Who "HODLs" the Power in the Australian Crypto Market

Regulation of Australian Crypto-assets

Australia – October 2022

Australia's federal government has committed to regulating the burgeoning digital asset market in Australia. As announced on 22 August 2022, Australia intends to implement regulation that will safeguard consumers while embracing new and innovative technologies in the crypto and digital assets space.

At this stage, the exact scope of reform is unclear. In the first instance, the Australian Department of the Treasury is proposing to undertake a "token mapping" exercise to catalogue and categorise existing cryptocurrencies and digital tokens. This process, which the Australian government considers will be a world first, is intended to inform policymakers and the market of the existing crypto-asset ecosystem and establish where and how to best regulate this space. This exercise will then form a foundation for future stakeholder consultation and policy framework which aims to identify notable gaps in existing regulations, develop additional consumer safeguards, implement licensing frameworks and explore innovative engagement options.

An initial consultation paper on the government's "token mapping" exercise is still outstanding. The Albanese government has characterised this process as a "serious approach" to regulatory reform, and criticised Australia's prior Liberal government for rushing action in this sector. Accordingly, we suspect it will be a long road to the adoption of meaningful reform on crypto-assets.

Until this reform process is completed, crypto and digital assets in Australia will remain subject to existing securities, tax and consumer laws, which the Australian government concedes is currently "largely unregulated". A high-level summary of the existing position is considered below.

While there is no specific definition of what constitutes a "crypto-asset" in any Australian legislation, the Australian Securities and Investments Commission (ASIC) has adopted an internal definition for policy, guidance and consultation purposes that "crypto-assets" are understood as "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".

This definition includes traditional "cryptocurrencies", as well as other digital tokens and assets. Critically, the rights and features of each crypto-asset are unique, meaning that regulation will differ depending upon the rights and features of the applicable crypto-asset.

While there is no universal position on what a crypto-asset is, the Reserve Bank of Australia and the Australian Taxation Office know what crypto-assets are not – money. Accordingly, even traditional cryptocurrencies, such as Ethereum's ether (ETH), are considered assets and are subject to capital gains tax and related tax implications when being sold (even when used as a form of payment).

Beyond this, the regulation of crypto-assets in Australia is dependent upon the nature of the asset itself. Notable applicable instances of Australian regulation include:

- **Securities** – A crypto-asset may be a "security" for the purposes of the Australian Corporations Act 2001 (Cth) (Corporations Act). ASIC will consider a particular cryptocurrency or digital token a "security" if the rights it provides the holder are sufficiently analogous with traditional securities, such as shares, options or debentures. Therefore, to the extent that a crypto-asset provides voting rights, dividend or distribution rights and/or ownership rights of a business, body or organisation, that crypto-asset may be considered a security. An example of when a crypto-asset is considered a security includes tokens in "decentralised autonomous organisations" (DAO) that operate subject to coded rules and token holder referenda. To the extent that a crypto-asset is a security, a number of traditional Australian securities law mechanisms will be invoked, regulating the issue and marketing of such assets (among others).

- **Initial coin offerings (ICOs)** – Further, to the extent that a crypto-asset is a "security" under Australian law, public offerings of those crypto-assets will require disclosure in accordance with Chapter 6D of the Corporations Act. A prospectus or related disclosure document may be required in order to undertake an ICO in Australia.

- **Derivatives** – A crypto-asset that derives its value from the price of another financial product, underlying market index or asset may be considered a derivative for the purposes of the Corporations Act. The issuer of crypto-asset derivatives may need to prepare a product disclosure statement or hold an Australian Financial Services (AFS) licence.

- **Managed investment scheme** – Besides securities, crypto-assets may be considered other "financial products", which are also regulated under Australian financial law. To the extent that a crypto-asset takes the form of a managed investment scheme, it will be considered a financial product and may need to be registered with ASIC and operate in accordance with an AFS licence.

- **Exchanges and market operators** – Due to the use of cryptocurrencies in connection with cybercrime and other nefarious activities, Australia's anti-money laundering and counter-terrorism financing (AML/CTF) laws were expanded in 2018 to require cryptocurrency exchanges and market operators to comply with strict "know your customer" laws when onboarding customers to their exchange. To the extent that such markets or exchanges deal in crypto-assets that are considered financial products (such as securities, derivatives or managed investment schemes), they will also need to hold and comply with AFS licences when offering those products for trade.

- **Businesses** – Businesses operating in Australia will need to be conscious of misleading and deceptive conduct prohibitions within the Australian Consumer Law. Making or engaging in misleading, incorrect or deceptive activity with respect to crypto-assets offered or held by a business could result in civil and criminal offences.

- **Companies** – Companies need to ensure their financial reporting and continuous disclosure obligations (to the extent applicable) adequately address the rights and liabilities associated with crypto-assets held or issued by the company. Some crypto-assets are notoriously volatile, and substantial variations in crypto-asset prices may trigger disclosure obligations for companies associated with crypto-assets. Further, company boards will need to ensure they act within their directors' duties when determining to purchase or issue crypto-assets, making sure that the company remains solvent and that they act with sufficient care, skill and diligence.

Many common crypto-assets, such as bitcoin (BTC) and ETH (among others), fall outside the scope of Australia's existing securities and financial markets regulation. Accordingly, it is true (at least by volume) that the crypto-asset market is largely unregulated in Australia. Despite this, there are regulatory concerns when operating with innovative and volatile asset products such as cryptocurrency. Further, to the extent that your company, business or decentralised autonomous organisation (DAO) offers or holds unique cryptocurrencies that may be considered a financial product under Australian law, compliance steps may be required. At this stage, ensuring compliance requires a contextual analysis of the rights and liabilities of the relevant crypto-asset. To the extent you require assistance unravelling the morass of crypto-asset regulation, we can assist in analysing the applicable risks and advising on compliance.

Authors

Chris Rosario
Partner, Perth
T +61 8 9429 7553
E chris.rosario@squirepb.com

Kate Kim Tuma
Partner, Tokyo/Los Angeles
T +81 3 5774 1800/T +1 213 689 5147
E kate.tuma@squirepb.com

Connor McClymont
Associate, Perth
T +61 8 9429 7534
E connor.mcclymont@squirepb.com

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squirepattonboggs.com

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