Article Information

Authors: Steven Pettigrove, Jake Huang, Lola Hickey, Luke Misthos, Michael Bacina
Service: Blockchain, FinTech
Sector: Financial Services, IT & Telecommunications

Blockchain Bites: ASIC Chair briefs Parliament on FTX fallout, Kiwis consult on the future of money, Ripple case nears high tide

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

ASIC Chair briefs Parliament on FTX fallout

The Chairman of ASIC, Mr Joe Longo, appeared before the Parliamentary Joint Committee on Corporations and Financial Institutions (the Committee) on Monday and addressed questions on the collapse of FTX and the corporate regulator's scrutiny of crypto-assets.

The Committee questioned the circumstances which permitted FTX to obtain a license to operate in Australia. Mr Longo noted that FTX had acquired its AFSL lawfully from an existing licence holder. In response to further questioning, ASIC's representatives noted that the corporate regulator does not as a matter of course scrutinize AFSL licence acquisitions and that there are limits to its ability to scrutinize fit and proper persons in those circumstances. It was suggested that ASIC should be empowered with an approval process for the acquisition of licence holding entities, as exists in the UK, rather than relying on ASIC's already powerful investigative tools under the *ASIC Act* and the *Corporations Act*.

Mr Longo commented more broadly on ASIC's recent work in relation to crypto-assets which he referred to as one of ASIC's top 8 priorities (which also now includes the ASX following the failure of its CHESS replacement program). He reiterated his previous comments that investors should be wary of investing in crypto-assets and expressed concern about consumer harm, saying:

> *Promotion of crypto assets through popular and viral channels can make them appealing to investors, but there continues to be lack of public awareness of their highly volatile, risky and complex nature.*

Mr Longo stated that ASIC had added internal resourcing over the last year to prioritise its work and enforcement activity in relation to crypto-assets. He noted that ASIC was increasingly scrutinizing crypto-based financial product offerings and testing the limits of the regulatory perimeter:

> *We think it's important to test this position in the courts, as the financial services law provides important protections for consumers.*

Mr Longo nevertheless sought to temper expectations of ASIC's work, suggesting that ASIC's jurisdiction over crypto-assets as a whole remains "very limited":

> *Unless it's a financial product, we don't have any regulatory remit.*

Representatives from ASIC briefed the Committee on ASIC's recent enforcement action against Qoin over allegations of misleading and deceptive and unlicensed conduct. They also referenced its action, two weeks ago, commencing civil

penalty proceedings against Block Earner for allegedly offering products without an AFS licence that ASIC believes are financial products under the financial services law.

Mr Longo commented that a coordinated government response is required to address the regulatory challenges posed by crypto-assets, including AUSTRAC, the ACCC, RBA and Treasury, and reiterated his support for a regulatory regime in relation to crypto-assets. However, he reiterated the importance of getting it right and not moving too hastily to impose a regime which may not be fit for purpose:

> *To be very clear, I'm not against regulating the space—I'm clearly in favour of it—but what concerns me about it is that it does pose some unique challenges. I think my message is that we need not to rush into it; we need to try to do our best to get it right.*

The ASIC Chair's comments to the Committee underline that crypto is now firmly on Australia's legislative and regulatory agenda following the FTX collapse. With the Government moving up its timeline for introducing a draft bill addressing cryptocurrency exchanges and custodians, crypto is likely to remain high on the agenda for some time to come.

Kiwis consult on the future of money

New Zealand's Central Bank (the **RBNZ**) has launched a consultation on the future money focusing on the risks and opportunities posed by private innovation in money, including cryptoassets and stablecoins.

The consultation is accompanied by an Issues Paper: 'The Future of Money — Private Innovation' (the **Issues Paper**) which explores private innovation in money with a focus on opportunities and risks to New Zealand.

The RBNZ's paper outlines its current thinking about innovation in private money and seeks feedback on:

- the opportunities and risks posed by private innovation in money;
- how these innovations might impact the RBNZ's objectives as the steward of money; and
- what regulatory responses could be required to help deliver those objectives in the context of private innovation in money.

The paper recognizes that there are opportunities attached to 'beneficial innovation in private money', which may in turn:

> help broaden access to the money and payment system from outside the banking sector. Broadening access supports competition, which is key to delivering efficiency and supporting further innovation.

The RBNZ's paper is written from the perspective of the RBNZ as a steward of money. The RBNZ is collaborating with other stakeholders, such as members of the Council of Financial Regulators (**CoFR**) to address cross-cutting risks and shared challenges. The CoFR has welcomed the continued exploration of whether crypto-assets and their underlying technologies such as DLT and cryptography can support greater competition and more innovation in financial services.

The Issuers Paper discusses broader developments in the money and payments system, including:

- concerns about existing inefficiencies in private money (e.g. in cross-border payments), and calls by some for wholesale 'disruptions' in money;
- the perceived need for and benefits offered by new forms of money in an ever more digitalised economy (e.g. web3 and the metaverse);
- the claim of crypto-assets to be 'money' and the potential for them to be used this way, which purports to address those new or existing demands;
- the declining use of cash, the only public alternative to new and existing forms of private money, and the potential impact on central bank money as the value anchor; and
- the growth of crypto-assets without regulatory safeguards, or a value anchor in central bank money.

The RBNZ's broadly based consultation on the future of money is a welcome contribution to the global debate on these issues. The decision to examine this issue in the round will no doubt inform broader policy development as regulators look to harness the opportunities and mitigate the risks posed by private innovation in money. As usual, New Zealand appears to be charting a progressive path which will be closely watched across the Tasman.

Ripple case nears high tide

The SEC and Ripple Labs, Inc. (**Ripple**) have filed their reply submissions in the hotly anticipated SEC action over whether the XRP token offering was an unregistered securities offering.

The SEC first filed proceedings against Ripple in 2020. The SEC claims that Ripple sold over USD$1.38 billion in XRP over a six year period to fund Ripple's operations, which it alleges was an unregistered securities offering.

The suit is premised on the SEC's position that the cryptographic token XRP is a security. If this is correct, then Ripple would have evaded the requirement to provide investors with material information that other issuers are required to provide – the SEC say this benefited Ripple's founders to the tune of over $600 million in personal profits.

The law suit has evolved into a tug of war between the SEC and Ripple. Previously, the SEC successfully applied for the court to order Ripple to produce over 1 million Slack messages. The SEC believed the messages contain vital company communications which may assist them in determining whether Ripple sold unregistered securities.

Ripple fought back and claimed it had been unfairly singled out. It sought and was granted access to the SEC's internal records, in hopes of finding "*evidence the regulator defined XRP as being similar to Bitcoin and Ether.*"

Ripple's reply submissions filed last week advanced the following key arguments in an attempt to refute SEC's claim that XRP is a security:

1. **XRP does not constitute an investment contract**. Ripple argues the *Howey* test, which is the established principle to determine whether something is a security, requires the "essential ingredients" of an investment contract. The fact that "XRP grants no post-sale rights to recipients as against" Ripple, and XRP "imposes no post-sale obligation" on Ripple "to act for the benefits of those recipients", means there is no investment contract involved in the offer and sale of Ripple.
2. **No invesment of money**. The *Howey* test requires an "investment of money" for XRP to constitute a security. Ripple points out that many XRP transactions did not involve an exchange of money, including the 500 million XRP which Ripple gave away to early adopters and developers. Further, even in transactions that did involve an exchange of money, Ripple argues there should be a difference between "payment" and "investment" of money.
3. **Lack of common enterprise**. Ripple says the SEC has no factual support for any legally cognizable common-enterprise claim, which is another element required by *Howey*. As *Howey* explained, the common enterprise must have "all the elements of a profit-seeking business venture" in which "investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise". Ripple argues that a common enterprise requires an ongoing relationship between the promoter and the investor; without that, there is nothing that can fairly be called an "enterprise" in which the investor holds a share.
4. **XRP holders do not reasonably expect profits from Ripple's efforts**. Ripple argues there can be no reasonable expectation of profits from its efforts without some obligation by it to undertake efforts in the first place. For an asset sale to be a security, the purchaser must be buying, "in addition" to the asset, a commitment from the promoter to take actions to return a profit to the purchaser.

In its reply submissions, the SEC relies on a substantial body of case law to support its argument that the XRP token is security. However, there remains relatively limited precedent which directly addresses the question of whether cryptocurrencies are securities. The Ripple case is the first major action before a US Court which will consider this question.

A decision on the parties' respective summary judgment applications is expected next year. The Court may give summary judgment in favour of one party or another or order the matter to proceed to a jury trial. That outcome will be closely watched by regulators and the crypto-asset industry and will likely become a ground-breaking precedent with significant ripple effects in the United States and beyond.