3 March 2023

Director – Crypto Policy Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Submitted via email to crypto@treasury.gov.au

Subject: Response to Public Consultation on Token Mapping by the Australian Government's Treasury

To whom it may concern,

The Cardano Foundation appreciates the Australian Government's engagement with the digital asset and distributed ledger technology community, and welcomes the opportunity to provide inputs to its Token Mapping Consultation Paper.

The Cardano Foundation is the independent, Swiss-based non-profit organization responsible for stewarding the advancement of the public, permissionless blockchain platform Cardano. Our mission is to anchor the Cardano blockchain as a digital infrastructure for current and future financial and social systems so as to empower the social architects of the future. We aim to explain and address decentralization risks for various stakeholders, while giving the Cardano community the tools and support necessary to leverage the Cardano infrastructure to solve world problems.

Kindly find our general comments (see section 1) and responses to the respective questionnaire (see section 2) below. We would gladly address any follow-up questions or participate in further discussions with the Australian Government and any of its associated institutions.

Yours sincerely,

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1. General Remarks

The Cardano Foundation is convinced that an adequate, risk-based legal and regulatory framework is beneficial to realizing the potential of digital assets and blockchain technology. Appropriate rules, built on sensible and suitable principles, help foster innovation while reducing potential risks and unwanted social costs.

We appreciate the prudent and well-informed approach of the Australian Government's Treasury (hereinafter "the Treasury") reflected in the Token Mapping Consultation Paper of February 2023 (hereinafter "the Consultation Paper")[1].

We would like to highlight three key items which we believe provide the necessary foundation for answering the specific questions raised by the consultation: :

- **Necessity for appropriate differentiation**: Sound, innovation-friendly and risk-adequate regulatory policy should duly consider material differences between blockchain infrastructures and their applications. Even if the currently predominant use of blockchain technology revolves around financial or finance-like activities, it should not be reduced to that. Use cases and their potential risks should be assessed with due care to avoid overreaching or inadequate regulation, which would ultimately hamper growth and innovation. It is crucial to differentiate between activities that concern the crypto networks as an infrastructure versus activities that build and implement use cases and business models on said infrastructure.

  Against this background, we appreciate the Consultation Paper's high-level taxonomy which explicitly recognizes the breadth of possible functions of crypto assets and crypto networks. However, we are of the view that a more granular and function-focused categorization would further improve clarity for both legislative and market stakeholders.

- **Outcome-driven, principle- and risk-based approach:** As identified in the Consultation Paper, crypto assets and crypto networks may cover a myriad of possible functions. Comprehensively anticipating all functions and use cases, let alone the respective associated risks, does not seem feasible. The fast-paced innovation in the blockchain

[1] As published under <https://treasury.gov.au/consultation/c2023-341659>, lastly visited on 28 February 2023.

space tends to make overly prescriptive rules quickly out-dated or outright obsolete. The Cardano Foundation believes that an appropriate legal framework should therefore follow a functional- and outcome-driven approach, based on flexible principles, that mitigate immediate risks in a proportionate manner.

Overall we welcome the Treasury's approach underlying and guiding the Token Mapping process. The functional approach should, however, not be exclusively focused on financial services regulation, but additionally consider the broad range of existing legal and regulatory instruments and remedies (e.g. contract, consumer protection, tort, or corporate law). Such current instruments and frameworks might be able to address some of the commonly perceived regulatory shortfalls, if applied and enforced proportionally.

- **Perception of opportunities and risks:** Blockchain technology and its associated tokens are often seen solely through the lens of the risks associated with financial or finance-like activities. We fully acknowledge that these risks exist and support the principle of "same activity, same risk, same regulation". However, it becomes equally important to recognize that this alone should not dominate the perception of the risks and opportunities of blockchain as an infrastructure technology.

2. Responses to Consultation Questions

- The below responses follow the Treasury's questions as per the Consultation Paper.
- To avoid repetition, cross-references between responses are made.
- Certain answers are omitted and indicated accordingly.

Q1) What do you think the role of Government should be in the regulation of the crypto ecosystem?

In our view, the Government should focus on two core roles:

- Provide guidance and facilitate supplementary clarification on the application of existing legal and regulatory frameworks, where such have been identified to cover equivalent functions and where such provide appropriate means to remedy identified risks;
- amend existing legal and regulatory frameworks where they do not appropriately provide means to address relevant risks and/or gaps have been identified.

Q2) What are your views on potential safeguards for consumers and investors?

We assume responsible and informed consumers and investors. In our view, education plus access to reliable, independent information stand as core pillars in this context and may act as preventive measures.

Furthermore, and as pointed out in the general remarks, we subscribe to the view that, in many cases, existing legal and regulatory instruments—such as those stemming from financial, contract, tort, or corporate law provisions—can already provide sufficient safeguards if applied and enforced appropriately.

Q3) Scams can be difficult for some consumers to identify.

a) Are there solutions (e.g. disclosure, code auditing or other requirements) that could be applied to safeguard consumers that choose to use crypto assets?

Please refer to the above answer to Q2.

b) What policy or regulatory levers could be used to ensure crypto token exhanges do not offer scam tokens or more broadly, prevent consumers from being exposed to scams involving crypto assets?

If not already provided for by other applicable provisions, in particular from risk adequate financial regulation, self-regulatory initiatives, defined minimal disclosure standards and requirements for conduct rules or due diligence, could be important tools to enhance responsibility and transparency vis-a-vis consumers.

Q4) No comments at this time.

Q5) This paper sets out some reasons for why a bespoke 'crypto asset' taxonomy may have minimal regulatory value.

a) What are additional supporting reasons or alternative views on the value of a bespoke taxonomy?

In our experience the most prevalent question surrounds the conceptual delimitation between financial and non-financial activities involving blockchain infrastructures. The proposed taxonomy seems to provide limited guidance in this regard, which is a missed opportunity to equip the market with a clear differentiation between (i) the underlying infrastructure/token system, (ii) the token/crypto asset, and (iii) the realised business model/function. This is especially unfortunate in the light of Australia's functional perimeter concept.

b) What are your views on the creation of a standalone regulatory framework that relies on a bespoke taxonomy?

No comments at this time.

c) In the absence of a bespoke taxonomy, what are your views on how to provide regulatory certainty to individuals and businesses using crypto networks and crypto assets in a non-financial manner?

On one hand, we see great potential in the Government, through its respective agencies, providing ex-ante guidance and ex-post clarifications on the application of existing legal and regulatory frameworks. A categorization exercise as described above would also help foster regulatory certainty, especially regarding the distinction between financial market and non-financial market use cases.

Q6) No comments at this time.

Q7) It can be difficult to identify the arrangements that constitute an intermediated token system.

a) Should crypto asset service providers be required to ensure their users are able to access information that allows them to identify arrangements underpinning crypto tokens? How might this be achieved?

In our view, the answer to this question depends on potentially various different dimensions, including the kind of service provided and how that service is being facilitated, what kind of product or underlying asset the service concerns and what risk that product bears, the type of client/user in question etc. Therefore, we consider this question cannot be answered generally.

b) What are some other initiatives that crypto asset service providers could take to promote good consumer outcomes?

No comments at this time.

Q8) No comments at this time.

Q9) Some regulatory frameworks in other jurisdictions have placed restrictions on the issuance of intermediated crypto assets to specific public crypto networks. What (if any) are appropriate measures for assessing the suitability of a specific public crypto network to host wrapped real world assets?

Various blockchain systems can be used as technological infrastructures (i.e. a backend technology) to implement financial and non-financial business models. Some projects may indeed make unsuitable choices. However, the same applies to traditional (i.e. centralized) digital infrastructures. Restricting, prohibiting, or prescribing the use of specific crypto networks as the underlying infrastructure may unduly stifle innovation and result in state-controlled markets. The provider should ultimately decide how, and based on what specific technological base layer, a function is being implemented. Having said that, the provider should also be liable for such choices in accordance with general principles of law. Regulation could at most define certain general qualitative requirements (e.g. no single-point of failure) but should, in our view, restrain from being overly prescriptive.

Q10) Intermediated crypto assets involve crypto tokens linked to intangible property or other arrangements. Should there be limits, restrictions or frictions on the investment by consumers in relation to any arrangements not covered already by the financial services framework? Why?

Again we assume responsible as well as informed consumers and investors. We believe that the majority of such cases should already be subject to existing legal and regulatory instruments (e.g. stemming from financial, contract, tort or corporate law provisions), provided these are applied and in particular enforced appropriately. In the light of technology neutrality, we would not see sufficient reason to restrict or differentiate consumers' freedom based on the underlying technology used to represent a certain intangible property or other arrangement.

Q11) No comments at this time.

Q12) Smart contracts are commonly developed as 'free open-source software'. They are often published and republished by entities other than their original authors.

a) What are the regulatory and policy levers available to encourage the development of smart contracts that comply with existing regulatory frameworks?

It is important to differentiate between developers providing free open-source software versus service providers using and operating such software for their own purposes (and usually profit). While these roles may coincide, it is critical for continued advancements in software development and IT technology to avoid allocating (regulatory) responsibility to an overly extensive group. That said, it should be noted that open-source-software developers are already subject to existing laws and liability provisions. We would consider an educational approach as much more fit for purpose than specific, potentially restrictive regulatory means.

Furthermore, it is crucial to distinguish between two types of smart contracts: open-source ones that are used for inspiration, innovation, and reference; and the ones actually deployed on the blockchain. Open-source smart contracts are developed and hosted by developers and are free for anyone to use, as governed by the respective open-source license. On the other hand, service providers use and operate smart contracts for their own purposes and profits. Ultimately, the differences come down to the level of control one has over the smart contract once deployed on a public, permissionless blockchain. While more control allows for changes to the code of a smart contract (e.g. for functional updates or bug fixes), it also usually implies

some form of centralized undertaking which regulatory responsibility may be attributed to. A smart contract, however, may also happen to be deployed without it retaining any means of control. Such instances allow for greater transparency and decentralization, but they also require users to trust the code's integrity, as it cannot be modified once deployed. A suitable regulatory approach should carefully consider the whole range of this spectrum in order to avoid overreaching or inadequate regulation.

b) What are the regulatory and policy levers available to ensure smart contract applications comply with existing regulatory frameworks?

No comments at this time.

Q13) No comments at this time.

Q14) No comments at this time.