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27 November 2014

Dr Kathleen Dermody
Committee Secretary
Senate Economics Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Dr Dermody,

Re: Senate Economics Reference Committee Inquiry into digital currency.

MasterCard writes in response to your letter dated 14 October 2014 inviting a submission to the Inquiry into Digital Currency. MasterCard appreciates the opportunity to provide comments on digital currency (also commonly referred to as virtual, crypto and electronic - currency).

About MasterCard

MasterCard is a technology company in the global payments industry. We operate the world's fastest payments processing network, connecting consumers, financial institutions, merchants, governments and businesses in more than 210 countries and territories. MasterCard's products and solutions make everyday commerce activities – such as shopping, traveling, running a business and managing finances – easier, more secure and more efficient for everyone.

MasterCard believes it is imperative that consumers and merchants are able to conduct business and commerce in a way that is safe and simple for all.

Developing an effective regulatory system

It is our view that all participants in the payments system that provide similar services to consumers should be regulated in the same way to achieve a level playing field for all. Moreover, any regulations should be technology neutral to ensure that they can and do apply to all new providers of payment services to consumers, especially with advancements in technology. Finally, consumer protection, anti-money laundering, counter-terrorist financing and payments system stability should be cornerstones of any regulation of electronic payments – including digital currencies.

Proposed Definition

In response to your request for specific information on ways to develop an effective regulatory system for digital currency, we support the definition that a digital currency is any type of digital unit that is used as a medium of exchange that does not have all the attributes of real currency and is convertible into, and has an equivalent value in, real currency, or acts as a substitute for real currency. Examples of a digital currency include Bitcoin (the predominant digital currency) and Ripple.

Consumer Protection

The minimum standard for any payment service, including the exchange and transmission of digital currency, is that it must be safe, stable and reliable for consumers; it must provide an accepted value guarantee without exposure to significant fluctuation and risk; and it must offer all the basic protections that consumers and other stakeholders (regulators, governments, banks and merchants) have come to expect.

MasterCard strongly advocates that these standards underpin any regulation that is implemented in Australia and that the challenges (discussed below) presented by digital currency are also addressed by such regulation.

Currently, digital currencies lack the basic protections consumers have come to expect when transacting online. For example, contrary to a consumer's experience when paying with a MasterCard product, if a consumer uses digital currency to make a purchase online and the merchant fails to deliver the goods, the consumer has no recourse through the digital currency's network. Similarly, if the consumer's device containing digital currencies is lost or stolen, the digital currencies may be lost forever, just like cash.

In addition, digital currencies can be highly volatile. For example, in 2014, the price of Bitcoin fluctuated significantly. This can be attributed to a number of factors such as speculative investors, security vulnerabilities, lack of liquidity, and the uncertainty of its long term value. These price fluctuations could create significant losses for consumers and hinder the utility of digital currencies as a reliable means of payment.

Other Considerations

- **Anti-Money Laundering and Counter-Terrorist Financing / Anonymity / Facilitating Trade in Illegal Goods and Services**

Any regulation adopted in Australia should address the anonymity that digital currency provides to each party in a transaction. Contrary to transactions made with a MasterCard product, the anonymity of digital currency transactions enables any party to facilitate the purchase of illegal goods or services; to launder money or finance terrorism; and to pursue other activity that introduces consumer and social harm without detection by regulatory or police authority. As we have learned from the experiences emanating from the Mt. Gox Bitcoin exchange collapse, the existence of a "block chain" does nothing to allow law enforcement, other government authorities or the public to identify the real identity of the parties to a digital currency transaction.

- **Lack of a trusted third party**

When transacting with a digital currency there is no bank, administrator, or regulator that could otherwise stand behind the value of a digital currency or its network. This means that consumers have no recourse if a digital currency loses its value or if the digital currency system fails.

Observations from Other Countries

The challenges described above have driven a number of governments to take action on digital currency.

In June 2014, the European Banking Authority (EBA) identified approximately seventy risks associated with digital currencies: risks to non-user market participants; risks to financial integrity, such as money laundering and other financial crimes; risks to existing payment systems in conventional fiat currencies, and risks to regulatory authorities. The EBA acknowledged that regulation to address all elements would be substantial and therefore recommended that national supervisory authorities discourage credit institutions, payment institutions and e-money institutions from buying, holding and selling digital currencies.

In addition, Russia deemed digital currencies as an unlawful substitute for money and is planning to pass a law in 2015 that would ban digital currencies. India and China banned their financial institutions from handling digital currency transactions.

In 2013, the U.S. Department of the Treasury's Financial Crimes Enforcement Network published guidance stating that digital currency exchangers and administrators are money services businesses requiring registration, reporting and recordkeeping. This includes, among other things, establishing an anti-money laundering program and filing suspicious activity reports.

The New York Department of Financial Services proposed a BitLicense framework that included provisions for companies operating in the digital currency space to, for example, conduct Know Your Customer (KYC) on customers; obtain a bond to safeguard consumers' digital currency deposits; hire a Chief Information Security Officer and Compliance Officer; and submit quarterly financial statements.

Suggestions for an effective regulatory system

For Australia to take a market leadership position, it will have to address risks that harm consumers and those that enable criminal behaviours while developing clear and consistent regulation which allow lawful digital currency businesses to flourish.

To help achieve these outcomes, the following elements - while not exhaustive - should be included within any regulation:

- A requirement that all transactions go through regulated and transparent administrators subject to supervision by Australia authorities (rather than just the current block chain process);
- Licensing and prudential supervision of all administrators comparable to non-bank money transmitters, with obligations to perform KYC, maintain an Anti-Money-Laundering and Counter-Terrorist Financing program, file suspicious activity reports, and address cybersecurity vulnerabilities; and
- Protections for the consumer (e.g., reversal of unauthorised charges and consumer complaint processes).

These provisions should support Australia in developing an effective regulatory scheme that also protects society against criminal activities and also provides consumers in Australia with safety, stability and reliability when transacting with digital currencies.

We appreciate the opportunity to make this submission, and would be happy to continue to engage with the Committee as it continues to consider this important issue.

Yours sincerely,

Eddie Grobler

Division President, Australasia