

1. About the Author of the submission

This is Moresh and I am the founder of EstateBaron.com and Konkrete.io

Estate Baron can be best characterized as a technology and corporate advisory service where we help property developers across Australia raise equity funding for their development projects by doing a full prospectus. We rely on the standards set in RG228 to achieve clear concise and effective disclosure for our clients. We do not rely on the CSEF regulation as it is unsuitable for the nuances inherent in real estate development.

I have done my RG146 in securities, interests in MIS and have been a CAR of both wholesale and retail AFSLs. My team and I have assisted in drafting several disclosure documents including Information Memorandums, Product Disclosure Statements, Prospectuses and Offer Information Statements. We have significant understanding of the Australian regulatory environment for securities as well as for other international jurisdictions such as New Zealand, Singapore, USA and UK.

I am an Information Technology Engineer by training and have worked in the finance and technology space for 16 years for clients in the USA, India and Australia. We have an unique perspective where we understand both technology and compliance in a close-up manner.

Our new venture Konkrete is focused on utilizing DLT for securities.

2. General position

Australia is one of the best places to operate a financial technology business including those utilizing Blockchain or DLT. ASICs approach of principles based, technology agnostic is the right way to go and has generally served the industry well and goes a long way in preserving trust in the system.

No wholesale changes to this tried and tested approach to securities regulation is necessary and if incorporated will serve to be counter-productive to the objectives of maintaining trust in the ecosystem as well fostering innovation.

Australian regulatory framework has enough tools that any venture can use regardless of which technology they use to achieve their business goals.

There is however an opportunity to tweak certain positions, increase the thresholds in others which will make Australia a more attractive destination for ventures focused on DLT and Blockchain. There is also a need to tighten market regulation in other areas such as crypto exchanges in particular to protect investors from getting scammed.

2.1. Key recommendations

- Increase thresholds for payment facility
- The Use of stable coins (fiat pegged not algorithmic) to subscribe for IPOs
- Use of smart contracts where stable coins can be sent instead of or in addition to bank accounts
- Reduced or removed disclosure and audit requirements for smart security contracts due to their use of public visibility of money movement by default
- Increased threshold for low volume market operators

2.2. Supplementary recommendations

- Allowing pure payment product ICOs for platforms and products that are yet to be built without them needing to be a MIS. Impose standards on whitepapers.
- Tightened regulation of crypto secondary markets to protect investors

We will go through the specific recommendations in detail later in the document, but before that we will discuss the specific questions posed as part of the consultation process.

3. Consultation queries

3.1. What is the clearest way to define ICOs and different categories of tokens?

There are only 3 types of tokens

1. Payment tokens
2. Security tokens
3. Crypto Collectibles

3.1.1. Payment tokens

These are means to pay for any services on the platform or the wider ecosystem. They are in essence a specialized currency with a limited use case. For instance if it was an arcade this would be equivalent to the physical tokens that can be used in exchange of game time. In a casino they are equivalent to the chips that can be used to bet within the casino. They are equivalent to currency or a medium of exchange at its very core.

These include the so called utility tokens, access tokens and also other currency like coins such as XRP (Ripple), Litecoin etc. They also include Ethereum which is used in the form of GAS to pay for transactions on the network.

They also include Stable coins such as Tether, USDC, Gemini, Maker Dai, OnRamp (AUD stable coin which uses a Registered MIS).

They should however be carefully vetted out to ensure they do not exhibit any characteristics of a security and their sole purpose should be only to pay for use on the platform and not as a medium of speculation. While investors can use anything for speculation (paintings, rare cars and so on), it should not become its dominant purpose.

They should not generate any ongoing revenue or profits for its holders and realistically speaking given that their inherent utility does not change, they should have no appreciation in their value. Where the token offering was done for a platform that is yet to be built (99% of all ICOs) then they are a right to future use on a platform that is often yet to be built.

Consider an example in which you want to build a casino and you don't want to or are unable to attract equity investor partners for your venture. What you do instead is create a bunch of chips and sell them to the general public in a kind of pre-sale. The premise is that these chips can be used to play in the casino once it is built.

Now consider the following two scenarios:

1. Your business plan does not work out

Building any kind of new business is hard. Very hard. That's why most new ventures fail, even when the founding team sets out with the best intentions. Here you tried to set up a casino but underestimated the costs and licensing requirements, came up short, and ended up being unable to execute on your plan. Those who bought your chips are now holding a pile of garbage. This is the most common scenario for crypto startups. They have sold their tokens but they are nowhere close to delivering a working product or platform. Nor is there any realistic scenario in which they will build something close to what they promised. This may be due to reasons such as a poor team, poor execution, or external factors, or it could be that the whole ICO was only ever just a cash grab.

Regardless of the reason, the chips you sold to the public for your casino venture are now worthless, with the state of the market reflecting their true value.

2. Your business plans work out as expected

In this scenario, you actually pull things off and build your casino. This is great news for those who bought your chips because now they can use them. But what are they actually worth? They are worth what the casino will accept them for. Logically, under no scenario can they be worth more than what they can be used for in the casino. Their maximum value is the utility they can derive on the platform.

If you sold your chips at a discount to the potential future value and you ended up building something that works that will accept these chips, then, yes, your early backers could make an upside.

But once such a platform becomes operational, the value of the chips (or tokens, to bring the scenario back to the crypto world) should have no reason to fluctuate. It could go down if the

platform performs poorly or shows signs of failing, but even if the platform does well, the chips are unlikely to command a higher value. Even if your casino expands and you build a chain of casinos that will accept the chips, the value of the chips will not exceed what the casino will accept them for. And the casino will never accept them for more than what their initial promised face value was.

Thus, even in the best-case scenario in which a platform exceeds all expectations, the upside for those who invested in ICO token sales is limited. Growth in a platform's business does not translate to an increase in value for the tokens. A token is not a share in the business, so its success does not rub off on the token's price.

Even if there was a secondary market place where you could trade your chips with others, the opportunities for arbitrage would be limited or non-existent. Either the casino is a flop and the chips are worthless, or the casino does well and you can cash in your chips for their face value. But nothing more.

If a payment token exhibits significant upswing in its price then questions need to be asked about why that is happening. The likely answers are

1. It is a security and the success of the underlying venture is rubbing off it
2. The market is acting irrationally or is being manipulated

The more likely answer is often the second one. Consideration should be given on how new regulations can be enacted to prevent market manipulation in crypto exchanges (we will revisit that later)

3.1.2. Security tokens

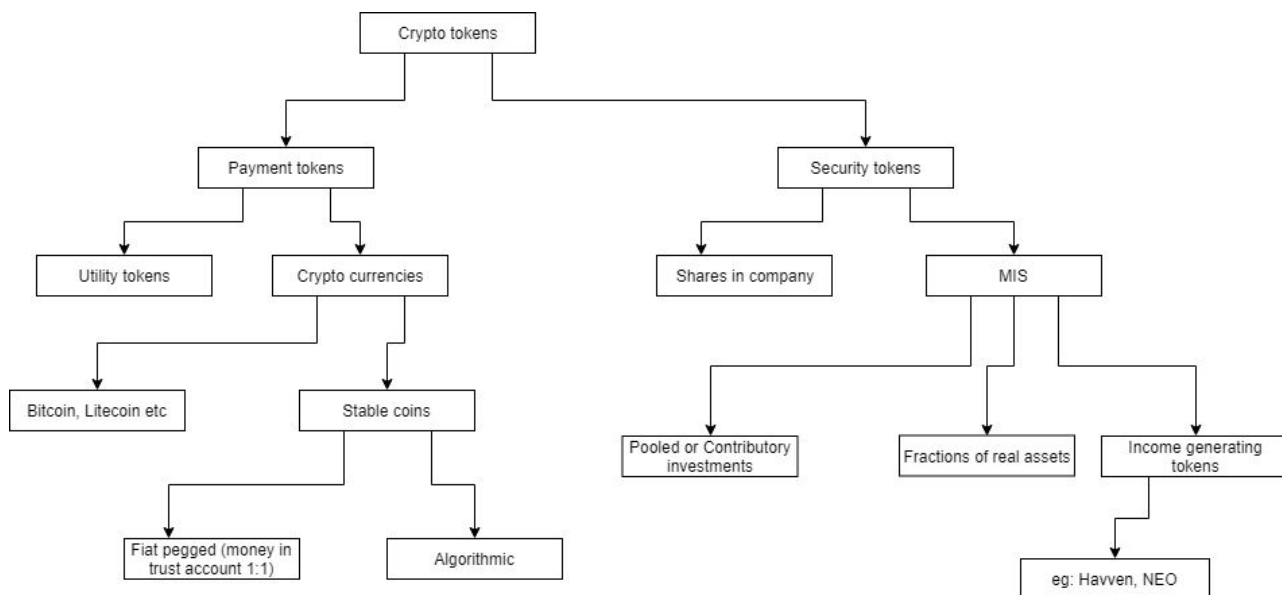
The second class of tokens is security tokens. These include shares in companies or Managed investment schemes (recognize the fact that MIS is technically different to being a security but ignoring it for practical purposes here as the disclosure requirements are similar). They also include Asset backed tokens which can represent a fraction of a property, they are nothing fundamentally different to property fractionalization as has been done for quite sometime by various ventures in Australia such as BrickX or Domacom. If the token is generating revenue for its holders or is steadily appreciating in value as the platform grows in user volume then chances are it is a security token. A key example to highlight here is the Havven stable coin which is an Australian project. It distributes transaction revenues from the platform to its holders, it is clearly a security. Same applies to the NEO token which distributes income to its holders from the transaction fees. This in effect gives the token holders rights to the profits (or revenues) from the platform which again brackets it as a security.

There are very few examples of a pure payment token. The reality of the crypto mania of 2017 to early 2018 was that bulk of the ICO investors were looking to make a quick profit by flipping the tokens as they increased in value once on a secondary market. Token issuers would often engineer their tokens in such a manner that would put upward price pressure. This would include doing a limited supply or burning tokens or generating income.

While a successful platform with a limited token supply can see an increase in token value, such a platform would be deflationary and transactions would eventually grind to a halt.

If token supply is steadily reduced via burning tokens that reduces transaction volume through deflationary pressure which in turn runs counter to the objectives to achieving widespread use of the platform. Which leads to the conclusion that the purpose of the issue of the token was to generate a speculative asset rather than drive the use of the platform or fund its growth. Hence any token demonstrating these attributes in particular of burning and reducing token supply actively in one direction should also be considered a security token.

Incentivizing early investors by giving away payment tokens for a lower price in early rounds of fundraising should be acceptable. But investors should be clearly informed with warnings that the effective value of the payment token has an upper ceiling by the very nature that it is not a security token and can only have a limited ceiling on its exchange value for services on the platform.



Australian regulators (ASIC in particular) have taken the position that if you are issuing payment token for a platform that is yet to be built then it is a Managed Investment Scheme. Setting up a retail MIS is cost prohibitive for an early stage venture and would stifle innovation.

There are other well respected jurisdictions such as Singapore that do allow ICOs for payment (utility tokens) even if your platform is yet to be built.

ICOs for utility tokens should be allowed but with clear warnings as part of their offer documents on the fact that they should not be expected to rise in value and are not linked to the growth of the platform. Standards should be setup around white-papers (similar to RG228, RG261) and have them registered with ASIC. These standards need not be as strict as those around Prospectuses (or even OIS) but they should provide investors clear, concise and effective disclosure.

Investors should be provided warning statements around the fact that the token values should have an upper ceiling in terms of their inherent utility and issuers of the token should be required to explain as part of their initial offer what they expect the utility to be in terms of dollar value and their reasoning behind it. The current free for all regime needs to be replaced with something that is more standardized and regulated (light touch). This will in turn make Australia a very attractive destination for ventures looking to conduct ICOs.

3.2. Crypto Collectibles

These are non fungible tokens representing a unique digital commodity. They could also be used to represent physical commodities such as title to properties including real estate, cars etc. They also have an interesting application where they could be used to represent invoice receivables and a secondary market in these receivables would help in cash flow for businesses.

Crypto collectibles under most circumstances should not fall under the securities or financial product bracket. Since they usually represent a single indivisible non-fungible unique commodity they would be owned by one person or entity and no fractionalization or part ownership would occur. Even if they generate income or show appreciation in price that would not be different than owning a house which can generate rental income and also have capital appreciation.

In addition there is no evidence of significant volume or bubble like conditions in any secondary market for crypto collectibles.

There is however a potential for someone to build a set of crypto-collectibles that could represent the steering wheel, engine, and body of a particular car respectively. These crypto collectibles are non fungible, each have a different worth. But on their own they do not have any real utility. But when the items they represent are put together in a car then it has the potential to generate income in terms of lease of the car.

This raises the question whether these are securities on their own as it would require common enterprise for these tokens to be worth anything. However it is our opinion that they should not be deemed as securities or financial products till the act of generating income via common enterprise occurs. At that point the issues of whether disclosure requirements and promotion requirements apply would depend on specifics of the case. Whether the uniqueness of the crypto collectible is superficial and the whether it is in fact fungible for all practical purposes and whether these tokens are being used in a fashion to generate income or achieve capital growth via common enterprise and how widely spread such activity is.

At this point in time this does not seem to be a significant concern to merit attention. However given that with the use of technology it is quite possible that such activities may emerge in the future to work around securities regulations at which point this would need to be looked at more closely.

3.3. What is the effect and importance of secondary trading in the ICO market?

All secondary trading, whether it is in securities or pure utility tokens is valuable as it provides liquidity for the investment before material outcomes can be achieved by the venture involved in the security or the tokens issue.

This in turn increases demand as well as reduces the cost of capital. This much is quite widely acknowledged already.

In terms of ICOs (and we will only discuss those claiming themselves to be non-security or pure utility or payment tokens) the impact of the presence of a secondary market means the initial public raising happens faster.

The premise behind the ICOs is to have potential future users of your system to fund the development of what they deeply care about. But to say that only potential users of all these systems participated in token sales is a bit of stretch. You had people scooping up tokens in the initial release who essentially perform the same role as ticket scalpers.

Scalpers for all the negative attention they attract perform a vital role, they ensure that the show gets the necessary funds on time and then they resell the tickets at a higher price in due time to interested buyers. Often times those putting up shows do not have the necessary marketing budgets to attract attention from the intended audience in time. A smart scalper would identify good shows in advance and performs a necessary economic service by making funds available faster to the performers. This is a valuable arbitrage.

In the same vein there is nothing wrong with those who participated in ICOs and looked to sell the tokens at a higher price at a later date. It is a necessary economic service and makes it possible for good projects to come to life.

However tickets to a rare music concert hold emotional value to those who want to experience it, and hence can command a significant increase in price as compared to their face value.

Payment tokens on the other hand have an upper ceiling on their utility on the platform even if we assume that the platform is built successfully. (There have been several instances where the lack of any checks and balances on founders who raise money via ICOs has meant that platforms never end up being built and capital is not deployed as planned or is done in an extremely wasteful manner which leads to adverse outcomes for those who participated in the ICO.)

Since there is an upper limit to their inherent utility value these tokens should never exceed their face value on a secondary market. Scalpers participating in an early round can still profit assuming they got a discount on early releases.

Given that most payment tokens in Australia are treated as a commodity, secondary markets in these are largely unregulated. This has led to some of the oldest scams in markets being repeated on crypto exchanges. Painting the tape, whale action, insider trading, and all assorted tricks are played on unsuspecting retail investors who assume these markets are free and fair.

Crypto secondary markets should absolutely be regulated at a minimum to ensure that all investors are provided a level playing field. The key principles around governance of secondary markets should be applied here as well.

Investors should be provided warning statements by the exchange around the fact that the token values should have an upper ceiling in terms of their inherent utility and issuers of the token should be required to explain as part of their initial offer what they expect the utility to be in terms of dollar value. Warnings need to be provided to investors on the exchange when the token values deviate significantly on the upper side.

3.4. What will be the key drivers of the ICO market going forward?

Before we delve in to the key drivers going forward for the ICO market, we must first understand the key drivers till date and the reasons why the crypto market has had a dramatic rise and fall.

2017 was the year of ICOs. It was in general a time of mania for crypto investors. The inexorable rise of Bitcoin and a number of other small coins in its wake burst in to mainstream consciousness. There were several factors that led to this boom:

3.4.1. Past

3.4.1.1. Crypto anarchists and individual asset sovereignty advocates

The great crash of 2008 was never really fully resolved. Instead, the credit crunch was ameliorated by central banks resorting to quantitative easing, which is basically printing money. The huge money spigots found its way to capital markets where the increased money supply led to higher asset prices for both stocks as well as real estate. But those in the know were hunkering down in the search of assets that were beyond the reach of the state, such as gold, that could weather the inevitable next storm to come.

Bitcoin, with its bearer characteristics, was a powerful tool for any one who wanted to stake out a position out of what they perceived as current corrupt financial markets.

3.4.1.2. The followers

However, to pin the rise of bitcoin on the world suddenly becoming a libertarian utopia would be to misread the situation. The bulk of those who jumped in were those who saw the opportunity to make a quick buck by riding the trend. The rising price attracted more buyers which in turn fuelled the upward cycle. A vicious (or virtuous, depending on your leanings) cycle ensued.

3.4.1.3. Worldwide reach

Because these crypto assets claimed that they were not securities, they could be traded worldwide without the restrictions that are typically placed on a security. Which meant massive distribution, and lower (or zero) cost of compliance.

3.4.1.4. Shillers and mania

Because these were not securities, restrictions around promotions of securities did not apply. Shillers, paid influencers like Floyd Mayweather, Paris Hilton and DJ Khaled started promoting cryptocurrencies. Youtube and other social media celebrities peddled crypto. Every man and his dog seemed to be talking about some or other coin and how they either already had bought a Lambo or were oncourse to. These were heady days and the working philosophy was, Anything goes!

3.4.1.5. Liquidity

One of the big reasons why crypto mania took off is that secondary markets emerged where the coins you bought in an exchange could be traded. Whether or not the project for which the ICO was conducted achieved its goals, whether or not the coins/tokens could be used for the purpose what they claimed they were for, you had a mechanism to liquidate it. And given the wide distribution there would always be enough demand from those who'd ultimately be left with worthless tokens.

3.4.1.6. Zero regulatory oversight

Zero regulatory oversight also meant that there was widespread fraud, market manipulation of all kinds. This would ordinarily mean that the market participants would lose faith and the market would collapse. And while that did happen eventually and as of late 2018 we are having a front row seat to this exact phenomenon, market manipulation led to superficially rising prices on various crypto exchanges which suckered in ever more participants.

3.4.2. Current state : February 2019

The lack of regulation on the initial offers and secondary exchanges combined with the drivers highlighted above created a massive bubble, the biggest of all time by various measures. This bubble imploded in 2018 and the ICO market has completely died. Secondary exchanges including the biggest ones have seen a significant drop in trading volumes, several of them are about to exit the business. Most small investors have lost money and faith in the marketplace and exited it altogether. The only players to have made any money are the ones who got in very early, are involved in liquidity providing and OTC market making and those who were in a position to manipulate the market (whale action, markets operating their own trading desks and being privy to insider information). The lack of investors and regulatory attention has meant that most ventures have shelved their plans for an ICO.

There has been a lot of commentary around how ICOs will be replaced by STOs (Security token offerings) and how it will be a far bigger phenomenon than ICOs. While this statement is fundamentally true, the short run adoption of STOs is unlikely to exhibit any of the attributes that led to the phenomenal boom in ICOs.

Below is a list of just some of the reasons that would mean that STOs won't be the rocket ship that was ICOs.

1. STOs are regulated, they are essentially an IPO where the shares are represented on the Blockchain in the form of tokenized certificates. The disclosure requirements around making a public offer would still apply. Which means there is a significant regulatory burden to overcome before launching
2. Advertising of securities has to be factual which means none of the Crypto Mayweather stuff will fly. You would be governed by regulatory restrictions on how securities or security tokens can be promoted.
3. Liquidity would not be as easy, depending on the specific regulatory structures there would be restrictions on secondary market trading. Establishing and running such a secondary market in securities would require onerous market licensing.
4. Jurisdictional restrictions would mean that global distribution would not be a default option.

Security tokens won't be a free for all, the way utility tokens are. Which means while STOs won't have the same short term boom, the protections that are inherent to it would eventually prove to be a more sustainable model.

3.4.3. Future Drivers

In order to resurrect the ICO industry and ensure it operates in a sustainable manner the following needs to be done

1. Allow ICOs for pure payment tokens for platforms that are yet to be built without necessitating a full blown MIS
2. Impose standards on whitepapers for these payment tokens and require registration with ASIC
3. Impose RG234 style restrictions on promotions of ICOs to prevent misleading advertizing
4. Impose regulations on crypto exchanges to ensure that a level playing field exists for investors participating in it and investors are informed clearly that these are not shares and are not expected to gain in value even if the platform gains traction
5. Significantly increase the thresholds for non cash payment facility exemptions. The current threshold for Low value facilities' (where the maximum held by any one person is \$1000 and the maximum held in total is less than \$10 million) would be quickly crossed by a payment token (or a utility token) and that would get it in the crosshairs for licensing requirements around payment facilities and ADI regulations. This needs to be increased substantially to have no restrictions on what one person may individually own and increase the maximum to \$100 Million or more
6. The current best way of achieving liquidity for unlisted companies is to apply for a low volume market operator exemption. The thresholds here are quite restrictive, 100 transactions and \$1.5 Million in transaction volume. Given that the counterparty to all transactions is the issuer, who in turn is not going to do a buy back till there is a buyer on the other side, the reality is the 100 transactions are actually only 50. The threshold of 100 transactions needs to be significantly increased or even potentially lifted to allow meaningful liquidity. Units in a Registered MIS currently are allowed to be made a market in without restrictions, that exemption should be extended to shares in public unlisted companies that have issued a full disclosure document such as a Prospectus or an OIS. Suitable regulatory requirements can be enacted to ensure investors are provided a level playing field.

3.5. How can ICOs contribute to innovation that is socially and economically valuable? What do ICOs offer that existing funding mechanisms do not? Are there other opportunities for consumers, industry or the economy that ICOs offer?

Early stage capital for innovative ventures in Australia is extremely limited as compared to other western jurisdictions. In addition Australian investors tend to invest typically in tangible assets such as real estate, or advanced stage businesses with revenue and product market fit.

Banks and other lenders will typically only lend on a personal basis and ask for tangible security. This lack of capital can often stifle new ventures.

Having your potential customers fund the development of the venture is a win win, where they get discounted services and the entrepreneurs get the capital they need. In addition the presence of a liquid secondary market for these tokens make these tokens a more attractive proposition and helps faster raisings.

For a country like Australia with a relatively small population base with a risk averse investor mindset, ICOs can be a good avenue for early ventures to raise capital from a global pool of customers/investors.

3.6. Is there ICO activity that may be outside the current regulatory framework for financial products and services that should be brought inside? Do current regulatory frameworks enable ICOs and the creation of a legitimate ICO market? If not, why and how could the regulatory framework be changed to support the ICO market? What, if any, adjustments to the existing regulatory frameworks would better address the risks posed by ICOs?

Almost all of the ICO activity is outside the current regulatory framework and it most certainly needs to be brought inside to restore trust and resurrect this industry.

Currently the regulation veers between two extremes, either there is almost zero regulation or you have securities disclosure requirements which can be too stifling. ICOs for a platform that is yet to be built (even that would be classed as a payment or utility token, note that in this submission we class utility token as payment tokens) would be deemed as needing a Registered MIS structure which can be quite restrictive.

Instead lessons can be taken from Singapore which does not treat ICOs in the same manner as well as from Malta and Wyoming.

Key adjustments should be

1. Impose standards on "white papers" and require them to be registered with ASIC
2. Allow ICOs to be done for platforms yet to be developed without needing a MIS
3. Standards around promotions similar to RG234, additional warnings around the fact that these tokens should have limited upside
4. Regulations on crypto exchanges to ensure investors have a level playing field
5. Lift thresholds around payment facilities significantly
6. Allow unlisted public companies that have a Prospectus or OIS to be able to make a market in their own shares without restrictions by default (similar to a Registered MIS).

3.7. What role could a code of conduct play in building confidence in the ICO industry? Should any such code of conduct be subject to regulatory approval?

If the above regulations surrounding standardization of whitepapers, promotion activity and secondary market are incorporated that would negate the need for a new code of conduct. The industry can develop a code of conduct in due time but it should not be subject to a separate regulatory approval.

3.8. Are there other measures that could be taken to promote a well-functioning ICO market in Australia? Does the current tax treatment pose any impediments for issuers in undertaking capital raising activities through ICOs? If so, how? Is the tax treatment of tokens appropriate for token holders? Is there a need for changes to be made to the current tax treatment? If yes, what is the justification for these changes?

In general the Australian tax treatment for ICO activity and crypto tokens is fair and appropriate. It correctly does not have GST on crypto-currencies used for payments as that would lead to double taxation. Utility or access tokens are in effect a form of internal currency in the platform. Hence as part of this submission we have classified them under payment tokens. Given their use as an internal currency, there should be no GST on transactions conducted using them.