



Digital Currency Inquiry Submission

PayPal Australia –
Wednesday 24 December 2014



Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Via email: economics.sen@aph.gov.au

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Dear Secretariat,

Re: Digital Currency Inquiry

PayPal welcomes the opportunity to lodge a submission to the Digital Currency Inquiry referred to the Senate Standing Committees on Economics.

PayPal was founded in 1998 and has been operating in Australia since 2005. In the third quarter of 2014, in Australia, PayPal has almost 5.5 million active consumer accounts¹. Globally, PayPal has 157 million active accounts and is available in 203 markets. PayPal supports payments in 26 currencies.

PayPal's submission will focus on the following issues:

- PayPal's current regulatory structure in Australia versus digital currencies.
- Distinction between PayPal's business model and digital currencies.
- PayPal's view on digital currencies and Bitcoin.
- PayPal's position on anti-money laundering and counter terrorism financing.
- Regulation of digital currencies – recommendations.

Executive Summary

- There is a clear distinction between Digital Wallets (e.g. PayPal) and Digital Currencies (e.g. BitCoin).
- PayPal, as the world's leading Digital Wallet provider, is appropriately regulated and takes very seriously our commitment to AML/CTF and Fraud Management.
- Digital Currencies provide innovation and market opportunities; however they appear to be currently escaping regulatory frameworks in Australia and in other jurisdictions.
- PayPal believes that governments should pursue principles-based regulation of Digital Currencies, and encourage cautious adoption of their use within the financial system.
- In line with the approach recommended above, PayPal has, through its payment gateway subsidiary Braintree, enabled the integration of Digital Currency payments –

¹ https://www.paypal-media.com/assets/pdf/fact_sheet/PayPal_Q3_2014_Australia_Fast_Facts.pdf



however this does not enable the use of any Digital Currencies within PayPal's core digital wallet services.

In December 2014, PayPal commissioned Deloitte Access Economics to undertake a study on innovation and technology neutral regulations, including digital currencies, and we would be pleased to table this to the Inquiry in early 2015. We also note the recommendations in the Financial System Inquiry (released 7 December 2014) regarding digital currencies and endorse the approach set forward by that Inquiry.

Please do not hesitate to be in contact with this office if the Inquiry has any further questions or feedback in relation to the positions outlined in this submission

PayPal wishes the Inquiry all the best in its deliberations and the release of its final report into digital currency and appropriate regulations governing the companies that trade or transmit digital currencies for consumers.

Yours sincerely,

Kristen Foster

Director, Government Relations & Corporate Affairs



PayPal’s Current Regulatory Structure in Australia Versus Digital Currencies

PayPal is licensed by the Australian Prudential Regulation Authority (APRA) as an authorised-deposit taking institution (ADI) providing online payments (classified by APRA as ‘purchased payment facilities’) for the sale of goods and services and for person to person transactions. PayPal also holds a Financial Services Licence in Australia from the Australian Securities and Investments Commission (ASIC). In addition, PayPal is regulated by the Australian Transaction Reports and Analysis Centre (AUSTRAC) as a Reporting Entity.

PayPal is therefore appropriately regulated in the Australian market and given the types of services we provide does not constitute a digital currency for the purposes of regulation.

On the other hand, in comparison to the regulatory framework, under which PayPal operates, digital currencies are not regulated in Australia.

BUSINESS NAME	REGULATORY FRAMEWORK IN AUSTRALIA	REGULATED IN AUSTRALIA
PayPal	APRA (ADI licence) ASIC (AFSL licence) AUSTRAC (AML)	YES
Digital Currencies	None – not regulated in Australia	NO The ATO does not deem Bitcoin and other crypto-currencies to be money or foreign currency - they’re treated as assets for capital gains tax purposes, making them more like a barter arrangement. ²

² <https://www.ato.gov.au/General/Gen/Tax-treatment-of-crypto-currencies-in-Australia---specifically-bitcoin/?page=1#Comments>



Clear Distinction between PayPal's business model and digital currencies

It is important to understand that a PayPal account (sometimes referred to as a Digital Wallet) is NOT a digital currency and therefore should not be captured under any definition of what constitutes a digital currency.

The flow chart of how PayPal's current business model for the digital wallet works, and its benefits, can be accessed at: [www.paypal-community.com/ppl/attachments/ppl/PPFWD/107/1/Competitive%20infographic%20v5\[2\].pdf](http://www.paypal-community.com/ppl/attachments/ppl/PPFWD/107/1/Competitive%20infographic%20v5[2].pdf)

On the other hand, the definition of a digital or virtual currency, while still in formative stages in many markets, was outlined in a June 2014 FATF Report in which it states:

“Virtual currency is a digital representation⁵ of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinguished from fiat currency (a.k.a. “real currency,” “real money,” or “national currency”), which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency. E-money is a digital transfer mechanism for fiat currency—i.e., it electronically transfers value that has legal tender status. Digital currency can mean a digital representation of either virtual currency (non-fiat) or e-money (fiat) and thus is often used interchangeably with the term “virtual currency”.³

³ FATF Report, [Virtual Currencies Key Definitions and Potential AML/CFT Risks](http://www.fatf-gafi.org/media/fatf/documents/reports/virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf), June 2014, pp4 at: <http://www.fatf-gafi.org/media/fatf/documents/reports/virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>



PayPal's View on Digital Currencies and Bitcoin

Digital currencies are changing the global payments landscape and will play an important role in the future, particularly in global trade and the broader global economy and ecommerce environment. While digital currencies are yet to become main-stream, for companies such as PayPal which embrace innovation and efficiency in the global digital economy we will continue to monitor developments in this ever-evolving arena. Indeed, questions have been raised with PayPal regarding how we not only view crypto-currencies but also how we may integrate them into our product.

First and foremost, PayPal's objective is to ensure a safe, frictionless and seamless buying experience for consumers and merchants compliant with all relevant legislation, including that on anti-money laundering and consumer protection. PayPal also aims to provide flexibility and freedom of choice to participants in the payments ecosystem.

In September 2014, in the United States, PayPal announced that U.S. businesses working with its subsidiary Braintree would soon be able, at the business' discretion, to accept Bitcoin as a payment option. Braintree is a "payment gateway" technology provider which enables merchants to integrate a variety of different payment methods into the merchant's online and mobile shopping processes. On 23 September 2014 PayPal announced our next step in helping U.S. merchants accept Bitcoin payments. Per the announcement, PayPal has now entered into agreements with leading Bitcoin payment processors [BitPay](#), [Coinbase](#) and [GoCoin](#). These agreements let PayPal digital goods merchants accept Bitcoin with a simple integration through the [PayPal Payments Hub](#). This will be available to digital goods merchants in North America first, as a test platform, and is not currently available in the Australian market. The three aforementioned partners will conduct the Bitcoin processing for our merchants – neither PayPal nor Braintree will buy, sell, or process the Bitcoin digital currency.

PayPal chose to work with BitPay, Coinbase and GoCoin in the United States because of our commitment to offering innovative and safer ways for businesses to accept payments. All three companies have taken steps to develop Anti Money Laundering programs and to ensure that they know their customers. PayPal's view is that digital goods merchants will be excited to work with these industry-leading companies to sell ringtones, games and music and get paid with Bitcoin.

However, it must be emphasised to the Senate Inquiry that PayPal's announcement does not mean that PayPal has added Bitcoin as a currency in our digital wallet in the US or that Bitcoin payments will be processed on the PayPal payments platform. At this stage, consumers will not be able to store Bitcoins in their PayPal digital wallets. The rationale for this is that PayPal wants to ensure that while embracing innovation we remain committed to making payments safer and more reliable for customers – all users of PayPal are linked to a specific named PayPal account, with consumer protection for buyers, but identity and consumer protection are not built into Bitcoin today. Therefore, we are proceeding gradually, with some support for merchants in the U.S. who want to accept Bitcoin, while holding off on other aspects.



PayPal's Position on Anti-Money Laundering and Counter-Terrorism Financing

As a global financial institution, PayPal is committed to full compliance with all applicable laws and regulations regarding Anti-Money Laundering and Counter Terrorism Financing (AML/CTF). PayPal's policy is to prevent people engaged in money laundering, fraud and other financial crimes, including terrorist financing, from using PayPal's services. We have a comprehensive 'Know Your Customer' system.

PayPal has robust policies and procedures to detect, prevent and report suspicious activity. To comply with U.S. OFAC (Office of Foreign Asset Control) requirements, and Australian and other international sanctions, we screen our customer accounts against government watch lists. In addition, we may request that users provide us with documentation to help prove their identity or for business verification purposes. The Massachusetts Institute of Technology's Geospatial Data Centre has outlined PayPal's commitment to anti-money laundering and counter terrorism, stating that:

"For PayPal to operate, it has a comprehensive KYC (Know Your Customer) sign-up system (which if someone is to use purely for money-laundering purposes, would think twice). Laundered money operators try to avoid extensive KYC checks. In addition to this, PayPal does the following:

- All payments in the PayPal system (especially overseas payments) go through an AML check. PayPal can easily detect multiple payments (velocity checks), payments made using different financial instruments, payments to multiple people / same people by multiple people (1-to-1, Many-to-1, 1-to-Many) etc.
- The AML infrastructure (primarily through Transaction Monitoring) can detect patterns that are common money laundering scenarios.
- PayPal is also required to file Suspicious Activity Reports (SAR) with the Financial Crimes Enforcement Network (FinCEN).
- PayPal also does OFAC (Office of Foreign Assets Control) checks – again with Department of Treasury

All of the above *aid* PayPal in reducing money laundering⁴. Similar structures and processes should also be followed by digital currency transmission services to protect consumers.

PayPal reports suspicious transactions to the financial intelligence unit in the jurisdictions in which we operate. In Australia, we work closely with AUSTRAC on all aspects of AML and counter-terrorism measures to ensure strict compliance with the regimes in place. On digital currency financial service companies our view is no different - they must comply with all laws and regulations in the jurisdictions in which they operate.

⁴ <http://cybersecurity.mit.edu/2012/11/cyber-laundering-part-iii-paypal-example/>



PayPal also has in place an Acceptable Use Policy⁵ (AUP) which clearly outlines prohibited activities in PayPal's system, including but not limited to the sale of narcotics and other controlled substances, sale of weapons and knives, sale of tobacco and of course also prohibits all illegal activities. This Policy is backed up by people and processes to detect and prevent potential violations.

⁵ <https://www.paypal.com/webapps/mpp/ua/acceptableuse-full>



Regulation of Digital Currencies

PayPal has built a digital wallet that can take multiple types of currency – in recognition of the changing payments environment. Therefore regulation of digital currencies should not be applied to PayPal as we are already appropriately regulated.

One of the factors that has discouraged PayPal from adding Bitcoin as an additional type of currency in the PayPal wallet is the lack of clarity related to regulation of digital currencies (as with other jurisdictions PayPal is regulated in Australia and is a significantly different business model to digital currencies).

It is important to draw a distinction between digital currencies, versus the companies that trade or facilitate transactions in digital currencies. While the currency itself should not be regulated, and transactions by individual users without the assistance of intermediaries should not be regulated, companies that provide a financial service for digital currency transmission, for issuance or sale of digital currency, or for exchange with other currencies such as the Australian Dollar, should be regulated in a manner similar to the existing regulations that apply to other payment services. Those regulations, however, should be adapted to recognise the specific details of how different digital currencies work, particularly “decentralised” digital currencies that are not controlled by a specific issuer.

With respect to Bitcoin and other decentralized digital currencies, it is also important to note that the Blockchain technology which provides protection against counterfeiting and double spending of the currency also has many potential applications that do not involve payments. The government should clarify that non-payments applications will not be subject to payments regulation.

In the US, digital currency sellers, exchanges and processors must register with the Department of the Treasury as a Money Service Business, and implement an Anti-Money Laundering/Counter Terrorist Financing program. The Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) enforces federal regulation of money services businesses in the United States.

On 18 March 2013, FinCEN [published guidance](#) announcing that it would make no distinction between transmitters of government (or “fiat”) currency and transmitters of bitcoin, or what it termed, “decentralized convertible virtual currency” or money service businesses. This was taken a step further when on 10 November 2014, FinCEN provided a statement on providing banking services to money services businesses⁶. In that statement FinCEN noted that MSBs were:

“losing access to banking services, which may in part be a result of concerns about regulatory scrutiny...MSB’s play an important role in a transparent financial system,

⁶ http://www.fincen.gov/news_room/nr/pdf/20141110.pdf



*particularly because they often provide financial services to people less likely to use traditional banking services”.*⁷

The United Kingdom also has a current inquiry into digital currencies. On 3 November 2014 the Treasury issued a call for information on digital currencies and associated technologies, namely that, “the scope of this Call for Information is digital currencies, with a focus on digital currencies in their function as a payment method, rather than as a speculative investment. For the purpose of this Call for Information, a digital currency scheme is one which incorporates both a decentralised payment system and a related currency. All the schemes exhibit a publicly visible ledger which is shared across a computing network. A key defining feature of each digital currency scheme is the process by which its users reconcile changes to its ledger (that is, on which transactions to accept as valid).”⁸

The UK Digital Currency Association lodged a submission to that review which outlined that digital currencies should be treated as a 'financial measure'. The UKDCA also argued that over-regulation of the industry would stifle innovation. PayPal’s position is that technology neutral regulation is preferable to ensure the continuation of innovation in markets.

Applied in the Australian context, a number of regulators, namely, AUSTRAC, APRA, the Australian Securities and Investments Commission and the Reserve Bank of Australia could regulate digital currency financial service companies and provide effective regulatory oversight of the development of digital currencies in the Australian market. As noted in the recent report of the Financial Services Inquiry, regulation should be graduated so that new startup companies can introduce new services to the market without the full weight of regulation, but the companies would also know to begin planning right away to build out all the appropriate internal controls and compliance programs.

⁷ http://www.fincen.gov/news_room/nr/pdf/20141110.pdf

⁸ <https://www.gov.uk/government/consultations/digital-currencies-call-for-information/digital-currencies-call-for-information>



Recommendations

PayPal recommends the following approach to digital currencies in the Australian market:

- Digital currencies should be clearly defined and regulated and recognised as financial instruments - this would facilitate more certainty and clarity of digital currencies and create more consumer protection.
- Technology neutral regulation is preferable to ensure innovation is not stifled.
- A registration process and licensing regime could be applied to companies providing digital currency financial services in Australia.
- Regulators such as AUSTRAC, the Australian Securities and Investments Commission and the Reserve Bank of Australia could regulate digital currency financial services companies and provide effective regulatory oversight and prudential supervision of the development of digital currencies in Australia.
- Digital currency financial services companies at a minimum should be subject to the AML/CTF Act.

PayPal looks forward to further consultation with the Inquiry.