



THE LAW SOCIETY
OF NEW SOUTH WALES

Our ref: BLC:CBslh061223

6 December 2023

Dr James Popple
Chief Executive Officer
Law Council of Australia
PO Box 5350
Braddon ACT 2612

By email: Nathan.MacDonald@lawcouncil.au

Dear Dr Popple,

Regulating Digital Asset Platforms

The Law Society of NSW appreciates the opportunity to provide input to the Law Council of Australia for its submission to the Treasury's consultation paper, *Regulating Digital Asset Platforms*. The Law Society's Business Law Committee has contributed to this submission.

We note that the proposed regulatory framework, as outlined in the consultation paper, seeks to establish safeguards for consumers by extending the Australian Financial Services Licence framework to apply to digital asset platforms.

Our comments in response to relevant consultation questions are set out in **Annexure A** to this letter.

If you have any questions about this submission, please contact Sonja Hewison, Policy Lawyer at sonja.hewison@lawsociety.com.au or on (02) 9926 0219.

Yours sincerely,

Cassandra Banks
President

Encl.

**Regulating Digital Asset Platforms – Proposal paper
Feedback from the Law Society of NSW**

	Questions	Law Society comments
2. Regulating digital asset intermediaries		
Set 1	<p>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.</p> <p>What are the benefits and risks that would be associated with this? What would be the practical outcome of a safe harbour?</p>	<p>We support the general proposition of a regulatory “safe harbour” to foster innovation, promote certainty and prevent regulatory arbitrage. However, in recognising that digital assets are not a homogenous asset class and are used for a variety of financial and non-financial purposes, we suggest consideration of conditions to be met by “digital asset facility” (DAF) providers in order to access safe harbour protection, which may include appropriate disclosure requirements, regarding the nature of the assets held, and relevant tax information, as well as implementing best practice guidelines in relation to consumer protection.</p> <p>It will be important to ensure a reasonableness standard is applied so as not to undermine the purpose of the safe harbour protections by imposing an overly onerous burden on the DAF provider in meeting the conditions.</p> <p>Given the high price volatility of digital assets, we also submit consideration should be given to safe harbour protections applying in the context of calculating the value of digital assets for the purposes of the exemption thresholds (Info Box 3 – see Set 2 below) and general net tangible assets (NTA) for the purposes of meeting the financial requirement threshold (Info Box 6 – see Set 4 below).</p>
3. Licensing digital asset intermediaries		
Set 2	<p>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?</p>	<p>We support the general proposition of a low value threshold and note the proposal is based on the existing exemption for non-cash payment facilities. However, the high price volatility of digital assets is not conducive to a sharp line threshold amount. There is a risk that DAFs holding assets just below the total threshold would be shifted outside the scope of an exemption should the market adjust upwards quickly. A more appropriate method may be a threshold calculation on a sliding scale to allow for market fluctuations. Consideration might also be given to require platform providers to confirm annually that they meet the exemption criteria.</p> <p>Bitcoin (BTC) is the closest thing to a “standard” in terms of the value of digital assets and, historically, the value of the market as a whole reflects the rising and falling value of BTC. As such, the value of BTC might be considered as a standard for monitoring the value of exemption thresholds.</p>

	Questions	Law Society comments
Set 3	<p>What would be the impact on existing brokers in the market? Does the proposal create additional risk or opportunities for regulatory arbitrage? How could these be mitigated?</p>	<p>The proposed framework is considered appropriate to meet the objective of promoting consumer confidence insofar as it makes “dealings” and “arrangements” by brokers and agents in relation to acquisitions through DAFs subject to the same regulations as brokers and agents dealing in any financial product.</p> <p>However, there may be perceived compliance problems for brokers and agents that deal in or arrange an acquisition through a DAF when that dealing involves assets that are non-financial.</p>
Set 4	<p>Are the financial requirements suitable for the purpose of addressing the cost of orderly winding up? Should the net tangible assets (NTA) requirement be tailored based on the activities performed by the platform provider?</p> <p>Does the distinction between total NTA needed for custodian and non-custodian make sense in the digital asset context?</p>	<p>The requirements are considered suitable for the purpose of addressing the cost of an orderly winding up. However, clarification is required as to how the value of a DAF will be calculated. Assuming the value of all digital assets held must be counted, the same concerns regarding the volatility of digital assets as expressed in Set 2 apply here.</p> <p>As the NTA requirements are designed to provide a financial buffer, consideration might be given to invoking safe harbour provisions during volatile market conditions.</p>
Set 5	<p>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.</p>	<p>It is not considered appropriate to expand the financial advice framework to incorporate non-financial digital assets. The framework put forward in the consultation has been specifically designed with a focus on the regulation of DAFs holding digital assets, and the provision of financial services in relation to those DAFs, rather than the digital assets themselves.</p> <p>This is in line with international approaches which have sought to minimise regulatory arbitrage and the hampering of innovation in the cryptocurrency ecosystem by way of a risk-based framework that excludes non-financial assets, or those that are already regulated under existing consumer protection regimes. Extension of the framework to incorporate non-financial assets may result in overlapping regimes that cause unnecessary complexity.</p>

	Questions	Law Society comments
Set 6	<p>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?</p> <p>Should there be an ability for discretionary facilities dealing in digital assets to be licensed (using the managed investment scheme framework or similar)?</p>	<p>It is noted the proposed disclosure obligations adopt the “rulebook” model for non-discretionary trading facilities, including a facility guide and facility contract. This will require platform providers to standardise rules and procedures for trading. Given the automated nature of the token marketplace, it is acknowledged there would be broad capacity to build these rules into platform systems. However, one general concern is that governance needs may not be completely addressed by automation and the risk scope in this environment, including risks in relation to security and crisis management, is uncertain.</p> <p>It is also noted that the proposed framework ensures all arrangements involving digital asset facilities would be required to be structured as non-discretionary. While automated blockchain-based systems may have the attributes of a discretionary managed investment schemes (for example, by providing token staking functionality – see further under Set 11) it is unclear what is proposed regarding licensing. However, as a general principle, we would not be opposed to enhanced disclosure obligations also applying to discretionary trading facilities.</p>
4. Minimum standards for facility contracts		
Set 7	<p>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?</p> <p>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)?</p>	<p>We generally support the proposed adoption of minimum standards for holding digital assets to apply to DAFs and note they largely replicate existing minimum standards for traditional financial assets, including holding assets on trust.</p> <p>Regarding what assets might be held on trust, we note that in some situations customers will be wary of handing over any record of their private keys, considering that this is the main element through which a user executes transactions and controls their digital assets, and the loss of which is irreversible. In this regard, we note that there are existing business models (primarily Ethereum staking service providers) which are able to operate as custodians without needing a record of private keys.</p> <p>Appropriate guidance is required to cover the varying forms of custody arrangements. We would anticipate these minimum standards will be further considered and expanded upon, and may become the subject of separate, more targeted consultations.</p>

	Questions	Law Society comments
Set 8	Do you agree with proposed additional standards for token holders? What should be included or removed?	We agree in principle, but see the comment above in Set 7.
Set 9	<p>This proposal places the burden on all platform providers (rather than just those facilitating trading) to be the primary enforcement mechanism against market misconduct.</p> <p>Do you agree with this approach? Should failing to make reasonable efforts to identify, prevent, and disrupt market misconduct be an offence?</p> <p>Should market misconduct in respect of digital assets that are not financial products be an offence?</p>	We agree with this approach, on the assumption that the framework is designed to balance the imperatives of consumer protection and minimising compliance burden. This may include consideration as to what would constitute “reasonable efforts”. An appropriate mechanism may be to require DAF providers to prepare their own policies which must comply with a set framework.
5. Minimum standards for ‘financialised functions’		
Set 10	<p>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.</p> <p>Do you agree with suggested requirements outlined above? What additional requirements should also be considered?</p> <p>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?</p>	We broadly agree with the suggested requirements, with the caveat that further analysis is required as to the operation of decentralised autonomous organisations (DAO), given the structural challenges in regulating decentralised finance (DeFi). Agility in regulatory architecture is necessary to respond to the rapid advancement in DeFi developments.
Set 11	<p>What are the risks of the proposed approach? Do you agree with suggested requirements outlined above? What additional requirements should also be considered?</p> <p>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?</p>	Staking can take various forms depending on the protocol it is built upon. While the proposed approach provides sensible high-level guidance in respect of a DAF, as intermediary, providing token staking functionality, we consider further analysis is required to ensure the regulatory outcome is achieved. Recent developments in Switzerland and Singapore, where regulators have been criticised for restricting digital asset service providers from offering staking, should also be considered.
Set 12	<p>How can the proposed approach be improved?</p> <p>Do you agree with the stated policy goals and do you think this approach will satisfy them?</p>	We agree with the proposed approach. As a general principle, we support harmonisation with international regulatory frameworks, and note the policy goal stated in the consultation paper of consistency with the European Union’s “Markets in Crypto Assets” framework.

	Questions	Law Society comments
Set 13	<p>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?</p> <p>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?</p>	<p>We submit further development of the regulatory framework should be undertaken in respect of crowdfunding intermediated by a DAF, beyond what is presently set out in the Corporations Act.</p> <p>In particular, the proposal may conflict with current industry practices relating to the funding of crypto projects. As such we would recommend further targeted industry consultation on this issue.</p>
6. Other activities		
Set 14	<p>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?</p>	<p>We agree with the proposed approach in principle.</p>
Set 15	<p>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?</p>	<p>We have no comment to make at present regarding debenture-like arrangements and margin lending-like arrangements, or any other activities to be added as financialised functions.</p> <p>While out of scope at this stage, we submit transactions involving stablecoin and DAOs should be considered in the future development of the overall framework. Questions around the lending of digital assets might flow from further analysis of these matters.</p>
7. Next steps		
Set 16	<p>Is this transitional period appropriate? What should be considered in determining an appropriate transitional period?</p>	<p>We submit the 12-month transitional period may be insufficient given the broad scope of the proposed framework and the potential impact on participants and regulators. We consider a 24-month period may be more appropriate.</p>