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Blockchain Bites: ASIC Chair calls for strong crypto enforcement, JPMorgan chasing the future with tokenised settlements, Assistant Treasurer unveils proposed crypto regulation, SEC drops claims against Ripple CEO and Chairman, NSW Court decision curb no reason de-banking?

Michael Bacina, Steven Pettigrove, Tim Masters, Jake Huang, Luke Higgins, Luke Misthos and Kelly Kim of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

Navigating the Regulatory Trilemma: ASIC Chair calls for strong crypto enforcement

Earlier this week at the AFR Crypto Summit, ASIC Chair Joe Longo delivered a speech making his case for strong crypto regulation and enforcement.

Mr Longo's spoke following a positive speech by the Assistant Treasurer, Stephen Jones, earlier that day announcing the release of Treasury's Consultation Paper setting out its plans for regulating digital asset platforms as a new form of financial product, to encourage innovation and consumer protection.

The decline of Rome

Mr Longo drew a curious parallel between the economic conditions of the Third Century Roman Empire and the economic landscape of October 2023. Amidst economic instability and dwindling trust in traditional financial systems, saying that Roman citizens resorted to forms of private money and bartering. In ancient Rome, the debasement of the silver denarius led to widespread distrust, which Mr Longo sought to analogise to today's skepticism towards centralised currencies. The speech then delved into his view on the need for robust regulation in the cryptocurrency space.

Trust in Crypto

Mr Longo mentioned the fundamental role of trust in any financial system, but didn't draw any distinction between decentralised systems and centralised systems which used decetralised products. He focused on the original libertarian intentions of cryptocurrencies to create trustless systems which would disintermediate banks, but that the ecosystem has evolved so that users are still placing significant trust in various parties within the crypto ecosystem, particularly in custody.

As Mr Longo put it:

> This, I will argue, makes a clear case for strong regulation supported by effective enforcement.

Mr Longo noted the recent "crypto winter" following the collapse of key platforms as a stark reminder of how much trust is placed in intermediaries and the consequences when things go wrong. The crypto industry in Australia has been calling for custody rules quite publicly long before the collapses of last year.

Balancing Regulation and Innovation

One of the most significant challenges in the crypto space is finding the right balance between regulation and innovation. Mr Longo said:

> Ultimately, the challenge for regulation is to resolve the tension arising from not discouraging financial innovation while also seeking to provide clear rules and maintaining market integrity.

The careful balancing of these three concepts (i.e. fostering innovation, protecting consumers, and maintaining market integrity) has been referred to as the "regulatory trilemma", which Mr Longo has spoken about previously.

When it comes to the trilemma, Mr Longo made clear that ASIC will prioritise protecting consumers whatever the form of the future crypto regulatory framework, using air quotes when referring to consumers "investing" in crypto and repeatedly stating his skepticism of crypto as an asset class.

Consumer Protection

According to Mr Longo, ASIC places consumer protection at the forefront of regulatory concerns. On that basis, cryptocurrencies should be held to the same standards as traditional financial systems and services.

Mr Longo said:

> Offering services that involve new and innovative technologies doesn't afford service providers a regulatory exemption.

There regretfully was no comment on bright line guidance from ASIC on when a crypto-asset would be a financial product, or how a crypto-asset financial product could be offered under the existing regulatory framework, guidance which has been called for by the industry for many years.

International Collaboration

The global nature of cryptocurrencies necessitates international regulatory coordination. The Chair acknowledged that differences in approaches to regulating blockchain exist worldwide.

> Although a consensus is developing through international financial regulatory bodies such as the Financial Stability Board, IOSCO, the Bank for International Settlements and anti-money laundering Financial Action Task Force, more work is needed to ensure we get our domestic settings right for this complex issue.

The FSB, IOSCO and BIS have all published risk-focused reports on crypto-assets and have set out principles in relation to DeFi which seek to 'look through' decentralised systems and locate persons who could be regulated.

Collaboration remains crucial to share lessons and establish harmonised regulatory efforts, which ensures that investor protection and market integrity remain consistent, regardless of the jurisdiction. It seems more education may be needed around how decentralised systems do not fit neatly within laws and regulations made for centralised systems.

Regulatory Clarity and Enforcement

On the question of enforcement, Mr Longo observed:

The most comprehensive regulatory framework in the world would be incomplete without strong enforcement to support it.

This is again a curious statement as there is no comprehensive regulatory framework for crypto-assets, but ASIC has brought a number of enforcement actions against crypto service providers operating at the regulatory perimeter.

Mr Longo also reiterated his previous calls to consumers to think twice before investing in cryptocurrencies, sending a very clear message that Australia seems set to continue on a regulation-by-enforcement path for the foreseeable future.

Conclusion

The ASIC Chair's views, that regulatory clarity, coupled with strong enforcement, provides the certainty needed to encourage innovation, will be welcomed by many if the regulatory clarity is fit for purpose and commercial so that start-ups can attract investment and grow. Many in the crypto industry who have sought regulation in order to require basic standards be met, tackle rogue operators and scammers, and give Australians confidence to use and adopt digital assets. We hope that ASIC's enforcement proceeds against rogue operators and not those who have been actively seeking clearer guidance, engaging in meaningful dialogue with the regulator and government, and makes proper allowance for those trying to protect consumers while facing an uncertain regulatory framework.

By Michael Bacina, Steven Pettigrove and Luke Higgins

JPMorgan chasing the future with tokenised settlements

JPMorgan has partnered with BlackRock and Barclays to execute its first blockchain-based collateral settlement for clients. The transaction was effected on JPMorgan's Ethereum-based Onyx blockchain, coupled with its Tokenized Collateral Network (**TCN**).

The transaction involved BlackRock, the world's largest asset manager, tokenising shares in one of its money market funds. These tokenised shares were transferred to Barclays Plc, as collateral in an over-the-counter (**OTC**) derivatives trade.

The tokenisation process was reportedly completed in minutes enabled by connectivity between the fund's Transfer Agent and TCN. The transfer between BlackRock and Barclays was practically instantaneous. The tokenised shares are now being utilized as collateral between counterparties to a derivatives trade, demonstrating the composability and speed of blockchain based protocols and tokens.

The benefits of tokenising securities and real-world assets have been a hot topic this year in mainstream financial markets. JPMorgan got the tokenisation ball rolling over a year ago, while other financials giants like Citi have highlighted tokenisation as blockchain's "killer use case".

According to Bloomberg, Tyrone Lobban, JPMorgan's Head of Onyx Digital Assets, commented:

> Onyx Digital Assets already enables clients to access intraday liquidity via repo transactions. Now, with the launch of TCN, clients can benefit from additional utility from their MMF investments by posting tokenized MMF shares as collateral – a faster, more cost-effective way of meeting margin requirements.

Tom McGrath, Deputy Global COO of the Cash Management Group at BlackRock, echoed this sentiment, emphasising the reduction in operational friction. He explained to Bloomberg that:

> the tokenization of money market fund shares as collateral in clearing and margining transactions would dramatically reduce the operational friction in meeting margin calls when segments of the market face acute margin pressures.

The successful collaboration between these financial titans further underscores that blockchain technology is quickly moving in the mainstream financial sector. This shift is marked by the promise of faster and more efficient settlement, along with greater transparency and security. While this journey is still underway, tokenization looks set to revolutionize traditional financial markets in the coming years.

Written by S Pettigrove and L Higgins

Crypto Regulation in Australia: Assistant Treasurer unveils proposed AFSL approach

The long awaited Treasury Consultation on digital currency exchange licensing has been released at the AFR Crypto Summit this morning and, as expected, rather than take an approach of using a bespoke fit-for-purpose digital currency regulation with a specialist regulator, such as the Dubai approach, Australia is proposing an approach closer to the Singapore model of licensing with feedback due by 1 December 2023 with a view to legislation to be brought to Parliament next year.

Stephen Jones, Assistant Treasurer said the changes are to be:

> pragmatic, consumer centric and … striking the right balance between innovation and consumer protection and system stability…. informing consumers to be protected to make the right decision while encouraging innovation.
>
> The Tax Office estimates there are over 600,000 taxpayers who have invested in cryptocurrency.
>
> Despite market volatility Australians remain heavily invested in these assets around the world…collapses are front and centre with around 50,000 investors tangled up with FTX.
>
> Platforms have sold tokens with overinflated prices and the issuers have cut and run leaving investors holding losses.
>
> We are concerned that exchanges are being used to facilitate scams, with scams increasing 33%… this is not to say crypto is criminal, but it is being used as a vector. Bank transfers remain the primary way for scammers to move money but there are protections and regulation to protect consumers.
>
> All of this points to a need for regulation to protect consumers, that's important in and of itself, but … providing certainty will drive innovation and it will drive investment.
>
> The government sees extraordinary opportunity in the underlying technology … it will be the tokenisation of real world assets which will drive real innovation in financial and product markets and, frankly, we want to encourage this… but for any of this consumers need to have trust.
>
> We need a fit-for-purpose regulation which keeps pace with the rapidly evolving ecosystem and technology… we did consider applying Australian financial products laws to all crypto-assets or starting a new custom regulation from the ground up but we felt both approaches would lead to regulatory overreach and impact products.
>
> Our approach is to regulate crypto-asset platforms to promote digital asset innovation, to provide clarity and to protect consumers.
>
> We have taken input from the consultation from our token mapping exercise… it's not every token in every scenario that requires oversight… instead our focus will be on the entities that hold customers digital assets for Australians. Digital asset platforms will be required to hold an [AFSL]. The benefits of this approach is that it leverages Australia's existing licensing laws.

The comments from the Assistant Treasurer are positive and if proposed regulation strikes the right balance then the on-going 'brain drain' may be addressed and Australia might start to catch up with other jurisdictions.

Businesses which hold more than $1,500 from a customer in a wallet or $5,000,000 in aggregate will be required to be licensed. Any threshold of this nature is likely to meet with submissions around the variability of digital asset pricing which could cause the threshold to be breached swiftly if asset prices move.

In interview with James Eyres, the Assistant Treasurer said, in relation to the FTX collapse and minimum standards for exchanges and custody requirement:

> You can imagine the sorts of things we have seen emerging…based on what's in the public domain the [FTX allegations] are the actions we are regulating against: conflicts of interest, acting in the best interests of customers, capital and custody rules, all of the things that you would expect to apply in a grown up business where someone is dealing in assets for customers.

And Mr Jones clarified in response to a question about tokens which "act and smell like a financial product":

> From our token mapping exercise… it was quite clear to us that a whole bunch of things being developed and offered was financial products… derivatives obviously… as we looked at the most appropriate regulatory model, we wanted to ensure we didn't create a whole new stack of regulation which sat in addition to Australian financial services law, and build into where it currently does apply.

James Eyers asked if ASIC is sufficiently resourced and has the know-how to do the task:

Short answer is yes, we will have a 12 month lead in, we fully expect to see further consolidation going on in the industry… there will be high expectations from ASIC… [the ASIC Chair Joe Longo]… wants to get into this area… there's no lack of willingness from the regulator to get involved.

Find our summary of the paper here.

Written by L Higgins and M Bacina.

Dismissed! SEC drops claims against Ripple CEO and Chairman

In a filing dated 19 October 2023, the Securities and Exchange Commission (SEC) officially dismissed claims against Ripple's CEO Bradley Garlinghouse and Executive Chairman Christian Larsen.

The regulator previously alleged that Garlinghouse and Larsen:

> aided and abetted Ripple's violations of Section 5 of the Securities Act of 1933 with Ripple's "Institutional Sales" of XRP.

This follows the summary judgment delivered back in July, which found that Ripple did not violate US Federal securities laws by selling its XRP token on public exchanges and that XRP was not in and of itself a security. However, in the same ruling, the Court identified that Ripple's USD$728.9 million worth of XRP sales to hedge funds and other institutional investors constituted unregistered sales of securities, with a promise to deliver future tokens to those investors.

In respect of this, the filing noted:

> SEC and Ripple intend to meet and confer on a potential briefing schedule with respect to the pending issue in the case – what remedies are proper against Ripple for its Section 5 violations with respect to its Institutional Sales of XRP.

SEC has requested a briefing schedule from Ripple by 9 November 2023, noting that in the case of disagreement or absence of submission by the deadline, they will seek a schedule from the Court.

Garlinghouse and Larsen responded to the recent dismissal in a statement, commenting:

> For nearly three years, Chris and I have been the subject of baseless allegations…the SEC went after the good guys…who are building a regulated business.
>
> Today, we are legally vindicated and personally redeemed in our battle against a troubling attempt to abuse the rules in order to advance a political agenda to suffocate crypto in America.

SEC's voluntary dismissal of the claims with prejudice 'obviates the need for the scheduled trial' in respect of the individual defendants, reflecting their shifted focus to the main case against Ripple. It follows the regulator's unsuccessful attempt at an interlocutory appeal and appears to be a strategic move to expedite its appeal on the previous ruling that XRP does not meet the definition of "investment contract" for the purposes of the US Securities Act and therefore is not a security under US federal securities law. Unresolved issues in the Ripple case will be addressed in a trial scheduled April 2024.

Written by K Kim and T Masters

Will a NSW Court decision curb no reason de-banking?

A judgment handed down by the Supreme Court of New South Wales last month could provide a foundation for those seeking to argue that they have been wrongfully de-banked. The decision of Parker J in *Human Appeal International Australia v Beyond Bank Australia Ltd (No 2)* [2023] NSWSC 1161 (**Human Appeal v Beyond Bank**) held that Beyond Bank had failed to provide a proper commercial basis for de-banking Human Appeal in accordance with the bank's terms

and conditions and to comply with applicable industry codes.

Background

The case centred on Beyond Bank's terms and conditions which state that the bank did not need to provide a reason for its decision to de-bank Human Appeal. The validity of this termination was questioned by Human Appeal who argued that Beyond Bank's right to terminate was subject to an obligation of good faith and reasonableness, among others.

This obligation, Human Appeal argued, arose from Beyond Bank's adoption of and voluntary subscription to the Customer Owned Banking Code of Practice (the **Code**). In his decision, Parker J considered Beyond Bank's incorporation of the Code, specifically the requirement that Beyond Bank's terms and conditions will strike a 'fair balance' between:

1. Client's legitimate needs and interests; and
2. Beyond Bank's interests and obligations, including their prudential obligations.

According to Parker J, Beyond Bank being able to terminate without reason did not strike a 'fair balance' between the parties. The Court also left open the possibility that an 'express' obligation of good faith and reasonableness arose based on Beyond Bank's obligations under the Code.

Web3 implications

While Human Appeal is a charity, its de-banking experience is common to many Web3 companies. Digital currency exchange operator Allen Flynn was de-banked by ANZ because he used his accounts to engage in cryptocurrency trading. Binance, one of the largest crypto exchanges, faced a de-banking event impacting fiat withdrawals earlier this year.

Web3 companies in the United States have also faced banking issues, with the US government accused of conducting a campaign to de-bank the whole crypto industry, and renewed concern this year over targeted de-banking of lawful crypto firms.

The issue of debanking was considered by the Senate Select Committee into Australia as a Technology and Financial Centre who, in their final report, recommended that the Government develop a clear process for businesses that have been debanked. The current Government has also weighed into support certain recommendations by the Council of Financial Regulators to address this issue.

AUSTRAC has cautioned against the practice of widespread debanking of certain industries which they see as counterproductive to implementing effective risk based measures to address anti-money laundering and counter-terrorism financing risks.

The Future

Parker J's decision in Human Appeal v Beyond Bank centred on specific terms and conditions adopted by Beyond Bank, but left open the question of whether a bank's right to terminate is *always* subject to the implied obligation of good faith or reasonableness.

The question of whether a bank owes such a duty remains ripe for further argument depending on the case and any applicable terms and conditions and industry codes. Changes to the unfair contract terms regime due to come into effect in early November could also give a boost to potential claimants.

By M Bacina, S Pettigrove and L Misthos