two, parallel, suites of rights and liabilities: those existing as real property, and those existing as personal property. The twin interests may be construed as a hybrid, when understood together. But the structure is somewhat of a departure of the law’s existing fairly strict delineation between real and personal property. On this basis, we submit that the concept of

⁹ For example, a core personal right of a mortgagee is the right to sue on the personal covenant.

¹⁰ In leases, see *Spencer’s Case* (1583) 77 ER 72.

bricklets including the blockchain ecosystem within which they are managed will fall within the remit of financial products¹¹ created and managed by FinTech—albeit personal property that holds an inherent connection to real property.

- 7.4. If bricklets represent a hybrid type of property, the characterisation of their value as a proportion of the value of the entire lot is likely to be mistaken. Bricklets as a discrete asset tied to real property differs from the value of real property itself.
- 7.5. If both real and personal property characteristics can be attributed to the bricklet scheme, there is a possibility of conflict between registered Torrens title interests and security interests registered under the personal property securities law¹² with further implications for the overall regulatory environment.

8. Challenges for FinTech Regulation

- 8.1. To the extent that land becomes ‘liquid’ through its integration with FinTech, it becomes globally tradeable. This raises questions about foreign ownership of land and compliance with Australia’s foreign investment framework.¹³
- 8.2. If the system is considered to be land ownership, there is potential for funds to be readily laundered through small scale investment in bricklets—ostensibly outside the financial regulation system yet with implications for the enforcement of anti-money laundering and counter-terrorism financing legislation.¹⁴
- 8.3. What disclosure requirements are desirable given the unique nature of the interest/s created and who will oversee these?
- 8.4. How will FinTech deal with the potential for dual/conflicting security interests to be registered against property interests under the scheme?
- 8.5. Who is responsible for liabilities arising from the platform’s code? The real property is government guaranteed—this is the nature of the Torrens system. But where a loss arises from either a defect in the blockchain or smart contract, or some other unanticipated aspect of the platform, the desirability of integration with the register is unclear. Remedies for losses occasioned through negligence related to coding or the functioning of the blockchain, or through the use of a FinTech product, for example, would not normally be sheeted home to the State. The hybrid interest falls between State government purview (land titles) and Commonwealth (financial regulation) and consumer protection measures will need to be determined and allocated as between governments. Without clarity as to the nature of the interests being traded, investors are likely to fall between regimes of protection.
- 8.6. The platform will require a system of identification. The greater the integration of the platform with financial and land administration ecosystems, the more desirable it is to have a standardised method of identification that will work across platforms. This method will inevitably intersect with FinTech more broadly.

9. Conclusions

- 9.1. Emergent technologies enabling trade in fractionalised land titles will inevitably involve integration with financial services and thus FinTech.
- 9.2. Because of this, governments need to be aware of the implications for FinTech and possibly RegTech arising from an interoperable technology system—in this case, fractionalised ownership of land titles on the blockchain—in planning regulation of a FinTech ecosystem.

¹¹ See section 763A *Corporations Act 2001* (Cth).

¹² *Personal Property Securities Act 2009* (Cth).

¹³ See Foreign Investment Review Board (Webpage, 2015) <<https://firb.gov.au/>>.

¹⁴ See AUSTRAC, ‘Who we are and what we do’ (Webpage, 2018) <<https://www.austrac.gov.au/>>; See *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth).