



RESERVE BANK OF AUSTRALIA

65 Martin Place
Sydney NSW 2000

GPO Box 3947
Sydney NSW 2001

T: +61 2 9551 8700
F: +61 2 9551 8024
richardsa@rba.gov.au
www.rba.gov.au

1 July 2021

Committee Secretariat
Select Committee on Australia as a Technology and Financial Centre
Department of the Senate
Parliament House
Canberra ACT 2600

By Email – fintech.sen@aph.gov.au

Dear Sir/Madam

Inquiry into Australia as a Technology and Financial Centre – Submission

The Reserve Bank (the Bank) welcomes the opportunity to make this submission. The Bank has a mandate to contribute to promoting efficiency and competition in the payments system and the overall stability of the financial system. Although the Bank does not have an explicit mandate for promoting Australia's growth as a technology and financial centre, it is supportive of the Committee's goals of promoting innovation and growth in the fintech and regtech sectors. Indeed, the Bank has a longstanding focus on encouraging innovation in the payment system in pursuit of its legislative mandate for efficiency, competition and stability in the payment system.

Australia has a number of different regulatory bodies responsible for the issues the Committee is considering. Whereas some jurisdictions (e.g. Singapore) have a single, integrated financial-sector regulator, internationally it is more common that financial regulatory issues are the responsibility of a number of different agencies. This type of arrangement requires close cooperation among regulators. In Australia, the Council of Financial Regulators (CFR) – which is composed of the Bank, the Treasury, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) – is the main coordination body. The Bank also has in place bilateral arrangements with other regulators on particular matters of mutual interest. For example, the Bank has a Memorandum of Understanding (MoU) with ASIC in relation to financial market infrastructures and a MoU with the Australian Competition and Consumer Commission (ACCC) regarding access and competition in the payments system.

In recent years, the CFR has considered a number of issues relevant to the Committee's work. In October 2019, the CFR delivered the conclusions of its review of the regulation of stored-value facilities (SVFs) in Australia to the Government. The CFR recognised the potential for SVFs to play a more prominent role in the payment system and the recommendations were aimed at modernising and simplifying regulatory arrangements for SVFs in a way that is conducive to innovation, while maintaining appropriate consumer protections. The Government accepted the CFR's recommendations in October 2020 and the details of the new regulatory regime, which will require legislative changes, are now being developed. And as is discussed further below, the CFR (together with AUSTRAC) has recently established a working group to consider regulatory

arrangements for stablecoins, which are a form of crypto-asset that aim to maintain a stable value relative to a specified unit of account such as a national currency, and are intended to be used primarily as a means of payment. The Bank and other agencies are also engaged in international work on the regulatory approach to stablecoins, including through the Financial Stability Board and the relevant international standard-setting bodies.

This submission focuses on cryptocurrencies and digital assets, including central bank digital currency. It also discusses a number of other issues of interest to the Committee: de-banking, neobanks and recent changes to the Bank's exchange settlement account (ESA) policy to clarify how payment service providers can settle payments directly; and ways in which the Bank's policy approach has contributed to promoting innovation in the payment system, consistent with supporting Australia as a desirable place for innovative businesses. Some of these issues have been covered in more detail in the Bank's previous submissions to this Committee.

Cryptocurrency, central bank digital currency and digital assets

There are significant differences between the various types of new digital assets or payment instruments that are of relevance to the Committee's work. It may be useful to describe them in three groups.

Central bank digital currency (CBDC) represents a potential new form of digital money that would be a liability of (or a claim on) the central bank. This could include both retail CBDC, which would be like a digital version of cash that is essentially universally accessible, and wholesale CBDC, which would be accessible only to a more limited range of participants (but probably including some that do not currently have access to settlement accounts at central banks). Like cash and settlement account balances, the unit of account of the CBDC would be the sovereign currency (i.e. the Australian dollar), the CBDC would be convertible at par (i.e. one for one) with other forms of money, and it would likely also be specified to serve as legal tender. While there is significant research underway globally on CBDC, there is really only one full live implementation, the retail-focused 'Sand Dollar' issued by the Central Bank of the Bahamas. The People's Bank of China is, however, in an advanced stage of testing possible issuance of a retail CBDC or 'digital yuan'. It is worth noting that while the interest in CBDC has in large part been a reflection of developments in cryptocurrencies, stablecoins and distributed ledger technology (DLT), there is no presumption that any CBDCs that are implemented will use DLT.

Like many other advanced-economy central banks, the Bank does not consider that a policy case has yet emerged for issuing a CBDC.¹ However, the Bank is continuing to closely monitor the case for a retail CBDC and is engaging with some other central banks on possible use cases, including for cross-border payments. The Bank has also been conducting research on the technological and policy implications of a wholesale CBDC. This work is taking place in the Bank's in-house Innovation Lab and included the development in 2019 of a limited proof-of-concept of a DLT-based interbank payment system using a tokenised form of CBDC backed by exchange settlement account (ESA) balances held at the Bank. Currently, the Bank is close to finalising a project with a number of external parties that extends the earlier proof-of-concept in a number of ways, including to incorporate tokenised financial assets. The project explores the implications of delivery-versus-payment settlement on a DLT platform as well as other

1 See Philip Lowe (2017), 'An eAUD?', Address to the 2017 Australian Payment Summit, Sydney, 13 December and Tony Richards, Chris Thompson and Cameron Dark (2020), 'Retail Central Bank Digital Currency: Design Considerations, Rationales and Implications', RBA *Bulletin*, September for a discussion for Australia. See Randal Quarles (2021), 'Parachute Pants and Central Bank Money', Address to the 113th Annual Utah Bankers Association Convention, Sun Valley, Idaho, 28 June for a recent perspective from the US Federal Reserve.

programmability features of tokenised CBDC and financial assets; a report on the project will be published shortly. The Bank is also participating in the Digital Finance Cooperative Research Centre (CRC), which will bring together academics and more than 20 entities in the finance industry, ranging from recently established fintechs to large established organisations.² The aim of the CRC is to develop and exploit the opportunities arising from the digitisation of assets so they can be traded and exchanged directly and in real-time between any individual or organisation.

Cryptocurrencies or crypto-assets are loosely defined terms that refer to a broad range of privately issued digital assets. They have their own 'currency' unit and are not denominated in the currency of any sovereign issuer. The distinguishing feature of most cryptocurrencies is that they utilise DLT and cryptography to store digital 'coin' ownership records and transactions in a digital ledger that is distributed (and synchronised) across a number of 'nodes' (or computers) rather than relying on a central party to operate the system. Bitcoin is the most prominent implementation of a decentralised cryptocurrency protocol, but thousands of variations have emerged. Cryptocurrencies have no intrinsic value, are typically not issued by any single entity and effectively rely on users' complete trust in the software protocol that controls the system. While the term 'cryptocurrency' may suggest that they are a form of money, the consensus is that existing cryptocurrencies do not provide the key attributes of money. As the Bank and many others have previously noted, they are rarely used or accepted as a means of payment, they are not used as a unit of account, and their prices can be very volatile and so they are a poor store of value. The effect of the *Currency Act 1965* is that crypto-assets are not legal tender, though this does not prevent their use where both parties wish to do so.

Globally, securities regulators and consumer protection agencies in many jurisdictions have issued warnings about the risks associated with investing in cryptocurrencies. In addition, tax authorities and agencies with responsibility for preventing financial crime are paying greater attention to transactions going through the on- and off-ramps linking cryptocurrencies to the traditional financial sector (e.g. digital currency exchanges). In addition, the very high use of energy involved in 'mining' cryptocurrencies, most notably Bitcoin, is attracting increasing attention from governments and policymakers. These various factors, plus the possibility that central banks will move towards issuing CBDCs which will prove to be superior payment instruments, have prompted many observers to suggest that cryptocurrencies are likely to have only niche uses and that current valuations of many cryptocurrencies are unlikely to be sustained.³ Of course, this would not preclude the potential for significant use elsewhere of some of the technology associated with cryptocurrencies – in particular, DLT, blockchains and smart contracts – particularly in areas where there are inefficient, legacy business processes involving many different parties; for example, syndicated lending and trade finance are possible use cases. However, these are likely to be permissioned applications of DLT, as opposed to open, permissionless systems such as the Bitcoin system. For example, ASX Limited is implementing a permissioned DLT environment in its current technology refresh for the clearing and settlement of cash equities.

So-called 'stablecoins' are another type of digital asset that have emerged in recent years. These are a type of cryptocurrency specifically designed to minimise price volatility against a widely used unit of account (such as the US dollar) or a common store of value (such as gold), to attempt to make them more attractive as a means of payment. One way their promoters seek to maintain a stable value is by holding assets that back the coins on issue; however, these backing arrangements can have varying degrees of credibility. Where a stablecoin is denominated in a

2 See <https://www.dfrc.com.au/>.

3 See, for example, Mark Carney (2021), 'The Art of Central Banking in a Centrifugal World', Andrew Crockett Memorial Lecture at the Bank for International Settlements, 28 June.

single currency and fully backed by high-quality assets in that currency, it may have many of the attributes of a SVF or 'e-money'. For example, in the latest proposed version of the Facebook-led stablecoin, the Diem Association (the governing body for the project) plans to partner with a US bank for the issuance of US dollar stablecoins and the management of the reserves backing the stablecoins, and will also operate a US-based payment network.

To date there has been essentially no issuance of Australian dollar stablecoins nor use of them as a payment method in Australia.⁴ Nevertheless, as noted earlier, the Bank and other CFR agencies, together with AUSTRAC, have formed a working group to study the benefits and possible risks associated with stablecoins and to identify any possible regulatory gaps. If a stablecoin is designed to be a safe payment instrument and act as an alternative to other forms of money, then it is important for consumer protection that it is appropriately regulated. This work builds on the CFR's work on the regulation of SVFs in Australia. The CFR agencies have also been engaging with their international counterparts on the regulatory issues surrounding stablecoins, and the potential risks to the financial system, especially from those stablecoins that have the potential to scale rapidly and become widely used in a number of countries (so-called global stablecoins). One element on this work is a forthcoming consultation by the Committee on Payments and Market Infrastructures and the Board of the International Organization of Securities Commissions on the applicability of some existing international standards (the Principles for Financial Market Infrastructures) to stablecoin arrangements.

De-banking and access issues

The Bank is aware that many non-bank digital providers (or 'fintechs') have in recent years faced challenges in obtaining and retaining access to the core banking and payment services that they need to provide services to Australian customers. A range of fintechs have been affected, most notably providers of international money transfers and digital currency exchanges, but also fintechs offering other services. 'De-banking' risks appear to reflect a range of factors, including financial institutions' focus on the profitability of their relationships, 'know your customer' (KYC) compliance costs, and apparent heightened risk aversion and uncertainty among financial institutions about AML/CTF and sanctions obligations. Difficulties in assessing risks associated with small and unique fintech businesses may also be a factor.

The Bank and other financial regulatory agencies understand that the de-banking of fintechs could impede competition and innovation in financial services. Accordingly, the agencies are undertaking further work to explore the underlying causes and examine possible policy responses to de-banking. The Bank's submission to the Treasury Review of the Payments System suggested that a tailored licensing and oversight regime for non-bank payment service providers might address some of the specific risks posed by these entities, and thereby help alleviate some of the de-banking and access issues in this market.

The Bank is also monitoring access by fintechs and other non-ADIs to the New Payments Platform (NPP), Australia's fast payment system. As most fintechs are not prudentially regulated by APRA, they are not able to access the NPP directly to clear payments. However, there are a number of indirect access routes for non-ADIs and there are a number of direct participants (ASL, Cuscal, Indue, and some of the major banks) which provide indirect connectivity services on a competitive basis. These indirect access arrangements appear to be working quite well

4 While it remains to be seen whether the proposed Diem stablecoin system will launch internationally, there is no indication that Australia is an early target market. Facebook noted in April that it is yet to take any of the steps that would be required to set up a local entity to provide Diem-based payment services to Australian households. It also indicated that even when it launched in other countries, its 'Novi' digital wallet would not be available for download in Australia or be open for Australian users to register because it is not licensed or authorised to provide services in Australia.

considering the large number of entities (currently over 90, including 8 non-ADI entities) that are now indirectly connected and using the NPP to provide services to their customers. Non-ADIs can also become 'connected institutions', which can connect to the NPP directly and will be able to create payment mandates and send payment initiation requests under the NPP's PayTo service, which is expected to become available from mid-2022. NPP Australia has sought to align its certification and accreditation criteria for entities wishing to become connected institutions with the ACCC's Consumer Data Right accreditation model that will facilitate open banking.

In 2018/19, the Bank conducted a consultation on NPP functionality and access, with input and assistance from the ACCC. Among the motivations for this review were concerns expressed by various stakeholders, including some fintechs, about the slow rollout of NPP services by the major banks, the ability to develop overlay services that leverage the NPP capabilities and potential constraints on the ability of entities to connect to the NPP. Following the review, NPP Australia made a number of changes to facilitate access to the system, including by lowering shareholding requirements and enhancing the governance and transparency around applications for access. The Bank and ACCC plan to conduct a second consultation pending the results of the Treasury Payments System Review.

Neobank issues

While the Bank's interactions with neobanks are limited, it has taken a number of actions that are supportive of access to the payments system for new entrants, including neobanks. For example, in the early 2000s, using its regulatory powers under the *Payment Systems (Regulation) Act 1998*, the Bank imposed access regimes on the Visa and Mastercard credit card schemes, to give access to a wider range of entities; revisions to these regimes in 2014 expanded access further to non-ADIs. Similarly, the Bank introduced access regimes for the eftpos and ATM systems that were aimed at making it easier for new entrants to become direct participants in those systems, thereby promoting competition in those markets.

The Bank has also sought to support competition in banking and payment services through its policy on access to Exchange Settlement Accounts (ESAs). In 1999 the Bank was one of the first central banks to liberalise access by allowing non-ADI providers of third-party payment services to apply for an ESA to settle clearing obligations with other providers. In recent years, a number of other central banks have similarly extended settlement account access to non-bank payments service providers (PSPs), but in most cases access is only available to entities that are regulated by a relevant supervisory authority within the central bank's jurisdiction. There are currently only a few non-ADI PSPs that hold an ESA, but there has been increased interest in applying for ESAs in recent years, including from a variety of fintech firms involved in payments. Given the increased demand, in 2019 the Bank made a number of changes to the ESA Policy to provide more information about the eligibility requirements and application process, including the risk management criteria applicants would be required to meet. These changes sought to ensure that the ESA Policy continues to promote competition in the market for payment services, while also ensuring that risks are appropriately managed.

In 2018, following amendments to the *Banking Act 1959* to liberalise the use of the term 'bank' and the introduction of APRA's restricted ADI regime, the Bank removed a requirement for all banks to hold an ESA for use in a contingency, even if they used an agent to settle their transaction under normal circumstances. This change was intended to reduce the cost and regulatory complexity for neobanks and other smaller institutions that chose to become banks, providing them the option to apply for an ESA at their own discretion.

Australia as a technology and financial centre

As mentioned above, the Bank has a mandate and regulatory powers to promote competition and efficiency in the payment system and control risk. While the Bank does not have an explicit mandate to promote Australia as a financial and technology centre, in regulating to promote access and competition, the Bank's regulatory powers can have benefits in terms of encouraging innovation in the Australian payments system. The Bank is also able to use non-regulatory means to encourage and support innovation, in particular using suasion of industry participants to help overcome coordination problems which can act as a barrier to innovation in a network with many participants. The development of the NPP, Australia's fast payment system, is an example of where the Bank played an important role in setting strategic objectives for the payments industry and coordinating action by participants in the payments system. This combination of actions – both regulatory and otherwise – have contributed to Australia having a payment system that is innovative and relatively low-cost by international standards and meeting most of the needs of households, businesses and government entities.

The Bank would be happy to discuss any of these matters further with the Committee.

Yours sincerely

A handwritten signature in cursive script that reads "Anthony Richards".

Tony Richards
Head of Payments Policy
Payments Policy Department