

Article Information

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Blockchain Bites: Agony of ACX Exchange users continues, Ripple - built for a CBDC?, Non-Fungible Tokens Take Flight, China makes it rain CBDC, Beeple's \$70m NFT debut, US Treasury Secretary stuck with digital asset myths

Michael Bacina, Barbara Vrettos and Jade McGlynn of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

The agony of ACX Exchange customers continues

It's been 12 months since the Australian-based digital currency exchange, ACX dramatically stopped responding to users' withdrawal requests and ceased updating the price of tokens on their website, yet <u>customers involved are no further ahead</u> (<u>paywalled</u>) in understanding what has happened to their money.

The Australian Financial Review reported:

About 200 [customers of ACX] are understood to have lost as much as \$10 million ... ACX has been banned for life by the peak industry body [Blockchain Australia] while the financial regulator AUSTRAC has revoked the digital currency [registration of] the platform. Yet investors still have no visibility over a path to restitution or justice.

<u>Prior to 5 February 2020</u>, the terms of use on the ACX's website identified Blockchain Global Limited (**Blockchain Global**) as the operator, yet an unannounced change suddenly named Peak Trading Group Pty Ltd as the operator of the exchange. Peak Trading Group appears to have been registered as a DCE with AUSTRAC but that registration was cancelled on <u>23</u> <u>December 2020</u>.

The AFR reported that:

Many [customers] believe they are victims of a well-planned scam and have given up hope of ever getting their money back.

While Blockchain Global has offered to fund legal fees for "the liquidation of all related entities to return consumer funds", given that very few liquidations result in a meaningful return to creditors, it seems until legal action is commenced against those who were operating the exchange, many questions will remain unanswered.

Ripple - built for a CBDC?

Research shows that <u>80% of central banks</u> worldwide are engaging in central bank digital currency (**CBDC**) related research, with banks exploring existing open source platforms to run a CBDC on, such as Ethereum which the Reserve Bank of Australia has considered for wholesale bank settlements.

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A fully open model such as used in the Bitcoin network, where anyone can run a node transact, validate and view the transactions does not fit in with the requirements of a CBDC for most central banks. This is in part due to concerns about speed and that pseudononymous blockchains are not very private once wallet addresses start to be identified. Additionally, the speed and volume required for CBDC payments simply cannot be matched by public permissionless systems.

Ripple has proposed a solution to help speed CBDC adoption, announcing that it is:-

piloting a private version of the public, open-source XRP Ledger that provides Central Banks a secure, controlled and flexible solution for the issuance and management of digital currencies.

A report by <u>CPA Australia</u> notes that France has "openly discussed Ripple/ XRP as a possible platform to Europe's central digital currency" and the reiterates the preferential features of XRP as:

Ripple and XRP enjoy the trust of many banks as a model for CBDCs because it is highly centralised and is based on a permissioned network where only certain network nodes can validate transactions, as opposed to decentralised and permissionless Bitcoin and Ether.

Ripple's proposal is an example of how some features of blockchain technology may be incompatible with the pursuit of CBDCs, however, there are configurations of that existing technology which can satisfy the security and speed required by such projects.

Non-Fungible Tokens Take Flight

The Australian Financial Review published a piece this week titled "<u>Crypto-art becomes the new cultural currency</u>" which updates the whirlwind rise of non-fungible tokens but regretfully continues to spread myths and mistakes about blockchain and this exciting way that collectibles are going digital.

Digital collectibles have been around for a long time; from the days of physical / digital Tamagotchis through to purely digital critters and collectors today. The epic market created by companies like Blizzard and Epic in their massive online multiplayer games World of Warcraft and Fortnite continue to grow.

Non-fungible tokens (**NFTs**) represent an important shift away from the existing walled garden of digital assets games and open up collectibles of all kinds to a new global audience. Those playing online games and spending their hard earned cash on skins and art and other assets risk a problem if they stop playing, the value of all the in-game collectibles is lost when the user leaves the game environment. This has led to odd situations like game accounts being offered for sale (usually in breach of terms and conditions of the game itself).

NFTs are designed to be portable and transferable so that collectors can engage trading at a peer-to-peer level, just like takes place with collector cards in school yards and at card meets and stamp trading conventions now. The biggest change is a true global reach and lower barriers to reaching keen collectors.

Some myths still persist, repeated in the AFR piece which are worth clarifying:

- 1. The AFR reports on "complaints" of NFT marketplaces, which charge people to list items for sale, just like eBay does, which is entirely consistent with almost every marketplace currently operating to sell goods or services;
- 2. The AFR also notes that "unpredictable 'gas' payments" are needed to "cover the cost of ethereum's baroque processing methods" a curious choice of word given Gas is a straight processing fee for the ethereum network shared by the computers processing transactions. It's not remotely "baroque".
- 3. Despite most NFTs being on Ethereum, which is rapidly moving towards proof of stake, it wouldn't be a news article if a shot wasn't taken about electricity usage. It would be useful to compare the costs of what NFTs are delivering with the existing systems of galleries, storage and the payment rails globally which enable artists to sell their creations but it is impossible to calculate the magnitude of electricity used in all of that infrastructure. Needless to say, we are comfortable in saying the Ethereum network is vastly more efficient in energy use for what it delivers than the existing "real world" infrastructure it replaces.

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China makes it rain centralised digital currency

Winners of a government lottery to test the eCNY are <u>singing their praises (paywalled)</u> for the new national digital currency. As an already significant player in the e-money space with AliPay and WeChat Pay dominating conventional payment channels, the eCNY is the next step for China in embracing a central bank digital currency.

A total of 60 countries are now experimenting with digital currencies, a significant increase since China's first explorations which started in 2014. However, the eCNY has an interesting focus. Yaya Fanusie, a fellow at the Center on Economic and Financial Power, recently said:

This is about more than just money... It's about developing new tools to collect data and leverage that data so that the Chinese economy is more intelligent and based on real-time information.

<u>Jason Brett of Forbes opines</u> that harnessing data in this way "will arm China's economic planners with a range of data that no other government has ever been able to efficiently assemble."

This is because both commercial banks distributing the digital currency and the central bank will maintain distributed databases tracking the movements of the eCNY between users, in a way not possible with cash or traditional fragmented payment systems.

While eCNY used distributed ledger technology in its prototype, it doesn't appear that the technology is being used in the current deployment, which is not surprising given part of the goals of China's CBDC is greater tracking and central control is a political theme of China.

The eCNY remains open for trials and is a natural experiment in moving digital commercial bank money into a purer form of digital cash with central bank backing. The aggregate data availability to government for economic purposes under even a centralised system like this is dramatic and both incredibly valuable while also being potentially highly invasive. Other countries have been exploring more decentralised models of CBDC issuance which align more closely with the Western liberal tradition.

It seems to us that a highly centralised central bank digital currency invites central points of attack and so this model of a CBDC may not lead to China's stated "aims of internationalising ... currency".

Beeple's \$70 million NFT debut

"The First 5000 days" by the American Artist known as Beeple has recently sold for an impressive <u>US\$69.4 million</u>, especially considering it does not exist in a physical form. The collection of 5000 individual images form a 'NFT', meaning a non-fungible token that acts as a collectible. These collectibles use the blockchain to certify its originality and ownership.

This sale marks a few industry firsts:

Christie's is the first major auction house to offer a purely digital work with a unique NFT (Non-fungible token) — effectively a guarantee of its authenticity — and to accept cryptocurrency, in this case Ether, in addition to standard forms of payment for the singular lot.

While a landmark sale, the excitement surrounding NFT has been an $increasing\ trend$ in the past months. This may be due to the fact that, in $Beeple's\ words$

Without the NFTs, there just legitimately was no way to collect digital art.

Another feature enticing artists is that the use of NFTs can also entrench royalties. Beeple for example, has used 'smart contracts' to ensure that he will receive "10% each time the NFT changes hands after the initial sale".

As the explosion of NFTs continues it is important to consider the rights being purchased. Specifically, if terms are written into the smart contracts guaranteeing that 10% of future purchase prices will be passed on to the artist, or if only certain rights are being transferred with a purchase, it is important that these are clearly displayed and communicated to purchasers.

NFTs have great promise in safeguarding against copies claiming to be the original, ensuring the authenticity of digital art

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and allowing for artists to obtain royalties downstream, however, it is crucial that consumers know what they're buying when entering the market for digital art.

US Treasury Secretary stuck with myths and mistakes in dealing with digital assets

Newly appointed US Treasury Secretary, Janet Yellen <u>has made very bold</u> and unfortunately mistaken comments which inform her regrettable and outdated view of digital assets, falling into a long debunked but persistent narrative that these innovative products are only used for illicit purposes. Confirming <u>her reputation as a crypto-critic</u>, during her recent virtual confirmation hearing before the US Senate, <u>she said</u>:

I think many [cryptocurrencies] are used, at least in transactions sense, mainly for illicit financing and I think we really need to examine ways in which we can curtail their use and make sure that money laundering doesn't occur through those channels.

US authorities, however, appear to take have a more positive view of digital assets than Yellen. The US Securities and Exchange Commission (SEC) has recently released a digital asset memo with the reported "purpose of assisting firms dealing with digital asset securities in developing and enhancing their compliance practices". By identifying common risks and issues that firms dealing with assets may come across in practice, the report represents a willingness by authorities to assist these types of firms to be a lot more proactive and protect themselves from running into legal trouble down the line.

The US Treasury Secretary has seemed to change her tune, perhaps in light of the SEC's support. Yellen recently commented that:

it [is] important we consider the benefits of cryptocurrencies and other digital assets, and the potential they have to improve the efficiency of the financial system.

Instead of advocating for the US to get rid of digital assets, she now speaks of "encouraging their use for legitimate activities" and her intentions to "work closely with the Federal Reserve Board and the other federal banking and securities regulators on how to implement an effective regulatory framework for these and other fintech innovations."

With Yellen jumping on the bandwagon of an increasingly popular quest for building more robust regulation around digital assets, there emerges a clear indication that the US is becoming much less reluctant and much more willing to legitimise the digital asset space.

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