

Article Information

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Blockchain Bites: A\$DC used in Carbon Credit purchase, Three Arrows to be liquidated in BVI, Laying the first blocks of US crypto regulatory reform, Hong Kong to licence VASPs and regulate market conduct

Michael Bacina, Steven Pettigrove, Luke Misthos and Jordan Markezic of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

A\$DC used in Carbon Credit purchase

On Monday, the Australia and New Zealand Banking Group (ANZ) [announced](#) the first purchase of tokenised Australian carbon credits using its [Australian Dollar stablecoin, the A\\$DC](#). The deal indicates the role that stablecoins and digital assets may play in the future of energy markets and represents another milestone in ANZ's A\$DC project.

The deal involved carbon trading platform, BetaCarbon, tokenising Australian Carbon Credit Units (ACCUs) to create digital security tokens known as BCAUs. Victor Smorgon Group then purchased the BCAUs on chain using A\$DC leading to the first deal of its kind.

Using the ethereum blockchain to facilitate the transaction enabled Victor Smorgon Group to avoid traditional roadblocks such as slower settlement times and counterparty risks. The deal was expedited through the use of blockchain and digital assets, compared to the traditional method of sourcing ACCUs through, for example, the Carbon Market Institute's Carbon Marketplace.

As BetaCarbon accepted USDC (a US-Dollar stablecoin) for its BCAUs, a market had to be created for the credits to be purchased with A\$DC. This was done by a digital asset manager and custodian, Zerocap, who acted as a market maker in the transaction.

ANZ appear eager to continue their involvement in the digital transition of financial markets. ANZ's Banking Services Lead, Nigel Dobson said:

We see this is evolving from being internet-protocol based to one of 'tokenised' protocols. We think the underlying infrastructure - efficient, secure, public blockchains - will facilitate transactions, both ones we understand today and new ones, that will be more efficient.

Victor Smorgon Group and Zerocap were provided with redemption rights for A\$DC, ensuring the tokens could be liquidated.

Three Arrows to be liquidated in BVI

A court in the British Virgin Islands has [ordered Three Arrows Capital](#) - the crypto-focused hedge fund - into liquidation after failing to repay its creditors following significant declines in the price of bitcoin and other cryptocurrencies.

[Three Arrows Capital](#) - formed in 2012 by Su Zhu and Kyle Davis - had been known in the crypto-industry for its 'bullish'

investment strategy. Su Zhu admitted in May 2022 that the firm's bet on escalating crypto prices was 'regrettably wrong'. Following [reports](#) in June that the firm faced significant liquidations by its lenders, Su Zhu posted a cryptic tweet stating that '[they were] fully committed to working this out' without providing further clarification.

Last week, crypto broker Voyager Digital announced that Three Arrows Capital had [defaulted on a loan valued at more than \\$665 million](#), partially paid in bitcoin. Global advisory firm, Teneo, has been appointed liquidators to oversee Three Arrow Capital's liquidation. The firm is expected to launch a website in the coming days to allow creditors to submit claims and receive information about the insolvency.

Prior to the liquidation and recent crypto market downturn, Three Arrows Capital had claimed [\\$3 billion in assets](#) under management. The recent crypto market downturn has attracted US legislators to comment on the lack of financial oversight and investor protections in the sector.

Yesterday, Three Arrows Capital was dealt another blow after the Monetary Authority of Singapore (MAS) [issued](#) an official letter - labelled a 'reprimand' - to the hedge fund citing licensing and compliance failures. The MAS noted that it is investigating further regulatory breaches in light of recent developments.

This is a timely reminder of the need for legislative clarity in the industry and for individual investors to exercise caution when making high-volatility investments.

Laying the first blocks of US crypto regulatory reform

Two key US Senators sitting on important Congressional Committees have co-sponsored a balanced bipartisan bill to introduce regulation for crypto in the US, providing valuable leadership to global crypto regulation efforts. The [Responsible Financial Innovation Act \(RFI Act\)](#) is expected to take some time to become law, but has a number of exciting features covering key areas which have remained unclear for too long, and some important developments which may influence crypto regulation in Australia

Definitions

It's key to have a standard set of common definitions when any new technology is being regulated. The RFI Act sets out a range of definitions which don't match up to the European approach. For example, it defines a 'digital asset' as:

[A] natively electronic asset that (i) confers economic, proprietary or access rights or powers; and (ii) is recorded using cryptographically secured distributed ledger technology, or any similar analogue; and [B] includes (i) virtual currency and ancillary assets, consistent with ... the Commodity Exchange Act; (ii) payment stablecoins ...; and (iii) other securities and commodities, that meet the digital asset definition.

The definition in the RFI Act of 'stablecoin' is based on collateral backed stablecoins, so algorithmic stablecoins (such as the recently collapsed Terra) will fall outside the framework set out for stablecoins, but would be picked up as 'virtual currency'. Under this proposed regulation, 'payment stablecoins' must have 100% dollar or financial asset backing, but a virtual currency could be an algorithmic stablecoin and not have a dollar or asset backing.

Other key terms defined in the RFI Act include: 'smart contract' (being computer code within a distributed ledger that executes instructions based on specified conditions), and 'distributed ledger technology' (a network of nodes which can cover open or closed systems and which must include some kind of consensus mechanism) and 'digital asset intermediary' (being a licensed provider of digital asset market services but which excludes depository institutions - banks).

Taxation of Digital Assets

The RFI Act proposes that all:-

- digital asset transactions beneath USD\$200 be considered tax-free;
- lending against crypto assets become a non-taxable event, which would remove a significant and growing burden created by current reporting requirements being imposed on US citizens and encourage the use of crypto payment systems; and
- DAOs be recognised as business entities for US tax purposes. Like all matters relating to these leaderless collectives, mapping out how a legacy legal system will fit DAOs under any traditional rules will likely be a lengthy and complex process given the range of ways DAOs can be structured.

Securities / Financial Products

Likely the most important part of the RFI Act is that it seeks for digital assets to be treated as commodities or digital property rather than as securities. Instead of the Securities and Exchange Commission, which has long argued that digital

assets are securities and under its powers, the bill seeks to make the US Commodities Futures Trading Commission (CFTC) the principal regulator of digital assets through its introduction of a rebuttable presumption that digital assets sold are a commodity, not a security.

If enacted, this would settle longstanding grey areas and concerns around token sales and unlock significant commodities innovation across Consumer Protection, Payments Innovation, Banking Innovation and Interagency Coordination.

The progress of this rare bipartisan bill is going to be followed closely around the world.

Hong Kong to licence VASPs and regulate market conduct

After a public consultation completed last year, the Hong Kong Government has gazetted [draft legislation](#) which is expected to implement a new licensing regime for Virtual Asset Service Providers (VASPs). The draft bill promises a comprehensive package of reforms which are also targeted at addressing specific concerns around investor protection, marketing by offshore exchanges and market conduct in trading of digital assets.

The bill seeks to establish a licensing regime for Hong Kong VASPs and gives the Hong Kong Securities and Futures Commission broad oversight of their operations. The bill requires VASPs to incorporate or register in Hong Kong and imposes a fit and proper person test for licensees and responsible officers. It will also impose significant penalties for carrying on unlicensed activity and seeks to restrict marketing to the Hong Kong public by unlicensed persons or offshore exchanges.

The bill outlines a range of licensing conditions for VASPs many of which will be familiar to financial services licensees. Notably, it is also [anticipated](#) that the SFC will impose a licensing condition on VASPs which restricts them, at least initially, to servicing professional investors only. The bill also requires VASPs to comply with existing AML/CTF requirements in relation to customer due diligence and record keeping.

The broad scope of the bill is underlined by proposed new offences which address fraudulent or misleading conduct and market manipulation. The bill would prohibit fraudulent or reckless misrepresentations with the intention of inducing another to invest in Virtual Assets and the use of fraudulent or deceptive acts in transacting in Virtual Assets. The latter offence may be used to target insider trading and market manipulation occurring on or off exchanges.

The bill is stipulated to take effect on 1 March 2023, subject to legislative approval. There are transitional provisions for existing providers of Virtual Asset services.

The Hong Kong bill represents the latest attempt by Governments and regulators to establish more comprehensive regimes regulating cryptocurrency firms and markets. It will be interesting to monitor if certain proposals outlined in the Hong Kong bill are pursued elsewhere as regulators around the globe contemplate their own legislative reforms.