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Director – Crypto Policy Unit  
Financial System Division  
The Treasury  
Langton Crescent  
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Submitted by email: [crypto@treasury.gov.au](mailto:crypto@treasury.gov.au)

Dear Director,

### **Regulating Digital Asset Platforms Proposal Paper**

Thank you for the opportunity to provide a confidential and detailed submission to the consultation questions contained within the Regulating Digital Asset Platforms Proposal Paper released in October 2023, which supplements the open submission provided on 4 December 2023.

Responses to each consultation question are set out in **Annexure A**. A sample ‘safe harbour’ and ‘sandbox principles’ are each set out in **Annexure B**.

In short:

- 1) Regulatory settings must be clarified at the same time as the tax treatment of crypto-token activities on ‘digital asset platforms’. If the potential adverse tax outcomes are not addressed while regulatory clarity is attempted, the effort of seeking regulatory clarity is rendered close to useless because it is uneconomical from a tax perspective to start or conduct a ‘digital asset platform’ business in Australia.
- 2) Without a regime that supports composable, multi characteristic tokens and token incentives, Australia will not be able to participate in the development of online global communities and innovative mechanisms for online coordination of human activity.

The regulation of ‘digital asset platforms’ (and necessarily, what will be excluded or signposted for eventual reform) is an opportunity to strategically position Australia for productivity growth from use of this technology and to defend itself from threats (including geopolitical competition) from use of this technology. Critical to this is Australians’ ability to contribute to permissionless protocol security through activities like staking, and for those Australians to not be adversely impacted by anomalous potential tax events that don’t correlate to the economic reality of the activity.

Australians simply cannot be left to fend for themselves when dealing with offshore products because the Australian regulatory and tax regime is not able to nurture responsible innovation and healthy competition for overall better choice to everyday Australians.

If the right balance is struck, Australia can participate in the economic upside of the global shifts towards permissionless blockchain innovation. Without getting the fundamentals right, then permissioned interactions performed on permissionless blockchains (such as privately issued stablecoins, tokenisation and transfers of real-world assets / fractions, etc) will suffer.



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I welcome the opportunity to discuss this submission and assist the Treasury with their ongoing efforts.

Yours sincerely,

Signed by:  
  
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*A web3 focussed firm providing legal, strategic and policy services.*

## Annexure A

1. **Questions (Set 1) Prior consultation submissions have suggested the Corporations Act should be amended to include a specific ‘safe harbour’ from the regulatory remit of the financial services laws for networks and tokens that are used for a non-financial purpose by individuals and businesses. What are the benefits and risks that would be associated with this? What would be the practical outcome of a safe harbour?**

BADAS\*L has advocated, and continues to advocate, for a safe harbour – on regulatory and tax fronts. This submission will largely focus on the regulatory side, as the tax requirements are more like a voluntary compliance program or interim administrative approach until tax reform is implemented.

A safe harbour can have many different names such as transitional/interim relief, or accelerated licence pathway, or sandbox, or grandfathering.

The desired outcome of a safe harbour is that responsible innovators are permitted an environment to do things differently in and from Australia, which is a necessary ingredient for overall better choice for everyday Australians.

A safe harbour from certain provisions of the Corporations Act is critical to preserve innovation in and from Australia because:

- firstly, composable tokens are inherently multi characteristic – neither solely a financial product, neither solely a digital consumer good; and
- secondly, by design, an allocation of token supply is typically released for circulation through ‘emissions’ from the blockchain protocol or an autonomous contract deployed on a permissionless blockchain to incentivise security of the protocol or sustainable involvement of contributors and governance input, where there is no clear ‘issuer’ or ‘operator’ of an interest in a scheme or scheme or market, respectively.

Without a regime that supports composable, multi characteristic tokens and token incentives, Australia will not be able to participate in the development of online global communities and innovative mechanisms for online coordination of human activity. This is one of the single biggest world wide trends relevant to productivity growth in a digital age that Australia simply cannot miss out on.

Even if the primary purpose of one crypto-token unit is to represent a *right* to use or access something (e.g. ETH is required to pay for gas used in the computations required when executing a smart contract function on the Ethereum blockchain), there is an ancillary *ability* to sell the crypto-token unit on a peer-to-peer basis or through a secondary sale mechanism (either centralised platform/s or an autonomous protocol deployed on permissionless blockchain).

Transferability and composability for the mere purpose of benefiting from hype cycles is often easily identifiable and should be stopped with existing and new regulatory frameworks. However, where a sustainable plan is proposed or in place for a business or community then a transferable and composable token is part of its lifeblood. To chill or kill innovative uses of the token would be to chill and kill innovative forms of online human coordination.

As such, a safe harbour is a regulatory tool that achieves the following practical benefits:

- a) an orderly form of clear warning to market participants and the public about business models (in the case of centralised businesses) or community/network incentivisation models (in the case of DAOs, including permissionless blockchain networks) that are not

sustainable and may not be able to continue as is or at all in or from Australia;

- b) an outward, global signal that Australia has and can execute upon a multi-year strategic plan that supports responsible innovation, with consumer protection and market integrity at its heart; and
- c) the attraction of capital to Australian projects in their very early and high growth stages;
- d) the retention of Australian talent in Australia (that breeds skill development, and thriving projects and communities in Australia), and
- e) preservation of, and positioning for, Australia to capture the benefits of responsible innovation with this technology – in online human coordination, the tokenisation of money and traditional financial instruments, and the programmability possible from tokenisation and financialised activities.

There are risks of a safe harbour if the policy direction (and how existing or new law is to be enforced) is not clear because bad actors may be attracted to operate here and claim 'safe harbour'. However, from the many years of consultation, Australia is closer now to its policy direction than ever before. As such, a mitigant for the 'bad actor' risk is to have any safe harbour announced as a transitional measure alongside the implementation of Australia's targeted policies for this sector.

An extract of what a 'safe harbour' could look like is set out in Annexure B and takes from the submission filed by Joni Pirovich on 11 August 2021 with both ASIC and the Senate. Upon reflection and after feedback from the market since providing the submission in 2021, BADAS\*L now proposes a safe harbour combined with 'sandbox principles' instead of or in addition to an application-assessed and supervised sandbox. Frontier innovators see traditional sandboxes as "the place where innovation goes to die" and would be better served by steadfast sandbox principles and even better served if those principles were available as mandatory tooling easily plugged in and tested with during the development process.

Notable examples of 'safe harbours' (or the other names they are known by) include the approach taken by the Monetary Authority of Singapore (in respect of the ability to continue business as is if a payments licence was applied for under their Payment Services Act by the relevant time and whilst the licence application was being considered). Similar approaches have been taken by the Financial Conduct Authority in the United Kingdom (in respect of the Financial Promotions regime) and the Virtual Asset Regulatory Authority in Dubai of the United Arab Emirates (in respect of requirements for virtual asset licensing per virtual asset activity).

**2. Questions (Set 2) Does this proposed exemption appropriately balance the potential consumer harms, while allowing for innovation? Are the proposed thresholds appropriate? How should the threshold be monitored and implemented in the context of digital assets with high volatility or where illiquid markets may make it difficult to price tokens?**

Low-value exemptions only work with closed loop products. Most crypto-token projects are not meant to be confined to a closed loop and instead seek to connect with the larger ecosystem so that composability benefits can be realised by multi characteristic tokens.

Not all 'digital asset platforms' will seek to operate closed loop products. In fact centralised token exchanges and centralised non-fungible token marketplaces would be the only business models to either clearly stay below the thresholds or definitely decide to obtain the licence to exceed the thresholds.

If the urgently desired regulatory outcome is to limit digital asset platforms that provide digital asset exchange services to only those that can obtain the 'digital asset facility' licence, and to throttle those that cannot obtain the 'digital asset facility' licence with the low-value thresholds to qualify for the proposed exemption, then the proposal is good.

However, looking more broadly (because 'digital asset facility' is defined broadly) the proposed low-value exemption – in and of itself – will not achieve an appropriate balance that allows for responsible innovation. Nor does the two-prong low-value exemption instil an appreciation from the inception of a project of the regulatory outcomes desired from products and services that are the same or similar to those that trigger obligations under the Corporations Act and other existing laws.

Rather, one of the unintended (or perhaps intended) consequences of the proposed exemption (in the context of the broader licence proposed) is that several smaller centralised 'digital asset trading platforms' that 'hold' 'digital assets' on behalf of their customers may be forced to cease business.

A likely byproduct of a 'digital asset facility' licence with the corresponding level of compliance obligations proposed, is that retail consumers are more likely to choose the 'trusted' businesses that are large and licenced. That is so unless the smaller platforms can compete sustainably on one or more of number of tokens and token pairs listed, trading fees, custody fees, trading tools, consumer education and safety measures, availability of insured custody, availability and variety of other products and services, or innovative approaches to any or all the above. However, since the proposed low-value exemption is to apply on a platform-wide basis more variety is likely not a vector for competition.

Based on the needs of high-growth-potential innovators and innovations being built, BADAS\*L proposes that:

- a) existing centralised 'digital asset trading platforms' that 'hold' 'digital assets' on behalf of their customers be regulated largely as is proposed; and
- b) for new business models or existing or new (decentralised) communities/network incentivisation models either:
  - i. existing laws about 'financial products' and what activities constitute a 'financial services business' are explicitly subordinated so that 'sandbox principles' (such as those proposed by BADAS\*L at Annexure B) apply in priority to the existing laws but with a requirement to assess the consumer protection and market integrity risks of the business or community/network model against the regulatory outcomes desired from existing laws as if they apply to determine how a similar or different approach may achieve the same or better regulatory outcome; or
  - ii. the value-based limits be increased on a scale subject to the conditions that:
    1. the 'platform provider' and relevant intermediaries have a model of governance in place to identify, monitor, address and evaluate the consumer protection and market integrity risks specific to their offering; and
    2. the model can evolve with the growth in scale of their offering; and
    3. the exemption be extended to the intermediaries performing financial services in relation to a licensed 'digital asset facility'.

The practical results of the proposed approach are that:

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- small ‘digital asset trading platforms’ will likely die-off unless their value proposition is so desirable;
- start-ups will focus on either or both of keeping below the value-based exemptions or not ‘holding’ ‘digital assets’ without seeking to understand whether they are a ‘platform provider’ or how to get ‘licence-ready’ to apply for a ‘digital asset facility’ licence when the thresholds are near to or temporarily exceeded.

Neither of these outcomes achieve an appropriate balance of allowing for innovation and protecting against potential consumer harms.

Due to the capacity of crypto-token prices to be volatile and the propensity of some to increase quickly but stabilise at a much higher price than previous periods, it will be critical that ‘platform providers’ have and understand policy principles that achieve the regulatory outcomes of consumer protection and market integrity in times of price volatility and price growth, even if only managing low balances, such as the requirement to consider whether the price volatility is short-term and explainable or is prone to hype cycles and forms of market manipulation.

In addition, the proposed low-value exemption relies first on an identifiable person or persons being characterised as a ‘platform provider’ (or not a ‘platform provider’). Notably, if a person is not a ‘platform provider’ then they never have the protection of the value-based exemptions. Only if the person is (or persons are) a ‘platform provider’ that ‘holds’ ‘digital assets’ can that person or persons rely on the two-prong low-value exemption.

The question of who is or what constitutes a platform provider must be the subject of policy clarification and regulatory guidance once the legislation is implemented.

#### ***Who is (or what constitutes) a platform provider?***

The proposed definition of a ‘platform provider’ (i.e. the issuer of a ‘digital asset facility’) is the person or persons responsible for the obligations owed to customers under the terms of the asset holding arrangement. ‘Platform providers’ and other intermediaries performing financial services in relation to ‘digital asset facilities’ are proposed to be required to hold an Australian Financial Services Licence (AFSL). Furthermore, where a ‘digital asset facility’ has more than one ‘platform provider’ each is required to take responsibility for their part of the facility and have an AFSL.

As Example 1 below with show, the likelihood that an unregulated provider is involved in a ‘digital asset facility’ is high without clear policy clarity in the incoming legislation. If regulatory uncertainty continues around use of permissionless protocols – as to whether they are an ‘unregulated provider’ or simply not a ‘platform provider’ – innovation in Australia with permissionless protocols will be chilled or killed.

The proposed regulatory catchpoint of ‘platform provider’ will capture a wide range of people and autonomous automations (or the developers of autonomous automations) involved in various business models and community/network incentivisation models.

These people and automations (or their developers) will require resolution of the following issues:

- c) whether they are a ‘platform provider’; and
- d) whether they fall within the exemptions:
  - i. ‘\$1,500 per client limit’: total value of platform entitlements held by any one client of the platform does not exceed AU\$1,500 at any one time; and

- ii. '\$5 million platform limit': total amount of assets held by the platform provider does not exceed AU\$5 million at any time; and
- e) the impact on their model of falling outside of the exemptions as either:
  - i. an unsustainable model to use in Australia or that involves participation from Australians (requiring immediate wind-down or sunseting, or restructure offshore with geoblocking to prohibit Australian participation); or
  - ii. a 'heavy lift required' model to use in Australia or that involves participation from Australians, that requires significant restructuring possible in Australia upon either forecasting or actual falling outside of the exemptions; or
  - iii. a 'flexible' model that enables the business or community/network to come into compliance with the requirements of the proposed 'digital asset facility' licence without significant disruption to the smooth continuity of the business or community/network in Australia or that involves participation from Australians.

Unlike fully formed consumer software products or fully formed financial products provided by licensed persons, this technology enables the building of pieces that are inherently composable with each other. In other words, this technology has introduced to the world a means of accessing many small open-source licenced pieces, built by different persons, and the ability to compose several small pieces to automate the steps of an activity such as collateralised lending, or implementing managed token investment strategies.

So, to better support responsible innovation with this technology, there should be clear policy on:

- a) what constitutes a 'platform';
- b) what constitutes a 'provider'; and
- c) what constitutes 'held'; and
- d) what constitutes 'held by the platform provider',

in the context of using and relying on one or more 'pieces' developed by others.

If the desired outcomes of regulating 'digital asset platforms' are consumer protection and market integrity but the context in which those regulatory outcomes are to be delivered is different to the context in which fully formed consumer or financial products are provided, then the context demands a different approach.

A different approach that understands the idiosyncrasies of this technology, and how it is developed in 'pieces', could see the appropriate framing of the policy goal of regulating 'digital asset platforms' as: That market participants understand the activity/ies that rise to the level of being a 'platform provider' *as well as* the measures that can be taken upstream or downstream to lower the overall compliance burden of a 'platform provider' (or inadvertent platform provider).

Accordingly, to preserve the continued ability of each participant in the sector to act responsibly and to develop in composable 'pieces' rather than fully formed products, BADAS\*L has proposed the 'semi-optional leapfrog' (SLF) approach in its submission to IOSCO filed on 16 October 2023, available at: <https://img1.wsimg.com/blobby/go/dff9c8cc-42b6-43e1-ac50-b1569230f52c/downloads/231016%20->

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[%20Submission%20to%20IOSCO%20DeFi%20consultation.pdf?ver=1697497293058](#). These are reflected in the sandbox principles proposed at Annexure B.

The SLF approach is discussed in Example 1 below.

#### **Example 1**

##### ***Background facts***

A person (Cody) uses the open-source application named Fractional.art (developed by the Fractional Token Company) to fractionalise their digital art, and then uses the open-source application named Swap (developed by SushiSwap community/DAO) to seed a liquidity pool (art tokens – WETH) that enables third parties to buy and sell the fractions to participate in the art community or step away from the community, respectively. Cody does not intend to ever sell the underlying art and has set an extremely high reserve price so the likelihood that an auction of the underlying art will be triggered by a person agreeing to pay the reserve price is low or non-existent. However, if a person does trigger an auction then every person that holds an art token can interact with the Fractional.art interface, or with the contract via the Etherscan block explorer, or directly with developer tooling, to claim their pro rata share of the auction proceeds.

Cody does not build and host an independent interface for his art community but creates a twitter (X) profile that token-holders can follow and comment on. Cody sets community conduct rules based on respect for each other and discloses when he intends to sell portions of his art tokens for ETH and how much of the proceeds he intends to give as grants to people that regularly comment on his twitter posts in an entertaining way.

##### ***Issues and considerations:***

- Whether Cody is a 'platform provider'? And of how many platforms? For example, since it is possible for a person to claim their pro rata share of proceeds on auction of the underlying art, is Cody a 'platform provider' in respect of how a person holding his art tokens can claim proceeds via the Fractional.art protocol?
- If Cody is not a 'platform provider' is there another person or persons that meet the definition of 'platform provider'?
- If there is a person or persons that meet the definition of 'platform provider' for Fractional.art and SushiSwap, but they do not hold a 'digital asset facility' licence is each an 'unregulated provider'?
- Whether the art tokens and WETH, represented in the state of the liquidity pool contract, are 'held' by Cody?
- Whether the art tokens and WETH, represented in the state of the liquidity pool contract, are 'held by [Cody as] the platform provider'?
- Upon what conditions (such a safety and security guarantees in the protocol design, which may include decentralisation of governance) would Fractional.art and SushiSwap not be considered 'platform providers'?

3. **Questions (Set 3) What would be the impact on existing brokers in the market? Does the proposed create additional risk or opportunities for regulatory arbitrage? How could these be mitigated?**



The approach to regulate 'digital asset facilities' means practically that brokers will be forced to interact only with licensed or exempt 'digital asset facilities'.

Professional indemnity insurance for professional services related to crypto-tokens and crypto-token activities is still largely unaffordable. This means most if not all existing brokers that are able to secure professional indemnity insurance in respect of a 'digital asset facility' will likely not offer brokerage services with respect to crypto-tokens not available on a licensed or exempt 'digital asset facility'. This perpetuates the status quo where everyday Australians cannot seek financial advice from licensed financial advisors about crypto-tokens and likely the riskier types of tokens.

Thus, the policy issue remains that persons seeking to acquire a balance of crypto-token units and deal in all or part of the balance of crypto-token units, of crypto-tokens not available on an Australian platform, will simply go offshore and support the success of offshore platforms. If one presumes that tokens listed on offshore platforms are either or both new and highly risky, then Australian consumers remain unprotected in this regard. Further, such market behaviour practically results in capital and liquidity flows into offshore markets which continues to reduce Australia's capacity to compete and participate in productivity growth opportunities from this technology.

**4. Questions (Set 4) Are the financial requirements suitable for the purpose of addressing the cost of orderly winding up? Should NTA be tailored based on the activities performed by the platform provider? Does the distinction between total NTA needed for custodian and non-custodian make sense in the digital asset context?**

The proposed financial requirements, combined with the proposal for 'digital asset facilities' to enter a standard form contract with their customers, appear appropriate as a baseline to meet the cost of orderly winding up of a centralised 'digital asset trading platform'.

However, there should also be technology requirements that extend to requirements for open-source content hosted in a github or content referenced in technology such as non-fungible tokens. If a business becomes insolvent and cannot pay for hosting content that others rely on or that is referenced to a token, then for example tokens will still circulate but the content will no longer be accessible leaving unsuspecting buyers still in harms way. Further thought should be given to the non-financial requirements for orderly winding up of technology native businesses.

Furthermore, to the extent it is the policy intention to cast the net widely of what constitutes a 'platform provider' or 'issuer of a digital asset facility' and if the desired regulatory outcome is orderly winding up, then a future-fit and more market-responsive regulatory approach is required. Such an approach would preserve flexibility and permit innovation where a person proposes same or better 'insolvency event' or winding up guarantees or protections than the 'protection' that is presumed to be deliverable by the blunt instrument of a net tangible assets requirement.

**5. Questions (Set 5) Should a form of the financial advice framework be expanded to digital assets that are not financial products? Is this appropriate? If so, please outline a suggested framework.**

This response builds upon our response to Questions (Set 3).

Practically, licensed financial advisors will continue to face high professional indemnity insurance premiums and unattractive insurance terms without a financial advice framework or a crypto-token marketing or financial promotions regime (such as in the United Kingdom). If there is an opportunity to simplify and modernise the existing financial advice framework then that opportunity could be taken and tested in respect of 'digital assets'.

Furthermore, just because a financial advisor is already licensed does not mean they have the relevant skills and experience to provide financial advice about 'digital assets'. An explicit requirement around competency in advising and investing in 'digital assets' should be required.

BADAS\*L refers to the approach taken by the Hong Kong Securities and Futures Commission's 'Virtual Asset Trading Platform Guidelines' which became effective on 1 June 2023. The Hong Kong SFC approach requires the platform operator to seek from its clients (except those which are institutional and qualified professional investors) information about their financial situation, investment experience and investment objectives and assess their risk tolerance level and risk profile relevant to the services to be provided. Whilst on one level this makes sense and would be convenient for clients, the independence and objectivity of personnel within the platform making such assessments would have to be supervised closely.

An alternative approach would be in the same thread as the standard form contract proposed for 'digital asset platforms'. That is, minimum or floor standards could be proposed which a platform may vary if a risks analysis and disclosure is provided. For example, to prevent token by token risk disclosures a minimum standard for new retail client seeking to engage in exchange activities could be no more than AU\$5k of trading volume per day unless a higher limit is granted. The platform would have to publish its policy and relevant factors in deciding whether to grant a higher limit than the minimum standard.

**6. Questions (Set 6) Automated systems are common in token marketplaces. Does this approach to pre-agreed and disclosed rules make it possible for the rules to be encoded in software so automated systems can be compliant? Should there be an ability for discretionary facilities dealing in digital assets to be licensed (using the managed investment scheme framework or similar)?**

To the first question in this Set 6, yes. Rules can be encoded in smart contracts or a suite of smart contracts (with a corresponding architecture that likely relies on proprietary databases and data-feeds from those databases talking to the smart contracts) to the extent the outcome of applying the rules is deterministic and not arbitrary.

If the rules require the consideration of variable factors for a human or responsible person to exercise discretion (such as to resolve a complaint), then generative artificial intelligence automation (rather than smart contract automation or real time compliance by programmability) may also be used in the compliance workflow. For either automation approach, the desired regulatory outcome of use of automated systems to aid compliance should be a) reliability and security of the automation (and its underlying technology) and b) effectiveness in maintaining compliance.

To the second question in this Set 6, insufficient detail is provided in the Proposal Paper to provide an informed response.

**7. Questions (Set 7) Do you agree with the proposal to adopt the 'minimum standards for asset holders' for digital asset facilities? Do you agree with the proposal to tailor the minimum standards to permit 'bailment' arrangements and require currency to be held in limited types of cash equivalents? What parts (if any) of the minimum standards require further tailoring? The 'minimum standards for asset holders' would require tokens to be held on trust. Does this break any important security mechanisms or businesses models for existing token holders? What would be held on trust (e.g. the facility, the platform entitlements, the accounts, a physical record of 'private keys', or something else)?**

If tokens must be held on trust as a minimum standard for holding assets, then each of the following points are critical.

- a) It is only applicable to centralised 'platform providers' that have clearly established legal capacity to act as a trustee. To the extent an autonomous automated protocol (i.e. smart contract or suite of smart contracts deployed on a permissionless blockchain) has no clear legal personality in and of itself, the requirement that tokens be held on trust breaks the important security mechanism of use of such a protocol as a piece of deterministic software and not a human that could engage in fraud or mistake.
- b) Narrow statutory reform is required to recognise that the rights to deal with a balance of crypto-token units (i.e., the private key that corresponds with the public key, and the seed phrase that corresponds with the wallet software used) are more than mere confidential information and are the relevant rights worthy of protection if held on trust. The statutory reform should also recognise that the value of those rights is determined on a 'look through' basis by multiplying the price of one crypto-token unit by the number of crypto-token units that make up a person's balance.

Narrow statutory reform is required in Australia and is a policy measure already recommended by the Law Commission of England and Wales. Narrow statutory reform would deliver foundational certainty to the market where case law is expected to evolve but will take far too long. In this regard, BADAS\*L has acted for an Australian taxpayer since 2017 that has sought to obtain clarity about the property rights associated with a crypto-token versus the rights to deal with a balance of crypto-token units both from the Commissioner of Taxation (**Commissioner**) and in the Federal Court of Australia and the matter is still ongoing. Certainty on this foundational property issue will likely not arrive from Australian courts for at least one to two years, pressing the need for urgent and narrow statutory reform.

- c) Based on the latest Australian Taxation Office website guidance (which sets out the Commissioner's interpretation of existing law and is not binding on the Commissioner but likely results in penalties being levied upon a taxpayer in the higher ranges if the guidance is not followed) likely all tokens 'held' by a 'platform provider' will be treated as disposed at the time transferred to the platform or acquired 'in platform' for Australian income tax purposes. Please refer to the BADAS\*L Crypto Tax Note enclosed with this submission for a high level summary of the foundational and consequential tax uncertainty that flows from lack of tax policy and existing tax law clarity of the tax treatment of activities with balances of crypto-token units.

**8. Questions (Set 8) Do you agree with proposed additional standards for token holders? What should be included or removed?**

Yes. Although precise language should be used to reflect the narrow statutory reform required and set out in our response to Questions (Set 7). For example, replace the following wording:

"Tokens must be held through arrangements that can ensure the tokens are:...",

with revised wording such as:

"The rights to deal with a balance of crypto-token units held on behalf of a customer must be held through arrangements that can ensure those rights (and the crypto-token unit balances the rights relate to) are:..."

- (i) – (iv); and
- prohibited from use by the 'platform provider' for voting in DAO governance or other activities that do not involve rehypothecation but which generate rewards denominated in crypto-token units, unless explicit consent is obtained from the customer and all benefits or

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rewards accrue to the customer (less reasonable fees that may be charged by the 'platform provider' for such a non-financial service);

- readily verifiable such as with a 'proof of state' mechanism that a customer can engage with that takes account of the custodied crypto-token unit balances and how fees may be deducted from those balances, and any other assets available to offset against liabilities of providing the custody (i.e. asset holding) services;
- protected from risk of contamination, such as where 'dusting' may occur (e.g. ETH routed through the OFAC-sanctioned Tornado Cash protocol into many public addresses); and
- protected from loss by blockchain-native activity (such as engaging with an original or new balance of crypto-token units following a contentious hard fork, where attackers prey on the particular vulnerabilities that arise when a person attempts to send the original or new token; and
- protected from loss from malicious activity, such as where scam tokens are airdropped to the addresses being used in the custody arrangement (requiring either disclosure on the official interface and/or reporting to a dedicated web3 agency but a strict policy of no dealing in the scam token or suspected scam token or any web links associated with the token).

In addition, 'routinely audited' should be clarified to allow for audits by reputable audit firms and not audits by the platform provider.

**9. Questions (Set 9) This proposal places the burden on all platform providers (rather than just those facilitating trading) to be the primary enforcement mechanism against market misconduct. Do you agree with this approach? Should failing to make reasonable efforts to identify, prevent, and disrupt market misconduct be an offence? Should market misconduct in respect of digital assets that are not financial products be an offence?**

Per our response to Questions (Set 1) the Proposal Paper provides insufficient detail about whom or what constitutes a 'platform provider'. Accordingly, it is not clear whether placing the burden on all 'platform providers' achieves the desired regulatory outcome of effective prevention of, and enforcement against, market misconduct. In fact, it likely drives more activity offshore.

The requirement to make reasonable efforts to identify, prevent and disrupt market misconduct should form part of the 'sandbox principles'. However, in a similar way that some sandboxes are actively supervised and used to educate the 'to-be-regulated' population, offences (and the extent of penalties) should reflect a tailored but escalating approach to enforcing compliance.

For example, if as a first time event three retail customers paid a higher price for a balance of crypto-token units than they otherwise would have if the market manipulation did not occur on the platform then the platform is statutorily obliged to reimburse those customers based on a best efforts calculation of the 'overpayment' unless the platform can produce mitigating evidence that can remit in full or in part the obligation to reimburse the overpayment (such as a 'first of kind of market manipulation'). Unless and until professional indemnity insurance becomes affordable and available on reasonable terms, at which point affected customers could make a claim against the platform and receive proceeds derived from the platform making a claim under its insurance policy, platforms would be incentivised to put identification, prevention and remedial measures in place to deal with alleged or actual events of market manipulation and customers affected would be 'most protected' by such a statutory reimbursement obligation.

**10. Questions (Set 10) The requirements for a token trading system could include rules that currently apply to 'crossing systems' in Australia and rules that apply to non-**

**discretionary trading venues in other jurisdictions. Do you agree with suggested requirements outlined above? What additional requirements should also be considered? Are there any requirements listed above or that you are aware of that would need different settings due to the unique structure of token marketplaces?**

BADAS\*L agrees with the proposed requirements on page 38 of the Proposal Paper.

To the extent the 'digital asset facility' performs bridging, wrapping or cross-chain swaps on behalf of its client, say to ultimately provide the client with access to a non-financialised token activity, then perhaps some rules applicable to 'crossing systems' could be leveraged. However, there is a need for policy clarity on the extent of activities that can be performed under a 'digital asset facility' and when separate facilities are required and the extent of non-financialised token activity that is permitted within the facility or by its related entities.

- 11. Questions (Set 11) What are the risks of the proposed approach? Do you agree with suggested requirements outlined above? What additional requirements should also be considered? Does the proposed approach for token staking systems achieve the intended regulatory outcomes? How can the requirements ensure Australian businesses are contributing positively to these public networks?**

To the extent that blockchain technology, and its networks of miners or validators, become the global infrastructure for trusted online transactions – not just payments, but trusted online transactions – ***Australia should defensively position itself in relation to each major blockchain network as critical global financial and security infrastructure.***

Bluntly, this means that miners and validators, and their supply chains which include silicon and crucial knowledge skills, need to be incentivised to do business from here. Australia's ability to participate in web3 effectively and strategically will become increasingly important to preserve the integrity of our sovereignty, maintain national security, and to replace our existing tax base with new and structural sound forms of tax revenue from the decentralised digital economy.

As such, direct to blockchain protocol staking (as a network security mechanism) should not fall within the financial services regime. However, direct to application protocol staking (such as for liquidity mining schemes) should fall within the financial services regime to prevent hype based token emissions models that ultimately harm consumers. Stepping back though, policy clarity is really required on what is a 'platform provider' because various stakeholders could unintentionally become 'unregulated providers' under the current proposal and deem Australia an unviable place to stay for critical staking activities.

- 12. Questions (Set 12) How can the proposed approach be improved? Do you agree with the stated policy goals and do you think this approach will satisfy them?**

BADAS\*L disagrees with the statement at page 43 that the process of creating an asset-backed token is relatively simple. It is definitely not simple and should not be represented as such.

Part of the process of asset tokenisation which is designing the token contract is simple. However, ensuring the token moves only as permitted according to a trust deed or constitution, if units or shares are tokenised, is difficult. Referring back to Example 1 above in this submission, it becomes even more complex if a token is fractionalised using fractional.art and for example, the 50-shareholder limit for a private company is inadvertently breached by the directors because of a fractionalisation token activity that was not anticipated and not prevented with the contract's permissioning.

The proposed approach is admirable but requires coordinated effort including with State legislatures, particularly around tokenisation of interests in trusts and real property. In addition, the stamp duty, land tax and GST implications are considerable.

There is much work to be done to enable real world asset tokenisation in Australia. Tokenisation of real estate should be one of the first priorities for holistic legislative reform required to unlock a key growth area in Australia for real world asset tokenisation.

Jurisdictions like Switzerland have already introduced laws to permit the issue and transfer of 'regulated tokens' on permissionless blockchains with template disclosure documentation. Template disclosure documentation is a common theme amongst Switzerland, and the European Union.

- 13. Questions (Set 13) Is requiring digital asset facilities to be the intermediary for non-financial fundraising appropriate? If so, does the proposed approach strike the right balance between the rigorous processes for financial crowdsource funding and the status quo of having no formal regime? What requirements would you suggest be added or removed from the proposed approach? Can you provide an alternate set of requirements that would be more appropriate?**

The key challenge for existing licensed crowd-sourced equity funding platforms is that only an ordinary share can be offered. There is no confidence that a token can be distributed in lieu of an ordinary share or as a valueless (and non-transferable) bonus with an ordinary share. If these aspects can be clarified with narrow reform or regulatory guidance, the problem is 80% solved.

What then remains is whether 'digital asset facilities' should be required to obtain a 'crowd-sourced equity funding' authorisation in addition to the 'digital asset facility' authorisation, and whether a separate entity is required for each separate activity.

- 14. Questions (Set 14) Do you agree with this proposed approach? Are there alternate approaches that should be considered which would enable a non-financial business to continue operating while using a regulated custodian?**

To preserve choice and flexibility, consumers should be given the choice to use a deterministic custody protocol instead of a regulated custodian. A requirement of a non-financial business to afford this choice to its users or clients may be a security audit of the protocol with no material risks remaining.

- 15. Questions (Set 15) Should these activities or other activities be added to the four financialised functions that apply to transactions involving digital assets that are not financial products? Why? What are the added risks and benefits?**

The key risk of items left out of scope is continued regulatory uncertainty, which drives innovators offshore to jurisdictions that are prioritising regulatory certainty in these areas.

- 16. Questions (Set 16) Is this transitory period appropriate? What should be considered in determining an appropriate transitory period?**

A 12-month transitory period appears appropriate. However, existing business should be able to continue to operate 'as is' until the licence is approved or disapproved. If disapproved, it must wind down in Australia or restructure away from Australia within a stipulated time (e.g. no more than six months from the date of disapproval).

## **Annexure B      Sample Safe Harbour and Sandbox Principles**

### **Sample Safe Harbour**

1.      Time period, sunseting review, and applicants

The Safe Harbour should include threshold conditions to access and further conditions to be met over a defined go-forward period of 2 to 3 years, and apply to digital asset 'issuers', digital asset 'market operators' and digital asset 'scheme operators'.

A review of the Safe Harbour should be conducted prior to it expiring to inform whether an extension and/or law reform is warranted at that time.

The persons that may make an application to enter the Safe Harbour are set out more fully below and assumes that retail consumers and investors would (at least initially) rely on access through a website 'front-end' or social media groups and channels rather than directly accessing the technology, which can be problematic and difficult for an inexperienced technologist without considerable education.

Once responsible entities of registered schemes and licensed financial advisors can clearly deal in and advise about digital assets within the Safe Harbour or that have applied for or obtained a 'digital asset facility' licence (which does not mean that all digital assets are or will have to be financial products), retail investors would have good and safer entry point to the digital asset market.

Safe Harbour applicants should be responsible for collating information necessary for the assessment of threshold conditions and being available to provide further information.

2.      Verifiable 'Smart Mark' that applicant displays on website, and list of applicants

Safe Harbour applicant/s should be responsible for displaying a verifiable 'Smart Mark' (leveraging the IP Australia technology) issued by a newly created Digital Asset Taskforce (within or separate to ASIC) to signify to retail investors and consumers that they have made a Safe Harbour application.

A different 'Smart Mark' could be issued by the Digital Asset Taskforce once the applicant has successfully entered the Safe Harbour.

The Digital Asset Taskforce website should also display a list of applicants including the application, the status of the application, the associated website 'front-end', and a link to the application outcome.

3.      Moratorium on enforcement actions

To deter a flood of fraudulent and scam fundraisings using digital assets as soon as the Safe Harbour is announced, only those projects that apply for the Safe Harbour and meet the threshold conditions should be able to fall within the moratorium.

A moratorium would apply to Australian enforcement action only but would prevent enforcement action from ASIC for past fundraisings, schemes and markets for which disclosure obligations may have applied, and where registration and licensing (and obligations associated) may have been required.

#### 4. Information for application

Information required for the application to assess threshold conditions could include:

- a) Australian dollar value of funds raised (at the time raised) or to be raised in a token distribution event (TDE).

Two triaging tiers could be projects that have raised or intend to raise in excess of, or less than, AU\$5 million in any 12-month period (the same caps in value and time as the crowd-sourced equity funding regime). Alternatively, the small-scale offer exemption cap of AU\$2 million could be used to split triaging tiers.

- b) A financial report that summarises how the TDE funds raised have been or will be spent, including the Australian dollar value of the pre-mined but undistributed digital assets held in the 'Treasury' wallet/s at the time of the application and any plans or proposals in relation to the distribution of undistributed digital assets and spending of other digital assets held in the Treasury wallet/s.

The Treasury wallet is a well-known and well-used mechanism where digital assets in the Treasury wallet signify the ability to fund further development and growth for the blockchain or decentralised application (dApp).

- c) Disclosures and representations made about the digital asset at the TDE, including the Whitepaper (if available), the website and social media channels (including Discord, Medium, Twitter).
- d) Any existing licenses or registrations, such as a digital currency exchange registration with AUSTRAC (if relevant).
- e) Extent of 'know your customer' (KYC) or other 'customer due diligence' (CDD) enquiries or work undertaken at the TDEs, including level of research undertaken to identify any or all of privacy enhancing technologies (PETs) and blockchain analytics to understand geographic location of those participating in the TDEs, whether the participant is a retail or sophisticated investor, whether the participant is known to be associated with criminal, suspicious or market manipulative behaviour ('pump and dumping').
- f) Statistics about the project's community, including number of wallet addresses that hold the digital asset at the time of the application, number of followers on each social media forum (to assess how many potential retail investors are involved), number of core contributors and the country of residence for each.
- g) Summary of any correspondence received from regulators, any complaints received to date and how each have been dealt with or are being dealt with.
- h) Whether the blockchain or dApp has been copied from an existing blockchain or dApp and if so, a summary of that similar blockchain or dApp and how the digital asset is differentiated, benefits investors and/or consumers, and/or reduces risk.
- i) Self-assessment of digital asset features, rights and obligations.
- j) Threshold conditions (which inform further conditions) A sample of threshold conditions could include:



- i. Provision of a completed application with supporting information. Specific further conditions may be informed by the nature of information provided in the application.
- ii. Statement of intention. The applicant/s should make a statement and show evidence that they have been 'well-intentioned' in their innovation, which means that they have not been intentionally or deliberately dishonest in the design of technology and operation of the project in such a way that harm is knowingly done to investors and consumers.
- iii. Where funds have or may have been raised from retail investors around the world, an immediate notice is posted on all forums (e.g. website, social media) with a short disclosure statement of no more than 2 pages and a link to the Safe Harbour application. The Digital Asset Taskforce should design and publish a pro forma notice statement.
- iv. Where there have been or are scams known to be associated with the digital asset project but by people unrelated to the project, information about those scams should be displayed clearly with warnings on the 'front-end' and social media with steps taken to report and take action to shut down the scam.
- v. If cyber security audits of smart contracts have not been completed, that they are completed as soon as possible by a reputable auditor.
- vi. Where no or insufficient KYC or CDD has been undertaken, the applicant states they are willing to: a) implement blockchain analytics and regular reporting back to their communities including the Digital Asset Taskforce (and other regulators such as AUSTRAC and ASIC) to identify and report digital asset activity that is associated with wallet addresses known to be bad (money laundering, terrorism financing, funding crime, market manipulation) and determine appropriate actions to be taken in conjunction with regulators; and b) actively explore PET solutions in development and commercially available to conduct privacy preserving KYC processes such as digital identity (including self-sovereign identity and 'zero knowledge KYC'), 'DeFi passports', and as soon as appropriate implement a suitable solution.
- vii. Currently unregistered and unlicensed scheme operators or market operators (or the developers of a self-executing applications that operate as a market or managed investment scheme) should implement standards and automated processes in the best interests of retail consumers and investors that are appropriate, adapted and can be flexibly applied in this still nascent and emerging industry. Standards and automated processes may include clear warnings, value limits on financial transactions, threshold questions about skills and experience, alternative compensation arrangements and a decentralised dispute resolution process. Pre-deployment of smart contract standards could involve mandatory auditing of smart contract code, and proposals to update variable parameters of code.
- viii. Disclosure of dApps, and other blockchain ecosystems, that the digital asset can be used in.

### **Sample Sandbox Principles**

1. Do no harm.
2. Avoid conflicts of interest.
3. Define the one or more activities that you are trying to do differently, and why your approach is better than the current.
4. Understand whether your approach meets or exceeds the outcomes desired by regulatory protections contained in existing law for same or similar activities.
5. Commit to compliance with laws about regulatory, labour, privacy, and tax.
6. Take a risk-based approach. Regularly reflect on the types of risks that could eventuate from the innovation and commit to mitigating risks, focussing on the people most sensitive to harm if the risk eventuates.
7. Hypothesise, test, observe in test environments, then capped environments, then larger environments.
8. Keep records to demonstrate all of the above.
9. Slow things down if the pace of growth outstrips the pace of competence to meet all of the above.