



Response to the Treasury's Consultation Paper: Payments System Modernisation (Licensing: Defining Payment Functions)

19th July 2023

Payments Licensing Unit

Financial System Division

The Treasury

Langton Crescent

PARKES ACT 2600

Dear Director,

Blockchain Australia welcomes the opportunity to respond to the Treasury's consultation paper, *Payments System Modernisation (Licensing: Defining Payment Functions)*, published in June 2023. We encourage the government's continued efforts to ensure Australia's payment infrastructure remains fit for purpose by increasing its resilience and ability to embrace new forms of payment, including blockchain-enabled products and services.

In responding to this consultation, Blockchain Australia on behalf of its members seeks to ensure that any changes enacted by government support the following objectives:

- Provides a level playing field for fintechs, start-ups and home-grown businesses.
- Encourages innovation and facilitates the adoption and use of tokenised assets and blockchain infrastructure; including by providing pathways to licensing and by seeking to minimise policy uncertainty.
- Provides appropriate consumer protection that is proportional, effective and risk-based.

We would welcome the opportunity to meet with the Treasury to discuss the matters raised in our submission.

Please direct all queries to:

Simon Callaghan

Chief Executive Officer

Blockchain Australia

c/o Hall & Wilcox

L 11 South Tower, Rialto

525 Collins Street, Melbourne VIC 3000



ABOUT THIS SUBMISSION

In this submission, we focus our comments and recommendations on the issues that are most relevant and unique to Blockchain Australia's members, particularly with respect to 'payment stablecoins.' In Australia and around the world, policy questions are being explored in relation to the unique challenges and opportunities posed by payment stablecoins. We are pleased to make a leading contribution to this discourse. We note that Blockchain Australia has also responded to the Treasury's related recent consultation on *A Strategic Plan for the Payments System*, in February 2023. Our submissions are publicly available for viewing at <https://blockchainaustralia.org/submissions/>.

This submission has been prepared in close consultation with Blockchain Australia's members. We thank our members for their inputs to this process, which have formed the basis for the Policy Recommendations contained within.

The growing importance and relevance of stablecoins

Payments are arguably one of the most popular and important services to emerge from the blockchain and digital asset sector, with stablecoins and CBDCs offering programmability, modularity, and enhancing competition and choice for consumers. They now represent a material portion of digital assets with \$140b in stablecoins in circulation today. Fiat-backed stablecoins represent 91.7% of this amount, and nearly all are pegged to the U.S. dollar. (Coinbase Institute Stablecoins Whitepaper July 2022

<https://assets.ctfassets.net/c5bd0wqjc7v0/79db1PxjBTv1JbL574fFvA/dc38c8c96dc97c3752fd81a61d0f134a/CBI-StablecoinWhitepaper-July-2022.pdf>).

As well as being used in crypto trading, both institutional and public stablecoins are utilised (especially in cross-border transfers) for their almost-immediate, intermediary-free, 24/7 transfers which often involve lower fees.¹ Further, due to being programmable and composable, stablecoins have also become an indispensable component of decentralised finance (“DeFi”) markets. This is because dollar stablecoins have enabled investors to generate yield on their crypto assets without being negatively impacted by market volatility. In 2022, stablecoins facilitated a record high total settlement volume of \$7.4 trillion, surpassing all major credit card providers except for Visa (<https://thedefiant.io/stablecoin-volume-hits-record-high-of-7-4t-in-2022>).

As a result of these benefits, stablecoins have experienced periods of rapid growth, which also accelerated links between traditional finance and the crypto ecosystem. However the involvement of large financial institutions in areas like reserve management, custody, and issuance has the potential to rapidly generate new risks. Higher volatility correlation has been observed between stablecoins and stock markets, especially during recent market stress periods.² Without proper regulation, contagion risks between traditional finance and the crypto ecosystem will increase.

On this basis, the Policy Recommendations contained within this submission have a strong focus on consumer protection, while also acknowledging the reality of the challenges faced. We also include international policy benchmarks, specifically the European Union (EU) and the Bank for International Settlements (BIS). We further note that the Financial Stability Board (FSB) released its [Final Report](#) on “High-level Recommendations for the Regulation, Supervision and Oversight of Global Stablecoin Arrangements” on 17 July 2023.

¹ Liao, Gordon Y. and John Caramichael (2022). “Stablecoins: Growth Potential and Impact on Banking,” International Finance Discussion Papers 1334. Washington: Board of Governors of the Federal Reserve System, <https://doi.org/10.17016/IFDP.2022.1334>.

² International Monetary Fund Fintech Notes - Regulating the Crypto Ecosystem: The Case of Stablecoins and Arrangements (<https://www.imf.org/-/media/Files/Publications/FTN063/2022/English/FTNEA2022008.ashx>)

Policy Recommendations

1. Access to Banking

A priority for the Australian blockchain sector is to ensure that legitimate businesses, including stablecoin issuers, have reliable and consistent access to banking services.

To achieve this, we propose to grant the option of provisioning RBA accounts and services to stablecoin issuers, in order to support competition, and to mitigate any potential conflicts of interest for issuers relying on ADIs for access to banking.

We note the work that is already underway on de-banking, including the “Government response to Potential Policy Responses to De-banking in Australia” published on 28 June 2023, and we urge the Government to maintain energy and focus on this matter.

2. Policy Framework & Regulatory Perimeter

2A – Scope of regulations and industry self-regulation

- We agree with the proposal to define a policy framework and regulatory perimeter specifically designed for payment stablecoin issuers. We encourage the Treasury to take a proportional and risk-based approach that creates a level playing field for fintechs, start-ups and domestic issuers.
- We also agree with the approach that non-payment stablecoins are to be left out of scope for the purposes of this exercise (e.g., stablecoins backed by commodities or other digital assets, or algorithmic stablecoins).
- **As an interim measure, we recommend that industry should make coordinated and earnest attempts at self-regulation to ensure the safety of infrastructure that could affect payment stablecoins but which may fall outside the regulatory perimeter.**
 - Specifically we suggest that industry should focus its initial efforts on ‘bridges’ with a focus on consumer protection.

2B – Definition of ‘payment stablecoins’

- We note that the term ‘payment stablecoin’ is not referenced in Treasury’s Token Mapping paper.
 - **We recommend the use of the term ‘Fiat-backed stablecoin’ instead of ‘Payment stablecoin.’**
- We recommend clarifying the definition of ‘payment stablecoins’ with regards footnote 16 outlining that the intention of the definition is “to confine the regulatory perimeter of ASIC to only cover payment stablecoins that are actively marketed or sold in Australia.”
 - **In particular, we recommend clarifying the determination as to whether a product is actively marketed or sold in Australia, and whether this covers payment stablecoins redeemable for foreign currencies that are traded on Australian exchanges (eg USDT and USDC).**

- Further to the above, we encourage a level playing field for Australian issuers of payment stablecoins, by ensuring that there are not two standards of rules: one for Australian issuers of payment stablecoins and one for international issuers of payment stablecoins that are actively traded in Australia.
- **We recommend clarifying that payment stablecoin issuers are not considered investment companies or investment advisors.**

2C – Definition of ‘issuer’

- What characteristics need to be present for an issuer of a payment stablecoin to be regarded as such?
 - The technical operation of the system to issue? or
 - Holding the backing cash (or cash equivalents) of the payment stablecoin? or
 - Both?
- Bridging stablecoins = issuance? I.e: Allbridge, Spacewalk.

2D – Transitional arrangements

- As a general principle, issuers should be given time to meet their regulatory obligations. To see international precedents on safe harbour and transitional arrangements for virtual assets, we refer to practices in the UK, EU, Canada and Singapore in our [submission](#) to the Senate Inquiry in 2021.

3. Public register and naming conventions

We recommend that ASIC should create and maintain a public register of approved issuers of payment stablecoins. Ensure naming conventions are enforced in such a way that issuers cannot mislead the public by suggesting through their branding that they are associated with the Treasury, Royal Mint, RBA or other public entities.

As part of this registration process, ASIC could also consider requiring disclosure of issuing addresses or contracts in relation to native issuance. This could help to prevent consumer scams, and deceptive conduct.

4. Digital Currency Exchanges (DCEs)

We recommend that at this time no additional regulatory burden should be imposed upon DCEs specifically in relation to payment stablecoins. DCEs will continue to meet their existing obligations including AML/CTF compliance.

To the extent that payment stablecoins are classified as financial products, licences should only be required by the issuers, and not by DCEs that list those products for trading or exchange purposes and/or custody those assets on behalf of their customers in digital wallets.

Further to the above, the DCEs seek to establish that they are not issuers of payment stablecoins by way of providing exchange and custody services for such assets, but rather should be considered ‘Distributors’ of payment stablecoins. We do not consider it practical nor reasonable for the obligations required of issuers to be passed on to DCEs, noting that they provide Custody and Exchange services for these payment stablecoins but do not control the reserve assets.

5. Prudential Policy and Risk Management

We recommend that consideration be given as to how the design of new regulations on payment stablecoins could potentially impact the prudential requirements of ADIs.

We note the FSB’s recommendations on Global Stablecoins, particularly risk management frameworks (Recommendation 5), and prudential requirements (Recommendation 9) which states that prudential requirements and capital buffers should be proportionate to risks and to size. We encourage the Treasury to consider how prudential policy can be balanced against growth and innovation objectives.

6. Disclosures and Permissible Assets for Consumer Protection

6A – Disclosures

- We recommend standardised public disclosure requirements for all payment stablecoin issuers, including at a minimum:
 - the assets backing the payment stablecoin;
 - redemption policies; and
 - attestations from registered public accounting firms.

6B – Restrictions on the Issuer’s Balance Sheet

- We recommend that regulations should require all issuers to fully back their payment stablecoins with high-quality liquid assets. A collateralization ratio of at least 1:1 should be maintained at all times. In particular, the assets backing the stablecoin cannot include assets that were also issued by the same stablecoin issuer (for example, if FTX had issued a stablecoin that was backed by its own token, FTT, this would be disallowed under this proposal).
- We therefore recommend no rehypothecation of assets should be allowed unless it is transparently reported to token-holders. This is intended to protect the reserve assets and avoid exposing the underlying collateral to counterparty risk in case of e.g. cascading defaults, and enables users to manage their risk in a more informed manner.
- For consumers to make an accurate assessment towards the risk of holding private stablecoins, they need access to information regarding issuers’ proof of reserves and proof of liabilities.
- No proprietary trading allowed unless it is transparently reported to token-holders.

7. ASIC’s role as point of contact

We are supportive of the proposal that ASIC be a single point of contact, providing that the regulator is adequately resourced and skilled.

8. Thresholds for APRA supervision

We recommend higher thresholds for triggering APRA supervision, as our view is that \$50 million is too low. \$100-200m would be considered an acceptable range.

We note that customer funds are intended to be held in trust 1:1 and not lent out, as is the case for ADIs. Without credit risk, the inherent risk in Major SVFs (as a "special class of ADI") is materially lower than that of traditional ADIs. As such it is our view that the proposed approach does not appear to "target regulation to the risk posed" as per the principles under section 2 of the consultation paper.

Treasury should also clarify what happens once the threshold is met, i.e. whether meeting the threshold is an automatic trigger to halt further issuance.

9. Privacy Protections for Digital Assets Payment Stablecoin Users

We make a number of recommendations to protect consumer privacy:

- Implement and update data and privacy governance, protections and standards to include digital asset terminology for both issuers and dealers of stablecoins.
- Educate on the risk of unnecessary disclosures of customer PII information with transactional information on-chain.
- Share guidance on navigating the benefits from the transparency of stablecoins issued on public blockchains for compliance, and provide recommendations for how to ensure privacy protections for users.
- Explore the potential for digital asset native technology to help ensure privacy for users such as; zero knowledge proofs (ZKPs), decentralised identifiers and soulbound tokens.
- In considering how existing privacy and data security requirements could apply to payment stablecoin issuers, actively enable issuers to make use of ZKPs and other cryptographic technology to meet their AML/CTF obligations and also preserve user privacy and data security.

To illustrate the potential of this, we wish to draw your attention to research published by [Pauwels \(2021\)](#), and to which expert members of Blockchain Australia have built upon, that describes an approach to "zero knowledge KYC" to break the regulatory transparency vs. user privacy trade-off. We also recommend the [BGIN SR 008](#) Soulbound Tokens (SBTs) Study Report, to which expert members of Blockchain Australia also contributed.

10. Treatment of Insolvent Payment Stablecoin Issuers

We recommend that payment stablecoin holders will have priority in the event of an issuer's insolvency, to protect consumers.

We wish to emphasise here that the Government's clear guidance on treasury management is required. As a starting point, the separation of reserve assets from operating funds is essential in our view. An analogous legal structure may be that of a Trust, however we are not proposing that Trustees would necessarily be the identified beneficiaries in the case of an insolvency, as the stablecoin is not being issued to Trusts but to users. We recommend further exploration of insolvency hierarchies for payment stablecoins.

11. Minimum Insurance Requirements

To the extent that insurance requirements apply, they should only apply where a market for that insurance product actually exists and is accessible in practice by the virtual asset sector.

We note that to date there is not a comprehensive nor competitive market for insurance available to virtual asset businesses.

International Policy Benchmarks

European Union (EU) – Markets in Crypto-assets (MiCA)

While [MiCA](#) is not yet in force, it has passed Parliament in the European Union and will become the default policy framework across member states. In this section we draw your attention to a few particularly relevant features of MiCA that could serve as inspiration for Australia.

Taxonomy

We note that MiCA addresses payment stablecoins as well as ‘asset-referenced tokens:’

- ‘electronic money token’ or ‘e-money token’ means a type of crypto-asset that purports to maintain a stable value by referencing the value of one official currency;
- ‘asset-referenced token’ means a type of crypto-asset that is not an electronic money token and that purports to maintain a stable value by referencing another value or right or a combination thereof, including one or more official currencies or bonds.

We further note that the final taxonomy of the MiCA legislation is more principles-based and less prescriptive than the original draft policy proposal initially put forward, and we encourage a principles-based approach that is flexible in accommodating future developments in the usage and popularity of tokenised assets and blockchain infrastructure.

Reserve Assets for Payment Stablecoins

The EU has not yet provided guidance on what assets should back a payment stablecoin. Article 38 of MiCA states: “EBA, in cooperation with ESMA and the ECB, shall develop draft regulatory technical standards specifying the financial instruments that can be considered highly liquid and bearing minimal market risk, credit risk and concentration risk [...] EBA shall submit the draft regulatory technical standards referred to in the first subparagraph to the Commission by 30 June 2024.” However, we note the expectation is to hold a minimum of 30% of the reserve assets in cash. Blockchain Australia would be supportive of replicating this requirement in an Australian stablecoin regime.

Bank for International Settlements (BIS)

In July 2022, the BIS Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) published their [guidance](#) on the application of the Principles for financial market infrastructures (PFMI) to systemically important stablecoin arrangements (SAs), including the entities integral to such arrangements.

We note the following Key Considerations for Stablecoin Arrangements:

- The stablecoin should be convertible into other liquid assets as soon as possible, with a minimum requirement of conversion by the end of the day and ideally within the same day.
- The creditworthiness, capitalisation, access to liquidity, and operational reliability of the stablecoin issuer, settlement account provider, and custodians of reserve assets should be

ensured. Custodians must protect reserve assets against their own creditors and should have robust account practices, safekeeping procedures, and internal controls in place.

- The regulatory and supervisory framework applicable to the stablecoin issuer, reserve managers, and custodians should be sufficient.
- Risk controls, such as collateral pools, third-party guarantees, and loss allocation procedures should be in place to mitigate credit and liquidity risks.
- The emergence of stablecoins has prompted global regulatory bodies like the G7 Working Group on Stablecoins and the Financial Stability Board to recommend regulations and oversight. The Committee on Payments and Market Infrastructures (CPMI) and the International Organisation of Securities Commissions (IOSCO) will address regulatory and oversight issues related to stablecoin arrangements and coordinate with other standard setting bodies as required.

Blockchain Australia broadly agrees with these Considerations, which are consistent with our own Recommendations.

We also find that our positions are consistent with many of the recommendations considered by the Financial Stability Board in relation to Global Stablecoins, as published in their Final Report on 17 July 2023.

Conclusions on the future of Payments Licensing in Australia

As key stakeholders in the payments domain, we fully acknowledge the progressive steps taken to date, while highlighting areas of improvement to achieve a robust, inclusive, and efficient digital payments landscape. While the Treasury's proposed key priorities are well-considered, we wish to emphasise again the importance of inclusiveness in the payments system, and urge the Treasury to prioritise action against debanking, and to consider fairness and competition aspects when developing a licensing framework for payment stablecoins and other fintech in the payments space. With the continued transition away from cash towards digital-only payment options, access to digital payment capabilities becomes a necessity, perhaps even a right.

Finally, it is essential to consider international interoperability in the domain of virtual assets licensing. We encourage the appointment of dedicated resources with expertise in blockchain as a part of your active and ongoing budgeting and recruitment processes. These resources should be given mandates to engage with and influence key international bodies including the Financial Action Task Force (FATF), the Bank for International Settlements' Committee on Payments and Market Infrastructure (CPMI), International Organization of Securities Commissions (IOSCO), Group of 20 (G20) and the Financial Stability Board (FSB).

In conclusion, we support the government's approach to modernising the digital payment landscape and propose enhancements to ensure its success. The recommendations contained within this submission aim to strengthen Australia's legal framework, promote inclusiveness, and foster innovation, thus preparing our nation for a fair and prosperous digital payments future.



About Blockchain Australia

Blockchain Australia is the peak industry body representing Australian businesses and business professionals participating in the digital economy through blockchain technology. Blockchain Australia encourages the responsible adoption of blockchain technology by the government and industry sectors across Australia as a means to drive innovation and create jobs in Australia.

The Blockchain Australia membership base consists of 120+ leading cryptocurrency and blockchain-centric businesses and 100+ individuals across multiple verticals, including:

- Accounting and Taxation
- Artificial Intelligence
- Art
- Banking
- Building & Construction
- Cyber Security
- Development
- Digital ID
- Education
- Energy and Resources
- Entertainment
- Gaming
- Health and Wellbeing
- Insurance
- Investment
- Legal
- Professional Services
- Recruitment
- Real Estate
- Risk and Compliance
- Supply Chain
- Venture Capital

According to an EY report, published in December 2021, the sector contributes AU\$2.1 billion, employs approximately 11,600 people, and with support from government and natural market growth, these figures could increase to AU\$68.4 billion and over 206,000 people employed in the sector. To ensure Australia realises these opportunities, we seek a fit for purpose regulatory framework with clear guideposts and a focus on driving innovation and investment.