

Chapter 5

Regulatory frameworks

5.1 One of the concerns raised in evidence about digital currencies is that they are largely unregulated. This chapter examines the unique challenges that digital currencies have created for regulators, including how to maintain the integrity of the financial system while creating a regulatory environment that encourages innovation. This chapter will focus on two separate, but overlapping, regulatory issues:

- whether digital currency should be treated as a financial product for the purposes of the Corporations Act and ASIC Act; and
- how digital currency payments facilities fit within the current payments system regulations.

Concerns raised by submitters

Lack of clarity

5.2 A range of concerns were expressed about the lack of clarity around the regulation of digital currencies. PayPal, an online payments service, explained that the lack of regulatory clarity was one of the factors in its decision not to add Bitcoin as an additional type of currency in the PayPal wallet.¹

5.3 CoinJar noted that 'much of the uncertainty faced by digital currency companies is not the absence of a rulebook, but rather an abundance of possible existing rulebooks and no clarity on which one will ultimately apply'.²

5.4 ASIC advised that, as there was some uncertainty initially about the application of the Corporations Act and the ASIC Act to digital currencies, it had consulted with individual businesses as well as ADCCA to clarify the legal position of digital currencies.³

Appropriate level of regulation

5.5 A number of submitters expressed a range of view on the appropriate level of regulation, as well as which businesses should be included in any proposed regulatory framework.

5.6 Dr Rhys Bollen, Faculty of Law, Monash University, noted that 'a well designed and proportionate legal and regulatory regime will support user confidence in, and therefore growth of, innovative payment systems such as virtual currencies'.⁴

1 PayPal, *Submission 45*, p. 7.

2 CoinJar, *Submission 12*, p. 5.

3 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 39.

4 Dr Rhys Bollen, *Submission 46*, p. 37.

5.7 Mr Chris Mountford, a software engineer at Australian software company Atlassian, was worried that 'kneejerk reactions to regulation fuelled by headlines and hysteria will obviously endanger innovation in Australia and push FinTech companies offshore'.⁵ Similarly, mHITs Limited warned against overregulation.⁶

5.8 Mr Antonopoulos maintained that 'regulation of the protocol itself is not really possible at this time'.⁷ The Chamber of Digital Commerce outlined the importance of understanding the distinction between digital currencies and the underlying technology or protocol when developing public policy:

...not all that is labelled as a 'currency' in fact functions as a currency. In particular, it is important that we avoid imposing onerous and commercially unproductive burdens on those who work with the protocol, developing and deploying applications, and who do not use crypto-currencies as a medium of exchange.⁸

5.9 Ripple Labs also noted that 'as pure technologies, these protocols cannot themselves be regulated. However, the entities that make use of the protocols to buy, sell, or exchange those virtual or fiat currencies can be subject to regulation'.⁹

5.10 PayPal drew a distinction between digital currencies and the intermediary 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.¹⁰

5.11 Furthermore, PayPal observed that the distributed ledger technology has many potential applications that do not involve payments. As such the 'government should clarify that non-payments applications will not be subject to payments regulation'.¹¹

5 Mr Chris Mountford, *Submission 40*, p. 7.

6 mHITs Limited, *Submission 48*, p. 14.

7 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 5.

8 Chamber of Digital Commerce, *Submission 37*, p. 2.

9 Ripple Labs, *Submission 21*, p. 3.

10 PayPal, *Submission 45*, p. 9.

11 PayPal, *Submission 45*, p. 9.

Regulation of the sale and purchase of digital currency

5.12 The current Corporations Act financial services regulatory regime applies to 'financial products'. In broad terms, financial products are a facility through which a person:

- (a) makes a financial investment
- (b) manages financial risk; or
- (c) makes non-cash payments.¹²

5.13 ASIC's view is that digital currency does not fit within these legal definitions, and digital currencies are not financial products. This means that a person does not need:

- (a) an Australian market licence to operate a digital currency trading platform; and
- (b) an Australian financial services (AFS) licence in order to:
 - (i) trade in digital currency;
 - (ii) hold a digital currency on behalf of another person;
 - (iii) provide advice in relation to digital currency; and
 - (iv) arrange for others to buy and sell digital currency.¹³

5.14 Consistent with the ATO's view, ASIC does not consider that digital currencies are money or currency for the purposes of the Corporations Act or the ASIC Act, instead they are more akin to a commodity. As such, the exchanges of digital currency and national currency are not treated as foreign exchange contracts.¹⁴

5.15 Also, although digital currency is not considered to be a financial product under the ASIC Act, it does fall under the equivalent general consumer protection provisions administered by the ACCC in the *Competition and Consumer Act 2010*.¹⁵ The consumer protection obligations in both the ASIC Act and the *Competition and Consumer Act 2010* state that service providers must not make false or misleading representations or engage in unconscionable conduct.¹⁶

Should digital currencies be treated as currency?

5.16 Some submitters, such as CoinJar, suggested that many of the big regulatory questions surrounding digital currencies could be addressed by treating them in the same way as foreign currencies, rather than as commodities or assets. For example,

12 Australian Securities and Investments Commission, *Submission 44*, p. 8.

13 Australian Securities and Investments Commission, *Submission 44*, p. 3.

14 Australian Securities and Investments Commission, *Submission 44*, p. 12.

15 Australian Securities and Investments Commission, *Submission 44*, p. 12.

16 Australian Securities and Investments Commission, *Submission 44*, p. 8.

'imposing the same obligations on digital currency businesses as those for companies holding funds, lending [and] offering financial advice'.¹⁷

5.17 However, ASIC noted that if digital currencies were treated in the same way as foreign currency, they would not automatically be considered a financial product under the Corporations Act.¹⁸ For example, credit facilities and foreign exchange contracts that are settled immediately are considered financial products for the purposes of the ASIC Act, but not the Corporations Act.¹⁹

5.18 ASIC advised that its understanding was that contracts for exchanging national currency for digital currency through online platforms or ATMs are typically settled immediately, and the normal licensing and disclosure requirements under the Corporations Act would not apply to digital currency exchanges. However, if digital currencies were treated as foreign currencies, digital currency would be subject to the consumer protection provisions of the ASIC Act, as foreign exchange contracts that are settled immediately are considered financial products.²⁰ The definition of financial products varies slightly between the Corporations Act and the ASIC Act. This means that while a person may have to comply with the general consumer protection obligations under the ASIC Act, they may not be subject to the licensing, conduct and disclosure rules in the Corporations Act.

5.19 ASIC noted that there were no meaningful differences between the consumer protection provisions in the ASIC Act and the *Competition and Consumer Act 2010*.²¹ ASIC and the ACCC are able to refer powers to each other in cases of regulatory overlap, where it is considered more appropriate for matters within one regulator's jurisdiction to be dealt with by the other regulator.²²

Should digital currencies be treated as financial products?

5.20 As digital currency exchanges are generally settled immediately, even if the decision were made to treat digital currency as currency, they would not necessarily be considered financial products under the Corporations Act. ASIC explained that if digital currencies were subject to the licensing, conduct, and disclosure rules in the Corporations Act, they would need to be defined in the regulations of the Corporations Act as financial products, or something akin to financial products. Mr Saadat, ASIC, noted that under the current legal definition:

A digital currency, in and of itself, is not a financial product. Providing advice about a digital currency is not financial product advice, buying and selling digital currency means you are not making a market in a financial

17 CoinJar, *Submission 12*, p. 5.

18 Australian Securities and Investments Commission, *Submission 44*, p. 21.

19 Australian Securities and Investments Commission, *Submission 44*, pp. 8–9.

20 Australian Securities and Investments Commission, *Submission 44*, p. 21.

21 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, pp. 39, 43.

22 Australian Securities and Investments Commission, *Submission 44*, p. 12.

product. But some ancillary services you might provide that are associated with digital currencies could be regulated by ASIC.²³

5.21 ASIC advised the committee that extending the definition of financial products under the Corporations Act and the ASIC Act to digital currencies, such as Bitcoin, would not be straightforward as the decentralised framework means that the normal obligations on product issuers cannot be imposed.²⁴ For example, if digital currency were to be included in the financial services regulatory regime, product disclosure obligations may need to be tailored to clarify that digital currencies do not have an identifiable 'issuer'.²⁵

5.22 If digital currencies were declared financial products, trading platforms may need to hold Australian market licences. The compliance costs of obtaining and maintaining an Australian market licence may be too burdensome for digital currency trading platforms and encourage businesses to move offshore.²⁶ Mr Saadat explained:

I think the difficulty in regulating the trading platforms like traditional markets is that the compliance obligations that are associated with running a traditional financial market are quite high. The bar is set quite high. I think it is likely that if you were simply to apply the existing framework to platforms that sell digital currency, most would find it uneconomic to sustain in Australia. And because the market for these bitcoins is global, a lot of that activity would move offshore and Australian consumers would probably still end up being able to speculate with digital currency by buying and selling on foreign trading platforms.²⁷

5.23 Also, if digital currencies were declared financial products, a number of industry participants, including overseas entities that deal with Australian based buyers and sellers, may be required to obtain Australian financial services (AFS) licences as they would be providing financial products. This may cause difficulties for digital currency businesses, as well as ASIC, as it may be difficult to determine that a person does not require an AFS licence because they do not provide services to Australian clients.²⁸ Mr Saadat stated:

...it is not straightforward to regulate digital currencies like financial products. You would have to solve a number of unique issues associated with digital currencies, and also the industry would probably look for a

23 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 43.

24 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 44.

25 Australian Securities and Investments Commission, *Submission 44*, p. 24.

26 Australian Securities and Investments Commission, *Submission 44*, p. 23.

27 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 38.

28 Australian Securities and Investments Commission, *Submission 44*, pp. 2–3.

more tailored regulatory regime that makes the industry still commercially feasible in this country.²⁹

Consumer protections for buying and selling digital currencies

5.24 As noted earlier, the general consumer protection provisions of the *Competition and Consumer Act 2010*, which is administered by the ACCC, apply to digital currencies. Mr Bezzi, ACCC, noted that consumers ought be allowed to speculate, and be able to take risks with regards to investing in digital currencies. He noted:

We cannot wrap people up in cottonwool. They may be taking risks with the full knowledge that what they are doing has risk associated with it. I should compliment ASIC on the very useful advice they give to consumers on their MoneySmart website about these issues. It points out all the risks. If people are informed and they want to take the risks, then why should we stop them?³⁰

5.25 Mr Lucas Cullen, Bitcoin Brisbane, pointed out that consumers should take the care when purchasing digital currencies, particularly from offshore exchanges, the same way they would for any online purchase. His advice to people wanting to buy digital currency was that 'you have to work out who you are dealing with and if these companies are reputable. Perhaps you should start small and only risk the amount of money you can afford to lose—just like any transaction on the internet'.³¹

5.26 A chartered accountant and crypto-currency enthusiast, suggested that consumers should be encouraged to educate themselves about the risks of digital currencies. He stated:

Regulation and consumer protection should focus on education. Upon being approached by potential users, nodes of entry, e.g. online exchanges and ATMs, should be required to issue warnings about the risks involved in the digital currency space, including the potential for scams and financial loss and the irreversibility of transactions. This could be similar to the warnings that fund managers, brokerages and money transfer providers are required to issue for many of their products.³²

Committee view

5.27 The committee understands that digital currency is currently covered by the consumer protection provisions under the *Competition and Consumer Act 2010*. The committee considers that, as discussed later in this chapter, further research should be conducted before any change to this arrangement is made, such as designating digital currency as either a foreign currency or a financial product.

29 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 36.

30 Mr Marcus Bezzi, Australian Competition and Consumer Commission, *Committee Hansard*, 7 April 2015, pp. 38, 43.

31 Mr Lucas Cullen, Bitcoin Brisbane, *Committee Hansard*, 26 November 2014, p. 18.

32 Name withheld, *Submission 26*, p. [3].

Digital currency as a form of payment

5.28 While digital currency itself does not fit within the definition of financial products, ASIC considers that some digital currency businesses offer facilities, such as non-cash payment facilities, which may be financial products.³³ ASIC noted that where regulated financial services providers have expanded their product offerings to include the use of digital currencies, these products are considered financial products. For example, PayPal recently entered into an agreement with leading Bitcoin payments processors Bitpay, Coinbase and GoCoin, to enable its merchants to accept Bitcoin. In this instance, the usual financial services licensing, conduct and disclosure obligations for financial products in the Corporations Act apply.³⁴

5.29 ASIC noted that intermediary facilities for paying for goods and services may be providing a facility through which non-cash payments are made in digital currency, regardless of whether the merchant accepts digital currency. Non-cash payments are a type of financial product and this type of digital currency intermediary facility may require an AFS licence. An example of this kind of facility is the recently announced CoinJar Swipe card, which allows CoinJar customers to convert the value in their CoinJar Bitcoin wallet to Australian dollars loaded onto an EFTPOS card.³⁵

5.30 The regulatory framework is designed to maintain trust and confidence in the payments system. MasterCard noted that in order to achieve a level playing field, all participants in the payments system that provide similar services to customers should be regulated in the same way.³⁶ Any payment service, including payment facilities using digital currency, should have the same minimum standards and consumer protections 'that consumers and other stakeholders (regulators, governments, banks and merchants) have come to expect'.³⁷

5.31 Dr Carmody, Westpac, noted that regulation should be based on the nature of the services that different businesses provide, for example:

...there are online wallets that provide effective custody of bitcoin...You might say that, by analogy, some of the regulations that apply to traditional providers of custody or banking services might apply to those businesses but may not apply to a pure broker. I think it really goes to the nature of the activity that different businesses provide.³⁸

5.32 In relation to the payments system, the Australian Bankers' Association's (ABA) broad position on emerging technologies was that the authorities should consider whether the 'regulatory oversight that is already provided for the established

33 Australian Securities and Investments Commission, *Submission 44*, p. 12.

34 Australian Securities and Investments Commission, *Submission 44*, p. 15.

35 Australian Securities and Investments Commission, *Submission 44*, pp. 15–16.

36 MasterCard, *Submission 18*, p. [1].

37 MasterCard, *Submission 18*, p. [2].

38 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, p. 24.

payment system should be extended to these emerging technologies—again to ensure the integrity of the system and confidence of consumers in operating the system'.³⁹

5.33 Mr Pearson, ABA, suggested that where digital currency businesses are providing complementary services to mainstream financial services, they should be brought within the regulatory framework. He suggested that digital currencies are likely to complement rather than replace the existing payments system. He noted:

If [digital currency] is just a complementary system that is outside the regulated system but does not really do much more than what you can do inside the system, perhaps the authorities should then be thinking, 'Maybe it would be appropriate to bring it within the house to make sure that all the protections that underpin our existing safe and secure system apply equally well to these new developments.'⁴⁰

5.34 APCA argued that it is 'prudent to ensure that the regulatory framework can respond to new payment methods as they develop'.⁴¹ APCA supported the conclusion of the Financial System Inquiry that regulators, such as the RBA, should review the extent to which:

...their current powers enable them to regulate system and service providers using alternative mediums of exchange to national currencies, such as digital currencies. The *Payment Systems (Regulation) Act 1998* empowers the [Payment System Board] PSB to regulate 'funds transfer systems that facilitate the circulation of money'. It is not clear that the PSB can regulate payment systems involving alternative mediums of exchange that are not national currencies. Currently, national currencies are the only instruments widely used to fulfil the economic functions of money—that is, as a store of value, a medium of exchange and a unit of account.⁴²

5.35 The RBA, under the regulatory framework of the *Payment Systems (Regulation) Act 1998*, 'does not automatically have to license payment systems—they can develop—but, at the point where the RBA thinks they represent a stability issue, it can then designate and regulate over the payment system'.⁴³

5.36 MasterCard submitted that any regulation should be technology neutral to ensure that with advancements in technology, regulations will apply to all new

39 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 20.

40 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 25.

41 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 1.

42 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 166.

43 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 7.

payment service providers.⁴⁴ The Financial System Inquiry also recommended that regulation should aim to be technology neutral.⁴⁵

Graduated regulation

5.37 The Financial System Inquiry supported broadening regulation to include services involving alternative mediums of exchange, such as digital currencies. It recommended graduated regulation for purchased payment facilities 'to enable market entry and ensure regulation is targeted to where it is most needed. At times, this may increase risks for some consumers, but it is expected to improve consumer outcomes overall'.⁴⁶

5.38 Mr Saadat, ASIC, noted that the current framework is already graduated in the way the Financial System Inquiry recommended. He advised the committee that there are already a number of exemptions for low-value facilities, for example:

...a non-cash payment facility where you can make and receive payments of digital currency—and if that facility only allows you to make...low-value payments, then there is relief in place that means that those kinds of providers do not need a licence from ASIC.⁴⁷

5.39 APCA supported the Financial System Inquiry's recommendation to develop a graduated regulatory framework.⁴⁸ Mr Hamilton, APCA, noted the 'idea is that you do not want to take something that is still very small and stifle it with the full protection appropriate to a system which touches millions of consumers'.⁴⁹

5.40 PayPal also supported the Financial System Inquiry's recommendation. It stated:

...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.⁵⁰

44 MasterCard, *Submission 18*, p. [1].

45 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 146.

46 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 146.

47 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 41. A low value non-cash payment facility is one where: a) the total amount available for making payments by any one person does not exceed \$1,000; b) the total amount available for making payments by all persons who hold a facility of that class does not exceed \$10,000,000; and c) the facility is not a component of another financial product; see ASIC, *Submission 44*, p. 16.

48 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 2.

49 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 6.

50 PayPal, *Submission 45*, p. 10.

5.41 Ripple Labs also supported a tiered regulatory regime to support innovation. It suggested:

Under such a scheme, smaller entrepreneurial companies could operate under a registration system, with lighter requirements than more established and larger players. Businesses operating above a certain threshold (in terms of risk and volume) could be required to obtain licenses to operate, with the full panoply of regulatory requirements, regular examinations and permissions.⁵¹

ePayments Code

5.42 The Financial System Inquiry recommended making the ePayments Code mandatory. The Code is currently voluntary and extending it to all service providers would 'help protect all consumers from fraud and unauthorised transactions'.⁵²

5.43 The ePayments Code provides a consumer protection regime, including:

- (a) provision for disclosure of the terms and conditions of the payment facility;
- (b) minimum expiry dates and disclosure of expiry dates;
- (c) provision of receipts for transactions;
- (d) disclosure of ATM fees;
- (e) provision of statements of transactions;
- (f) liability for unauthorised transactions; and
- (g) complaints procedures.⁵³

5.44 Mr Saadat noted that PayPal had 'recently come out and said that others should also be subscribing to the code from both a consumer protection perspective and a level playing field perspective'.⁵⁴

5.45 ASIC suggested if the ePayments Code was made mandatory, serious consideration would need to be given to how it would apply to services involving digital currency.⁵⁵ Mr Saadat noted that the application of the ePayments Code would depend on the nature of the digital currency business. For example the Code would not apply to digital currency trading platforms, but it may cover non-cash payments providers that facilitate online payments using digital currency.⁵⁶

51 Ripple Labs, *Submission 8*, p. 21.

52 The Australian Government the Treasury, *Financial System Inquiry: Final report*, November 2014, p. 167.

53 Australian Securities and Investments Commission, *Submission 44*, p. 25.

54 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 41.

55 Australian Securities and Investments Commission, *Submission 44*, p. 25.

56 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 42.

Self-regulation

5.46 Treasury noted that the digital currency industry is not objecting to regulation. Mr McAuliffe, Treasury, stated 'in fact, it is a situation where, the industry, domestically, is trying to do self-regulation that in some respects mirrors some of the actual legal requirements, because they see that there is benefit in having a self-regulatory model'.⁵⁷

5.47 ADCCA recommended a self-regulatory model for the digital currency businesses:

ADCCA believes a self-regulatory model enforced through its industry Code of Conduct, to which ADCCA members must adhere, is the ideal regulatory environment to support the Digital Currency industry. This framework will enable customers to have greater confidence in the entities providing Digital Currency FinTech services. The Code of Conduct comprises several best practice requirements benchmarked against requirements for Australian financial services institutions.⁵⁸

5.48 Mr Guzowski, ABA technology, noted that ADCCA's approach is to put standards on the industry and implement standards in the software, when the industry is starting. He explained that this approach would mean that digital currency businesses could be prepared 'rather than have some standards come in place or regulations come into place when the industry is already in full swing, which is much harder to implement and will cause disruption to services'.⁵⁹

5.49 Adroit Lawyers, a law firm specialising in Bitcoin and digital currency, supported the concept of self-regulation, given the unique characteristics of digital currency technology and the challenges it presents to the current regulatory framework. It cautioned, however, that:

...the ultimate regulatory framework needs to achieve a balance between mitigating risks to consumers and the wider market, and keeping the barriers to entry low enough to encourage innovation and growth in the digital currency industry.

This balance will only be achieved through ongoing consultation and collaboration between the industry, the government and regulatory bodies including ASIC.⁶⁰

5.50 The Bitcoin Foundation and Bitcoin Association of Australia noted that any regulatory framework would need to focus on regulating for innovation, regardless of whether it was industry based self-regulation or government regulation.⁶¹

57 Mr McAuliffe, Treasury, *Committee Hansard*, 4 March 2015, p. 23.

58 Australian Digital Currency Commerce Association, *Submission 15*, p. 3.

59 Mr Guzowski, ABA Technology, *Committee Hansard*, 26 November 2014, p. 23.

60 Adroit Lawyers, *Submission 39*, p. 7.

61 Bitcoin Foundation and Bitcoin Association of Australia, *Submission 13*, p. 11.

5.51 Ripple Labs believed that digital currency businesses should implement best practices, including terms of use, where appropriate, such as:

(1) any fees charged to consumers, (2) contact information and address, (3) the business's dispute resolution process, (4) description of protection against unauthorized transactions, (5) efforts around privacy and security, (6) customer services, and (7) chargeback policy.⁶²

5.52 Ripple Labs predicted that eventually 'the good actors (i.e., virtual currency businesses that comply with the regulatory regime on digital currency) will be distinguished from the bad actors (i.e., businesses that operate anonymous exchanges) and it will be easier for users to detect fraudulent scams'.⁶³

'Wait-and-see' approach to regulation

5.53 Treasury noted that it is monitoring the digital currency industry and 'waiting on this inquiry to finish its deliberations before coming back to look at it in a bit more detail'.⁶⁴

5.54 ASIC noted that it would be interested in better understanding emerging consumer adoption, particularly if the use of digital currency becomes more mainstream through online accounts such as PayPal or iTunes. ASIC was concerned about what this could mean for consumer protection in relation to loss of funds and unauthorised transactions. Mr Saadat stated:

Our view would be that transactions that are similar in substance should be regulated in similar ways. If someone is making a payment to Apple through their PayPal account, whether that is with Australian dollars, US dollars or a digital currency, then in principle it makes sense for those transactions to be regulated in similar ways and for consumers to be afforded the same protections. If there were a potential gap in ASIC's oversight based on the technical legal position, we would certainly bring that to the attention of Treasury and ensure that consumers were made aware of any gaps as well.⁶⁵

5.55 Mr Saadat noted that as digital currencies have not entered the mainstream a 'reasonable view might be to wait and assess whether further action is required'.⁶⁶ He stated:

...I suppose there is a bit of a chicken-and-egg issue around whether you wait for something like that to happen before you decide what regulatory framework you should apply, or you try and come up with a regulatory framework in anticipation of that occurring. I do not think there is an easy

62 Ripple Labs, *Submission 21*, p. 13.

63 Ripple Labs, *Submission 21*, p. 13.

64 Mr McAuliffe, Treasury, *Committee Hansard*, 4 March 2015, p. 23.

65 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 39.

66 Mr Michael Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 38.

answer to that question because the risk in creating a regulatory framework in anticipation of something happening is that you get it wrong.⁶⁷

5.56 Mr Antonopoulos also argued for a 'wait-and-see' approach to regulation, similar to the approach to the internet in its early years which 'allowed the network to thrive and change and morph into various different models based on consumer adoption'.⁶⁸ He noted that the industry has solved many of the problems with digital currency itself, through innovation rather than regulation. For example, the developments in security mechanisms which allow individuals to control their Bitcoin holdings directly, 'so they do not give them to custodial exchanges and other organisations where they can be stolen'.⁶⁹

5.57 APCA recommended that the newly-formed Australian Payments Council has a 'critical role in advising how to deal with new entrants and new technologies to minimise the potential for ill-considered interventions by public regulators'.⁷⁰

Need for further information

5.58 Mr Antonopoulos explained that there is a lot of uncertainty surrounding digital currencies as 'we are dealing with a very disruptive and fast-moving technology that has only recently emerged into the limelight'. He noted:

We do not really know where Bitcoin coin will be in a couple of years, in terms of whether it will be used primarily as a long-term store value—akin to a digital gold—for transactions involving large parties or, as I would like to say, the kind of currency used to buy aircraft carriers with, or if it will turn into a currency that is used for microtransactions and retail transactions and consumer online commerce—the kind of currency you use to buy a cup of coffee—or perhaps fill in both of those at the same time. There are many unanswered questions at the moment.⁷¹

5.59 There has been research conducted using the Bitcoin distributed ledger to determine the nature of Bitcoin transactions. For example, Dr Dirk Baur, Dr KiHoon Hong and Dr Adrian Lee from the Finance Discipline Group, University of Technology, Sydney provided a submission outlining their research using the Bitcoin distributed ledger. Their research found that there was a trend towards investment with a minority of users using Bitcoin as a medium of exchange.⁷² Dr Carmody, Westpac, noted that research that has been conducted using the Bitcoin distributed ledger, suggested that 25 to 50 percent of the transactions that take place each day are

67 Mr Saadat, Australian Securities and Investments Commission, *Committee Hansard*, 7 April 2015, p. 38.

68 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 6.

69 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 6; see also Mr Chris Mountford, *Submission 40*, pp. 4–7.

70 Australian Payments Clearing House, *Submission 43*, p. 3.

71 Mr Andreas Antonopoulos, *Committee Hansard*, 4 March 2015, p. 6.

72 The Finance Discipline Group, University of Technology, Sydney, *Submission 7*, p. [12].

made by people investing and trading in Bitcoin, rather than as payments for goods and services.⁷³

5.60 Mr Hamilton, APCA, noted the 'striking' lack of information about the levels of activity in digital currencies. APCA suggested that additional research in this area would be useful. Mr Hamilton noted that it would be a 'valuable undertaking to actually get a handle on how much volume and value there was relative to the mainstream payment system—what gets measured, gets managed'.⁷⁴

5.61 Similarly, Mr Pearson, ABA, noted that it is difficult to make a definitive statement on the most appropriate regulatory framework, until more information has been gathered.⁷⁵ He noted that 'you really need to understand the size and role of these emerging players vis-à-vis the established industry to be able to then make the next step, which is how to most appropriately regulate it'.⁷⁶ Mr Pearson commented that the UK government's approach seemed to be to invest 'the money into research to gather the information as a first step to see if it is appropriate to then move to the next step, which would be to bring these new technologies and new frontiers within the existing regulatory system'.⁷⁷ He suggested the RBA may be the appropriate agency to gather this information.⁷⁸

5.62 Mr Kendall, APCA, reasoned that 'the more data that we have available the better we will know what level the transactions might be of some concern'.⁷⁹ Ripple Labs view was that the government should seek to clarify the actual risks and opportunities presented by different digital currency businesses.⁸⁰

Committee view

5.63 The committee acknowledges the need for a clear regulatory approach for both consumers and the digital currency industry. The committee considered concerns raised by submitters about the negative effect overregulation would have at this early stage in the development of the industry. In this respect, the central concern was any regulatory framework should balance the need to mitigate risks facing consumers and the broader financial system, while still encouraging innovation and growth in the industry by keeping the barriers to entry low. As the digital currency industry is still in its early stages, the committee supports a 'wait-and-see' approach to government regulation. The committee believes that the relevant government agencies should closely monitor the development of the digital currency industry in Australia, and

73 Dr Sean Carmody, Westpac, *Committee Hansard*, 7 April 2015, p. 21.

74 Mr Christopher Hamilton, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 2.

75 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 23.

76 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 20.

77 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 22.

78 Mr Tony Pearson, Australian Bankers' Association, *Committee Hansard*, 7 April 2015, p. 22.

79 Mr Kendall, Australian Payments Clearing House, *Committee Hansard*, 7 April 2015, p. 8.

80 Ripple Labs, *Submission 21*, p. 13.

conduct further research to determine the actual risks and opportunities presented by different types of digital currency businesses, for example Bitcoin exchanges and ATMs, or payment facilities. The committee supports ADCCA's continued development of industry best practices based on the standards set for financial services and payments services. This self-regulation model should be developed in consultation with government agencies, as well relevant stakeholders in the banking, finance and payments sectors. The committee considers that this will ensure that businesses are prepared for regulatory oversight in the future, as the industry expands and grows.

Recommendation 3

5.64 The committee recommends that the Australian government consider establishing a Digital Economy Taskforce to gather further information on the uses, opportunities and risks associated with digital currencies. This will enable regulators, such as the Reserve Bank of Australia and ASIC, to monitor and determine if and when it may be appropriate to regulate certain digital currency businesses. In the meantime, the committee supports ADCCA's continued development of a self-regulation model, in consultation with government agencies.

