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Submission in response to Consultation Paper 381: Updates to INFO 225 - Digital Assets - Financial products and services

Submission by:
/ Queensland University of Technology;
/ HopgoodGanim Lawyers; and
/ Zerocap.

Prepared for:
Digital Assets Team
Australian Securities and Investments Commission

/ 28 February 2025

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Dear Digital Assets Team,

HopgoodGanim Lawyers, Queensland University of Technology School of Law, and Zerocap appreciate the opportunity to make a submission in relation to the Consultation Paper 381: Updates to INFO 225: Digital Assets: Financial products and services.

HopgoodGanim Lawyers is a leading Australian independent legal and advisory firm operating nationally and internationally to deliver exceptional outcomes to clients across a broad range of industry. It focuses on five key priority markets nationally, one of which is its technology and digital economy priority market.

Tim Edwards is a Partner of HopgoodGanim Lawyers, the head of its cross-discipline digital assets practice group, the national lead of its technology & digital economy priority market, and an accredited specialist in commercial litigation (awarded by the Queensland Law Society). Tim was assisted by Jonah Farry, a Law Graduate with the firm who has a particular interest in digital assets and experience working in commercial litigation.

Dr Lachlan Robb is an academic at Queensland University of Technology School of Law, focusing on the socio-legal dimensions of emerging technologies. Lachlan researches blockchain start-ups, and how technology such as blockchain and AI potentially disrupt legal and normative orders. He currently studies the wider responses to emerging technologies as seen by both regulators and the legal profession. Dr Lachlan Robb was assisted by Dr Bikalpa Rajbhandari.

Zerocap is a digital asset-focused capital markets firm which primarily provides liquidity, structured products and on-chain custody to institutional clients and investors. Ryan McCall, Founder and CEO of Zerocap, has assisted with the preparation of these submissions from an industry participant's perspective. Zerocap is a loud advocate for Australia's digital asset industry and a long-standing client of HopgoodGanim Lawyers.

We are pleased to see the progress that is being made by the Australian government towards blockchain regulation, and this latest step represents a significant effort to clarify the regulatory treatment of digital assets, which we applaud. However, we have a few specific consultation questions that, based on our expertise and experience, we wish to bring to your attention.

1. Background

1.1 CP 381 makes it clear that it is essential to clarify the kinds of digital assets that may constitute a financial product under current financial services laws. To do this, ASIC has made productive steps towards adding examples that help readers understand various positions and possible determinations on digital asset categorisation.

1.2 Based on the expertise and experiences of the authors of this submission, we have focused on a few select questions raised by this consultation paper, most relevantly:

(a) A2 examples;

(b) A3 stablecoins and wrapped tokens;

(c) B1 related to safe harbour provisions;

(d) comments on the role of ICOs; and

(e) comments on the use of a definition that includes crypto assets as property.

1.3 However, we first wish to make the following overarching comments, which should be kept front of mind when considering and interpreting the balance of our comments in this submission.

1.4 Ultimately, there is a need for caution here. The digital asset industry is driven by fierce innovation but concerned with the future direction of applicable regulation. It has been said that technology regulation can act like a wildfire - insofar that it can burn a great swath of land but will not eradicate every tree; the saplings, weaker trees, and unusual growths don't stand a chance, and so what remains are the tallest and strongest. This can be beneficial when the 'bad actors' are those that are likely to be burnt and removed, but in doing so, the scorched earth destroys many others who may have been promising innovators or future leaders. This process leaves behind a small core of the biggest (or richest) actors, who are then emboldened to act in new ways whilst supported by more power and a greater share of the market. The Royal Commission into the Australian Banking and Finance sector raised many critical questions about the consequences which can flow from the fact an industry's power is centralised in but a few hands. We caution against inadvertently replicating this in the digital asset industry - one that relishes centralisation and ideologically seeks to redistribute power and opportunity. There is a power in the hands of regulators which needs to be appreciated, because a misplaced match may start a fire which then burns indiscriminately and causes more harm than good in the long term.

1.5 It is also clear from recent litigation in this space that ASIC has adopted an enforcement-by-regulation approach. Granted, this is likely prompted by some frustration or impatience towards a lack of clearly applicable legislation. However, the guidance addressed in this consultation paper is not legislation – the information sheet would not be binding nor enforceable. That said, considering the current regulatory climate, and the fact it will apply to an industry which is loudly yearning for regulatory clarity, the power of the proposed information sheet needs to be appreciated by its drafters. The sheet is functionally a tool to support prospective or actual litigation and is likely to influence the paths taken by the digital asset community – particularly those members (being, we expect, the majority) who would not have the resources to defend protracted litigation. The detail in the draft sheet and the way it appears intended to guide and support future litigation (rather than play any functional role akin to legislation, which it simply cannot, due to its very nature) gives us cause for concern that ASIC is maintaining its desire for enforcement-by-regulation. At the very least, we hope that this approach does not take effort or resources away from the overarching role of ASIC as a body to liaise with legislative bodies to create the true regulatory certainty the industry would and should prefer to be in place. This is preferred to the current path of enforcement-by-regulation for numerous reasons.

2. Proposal A2 – To include the worked examples as set out in the updated draft of INFO 225

2.1 A2Q1 seeks comments on the proposed examples. We have made comments relating to the way examples were structured, as well as comments on the specific content of examples 1, 2, 3, 4, 6, 12 and 13. We acknowledge that ASIC is 'keeping the guidance principles-based' to 'cater for the broad range of products and services in the market…and noting that the rights and benefits of a digital asset can change over time.' This is a difficult balance to strike. Any suggestions provided here are given with this position and balance in mind.

(a) **Counterexamples would assist a comparative reasoning approach**

We encourage the development of additional examples (per A2Q2) which emphasise nuanced applications, rather than solely focusing on technology and token types. These examples should illustrate how subtle changes in key concepts can lead to different regulatory approaches and, perhaps even more critically, enable the use of comparative or deductive reasoning by readers in order distil a relevant and specific 'rule of practice' from the example which applies to the situation they are considering. Creating a means for readers to distil rules of practice can permit these examples to provide real guidance in scenarios not even envisioned by the drafters – which would no doubt be beneficial for the industry.

For instance, providing pairs of dichotomous examples would be beneficial - one demonstrating a scenario where a token is regulated in a specific manner, and another presenting a similar scenario with a slight alteration in a key concept, resulting in a different regulatory approach – 'counterexamples' which create a contrast that assists understanding of the reasoning process. This comparative approach will help highlight the impact of nuanced changes on regulatory outcomes, and again, help readers to distil useful patterns or rules of practice that can be applied, at least tentatively, to their circumstances.

(b) **Structural comments**

The structure adopted for presenting the examples may benefit from changes. While it is stated that ASIC has taken a 'principles-based' approach, in all examples listed, there is a focus on identifying different token types, but no explanation dedicated to the way that the qualities of each token lead to different regulatory outcomes. This indicates a relatively absolutist choice between those two different types of approaches to presenting information and examples.

We would encourage ASIC to rethink the examples given in terms of concepts and legal themes, rather than only objects. Ideally, a combination of both paths would yield the clearest results. We recommend a hybrid approach.

(c) **Conceptual explanation needed (including objective intent)**

Many of the examples reflect the application or consideration of the legal quality known as 'objective intent'. However, they do so without necessarily specifying that, nor describing or explaining that quality or its importance.

It is a central concept to many causes of action relevant to enforcement in the digital asset space. It has also been quite persuasive in a number of recent relevant cases (e.g. Block Earner1).

There is no neat way to give exhaustive and proscriptive guidance about a concept such as objective intent – but even this fact, and the resulting uncertainty, ought to be mentioned in the information sheet. An explanation of ASIC's views

[1] *Australian Securities and Investments Commission (ASIC) v Web3 Ventures Pty Ltd* [2024] FCA 64

towards this concept, if it is to be central to a number of relevant legal principles, should be included in the sheet. It is too important to be glossed over; and ignoring it, may make these examples appear more useful and proscriptive than they ever fairly could be.

More generally, and in addition to objective intent, there are many other types of 'concepts' which are also thematic through the decision making in the examples, but which are never fully explained or articulated. We encourage a deeper reflection of this and reconsidering how examples are categorised or then deconstructed by explanation. Many readers would be best off 'working backwards' from an answer or discerning patterns or rules from examples, and this would be more easily done if the various components used to create and resolve an example are explained more thoroughly.

(d) **Readability**

To enhance readability, it would also be helpful if each example included clear headings, aligning with the format outlined in the consultation paper. Additionally, using subheadings to break down complex scenarios could further improve clarity. Currently, the examples attempt to cover too much ground (particularly in examples 1, 2, 3 and 4), with too many variables shifting within each. This makes it difficult to determine the principle under which each decision is explicitly drawn from, and how individual factors contribute to the decision and position taken in the example. By limiting the number of variables which change within each example and clearly linking each decision or position to specific principles or factors, the examples will become more focused and easier to understand.

(e) **Example 1 – Exchange Token**

The example exploring the concept of an exchange token needs additional information. It needs to be clarified that the 'business project 'mentioned therein is the operation of the exchange. By just talking about business projects, it can be read very widely, particularly by non-lawyers, and may have unintended consequences (per A2Q3).

Providing a counter-example (as discussed above in 2.1(a) would be ideal to demonstrate what the effect of changing certain aspects of the token arrangement would be.

(f) **Example 2—Native token staking service**

The logical process within this example skips a number of steps in a manner which make it more difficult to distil a rule of practice than would otherwise be the case. This is propounded by some generality in the example.

For instance, it leaps to state that company B is running the staking mechanism, without specifying what role that actually entails (is it a mere technical interface or is there a management or even governance function).

This example would, on whole, benefit from greater detail – particularly around what benefits are being received by the parties involved, and why they differ from benefits in different staking (including direct-access staking) arrangements might otherwise bestow.

For example, when referring to access to staking which is 'not otherwise available' to users, it could be specified, from there and as an example only, that the benefit is staking with less than 32 ETH (being less than the minimum needed to stake ETH directly).

Counter-examples would, again, provide some of this clarity.

(g) **Example 3—in-game non-fungible tokens (NFT)**

We agree with the outcome and discussion in example 3. However, we wish to highlight that the principles seemingly applied in the example scenario can have many nuances which are not discussed or alluded to when discussing the example. This may cause unintended issues, as highlighted above (including misconceived confidence from industry in particular ideas) - and the concept of objective intent should, again, be addressed. Once more, counterexamples would assist to overcome some of these limitations.

(h) **Example 4—Yield-Bearing Stablecoin**

This example needs additional information in order to clarify the exact grounds on which it has been determined or resolved. It reads very clearly, but there is often a lot more nuance that is found in these types of matters (and which is, here, needed in order to distil a clear rule of practice).

Anecdotally, clients wishing to operate these types of stablecoins in Australia have thus far typically tried to avoid the offering of yield-based assets. Instead, they have set about trying to earn income from stablecoin projects either indirectly (the indirect benefits of creating a network or ecosystem), or simply by earning interest on the reserve of linked AUD. This has been motivated by an attempt to avoid interactions with financial services regulation – including the interaction imposed in this example.

This motivation has been predominantly justified by a view taken by much of the industry, at least until recently, that if the stablecoin does not earn yield and is structured to be minted, issued and redeemed in a particular way and on particular terms, it is not necessarily a financial product at all.

That view has come under scrutiny following the Qoin decision[2] (discussed further with respect to example 13 below) and ASIC's apparent view that many stablecoins may, themselves (at the token level) constitute non-cash-payment facilities (**NCPFs**). This adjacent area of enquiry makes the presence of nuance in example 4 even more important.

(i) **Example 6—Membership NFT**

It is commendable that this example is succinct, however, there is a lot less detail here than in some of the other examples and that may cause problems. We would recommend referencing the role of secondary markets. Following the logic in example 3 and what we have discussed above in 2.1(c), objective intent needs to be considered. The scenario referenced in example 6 may lead to a very different outcome if there is a secondary market involved and depending on the the objective intent of the token provider and their relationship to that market. Anecdotally, this is a common concern, and there is a need to consider the use of secondary markets and how this may or may not alter the determination of how an asset is to be treated by financial services regulation.

(j) **Example 12—Contract for Difference Over a Digital Asset**

This example needs to be clarified. We encourage the splitting of this into multiple examples that alter key facts to show how and when it is a derivative, or not—and also when it may instead amount to a debenture. Anecdotally, the risk of debentures is raised in analogous scenarios and having clearer examples that address this will make substantial moves towards clarifying ASIC's position.

[2] *Australian Securities and Investments Commission (ASIC) v BPS Financial Pty Ltd (BPS)* [2024] FCA 457.

(k) **Example 13—Digital Asset Wallet**

The example here has good detail, but it also clearly shows its origins from the Qoin decision.[3] Our view is that the decision in the Qoin case should be applied as authority for the fact that blockchain wallets will tend to be, let alone are, NCPFs, with some caution. That decision was made and reasoned by Her Honour in reliance upon the highly nuanced circumstances of that case, and the decision may well be distinguishable from – and thus not apply to – many other circumstances. We caution against the generic nature of example 13 as it does not fully appreciate this (or, generally, the complex process of distilling a *ratio decidendi* from a complex financials services decision and then applying it to different, potentially independently complex, factual scenarios).

For example, it may be possible to distinguish the decision due to:

- the fact that, in that case, both parties outright agreed there was a NCPF 'somewhere' in the mix. Further, Qoin had previously published material stating, and thus effectively admitting, that the wallet was an NCPF. This led the Court to scope its enquiry as 'which part the product is the NCPF' rather than 'is there one at all'. This had important consequences for the sort of analysis then undertaken by Her Honour. These arguments may well be used to distinguish the decision from other aesthetically similar circumstances;

- the character and potential use of the Qoin Wallet in that case was dependent on a number of factors, which may not exist in other cases, including the way in which the Qoin Wallet interacted with other parts of Qoin's offering and the terms and conditions under which it was issued or made available; and

- whilst one should not approach decisions that are appealable but not appealed as anything less than binding, it is true that this point is yet to be considered in detail by an appellate court, in an area of law where most, if not all, significant ASIC decisions are presently subject to an appeal (including another element of the Qoin case itself).

2.2 Ultimately, there is a need for more detail in these examples. We appreciate the effort that has gone into crafting these and the balance that needs to be struck between vague statements and concrete nuanced examples. However, for many of these examples, it may be beneficial to add more nuance and discuss specific steps and quantities – to both give more life to the examples, and to clearly demonstrate the separation of principles. This would keep a healthy degree of vagueness to the examples while also making them able to deliver clearer information and help the public distil rules of practice they can usefully apply.

2.3 Regarding **A2Q2** - we would encourage more examples that focus on legal concepts and themes and how these qualities are important for different assets, rather than just focusing on the name of these assets. We would also encourage companion examples that can state ways, not just how an asset would be categorised as a type of regulated asset but also examples that show when circumstances may change enough that it is no longer regulated in the same way. Please see comments above in 2.1(a). We would also encourage the inclusion of additional examples that elaborate on wrapped tokens and stablecoins, as discussed below.

2.4 A2Q3 seeks information on possible unintended consequences. We wish to highlight the difficulty of having a lack of nuance. Readers may then try and use these to develop a quick insight with unintended consequences. This is because the examples may appear to have more certainty, but it is just a potential for over-simplified conclusions being draw for an emerging industry that is yearning for clarifications.

[3] *Australian Securities and Investments Commission (ASIC) v BPS Financial Pty Ltd (BPS)* [2024] FCA 457.

3. Proposal A3 - Stablecoins and wrapped tokens

3.1 Proposal A3 focuses on stablecoin and wrapped token assets. It seeks discussion as to how these assets may be derivatives or NCPFs. There is a need for any further progress on regulating these assets to be considered and not impede innovation or cause unintended consequences.

3.2 A3Q1 asks if there is any need for examples of wrapped tokens and stablecoins. Further examples should be included here because, at pages 12 and 13 of CP 381, ASIC has identified particular characteristics of both stablecoins and wrapped assets which it considers would render them 'financial products' under existing law. Many real-life scenarios will involve assets having a mixture of 'financial product characteristics' as well as indicia with the opposite general effect. The indicia considered here could be more easily applied to complicated real-life 'mixed' examples of this sort if, again, counterexamples were included to assist the understanding and the distillation and then application of underpinning reasoning.

3.3 A3Q2 asks for practical implications if these assets were classified as financial products. Our overarching view on this point is that imposing unnecessarily obstructive licensing restrictions on protocols or companies which operate to provide the digital asset industry with interoperability mechanisms such as wrapping would stifle innovation. Such restrictions would serve as an enormous blockade to what is a much-needed remedy for, arguably, blockchain's biggest technical shortcoming – the non-interoperability of tokens between chains (i.e. one cannot send a BTC to an ETH because the technology cannot accommodate this).

3.4 A3Q3 seeks information on regulatory relief. We believe that a safe harbour should be deployed so as to allow innovation to continue, and perhaps, for interoperability service providers, and exchanges issuing wrapped assets to tailor their services so as not to reflect any of the contravening criteria set out at pages 12-13 of CP 381. However, any safe harbour provisions must be implemented carefully, as discussed below at 4.2.

4. B1 - Transitional Approach: Safe Harbour Proposals / 'Class no-action'

4.1 B1 concerns the 'class no-action' for digital asset businesses in the process of applying for an AFSL or applying to vary an existing AFSL and how this relates to safe harbour provisions. We wish to highlight the important difference between 'defences' and 'positive carveouts' to ensure that the approach taken by ASIC is considered and appropriate.

4.2 Question **B1Q1** asks if ASIC should progress with a class no-action position. This would apply to operators dealing with digital assets that may now be deemed to be financial products under the updated guidance. A 'safe harbour' framework would allow businesses to apply for an AFSL or market licences without the immediate risk of enforcement action, provided they meet certain precursory conditions and timelines.

(a) As stated in paragraphs [1.16] to [1.18] of HopgoodGanim and QUT's response to the 'Regulating Digital Asset Platforms' proposal paper of October 2023 (**RDAP Response**), there is a marked difference between a 'defence' and what is sometimes called a 'positive carveout'. The former does not inspire innovation, the latter does.

(b) Safe harbours mean that under certain circumstances, a person in 'breach' of provisions of the proposed legislation or existing legislation will be able to avoid personal liability. The onus is on the person deemed to be in breach, and hence it is sometimes called a 'safe harbour defence'.

(c) In our view, and again as stated in the RDAP Response, and with respect, a defence creates a greater risk of not only aggressive statutory interpretation by regulators, but also that poorly advised or misinformed industry participants failing to satisfy their onus to raise a defence for technical and/or legal reasons. Persons subject to statute ought to be encouraged to feel like certain acts are permitted, rather than simply 'excused' from illegality if certain criteria can be satisfied. The difference there may be substantial and create different legal outcomes, whether

intended or not. Further, innovators ought to be free from the risk that comes with having an onus of proof.

(d) If the goal is to continue encouraging innovation, ASIC must be mindful of the semantic differences of what otherwise may be construed as a 'defence' at law, and what is known as a positive carveout.

4.3 Existing licensees are 'grandfathered' into the framework, with ASIC seeming to maintain that no substantial regulatory changes are needed to accommodate digital assets. This position is likely to be challenged given that ASIC's starting point some ten years ago concerning digital assets was that the majority were almost certainly not financial products. On the other hand, startups and new entrants are legally obliged to seek licensing, raising questions about competition and fairness and whether this approach creates a regulatory advantage for established players.

4.4 Question **B1Q2** asks if the proposed conditions are appropriate. Our position is that a more reasonable timeframe would be 12-18 months. The primary reason is that such a short timeframe may cause a monopoly and an early advantage for companies with larger liquid cash holdings to put towards associated legal and compliance costs. Smaller companies may not yet have the cash to front the cost of an AFSL, and those companies should not be excluded from innovating and carrying on a business in the digital asset industry within the 'pay to play' environment of the sort which is at risk of being created if the current proposal remains as is (i.e., don't burn the forest).

5. Conclusions

5.1 We have selectively addressed a number of components in Consultation Paper 381 based on our professional expertise and experiences:

(a) **A2 examples.**
We engaged with examples 1, 2, 3, 4, 6, 12 and 13 and acknowledge ASIC's design in providing examples that are principles-based. We made several suggestions and ultimately highlight a need to rethink some examples and provide additional clarifications that can look to broader qualities that are shared across assets (e.g. objective intent) and providing examples for how these features are considered, rather than merely focusing on the assets themselves. We also recommend that counterexamples should be used. The goal is to make it easier for readers to discern a pattern and distil a rule of practice from the examples which they can tentatively apply to their own circumstances.

(b) **A3 stablecoins and wrapped tokens.**
We indicate our position on stablecoins and wrapped tokens, demonstrating that there is a clear need for more information on these, including further examples. We also warn that discouragement of mechanisms designed to give interoperability to blockchains could badly hurt innovation, and the surpassing of what is a substantial technical shortcoming for some blockchains.

(c) **B1 related to safe harbour provisions.**
We highlight the importance in adopting safe harbour provisions that clearly articulate if they operate as a defence, or as a positive carveout.

5.2 The level of detail in this guidance and its apparent support for future enforcement actions raises concerns that ASIC may continue to favour an enforcement-by-regulation approach. It is crucial that this strategy does not detract from ASIC's overarching role of collaborating with legislative bodies to create the regulatory certainty that the industry desperately needs. Ultimately, a clear and comprehensive legislative framework would be preferable to the current path of regulation through enforcement, providing the stability and clarity necessary for the digital asset industry to thrive responsibly

5.3 In conclusion, while regulation in the digital asset industry is necessary, it must be approached with caution. Overzealous regulation can, again, act like a bushfire - potentially eliminating not only bad actors, but also innovative startups and future industry leaders. This could inadvertently lead to centralisation of power among a few large players, contradicting the decentralised ethos of the digital asset space. Regulators must carefully balance the need for oversight with the preservation of innovation and diversity in the industry. We welcome clear regulation that provides Australians and the Australian digital asset industry with clarity and certainty as to the treatment of digital assets going forward. We would be happy to discuss further and contribute to the discussion, including providing assistance with drafting.

5.4 If we can be of any further assistance, please do not hesitate to contact the writers to discuss the matters further.

Yours faithfully

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