



Response to the Treasury's Consultation Paper: Payments System Modernisation (Regulation of Payment Service Providers)

6th February 2024

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 (Regulation of Payment Service Providers)*, published in December 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.
- Provides consumer protection that is proportional, effective and risk-adjusted.

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

Please direct all queries to:

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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 consultations on *A Strategic Plan for the Payments System*, in February 2023, and *Payments System Modernisation (Licensing: Defining Payment Functions)*, in June 2023.

Our submissions are publicly available for viewing at <https://blockchainaustralia.org/submissions/>.

The growing opportunities and risks 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 and payments in general, with over \$130b in stablecoins in circulation at the time of writing. As well as being used in crypto trading, both institutional and public stablecoins are utilised (especially in cross-border transfers) for their almost-immediate 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 markets that leverage their automation.

As a result of these benefits, and following a period of rapid growth, stablecoins have experienced accelerated links to traditional finance. 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>) including surpassing PayPal (https://niccarter.info/wp-content/uploads/token2049_niccarter_090923.pdf). 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 Most notably, all major stablecoin products absorbed stress from the traditional financial system when Silicon Valley Bank collapsed in March 2023.³

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 and market integrity, in line with global best practices. 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.

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>)

³ Kakebayashi (2023). Potential Points of Failure for Stablecoins - Did the Silicon Valley Bank Collapse Lead to Defi Instability? (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4533835)

Our 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 again 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 strongly urge the Government to maintain energy and focus on this matter.

We note section 5.8 of the consultation paper refers to Client Money Rules, specifically where Monies are to be held on trust with an ADI. We further note section 6.5.4 of the consultation paper referring to management of reserve assets. Specifically, issuers of PSC facilities will be required to maintain their reserves in high quality and highly liquid assets as determined under client money rules or as determined by APRA for Major PSCs. Given these considerations, if PSCs are to comply with the proposed requirements, the Government must urgently address the issue of debanking.

In the meanwhile, and likely on an ongoing basis, Client Money Rules should include the option of holding funds in ‘cash equivalents’ such as RBA issued Government Securities (bonds, bills etc.). This is because it requires issuers to hold reserve funds in what would most likely be a single ADI due to the limitation of banking options, resulting in high instances of counterparty and centralisation risk. This would ultimately position the PSC to contravene section 5.2 of the consultation paper in relation to managing risk. We discuss Client Money Rules further at the end of Our Policy Recommendations.

On a similar note, the Common Access Requirements proposed in section 7 of the consultation paper should look to include the provision of access to the securities market with the RBA. We note that the RBA currently sets the conditions of which institutions can purchase Government Securities (GSs) directly from them; there are only 12 approved institutions. A secondary market is then created for GSs which adds an element of volatility to the price. This is in comparison to practices in the United States, where there is an open market to purchase/sell government bonds directly from/to the Federal Reserve, and at a 1:1 rate. We encourage the Treasury to consider how principles of a fair and level playing field may apply.

2. Policy Framework & Regulatory Perimeter

We encourage the Treasury to take a proportional and risk-based approach that is fair for fintechs, start-ups and domestic issuers. As a complementary 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 including those which may fall outside the regulatory perimeter.

Specifically we suggest that industry should centre its initial efforts on blockchain ‘bridges’ with a focus on consumer protection.

Definition of ‘payment stablecoins’

We recommend the use of the term ‘Fiat-backed stablecoin’ instead of ‘Payment stablecoin.’ Using the term ‘Fiat-backed stablecoin’ will align Treasury’s proposed regulatory framework with other jurisdictions in the region, such as Singapore and Hong Kong. In Singapore, the Monetary Authority of Singapore (“MAS”) proposes to use the term ‘single-currency stablecoins’ (“SCS”)⁴ while in Hong Kong the Hong Kong Monetary Authority (“HKMA”) has put forward a legislative proposal to use the term ‘fiat-referenced stablecoin’ (“FRS”).⁵

On further definitional issues we refer to our submission provided in June 2023.

Classification of secondary market participants

In relation to section 2.2.2 of the consultation paper, we support Treasury’s efforts to distinguish and differentiate the roles between PSC issuers and participants in the secondary market. We recommend that the definition take into account the details of the backing assets when defining PSCs. This avoids ambiguity and confusion, particularly in relation to reserve management.

In relation to Section 6.5.6, we note the topic of bank issued stablecoins. We agree that non-bank-issued stablecoins should adhere to a strict 1:1 backing policy. However, the paper suggests that bank issued stablecoins would be regulated under existing prudential frameworks, potentially allowing them to rely on fractional reserve banking. This implies that bank issued stablecoins could issue more stablecoins than they have in liquid cash reserves; this could lead to risky financial practices and undermine the issuance of non-bank stablecoins; it would present an unfair competitive advantage. We propose that bank issued stablecoins should not be classified or promoted as PSCs, based on the assumption that PSCs must be issued with 1:1 backing.

We also note section 2.2.3 in relation to ensuring equitable regulation for domestic and foreign issued PSCs. We encourage the Treasury to establish clear criteria for assessing the equivalence of regulatory standards; this would ensure foreign issued PSCs meet the same quality of standards and thereby help to maintain a level playing field for Australian start-ups and product providers.

⁴ See

https://www.mas.gov.sg/-/media/mas-media-library/publications/consultations/pd/2023/response-to-consultation-on-stablecoins-regulation_15aug2023.pdf, Response to Public Consultation on the Proposed Regulatory Approach for Stablecoin-Related Activities, Page 4.

⁵ See <https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2023/20231227e4a1.pdf>, Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong, Page 8.

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 specifically for virtual assets, we refer to practices in the UK, EU, Canada and Singapore in our previous [submission](#) to the Senate Inquiry in 2021.

3. Public disclosures, public register and naming conventions

We acknowledge the inclusion of public disclosure requirements in section 6.5.2 and we further propose the inclusion of the stablecoin issuer's blockchain addresses and smart contracts. This could help to prevent consumer scams, and deceptive conduct. We further 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 our support for standardised public disclosure requirements for all payment stablecoin issuers, we advocate that, at a minimum, issuers should disclose: the assets backing the payment stablecoin; redemption policies; and attestations from registered public accounting firms, with clear guidelines from the Australian Accounting Standards Board (AASB). Such guidelines have proven to be necessary based on international experiences, whereby accounting firms are not properly equipped to provide attestations due to a lack of clear guidance availability.

4. Role of Digital Currency Exchanges (DCEs) in facilitating payments via stablecoins

We note section 2.2.3 of the consultation paper regarding the regulation of PSC activity through the DAPF. We support this approach. We advocate for increased support and resources for AUSTRAC to ensure effective monitoring and regulation of PSCs given the increasing crossover of stablecoin activities within remittance activities.

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

Further, 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. Following this, 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

We recommend that further 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. Permissible Backing Assets for Consumer Protection

Restrictions on the Issuer's Balance Sheet

As previously advocated, we reiterate our recommendation 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 should be allowed unless it is transparently reported to token-holders.

7. ASIC as the point of contact

We are supportive that ASIC should be a single point of contact, providing that the regulator is adequately resourced and skilled. In referring to section 2.2.3 of the consultation paper we wish to reiterate as stated in our previous submission that as part of endorsing ASIC's role as a single point of contact, it is critical to ensure that the regulator is adequately resourced and skilled.

8. Thresholds for APRA supervision

In our previous submission we recommended higher thresholds for triggering APRA supervision. We are pleased to see that the proposed threshold has now been increased from \$50 million to \$100 million, which was the minimum level that we advocated. In our previous submission we also requested that Treasury clarify what happens once the threshold is met, i.e. whether meeting the threshold is an automatic trigger to halt further issuance. Upon review of the new proposal, it appears that there is an abrupt cut-off in issuance when the threshold is met (section 6.1).

Given these new details, we are concerned that APRA's application processing times may be lengthy and may not be guaranteed, and as such we propose raising this threshold to the higher end of our initial recommendation (\$200 million) to allow enough time for APRA to process applications. A 'safe harbour' provision that covers the application period may be necessary and should be considered.

9. Privacy Protections for Users

We note ongoing inadequate coverage of privacy protections for stablecoin users. We wish to reiterate a number of recommendations that we presented in 2023 that we believe are important for protecting consumer privacy:

- 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.
- 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.

To illustrate the potential of this, we again 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. Insolvency

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. Insurance

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 noted in June 2023 that there is not a comprehensive nor competitive market for insurance available to virtual asset businesses. We reiterate that there remains an absence of insurance for this kind of activity at this time. Noting the general information provided in section 5.4, we advise that the Government will need to become more firm on this issue with insurance providers in order for PSCs to meet proposed requirements.

12. External Dispute Resolution

We note the requirement for PSCs to comply with existing regulations regarding EDR facilities, set out in section 5.2. We call attention to the fact that there is no suitable EDR scheme available for PSCs or digital assets in general. The Government must therefore act to support the development of an EDR scheme that is fit for purpose for the digital asset sector. Therefore, with respect to External Dispute Resolution we recommend that the Government:

- Adequately resource an existing scheme (i.e: AFCA) to manage this policy gap; and
- Support the establishment of a specialised EDR scheme that will enable compliance with the proposed approach.

13. Recognition of PSCs as a suitable asset to satisfy 'Client Money Rules'

Given the requirement for PSCs to satisfy Client Money Rules, we believe PSCs should be considered as suitable assets in lieu of funds with an ADI (refer back to our assessment above on Debanking). PSCs provide a number of benefits that would not otherwise be present with funds simply held with an ADI, such as:

- Transparency of balances through the blockchain, and
- Traceability of funds through the blockchain,

along with other benefits mentioned elsewhere in this submission. As such, beyond concerns about access to ADI facilities and the likely concentration of funds within a single ADI, the benefits offered by the underlying technology should stand as being relevant for consideration in a risk-adjusted analysis of a particular asset's suitability, particularly given the growing global trend towards regulation of blockchain-based products.

Concluding remarks on the future of Payments in Australia

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. With the continued transition from cash towards digital-only payment options, access to digital payment capabilities becomes a necessity, perhaps even a right. 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 carefully consider fairness and competition when developing a licensing framework for payment stablecoins and other fintechs in the payments space.



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.