
REIMAGINING DEFI REGULATION

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Response to ASIC's Consultation Paper 381:
Updates to INFO 225

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Intro

This paper presents a response to ASIC's [Consultation Paper 381, Updates to INFO 225: Digital Assets—Financial Products and Services](#) (December 2024). It addresses two key questions—B2Q1 and B3Q1—regarding whether existing regulations should apply to digital assets and their associated financial services. While ASIC's rationale behind the current approach may seem convincing, several overlooked aspects warrant further examination.

Recent macroeconomic shifts over the past quarter-century—especially in recent years—indicate that the real estate market is overheated due to an excessive influx of investments, while other sectors of the economy suffer from an investment shortfall. Favourable conditions in the emerging digital financial sector could help alleviate this imbalance. However, the proposed policy misses this opportunity. By attempting to fit the digital economy into a regulatory framework designed for the traditional economy, it subjects digital assets and related financial services to outdated complexities—a rigidity that is unnecessary when considering alternative approaches.

Section 1: The Impact of Regulatory Barriers on Investment Choices or the Second Reason of the Housing Crisis

Discusses broad macroeconomic picture and rationale behind tailoring DeFi* regulations.

Sections 2: Are Regulations Truly Technologically Neutral?

Points out overlooked differences of the traditional finance.

Section 3: Alternative regulation for DeFi

Discuss alternative approach to regulation.

B2Q1

Do you agree that the same regulatory obligations should apply to digital assets and traditional financial products of the same category (e.g. securities, derivatives)? Please explain your response and provide specific examples.

B3Q1

In relation to the authorisations sought during an AFS licence application, do you agree that the existing authorisations are generally appropriate to digital asset service providers?

About author

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- PhD in Law, Science, and Technology with a specialisation in Fintech and Blockchain Technologies
- Received a joint degree from the University of Bologna (Italy) and the Autonomous University of Barcelona (Spain)
- Worked as a researcher at the RMIT Blockchain Innovation Hub
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* **Decentralised finance (DeFi)** - hereinafter, this term is used in its broadest sense, encompassing cryptocurrencies, stablecoins, decentralised exchanges (DEX), automated market makers (AMM), decentralised autonomous organisations (DAO), smart contracts, decentralized applications (dApps), and other blockchain/DLT technologies.

Section 1:

The Impact of Regulatory Barriers on Investment Choices or the Second Reason of the Housing Crisis

The Australian real estate market has experienced an unprecedented rise in prices, driven not only by supply limitations but also by regulatory imbalances that disproportionately favour property investment. High barriers to entry in the financial sector prevent the emergence of innovative financial products that could serve as viable alternatives to real estate. As a result, investment capital continues to flow disproportionately into property, creating a cycle where prices rise simply because more people invest—exactly the kind of self-perpetuating loop that Nobel Prize-winning economist Robert J. Shiller has described as a speculative bubble.

Unlike financial advisors who must hold an Australian Financial Services Licence (AFSL) to recommend investments in regulated products, real estate promoters are not subject to the same qualifications and can freely advocate for property investment. While property investment **advisors shout from the rooftops**, financial products and services face extensive regulatory hurdles at every stage—from creation and market entry to promotion and operation—burdened by red tape.

The lack of financial product supply is not the only factor contributing to the housing crisis; the 'demand' side is also heavily distorted. Any individual can invest in and borrow **formally unlimited** amounts for real estate. In contrast, financial regulation has created a **segregated class of qualified investors** with exclusive access to a closed, privileged market of financial products. This creates an **uneven playing field**, where the loudest voices—those pushing real estate—dominate the investment landscape.

This lack of competitive financial products leads to a dangerous concentration of household wealth in real estate. In countries with high financial regulation and a strong cultural affinity for property, an outsized portion of wealth is tied up in real estate. In Australia, roughly 58% of household wealth is in non-financial assets (mainly housing), compared to a global average of 46% (The Australian Council of Social Service). This imbalance is not just a market trend; it is a consequence of regulatory structures that **limit financial innovation** and discourage diversification.

Heavy regulation can shift investment behavior. A George Mason University Mercatus Center study found that complex rules reduce entrepreneurship and divert funds from productive uses. When starting a new venture becomes too burdensome, entrepreneurs may turn to “safe” assets like real estate. Similarly, investors facing restricted access to alternative financial products may choose property investments, tilting the market in favor of real estate.

NSW Chief Justice Thomas Bathurst discussed how legal regulation is necessary for economic efficiency but also emphasised that overly complex legal requirements increase compliance costs and create uncertainty. He said: *"An individual should not need a senior counsel, junior counsel, and **a small army of solicitors** to tell them what the law they must comply with is."*

ASIC's proposal to fit the Digital Asset into the existing regulatory framework, designed for the traditional finance, risks missing a crucial opportunity to rethink the existing red tape to harness emerging technologies for Australia's economic growth. The next section outlines why DeFi is different and requires different approach.

Section 2:

Are Regulations Truly Technologically Neutral?

ASIC's paper does not provide or reference a comprehensive review of whether existing financial laws and regulations are fully technologically neutral and if digital assets and related services require a different approach. Has such a revision truly been conducted, and are its conclusions well-substantiated? Who at ASIC can confidently claim and put their reputation that this to be entirely accurate? The paper appears to make exactly this assertion without sufficient scrutiny.

Key Differences Between Traditional and Decentralised Finance

Several fundamental differences exist between traditional finance and decentralised finance (DeFi):

- **Decentralised ledger:** Regulatory requirements designed for centralised digital infrastructure may not be fully relevant to digital assets operating on those public blockchains, which ensure immutable, decentralised record-keeping.
- **Cybersecurity and custody:** While DeFi eliminates certain centralised risks and thus regulatory requirements, it needs greater attention to cybersecurity, especially in private key management, as transactions can be irreversible.
- **Custody risks:** Some custody models, such as multi-signature schemes (e.g., 2-of-3 models where the custodian controls only one key), reduce risk of exposure and misconduct, potentially justifying more tailored or relaxed regulatory requirements.
- **Clearing and settlement:** Automated and decentralised clearing and settlement in DeFi reduce risks associated with bad faith and counterparty obligations. Have all the license requirements been scrutinised?
- **Transparency vs. privacy:** While blockchain transparency can be seen as a privacy concern, it should be leveraged as a tool for accountability in financial services. Investors seeking privacy can still opt for traditional finance.
- **Regulatory inefficiencies in KYC/KYT:** Blockchain and DLT technologies enable more efficient Know Your Customer (KYC) and Know Your Transaction (KYT) frameworks, such as secure expanded KYC/KYT perimeter unfeasible in closed centralised system, reducing redundant efforts, lowering operational costs, and alleviating regulatory burdens.
- **Blockchain is The Register:** The use of blockchain allows for a fundamental rethinking of how public and private financial registers operate, including ABN/ACN. Traditional registration processes, which require extensive procedural steps, could be streamlined or even automated through blockchain-based smart contracts. This applies not only to public registries but also to private registers maintained by companies and scheme operators, such as member, option holder, and debenture holder registers. Registration itself is not a sacred act but a means to achieve specific objectives. If these objectives can be met through blockchain—both by ASIC and private entities—it may be more efficient and reduce unnecessary bureaucracy. Publishing a compliant authorised smart contract on-chain can server both as formal act of registration (without needing to duplicate and validate it elsewhere and as an operational engine of the financial product and service.
- **Smart Contract Multifaceted Nature:** Smart contracts themselves exemplify a fundamental technological shift, challenging the traditional separation of regulation and licensing for financial products, services, and markets. A smart contract can represent an indivisible entity of all three elements, highlighting the need for a more adaptable regulatory framework.

Missed Opportunities for Innovation

I have barely scratched the surface, yet none of these critical points appear to have been adequately examined in ASIC's paper. Digital assets are not merely another financial format, as ASIC suggests. They operate on fundamentally different technological principles than those established before 2008. Traditional financial regulations were often designed—whether explicitly or implicitly—based on the constraints of centralised digital systems and fragile paper-based financial structures. Applying outdated regulations to digital assets may seem convenient, but it is ultimately a short-sighted approach that disregards their technological advancements and economic potential.

Section 3:

Alternative regulation for DeFi

The existing regulatory framework is elaborate, broad, and comprehensive. It addresses a large variety (if not all possible) of ways to conduct financial services, markets, and operate financial products. Its strength lies in its ability to fit even the emerging market of digital assets. However, as questioned in Section 1, is it reasonable? And as discussed in Section 2, would it not be excessive for DeFi? Now, I want to open a discussion of alternative approaches.

Having studied Fintech and Blockchain technologies since 2016, I find the topic of alternative regulation too large to fit into the format of a response to the consultation paper. Therefore, let me briefly outline the core ideas.

Streamlined Licensing Procedure

Revising the entire body of regulations to fit digital assets and related services may be a challenging task, it is proposed to leave the regulation as is and develop within the limitations of the Corporations Act 2001 (Cth) tailored frameworks (perhaps experimental at first). These frameworks should not be comprehensive, overwhelming, and aimed at covering all possible scenarios and ways to operate digital assets. Instead, they should be targeted at specific scenarios taken from the most popular and promising use cases, limited to only certain types of assets, types of transactions, and volumes.

Model / Standardised Smart Contracts

There are so-called “replaceable rules” in Australia or “model company statutes/constitutions” in the EU. They exemplify the approach of a quick start for business creation. Once adopted by the government as a standard document or a set of rules for certain forms of businesses, it largely satisfies the demand for legal rules and does not require an army of lawyers to do the paperwork. DeFi regulatory scenarios can be streamlined through the adoption of model/standard smart contracts. This will not close the opportunity to other forms, but custom designs will require the standard application process and full expertise by the regulator.

Declarative Principle

The declarative principle or formal licensing is exercised in many jurisdictions for various industries. The idea is that the applicant submits a form in which they explicitly agree with certain statements and declare that certain requirements are met, taking legal responsibility that all statements are true. In contrast, for example, to PDS, where regulation does not explicitly prescribe which questions must be answered and elaborated, the statement will be exhaustive and limited to the scenarios where there are no unknown unknowns. Moreover, the standard smart contract will itself restrict unprovided scenarios and the ability of misconduct therein. The process of application and verification should be fully digital and automated, essentially guiding the applicant, cutting them off, or redirecting them to the standard application process when the applicant chooses options that are not provided within this limited license. The declaration becomes public and indicates to consumers the associated levels of risk.

Quick Start and Risk-Based Tiers

The initial stage of operation is expected to represent little threat to consumers or the market. Hence, the lower license tier should be fast and cheap, requiring no lawyers and limited (including technically by smart contract design) with certain amounts and volumes of accepted obligations. After reaching these limits, the applicant is required to extend the operation limit through higher license tiers.

KYC/KYT controlled perimeters

Blockchain allows for the creation of controlled perimeters for KYC/KYT. The use of digital identity, combined with various privacy-preserving techniques, makes it possible to operate DeFi within such shared perimeters of DeFi operators. Operating within such perimeters will be sufficient from the perspective of KYC/KYT obligations, overcoming the widely known problem that each operator deals with non-exhaustive practices and unformalised requirements of AUSTRAC on its own.

Preferential DeFi to the National Economy

Many DeFi instances operate solely in the digital space and represent no interest to the real economy. The Streamlined Licensing Procedure should be chosen for promising DeFi forms and activities, such as:

- Tokenisation of shares, bonds, and real-world assets
- Operation of AMMs/DEX
- Expanded KYC/KYT perimeters

Providing a quick and easy start compared to their heavy-weighted counterparts in traditional finance.