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New Zealand Government inquiry into the current and future nature, impact, and risks of cryptocurrencies

Submission by Stace Hammond Lawyers[1]

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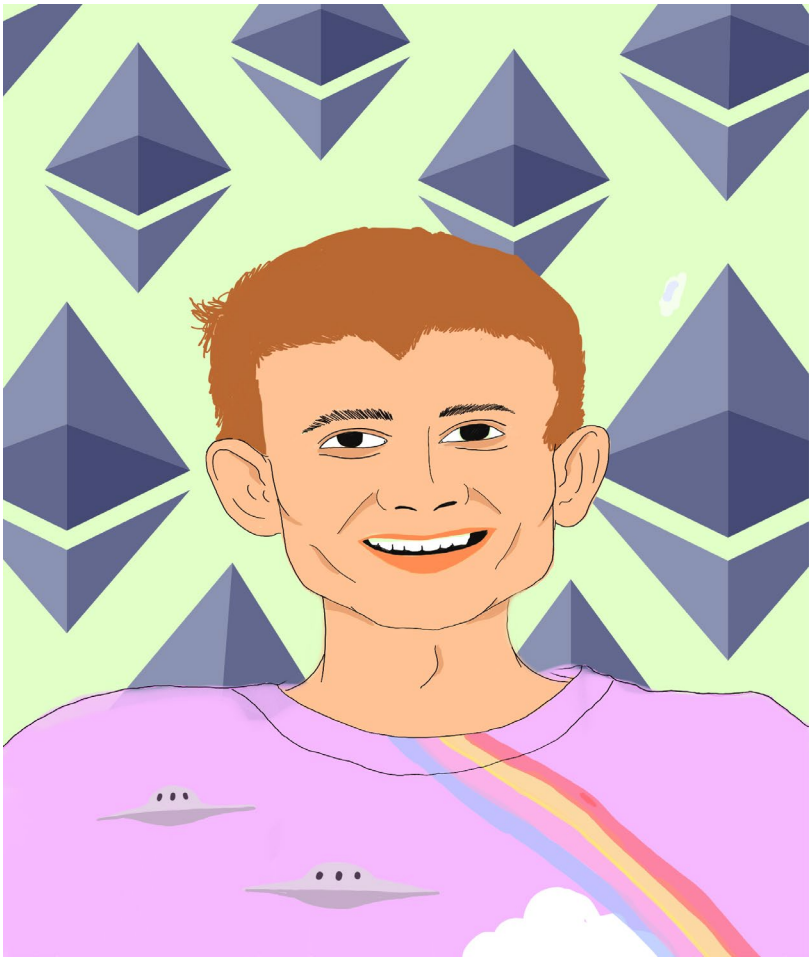

[1] https://www.stacehammond.co.nz/

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1. Overall submission[2]

1.1 Cryptocurrencies, or what we consider are better referred to as crypto-assets ('**crypto**'), challenge existing definitions and classifications of money, currency, property, commodities and financial products. The idea that truly decentralised protocols like Bitcoin have no centralised management or governance structure and may not be backed by anything tangible - that there is no central party to deal with or an asset to take possession of if things go wrong - is a real mental hurdle for many.

1.2 A key challenge in this space is the 'no knowledge' or 'lack of knowledge' problem. It is easy for many to dismiss the utility of crypto, or be fearful of it, because of complexity. Because it is relatively novel, technical, and rapidly evolving, there is, in general, a lack of education and understanding both for regulators and market participants.

1.3 Parliamentarians, regulators, lawyers, accountants, financial advisers, and journalists play a pivotal role as interpreters. All should approach the technology with an open mind and, as far as possible, absent pre-existing prejudices and sensationalism.

1.4 We are conscious that because of various issues with the economy and traditional banking system, people are exploring more risky or speculative opportunities. With that comes the potential for them to be exploited by bad actors. Clear rules are required to minimise and control those bad actors (e.g. those who promote sham projects, pump and dump type schemes, or who carry on predatory or misleading businesses). But the government needs to be careful not to single out crypto – these concerns have been around forever and exist in both the traditional space and the digital space.

1.5 It is important to remember that crypto brings a lot of opportunity to make financial transactions more accessible through technology (e.g. for persons who have been marginalised or excluded because of location or poverty). It presents a real lifeline for such disadvantaged parties, bringing with it financial opportunities previously unavailable (e.g. microfinance and microinsurance). It also presents a real economic opportunity for New Zealand.

1.6 That's why a balanced, careful and thorough approach to these issues is required. The focus for the Committee should be on consulting the best people, to educate themselves so they properly understand the technology, so they (with the help of

[2] **Disclaimer:** This submission is intended to assist the Committee. It is not intended as legal advice and it should not be considered by the Committee or relied on by any reader as such. Like most aspects of law, each crypto legal issue must be considered by reference to its own facts. Stace Hammond do not profess to be experts in any other field discussed in this paper, e.g. economics, financial advice, accounting. Please note that the material linked is for illustrative purposes only. Its inclusion is intended to make the paper accessible for all readers, not just lawyers. Except for our own web articles, Stace Hammond does not necessarily agree with or endorse the statements made in the linked material. We reference it for its overall usefulness for this discourse. Stace Hammond does not claim any copyright or other intellectual property rights in those linked works. We also reserve the right to correct any errors in this submission that we discover once it is filed.

those experts) can educate business and consumers and help them properly understand the risks. A considered approach is preferable to rushing through knee-jerk amendments to existing law or even creating a crypto specific Act that is not fit for purpose. An open minded and welcoming approach that provides individuals and businesses with some leeway, while at the same time makes it clear that traditionally unacceptable behaviour (e.g. fraud) is still treated accordingly is a useful starting point for the Committee for this stage of their crypto journey.

1.7 To that end, we endorse Blockchain Australia's recent recommendations to Australia's senate[3] but for New Zealand:

(a) That New Zealand should implement a coordinated and graduated approach to the regulation of crypto-assets. Focussed on providing greater certainty to consumers and businesses, while working to develop a fit-for-purpose framework. Facilitating an environment conducive to innovation and competition in crypto-assets. This involves:

(i) implementing immediate safe harbour provisions;

(ii) greater regulatory guidance and engagement in the short-term; and

(iii) a long term, fit-for-purpose legislative framework.

(b) Regulators can provide greater guidance in areas such as custody, debanking, taxation and anti-money laundering and countering financing of terrorism ('**AML/CFT**'). They will benefit both industry and enhance consumer protections by doing so.

(c) Regulators should increase their resourcing and undertake greater engagement with the industry through the establishment of a regulator-industry working group.

1.8 We also endorse most of the recommendations in Associate Professor Alexandra Sims's, Dr Kanchana Kariyawasam's, and Professor David Mayes's excellent paper, Regulating Cryptocurrencies in New Zealand,[4] including that:

(a) The Government should continue to allow crypto to be traded as well as used for the payment of goods and services within and outside New Zealand.

(b) New Zealand-based crypto exchanges to be encouraged and clear guidance provided as to their AML/CFT obligations by both the Te Tari Taiwhenua | Department of Internal Affairs ('**DIA**') and the Financial Markets Authority ('**FMA**') (i.e. follow Australia's example).

(c) Greater advice and therefore protection provided to consumers on crypto by the FMA, DIA and other organisations.

[3] Blockchain Australia – Submission to Senate Select Committee on Australia as a Finance and Technology Centre, 23 July 2021, https://blockchainaustralia.org/senate-select-committee-submission-on-australia-as-a-technology-and-financial-centre/

[4] As set out in section 9.

(d) Crypto exchanges and blockchain businesses that comply with AML/CFT and other requirements must have access to bank accounts with New Zealand banks.

(e) Merchants must be able to accept crypto payments by people or organisations for under NZD 100 (* in our view 1000 NZD is more practical) or payments made through a New Zealand exchange (or an overseas exchange) that complies with AML/CFT requirements, without the merchants losing their bank accounts.

(f) GST is removed from crypto that are used for the payment of goods and services.

(g) Te Tari Taake | The Inland Revenue Department ('**IRD**') (further) clarifies other taxation rules around the use of crypto and accepts crypto for the payment of taxes.

(h) New Zealand should follow countries, such as the UK and Australia, and create a regulatory sandbox to ensure that the regulators work alongside fintech companies.

1.9 We add that guidance and engagement by regulators should utilise various forms, not just writing on the regulators' websites. Because humans of different generations and cultures absorb communication differently in the digital age, regulators should also utilise video, audio, memes, and gifs across a range of platforms. We urge our regulators to consult their regulatory counterparts from other jurisdictions and utilise experts both in New Zealand and overseas.

2. Why does Stace Hammond care?

2.1 At Stace Hammond, our crypto law experts are cognizant of the expanding pervasiveness and importance of crypto-assets and platforms throughout the global financial and commercial landscape. We are passionate about this exciting, developing, ecosystem of digital technology and commerce. We understand the various legal implications this presents for individuals and businesses. We want to assist our clients and share in their crypto journey and help them achieve their digital goals – whether that means assisting them to understand and navigate the legislative hurdles of an initial coin offering ('**ICO**'), or simply the tax implications of trading a 'meme coin'.[5]

https://www.stacehammond.co.nz/expertise/cryptocurrency-cryptoassets/

[5] In the interests of disclosure, some Stace Hammond partners hold a range of crypto investments across a range of platfoms. We see involvement crypto in this manner as critical to our own education and understanding so we can best serve our clients. That said, we recognise that this could be perceived as bias in favour of crypto.

Terms of reference

3. (1) to inquire into, and establish the nature and benefits of cryptocurrencies

3.1 When considering the nature and benefits of crypto, it is useful to consider its history and the problem that crypto aimed to solve.

The problem that crypto solves – first principles

3.1.1 It is important to remember that prior to Bitcoin's creation by the pseudonymous Satoshi Nakamoto in 2008, commerce on the internet relied almost exclusively on financial institutions as trusted third parties to process electronic payments.

3.1.2 However, as documented in his/her/their Bitcoin white paper, this trust-based model has a number of weaknesses. Completely non-reversible transactions are not really possible. With the possibility of reversal, the need for trust spreads. Merchants require more information from customers (at the cost of privacy). Potential for fraud increases and, to a certain extent is accepted. Financial institutions cannot avoid mediating disputes which increases transaction costs.

3.1.3 Physical currency used in person avoids these costs and payment uncertainties, but no mechanism existed to make payments over a communications channel without a trusted party.

The crypto solution and how it works

3.1.4 What Satoshi proposed was an electronic payment system based on cryptographic proof instead of trust, allowing two third parties to contract with each other without the need for a trusted third party. A chain of digital signatures verified by a peer-to-peer digital network solves the double spending problem (i.e. the risk that a digital currency can be spent twice). As Satoshi noted, transactions that are computationally impractical to reverse would protect sellers from fraud, and routine escrow mechanisms could easily be implemented to protect buyers.

3.1.5 Essentially what Satoshi invented was a triple-entry accounting system using a proof-of-work chain across a decentralised network as a solution to the 'Byzantine generals' problem'. Triple-entry accounting offers a concept that is 'near' trustless.

3.1.6 See this video from WeUseCoins for a very simple explanation about bitcoin:

https://www.youtube.com/watch?v=Um63OQz3bjo

3.1.7 Bitcoin has been referred to by one NASDAQ listed company CEO as: "the most powerful and disruptive technology of our lifetime".[6] Some of the benefits of Bitcoin as a protocol are that:

(a) It is both open and traceable, but at the same time anonymous (the blockchain contains a record of all transactions, but they are anonymised by numerical addresses);

(b) It is permissionless (you don't need anyone's ok to access it, use it, or move it);

(c) It is trustless (code is law);

(d) It is divisible (you don't need to buy a whole bitcoin, you can buy as little as one 'satoshi' - there are 100 million satoshis in a bitcoin / you can split a bitcoin down to 0.00000001);

(e) It is durable (while it is possible to lose one's private key and effectively prevent yourself from transferring the bitcoin, the transaction remains visible on the blockchain distributed ledger);

(f) It is liquid (global market operating 24/7, 365 days a year – compare this with for example land which takes time to sell);

(g) It is transportable and immune from confiscation (unlike other forms of property);

(h) It is decentralised (as Elon Musk has noted, there is "no throat to choak" i.e. no one party can be coerced);

(i) Transactions are irreversible;

[6] https://www.zdnet.com/article/microstrategy-ceo-bitcoin-is-the-most-powerful-and-disruptive-technology-of-our-lifetime Note that Microstrategy is heavily invested in bitcoin

(j) Transaction fees are relatively low (when compared with remittance costs); and

(k) It has speedier processing (in terms of final settlement) compared to transactions conducted with fiat currencies.

3.1.8 Because of its nature and remarkable growth relative to traditional fiat currencies, Bitcoin has prompted much debate on a range of issues across most communication formats. The following are examples:

(a) **Common misconceptions** –

(i) In this podcast, Robert Breedlove,[7] discusses misconceptions about bitcoin with prominent investing podcaster Preston Pysch.

(ii) For those who prefer shorter pieces, see this video with Nic Carter.[8]

(iii) For those who like to read, see this article by Lyn Alden.[9]

(b) **Regulation of bitcoin** – In this video from 2014, Bitcoin and open blockchain expert, Andreas M. Antonopoulos educates the Senate of Canada about Bitcoin. Mr Antonopoulos has also given submissions to Australia's Senate:

https://www.youtube.com/watch?v=xUNGFZDO8mM

(c) Human rights –

(i) Alex Gladstein is an expert on bitcoin and human rights at the Human Rights Foundation.[10] In this video he discusses concepts of democracy, censorship, privacy, surveillance, and credit and data scoring. As New Zealanders we value a free and democratic society. This Government Inquiry evidences this.

(ii) The unbanked and remittance problems and how crypto solves them are elegantly explained by Ethereum/Cardano co-founder Charles

[7] Robert Breedlove is a finance and operations executive (CEO/CFO/COO/CIO) with broad spectrum leadership experience across the enterprise tech, consumer tech, corporate finance, international M&A, tax strategy, wealth management, Bitcoin, and cryptoasset domains.

[8] Nick Carter is cofounder of blockchain data aggregator Coinmetrics.io and previously Fidelity Investments' first cryptoasset analyst, who has a Masters in Finance and Investment from the University of Edinburgh and an undergraduate degree in Philosophy from the University of St Andrews.

[9] Lyn Alden is a research analyst. She provides equity research and investment strategies, catering to institutional investors and sophisticated retail investors https://www.lynalden.com/

[10] https://su.org/about/faculty/alex-gladstein/

Hoskinson in this video. The banking of the unbanked brings economic opportunity for New Zealand:

https://www.youtube.com/watch?v=97ufCT6lQcY&t=8s

(iii) In this podcast from What Bitcoin Did, Tongan lawyer and minister of parliament Lord Fusitu'a[11] discusses the remittance problem that Tonga deals with and how Bitcoin could improve the situation. Given Tonga's proximity to New Zealand and our large Tongan population, what Tonga chooses to do will impact New Zealand. Removing the remittance problem could be positive for both local economies. It is anticipated that the same issue applies to other Pacific nations.

(iv) **Freedom of speech** - This article considers bitcoin in relation to freedom of speech and democracy. It is interesting for its discussion of US Supreme Court case *Packingham v North Carolina* which reaffirmed that the US Constitution applies to online networks and protects rights to express and associate through them.

(d) **Company adoption** - In this video, notable S&P/NASDAQ listed company tech entrepreneurs Elon Musk (Tesla / SpaceX) and Jack Dorsey (Twitter / Square) and CEO / CIO Cathie Wood (ARK Invest) debate the benefits of Bitcoin and areas of concern for businesses:

[11] https://www.parliament.gov.to/members-of-parliament/nobles/136-lord-fusitu-a

https://www.youtube.com/watch?v=Zwx_7XAJ3p0

(e) Economics and philosophy –

(i) In this video, author and Assistant Professor of Economics, Saifedean Ammous[12] discusses Bitcoin and inflation. Associate Professor Ammous is the author of a leading text on Bitcoin, The Bitcoin Standard.

(ii) This Professor Jordan Peterson[13] interview also gives a great overview the philosophical and economic discourse around Bitcoin.

Alternatives to Bitcoin

3.1.9 The Committee will no doubt be familiar with the Reserve Bank of New Zealand Te Pūtea Matua ('**RBNZ**') 2017 Analytical Note on the topic ('**RBNZ Note**').[14] The paper is a thorough and commendable analysis by our central bank. It contains a useful discussion of what crypto is, its background, and the implications of crypto for consumers, financial systems, monetary policy, and regulatory policy. Among other things it provides some definitions and classifications. It makes it clear that crypto, at least in New Zealand, is not legal tender.

3.1.10 For those not familiar with the RBNZ Note, or not inclined to read it, this 'crypto 101' video from crypto education channel Coin Bureau provides a simple explanation about what crypto more generally is, how it works, and its benefits:

[12] https://everipedia.org/wiki/lang_en/saifedean-ammous; https://saifedean.com/

[13] https://www.jordanbpeterson.com/about/

[14] Aaron Kumar and Christie Smith, Crypto-currencies – An introduction to not-so-funny moneys, AN2017/07, November 2017, Reserve Bank of New Zealand Analytical Note Series, ISSN 2230-5505 https://www.rbnz.govt.nz/-/media/reservebank/files/publications/analytical%20notes/2017/an2017-07.pdf

https://www.youtube.com/watch?v=VYWc9dFqROI&t=3s

3.1.11 Since the RBNZ Note was published in 2017 much has changed:

(a) In 2017/2018 there was an ICO boom and crash, followed by a cold 'crypto winter'.[15]

(b) Both crypto and traditional markets were rocked in an unprecedented way by the global pandemic and the consequent monetary and fiscal responses of governments and central banks.

(c) We have seen the rise of access for retail investors via platforms like Sharesies in New Zealand and RobinHood in the USA, which have provided increased interest in and access to financial markets for retail investors and traders.

(d) Owing in part to crypto's resilience in the face of constant threats, there has also been an explosion in crypto related content, products, and businesses.

(e) Our New Zealand High Court has determined that crypto is property in *Ruscoe & Moore v Cryptopia Limited (in liquidation)* [2020] NZHC 728. This case highlights some of the unique challenges that insolvency practitioners and the courts face dealing with this new technology. For further discusion on the case and another notable Canadian crypto insolvency see our article.

(f) As we discuss in our article on M&A – Legal Due Diligence and Crypto Assets, there has been a tidal wave of institutional interest (from major financial and corporate institutions such as BNY Mellon, Goldman Sachs, JPMorgan, Citi, Morgan Stanley, BlackRock, Mastercard, Square, MicroStrategy, Visa, PayPal and, most notably, Tesla which converted US$1.5 billion of its cash reserves into Bitcoin in January).

[15] https://www.forbes.com/sites/jeffkauflin/2018/10/29/where-did-the-money-go-inside-the-big-crypto-icos-of-2017/?sh=706a7fa6261b

(g) The evolution of decentralised finance or 'DeFi' and centralised finance or 'CeFi'.

(h) The rise of 'meme coins' such as Dogecoin (DOGE) and Safemoon (SAFE). Committee members may have noticed advertising for the latter on the field during a recent rugby match between the Maori All Blacks and Manu Samoa.[16]

(i) El Salvador made history as the world's first country to make Bitcoin legal tender.[17] This gives rise to interesting legal issues for other countries and the traditional banking system. For an interview with El Salvador's President Nayib Bukele see this video.

(j) At the time of writing this submission, Google was representing their trade mark in pixelated jpeg form. This seems hardly coincidental given the explosion of interest in non-fungible tokens or 'NFTs', such as Visa's recent $150k USD purchase of Crypto Punk #7610, 2017.[18]

(k) Between 2017 and 2021 crypto's market capitalization has grown exponentially. As detailed in this link Bitcoin's market cap more than quadrupled since the peak of the 2017 bull market and this cycle's all time high in April this year.

3.1.12 New Zealand exchange Easy Crypto's website includes a wealth of easily digestible educational resource including this page explaining what cryptocurrencies are. EasyCrypto note in this recent article from April 2021, that:

> "As of this writing, there are over 9000 alternative cryptocurrencies (altcoins) have spawned, all with a similar goal of revolutionising payments, each with their own unique way of accomplishing this goal."

And then in another from June 2021 focusing on "altcoins" (ie alternatives to Bitcoin) that:

> "As of 2020, there are over 4000 different cryptocurrencies out there, and more are being added every month!"

3.1.13 This demonstrates the explosive growth in the market for these technologies. It also highlights the challenge facing the Committee, regulators, advisers, businesses and consumers in understanding and navigating this rapidly evolving ecosystem.

3.2 a. to establish how crypto-currencies are created and traded

Consensus mechanisms – proof of work, proof of stake, & proof of history

[16] https://www.rugbypass.com/news/random-cryptocurrency-labelled-a-scam-appears-on-the-field-in-maori-all-blacks-versus-samoa-test/

[17] https://www.forbes.com/sites/roberthart/2021/06/09/el-salvador-makes-history-as-worlds-first-country-to-make-bitcoin-legal-tender/?sh=66088391eaa3

[18] https://www.cnbc.com/2021/08/23/visa-buys-cryptopunk-nft-for-150000.html

3.2.1 Most forms of crypto, such as Bitcoin, are created via the mining process where blocks are added to the blockchain ledger and in return the successful miner is entitled to a block reward. The RBNZ Note says:[19]

> "The term 'accountant' is a more appropriate label than miner, since the important responsibility of the miners is to validate transactions and maintain the integrity of the duplicate ledgers that record transactions. The miners are rewarded with crypto-currency for this validation service as part of the programmed protocols underpinning the currency."

3.2.2 For a visual walkthrough how cryptography and blockchain technology works, presented by Anders Brownworth an MIT lecturer on blockchain, see this video from RealVision:

https://www.youtube.com/watch?v=cZ3dBURh55o

3.2.3 Other crypto, including the next largest by market cap, Ethereum, also relies on block rewards for miners. When an Ethereum miner succeeds in providing the mathmatical proof of a new block they are rewarded in its native token ether (ETH). The transaction fee is called 'gas'.

3.2.4 Bitcoin and Ethereum (at least for now) utilise proof of work. However, others such as Cardano use 'proof of stake'.[20] The latter is often referred to as being more environmentally friendly or sustainable'. Ethereum is famously switching to proof of stake.

3.2.5 The differences between the two are discussed in this CoinBureau video:

[19] RBNZ Note, pg 14.

[20] https://www.nasdaq.com/articles/why-cardanos-proof-of-stake-system-is-unique-for-a-cryptocurrency-2021-04-19

https://www.youtube.com/watch?v=08vnE2_cAeQ

3.2.6 Others, such as 'ETH killer', Solana (SOL), use what is called a 'proof of history' (PoH) model.[21] There are also a range of other consensus mechanisms including: delegated proof-of-stake (DPoS), practical Byzantine fault tolerance (PBFT), proof-of-capacity (PoC), proof-of-activity (PoA), proof-of-publication (PoP), proof-of-retrievability (PoR), proof-of-importance (PoI), proof-of-burn (PoB), proof-of-elapsed time (PoET), and proof-of-ownership (PoO).[22]

Not all protocols or tokens are created equally

3.2.7 Because of the differing consensus mechanisms not all crypto are created equally. Each consensus mechanism has its advantages and disadvantages. Bitcoin's trade off for being the most secure and decentralised protocol (and therefore arguably lower risk), is that the blocks are smaller, and less data is permitted at the base layer. That does not mean Bitcoin cannot be scaled via other layers, it can (e.g. the layer 2 'Lightening Network'). It just means the base layer is limited. Some consider this simplicity a feature rather than a flaw with Bitcion.

3.2.8 Other protocols with bigger block sizes at the base layer can handle more information / transactions and tend to be faster, but may be less secure because of the increased potential for bugs in the code. They are also more prone to centralisation.

3.2.9 Proof of stake protocols, which rely on users to stake their crypto to provide security to the network, may have environmental benefits, tend to be more centralised (and therefore more vulnerable to manipulation). This issue is discussed in this article.

3.2.10 Bitcoin's blockchain has famously never been hacked. Compare this, for example, to Poly Network, which is a newer protocol that recently suffered a significant security breach. The hack exploited a vulnerability in the way the protocol verified smart contracts which resulted in the theft of crypto worth about $600 million.

[21] https://medium.com/solana-labs/proof-of-history-a-clock-for-blockchain-cf47a61a9274

[22] https://www.sciencedirect.com/science/article/abs/pii/S0065245820300668

DAOs

3.2.11 Decentralised autonomous organisations or 'DAOs' can be a tricky concept for some to understand. As Emily Fry explains:[23]

> "This is a self-executing entity based on a complex web of smart contracts, with the potential to automate many aspects of how companies are run. The legal status of this structure is universally unclear, and is likely to present novel legal questions in corporate law in the future."

3.2.12 The most notable DAO is probably The DAO. This was a form of investor-directed venture capital fund project created by Slock.it built on the Ethereum network. It had no conventional management structure or board of directors, and its code was open source, which anyone could contribute to. It failed because a hacker managed to exploit some code and move 3.7m ETH. This resulted in a 'hard fork' of Ethereum to unwind the hack.

3.2.13 According to this decrypt.co article:

(a) A DAO, is a business structure where control is spread out rather than heirarchical.

(b) DAO's can be seen as operating like a machine, with the job it is instructed to carry out determined by pre-written smart contracts.

(c) A community can adapt a DAO and program it according to its own goals.

(d) Code is written in the form of smart contracts, which provides some sort of governance mechanism.

(e) Members typically use governance tokens to vote on topics such as fund allocation.

(f) In the case of many DAOs, the impact of a member's vote can increase based on the amount they have contributed to the project.

(g) The outcome can be based on the degree of participation as well as voting preference.

Fair launch vs pre-mine

3.2.14 As this article on 'tokenomics' notes, Crypto tends to be launched in two ways:

(a) Fair launch

(b) Pre-mine

3.2.15 They are described as follows:

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[23] Fry, E, *Blockchain Innovation and Securities Regulation, An Analysis of Initial Coin Offerings under the Financial Markets Conduct Act 2013*, October 2017 *otago698328.pdf

> "Fair Launch is having a publicly announced launch without any form of pre-mine. Everyone can start mining the coin or tokens. There are no coin or token allocations for fair launch cryptos.
>
> Whereas pre-mine is when the team behind the project mints some or all of the coins or tokens before opening the network to the public. Some portion of these coins or tokens is usually sold before the launch of the project to raise the funds needed to build it."

3.2.16 Bitcoin is an example of a fair launch project. Pre-mine are more synonymous with 'exit scam' and 'rug pull' risk. For more on these see this article.

ICOs, IDOs, and IEOs

3.2.17 Initial coin offerings (ICOs), initial DEX offerings ('**IDO**'), and initial exchange offerings ('**IEO**') are all ways to raise capital from the public to fund the development of a new, typically crypto / blockchain, project.

3.2.18 Unlike an initial public offering ('**IPO**'), investors in an ICO, IDO or IEO usually do not own any equity in the project. The capital is raised via 'token sales' via investments of crypto (rather than fiat) and the investor (usually) holds only tokens (although there can be hybrids where the investor receives shares also). An investor will often have to contribute an existing crypto token in advance (e.g. BTC or ETH) to receive the project token. This could require the investor to have more than one wallet set up to pay and receive tokens. Gains in the value of the project token are the usual incentive, although often the subject token will purport to provide 'utility' or 'governance' rights to the token holder allowing them to participate in the future direction of the project.

3.2.19 These articles explain the differences.[24] In summary:

(a) ICOs typically involve a development team selling a part of their total token supply to the public via their website.

(b) IEOs are typically launched on centralised exchanges ('**CEX**') (e.g. Binance Launchpad) these also raise capital via crowd funding, but the projects are vetted by the exchange.

(c) IDOs are launched via decentralised exchanges ('**DEX**') (e.g. Uniswap and Pancakeswap) and often involve investors buying 'IOUs' or acknowledgments of debt of the token that the project wants to launch and receive their tokens upon a token generation event.

(d) With ICOs and IDOs whether AML/KYC is required depends on the project and any exchange requirements. With IEOs AML/KYC is up to the exchange.

(e) Multi-chain IDOs, where the project launches via multiple launchpads, are also increasing in popularity.

[24] https://cointelegraph.com/news/to-ico-or-to-ido-that-is-the-question ; What is an Initial DEX Offering (IDO)? How is it Different Than ICO & IEO? (cryptopotato.com) ; https://coinmarketcap.com/alexandria/glossary/initial-dex-offering

(f) Most IDOs require their users be 'whitelisted' before they are eligible to receive an allocation. This can include AML/KYC checks, or performing various tasks such as following certain pages on Twitter, re-tweeting certain posts, and joining social media groups. This builds a 'marketing storm' for the project.

3.2.20 As Emily Fry observes in relation to ICOs (although the statement also applies to IDOs but less so to IEOs):[25]

> "The most disruptive feature of the technology underpinning ICOs is that it genuinely removes the need for intermediary institutions to be involved in the financing process. It also removes all jurisdictional and temporal boundaries. The blockchain enables funds to be securely transferred in a peer-to-peer manner almost instantaneously. This process contrasts dramatically to that endured by companies raising capital by traditional means…"

3.2.21 There are different pros and cons for projects and investors. Some investors may appreciate the familiarity of the platform or protocol and vetted nature of an IEO, although this means reposing more trust in a central party. Others might prefer more anonymity via an ICO or IDO, but with that generally brings more risk. Some projects may see greater opportunity via a large centralised marketplace / network of a CEX. Others may see the benefit in launching quickly on a DEX and the opportunity it presents for quick liquidity for their project.

The rise of NFTs and gaming

3.2.22 Non-fungible-tokens, or NFTs, have boomed in popularity in the last year and New Zealand's interest is certainly growing too.

3.2.23 An NFT is 'non-fungible' - it is a unique digital asset. By contrast, a crypto like bitcoin is 'fungible' (i.e. each fraction is equivalent to the next). Money is often described as fungible. For example, if Arthur gives Martha a $100 note, Martha can repay Arthur with the same $100 note, or two $50 notes, or 10 $10 notes etc. Compare this with a non-fungible item like a car. Arthur generally wouldn't agree to receive a different car to the one he lent Martha, even if it is the same model.[26]

3.2.24 As this BBC article notes:

> "In theory, anybody can tokenise their work to sell as an NFT but interest has been fuelled by recent headlines of multi-million-dollar sales."

3.2.25 This article by The Spinoff provides a useful breakdown of what they are, how they work, and where to buy them (e.g. platforms such as Opensea, SuperRare, Solsea and Solanart).

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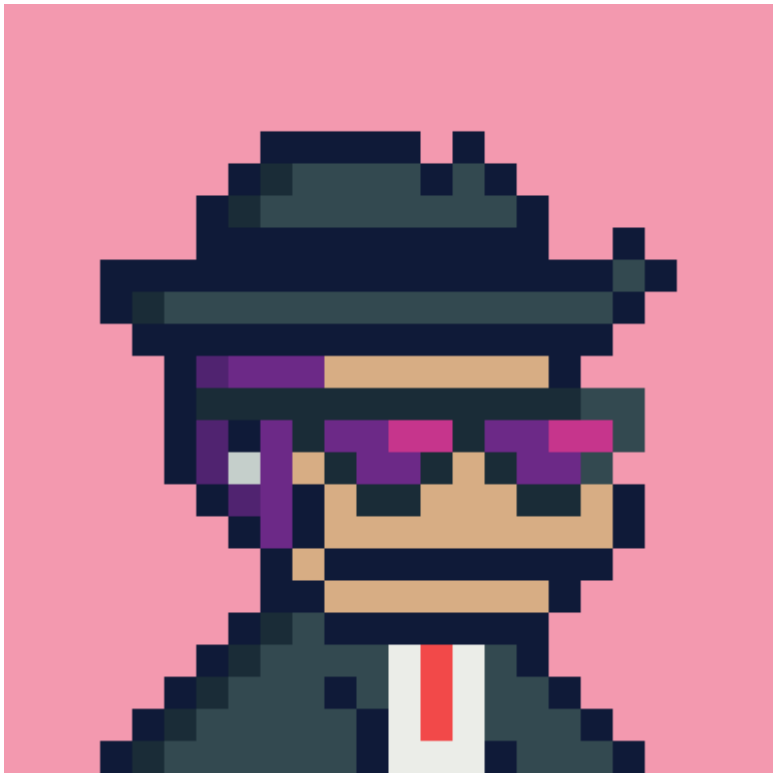
[25] Fry, E, *Blockchain Innovation and Securities Regulation, An Analysis of Initial Coin Offerings under the Financial Markets Conduct Act 2013*, October 2017 *otago698328.pdf

[26] https://www.investopedia.com/terms/f/fungibility.asp



An example of an 'SMB' NFT from https://solanamonkey.business/

3.2.26 NFTs have a range of use cases, from artwork, collectibles, sports, gaming, entertainment, identity verification, to real estate.[27] European Investment Bank has tokenised a bond.[28] The creator can mint a range of different forms of digital media (e.g jpegs and mp4s). They also allow the creator to build in a continuing royalty. In art terms, an NFT offers provenance via the publicly searcheable blockchain.

3.2.27 The Committee may have heard about digital artist Beeple's 'Everydays: The First 5000 Days' selling online via famous art auctionhouse Christies for $69m USD. Or they might be aware of Kings of Leon being the first band to release an album as an NFT which offered live show perks like front row seats for life.

3.2.28 Some NFTs cross-over between between use cases. For example, CyberKongz crosses over between artwork, collectibles, gaming and finance. The holder can 'stake' their Kongz on the CyberKongz platform and receive 'BANANA' tokens in return. If you have two genesis Kongz, once you have a certain amount of BANANA tokens, you can receive a 'BabyKong'.[29]

3.2.29 NFTs undoubtedly present enormous opportunity for New Zealand businesses to disintermediate middlemen who are clipping the ticket on their products. See, for

[27] https://whatis.techtarget.com/feature/5-business-use-cases-for-NFTs

[28] https://www.eib.org/en/press/all/2021-141-european-investment-bank-eib-issues-its-first-ever-digital-bond-on-a-public-blockchain#:~:text=On%2027%20April%202021%2C%20the,Sachs%2C%20Santander%20and%20Societe%20Generale.

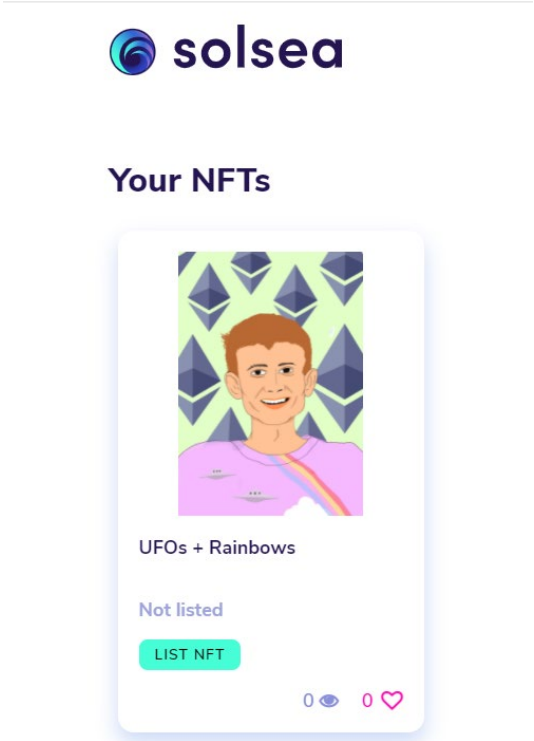
[29] See this video https://youtu.be/VmHY7deHRw4. https://opensea.io/collection/cyberkongz

example, New Zealand artist @askewone leveraging Instagram and SuperRare to promote his digital art:

Askew One on Instagram: "Just released Digilogue 10 on @superrare.co a short time ago. The tenth in my series of Digilogue works - the first seven were made with…"

3.2.30 As this submission was being typed, this Stuff article was published about NFTs and the launch of former All Black Dan Carter's new cryptocurrency art investing platform, Glorious. Platforms like Glorious are a welcome addition to the New Zealand marketplace. It is exciting to see New Zealand businesses competing and meeting the demand of New Zealand artists, sportspeople, entertainers and their enthusiasts. It is also exciting to see this built on a blockchain launched by a New Zealand organisation.

3.2.31 However, while Glorious claims to be 'artist centric', the platform still takes 30 percent of the sale price (compared with 'most galleries where it is closer to 50 per cent) and a 'small tranche of the revenue each time a work is resold'. Contrast Glorious with say, Solsea, where an artist or intellectual property owner can mint and list for a fraction of a SOL (less than 1c NZ), set the percentage of royaly they wish to receive from future sales, and decide the nature of the copyright licence attached to the NFT.



3.2.32 As this article notes, minting NFTs on different protocols and platforms costs varying amounts. The owner will also pay transaction fees (usually in the crypto for the protocol that the NFT was minted e.g. SOL or ETH) for the NFT to be listed. These fees can be volatile which can affect the market for the NFTs.

3.2.33 Again, not all platforms and protocols are created equal. A creator may view one protocol as more secure, or a marketplace as larger, and therefore be content to pay higher fees. For example, they may prefer an Ethereum based marketplace such as Opensea which relies upon the security of the Ethereum blockchain (a more established, more decentralised and therefore likely more secure protocol) even though the fees might be higher, vs a lower cost option like Solanart, which is

powered by the Solana blockchain, which is newer and arguably less decentralised (and therefore potentially at greater risk of vulnerabilities in the code or a 51 percent attack) where the fees are lower.

3.2.34 With all that said, investors and content creators may well prefer a platform like Glorious if, for example, they can have a higher degree of trust that the content originated from the original creator or intellectual property rights owner, than a platform where there is no guarantee what has been minted was legally owned by the minting party. The above highlights how there are markets for different platforms and blockchains and that they can all co-exist.

The greater fool[30]

3.2.35 It is important for all NFT enthusiasts to be aware that, unlike fungible crypto like bitcoin which is very 'liquid' (i.e. able to be transferred easily), because NFTs are unique they are potentially very 'illiquid' (i.e. cannot be transferred easily). This brings risk if, for example, there was to be a market correction and funds were to flow out of crypto into other asset classes (e.g. cash or treasury bonds). In such a case there may be no market for the NFT at all.

Play to earn games

3.2.36 NFTs and play to earn games highlight the growing market demand for and interrelationship between crypto and gaming. This is exemplified by exciting new games such as Axie Infinity, Aurory, and Star Atlas. These platforms allow digital artworks and collectibles to be 'minted' (i.e. included in the hash of a block) by the content creators, used in the game, and traded (similar to stocks) in crypto markets.

3.2.37 According to this video children as young as 12 are making a living playing Axie Infinity.

3.2.38 As we note on our Games Development webpage:

> "The gaming industry, globally, has a higher gross revenue than the film industry; it is an industry worth hundreds of billions of dollars internationally and, unlike the film industry, has a comparatively low cost of entry. With the encouragement of distribution systems such as the iPhone and Android app stores, and PC systems such as Steam, a game can be created by a team of any size, even an individual, and then sold internationally.
>
> This ease of entry has proved hugely beneficial to creative New Zealanders, where the industry has boomed. Local developers have achieved high praise for their releases, topping international sales charts and winning numerous game of the year awards. This has led to reported exports in 2019 in excess of $200 million, $50 million greater than that achieved by Australia's games industry, despite New Zealand's games industry employing half as many people. With the recent application for New Zealand residence, by the owner of a top US developer, as well as an active industry body in the NZGDA, New

[30] https://en.wikipedia.org/wiki/Greater_fool_theory

> Zealand can look forward to this growing industry, as our isolation from Covid-19 encourages more developers to consider migrating to our shores.
>
> The growth of the games industry also opens up new business methods and opportunities, including digital distributions across multiple jurisdictions (often on different platforms), licensing of code out of a country that doesn't allow software patents, cloud streaming, and many other new issues that many lawyers will not have touched on or understand."

3.2.39 Indeed, crypto and gaming in New Zealand already has a stronghold in Greymouth. As this Otago Daily Times article notes, a Westport-based online specialist company has spent three years setting [a crypto] up, including extensive work with lawyers and the FMA. The RUBY tokens have been developed by the RUBY Play Network, part of the same group of companies as EPIC Westport and CerebralFix, owned by Benjamin Dellaca.[31] More information about Gaming Rewards Group's capital raise via marketplace Snowball Effect can be found here. As far as we are aware it is one of the first raises where investors get both an equity position in the company and token rights.

Trading

3.2.40 Most trading occurs via centralised exchanges 'CEX' or decentralised exchanges 'DEX'.

3.2.41 This article provides a helpful summary of the differences. As it notes:

> *The main difference between centralized and decentralized exchanges is that the former has control over your funds while you are interacting on the trading venue while, with the latter, users retain control over the funds while trading.*

3.2.42 Because of the differences in custody - CEXs typically being 'custodial' vs DEXs being 'non-custodial' – the risk profile of each differs.

3.2.43 Because there have been a number of notable CEXs fail, perhaps the most notable being MtGox, it is often perceived that CEXs are more risky than DEXs. However, this is not necessarily true. With DEXs, because only you have control over your funds, if

[31] http://www.screenz.co.nz/game-dev-a-finalist-for-entrepreneur-award/

you lose your wallet's private key or recovery phrase, unless you have a multisignature setup,[32] you lose your crypto. DEXs have also been subject to hacks.[33]

3.2.44 In New Zealand, failed exchange Cryptopia is an example of a CEX. Another large failed CEX is Canadian exchange Quadriga CX. Both were subject to significant hacks. We discuss both insolvencies and some of the legal issues which faced liquidators and claimants in our article.

3.2.45 Perhaps the most notable examples of foreign CEXs which New Zealanders can trade on are Binance and Coinbase. The risk profile of each varies. For example, Coinbase, being a listed company is heavily regulated and licenced.[34] It also has some insurance cover that protects a portion of the digital assets from loss from theft and cybersecurity breaches.[35] Another exchange which has grown rapidly in popularity is crypto derivatives exchange, FTX, which claims to be 'built by traders for traders'.

3.2.46 However, a number of wallets, even non-custodial ones where the user controls their private keys, offer the ability to trade within the wallet platform. Exodus being an example. Often custodial exchanges will also offer a non-custodial wallet (e.g. Coinbase.com and Coinbase Wallet).

3.2.47 Some exchanges also offer institutional custody solutions. For example, Gemini is a fiduciary and qualified custodian under New York Banking Law and licensed by the State of New York to custody digital assets. It aso has insurance coverage for cold storage and offers Gemini customers the ability to purchase additional iinsurance for their segregated crypto assets.[36]

3.2.48 https://cryptospot.nz/ assists New Zealanders to understand best rates for buying and selling crypto.

3.2.49 Some platforms, e.g. Binance, also offer peer to peer or 'P2P' trading. This is how it looks within the mobile app.

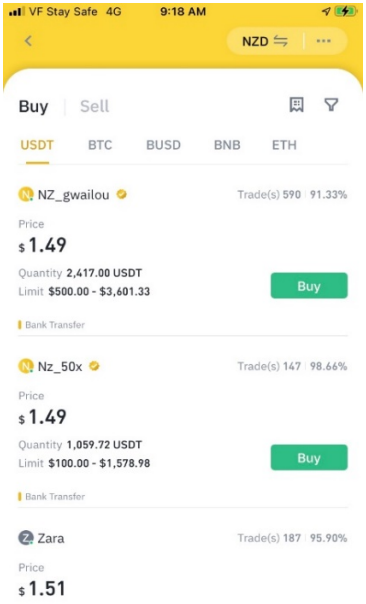
[32] Unchained Capital is an example of a third party that offers multisignature support. Single signature and multi-signature and the risks and benefits of each are discussed in this article from Unchained Capital's website: https://unchained-capital.com/blog/why-multisig/

[33] See for example this article about the hack of DODO DEX: DODO DEX Drained of $3.8M in DeFi Exploit (coindesk.com)

[34] https://www.investopedia.com/tech/coinbase-what-it-and-how-do-you-use-it/

[35] https://help.coinbase.com/en/coinbase/other-topics/legal-policies/how-is-coinbase-insured

[36] https://help.coinbase.com/en/coinbase/other-topics/legal-policies/how-is-coinbase-insured



3.2.50 Binance's webpage which explains P2P trading says that "Each Binance P2P trade involves escrow service protection, which ensures that counterparties in a transaction are protected from attempts by either party to act in bad faith."

3.2.51 Trading of NFTs also occurs via numerous NFT platforms, including Opensea and Solsea mentioned above, as well as Nifty Gateway, and NBA Top Shot.

Miners and policy considerations

3.2.52 This TedX talk by researcher and author Shermin Voshmgir[37] provides a useful primer on bitcoin, Web3, blockchain, decentralised networks, smart contracts, and the token economy. The clip at the start, of a television chat show from 1994 which discusses 'what the internet is', echos the present. Voshmgir highlights concerns around the development of the protocols, governance of and rules written into them, who is writing them, as well as regulation of them. She advocates for developers and policy makers to work together.

https://www.youtube.com/watch?v=JPGNvKy6DTA

[37] https://shermin.net/

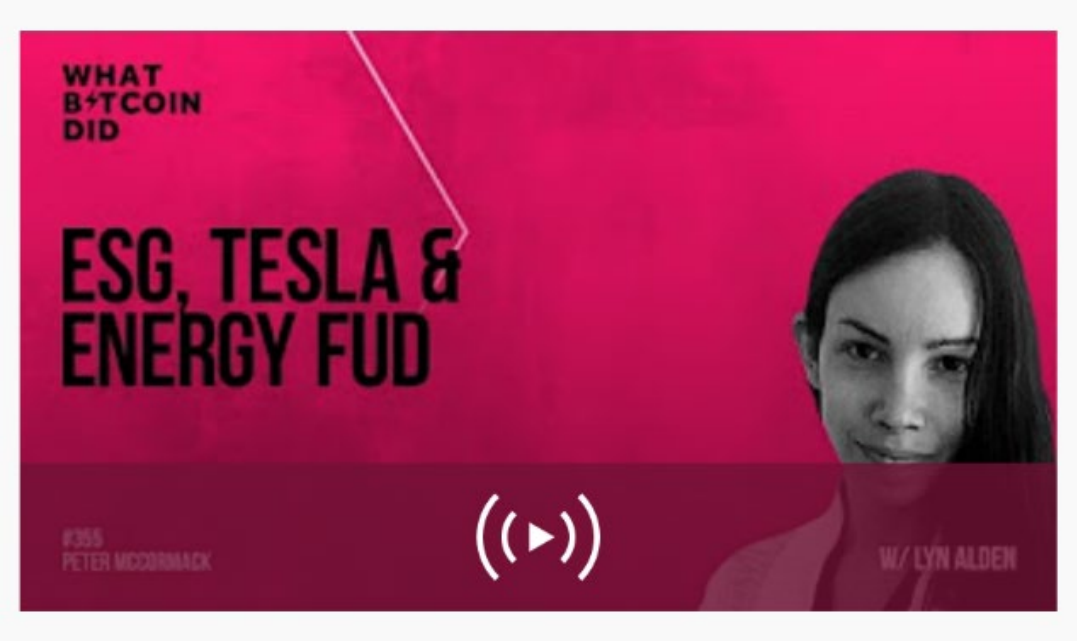
3.3 b. to understand the environmental impact of 'mining' crypto-currencies

3.3.1 Crypto, especially Bitcoin, which uses a proof of work model, is often lambasted by journalists and environmentalists as being environmentally unfriendly. This Newshub article is a good example. It refers to a report that found that bitcoin consumes about 4.5 times as much electricity as New Zealand.

3.3.2 However, there are compelling counter-arguments. Unfortunately for journalists these are not as easy to condense into soundbites and attention-grabbing headlines. For example, investment analyst Lyn Alden in this article notes:

> "And it's easier to sensationalize things for page views or political gain. For example, it's commonly said that the Bitcoin network uses more energy than some countries. That's true, but then so does Google, Youtube, Netflix, Facebook, Amazon, the cruise industry, Christmas lights, household drying machines, private jets, the zinc industry, and basically any other sizable platform or industry. From that list, Bitcoin's energy usage is the closest to that of the cruise industry's energy usage, but bitcoins are used by more people and the network scales far better.
>
> It's important to understand whether or not Bitcoin is an environmental problem and whether or not it is energy efficient, because these obviously affect its probability of being a good investment and a good payment network.
>
> If Bitcoin did indeed have serious energy scaling problems, it would eventually fail against competitors in the private marketplace by not offering enough utility for its energy consumption."

3.3.3 For those that prefer video, see this What Bitcoin Did interview with Lyn on the topic.



https://www.youtube.com/watch?v=6DGkExT8jXQ&t=1s

3.3.4 Nic Carter also comprehensively unpacks the issue in this article and this video:

https://www.youtube.com/watch?v=8sEifvSKw08&t=2s

3.3.5 Given Bitcoin provides a strong financial incentive for mining, game theory dictates a move towards more sustainable forms of power for proof of work models. Undoubtedly there was a problem with much of Bitcoin's miners being in China using 'dirty' forms of energy, but this issue has been moderated recently because of the Chinese Government's mining ban. As this article notes, the USA is positioned to benefit greatly from the shakeout.

Sustainable economic opportunities for New Zealand

3.3.6 This article from a party in the oil industry explores how Bitcoin can use otherwise-wasted energy. It notes how in USA and Russia:

> "Bitcoin mining rigs have been popping up on oil patches around the country to syphon off natural gas from active oil wells. Many oil drilling rigs have no pipeline connection to transport the natural gas that is a byproduct of the oil-drilling process, in which case the gas is simply burned off, or flared, going to waste while also creating greenhouse gas emissions. Bitcoin miners have been capitalizing on this opportunity by taking the natural gas that would otherwise be wasted and using it to power their mobile mining rigs."

3.3.7 In North Carolina a waste processing specialist is decomposing old tires to create energy which it is then using to mine cryptocurrency.[38]

[38] https://www.datacenterdynamics.com/en/news/prti-makes-cryptocurrency-from-old-car-tires-in-northern-carolina/#:~:text=Tires%20into%20Bitcoin&text=PRTI%20uses%20a%20thermal%20process,need%20for%20grinding%20or%20cutting.

3.3.8 This video with Adam Back[39] and Samson Mow[40] explains the economic benefit of bitcoin / proof of work mining for energy producers. It discusses the use of modular mining units by power providers in the development of zero emmissions installations (e.g. solar farm, wind farm, hydro farm and e.g. to provide capital). This presents a huge economic opportunity for power producers with unused and / or variable power. They also make the case that new technology presents advancement in energy production.

3.3.9 In New Zealand electricity is generated by 5 major electricity generating companies. Genesis Energy, Mercury and Meridian Energy operate under a mixed ownership model in which the government holds a majority stake, while Contact and Trustpower are private sector companies.[41] Furthermore, a large amount of New Zealand's total primary energy supply (TPES) comes from renewable resources. Hydro, geothermal, wind and bioenergy are used to produce electricity in New Zealand.[42]

3.3.10 In other words, in our submission:

> *There is an opportunity with Bitcoin mining for the New Zealand Government to generate revenue for taxpayers in an enviromentally sustainable way. Equally, there is opportunity for the Government to generate tax revenue from private Bitcoin mining corporations to fund other projects that benefit New Zealanders.*

The importance of policy for local and overseas investment

3.3.11 Stace Hammond notes that it has had interest from overseas parties in investment in crypto mining in New Zealand. A key aspect is the regulatory landscape and whether the venture could be subject to an ESG tax or levy if the energy used to power the mining rigs isn't 'clean'.

3.3.12 It is noted that the Government has set clear targets for reducing emissions in 2019 via the Climate Change Response (Zero Carbon) Act.[43] A particular concern is whether New Zealand will levy Bitcoin mining (like the Government will levy petrol and diesel vehicles as part of its electric vehicle policy)[44] or impose some form of regulatory condition on it (e.g. power source must be renewable wind, hydro or solar) as part of the Emissions Trading Scheme.

3.3.13 Clarity from Government in this regard would be welcomed and, we anticipate, would facilitate investment, as undoubtedly tax incentives would. That said, if regulation or

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[39] https://en.wikipedia.org/wiki/Adam_Back

[40] https://www.linkedin.com/in/samson/

[41] https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-generation-and-markets/electricity-market/electricity-industry/

[42] https://www.mbie.govt.nz/building-and-energy/energy-and-natural-resources/energy-statistics-and-modelling/energy-statistics/renewables-statistics/

[43] https://www.mpi.govt.nz/funding-rural-support/environment-and-natural-resources/climate-change-primary-industries/

[44] https://www.newsroom.co.nz/a-bugger-of-a-levy-on-utes

taxation is too aggressive the market will likely hunt out more economically favourable alternatives.[45]

3.4 c. to identify risks to users and traders of crypto-currencies.

3.4.1 Risk is a nuanced topic. It is objective, subjective and relative.

Inflation risk

3.4.2 Some, for example, might see enormous risk holding their capital in traditional fiat currencies. Others may see holding New Zealand dollars as less risky than holding, say, Turkish lira.

3.4.3 As this Reuters article highlights, if you live in Venezuela, where the local economy is in regression and mired by hyperinflation and sanctions, you may view crypto as a safe harbour.

3.4.4 Fortunately for us, we live in New Zealand. Bank depositers have not been subject to confiscation of their savings like citizens in Cyprus, or harsh capital controls restricting citizens from moving their funds, like those in Greece.[46] That said, RBNZ statistics show that consumer price index or 'CPI' inflation and house price inflation has spiked in 2021. There is currently significant news media focus on house price inflation.[47]

3.4.5 Globally, negative yielding bonds present large challenges for retirement funds.[48] Savers rates of return on their bank deposits are increasingly falling. A devaluation of purchasing power via inflation is a problem for those of all ages and cultures. It blows first home buyers out of the market and puts retirees at risk. Lack of certainty in the future as to what the dollar you hold today will be worth tomorrow, leads to more speculative investments. It also brings predatory actors.

User error

3.4.6 Most will be familiar with the expression 'not your keys, not your coin'. If you are using a non-custodial wallet, loss of keys or seed phrase will likely be a total loss. As this New York Times article notes, tens of billions worth of bitcoin have been locked by people who forgot their keys.

3.4.7 Because many new to the space will not be technically savvy, some will find it more practical not to be responsible for their own private keys / seed phrase and will prefer to entrust their crypto custody to others, e.g. a centralised exchange to hold coins. These users might not appreciate that their crypto is pooled rather than held in a

[45] The migration of Chinese bitcoin miners to Texas as discussed in this article is a perfect example: Why China's crypto cowboys are fleeing to Texas - Rest of World

[46] https://cointelegraph.com/news/how-the-greece-debt-crisis-showed-the-world-that-bitcoin-is-a-store-of-value

[47] For example BNZ's Stephen Toplis says house price inflation must fall and house prices could too. Supply growth exceeds demand growth and property returns are under pressure. He says the construction boom will moderate | interest.co.nz

[48] https://www.ft.com/content/1fdf201b-ed47-4e1a-b5ff-098310db8bc2

separate wallet and that this could have dramatically different consequences if the centralised party becomes insolvent.

Hacking / security breach

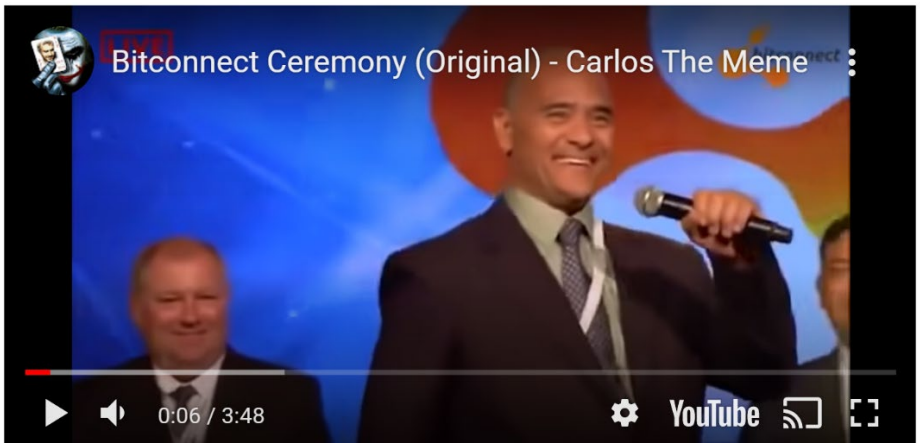
3.4.8 Hacking / cybercrime presents a major risk to individual users (e.g. by malicious code on their device or lax security practices such as allowing someone else to view their seed phrase).

3.4.9 It also presents a major risk to protocols (e.g. The DAO)[49] and exchanges (e.g. MtGox). In relation to the latter, New Zealand exchanges Cryptopia and Bitcoinica were both subject to hacks. As this NZ Herald article discusses, Bitcoinica was subject to more than one hack. Not only was Bitcoinica directly attacked but it had accounts with MtGox which was also hacked.

3.4.10 This NZ Herald article discusses the New Zealand police being hacked by the criminals they were investigating for money laundering. This resulted in the loss of $45,000 in tax payer bitcoin. Examples such as this highlight the need for not just individual users, but also corporates and government entities, who are dealing with crypto, to ensure they have robust security in place.

Scams

3.4.11 Another classic example of user risk are scam projects. Perhaps the most iconic is BitConnect:



https://www.youtube.com/watch?v=ICcwn6bGUtU&t=3s

3.4.12 As this article discusses, the Bitconnect Ponzi scheme, which launched via an ICO in late 2016, at one point boasted a market cap of over $2.6b and was one of the best performing cryptos in 2017. It used an army of multi-level affiliate marketers to recruit new investors, who would recruit their own new investors and so on. One of its promoters recenty pleaded guilty to charges brought by the United States Securities Exchange Commission ('**SEC**').[50]

[49] https://cointelegraph.com/ethereum-for-beginners/what-is-dao

[50] https://ct.com/9wn4

3.4.13 A recent example from Australia shows how fertile the space is for possible scams via social media.

3.4.14 Those familiar with the ICO boom at the peak of the last Bitcoin bull cycle, will recognise that the market is becoming 'frothy' when celebrity endorsements start appearing. The Committee may recall this article from The Spinoff which mentions hotel heiress Paris Hilton's foray into crypto 'shilling'. According to coingecko.com, the crypto that Miss Hilton was promoting 'LydianCoin (LDN)' is no longer active.

3.4.15 Boxer Floyd Mayweather, who was mentioned in the Spinoff article, and musician DJ Khaled have both recently settled charges against them brought by the USA securities regulator, the SEC, for failing to disclose payments they received for promoting investments in ICOs.

3.4.16 As discussed in this Twitter thread the user had their crypto stolen via a bad link shared in a social media group:

Platform / investment risk

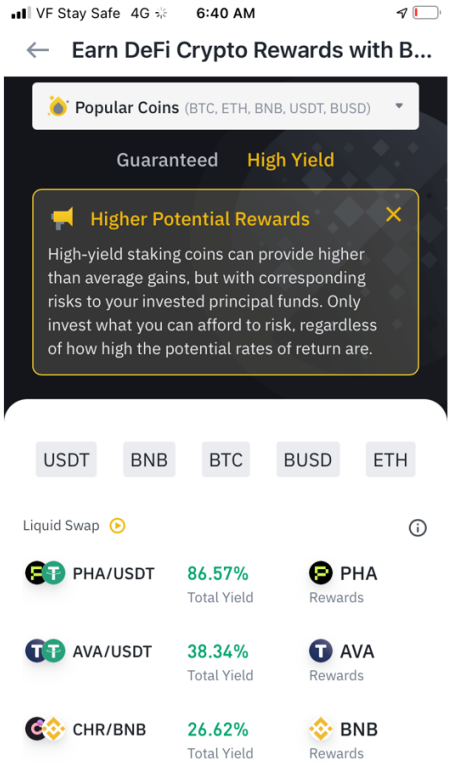
3.4.17 As centralised finance ('**CeFi**') and decentralised finance ('**DeFi**') crosses over with traditional banking, it is important that consumers especially, in their hunt for yield on their savings, take care to understand the risks around these different platforms.

3.4.18 UK regulators have recognised the challenge that exchanges like Binance, the world's largest cryptocurrency exchange platform, present.[51] Thailand's Securities and Exchange Commission has filed a criminal complaint against Binance for illegally operating a digital asset business without a licence under Thailand's Digital Asset Businesses Decree.[52]

[51] https://www.internationalinvestment.net/news/4036298/uk-financial-watchdog-admits-binance-supervised

[52] https://www.reuters.com/technology/thailand-sec-files-criminal-complaint-against-crypto-exchange-binance-2021-07-02/

3.4.19 Earning, for example, 86.57% APY yield on a PHA/USDT 'liquid swap' via Binance Earn, is probably instantly attractive to many over the 0.05% annual interest they can get on their savings in one of New Zealand's larger banks.



3.4.20 Binance's platform is commendable in the sense that it has comprehensive crypto educational resources via its Binance Academy.[53] The app also puts in place warnings and hurdles for riskier offerings such as liquid swaps to protect users (and probably also the humans behind the protocol).

3.4.21 However, consumers and institutions alike should be aware that there are a range of platforms that provide comparably 'less risky' ways for them to make yield on their crypto than the High Yield options on Binance Earn. For example, CeFi 'crypto banks' like BlockFi, Celsius, and Ledn, and DeFi platforms like Aave and Compound. Many of these offer users the ability to earn interest on their crypto and / or obtain loans in fiat money using their crypto as security. Many platforms require that the loans are 'over capitalised' (i.e. the amount of crypto required to be deposited exceeds the value of the fiat loaned).

3.4.22 However, while each CeFi and DeFi platform differs, they still have a host of risks (including total loss or 'liquidation' of the crypto offered as security for the loan if its value was to drop and the borrower was unable to post additional crypto as security).

3.4.23 Again, market participants require education. They should do their own research to try and understand these risks, and governments, corporates, professional advisers and journalists need to assist them. For example, some platforms are 'custodial' –

[53] https://academy.binance.com/en

i.e. the platform operates the wallet and the customer simply has an 'IOU' debt claim. The customer could therefore stand to lose significantly in the event of insolvency if the platform was unable to repay the IOU. Whereas other platforms are 'non-custodial', and at all times the 'deposited crypto' remains in the customer's own wallet. Different platforms also take different types of risk with their lending (e.g. some will only lend to large institutions). Some are licensed and regulated in other jurisdictions, and others are not. Unlike traditional banks these crypto banks (unless they are operated by a New Zealand entity) are probably unlikely to be covered by New Zealand's proposed bank insurance scheme which will provide some protection for savings depositors.

3.4.24 The challenge for regulators is to facilitate risk taking for those that have educated themselves and understand the risks, because this can drive innovation and economic growth, while at the same time protecting those less initiated. Indeed, this is a stated purpose of our Financial Markets Conduct Act 2013 ('**FMC Act**').

3.4.25 If a person wants to take risk gambling on Lotto or horse racing, they can. The odds are often more likely than not that they will lose all their money. That is why gambling is regulated under the Gambling Act 2003 ('**Gambling Act**').

3.4.26 Similarly, crypto market participants shouldn't be unreasonably restrained from taking risks with their capital. Otherwise they will find a potentially riskier internet workaround. If a market participant wants to spend their money, e.g. on a lucky dip bundle of NFTs collectibles - in some ways analogous to buying a pack of professional wrestling cards in the 1980s or All Blacks collector cards as people do today - then they should be able to. If a New Zealand operated platform offers the same, they will potentially need to comply with the Gambling Act and the other legislation that we discuss below. If the platform is not New Zealand domiciled, then consumers need to understand the risks.

3.4.27 While we can understand the reason for 'wholesale investors' and 'eligible investors' categorisations under the FMC Act, given the rise of CeFi and DeFi and the global access to opportunity it presents, we wonder whether these categorisations should be reconsidered to allow more New Zealand investors with access to New Zealand regulated projects with less red tape for those projects.

Volatility

3.4.28 A key risk in crypto markets for uninitiated investors is volatility. This investopedia page regarding bitcoin's price history shows how volatile the 'king of crypto' is. This is due to a range of factors. The smaller the market cap of a crypto typically the riskier and more volatile it is. However, for traders, volatility is their lifeblood. Again, the focus should be on education.

3.4.29 The Committee might recall news coverage regarding Elon Musk's tweets about bitcoin and dogecoin causing volatility in the markets. This article highlights challenges for regulators in relation to these matters.

Regulatory risk

3.4.30 As highlighted in our client mining example above, uncertainties regarding the law hamper New Zealand's economic growth. Businesses want to get 'rug pulled' by the Government as little as investors do by new crypto project developers. The recent

restrictions put in place on tech company Didi by the Chinese Government immediately after its IPO, crashing its share price for investors, is an example.[54]

3.4.31 Entrepreneurs, including games developers who create play to earn products that leverage crypto (e.g. Axie Infinity and Ruby Play Network), or digital artists making NFTS and leveraging social media to sell them, need to be able to understand the law without being drowned in legalese, regulatory red tape and cost.

3.4.32 Ths coindesk article, which discusses crypto and freedom of speech, notes:

> "Regulators tend to view virtual currencies monolithically, treating cryptocurrencies like bitcoin no differently from centralized projects that share little in common with it. As a result, the federal government and many states define "virtual currencies" in such broad terms that anyone dealing in them is required to obtain a license and keep records about their customers."

It goes on to say:

> "At its most basic level, Bitcoin is a protocol by which like-minded participants across the world maintain a public truth. Nodes maintain a record of that truth and miners work to ensure the record is accurate. Anyone can join Bitcoin's network and the software needed to do so is freely available.
>
> That is not to say Bitcoin cannot be regulated, but that efforts to do so likely must meet the high standard applied to the deprivation of constitutional rights and that subordinate guarantees such as the right to associate anonymously may be implicated."

3.4.33 Over-regulation in New Zealand could raise similar issues in relation to our New Zealand Bill of Rights Act 1990 and Human Rights Act 1993.

3.4.34 Central bank digital currencies or 'CBDCs', which are blockchain based virtual currencies issued by central banks, differ from decentralised protocols, because they are by their nature centralised. While they do have the potential to simplify the implementation of monetary and fiscal policy, and promote inclusion by bringing unbanked to the financial system, some may be sceptical of the benefits that CBDCs present given the potential for loss of privacy and confiscation.[55] However, that does not mean the two cannot co-exist, or indeed, operate alongside traditional cash money.

[54] https://www.forbes.com/sites/richkarlgaard/2021/08/15/the-bigger-picture-behind-chinas-tech-crackdown-ambition-to-achieve-tech-supremacy/?sh=c81f0bfee77d

[55] See for example this article: https://www.cato.org/blog/chinas-digital-yuan-threat-freedom

Director / professional liability risk

3.4.35 With corporate giants like Tesla holding significant sums of crypto on their balance sheet, and others inevitably following suit, issues of director liability for doing so or not doing so arise.

3.4.36 Some have even posited that with purchasing power decreasing, and bond yields trending downwards, not having any crypto in a portfolio or on the balance sheet could present professional liability risks for financial advisers.

3.4.37 According to this coindesk.com article there is a lacuna in the insurance market in relation to crypto, in part due to a lack of education. It notes:

> Third, I've been told that some members of the insurance industry do not understand cryptocurrency and tend to dismiss it as being a scam or too risky to insure. A colleague recently related a story where he spent almost an hour debating with an insurance broker about why Bitcoin is not a Ponzi scheme.
>
> My hope is that as crypto enters the mainstream we will see critical industries, such as insurance, better understand and warm up to the technology. Ideally, as a crypto corporation commences operations, it will have an adequate D&O insurance policy in place. But in the absence of a proper D&O insurance policy, crypto entrepreneurs can still mitigate their risks via a properly drafted set of corporate bylaws or an indemnification agreement.

Tax and debanking risk

3.4.38 For crypto traders, AML / KYC and the possibility that banks will remove their access to their fiat money and the legacy banking system is a significant risk. While we appreciate why AML legislation is required (movement of illicit funds facilitates further criminal activity) if controls are too rigid this could unreasonably restrict legitimate market participants.

3.4.39 If, for example, a sophisticated day trader, even one allocating only a small portion of their portfolio to trading crypto, cannot access traditional banking because the banks do not understand or too officiously apply the law, how are those parties who may have traditionally been good tax paying citizens able to meet their tax obligations (given tax liabilities in New Zealand cannot be settled in crypto because it is not legal tender)?

3.4.40 As we discuss further below, a lack of knowledge of tax law or an inability to pay for legal or accounting tax advice, is likely to present a real risk for creatives and gamers utilising NFTs and the token economy.

3.4.41 Sims et al also discuss at length how New Zealand businesses that trade or otherwise deal in crypto have lost their banking services, as has occurred in Australia. One reason given by the banks is that the banks are concerned that they would not comply with their AML/CTF obligations. Sims' and her co-authors' recommendation, in this regard, is that crypto exchanges and blockchain businesses that comply with AML/CFT and other requirements must have access to bank accounts with New Zealand banks.[56] Blockchain Australia also sees 'debanking' as an area of concern.

[56] https://www.lawfoundation.org.nz/wp-content/uploads/2018/09/Sims-et-al-ILAPP-Cryptocurrencies-Findings-Final-Report-Sep2018.pdf , see e.g. pg 123 – 126, and 128 - 129.

4. (2) to identify the risks crypto-currencies pose to the monetary system and financial stability, including tax implications, in New Zealand

4.1 We have already addressed several risks to market participants throughout this paper. We do not repeat them in this section. However, we make the following further comments.

4.2 Crypto markets are still reasonably nascent. As market capitalisation continues to grow, as more sophisticated parties enter, with growth and maturity of derivatives markets, access to insurance grows, and there is greater clarity around the law via guidance from regulators and court judgments, we anticipate that volatility should reduce, at least for the more established and larger market cap cryptos such as BTC and ETH. Newer projects of lower market cap will continue to be volatile as they are further out on the risk curve.

4.3 One could make the argument that over-regulating crypto (i.e. internet money) poses a risk to the monetary system and financial stability in New Zealand, in the same way over-regulation or censorship of the internet tends to result in negative outcomes. For further on the economic and social benefits of internet openness see this World Bank clip and this comprehensive OECD paper.

4.4 In our submission:

> *If New Zealand regulation of crypto is accommodating, then market participants will hunt out opportunity. The fact it is difficult or impossible to regulate foreign platforms like Binance or OpenSea, or DEXs with no obvious domicile or board of directors, only highlights the need for moderately regulated New Zealand exchanges and other crypto related businesses, that facilitate the demand in this market. This provides better protection for consumers and our financial system.*

4.5 To the extent that CBDCs are treated as falling within this category (even though they are not comparable to other crypto protocols such as Bitcoin), the Committee should also consider the section on CBDCs in Sims, Kariyawasam, and Mayes's paper, Regulating Cryptocurrencies in New Zealand.

5. (3) to establish how crypto-currencies are used by criminal organisations

5.1 This is a topic of much debate. This article addresses the arguments for both sides.

6. (4) to establish whether means exist to regulate crypto-currencies, either by sovereign states, central banks, or multi-lateral co-operation

6.1 Is crypto regulated in New Zealand?

6.1.1 The FMA website guidance for investors - Cryptocurrencies | FMA says that cryptocurrencies are not regulated in New Zealand. Specifically, it says:

> "Cryptocurrencies are not legal tender (money that must be accepted as payment) in most countries and do not exist physically as notes and coins. They are also not viewed as financial products so are not regulated in New Zealand. There are over 4000 different cryptocurrencies available on the internet including Bitcoin, Ethereum and Litecoin to name a few."

6.1.2 This is true for truly decentralised protocols like Bitcoin which have no centralised management or governance structure, such as a CEO, board of directors, or trustees.

6.1.3 This is a lot for some people to get their heads around – i.e. that there is no central party to deal with if things go wrong. Unlike a bank, where you can get a new password, or can possibly have a transaction reversed if it was made in error or was fraudulent, if you lose your private key or seed phrase or transfer crypto to the wrong wallet / public key, that's it. There's no call centre to call for assistance and, in most cases, no way to reverse the transaction.

6.1.4 An absence of regulation is also possibly true for those platforms that are headquartered overseas but can be used by New Zealanders, e.g. a centralised exchange like Binance that operates globally via the internet. We have already noted the UK regulator's difficulty in this regard.

6.1.5 However, people investing in crypto and building and operating crypto businesses in New Zealand that affect New Zealand based market participants still need to comply with all relevant NZ laws on an ongoing basis. In this regard there is comprehensive regulation.

6.1.6 According to the FMA guidance Cryptocurrencies - Compliance | FMA, which is a helpful starting point for any crypto business, the key acts that apply to ICO's (and therefore probably IEOs and IDOs) are:

(a) the FMC Act;

(b) the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 ('**AML/CFT Act**'); and

(c) the Financial Service Providers (Registration and Dispute Resolution) Act 2008 ('**FSP Act**'),

6.1.7 However, because crypto is property, there are several other acts that potentially apply including:

(a) **Financial advice** – Financial Advisers Act 2008 ('**FA Act**');

(b) **Tax** - As we discuss in our crypto tax articles, these include:

(i) the Income Tax Act 2007; and

(ii) Goods and Services Tax Act 1985;

(c) **Consumer protection** laws such as:

(i) the Fair Trading Act 1986 ('**FTA**'); and

(ii) Credit Contracts and Consumer Finance Act 2003;

(d) **Crime** - Criminal activity is of course covered under the Crimes Act 1961;

(e) **Company law** - the Companies Act 1993, among other things, requires directors to act in the best interests of a corporation and discharge their duties for a proper purpose. The Property Law Act also has provisions relating to dealings with intention to defeat creditors;

(f) **Overseas investment** – the Overseas Investment Act 2005 potentially applies to real estate purchases, e.g. in relation to a bitcoin mining business, if parties interested are overseas persons;

(g) **Trusts law** – Trusts Act 2019 might apply if the crypto has been acquired or invested by, for example, an individual on behalf of a company.

6.1.8 For an in depth analysis of crypto regulation in New Zealand see the aforementioned paper by Sims, Kariyawasam, and Mayes, Regulating Cryptocurrencies in New Zealand, and the New Zealand chapter of The Virtual Currency Regulation Review, by Deemple Budhia and Tom Hunt.

6.2 Regulation under the FMC Act and FSP Act

6.2.1 A key point for consumers and crypto businesses to be aware of, and a real challenge for regulators, is that because crypto is technology it can evolve over time. A crypto which starts one way may be a different one in 12 months.

6.2.2 If the crypto business is an ICO, IEO or IDO (i.e. taking money in exchange for tokens as a means of fund raising), it is reasonably safe to assume it could be offering financial products or a financial service.

6.2.3 In summary, how a particular crypto or business is regulated under the FMC Act and FSP Act depends on:

(a) whether the investor is based in New Zealand or overseas (i.e. is it an offer in New Zealand) – it is less likely to be regulated if investors are not based in New Zealand or New Zealand investors are excluded from the offer;

(b) whether the person buying the crypto is a member of the general public (i.e. a 'retail investor') or an experienced investor (i.e. a 'wholesale investor') – More onerous obligations apply to retail investors / exceptions apply to wholesale investors;

(c) whether the crypto is a 'financial product' (also known as a 'security token') – not all are, although the FMA can declare a particular token to be if it decides to;

(d) whether the party offering the crypto is in the business of providing a 'financial service'.

6.2.4 If individuals or businesses are uncertain, then guidance should be sought from a lawyer with expertise in crypto and / or the FMA. We understand that the FMA's approach in relation to crypto has been reasonably collaborative. However, some concepts are not well understood and to some extent there seems to be a desire to fit 'square pegs' into 'round holes'. The same is probably true of the IRD.

Types of financial products

6.2.5 In general, issuers of financial products under the FMC Act must comply with various fair dealing, disclosure, governance and operational obligations (with certain exceptions). The four categories of financial products are:

(a) debt securities (a right to be repaid money or interest, e.g. debentures, bonds, notes and certain derivatives);

(b) equity securities (e.g. shares);

(c) managed investment products (any scheme where participating investors contribute money to acquire an interest in the scheme, interests are rights to particpate in or receive financial benefits produced by others, and the participating investors do not have day to day control of the operation of the scheme); and

(d) derivatives (an agreement where certain defined conditions are satisfied).[57]

6.2.6 There are different requirements for each type of financial product.

6.2.7 However, the FMA has the power to make any other 'securities' as considered necessary subject to the FMC Act (i.e. designate them as 'financial products'). A 'security' is defined as '*an arrangement or a facility that has, or is intended to have, the effect of a person making an investment or managing a financial risk*'. This is deliberately very broad.

6.2.8 Some crypto will already be, depending on their features, debt securities, equity securities, managed investment products, or derivatives. For example, a 'stablecoin' or some other form of asset backed crypto could well be a derivative.

6.2.9 However, because, many tokens issued in an ICO, IEO or IDO are capable of falling outside the four discrete categories that are defined, this makes the FMA's designation power particularly relevant. Potentially even a DAO could be classed as a financial product and subject to the FMAs control under the FMC Act.[58]

[57] https://www.fma.govt.nz/compliance/role/derivatives-issuers/

[58] See, Fry, E, *Blockchain Innovation and Securities Regulation, An Analysis of Initial Coin Offerings under the Financial Markets Conduct Act 2013*, October 2017 *otago698328.pdf

Requirements for financial products

6.2.10 If a crypto is a financial product, and the token is offered to retail investors in New Zealand, the offer is likely a 'regulated offer'. If so, there are several requirements for party issuing the token to meet under the FMC Act including:

(a) **Disclosure** – the offeror must provide a product disclosure statement ('**PDS**'). There are highly prescribed and may not be practical for some projects;

(b) **Governance** – if the crypto is a debt security or managed investment product, the offeror will need to appoint an independent supervisor operating under a trust deed – this is likely to present real difficulties for DAOs which, by their nature, have no centralised governance or management;

(c) **Licensing** – if the token is a debt security, managed investment product, or derivative, a licence for the issuer will be required from the FMA or the RBNZ;

(d) **Financial reporting** – including registering publicly available audited accounts – again this presents a practical issue for a DAO.

6.2.11 As can be seen, the requirements vary depending on what type of financial product the project is classified as.

6.2.12 While FMA's designation power is important, an equally significant power that the FMA possesses is the power to exempt any person or class of persons, or any transaction or class of transactions from compliance with certain obligations under the FMC Act (meaning that e.g. if the crypto fell within the definition of a managed investment product, but this was not practical, e.g. because it was a DAO, the FMA could treat it as an equity security removing the need for an independent supervisor).[59]

6.2.13 As a general comment, we believe that some form of prescribed disclosure for retail investors is desirable so that they have a better chance of understanding their rights and the risks involved. Similarly, a standardised form of agreement, such as the 'simple agreement for future tokens' of 'SAFTs' which are being used in the USA, could reduce cost of compliance in relation to wholesale investors.

Fair dealing requirements

6.2.14 In most cases, consumers and other market participants are protected by fair dealing requirements under both the FMC Act and the FTA. These prevent misleading and deceptive conduct, such as false or unsubstantiated statements in a white paper, or misleading representations or omissions in relation to a wallet, exchange, token or game.

6.2.15 If a PDS is required, the PDS will need to be updated as the project evolves to avoid it becoming misleading.

[59] https://www.fma.govt.nz/compliance/exemptions/

Financial services

6.2.16 According to the FMA's guidance key crypto activities considered 'financial services' include exchanges, wallets, deposits, broking and ICOs.

6.2.17 If financial services are provided to persons in New Zealand and the FSP Act applies, that entity must be registered on the Financial Service Providers Register ('**FSPR**'). Furthermore, if you provide crypto-related financial services in the ordinary course of your business, you will likely be captured as a 'financial institution' and will have obligations under the AML/CFT Act.

6.2.18 **Exchanges** - In relation to exchanges the FMA guidance notes:

> "Exchanges issuing their own cryptoassets to facilitate trading fall within the financial service category of 'issuing and managing means of payment'.
>
> Exchanges allowing cryptoasset trading fall within the financial service category of 'operating a value transfer service'."

6.2.19 **Wallets and custodians** - The FMA guidance states that wallet providers who store crypto and facilitate transfers between exchanges may also be 'operating a value transfer service'. If the project provides safe keeping or administration services in relation to crypto, it might be providing the financial service of 'keeping, investing, administering, or managing money, securities, or investment portfolios on behalf of other persons'.

6.2.20 **Brokers** - Similarly, persons who receive crypto which are financial products and hold, pay, or transfer the tokens to others may be providing a 'broking service' and have obligations under the FA Act.

6.2.21 **Promoters** – Persons providing investment opportunities in crypto (e.g. via a derivatives issuer providing crypto options or via a managed investment scheme investing in cryptoassets), are regulated in the same way as if those persons were providing investment opportunities in traditional assets or financial products.

6.2.22 **Advisers** – an individual or entity advising in relation to crypto will likely be providing a financial advice service and will need to be registered on the FSPR. Anyone who gives regulated financial advice to retail clients must either hold, or operate under, a Financial Advice Provider ('**FAP**') licence issued by the FMA.

6.3 Is the existing legal framework fit for purpose?

6.3.1 This is not a straightforward issue.

6.3.2 Published guidance from the FMA and IRD is certainly helpful. But we question whether this guidance goes far enough or is it in a form that will resonate with the market. People consume information differently in the digital age. More educational content is certainly encouraged.

6.3.3 Without court judgments, crypto specific legislation, or clearer guidance, will, for example, the average New Zealander understand that they could trigger a tax liability if they transfer some of their crypto to a family member for their birthday or Christmas? Will they know they may have a tax liability for capital gains if they converted some of their BTC to ETH in order to buy an NFT even if they never converted their crypto back into NZ dollars?

6.3.4 Will a conveyancing lawyer know where to start if a vendor wants to accept payment in crypto? Will a relationship property lawyer know what questions to ask of a crypto savvy spouse for their non crypto savvy client? Will they know how at a practical level this form of property can change hands? Do they know what steps can be taken to mitigate risk to properly protect their clients and promote their interests?

6.3.5 Does an investor or business know how to deal with crypto in terms of asset succession planning? Is an executor going to have the first idea what a Phantom wallet is and how to access it if one is mentioned in the will?

6.3.6 We expect many digital artists, entertainers, game developers, and the lawyers advising them, won't necessarily appreciate that they / their clients could be providing financial products or services if they involve themselves with crypto projects.

6.3.7 It is also safe to assume that the average New Zealand 12-year-old gamer, or their parents who let them use their credit card for in-game purchases, will not appreciate that they could have tax liabilities for trading tokens within a game, e.g. to get a new costume for their avatar. The need for clarity in, for example the tax treatment, of games like Axie Infinity, highlight why a safe harbour may be beneficial. For example, how will the gamer and the IRD deal with multiple transactions involving different tokens, where the gamer trades different characters and land within the game? As this article notes, players can breed and battle Axies, purchase land, as well as complete quests and farm resources. Is the gamer going to know they may be engaging in a 'profit making scheme' according to the IRD's tax guidance?

6.3.8 Similarly, most people wouldn't know that they do not necessarily acquire the copyright in the image when they purchase an NFT. What rights does an artist have against someone who mints an NFT of their original artwork without their permission?

6.3.9 Many New Zealand celebrities and influencers, some of whom have enormous followings on social media, who might be promoting their new favourite 'meme coin', or NFTs, wouldn't realise they could be seen as providing financial advice or promoting financial products. Nor will most of their followers.

6.3.10 Would an artist experimenting with new digital media, as you would expect creatives to do, minting their art as NFTs and selling them, perhaps via their website in conjunction with Instagram or Facebook, understand that they could be viewed as operating an exchange selling products regulated by the FMA? Would even a global auction house appreciate that they could be violating NZ law if the product being sold was available to New Zealanders to purchase?

6.3.11 Would, for example, a two person start-up being built university students, know that their project could potentially be viewed by the FMA as a managed investment scheme (and therefore need to be licensed and have a supervisor) if they do not have the capital to, say, access the former Solicitor General as chairman? Most start-ups have negligible start up capital and hence the explosion of interest in crypto funding.

6.3.12 Given the broad wording used in the FMA guidance it is easy to see how an officious regulator could take a heavy-handed approach. However, most people would not automatically think to classify a digital artist's website as an exchange. Likewise, if a game has a 'wallet' the developer may not appreciate that they are providing a 'value transfer service' and need to be registered on the FSPR.

6.3.13 Likewise, other social platforms such as Telegram, Signal and Discord are commonly used to promote new crypto offerings within their online communities. Regulating these platforms, where the users can operate with pseudonyms, avatars, and from unknown locations possibly via VPN, might be an insurmountable challenge logistically for regulators. That said, bad actors have existed for ever. Fraud is still

fraud. FMC Act covers fair dealing. The FTA covers misleading and deceptive conduct in trade. Companies Act and Property Law Act have provisions to unwind transactions made with intention to defeat creditors.

6.3.14 Examples like Cryptopia and MtGox highlight how crypto also presents new challenges for insolvency practitioners, such as how to recover digital assets and how to secure them against hacks, how to verify creditor claims, and how to manage 'forked' assets etc.

6.3.15 The beauty of open blockchain ledgers is that regulation of even sophisticated crypto derivatives trading isn't impossible. The recent acquisition by crypto exchange FTX.US of CFTC-regulated derivatives platform LedgerX is an example. This CNBC interview discusses the LedgerX acquisition and regulation of crypto in the USA.

7. Conclusion

7.1 The way forward

7.1.1 For the above reasons, as noted in our overall submission, we agree with Blockchain Australia's recommendations. We also endorse the recommendations of the authors of Regulating Cryptocurrencies in New Zealand.

7.1.2 Some points made by Blockchain Australia that we support in particular are:[60]

> "The role of good regulation is to support business, encourage innovation and ensure that consumers are protected. Regulation should not be so burdensome that it becomes unwieldy and expensive to comply with. Well designed regulation should solve these problems with as little friction as possible. We should not attempt to fit these new square pegs into our existing regulatory round holes."
>
> …
>
> "regulatory uncertainty remains an issue that is inhibiting the widespread uptake of blockchain and distributed ledger technology."
>
> …
>
> "A clear regulatory framework brings symbiotic benefits to both consumers and businesses…
>
> Globally there is a race to regulate crypto-assets as countries seek to attract new business, investment and talent. While overregulation, or regulation that is not fit-for-purpose, can introduce unnecessary friction and costs, regulatory uncertainty also results in significant costs from lost opportunities as well as high levels of expenditure on legal and compliance advice."

[60] https://blockchainaustralia.org/senate-select-committee-submission-on-australia-as-a-technology-and-financial-centre/

7.1.3 Anecdotally we have heard of businesses spending many millions of dollars to bring their crypto product to market. Most businesses in New Zealand are SMEs and cannot handle such a cost outlay.

7.1.4 Similarly, while some of our individual crypto investor clients may have made eye watering gains in recent times, a $2,000 fee to the IRD for a short process ruling, plus costs of legal and accounting advice and assistance relating to the same, will be cost prohibitive and a disincentive for many, particularly if they have been adversely affected by e.g. the current COVID environment or a bearish change in crypto markets.

7.1.5 Cost and complexity are major barriers to compliance. A welcoming approach to tax, with safe harbour rules or even with an incentives-based model (e.g. wiping penalties, discounts in total tax, no-capital gains tax up to a certain limit, or even token drops of NZDs or some other crypto for e.g. disclosing wallet information), we believe will result in better tax compliance. Look how people have adopted platforms such as Netflix and Spotify, moving away from others like Napster and Limewire, once the cost was reduced via rights holder participation and user access was improved.

7.1.6 In terms of overseas investment opportunity, one client interested in New Zealand renewable energy for Bitcoin mining wants to understand the regulatory landscape and risks, e.g. around possible levies or restrictions due to environmental concerns. A lack of clarity in the law or any incentive to invest (e.g. favourable tax treatment) could see the opportunity leave New Zealand. While regulatory uncertainty brings opportunity for us lawyers, we would have no objection to a clearer regime that increases opportunities for New Zealand generally.

7.2 Further assistance

7.2.1 We thank the Committee for considering our submission. We are available for consultation or to present and answer questions in relation to our submission if that would assist the Committee.