



Australian Government

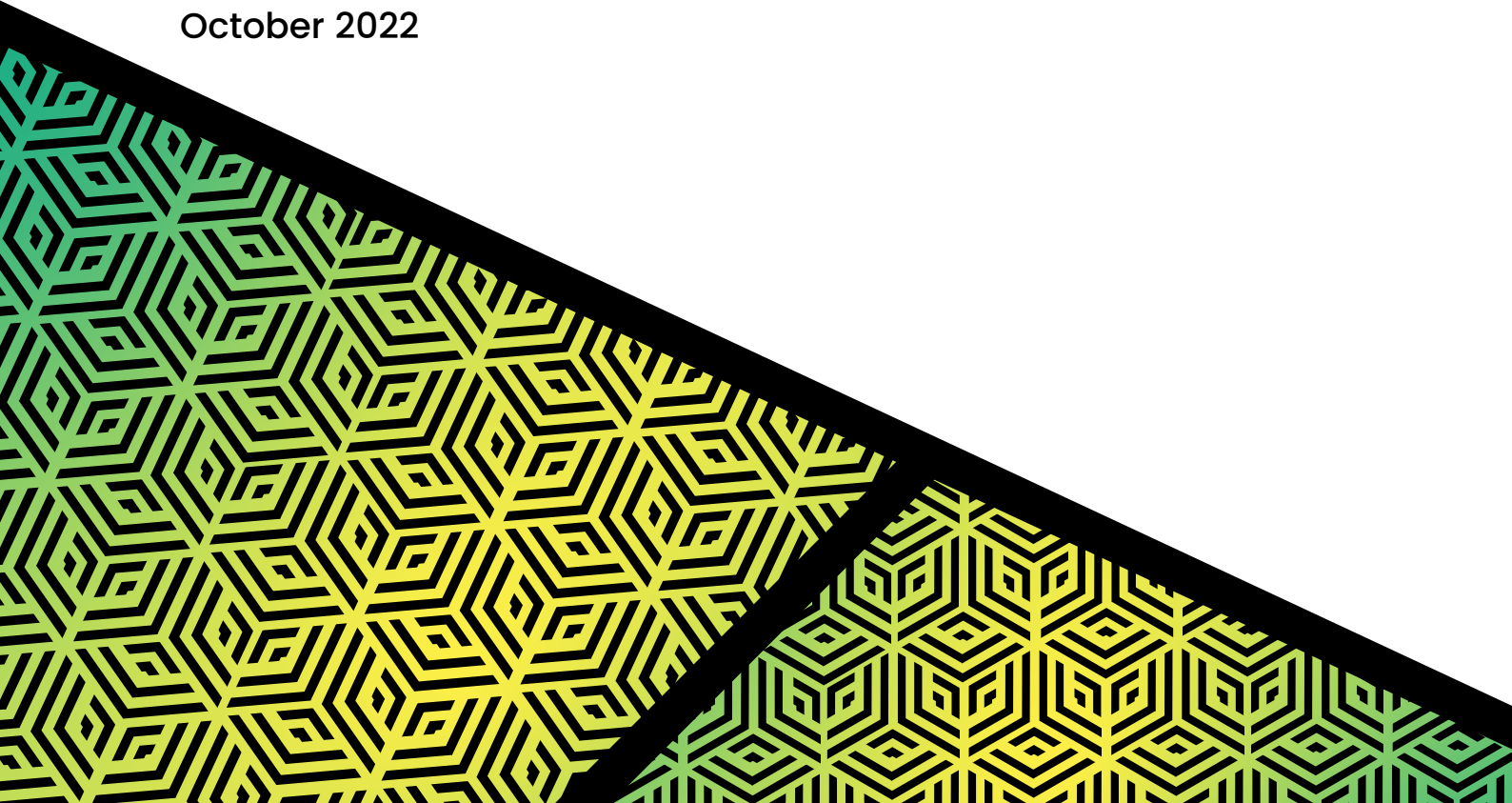
Australian Law Reform Commission

BACKGROUND PAPER FSL7

LEGISLATIVE FRAMEWORK FOR CORPORATIONS AND FINANCIAL SERVICES REGULATION

New Business Models, Technologies, and Practices

October 2022



This discussion of the regulation of new business models, technologies, and practices is the seventh in a series of background papers to be released by the Australian Law Reform Commission ('ALRC') as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation ('the Inquiry').

These background papers are intended to provide a high-level overview of topics of relevance to the Inquiry. Further background papers will be released throughout the duration of the Inquiry, addressing key principles and areas of research that underpin the development of recommendations.

The ALRC is required to publish one further Interim Report during the Inquiry, which will include specific questions and proposals for public comment. A call for further submissions will be made on the release of the third Interim Report. In the meantime, feedback on the background papers is welcome at any time by email to financial.services@alrc.gov.au.

[View the Financial Services Legislation Background Paper Series.](#)

The Australian Law Reform Commission (ALRC) was established on 1 January 1975 and operates in accordance with the *Australian Law Reform Commission Act 1996* (Cth).

The office of the ALRC is at Level 4, Harry Gibbs Commonwealth Law Courts Building, 119 North Quay, Brisbane QLD 4000.

Postal Address:

PO Box 12953,

George Street QLD 4003

Telephone: within Australia (07) 3052 4224

International: +61 7 3052 4224

Email: info@alrc.gov.au

Website: www.alrc.gov.au

CONTENTS

Introduction	7-1
Part One: Background	7-1
Part Two: What are crypto assets?	7-4
Part Three: What are DAOs?	7-9
The concept	7-9
The technology	7-11
Definitions adopted to date	7-13
Part Four: Regulatory design	7-14
Technology neutrality	7-14
References to innovation and technology in the Corporations Act	7-17
Regulatory policy concerning technology	7-18
Regulatory design theory in respect of technology	7-19
Regulatory approaches in respect of crypto assets	7-20
The current regulatory framework for crypto assets in Australia	7-22
Regulatory approaches in respect of DAOs	7-26
Part Five: Reform considerations in Australia	7-30
Regulation of crypto assets	7-30
Regulation of DAOs	7-32
Benefits of the ALRC's proposed legislative hierarchy model	7-34
Direction of reform generally	7-35

Introduction

1. The past decade has seen extraordinary growth in technological innovation. The emergence of blockchain technology (and distributed ledger technology more broadly) has led to a range of innovations in the area of financial services. These innovations include new ways of raising finance, such as initial coin offerings ('ICOs'), new means of exchange for payment purposes, such as cryptocurrencies, and new asset classes, such as crypto assets (which include cryptocurrencies and tokens generally). The new terminologies and taxonomies that have emerged alongside these innovations have presented challenges for both regulators and regulatory design.

2. In addition, a range of new business models have emerged in the financial services sector over the past decade, including buy-now-pay-later; robo-advice; peer-to-peer lending; crowd-sourced equity funding; and decentralised autonomous organisations ('DAOs'). Many of these models utilise developments in technologies that have resulted in new practices, including digital disclosure and dealings in crypto assets.

3. The development of new technologies and business practices poses challenges for financial services regulation in Australia. How should the regulatory system adapt to accommodate business models, technologies, and practices that are constantly evolving? This Background Paper examines, in particular, the regulation of crypto assets and DAOs, and identifies reform considerations for regulation in Australia. Given that crypto assets and DAOs are currently not subject to specific regulation, it is relevant to consider the extent to which reforms proposed by the Australian Law Reform Commission ('ALRC') in its current Inquiry may accommodate future regulatory developments in this regard.

4. One focus of the current ALRC Inquiry is the extent to which reform of the existing regulatory framework might recognise 'the continuing emergence of new business models, technologies and practices'.¹ Another consideration is 'the importance, within the context of existing policy settings, of having an adaptive, efficient and navigable legislative framework for corporations and financial services'.² The extent to which the regulatory framework is adaptive to technological developments is a key part of this consideration.

5. This Background Paper examines relevant issues in this context, including the use of defined terms, particularly the functional definition of 'financial product', and the potential benefits of the proposed legislative model foreshadowed in Interim Report A³ and examined in detail in Interim Report B.⁴

Part One: Background

6. In its response to various inquiries and reviews, the Australian Government has acknowledged the need to modernise the regulatory architecture and to adapt it to accommodate new technologies and services. These inquiries and reviews include an inquiry by the Senate

1 See Australian Law Reform Commission, 'Terms of Reference', *Review of the Legislative Framework for Corporations and Financial Services Regulation* (11 September 2020) <www.alrc.gov.au/inquiry/review-of-the-legislative-framework-for-corporations-and-financial-services-regulation/terms-of-reference/>.

2 Ibid.

3 See, in particular, Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) Chapter 10.

4 See, in particular, Australian Law Reform Commission, *Interim Report B: Financial Services Legislation* (Report No 139, 2022) Chapter 2.

Select Committee on Australia as a Technology and Financial Centre,⁵ the Payments System Review,⁶ and the Parliamentary Joint Committee Inquiry into Mobile Payments and Digital Wallets.⁷ According to the Australian Government:

The reviews found new technologies and services are testing our current regulatory definitions, perimeter and powers, and exposing regulatory gaps which could contribute to increased risks of consumer and business harm, possible future systemic instability and impeding private sector investment in innovative products and services.

Failure to modernise our regulatory framework will mean Australian businesses and consumers are increasingly engaging with unregulated parties and the rules governing our systems could be increasingly determined by foreign governments and large multinational companies.⁸

7. According to the Australian Securities and Investments Commission ('ASIC'), 'more than 800,000 Australian taxpayers have transacted in digital assets in the last three years', representing a '63% increase in 2021 compared to 2020'.⁹ The increasing importance of digital (crypto) assets — and the concomitant need to determine whether and how digital assets such as cryptocurrencies fit within the regulatory framework — has also been acknowledged by the Australian Government. In March 2022, the Minister for Superannuation, Financial Services and the Digital Economy issued a joint media release with the Treasurer, to announce that the Government was

progressing to the next stage of the most significant reforms to Australia's payment systems in more than 25 years, ensuring Australia can capitalise on the significant opportunities being created by new payment and crypto technologies.¹⁰

8. The announcement noted the release by the Department of the Treasury (Cth) of a Consultation Paper concerning proposed new licensing and custody requirements for crypto asset secondary service providers ('Treasury Consultation Paper') and the first stage of a broader token mapping exercise to be completed by the end of 2022.¹¹ The purpose of the token mapping exercise, which was recommended by the Senate Select Committee on Australia as a Technology

5 Australian Government, *Transforming Australia's Payments System* (2021) 4. This report focussed on reforms in Australia's technology, finance, and digital asset industries, including reforms in the regulation of cryptocurrencies and digital assets. For details of this inquiry and copies of the reports, see Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, 'Australia as a Technology and Financial Centre' (18 March 2021) <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Financial_Technology_and_Regulatory_Technology/FinancialRegulatoryTech>.

6 Department of the Treasury (Cth), *Payments System Review: From System to Ecosystem* (2021). This review focussed on the payments system and how it should be reformed to accommodate new technologies, business models, participants, and new forms of money. For details of this review, see Department of the Treasury (Cth), 'Review of the Australian Payments System' <<https://treasury.gov.au/review/review-australian-payments-system>>.

7 For details of this inquiry, see Parliamentary Joint Committee on Corporations and Financial Services, Parliament of Australia, 'Mobile Payment and Digital Wallet Financial Services' <https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Mobileanddigitalwallet>.

8 Australian Government (n 5) 4.

9 Cathie Armour, 'Regulating Crypto-Asset-Based Investment Products within the Financial Services Framework' (Speech, AFR Cryptocurrency Summit, 6 April 2022) <<https://asic.gov.au/about-asic/news-centre/speeches/regulating-crypto-asset-based-investment-products-within-the-financial-services-framework/>>.

10 Senator the Hon Jane Hume and the Hon Josh Frydenberg MP, Treasurer, 'Driving Australia's digital revolution' (Media Release, 21 March 2022) <<https://ministers.treasury.gov.au/ministers/jane-hume-2020/media-releases/driving-australias-digital-revolution>>.

11 See Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers: Licensing and Custody Requirements* (Consultation Paper, 21 March 2022) 12 ('*Crypto Asset Secondary Service Providers*'), which states that the 'token mapping exercise to be completed by end of 2022 will provide further clarity as to how crypto assets are classified on a risk-based and technology agnostic basis'. The announcement also noted the terms of reference for a review by the Board of Taxation into the appropriate policy framework for the taxation of digital transactions and assets such as crypto (due to completed by 31 December 2022) and for advice from the Council of Financial Regulators (CFR) on potential policy responses to address the issue of de-banking for financial technology firms, digital currency exchanges, and remittance providers (due to complete by the end of June 2022): see Department of the Treasury (Cth), 'Terms of Reference' <<https://treasury.gov.au/review/de-banking/tor>>; Australian Government, *Review of the Tax Treatment of Digital Assets and Transactions* (Consultation Guide, The Board of Taxation, August 2022).

and Finance Centre, is to seek ‘early views on how to categorise and classify crypto assets to provide more certainty to crypto asset secondary service providers, consumers, and regulators’.¹²

9. The background context referred to in the Treasury Consultation Paper includes a ‘surge in retail consumer exposure to crypto assets’, which ‘has led to calls, including from some service providers, for additional regulation in Australia’.¹³ The Treasury Consultation Paper notes that such regulation ‘would support consumer confidence and trust in the crypto asset ecosystem and provide regulatory certainty to support crypto businesses’ investment decisions’.¹⁴ It further noted the difficulties of enforcing regulation on providers delivering secondary services from overseas and the possibility that domestic providers would ‘benefit from a more reliable and trustworthy crypto market here in Australia through a licencing system or an Australian stamp of quality’.¹⁵ In the context of any proposed regulatory reforms, a fundamental question is what should be regulated and the extent to which crypto assets and crypto asset secondary service providers are already subject to regulation.

10. The term ‘crypto asset secondary service provider’ is predicated on an understanding of the term ‘crypto asset’, as discussed further in Part Two below, and is defined in the Treasury Consultation Paper as follows:

any natural or legal person who, as a business, conducts one or more of the following activities for or on behalf of another natural or legal person:

- exchange between crypto assets and fiat currencies;
- exchange between one or more forms of crypto assets;
- transfer of crypto assets;
- safekeeping and/or administration of virtual assets or instruments enabling control over crypto assets; and
- participation in and provision of financial services related to an issuer’s offer and/or sale of a crypto asset.¹⁶

11. The Treasury Consultation Paper focuses on ‘secondary’ service providers because the involvement of service providers who facilitate consumer access to crypto assets ‘introduces risk, and a requirement for trust’.¹⁷

12. In relation to whether crypto assets should be defined for regulatory purposes, the Treasury Consultation Paper suggests that the ‘current definition of a financial product, which was written prior to the invention and proliferation of crypto assets, does not provide sufficient clarity as to the intended regulatory treatment of a wide variety of novel crypto assets’.¹⁸ The difficulty of applying the definition of ‘financial product’ and ‘financial service’ to products and services ‘on the margin’ has been noted by Howell, who states that ‘the difficulty is likely exacerbated by the developments in technology, where some types of products or services that exist now could not even have been contemplated at the time of the drafting of the original definitions’.¹⁹ In theory, this should not be a problem in view of the inclusive approach to the definitions of ‘financial product’ and ‘financial service’ currently adopted in Australia. However, challenges arise in determining

12 Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 3.

13 Ibid 2.

14 Ibid.

15 Ibid 4.

16 Ibid 10.

17 Ibid 13.

18 Ibid 7.

19 See Nicola Howell, ‘Addressing the Contrasting Definitions of Financial Product and Financial Service in Australian Financial Services and Consumer Legislation’ (2022) 39 *Company and Securities Law Journal* 86, 97 n 70, noting ‘there is some uncertainty about the extent to which digital currency/cryptocurrencies fall within the definition of financial product’. See also Paul Latimer and Michael Duffy, ‘Deconstructing Digital Currency and Its Risks: Why ASIC Must Rise to the Regulatory Challenges’ (2019) 47(1) *Federal Law Review* 121.

whether certain types of crypto assets should be excluded from the regulatory framework or be subject to additional or bespoke regulation.

13. For example, the Treasury Consultation Paper suggests that the ‘absence of specific regulation for crypto assets and their associated service providers has led to actual and perceived regulatory gaps’.²⁰ This resonates with previous comments by ASIC:

whether a crypto asset is within or outside the financial regulatory framework depends on particular characteristics of the crypto-asset offering. This can cause uncertainty for investors and consumers as well as issuers and distributors of these assets. It is a policy matter for government whether or not there should be clarity on this issue.²¹

14. The Treasury Consultation Paper presents two ‘foundational principles’ for the regulation of crypto assets:

First and foremost, products should be regulated according to the risks they could present. Products which use new technologies which reduce risk should be subject to different and lighter regulation than existing products, even if they provide the same service to the consumer ... Secondly, any regulation should be technology neutral.²²

15. Further, the Treasury Consultation Paper identifies three possible regulatory approaches for crypto asset secondary service providers (‘CASSPs’):

- Implement a CASSP licensing regime which is separate from the existing Australian financial services licensing regime (‘AFSL regime’).²³
- Regulate CASSPs under the existing AFSL regime but give the Government or the regulator ‘powers to “carve out” particular crypto assets which do not warrant regulation under the financial services regime’.²⁴
- Permit a self-regulatory approach under which CASSPs abide by a code of conduct developed by them for crypto asset services. The code could be subject to approval by a regulator and be required to satisfy minimum regulatory policy goals.²⁵

16. As noted in Part Four below, the effect of the functional approach to the definition of ‘financial product’ in Chapter 7 of the *Corporations Act 2001* (Cth) (‘*Corporations Act*’) is as follows: to the extent that a particular crypto asset functions as a financial product, it is regulated as such and attracts the relevant obligations, including those in respect of licensing and disclosure, under the current regulatory framework.

Part Two: What are crypto assets?

17. Any decision to regulate an activity or transaction in an economic sector, such as financial services, will require a determination as to why regulation is appropriate and how regulation should be designed. A critical question in this regard is how the activity or transaction should be defined for regulatory purposes. This Part outlines how crypto assets have been defined to date and their broader taxonomy. There is no settled definition of ‘crypto asset’, although Australia has two statutory definitions of a ‘digital asset’, as explained below.

18. Crypto assets are defined in different ways and for different purposes. The Treasury Consultation Paper provides a general definition of a ‘crypto asset’:

20 Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 8.

21 Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Second Interim Report* (2021) [5.56] citing ASIC’s answers to questions on notice.

22 Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 12.

23 Ibid 16–18.

24 Ibid 18.

25 Ibid 19.

A crypto asset is a digital representation of value that can be transferred, stored, or traded electronically. Crypto assets use cryptography and distributed ledger technology.²⁶

19. The Treasury Consultation Paper states that ‘crypto assets have three primary uses: as an investment; as a means of exchange; and to access goods and services’.²⁷ Crypto assets ‘are a subset of digital assets, that uses cryptographic proof to determine ownership’.²⁸ As noted by ASIC, crypto assets ‘are not a homogenous asset class’.²⁹ They ‘are commonly referred to as speculative assets with volatile prices and minimal to no regulatory oversight’.³⁰

20. The general definition in paragraph [18] above refers to ‘cryptography’ and ‘distributed ledger technology’ (‘DLT’). The Financial Policy Committee of the Bank of England has provided a general definition of the concepts:

DLT is a set of technological infrastructure and applications. It allows simultaneous access, validation, and record updating in a secure and unchangeable way across a network spread across multiple entities or locations (as opposed to a central ledger, where a single entity records transactions and ownership). Cryptography is a technique for protecting information by transforming it into a secure format.³¹

21. In Consultation Paper 343, ASIC sets out its understanding of crypto assets:

What are crypto-assets?

For the purposes of this consultation paper, a crypto-asset can be understood to be a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof. A crypto-asset may or may not have identifiable economic features that reflect fundamental or intrinsic value.

Note: This is ASIC’s working understanding of crypto-assets and may evolve over time.³²

22. The definition of a ‘crypto asset’ in paragraph [21] above is similar to that adopted to date in guidance by the Reserve Bank of Australia.³³ ASIC has noted that crypto assets ‘may also be

26 Ibid 2. A similar definition is adopted by the UK Government. See HM Revenue and Customs, United Kingdom, *Cryptoassets Manual* <<https://www.gov.uk/hmrc-internal-manuals/cryptoassets-manual/crypto10100>>. See also European Commission, Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 (2020/593, 24 September 2020) art (1)(2-5) <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020PC0593>>.

27 Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 2.

28 Ibid.

29 Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Second Interim Report* (n 21) 8, quoting Australian Securities and Investments Commission, Answer to Question on Notice, 12 February 2021 (received 15 March 2021) 2.

30 Australian Securities and Investments Commission, *Crypto-Assets as Underlying Assets for ETPs and Other Investment Products* (Consultation Paper 343, June 2021) [9]. See also ASIC’s submission quoted in Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Final Report* (2021) [2.5]: ‘A crypto-asset is a digital representation of value or contractual rights that can be transferred, stored or traded electronically. Crypto-assets use cryptography, distributed ledger technology or other technology to provide features such as security and pseudo-anonymity. A crypto-asset may or may not have identifiable economic features that reflect fundamental or intrinsic value’. In its submission, ASIC noted that this definition was adapted from HM Treasury, *UK Regulatory Approach to Cryptoassets and Stablecoins: Consultation and Call for Evidence* (January 2021) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1088774/O-S_Stablecoins_consultation_response.pdf>.

31 Financial Policy Committee, Bank of England, *Financial Stability in Focus: Cryptoassets and Decentralised Finance* (2022) 5 n 1. See also Financial Stability Board, *Assessment of Risks to Financial Stability from Crypto-Assets* (16 February 2022) 25, which defines cryptography as ‘the conversion of data into private code using encryption algorithms, typically for transmission over a public network’.

32 Australian Securities and Investments Commission (n 30) [8].

33 See Reserve Bank of Australia, ‘Digital Currencies: What Are Cryptocurrencies?’ <<https://www.rba.gov.au/education/resources/explainers/cryptocurrencies.html>>.

commonly referred to as digital assets, virtual assets, tokens or coins', and that ASIC is 'not aware of a universally accepted name for, or definition of, "crypto-asset"'.³⁴

23. At present, there is no definition of 'crypto asset' or 'digital asset' in financial services legislation in Australia. However, a definition of 'digital currency' appears in s 5 of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) ('*AML/CTF Act*')

"digital currency" means:

- (a) a digital representation of value that:
 - (i) functions as a medium of exchange, a store of economic value, or a unit of account; and
 - (ii) is not issued by or under the authority of a government body; and
 - (iii) is interchangeable with money (including through the crediting of an account) and may be used as consideration for the supply of goods or services; and
 - (iv) is generally available to members of the public without any restriction on its use as consideration; or
- (b) a means of exchange or digital process or crediting declared to be digital currency by the AML/CTF Rules;

but does not include any right or thing that, under the AML/CTF Rules, is taken not to be digital currency for the purposes of this Act.³⁵

24. The above definition is similar to the definition published by the Financial Action Task Force, an international standard-setting body, in 2014.³⁶ Part 6A of the *AML/CTF Act* imposes requirements on providers of digital currency exchange services to be registered. Such providers are subject to various obligations, including those in respect of customer due diligence and transaction reporting.

25. A definition of digital currency also appears in the legislation governing the goods and services tax ('GST').³⁷ The two statutory definitions incorporate common elements in respect of a digital currency: (1) it functions as a means of exchange or as consideration for the supply of good and services; (2) it is generally available to members of the public without any restriction on its use as consideration; and (3) it is not issued by a government body or denominated in a fiat currency.

26. The above definitions of digital currency have been designed specifically for the purposes of the *AML/CTF Act* and the GST regime. Their relevance or applicability for the purposes of financial services legislation and, specifically, for the purposes of regulating crypto assets that function as a 'financial product' would need to be examined in detail.³⁸

34 Australian Securities and Investments Commission (n 30) [8]. See also Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Final Report* (n 30) [2.4], which notes that ASIC 'uses the term "crypto-asset" as an umbrella term to describe products that are also commonly referred to as "digital assets", "virtual assets" or "digital tokens"'.
35 See also the definition of digital currency (or cryptocurrency) provided by AUSTRAC, Australian Government, 'Glossary: Digital Currency (or Cryptocurrency)' <<https://www.austrac.gov.au/glossary?name=digital+currency>>: 'A type of currency that only exists in digital rather than physical form (not coins or notes, for example). Digital currency: can be exchanged for goods, services or physical currency; is not issued by or under the authority of a government'.

36 Financial Action Task Force, *Virtual Currencies: Key Definitions and Potential AML/CFT Risks* (Report, June 2014) 4.
37 *A New Tax System (Goods and Services Tax) Act 1999* (Cth) Part 6.3 (Dictionary). See also Australian Taxation Office, 'GST and Digital Currency' <<https://www.ato.gov.au/business/gst/in-detail/your-industry/financial-services-and-insurance/gst-and-digital-currency/>>.

38 See further in Part Five below.

27. Other jurisdictions have adopted relevant legislative definitions. Singapore, for example, has adopted a legislative definition of ‘digital payment token’ for the purposes of its payment services legislation.³⁹

28. Jurisdictions around the world differ in the taxonomy or typology adopted for crypto assets generally, whether for regulatory purposes or otherwise. The United Kingdom (‘UK’) Government, for example, has stated that the main types of crypto asset include:

Exchange Tokens

Exchange tokens are intended to be used as a means of payment and are also becoming increasingly popular as an investment due to potential increases in value. The most well-known token, bitcoin, is an example of an exchange token.

Utility Tokens

Utility tokens provide the holder with access to particular goods or services on a platform, usually using DLT [distributed ledger technology]. A business or group of businesses will normally issue the tokens and commit to accepting the tokens as payment for the particular goods or services in question. In addition, utility tokens may be traded on exchanges or in peer-to-peer transactions in [the] same way as exchange tokens.

Security Tokens

Security tokens provide the holder of a security token particular rights or interests in a business, such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits.

Stablecoins

Stablecoins are another prominent type of cryptoasset. The premise is that these tokens minimise volatility as they may be pegged to something that is considered to have a stable value such as a fiat currency (government-backed, for example US dollars) or precious metals such as gold.⁴⁰

29. A further type are non-fungible tokens, commonly referred to as ‘NFTs’, which are typically used to record ownership of digital files such as photos, videos, and audio recordings.

30. The proposed European Union Markets in Crypto-Assets Regulation (‘MiCAR’) adopts a slightly different taxonomy. If enacted, MiCAR would regulate:

- ‘asset-referenced tokens’, including stablecoins;
- ‘e-money tokens’, which function primarily as a medium of exchange and are denominated in a fiat currency; and
- ‘crypto-assets, other than asset-referenced tokens or e-money tokens’, which include utility tokens that are issued for non-financial purposes and may include cryptocurrencies such as Bitcoin.

31. MiCAR does not cover security tokens, which are regulated as a ‘financial instrument’ under the Directive on Markets in Financial Instruments, commonly known as MiFID2.⁴¹ In addition, central bank digital currencies are exempted from MiCAR if they are issued by central banks acting in their monetary authority capacity or by other public authorities.

32. The Treasury Consultation Paper includes a ‘non-exhaustive list of descriptions’ for crypto assets, highlighting the broad range of functions that crypto assets may perform:

39 *Payment Services Act* (Singapore, 2020 rev ed) s 2.

40 See HM Revenue and Customs, United Kingdom (n 26).

41 *Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Directive 2002/92/EC and Directive 2011/61/EU* [2014] OJ L 173/349 6.

- utility crypto assets which can only be redeemed for goods or services by the issuer. This includes loyalty schemes and digital vouchers represented with crypto assets. For example, crypto assets that are developed for storage and digital content and data;
- collectable crypto assets that include digital representations of real-world collectible items like art, images, music, in-game items, promotional posters;
- zero utility crypto assets that provide no promises, rights or other use case than the ability to transfer them via a network;
- membership crypto assets that allow access to communities or loyalty schemes. This can include ‘social crypto assets’;
- asset-backed crypto assets used as a store of value, means of exchange and unit of account. These would include certain stablecoins and Central Bank Digital Currencies (CBDCs);
- algorithmic stable crypto assets whether under-collateralised or over-collateralised;
- crypto assets used for fundraising similar to not-for-profits;
- crypto assets used for fundraising by performing artists, journalists, or similar publications as a form of income to offer their services;
- governance crypto assets that have no value accrual;
- governance crypto assets that have value accrual (for example, buy back and burn model);
- crypto assets that replicate the functions of a financial product (whether they strictly meet the definition or not, for example, derivatives where technology is the intermediary instead of the issuer); and
- hybrid crypto assets that may perform multiple functions across a number of categories.⁴²

33. One challenge with crypto assets in the form of tokens is that ‘most tokens perform hybrid functions — that is, they may serve both as securities and as a medium of exchange’.⁴³ Crypto assets, including governance tokens in respect of DAOs, can therefore be chameleon in nature, changing their function and economic purpose depending on the specific circumstances and the intention of their holders.⁴⁴ A token that is issued pursuant to an ICO can function both as an investment asset and as a medium of exchange, depending on the intentions or purposes of the token-holder. An additional challenge is that each token has its own rules as encoded in smart contracts and therefore may have its own distinctive features.

34. ICOs are the channel through which crypto assets are issued to the public. ICOs can be used both as a means of creating cryptocurrencies and also as a means of raising finance. Often the finance that is raised takes the form of cryptocurrencies — in other words, cryptocurrencies are used to subscribe for the coins or tokens that are issued as part of the ICOs. The regulation of ICOs is also the subject of examination and debate in many jurisdictions, particularly in relation to the nature and adequacy of disclosure under the offering documents used in ICOs (generally referred to as ‘white papers’).

42 Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 23.

43 Moshood Abdussalam and Mia Rahim, ‘The Advent of Decentralised Autonomous Business Networks in the Disembodied Economy: A Discussion on Why the Governance Regimes of Corporations and Partnerships Are Unsuitable to Them’ in Andrew Godwin, Pey-Woan Lee and Rosemary Teele Langford (eds), *Technology and Corporate Law: How Innovation Shapes Corporate Activity* (Edward Elgar, 2021) 306, 327, citing Hans Tjio and Ying Hu, ‘Collective Investment: Land, Crypto and Coin Schemes: Regulatory “Property”’ (2020) 21(1) *European Business Organisation Law Review* 171, 183–6.

44 In this sense, the challenges in classifying crypto assets resonates with the initial challenges involving a derivative, where one party enters into the transaction to hedge against risk and the other party enters into it to speculate on the movement in the value or price of reference assets or reference rates. Derivatives initially created challenges for regulation as it was unclear whether they should be regulated as a form of insurance or as a gambling contract.

Part Three: What are DAOs?

35. A fundamental issue for law reform is whether the law should make provision for decentralised autonomous organisations ('DAOs') to be registered and regulated and, if so, what an appropriate business form would be for this purpose. The answer requires an understanding of what a DAO is, how it operates, and why regulation may be necessary or desirable. A key challenge is that, from a functional perspective, a DAO is governed more by code (algorithms) than by law (contract and legal doctrine).

The concept

36. It is useful to locate the concept of a DAO within the concept of 'decentralised finance' ('DeFi'). DeFi refers to applications that use blockchain technology to provide financial services, such as peer-to-peer payments or lending, without the need to rely on centralised financial intermediaries. The Bank of England has described DeFi as

a collective term for a set of applications that seek to provide a range of financial services, including loans and exchanges, with the aim of reducing reliance on centralised financial intermediaries. These alternative financial applications are built on distributed ledger technology. Unlike traditional financial services firms that undertake these activities, DeFi applications are, at present, largely unregulated.⁴⁵

37. DAOs are the infrastructure that enables DeFi to be provided at scale and among a large number of users.

38. DAOs are described as decentralised because they remove the need for centralised management. As noted by the Bank of England, DAOs

usually rely on voting by holders of governance tokens to make decisions with the intention of decentralising decision-making (for example, on alterations to the computer code, or changes to the governance structure).⁴⁶

39. DAOs are described as autonomous because they operate in an automated manner and in accordance with the rules encoded in smart contracts rather than in accordance with articles of association, shareholders agreements, or written law.

40. DAOs are described as organisations because they operate as business networks made up of an assembly or network of nodes. A key issue in this regard is what type of organisation is created? If they are to be made the subject of regulation, should they be regulated by analogy to a company, by analogy to a partnership, by analogy to an unincorporated association, or by analogy to something else? Or should they be subject to a bespoke form of regulation?

41. Two additional principles should be noted in relation to DeFi and DAOs. The first principle is that they

rely on 'open source' technology where anyone can read the underlying source code that operates the applications and performs financial activities.⁴⁷

45 Financial Policy Committee, Bank of England (n 31) 29. See also International Organization of Securities Commissions, *IOSCO Decentralized Finance Report* (OR01/2022, 2022) 1, which provides that 'DeFi commonly refers to the provision of financial products, services, arrangements and activities that use distributed ledger technology ("DLT") in an effort to disintermediate and decentralize legacy ecosystems by eliminating the need for some traditional financial intermediaries and centralized institutions. Currently, there is no generally accepted definition of "DeFi," or what makes a product, service, arrangement or activity "decentralized"'.
46 Financial Policy Committee, Bank of England (n 31) 29.
47 Ibid.

42. The second principle of note is that:

Anyone can use DeFi applications, usually anonymously (or pseudonymously) and with minimal customer due diligence, as long as they can fulfil the application's technical requirements for participation (for example, ownership of a cryptoasset wallet).⁴⁸

43. A challenge in regulating DAOs is that they can have different functions and governance arrangements, even though the same technology is used. In other words, DAOs can be structured and governed in different ways and there are different design choices. These design choices involve at least three questions. First, who can participate in the operation of the organisation? Is access restricted to certain participating nodes on a 'permissioned' basis or is access open to anybody on a 'permissionless' basis?⁴⁹ Under a permissionless model, all participants

have access to past records of executed transactions between nodes. This is for the purpose of audibility, transparency and trustlessness. Any person running a node on the network may transact with any other person within the network so long as they satisfy the smart contract conditions.⁵⁰

44. Secondly, how is governance designed? Is governance centralised in a selected entity, algorithmic system or group of participating nodes, or is it completely decentralised on the basis that all token-holders have the right to participate in governance decisions by proposing and voting on resolutions?⁵¹ The challenges in this regard are compounded by informal governance arrangements and the possibility that token-holders might change the governance protocols after a DAO has been established. This may create difficulties in determining the extent to which governance is decentralised. Anecdotal evidence suggests that very few DAOs are completely decentralised. As noted by IOSCO:

While a DeFi product or service may claim to be decentralized, some DeFi products and services may actually retain a level of centralization. For example, the founders or other participants may retain control or significant influence over aspects of the product or service. Even as to protocols and smart contracts that are subject to change through votes of governance tokens, ownership and voting control of governance tokens may be concentrated in the hands of a few and therefore [the DeFi products and services] may continue to be controlled by centralized parties rather than protocols and smart contract designs.⁵²

45. Thirdly, does the DAO have a jurisdictional nexus in terms of operating through a registered form in a jurisdiction and therefore being subject to direct regulation in that jurisdiction? Some DAOs are referred to as 'wrapped' in terms of having a registered legal entity as their basis or being managed by a registered legal entity.⁵³ The terms 'wrapping' and 'legal wrapper' refer to the business form through which the DAO interacts with third parties in an off-chain (or real-world) context as distinct from interacting purely with its members in an on-chain context.

46. The question of whether a DAO adopts a registered business form to enable it to interact with third parties in an off-chain context — and, consequently, whether there are humans who can act as its agents or representatives and assume responsibility for its activities — is of critical importance in areas such as dispute resolution, creditor protection (including insolvency), and consumer protection (for DAOs that provide services to consumers).

48 Ibid.

49 See also Abdussalam and Rahim (n 43) 316–17, noting the existence of hybrid networks, which 'combine the features of a public network with those of a permissioned network' and '[build] a private network on the protocol of a public network'.

50 Ibid.

51 The latter arrangements are known as 'participatory DAOs' and are consistent with the notion of 'governance democratisation'.

52 International Organization of Securities Commissions (n 45) 9.

53 Simon Moore, 'Towards a Functioning Legal Framework for Emerging DAO Technologies in Australia' (2021) 2(2) *Australian National University Journal of Law and Technology* 109, 113.

47. In their purest form, DAOs are permissionless (or public), decentralised in terms of their governance, and unregistered.

Table 1: DAO design choices

Issue	Design choices	
Access	Permissioned (private)	Permissionless (public)
Governance	Centralised	Decentralised
Jurisdictional nexus	Registered	Unregistered

48. As previously noted, a challenge in regulating DAOs is that they can have different functions and governance arrangements, even though the same technology is used. Similar challenges arise in relation to crypto assets, which can functionally operate as a means of exchange similar to currency, as advance payment for certain goods or services, or as a security similar to shares in a company or a unit in a managed investment scheme.

The technology

49. The foundational technology for DAOs is DLT, which enables a database of information to be distributed across several — often thousands of — computing devices or nodes. The rules that govern the operation of the technology are encoded in programs known as ‘smart contracts’.

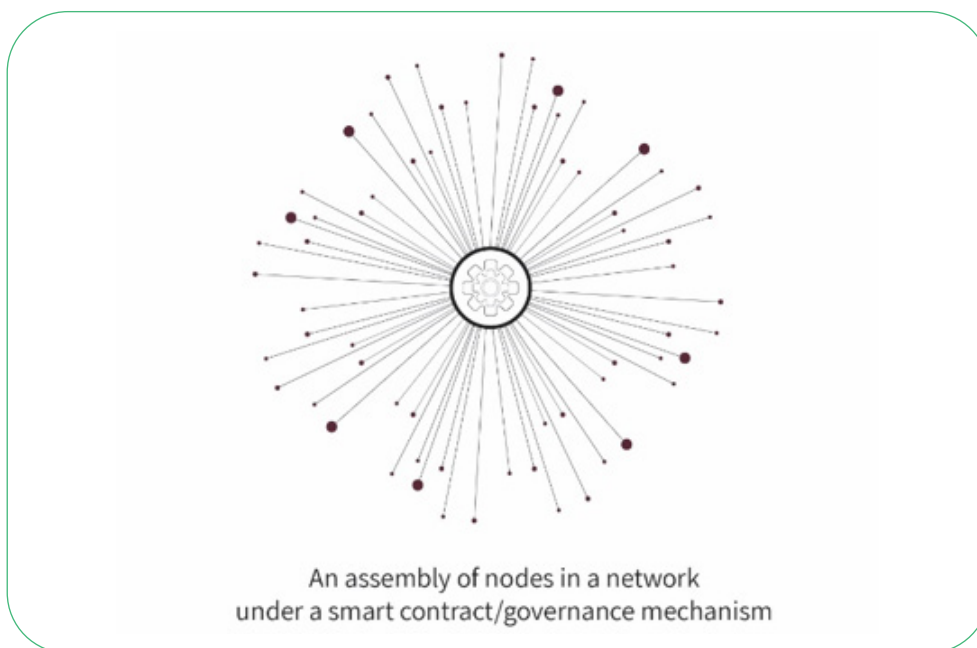
50. As a subset of DLT, blockchain technology organises data in blocks and a new block is added to the chain each time a development occurs, whether in relation to a transaction (such as the transfer of a cryptocurrency) or in relation to an event (such as a vote by participating nodes in a DAO).

51. The combination of DLT, smart contracts, and blockchain is said to remove the need for trust that would otherwise exist if the data were being managed by humans instead of by computer algorithms.

52. Figure 1 contains a depiction of an assembly of nodes in a network under a smart contract/ governance mechanism.⁵⁴ The smart contract is at the centre of, and governs, the network of nodes.

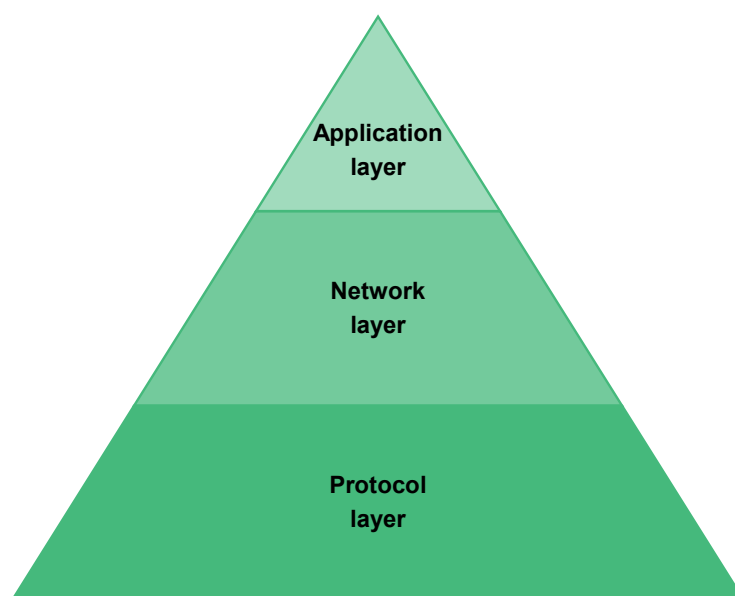
54 Figure 1 is taken from Abdussalam and Rahim (n 43) 319.

Figure 1: A visual representation of DAOs



53. The pyramid in Figure 2 depicts the various layers of blockchain technology as it is used in the context of DAOs.⁵⁵ The foundation consists of the protocol layer, which incorporates the relevant DLT technology and the smart contract. Many DAOs run on blockchain protocols such as Hyperledger, Corda, and Ethereum.

Figure 2: A visual representation of blockchain



54. The network layer is where the question of governance between the members or token-holders of the network or DAO becomes relevant.

55 Ibid 315–16.

55. The application layer consists of applications (often referred to as decentralised applications or 'dApps') that allow third parties to interact with the DAO for various purposes. This might, for example, support a marketplace in which third parties can buy and sell crypto assets.

Definitions adopted to date

56. A model law on DAOs has been published by the Coalition of Automated Legal Applications ('COALA').⁵⁶ This model law contains the following definitions, which expand on the concepts outlined above:

'Decentralized Autonomous Organization' (DAO) refers to smart contracts (i.e. blockchain-based software) deployed on a public Permissionless Blockchain, which implements specific decision-making or governance rules enabling a multiplicity of actors to coordinate themselves in a decentralized fashion. These governance rules must be *technically*, although not necessarily *operationally*, decentralized. ...

'Permissionless Blockchain' means a public distributed ledger, allowing any entity to transact and produce blocks in accordance with the blockchain protocol, whereby the validity of the block is not determined by the identity of the producer. ...

'Smart Contract' is code deployed in a blockchain environment. It is made of a set of *predefined* and *deterministic* instructions executed in a distributed manner by the nodes of the underlying blockchain network, if and when the underlying conditions are met. Execution of a Smart Contract will produce a change in the blockchain state.⁵⁷

57. A definition of a DAO appears in State of Wyoming legislation (in the United States ('US')) that permits DAOs to incorporate as limited liability companies ('LLCs'):

Definition and election of decentralized autonomous organization status.

(a) A decentralized autonomous organization is a limited liability company whose articles of organization contain a statement that the company is a decentralized autonomous organization as described in subsection (c) of this section.

...

(c) A statement in substantially the following form shall appear conspicuously in the articles of organization or operating agreement, if applicable, in a decentralized autonomous organization:

NOTICE OF RESTRICTIONS ON DUTIES AND TRANSFERS

The rights of members in a decentralized autonomous organization may differ materially from the rights of members in other limited liability companies. The Wyoming Decentralized Autonomous Organization Supplement, underlying smart contracts, articles of organization and operating agreement, if applicable, of a decentralized autonomous organization may define, reduce or eliminate fiduciary duties and may restrict transfer of ownership interests, withdrawal or resignation from the decentralized autonomous organization, return of capital contributions and dissolution of the decentralized autonomous organization.

...

(e) A statement in the articles of organization may define the decentralized autonomous organization as either a member managed decentralized autonomous organization or an algorithmically managed decentralized autonomous organization. If the type of decentralized autonomous organization is not otherwise provided for, the limited liability company will be presumed to be a member managed decentralized autonomous organization.⁵⁸

56 Coalition of Automated Legal Applications, *Model Law for Decentralized Autonomous Organizations (DAOs)* (2021). The Model Law applies only to DAOs operating on permissionless blockchains.

57 Ibid.

58 Wyo Stat Ann § 17-31-104 (2022).

58. The above statutory definition identifies essential elements of DAOs, including that DAOs are governed by smart contracts and may be either member-managed or algorithm-managed, with the former being the default position.

Part Four: Regulatory design

59. This Part discusses the following issues relevant to the design of regulation in respect of crypto assets and DAOs: the concept of technology neutrality; current references to innovation and technology in the *Corporations Act*; regulatory policy; regulatory design theory; regulatory approaches in respect of crypto assets; the current regulatory framework for crypto assets in Australia; and regulatory approaches in respect of DAOs.

Technology neutrality

60. As noted in Part One above, one of the foundational principles identified by the Treasury Consultation Paper for the regulation of crypto asset secondary service providers is that regulation should be technology neutral.⁵⁹ The ALRC recognises the importance of this principle. The principle has also been recognised by the US Securities Exchange Commission, the Chair of which remarked:

There's no reason to treat the crypto market differently just because different technology is used. We should be technology-neutral.⁶⁰

61. Technology neutrality is an important regulatory principle in Australia.⁶¹ As noted by former ASIC Commissioner, Cathie Armour:

Our regulatory regime is principles based and operates in a technology-neutral way. What this means is that in Australia the rules are the rules no matter whether you are dealing face-to-face with a customer sitting in front of you, or via an app on the customer's smartphone. Pragmatism means that we do sometimes amend our regulatory regime to facilitate or recognise new technologies — for example, we have facilitated electronic securities offering documents — but mostly our regulation is technology-neutral.⁶²

62. The importance of technology neutrality was confirmed in 2021, when the Australian Government released and consulted on draft legislation to improve the technology neutrality of Treasury portfolio laws as part of the Department of Prime Minister and Cabinet's 'Deregulation Taskforce'.⁶³ The push for technology neutrality was based on concerns that consumers and businesses 'can miss out on the benefits of new technology when old methods of conducting business become entrenched in law'.⁶⁴

63. The origins of the regulatory principle of technology neutrality can be traced to the 1996 Report of the Financial System Inquiry led by Stan Wallis ('the Wallis Inquiry'). In establishing the Wallis Inquiry, the Hon Peter Costello MP counted technological development among the 'forces driving further change' to the financial deregulation of the Australian financial system since

59 Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 12.

60 Gary Gensler, 'Prepared Remarks of Gary Gensler on Crypto Markets' (Speech, Penn Law Capital Markets Association Annual Conference, 4 April 2022) <<https://www.sec.gov/news/speech/gensler-remarks-crypto-markets-040422>>.

61 For a discussion of technology neutrality, see Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [6.57]–[6.63]. Among other things, Interim Report A noted, at [6.57], that definitions referring to 'specific technologies may require more frequent amendment than "technology neutral" expressions to keep up with technological changes'.

62 Cathie Armour, 'An Australian Regulator's View on Financial Technology' (Speech, China Financial Summit, Beijing, 23 October 2019).

63 Department of the Treasury (Cth), *Modernising Business Communications: Improving the Technology Neutrality of Treasury Portfolio Laws* (Consultation Paper, December 2020). See also Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [6.63].

64 Department of the Treasury (Cth), *Modernising Business Communications: Improving the Technology Neutrality of Treasury Portfolio Laws* (n 63) 2.

the early 1980s.⁶⁵ Following the Wallis Inquiry, the Corporate Law Economic Reform Program ('CLERP') was tasked with implementing the Wallis Inquiry's recommendations relating to the regulation of financial products and services.⁶⁶ In its Proposals Paper, CLERP 'noted the change that had occurred in the financial system since the Corporations Law framework was developed, due to technological developments, globalisation, increased competition, and increased retail investment'.⁶⁷

64. In developing its recommendations, the Wallis Inquiry sought in particular to design a regulatory framework that would be adaptable to financial innovations.⁶⁸ The Wallis Inquiry noted that:

In the face of new technologies, alliances and market structures, increased regulatory attention has been given to ensuring competitive conduct in all segments of the market and to providing a competitively neutral environment.⁶⁹

65. In this regard, the Wallis Inquiry made the following recommendations:

Recommendation 91: Legislation should be amended to allow for electronic commerce.

Regulation should not differ between different technologies or delivery mechanisms such as to favour one technology over another. A large number of legislative amendments will be required to implement this recommendation.

...

Recommendation 94: Regulators should coordinate on technology.

Financial regulatory agencies should keep abreast of technological developments as they affect the financial system and liaise with each other as well as government departments and other agencies.⁷⁰

66. The Financial System Inquiry led by David Murray in 2014 ('the Murray Inquiry') discussed the principle of technology neutrality in detail, reflecting an increased focus on technological change in line with its Terms of Reference.⁷¹ The Murray Inquiry stated that policy settings 'should seek to encourage innovation by being technologically and competitively neutral in design'.⁷²

67. Recommendation 39 dealt with the principle of technology neutrality:

Identify, in consultation with the financial sector, and amend priority areas of regulation to be technology neutral.

Embed consideration of the principle of technology neutrality into development processes for future regulation.

65 Stan Wallis et al, *Financial System Inquiry* (Final Report, March 1997) vii. See also Australian Law Reform Commission, 'Historical Legislative Developments' (Background Paper FSL4, November 2021) ('Historical Legislative Developments').

66 Department of the Treasury (Cth), *Financial Markets and Investment Products: Promoting Competition, Financial Innovation and Investment* (Corporate Law Economic Reform Program, Proposals for Reform: Paper No 6, 1997) 22 ('*Financial Markets and Investment Products*'); Australian Law Reform Commission, 'Historical Legislative Developments' (Background Paper FSL4, November 2021) [63].

67 See Australian Law Reform Commission, 'Historical Legislative Developments' (Background Paper FSL4, November 2021) [64] citing *Financial Markets and Investment Products* (n 66) 7.

68 See Wallis et al (n 65) Chapter 2, Technology Driven Innovation.

69 Ibid 641.

70 Ibid 32.

71 David Murray et al, *Financial System Inquiry* (Final Report, November 2014) vii: 'On 24 March 2014, the Treasurer appointed an International Advisory Panel (the Panel) to the Inquiry. The Panel's role was to provide the Inquiry with an expert perspective on aspects of the terms of reference, including technological change, Australia's global competitiveness and offshore regulatory frameworks'.

72 Ibid 12.

Ensure regulation allows individuals to select alternative methods to access services to maintain fair treatment for all consumer segments.⁷³

68. The Murray Inquiry explained that technology neutral regulation

enables any mode of technology to be used and tends to be competitively neutral. Generally, regulation should be principles-based and functional in design, focusing on outcomes rather than prescribing the method by which it should be achieved. However, the Inquiry recognises that technology specific regulation may continue to be required and be beneficial in cases where adopting a common technology standard would improve overall system efficiency. In these cases, future review mechanisms should be established to ensure technology-specific regulation does not impede innovation.

...

A technology-neutral approach to regulation enables regulators and government to adapt to innovative developments and manage risks. It can also reduce compliance costs by removing unnecessary regulatory impediments and improving the stability and longevity of regulation. It can also give financial product providers greater flexibility to innovate to meet changing consumer expectations.⁷⁴

69. The Murray Inquiry noted that technology-specific regulation could ‘impede innovation by preventing the adoption of best technology or innovative approaches’ and referred to regulation entrenching paper-based disclosure documentation as an example where inefficient outcomes had been created.⁷⁵ A key area of innovation identified by the Murray Inquiry was disclosure,⁷⁶ which led to developments in digital disclosure in 2015.⁷⁷

70. The importance of technology neutrality in the context of adaptive and robust legislative design was recognised by Interim Report A:

An ‘adaptive’ legislative framework is one that adapts to change. Adaptive regulation should ‘evolve with the financial system and not become an obstacle to innovation’; for example, regulation should not create barriers to entry or discourage new business models, and obsolete rules should be removed or revised.⁷⁸

Laws can be adaptive in the sense that they are designed in such a way as to remain appropriate in their existing form despite changing circumstances. For example, laws drafted in a technologically neutral manner may be less likely to require amendment to accommodate new technologies.⁷⁹

71. Relevantly for the purposes of this Background Paper, another area of innovation on which the Murray Inquiry focussed was ‘alternative business models’:

Technology is facilitating the disintermediation of traditional institutions, attracting many new entrants and non-traditional businesses. New technology-enabled mechanisms for accessing finance and obtaining credit are emerging in the Australian market, such as crowdfunding and peer-to-peer lending.⁸⁰

73 Ibid xxviii.

74 Ibid 270.

75 See also ibid 145, 195, 269.

76 Ibid 28. See Recommendation 23: Facilitate innovative disclosure.

77 For a discussion of developments in digital disclosure, see Andrew Godwin, ‘Brave New World: Digital Disclosure of Financial Products and Services’ (2016) 11(3) *Capital Markets Law Journal* 442, 446.

78 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [2.9] citing Prasanna Gai et al, *Regulatory Complexity and the Quest for Robust Regulation* (No 8, European Systemic Risk Board, June 2019) 3 (Principle One: ‘adaptability’).

79 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [2.10], citing the Australian Government’s project to ‘modernise business communications’, including ‘improving technology neutrality of Treasury Portfolio laws’.

80 Murray et al (n 71) 143.

72. The principle of technology neutrality is also referred to in the Treasury Consultation Paper, which notes that one of the Government’s objectives for the proposed regulatory regime in respect of crypto asset secondary service providers is ‘ensuring that regulation is fit for purpose, technology neutral and risk-focussed’.⁸¹

73. The need for regulation to be risk-focussed reflects the fact that ‘risk is an inevitable and, indeed, desirable feature of financial markets.’⁸² The impact of risk and the need to achieve an appropriate balance between innovation and regulation from a risk perspective are relevant considerations in any proposed reform to the regulatory framework. As stated by the Murray Inquiry:

The pace of technology-driven market developments can challenge regulatory frameworks and make it difficult for regulators to adapt with sufficient speed. Failure to manage these risks may result in system-wide impacts and/or adverse consumer outcomes.⁸³

74. Professor Armour and others have noted that ‘the recitals to a number of the relevant EU Directives speak of the need to “balance costs and benefits”, and the need to “encourage innovation in financial markets”’.⁸⁴ They further argue that financial ‘services and financial institutions are in a continuous state of flux, making it difficult for regulators to keep pace’⁸⁵ and that one way in which firms seek to reduce regulatory costs is ‘by moving the activity outside the scope of the regulation’, with the result that ‘financial regulation is itself a stimulant to financial innovation’.⁸⁶ This creates challenges for regulators, who must ‘determine whether the innovation is consistent with, or undermines, the regulatory goals’⁸⁷ and ‘must distinguish the “good”, welfare-enhancing innovation from the “bad” one that aims to avoid beneficial regulations’.⁸⁸ In terms of the design of regulatory institutions, the authors suggest that ‘a goal-based model is likely to be best.’⁸⁹

References to innovation and technology in the Corporations Act

75. The concepts of innovation and technology are not new to Commonwealth legislation. Statistical analysis by the ALRC reveals that 168 pieces of legislation contain or refer to the terms ‘technology’ and ‘innovation’. The term ‘innovation’, for example, appears in s 760A(a) of the *Corporations Act*, which provides that the main object of Chapter 7 of the Act includes promoting

confident and informed decision making by consumers of financial products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services ...

76. The term ‘technology’ appears in a number of provisions in Chapter 2D of the *Corporations Act* concerning virtual meetings.⁹⁰ As noted above, the Australian Government has a current project to ‘modernise business communications’, including ‘improving technology neutrality of Treasury Portfolio laws’.⁹¹

81 Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 6.

82 Australian Law Reform Commission, ‘Risk and Reform in Australian Financial Services Law’ (Background Paper FSL5, March 2022) 4.

83 Murray et al (n 71) 144.

84 John Armour et al, *Principles of Financial Regulation* (Oxford University Press, 2016) [3.4.7], noting that this is recognised in legislative measures such as the Prospectus Directive and the UCITS V Directive.

85 Ibid 80.

86 Ibid 84.

87 Ibid.

88 Ibid 98.

89 Ibid.

90 See, eg, Department of Prime Minister and Cabinet (Cth), ‘Modernising Business Communications’ <deregulation.pmc.gov.au/priorities/modernising-business-communications>; *Corporations Act 2001* (Cth) s 252J (Contents of notice of meetings of members): ‘A notice of a meeting of a registered scheme’s members must: (a) set out: ... (iii) if virtual meeting technology is to be used in holding the meeting — sufficient information to allow the members to participate in the meeting by means of the technology’.

91 See, eg, Department of Prime Minister and Cabinet (Cth), ‘Modernising Business Communications’ <deregulation.pmc.gov.au/priorities/modernising-business-communications>.

77. The term ‘technology’ also appears in substantive provisions in Chapter 7 of the *Corporations Act*. For example, s 792A(1)(d) provides that a market licensee must have sufficient resources (including financial, technological and human resources) to operate the market properly; s 821A(1)(d) provides that a clearing and settlement facility licensee must have sufficient resources (including financial, technological and human resources) to operate the facility properly and for the required supervisory arrangements to be provided. Further, the technology used, or proposed to be used, in the operation of the market or the facility (as the case may be) is a matter to which the Minister must have regard in making decisions in respect of the licence.⁹²

Regulatory policy concerning technology

78. In recent years, particularly as the impact of technology on the delivery of financial services has increased, there has been a trend towards more proactive intervention and advocacy in respect of technology. As noted by Cathie Armour in 2019:

Globally, regulators are starting to think about whether regulatory frameworks should be more than just open to technology solutions — perhaps the time has come when we should *expect* and *advocate for* new technologies and new approaches, particularly where outcomes have otherwise been suboptimal. Nick Cook, the Director of Innovation at the UK’s Financial Conduct Authority recently posed the question, ‘can we remain “technology-neutral” in a world where technology is so embedded in the delivery of financial services and so fundamental a driver of consumer outcomes?’⁹³

79. As early as 2000, it was recognised that the advent of the internet and e-commerce had created various challenges, including practical enforcement difficulties (exacerbated by the ease with which a website closed down in Australia could re-open again in another jurisdiction) and difficulties in identifying parties to a transaction, maintaining transaction records, and ensuring redress for failed or unsuccessful transactions.⁹⁴ Accordingly,

technology presents our existing values with new delivery channels and the challenge for all of us is to engage in ecommerce in a way that is conducive to delivering trust, confidence and certainty.⁹⁵

80. Many of these challenges have modern parallels with the advent of crypto assets and DAOs. In addition, the challenge of achieving an appropriate balance between innovation and consumer protection remains.

81. As ASIC observed:

It is clear that we must ensure that regulation and regulators have the capabilities to properly respond in ways that do not impede innovation while at the same time protecting consumers from unfair and abusive practices.

... We need to adapt existing policy to facilitate change, whilst preserving the old to maintain business certainty and investor protection.⁹⁶

92 See *Corporations Act 2001* (Cth) ss 798A(2)(f) (in the case of an Australian market licence), 827A(2)(f) (in the case of a CS facility licence).

93 Armour (n 62).

94 Ian Johnston, ‘Staying Apace of Emerging Technology: An ASIC Perspective’ (Address, Financial Planners Association National Conference, 9 December 2000).

95 Ibid.

96 Ibid.

82. In the context of digital transformation, ASIC has stated its role is ‘to balance innovation and, at the same time, monitor and uphold market integrity and protect consumers’.⁹⁷ ASIC has additionally stated that ‘we expect innovation to lead to better consumer outcomes’.⁹⁸

83. The need to reconcile trade-offs has been noted by a member of the Executive Board of the European Central Bank in relation to the potential move towards a digital Euro:

Defining the legal framework will entail reconciling trade-offs arising from several objectives, such as the right of individuals to confidentiality versus the public interest in maintaining the level of transparency required to combat illicit activities, or the benefits of allowing the digital euro to be widely used — also internationally — versus the need to safeguard financial intermediation and stability.⁹⁹

84. Perhaps the most advanced form of proactive intervention in support of innovation is a regulatory sandbox, which involves the relaxation of regulatory requirements (such as licensing) within defined parameters and operates as ‘a controlled and supervised environment allowing innovative businesses to test their business model’ with real customers.¹⁰⁰ An example is ASIC’s ‘enhanced regulatory sandbox’.¹⁰¹

Regulatory design theory in respect of technology

85. Chiu has identified three possible approaches to regulating the crypto economy.¹⁰² The first approach — the coherentist approach — seeks to adapt and develop the existing law in a coherent and continuing manner. This approach is based on the view that new developments should be interpreted within the existing framing and in accordance with recognised principles.

86. The second approach — the regulatory instrumentalist approach — focuses on the use of law as an instrument for achieving policy innovation, and is therefore less tied to existing concepts or principles. A regulatory instrumentalist approach lends itself to an adaptive, flexible regulatory framework that utilises various forms of regulation, including self-regulation, to achieve the right policy objectives.

87. The third approach — the technocratic approach — focuses on pragmatic solutions that may go beyond or avoid legal solutions altogether. For example, as Chiu writes,

if code can be written to perform and achieve desired ends by blockchain participants, then ‘code is law’, and there is no need for other institutions to govern the transaction or relationship.¹⁰³

97 Armour (n 9). See also John Price, ‘The Fintech Sector Opportunity: ASIC Perspective’ (Speech, 4th Annual FinTech Summit 2017, Sydney, 2 November 2017): ‘Our overarching aim is to maintain sensible and appropriate frameworks that harvest the benefits of innovation while fostering consumer trust and confidence in financial services’.

98 John Price, ‘Banks and Financial Technology: Will Banks Become Back Offices for Fintech Companies?’ (Speech, International Bar Association Annual Conference 2017, Sydney, 12 October 2017) 4: ‘In fact, without consumer trust and confidence there will be no market at all. Sensible regulation can help achieve market integrity and promote investor and consumer trust — for that reason regulation should be seen a friend of fintech and the financial sector rather than just a hindrance’.

99 Fabio Panetta, ‘Public Money for the Digital Era: Towards a Digital Euro’ (Keynote Speech at the National College of Ireland, Dublin, Ireland, 16 May 2022) <<https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220516~454821f0e3.en.html>> citing Fabio Panetta, ‘Evolution or Revolution? The Impact of a Digital Euro on the Financial System’ (at the Bruegel online seminar, Frankfurt, Germany, 10 February 2021) <<https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210210~a1665d3188.en.html>>; Fabio Panetta, ‘A Digital Euro to Meet the Expectations of Europeans’ (at the ECON Committee of the European Parliament, Frankfurt, Germany, 14 April 2021) <https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210414_1~e76b855b5c.en.html>.

100 See Anton N Didenko, ‘A Better Model for Australia’s Enhanced Fintech Sandbox’ (2021) 44(3) *University of New South Wales Law Journal* 1078, 1081. Didenko also argues that APRA’s restricted authorised deposit-taking institution (‘RADI’) regime is a regulatory sandbox.

101 See generally Didenko (n 100). See also Australian Securities and Investments Commission, ‘Enhanced Regulatory Sandbox’ <<https://asic.gov.au/for-business/innovation-hub/enhanced-regulatory-sandbox/>>.

102 Iris HY Chiu, *Regulating the Crypto Economy: Business Transformations and Financialisation* (Bloomsbury Collections, 2021) 44–7.

103 Ibid 46.

88. The technocratic approach appears to overlook the extent to which technology can be fallible, and the corresponding need to achieve consumer protection in appropriate circumstances.

89. A further approach, one that is reflected in the model law on DAOs published by COALA, is recognition of DAOs by domestic legal systems based on functional and regulatory equivalence. In other words, if a DAO satisfies certain eligibility requirements, it is deemed to be a legal entity separate and distinct from its members and will be accorded certain attributes, such as the ability to enter into contracts and limited liability protection in respect of its members.

90. The Treasury Consultation Paper noted that an alternative option for regulating crypto asset services would be self-regulation by the crypto industry, under which ‘the industry would develop a code of conduct for crypto asset services’.¹⁰⁴ The code of conduct

could be approved by a regulator and meet minimum regulatory policy goals ... such as in respect of consumer protection and AML/CTF.¹⁰⁵

91. The Treasury Consultation Paper further noted that such an approach would be ‘closer to the US and UK, who do not specifically regulate crypto assets (excluding for AML/CTF) unless they are securities or financial products’.¹⁰⁶ Self-regulation in the context of DAOs and crypto asset secondary service providers could include voluntary codes and standards in areas such as auditing, insurance, disclosure, and dispute resolution. It could also include self-accreditation processes to certify ‘trusted’ or ‘virtuous’ DAOs.

92. It has been argued that a major benefit of self-regulation by codes of conduct is that it would likely ‘help to achieve the level of confidence that institutional investors are calling for’.¹⁰⁷ This would be achieved by outlining a code that stipulates clear principles and objectives to ‘reassure’ investors in a similar manner to the recent FX Global Code of Conduct 2021 for the foreign exchange market.¹⁰⁸ It has been suggested that self-regulation would enable accountability on the basis that if a crypto asset service were deficient, it would decline in popularity.¹⁰⁹ Accordingly, crypto services would seek to develop the most robust codes of conduct possible to maintain their market share. Such an approach appears, however, to overlook the significant consumer harm and loss that may be suffered in the event of a deficient service, before the decline in popularity of that service.

Regulatory approaches in respect of crypto assets

93. There are several questions that are relevant to the regulation of crypto assets. These are questions that all jurisdictions need to consider, irrespective of their institutional design. Seven examples are set out below.¹¹⁰

94. First, should the regulatory framework in respect of crypto assets — particularly private cryptocurrencies — be prohibitive or permissive? In September 2021, the People’s Bank of China declared that trading in cryptocurrencies was illegal and banned related activities, including fundraising through ICOs.¹¹¹ In South Korea, a ban on ICOs has also been in place since 2017.

104 Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 19.

105 Ibid.

106 Ibid.

107 Louisa Chender, ‘Crypto Code of Conduct Would Boost Investors’ Confidence-BSO’ (2018) 1 *Global Investor* 1.

108 Ibid.

109 Jacqueline Hennelly, ‘The Cryptic Nature of Crypto Digital Assets Regulations: The Ripple Lawsuit and Why the Industry Needs Regulatory Clarity’ (2022) 27(1) *Fordham Journal of Corporate & Financial Law* 259, 286.

110 Much of the text in this section is taken from Andrew Godwin, ‘Crypto Assets and the Challenges for Regulatory Design’, *TechREG Chronicle* (May 2022) <<https://www.competitionpolicyinternational.com/crypto-assets-and-the-challenges-for-regulatory-design/>>.

111 China has, however, started to trial its central bank digital currency, the digital yuan.

However, the South Korean Government is reported to be considering removing the ban and bringing ICOs within the regulatory framework.¹¹²

95. Jurisdictions that are permissive in nature include Australia, Singapore, and the Hong Kong Special Administrative Region, all of which regulate tokens and ICOs by reference to the existing regulatory framework.

96. Even permissive jurisdictions are beginning to impose restrictions, particularly in the retail market. For example, the Monetary Authority of Singapore has made clear its expectations that service providers should not promote digital payment token services to the general public in Singapore.¹¹³

97. Secondly, how should tokens or crypto assets be classified and what taxonomy should be used for this purpose? The taxonomical challenges have increased as a result of the pace of change that has been brought about by technological innovation and also the extent to which new asset classes have come to be defined more by technology than by traditional concepts or labels. As noted in Part One above, jurisdictions have begun to undertake token mapping exercises to determine the best way to characterise the different types of token.¹¹⁴

98. Thirdly, who or what should be the target of regulation? A particularly important related question is who should bear responsibility if things go wrong. Given that it is very difficult, if not impossible, in a practical sense to regulate technology itself, the focus inevitably shifts to those who utilise the technology or provide services, such as DLT services or crypto asset secondary service providers.¹¹⁵

99. Fourthly, what regulatory style or method should be adopted for the regulation of crypto assets? For example, should jurisdictions favour a principles-based approach, over a prescriptive, rules-based approach? An example of a jurisdiction that has adopted a principles-based approach to the regulation of DLT providers is Gibraltar, where a DLT provider is required to comply with specified regulatory principles. The principles include the requirement for a licensed DLT provider to: 'conduct its business with honesty and integrity'; 'pay due regard to the interests and needs of each and all its customers and communicate with them in a way that is fair, clear and not misleading'; 'have effective arrangements in place for the protection of customer assets and money when it is responsible for them'; and 'have systems in place to prevent, detect and disclose financial crime risks such as money laundering and terrorist financing'.¹¹⁶

100. Fifthly, should crypto assets be subject to bespoke (that is, separate) regulation or instead be incorporated into existing regulatory frameworks in respect of financial services? As noted above, some jurisdictions have regulated crypto assets within their existing regulatory framework and by analogy with the regulation of existing products and concepts. In these jurisdictions, crypto-specific provisions and definitions appear in legislation dealing with anti-money laundering (as in Australia) and in payments legislation in order to enliven the relevant licensing and other requirements (for example in Singapore and the UK). By contrast, jurisdictions such as Gibraltar

112 See Timothy Craig, 'ICOs Could Be Returning to South Korea', *Crypto Briefing* (19 January 2022) <<https://cryptobriefing.com/icos-could-be-returning-to-south-korea>>. See also Todd Ehret and Susannah Hammond, *Compendium – Cryptocurrency Regulations by Country* (1 June 2021) 28.

113 See Monetary Authority of Singapore, *Guidelines on Provision of Digital Payment Token Services to the Public* (17 January 2022) <<https://www.mas.gov.sg/regulation/guidelines/ps-g02-guidelines-on-provision-of-digital-payment-token-services-to-the-public>>: 'These guidelines set out MAS' expectations that Digital Payment Token ("DPT") service providers should not promote their DPT services to the general public in Singapore. DPT service providers include payment institutions, banks and other financial institutions, as well as applicants under the Payment Services Act (PS Act)'.

114 See Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 3, 12: 'Consistent with the Government's response to the Senate Report, a token mapping process will be completed as a separate piece of work and finalised by the end of year', and, 'the token mapping exercise to be completed by end of 2022 will provide further clarity as to how crypto assets are classified on a risk-based and technology agnostic basis'.

115 Ibid in relation to crypto asset secondary service providers.

116 *Financial Services (Distributed Ledger Technology Providers) Regulations 2017* (Gibraltar).

have adopted bespoke regulations for DLT providers. Many jurisdictions have also adopted a regulatory sandbox to provide an opportunity for technology-based products and services to be tested under controlled conditions outside the formal regulatory framework. In all contexts, a key concern is consumer protection.

101. Sixthly, what is the impact of the applicable financial regulatory model in the relevant jurisdiction? A related question is whether there is a single market conduct and consumer protection regulator and a single rule book for this purpose, or multiple regulators and different rule books for different sectors or industries. The Twin Peaks regulatory model, under which regulation is objectives-based and functionally split between a market conduct regulator and a prudential regulator, has been recognised as being conducive to technological innovation:

one of the advantages of Twin Peaks systems is that they are better suited to reach beyond traditional sectors to areas such as finance companies (New Zealand) or Fintech innovations (Hong Kong). With the rise of Big Tech and the ever-rising importance of various flavors of shadow banking, the comparative advantages of Twin Peaks structures should continue to grow. Objectives-based supervision may just be a better fit for the Twenty-First Century economy.¹¹⁷

102. Finally, what are the regulatory objectives, principles or philosophies that guide a jurisdiction in its regulation of crypto assets? By way of example, since the late 1990s when the design of corporations and financial services legislation was significantly influenced by the Wallis Inquiry, Australia has subscribed to the principle that there should be 'similar (or same) regulatory treatment for functionally equivalent products'.¹¹⁸ This has been a guiding principle in relation to the development of regulation in this area for the past 25 years. A critical challenge with a functional approach, however, is how to determine functional equivalence for this purpose.

103. The UK, by comparison, is guided by the principle of 'same risk, same regulatory outcome'.¹¹⁹ A risk-based approach is attractive, but there is a challenge in determining how to measure risk as it applies to financial products and services.

104. Similar to the UK, the European Union has adopted an approach to financial stability, based on the principle of 'same activity, same risk, same rules'.¹²⁰ However, the approach requires clarity around the classification of crypto assets for regulatory purposes, which is a challenge under MiCAR.¹²¹

The current regulatory framework for crypto assets in Australia

105. At present, cryptocurrencies and crypto assets are governed by the following formal and informal sources of law in Australia:

- to the extent that a crypto asset or related service constitutes a financial product or a financial service, the regulatory framework governing financial services and financial products generally, including Chapter 7 of the *Corporations Act*;
- otherwise, the *Australian Consumer Law*;¹²²
- legislation governing anti-money laundering and counter-terrorism financing ('AML/CTF');

117 Howell Jackson, 'Foreword' in Andrew Godwin and Andrew Schmulow (eds), *The Cambridge Handbook of Twin Peaks Financial Regulation* (Cambridge University Press, 2021) xix.

118 Wallis et al (n 65) 279.

119 See HM Treasury (n 30) 15.

120 European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on a Digital Finance Strategy for the EU' COM(2020) 591 [4]. <<https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52020DC0591&from=EN>>.

121 A key issue that is subject to debate is the difficulty in drawing lines between the different types of token and the challenges that this may create in terms of regulatory arbitrage. See Dirk A Zetzsche et al, 'The Markets in Crypto-Assets Regulation (MiCA) and the EU Digital Finance Strategy' 16(2) *Capital Markets Law Journal* 203.

122 The Australian Consumer Law is contained in Schedule 2 to the *Competition and Consumer Act 2010* (Cth).

- legislation governing taxation; and
- guidance issued by the regulators.

106. The primary regulators responsible for supervising this area are: ASIC; the Australian Prudential Regulation Authority ('APRA'); the Australian Transaction Reports and Analysis Centre ('AUSTRAC'); and the Australian Taxation Office. The Reserve Bank of Australia has also issued guidance.

107. To date, Australia has regulated crypto assets by reference to the existing legal and regulatory framework and has not enacted bespoke laws or legal provisions. To some extent, this has been facilitated by Australia's functional approach to regulating financial products.

108. Adopting a functional approach, s 763A of the *Corporations Act* provides that

a **financial product** is a facility through which, or through the acquisition of which, a person does one or more of the following:

- (a) makes a financial investment ... ;
- (b) manages financial risk ... ;
- (c) makes non-cash payments ...

109. The functional approach to the definition of 'financial product' in the *Corporations Act* means that, to the extent that a particular crypto asset or token functions as financial products under any of the three categories set out above, it is regulated as such and attracts the relevant obligations, including those in respect of licensing and disclosure. As Interim Report A highlighted,

cryptocurrencies and other digital assets ... may or may not be regarded as financial products depending on their characteristics, though they can also be used as the basis of other financial products such as cryptocurrency-linked derivatives.¹²³

110. One benefit of the functional approach is that it recognises the challenges in designing regulation by reference to labels instead of by reference to the function of a particular product or activity. The benefits of the functional approach have been recognised by the Financial Policy Committee ('FPC') of the Bank of England:

Where crypto technology is performing an equivalent economic function to one performed in the traditional financial sector, the FPC judges this should take place within existing regulatory arrangements, and that the regulatory perimeter be adapted as necessary to ensure an equivalent regulatory outcome.¹²⁴

111. The FPC acknowledged, however, that

while the existing regulatory framework should be adapted to ensure an equivalent regulatory outcome for equivalent risks, the regulatory measures used to achieve these outcomes may need to be tailored to the new technologies and platforms that underpin them.¹²⁵

112. This underscores the extent to which designing a regulatory framework for crypto assets and blockchain applications will require a combination of existing regulation and new regulation.

113. In contrast, many other jurisdictions rely on exhaustive lists of financial products or services to regulate securities, financial products, or investment products. Australia appears to be unique in relying on a broad, functional definition of 'financial product' — a point explored by the ALRC in

123 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [3.40] citing Senate Select Committee on Financial Technology and Regulatory Technology, Parliament of Australia, *Final Report* (October 2021) [6.23]–[6.27].

124 Financial Policy Committee, Bank of England (n 31) 4, 24.

125 *Ibid.*

some detail in Interim Report A.¹²⁶ Similarly, the US adopts a functional test — ‘the Howey Test’ — to determine whether a transaction is an ‘investment contract’ and is subject to the applicable registration and disclosure requirements.¹²⁷ This test, however, is relevant to determining what qualifies as a ‘security’ only, and does not cover financial or investment products more broadly.¹²⁸

114. Although the functional approach in Australia appears attractive in terms of accommodating crypto assets, ASIC recognises it

can cause uncertainty for investors and consumers as well as issuers and distributors of these assets [and that] it is a policy matter for government whether or not there should be clarity on this issue.¹²⁹

115. A key issue is how regulatory clarity can be provided for this purpose.

116. Regulatory guidance on cryptocurrencies, crypto assets, and ICOs explains how obligations under the *Corporations Act* and the *Australian Securities and Investments Commission Act 2001* (Cth) (‘ASIC Act’) apply if a business is involved with crypto assets, such as cryptocurrency, tokens, or stablecoins (whether there are elements that are decentralised or not), or if an entity is considering raising funds through an ICO.¹³⁰ The obligations that may apply include licensing obligations, disclosure obligations, and design and distribution obligations. Failure to comply with any applicable obligations may constitute a criminal offence.

117. For example, ASIC has noted that the requirements to hold the relevant licence (such as an Australian financial services licence or an Australian market licence) and to comply with the associated obligations apply where an entity:

- issues crypto assets that fall within the definition of a ‘financial product’;
- acts as an intermediary in terms of providing advice in respect of crypto assets that fall within the definition of a ‘financial product’;
- acts as a miner or transaction processor as part of the clearing and settlement process for tokens that are ‘financial products’;
- operates a market for crypto assets that are ‘financial products’;
- operates an investment product that offers investors exposure to crypto assets;
- provides a payment service that involves a ‘non-cash payment facility’; or
- acts as a wallet and custody service provider in respect of tokens that fall within the definition of a ‘financial product’.¹³¹

118. ASIC’s regulatory guidance provides a non-exhaustive list of questions that should be considered when crypto assets are issued or offered, whether through an ICO or through other means. The questions include: (1) is the crypto asset a financial product (or does it involve a financial product); and (2) is there ongoing compliance with all relevant Australian laws?

126 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [7.66].

127 As decided in *Securities and Exchange Commission v. W. J. Howey Co.*, 328 U.S. 293 (1946), an investment contract is ‘a contract, transaction or scheme whereby a person invests [their] money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party’.

128 The regulatory classification of cryptocurrencies was further complicated when, in 2015, the Commodity Futures Trading Commission defined Bitcoin and other cryptocurrencies as commodities under the *Commodity Exchange Act 1936* (US).

129 The Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Second Interim Report* (n 21) [5.56] citing ASIC’s answers to questions on notice.

130 Ibid.

131 See Australian Securities and Investments Commission, ‘Crypto-Assets’ (Information Sheet 225, October 2021) <<https://asic.gov.au/regulatory-resources/digital-transformation/crypto-assets/>>.

119. The guidance states:

The Corporations Act is likely to apply to a crypto-asset or an ICO that involves a financial product such as a managed investment scheme, security, derivative or non-cash payment (NCP) facility.¹³²

120. The guidance discusses each financial product and notes ASIC's experience that 'some crypto-assets and many ICOs may be, or involve, interests in a managed investment scheme'.¹³³

121. As noted in the guidance, even if crypto assets do not constitute financial products, the general consumer protections under the *Australian Consumer Law* will still apply, particularly the prohibition against misleading or deceptive conduct in contexts such as advertising and marketing.¹³⁴ The guidance provides an inclusive list of conduct that may be misleading or deceptive to consumers:

- stating or conveying the impression that the crypto-assets (such as coins or tokens) or ICO offered are not a financial product if that is not the case;
- stating or conveying the impression that a crypto-asset trading platform does not quote or trade financial products if that is not the case;
- using social media to generate the appearance of a greater level of public interest in a crypto-asset or ICO;
- undertaking or arranging for a group to engage in trading strategies to generate the appearance of a greater level of buying and selling activity for an ICO or crypto-asset;
- failing to disclose adequate information about the ICO or crypto-asset, or suggesting that the ICO or crypto-asset is a regulated product or the regulator has approved the ICO or crypto-asset if that is not the case.¹³⁵

122. ASIC has been delegated powers from the Australian Competition and Consumer Commission ('ACCC') 'to, in coordination with the ACCC, respond to potentially misleading or deceptive conduct relating to crypto-assets which affect Australian consumers'.¹³⁶ This delegation 'enables ASIC to take action against misleading or deceptive conduct in marketing or selling of ICOs, even if the ICO does not involve a financial product'.¹³⁷

123. It is also relevant to note that if an entity engages in retail lending activities in relation to cryptocurrencies (for example, lending money to consumers to acquire cryptocurrencies), the activities may fall within the scope of the *National Consumer Credit Protection Act 2009* (Cth) and require the relevant entity to hold an Australian credit licence or otherwise be exempt from the requirement to be licensed.¹³⁸

124. As noted in Part Two above, the *AML/CTF Act* contains a definition of 'digital currency', which was inserted in 2018. The Department of Home Affairs (Cth) and AUSTRAC have explained the application of the legislation to digital currency exchanges ('DCEs') as follows:

The regulatory obligations imposed on DCEs under the *AML/CTF Act* are in line with guidance developed by the FATF [Financial Action Task Force] in 2015. The Act does not regulate cryptocurrency or digital assets, just as it does not regulate fiat currency, such as the Australian dollar. However, following the 2018 amendments, businesses offering DCE services between fiat

132 Ibid.

133 Ibid.

134 See, eg, Australian Competition and Consumer Commission, *Advertising and Selling Guide* (July 2021), which provides guidance on how to ensure advertising complies with the *Australian Consumer Law*.

135 Australian Securities and Investments Commission (n 131).

136 Ibid.

137 See Australian Securities and Investments Commission, 'ASIC Takes Action on Misleading or Deceptive Conduct in ICOs' (Media Release, 1 May 2018) <<https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-122mr-asic-takes-action-on-misleading-or-deceptive-conduct-in-icos/>>.

138 See Gilbert + Tobin, 'Global Legal Insights: Blockchain & Cryptocurrency Regulation 2022' (27 October 2021) <<https://www.gtlaw.com.au/knowledge/global-legal-insights-blockchain-cryptocurrency-regulation-2022>>.

currency and digital currency (i.e. cryptocurrency), and vice versa are regulated for AML/CTF purposes only. It does not regulate transaction exchanges from digital currency to digital currency.¹³⁹

125. The effect of the *AML/CTF Act* is that DCEs that offer the service of exchanging between fiat currency and digital currency are required to register and enrol with AUSTRAC as a reporting entity and are subject to various requirements. These requirements include verifying the identity of their customers through the know-your-customer processes and complying with the ongoing monitoring and reporting obligations, including the requirement to monitor and report suspicious and large transactions.¹⁴⁰

126. The Senate Select Committee on Australia as a Technology and Financial Centre reported that it heard submissions

that the current requirement for DCEs to register with [AUSTRAC] for the purposes of AML/CTF regulation amounts to a very 'light touch' regulatory approach to these businesses, and that enhanced regulation is needed.¹⁴¹

127. In addition to ASIC and AUSTRAC, APRA has issued regulatory guidance on 'Crypto-Assets: Risk Management Expectations and Policy Roadmap'.¹⁴²

Regulatory approaches in respect of DAOs

128. To date, only a few jurisdictions have adapted their regulatory framework to recognise and regulate DAOs. As in the case of crypto assets, a fundamental issue is determining which approach would be appropriate as previously discussed: a coherentist approach, a regulatory instrumentalist approach, a technocratic approach, or an approach based on functional and regulatory equivalence?

129. As noted in Part Three above, the Senate Select Committee on Australia as a Technology and Financial Centre recommended that a new DAO company structure be established. The adoption of a company structure, which would represent a coherentist approach, received support among submissions to the Inquiry.¹⁴³ Support for adapting the company structure or for imbuing DAOs with the attributes of a company such as separate legal personality is also found in academic literature,¹⁴⁴ although there is debate as to whether the company structure is the appropriate form.¹⁴⁵ As Sims has noted, DAOs 'are increasingly resorting to a central body', analogous to a board of directors.¹⁴⁶ This appears to support structuring a DAO along the lines of a company. However, it would still be necessary to override various elements of Australian corporate law. Moore, for example, has written that:

Inherent to the blockchain technology underpinning DAOs is the notion of anonymity and pseudonymity, meaning that the requirements of DAO summoners to register the names of

139 Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Final Report* (n 30) [2.57] citing the submission by the Department of Home Affairs and AUSTRAC, 3.

140 See Gilbert + Tobin (n 138).

141 Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Final Report* (n 30) [3.26]. Hence the CASSP proposals discussed in Part One above.

142 'Crypto-Assets: Risk Management Expectations and Policy Roadmap', Letter from Wayne Byers, Australian Prudential Regulation Authority, 21 April 2022 <<https://www.apra.gov.au/crypto-assets-risk-management-expectations-and-policy-roadmap>>. This letter outlines effective risk management in respect of crypto assets and notes, at 2, that 'stablecoin arrangements bear similarities with Stored-value Facilities (SVFs) and APRA, in conjunction with peer agencies on the Council of Financial Regulators (CFR), is developing options for incorporating them into the proposed regulatory framework for SVFs'.

143 See, eg, Mycelium, Submission No 19 to Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Third Issues Paper* (2021); Herbert Smith Freehills, Submission No 60 to Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Third Issues Paper* (12 July 2021).

144 See, eg, Alexandra Sims, 'Blockchain and Decentralised Autonomous Organisations (DAOs): The Evolution of Companies?' (2019) 28 *New Zealand Universities Law Review* 423; Nathan Tse, 'Decentralised Autonomous Organisations and the Corporate Form' (2020) 51(2) *Wellington Law Review* 313.

145 See, eg, Moore (n 53) 115–17.

146 Alexandra Sims, 'Decentralised Autonomous Organisations: The State of Play' [2021] *New Zealand Law Journal* 337, 339.

participants as directors, officers or shareholders may well be impracticable, given that obtaining details of their identity may well be impossible due to the DAO's code.¹⁴⁷

130. In its response to the Senate Select Committee's Report, the Australian Government agreed to the above recommendation in principle, although the Department of the Treasury (Cth) agreed to commence consultation on an 'appropriate regulatory structure' for DAOs, leaving open the possibility that an alternative to the company structure will be adopted.¹⁴⁸

131. To date, with limited exceptions set out in Table 2 below, jurisdictions have not taken steps to regulate DAOs. Consequently, the legal treatment of a DAO is uncertain and there is debate as to whether the closest analogue for regulating a DAO is as a partnership,¹⁴⁹ an unincorporated association,¹⁵⁰ or a company.

132. In favour of adopting a bespoke, 'regulatory instrumentalist' approach, Chiu argues:

One does not have to treat a blockchain-based business as anti-organisational just because it is unlikely to fit with the hierarchical and management-centred structure in a typical corporation. Further, a blockchain-based business does not have to be regarded as anti-organisational in order to maintain its core peer-to-peer and distributed characteristics ... Governance needs for the commons may be more optimally addressed if we recognise the need for, broadly, an organisational framework defined in its widest terms.¹⁵¹

133. Similarly, Abdussalam and Rahim suggest:

The heart of a [DAO's] management and operation lies in its governance mechanism, which sits on the network layer. The purpose of the governance mechanism is to bring the aspirations of the network to fruition through the allocation and enforcement of rights, duties and responsibilities of participants within the network. The reality that attends these novel business networks ... is that their governance mechanisms are amorphous; namely, they lack a clear structure or form. Thus, they defy settled legal categorisation and conventions that apply to the regulation of traditional business organisations such as corporations and partnerships.¹⁵²

134. Abdussalam and Rahim continue that

a legal regime akin to that which applies to unincorporated associations should apply when determining the question of ownership and legal responsibility for events that occur within [DAOs, and that] the unincorporated association model is more dynamic and apt [than a partnership or corporation] in that it addresses each case based on its peculiarities, applying elements of corporate governance, partnership or agency as and when the situation demands it.¹⁵³

135. Two advantages of allowing DAOs to adopt a corporate form — whether in the form of a company or in the form of another 'body corporate' — are that: (1) the DAO would enjoy separate legal personality, enabling it to enter into contracts and hold property; and (2) the members would enjoy limited liability protection in dealings between the DAO and third parties such as creditors.

136. As previously noted, many DAOs have overcome existing uncertainties of their legal status by adopting a 'legal wrapper'; namely, interacting with third parties in an off-chain (or real-world) context through a conventional business form such as a company. For example, some DAOs (or

147 Moore (n 53) 115–16.

148 Australian Government (n 5) 12.

149 For a discussion about the difficulties in this regard, see Usman Chohan, 'The Decentralized Autonomous Organization and Governance Issues' (Discussion Paper, University of New South Wales, 19 March 2022); Sims (n 146) 453–4.

150 There is support for the notion of regulating DAOs as unincorporated associations: see Abdussalam and Rahim (n 43). See also Sims (n 146) 340, who posits that a not-for-profit DAO would likely be treated as an unincorporated association by default. DAOs appear to be increasingly used for charitable purposes: see Wulf Kaal, *How Decentralized Autonomous Organisations Optimize Charitable Giving* (Research Paper, University of St Thomas, December 2021) 9.

151 Chiu (n 102) 111–12.

152 Abdussalam and Rahim (n 43) 315–16.

153 *Ibid* 320. In support, see James Langford, 'How Should the Law Treat Decentralised Autonomous Organisations?' (2022) 39(1) *Company and Securities Law Journal* 194.

DAO founders) have incorporated companies through which to implement the purposes of the DAO. For this purpose, a synthetic structure is used, under which the company

establishes an advisory board represented by token holders, who serve as the pseudo-decision-makers of the company by initiating and voting on proposals. Then, a project team or other party, acting as members of the company, would execute the DAO's decisions. These members would then appoint directors, who owe a fiduciary duty to the company to act in its best interests, and they would in turn implement the will of the advisory board. The constitution of the company would establish the advisory board, while specifying that the members and directors are obligated to execute the wishes of the DAO advisory board.¹⁵⁴

137. Some jurisdictions, however, have taken direct steps to accommodate DAOs within their domestic law. Table 2 below refers to models that have been adopted or suggested to date.

Table 2: DAO legislative models

Jurisdiction/Model Law	Registered/unregistered	Approach
Wyoming	Registered	Limited liability company
Tennessee	Registered	Limited liability company
Vermont	Registered	Blockchain-based limited liability company
Marshall Islands	Registered	Limited liability company
Malta	Registered	'Innovative technology arrangements'
COALA Model Law	Unregistered	Recognition — based on functional and regulatory equivalence

138. Wyoming law recognises that DAOs may take the form of a registered LLC. As noted in Part Three, a DAO can constitute itself as an LLC by including in its articles a prescribed statement that the company is a DAO. Such a legislative step was relatively straightforward in Wyoming because the law already recognised or permitted 'member-managed' companies to register and receive legal personality and limited liability.¹⁵⁵ In addition, Wyoming has passed a digital identity statute, allowing DAOs to register their members with digital identities.¹⁵⁶ In taking these steps, Wyoming appears to be the first-mover in the US in relation to allowing DAOs to incorporate as LLCs. A similar approach was adopted in Tennessee in April 2022.¹⁵⁷

154 See O'Melveny & Myers LLP, 'DAOs: Looking for Limited Liability & Legal Personality', *Client Alert* (11 July 2022) <<https://www.omm.com/resources/alerts-and-publications/alerts/daos-looking-for-limited-liability-and-legal-personality/>>.

155 For general discussion about the position in Wyoming, see James Holbein and Justin Holbein, 'Legal Issues Confronting Formation and Operation of a Decentralized Autonomous Organization' <www.braumillerlaw.com/legal-issues-confronting-formation-operation-decentralized-autonomous-organization-dao/>.

156 Ibid.

157 See O'Melveny & Myers LLP (n 154).

139. Vermont law also recognises blockchain-based LLCs. It has been noted that this business form is relatively unwieldy as it is necessary to have constitutional documents that override unsuitable or contrary provisions in the law.¹⁵⁸

140. The Marshall Islands is anomalous insofar as it has not legislated expressly in respect of DAOs but, instead, has amended its *Non-Profit Entities Act* in a way that allows DAOs to be registered as non-profit LLCs and the Government has announced that DAOs will be registrable under the new law:

The new law essentially grants DAOs the same privileges as limited liability corporations (LLC), allowing them corporate personhood and the ability to hold real estate, done through a modification to the nation's Non-Profit Entity Act.¹⁵⁹

141. The announcement continues by stating that 'under the Marshall Islands' new law, DAOs incorporated within its territory would not have to register separate LLCs'.¹⁶⁰ This appears to be a reference to the ability of a DAO to incorporate in its own right, as distinct from having to incorporate a separate entity and adopt a synthetic approach as outlined above.

142. A DAO that registers in the Marshall Islands as a non-profit LLC would operate as a non-profit corporation, under which no part of the income or profit of the corporation would be distributable to its members.

143. Malta has adopted a regulatory instrumentalist approach, where it recognises registered 'innovative technology arrangements' ('ITAs') that operate other than in the form of an LLC. Unlike other jurisdictions, however, an ITA in Malta does not have separate legal personality.

144. A common limitation of the models discussed above is that registration invariably requires human agents or representatives to be appointed to act in certain capacities on behalf of the DAO. This inevitably detracts from the DAO's decentralised and autonomous nature, at least in its purest form. It is for this reason that the COALA Model Law instead recognises unregistered DAOs based on functional and regulatory equivalence:

The adoption of this Model Law by States, and thus the recognition of features of functional and regulatory equivalence of DAOs, would encourage DAO developers, administrators and members to implement these features into their DAOs so as to benefit from legal personality.¹⁶¹

145. There are, however, three potential issues with COALA's approach. The first issue is that the practical effectiveness of the COALA Model Law in a cross-border context is premised on its adoption by a number of jurisdictions, which is likely to be more an aspirational than realistic goal.¹⁶² The second issue is that to the extent a DAO operates outside the regulatory perimeter, concerns remain about consumer protection, enforcement, and the ability for third parties to

158 Chiu (n 102) 139.

159 See Ministry of Health and Human Services, Republic of the Marshall Islands, 'News example (3): Marshall Islands Is Trying to Become a Global Hub for DAO Incorporation' (Media Release, 24 February 2022) <<https://rmihealth.org/index.php/news/183-news-example-hospital-delivery-ward-spiffed-up-5>>.

160 Ibid.

161 Coalition of Automated Legal Applications (n 56) 9 n 7: 'Note that some jurisdictions have adopted a different approach than our Model Law by creating new types of registered DAO forms (eg, Malta, Wyoming) rather than providing a legal framework where unregistered DAOs qualify as legal entities if they meet certain conditions such as those outlined in the Model Law. In our opinion these approaches are limited in that they do not properly leverage the technological and crossborder characteristics of blockchain technology'.

162 Ibid 6: 'The Model Law provides uniform rules of law that can serve as a model for national legislators who wish to adopt substantive national law rules on DAOs. In a State that has transposed or adopted the Model Law into their domestic legal system, a DAO that is constituted according to the requirements of the transposed or adopted legal rules will qualify as a legal entity. This will result in the DAO being granted legal existence and legal personality in any State that has adopted or transposed the Model Law, which is essential to guarantee the legal effect of its actions'.

take action within the domestic court system (as opposed to being limited to the internal dispute resolution that might have been set up by the DAO itself).¹⁶³

146. The third issue — one that involves a fundamental question of policy — is that the conferral of corporate attributes on unregistered DAOs, such as the ability to enter into contracts and limited liability protection in respect of its members, is a decision that should not be undertaken lightly. This issue is particularly relevant given the traditional theory that corporations are ‘artificial entities created by the state’.¹⁶⁴ This theory ‘regards the separate legal status of the company as a concession or privilege granted by the state’.¹⁶⁵ Although the state has the power to deem unregistered DAOs to have legal personality, it would appear anomalous to do so in circumstances where this has only been done to date in respect of registered entities, whether domestic companies or registered foreign-incorporated companies, and where the concession of legal personality has been granted in return for meeting a range of requirements and obligations, including the conferral of rights on members against the company and the conferral of rights on creditors in the context of insolvency.

147. For this reason, jurisdictions that seek to regulate DAOs expressly are likely to require them to adopt a registered form to provide a jurisdictional nexus and to bring them within the scope of domestic law and regulation in all relevant respects. Even if a registered form is adopted, there are still uncertainties in relation to the legal treatment of DAOs, particularly in relation to their off-chain dealings with third parties, and questions of liability and accountability. As the Chair of ASIC has stated:

To paraphrase a concept familiar to corporate lawyers, to whom does ASIC turn to ascertain the directing mind and will of a DAO? It is not clear who is accountable if things go wrong, or don’t go as intended or anticipated. Nor is it clear how a DAO itself can be held accountable in a court of law.

The policy challenge for traditional forms and methods of regulation is readily apparent. Legal analysis of how DAOs work is at an early stage, with many unanswered questions: what is the nature of a member’s interest in a DAO? Is it like a share in a company or a unit in a managed investment fund?¹⁶⁶

148. Part Five below examines possible directions of reform in Australia in relation to the regulation of crypto assets and DAOs.

Part Five: Reform considerations in Australia

Regulation of crypto assets

149. As noted in Part One above, in its response to various reviews, the Australian Government acknowledged the need to modernise the regulatory architecture.¹⁶⁷ It further noted that the Department of the Treasury (Cth) would conduct a review in 2022 to determine a specific reform pathway for the regulation of crypto assets.¹⁶⁸

163 Ibid 22: ‘Dispute Resolution Mechanisms with non-member third parties do not have to meet minimum standards of due process for the time being, as no on-chain ADR process currently meets such standards and is unlikely to do so in the foreseeable future. However, third parties who enter into agreements with DAOs should be informed upfront about the Dispute Resolution Mechanism the DAO has opted into and that it may not meet the standards of due process that they might expect in an Off-Chain dispute resolution process, such as court litigation. This gives the third party prior notice and option to avoid transactions with the DAO and, if they choose to enter into such transactions, they do so on the basis of “participant beware”’.

164 See Stephen Bottomley, ‘Taking Corporations Seriously: Some Considerations for Corporate Regulation’ (1990) 19 *Federal Law Review* 203, 206–7.

165 Ibid.

166 Joe Longo, ‘Responsibility amid Change’ (Speech, AFR Super and Wealth Summit, 22 November 2021) <<https://asic.gov.au/about-asic/news-centre/speeches/responsibility-amid-change/>>.

167 Australian Government (n 5) 4.

168 Ibid 4–5.

150. The Senate Select Committee on Australia as a Technology and Financial Centre considered submissions concerning law reform in relation to the regulation of crypto assets and made the following recommendations:

Recommendation 1

6.16 The committee recommends that the Australian Government establish a market licensing regime for Digital Currency Exchanges, including capital adequacy, auditing and responsible person tests under the Treasury portfolio.

Recommendation 2

6.22 The committee recommends that the Australian Government establish a custody or depository regime for digital assets with minimum standards under the Treasury Portfolio.

Recommendation 3

6.28 The committee recommends that the Australian Government, through Treasury and with input from other relevant regulators and experts, conduct a token mapping exercise to determine the best way to characterise the various types of digital asset tokens in Australia.¹⁶⁹

151. Various reform options were identified in submissions to the Senate Select Committee. Reform options include greater regulatory clarity in relation to which crypto assets constitute financial products;¹⁷⁰ temporary regulatory relief in the form of a safe harbour;¹⁷¹ establishing a market licence regime for digital asset providers¹⁷² or, alternatively, introducing new categories of authorisation under the AFSL regime;¹⁷³ and incorporating certain crypto assets into the current regulatory framework for ‘financial products’ (as defined) in Chapter 7 of the *Corporations Act*.¹⁷⁴

152. A relevant question is whether it will be possible to continue to regulate cryptocurrencies and crypto assets by reference to the existing legal and regulatory framework (and the general definitions), or whether the framework will need to be tailored, including through adopting bespoke provisions and definitions, to achieve fit-for-purpose regulation.

153. APRA has noted the importance of a ‘robust regulatory framework’ for crypto assets to ‘guard against potential financial stability risks’ and has referred to the possibility of incorporating payment stablecoins into the proposed framework for regulating stored value facilities.¹⁷⁵ The Bank of England is similarly considering a proposal to bring systemic stablecoins into the Bank’s payments remit. The proposal would ‘allow for a non-bank regulatory regime for stablecoins’.¹⁷⁶

154. In any reforms to bring cryptocurrencies or crypto assets expressly within the scope of Chapter 7 of the *Corporations Act*, the definitions of ‘financial product’ and ‘financial service’ will be of critical relevance. The current definitions are complex for three reasons:

169 Senate Select Committee on Australia as a Technology and Financial Centre, Parliament of Australia, *Final Report* (n 30) vii.

170 Ibid [3.10].

171 Ibid [3.16].

172 Ibid [3.17], [3.23].

173 Ibid [3.23], [3.69].

174 Ibid [3.70]–[3.76].

175 Council of Financial Regulators, *Quarterly Statement by the Council of Financial Regulators – June 2022* (Media Release, 23 June 2022) <<https://www.cfr.gov.au/news/2022/mr-22-02.html>>. In 2019, the Council of Financial Regulators recommended that stored-value facilities (SVFs) ‘be introduced as a new class of regulated product, replacing “purchased payment facilities” in the regulatory framework’ and that SVFs and other payment products that pose limited risk to consumers ‘continue to be largely exempt from most regulatory requirements’: see Council of Financial Regulators, ‘Regulation of Stored-Value Facilities in Australia’ (October 2019) <<https://www.cfr.gov.au/publications/policy-statements-and-other-reports/2020/regulation-of-stored-value-facilities-in-australia/pdf/report.pdf>>.

176 Financial Policy Committee, Bank of England (n 31) 37–8.

- there are extensive lists of inclusions and exclusions for the definitions of the two terms in the *Corporations Act* and the *ASIC Act*, many of which contain further defined terms and so create a series of interconnected definitions;
- the definitions vary for the purposes of different provisions, obligations, and prohibitions in Chapter 7 of the *Corporations Act*, and the definitions are different again for the *ASIC Act*; and
- the extent and nature of variations to the definitions are difficult to ascertain as a result of incoherent use of the legislative hierarchy and, in particular, the creation of alternative regulatory regimes and notional amendments to provisions in the *Corporations Act*.¹⁷⁷

155. Accordingly, the ALRC made various proposals to simplify the definitions of ‘financial product’ and ‘financial service’.¹⁷⁸ These proposals include removing specific inclusions from the definitions in each of the *Corporations Act* and the *ASIC Act* and consolidating, in delegated legislation, all exclusions and exemptions from these definitions. This proposal is consistent with the suggestion in the Treasury Consultation Paper that

the Government (or the regulator) could be provided with powers to exempt or ‘carve out’ particular crypto assets which do not warrant regulation under the financial services regime in a risk-based manner.¹⁷⁹

156. The functional definition of a ‘financial product’ in s 763A of the *Corporations Act* is broad enough to capture crypto assets that involve: the making of a financial investment; the management of a financial risk; or the making of non-cash payments. Accordingly, if a definition of crypto assets were included in financial services legislation in Australia, its purpose may be to define a concept to which exclusions, exemptions, and specific rules (including obligations) could apply. The regulation of crypto assets that constitute financial products would be further supported by the ALRC’s proposed legislative hierarchy model set out in Interim Report B.

157. As posited in Interim Report A, it may be appropriate to include a new term in legislation ‘if there is no term with an equivalent meaning that is more widely understood’.¹⁸⁰ Such an approach provides a justification for inserting a definition of a ‘crypto asset’ in financial services legislation. There are, however, a number of questions that should be considered in determining both the label that should be adopted for the concept and the definition used to describe the concept. For example, questions arise as to whether terms such as ‘cryptocurrency’ or ‘digital currency’ would be appropriate, given that the concept does not involve a ‘currency’ as traditionally understood. In addition, the use of terms such as ‘stablecoins’ may be misleading, particularly given the collapse in May 2022 of a well-known stablecoin, which proved to be anything but stable.

158. Even the rationale for the use of the term ‘asset’, as in ‘crypto asset’, is equivocal to the extent that the proprietary nature of a crypto asset is subject to ongoing analysis and debate. Accordingly, the question of ‘what is in a name’ assumes a high level of importance, particularly from a consumer protection perspective. A related question is whether it would be better to use the term ‘crypto’ as an adjective to describe specific financial products that are the subject of existing regulation than to define the term ‘crypto asset’ itself.

Regulation of DAOs

159. Uncertainties about the legal treatment of DAOs and the allocation of liabilities, including liabilities of members *inter se* and vis-à-vis third parties, have led to calls for a business form to

¹⁷⁷ Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [7.2].

¹⁷⁸ *Ibid* [7.74]–[7.212].

¹⁷⁹ Department of the Treasury (Cth), *Crypto Asset Secondary Service Providers* (n 11) 18.

¹⁸⁰ Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [4.87].

be designed for DAOs so that they can operate as separate legal persons and their members can enjoy limited liability protection.

160. Various possibilities have been suggested in relation to the closest legal analogues to DAOs, including partnerships and unincorporated associations. The arguments in favour of treating DAOs as analogous to unincorporated associations are compelling to the extent that this business form appears capable of accommodating the DAO in its purest form without the need to adapt it to fit other business forms such as the corporate form.¹⁸¹

161. It has been noted that DAOs cannot currently be registered or incorporated under the *Corporations Act* and lack legal personality.¹⁸² Significantly, Bayliss points out that DAOs would have to forgo anonymity and autonomy, currently two of their essential characteristics, to comply with the applicable provisions of the *Corporations Act*, limiting the possibility of having a 'legitimate business structure entirely based upon blockchain'.¹⁸³

162. The adoption of the corporate form for DAOs in jurisdictions such as Wyoming have been made easier by the existence in the law of those jurisdictions of the LLC or 'close corporation', which removes any distinction between directors and shareholders, and by the availability of a digital identity statute, allowing DAOs to register their members with digital identities (permitting anonymity and pseudonymity). However, it has still been necessary to make compromises, which may detract from the essential nature of a DAO, particularly its decentralised governance. For example, in order to adopt a corporate form in those jurisdictions, every DAO must have and continuously maintain a registered agent to provide a legal address within that jurisdiction for service of process and to which the state government sends official documents for tax and legal purposes. Failure to maintain a registered agent will generally result in the revocation of the corporate/LLC status or the imposition of penalties (or both).¹⁸⁴

163. The challenges and inconsistencies that arise in trying to adapt DAOs to registered business forms in national jurisdictions underpin the thinking behind the COALA Model Law, which provides for eligible DAOs to be recognised on the basis of regulatory and functional equivalence. However, as previously noted, this approach raises queries about its practicalities and the ongoing limitations.

164. The question therefore arises as to whether the existing company form in Australia might be adapted to accommodate DAOs. Australia has previously adapted and tailored the company form to specific circumstances. The tailoring to companies limited by guarantee that has occurred in the context of charities is an example, although debate as to whether a bespoke corporate form for registered charities continues,¹⁸⁵ as does debate about whether Australia should recognise a 'close corporation' along the lines of the LLC in the US.¹⁸⁶ Significantly, to date the adaptation and tailoring of the company in Australia has occurred without a radical change to the basic skeletal structure of the company. Questions of incompatibility would arise if an entity with a fundamentally different governance structure from the traditional company were able to adopt the form of a company.

181 See Abdussalam and Rahim (n 43); Langford (n 153).

182 Myles Bayliss, 'Corporate Law for the Digital Age: Blockchain and the Corporate Form' (2020) 36(1) *Australian Journal of Corporate Law* 49, 58.

183 Ibid 56–9.

184 See Sandra Feldman, 'How Much Do You Know about Service of Process and Registered Agents?' (Wolters Kluwer Compliance, 15 April 2022) <<https://www.wolterskluwer.com/en/expert-insights/how-much-do-you-know-about-service-of-process-and-registered-agents>>.

185 See Ian Murray and Rosemary Teele Langford, 'The Best Interests Duty and Corporate Charities — The Pursuit of Purpose' (2021) 12 *Journal of Equity* 92.

186 See Samuel Chu, 'Should Australia Reintroduce the "Close Corporation" to Aid a Post-COVID-19 Economic Recovery – Or Take an Alternative Approach?' (2022) 39 *Company and Securities Law Journal* 138.

165. Alternative business forms such as incorporated associations or cooperatives, as recognised in the States and Territories, might be considered. However, similar questions of incompatibility may arise, alongside the constitutional issues in terms of whether the Australian Parliament would have the power to legislate in respect of such alternative business forms.

166. Accordingly, it is possible that regulatory design choices include the following:

- a DAO that operates in a purely decentralised, unwrapped form, which is treated either as an unincorporated association or otherwise, depending on the circumstances; or
- a ‘wrapped’ or hybrid arrangement under which a DAO operates through a company or other corporate form, which might be supported by some legal tailoring to facilitate the operation and activities of DAOs.¹⁸⁷

167. Irrespective of the business form that a DAO might adopt, it is likely that the ALRC’s legislative hierarchy model as proposed in Interim Report B would facilitate the regulation of their activities in areas such as financial services, capital-raising and disclosure, if the Australian Government were to decide that such regulation would be desirable.¹⁸⁸

Benefits of the ALRC’s proposed legislative hierarchy model

168. The proposed legislative model seeks to accommodate the following characteristics that underpin the regulation of financial products and services in Chapter 7 of the *Corporations Act*:

- the fundamental policy flowing from the Wallis Inquiry that functionally equivalent financial products and services should be regulated in an equivalent way; and
- the use of delegated legislation to manage the over-inclusiveness that has resulted from the adoption of functional definitions in pursuing that fundamental policy,¹⁸⁹ as well as enabling flexibility in the regulation of new and emerging products and services.

169. Chapter 7 of the *Corporations Act* includes a number of areas or regimes of regulation, such as licensing, disclosure, financial advice, and design and distribution obligations. The legislation currently determines the scope of ‘financial products’ to which each of these regimes applies by repeatedly tailoring the definition of ‘financial product’ for particular provisions, as well as by using similar defined terms such as ‘relevant financial products’¹⁹⁰ and ‘relevant provider’. This approach creates complexity and navigability challenges. The ALRC proposed that application provisions should be used in place of such defined terms and that this would delineate the respective scope of the relevant provisions in a more transparent way than is currently the case.¹⁹¹ Interim Report A discusses how this model could be implemented to simplify the current Part 7.9 of the

187 This might include, for example, similar tailoring to what has been undertaken in respect of collective corporate investment vehicles.

188 The ALRC’s legislative hierarchy model would comprise: (a) an Act legislating fundamental norms and obligations, and other provisions appropriately enacted only by Parliament; (b) a Scoping Order (a single consolidated legislative instrument) containing exclusions, class exemptions, and other detail necessary for adjusting the scope of the Act; and (c) thematic ‘rulebooks’ (consolidated legislative instruments) containing rules giving effect to the Act in different regulatory contexts as appropriate. For further detail, see Australian Law Reform Commission, *Interim Report B: Financial Services Legislation* (Report No 139, 2022) Chapter 2.

189 The High Court has observed that the legislative scheme implemented in Chapter 7 of the *Corporations Act* and Part 2 Div 2 of the *Australian Securities and Investments Commission Act 2001* (Cth) ‘has two significant characteristics. One is [over-inclusiveness]. Rights and liabilities are drawn in overtly broad terms, on the footing that instances of overreach which become apparent in the administration of the legislation may be remedied by adjustments to the Act made not by remedial legislation but by exercise of powers conferred upon the Executive Government or bodies such as the Australian Securities and Investments Commission. The second characteristic is the creation by the legislation of rights and liabilities by means of criteria which reflect fluid market and economic usage rather than any ascertainable and stable meaning in the law’: *International Litigation Partners Pte Ltd v Chameleon Mining NL (Receivers and Managers Appointed) & Ors* (2012) 246 CLR 455 [5].

190 For discussion about the use of ‘relevant financial product’ for the purpose of licensing, see Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [8.100].

191 See *ibid* [10.123].

Corporations Act relating to financial product disclosure.¹⁹² Interim Report B further develops the legislative hierarchy model and is accompanied by prototype legislation that demonstrates the application of the model in respect of both financial product disclosure and securities disclosure.¹⁹³

170. The ALRC's proposed legislative model supports the regulation of both crypto assets and any new business models such as DAOs, if Government were so inclined. Among other things, the model would: avoid unnecessary duplication and overlap of the regime-specific rules at the level of the primary legislation; enable rules governing disclosure and other areas of consumer or investor protection to be standardised and applied as appropriate; and reduce the problems created by the excessive use of exclusions, exemptions, and notional amendments.¹⁹⁴

Direction of reform generally

171. Finally, it is useful to reflect on what technological innovation in areas such as the regulation of crypto assets and DAOs suggests in terms of the direction of reform generally. Three observations might be made in this regard. First, it is important to ensure that regulation is not unduly driven by technology, whether in terms of how concepts should be labelled and defined, or in terms of whether new regulation should be created to govern technology-enabled innovation. In this regard, it is suggested that the regulation of crypto assets should be driven less by technology and more by the function that crypto assets perform and the obligations to which persons who deal in, or provide services in relation to, crypto assets should be subject. Otherwise, the risk of arbitrage (regulated entities changing the regulatory outcome by changing the technology) will arise, together with the risk of inadvertently capturing products and activities that are already regulated. A regulatory approach that is unduly driven by technology is likely to increase the complexity of the legislative framework for corporations and financial services regulation and make it more difficult to achieve meaningful compliance with the substance and intent of the law.

172. In the case of DAOs, it is similarly important to be clear about the purpose for which any legislative definition is adopted, and so to avoid unintended consequences. For example, if DAOs were defined purely by reference to DLT, the definition might capture existing business forms, such as registered companies, that utilise such technology for governance purposes. Instead of considering how existing business forms might be adapted to fit technology, it might be better to consider how technology might be adapted to accommodate existing business forms and enhance their effectiveness.

173. Secondly, it is possible that the impact of technology will result in a move away from a prescriptive, rules-based approach to regulation in favour of a more principles-based approach, one that is supported by clearer outcomes and can better accommodate new technologies and practices.

174. Thirdly, it is possible that the regulatory net will continue to expand to include a broader range of service providers than was traditionally the case. This has been recognised in the Payments System Review in respect of providers of payment facilitation services, and by the Treasury Consultation Paper in respect of crypto asset secondary service providers.

192 Ibid [10.124]–[10.148].

193 See Australian Law Reform Commission, *Interim Report B: Financial Services Legislation* (Report No 139, 2022) [2.7]–[2.10], [5.35]–[5.37]. Prototype legislation prepared by the ALRC and accompanying explanatory materials can be downloaded from the ALRC website.

194 For further details, see Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) Chapter 10; Australian Law Reform Commission, *Interim Report B: Financial Services Legislation* (Report No 139, 2022) Chapter 2.