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Mills Oakley
ABN: 51 493 069 734

All correspondence to:
PO Box 453
Collins Street West
MELBOURNE VIC 8007
DX 558 Melbourne

Head of Payments Policy Department
Reserve Bank of Australia
GPO Box 3947
SYDNEY NSW 2001

Contact
Joni Pirovich +61 3 8568 9629
Email: jpirovich@millssoakley.com.au
Fax: +61 3 9605 0933

Partners
Alec Christie +61 2 8035 7959
Email: achristie@millssoakley.com.au

Ross Higgins +61 3 9605 0925
Email: rhiggins@millssoakley.com.au

Email: pysubmissions@rba.gov.au

Attention: Tony Richards

Dear Mr Richards

Submission to Reserve Bank of Australia (Bank) Review of Retail Payments Regulation

Thank you for the opportunity to provide a submission to the Bank in relation to the review of retail payments regulation.

Our submission is set out at **Annexure A**, and responds to Questions 1 and 3 by:

- summarising the pros and cons surrounding the issuance of an electronic form of banknotes – i.e. an eAUD or central bank digital currency (**CBDC**) for general household use;
- suggesting an alternative, interim measure, that involves the Bank introducing a digital asset ratings system; and
- emphasising the importance of the Bank's participation in international forums that discuss the policy implications of CBDCs.

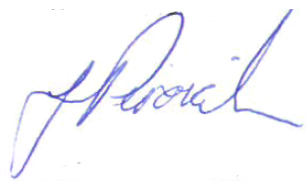
We urge that the Bank commence trials as soon as possible regarding the issuance of an eAUD for household use or the hybrid applications of an eAUD for blockchain infrastructure initially targeted at wholesale investors, similar to the trials already conducted with respect to an eAUD for wholesale use with the major banks. Only with experimentation can the Bank understand, with confidence, the opportunities and challenges of an eAUD that are specific to the Australian financial system. Such an understanding would better allow the Bank to develop an Australian hybrid CBDC model that gives Australians and Australian businesses a choice to use an eAUD rather than other digital assets.

Clear evidence of demand from the public for an eAUD (or similar digital asset) may be an overnight occurrence rather than being signalled some time before such demand arises. In the likely event that the Bank and policymakers must act expeditiously, experience and insights from eAUD trials will be invaluable, particularly regarding an eAUD's effectiveness in monetary policy, achieving/maintaining financial stability and in informing the role that commercial banks will play.

Mills Oakley look forward to discussing our submission and lending assistance as the consultation progresses.

If you have any questions or require further information, please do not hesitate to contact Joni Pirovich on +61 3 8568 9629 or jpirovich@millssoakley.com.au.

Yours sincerely



JONI PIROVICH
SPECIAL COUNSEL
Blockchain & Digital Assets



ALEC CHRISTIE
PARTNER
Digital Law



ROSS HIGGINS
PARTNER
Private Advisory

Annexure A Submission

1 Pros and cons of an eAUD

1.1 Pros of an eAUD for household use

- (a) An eAUD would encourage blockchain innovation in Australia. Blockchain projects would benefit from a native stable cryptocurrency (i.e. stablecoin) that is pegged to the Australian dollar, facilitates payment and information flows amongst stakeholders, and has the 'approval' of the Bank. Such Blockchain projects are currently dis-incentivised from incorporating a stablecoin and opt for less effective and efficient work-arounds, largely because of the following factors:
- (i) Cost and compliance effort: A native stablecoin that is pegged to the Australian dollar would likely be characterised and regulated as a derivative (as defined in the *Corporations Act 2001*) and require at least an Australian Financial Services Licence and a custodian to hold (and an independent auditor to audit) the collateral balance of Australian dollars. This would provide a level of comfort to individuals / consumers.
 - (ii) Regulatory uncertainty: With the uncertainty of release, and the model, of an eAUD it is difficult for some blockchain projects to justify the cost and compliance effort of incorporating a native stablecoin that is pegged to the Australian dollar when an eAUD might be issued within the short to medium term.
 - (iii) A relatively small number of Australians and Australian businesses that hold cryptocurrency, or more particularly a stablecoin, are willing to transact with it regularly for a number of reasons including volatility, the lack of Australian blockchain projects with a native cryptocurrency, and the unclear legal and tax implications surrounding regular or combined purpose holding and use.

The volatility and perceived 'unauthorised' or lack of 'bona fides' nature of bitcoin (BTC) and other cryptocurrencies is one of the major factors that has worked against broader uptake of cryptocurrencies as a frequently used method of payment. However, this has lent support to the interest in and use of stablecoins in an increasingly digital global economy.

- (b) An eAUD would enable Australians and Australian businesses to more fully and confidently participate in and be best positioned to take advantages of new digital business opportunities in an increasingly digital global economy. As an increasing number of central banks announce and launch CBDCs, without an Australian CBDC, Australians and Australian businesses are being left behind.

In addition, Federal and State Governments could enhance their push to digital services and a digital economy with the use of an eAUD. An Australian CBDC could assist government departments to more competitively and effectively administer government and tax functions and, in so doing reduce costs and corporate and individual tax rates. For example, governments could benefit from real-time tax collection where blockchain infrastructure includes smart contracts that automatically calculate and remit the correct amount of tax on a transaction.

Consumers and retail investors largely engage with financial services and payments through bank accounts, loans and credit and debit cards. While there are not necessarily gaps in the way each of these traditional services and payment options are provided, the current system (without an Australian CBDC) limits and stifles innovation in the way that it relies on a few large institutions that have successfully navigated and continue to navigate the high barriers to entry. In the alternative, blockchain-based infrastructure, wallets and applications can democratise the offer/funding of financial and payment services by allowing for

secure, cost efficient peer to peer transactions. For example, Nexus Mutual (<https://nexusmutual.io/>) is a blockchain-based offering that offers insurance for value tied up in smart contracts, such as peer to peer cryptocurrency lending (e.g. <https://saltlending.com/>).

- (c) An eAUD would encourage awareness among retail investors of cryptocurrency banking and investment options, some of which are outperforming traditional banking and investment options (such as bank accounts, term deposits, bonds and shares). Greater awareness and uptake of cryptocurrency banking and investment options should:
- (i) Enhance competition and promote efficiencies in the Australian financial services sector.
 - (ii) Lend support to the need for clear guidance regarding consumer and investor protections applicable to decentralised finance (**DeFi**) applications. For the top 20 DeFi applications and key metrics around their performance, refer to defipulse.com.
 - (iii) Allow the Bank to 'observe' how the eAUD is being used, obtain insights regarding cryptocurrency banking and investment trends and better inform the Bank and policy makers about digital asset trends that may pose a threat to or opportunity for Australia's financial stability.

Australia has not experienced zero or negative interest rates yet (and may never experience them) but consistently low rates provide a motive for Australians to experiment and potentially hold a portion or the majority of their assets in cryptocurrency wallets and cryptocurrency investment options. In European countries and in the United States where interest rates have been zero or negative for the last few years, people and businesses have had the motive and opportunity to experiment with digital assets and will, as a result, be better placed to engage with a CBDC issued by their central bank and connect to and fuel the growth of a digital economy.

- (d) An eAUD could be an avenue for the Bank to retain more and better control of monetary policy and financial stability than otherwise would be the case if Australians moved their stores of value into other digital assets and made payments and transfers in digital assets.
- (e) An eAUD would give Australians and Australian businesses at least a choice to participate in the growth of the Australian digital economy and digital asset business models.

Declining use of cash and cheques and increasing use of electronic means of payment means that Australians are becoming more familiar with digital payments and the digital economy. Financial inclusion is often stated by central banks as a reason for and against adoption of a CBDC. To our view, Australians and Australian businesses should at least have the choice of using an eAUD and participating in an increasingly digital economy.

As such, we suggest that eAUD models be explored that:

- allow cash to be retained, at least for a transition period;
- enable the eAUD to be used offline and in all places where cash is available; and
- ensure security, ease and convenience of access to the eAUD.

1.2 Cons of an eAUD for household use

- (f) If the eAUD is based on private blockchain infrastructure that effectively mirrors our existing financial system, Australians will have various disincentives and may refrain from using an eAUD in favour of either or a combination of:

- (i) decentralised infrastructure that supports “payment”, “utility” and/or “security” crypto-assets, which may offer features such as privacy (i.e. lack of jurisdiction, lack of KYC and AML/CTF requirements, lack of “surveillance” by regulatory authorities, avoidance of auto-taxing and auto-reporting), enhanced efficiency (i.e. faster transactions at a lower cost), better opportunities (i.e. ease and affordability of access to utility and investment products); or
- (ii) more attractive/competitive CBDCs issued by other countries or supranational bodies such as the European Union or a global stablecoin issued by an international body such as the International Monetary Fund or World Bank - a CBDC might encourage blockchain innovation in a particular country and, as a result, the ease of access to utility and investment products may be better or more well-advanced than that provided in Australia; or
- (iii) global stablecoins issued by tech companies (e.g. Apple) or private consortiums (e.g. Libra project).

To counter these cons, the Bank should consider a CBDC model that encourages Australians and Australian businesses to use the eAUD over decentralised infrastructure, CBDCs issued by other countries or supranational or international bodies, or global stablecoins issued by tech companies or consortiums. Alternatively, or in the interim, the Bank should work with other Australian and foreign regulatory bodies to implement basic information and/or tax collection and sharing standards for public blockchain protocols and decentralised applications that accept cryptocurrency other than eAUD from Australian residents.

Arguably one of the most important policy trade-offs that the Bank, in conjunction with Government and other regulators, must research and settle is the trade-off between anonymity and supervision. Research in this area is critical and will play a significant role in the policies that inform the design of an Australian CBDC, even before any technology requirements are considered.

The Bank’s ongoing consultation around retail payments should seek to obtain an understanding of what information is actually required by Government and regulatory bodies about paying, saving and transferring value in the context of a digital environment where compliance and real-time payments (including to regulatory bodies) can be baked into blockchain technology and smart contracts by design.

- (g) An eAUD could harm current innovative blockchain projects in Australia (and elsewhere) if an eAUD is viewed by the market as a premium asset and takes attention away from other good quality digital assets. For example, throughout history gold has generally been the asset most likely to hold its value during times of market volatility and risk. If Australians lose confidence in Australian dollars (or residents of other countries lose confidence in their local fiat currency), history suggests that investment in gold should increase.

In late 2019 we saw the launch of GoldPass and the Perth Mint Gold Token (**PMGT**) by The Perth Mint, which follows a number of foreign-based and decentralised gold-backed cryptocurrency propositions. Gold-backed cryptocurrencies are a type of stablecoin – the stability of which depends on the percentage of physical gold that is held by a custodian and the belief that it actually holds such.

GoldPass allows users to buy, sell and transfer physical gold via uniquely digitally secured certificates that are minted cryptographically and which represent physical gold stored at The Perth Mint.

If an eAUD is on issue and its value declines (relative to say, other central bank CBDCs), market reactions are unknown, difficult to predict and may not follow historical patterns. If the market reacts by attempting to acquire more eAUD (or derivatives based on an eAUD) rather than other digital assets like gold or the PMGT, the eAUD could become more of a disrupter of competition in the digital assets market than the traditional Australian dollar has been. As such, we suggest market scenario planning studies should be undertaken to determine the policy controls that should be implemented to maintain healthy competition and financial stability.

(h) An eAUD for general household use will introduce new policy questions for consideration for which there are little to no existing economic models, such as:

- the sustainability and ongoing role of the commercial banks where Australians and Australian businesses hold their eAUD deposits with the Bank; and
- whether the eAUD should be interest-bearing.

We recommend that Bank take a proactive approach to this ‘con’ by commencing market scenario planning studies to determine an appropriate range of policy controls.

2 Alternative – a rating system

If the Bank believes trials of an eAUD for general household use are not appropriate at this time, we recommend the Bank consider an interim step given the growing importance of digital assets in the Australian and the global economies.

The interim step could involve the Bank introducing a rating system for digital assets, similar to the health rating on foods. Based on published Bank criteria digital assets could be rated for quality, security (e.g. believability of asset backing claims) and public policy goals (e.g. they are easily accessible, have an AML program in place, information sharing qualities/permissions etc.).

The Bank’s role in introducing such a ratings system, in conjunction with other regulators, seems apparent. This is especially so in the absence of the ASX undertaking due diligence on and listing cryptocurrencies and without any existing digital currency exchange that holds an Australian Financial Services Licence which would impose greater scrutiny and reporting around the digital assets it lists on its exchange. Even if the ASX or a digital currency exchange listed high quality digital assets, their assessment criteria likely wouldn’t include any assessment of how a digital currency meets Australian monetary or financial stability policy goals, reinforcing the role for the Bank to produce a ratings system.

An ‘authorised’ transparent Bank backed rating system would assist Australians and Australian businesses in choosing which digital assets to invest in and use. This would, in turn, grow the use of ‘legitimate’ digital assets fuelling growth in Australia’s digital economy and supplement the Bank’s ability to keep pace with monetary policy decisions fit for an increasingly digital economy.

In developing the rating system, the Bank might have reference to the work of foreign and international policy work and risk assessment frameworks currently being used by digital currency exchanges to determine which digital assets to list. For example, Binance US’s Digital Asset Risk Assessment Framework or Coinbase’s Digital Asset Framework.

3 Participation in international forums

The Bank should actively participate in international forums that convene central banks and thinking around the policy implications of CBDCs due to the rapid pace with which this area is evolving.

