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Submission to the Senate Select Committee on Financial and Regulatory Technology

30/12/2020

Dear Committee Members,

Thank you for the opportunity to provide a submission in response to the Select Committee on Financial Technology and Regulatory Technology second issues paper.

Blockchain Australia is the peak industry body representing Australian businesses and business professionals participating in the digital economy through blockchain technology.

Blockchain Australia encourages the responsible adoption of blockchain technology by the government, industry, education and startup sectors across Australia as a means to drive innovation and create jobs in Australia.

The development of blockchain technology will enable business process transformation, impacting markets in almost every sector of the global economy.

Overview

Regulatory uncertainty is a persistent and recurring theme in blockchain and distributed ledger technology (“DLT”) discussions.

Clear regulatory frameworks are drivers of both efficiency and innovation.

The development and application of blockchain technology must, and does, include recognition that regulatory bodies will participate such that the integrity of networks and requirements including anti-money laundering, know your customer (“KYC”) and counter terrorism financing (“CTF”) protocols are appropriately incorporated.

Regulation should aid the establishment of the fairness and openness uniquely enabled by this technology.

Certainty afforded via the development of applications by a nimble regulatory regime will be the catalyst for uptake across industry, creating high value knowledge economy jobs and growth.



Debunking the myths

The development of blockchain technology remains in its early stages. Its impact however is now readily acknowledged in many quarters.

The interest in, and the implications of, advancements particularly in the financial services sector are profound. Most readily observed in conversations and development of central bank digital currencies, stablecoins and regulatory frameworks for the exchange of digital assets.

Governments and institutions who are embracing the opportunity of development have overcome a number of narratives that have slowed uptake or delayed consideration of the merits of blockchain applications.

In order for the sector to rapidly evolve, a number of misconceptions and misunderstandings need to be addressed. We bring to your attention the following “myths” that require reconsideration.

The Dark Web narrative

The nascent digital asset space, most readily recognised in the activity of digital exchanges and digital assets such as bitcoin and ethereum have and continue to suffer from a “dark web” narrative. One that suggests activity is primarily “illicit” or “nefarious”.

The narrative has been pervasive and is a material stumbling block to the development of confidence across the sector in Australia.

Statistics provided by [Chainalysis](#), a track and trace company aiding both industry and government alike in the development of regulatory compliant networks has estimated that between July 2019 and June 2020 -

- Australia ranked 18th for value received out of out of all 154 countries globally; and
- Only 1.7% of the value received was deemed illicit (Central & Southern Asia and Oceania average).

Chainalysis further reports that 0.8% of transactions comprise an illicit share of value sent from Australia (Central & Southern Asia and Oceania average).

Source: Chainalysis Digital Assets - Market Update November 2020

The “Killer App” narrative

The search for the killer app narrative is also often misguided, positing that absent some core adoption of a software usage, Blockchain and DLT will not see wider adoption.



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It fails to account for the fact that many of the applications of this technology are dedicated to the elimination of friction and business compliance costs across complex systems.

Supply chain management is an example of this consortia environment in which blockchain DLT has the greatest promise. The creation of solutions in this environment requires the development of solutions to address -

- Issues of risk and governance
- Stakeholder management
- Identity data management
- Removal or streamlining of paper based systems.

The complexity of these arrangements can be seen in supply chain projects such as the global [Tradelens](#) initiative that seeks to transform container logistics.

Legacy systems and existing networks

It is important to understand how this technology can improve existing organizations and systems.

A core outcome available through the development of shared ledgers, both public and private is the ability to coordinate compliance with rules and policies.

Examples include assurance or audit environments, real time continuous disclosure and the use of technology such as smart legal contracts.

“Smart legal contracts are legally enforceable agreements that contain certain clauses which are supplemented with computer programming code that enable automation or other digital activities arising from the contract, and that can run on digital platforms such as a Distributed technology ledger platform, such as blockchain.”

Source: [Herbert Smith Freehills - Adding a living dimension 4 November 2019](#)

Standards and Interoperability

As noted in issues paper 2, Australia has been at the forefront of developing international blockchain standards.

The World Economic Forum has recently made the following recommendations for the ongoing development of standards:

1. *Ensure further coordination and collaboration among standard-setting organizations*



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2. *Identify and specify where conversations about standardization may be premature – and where formal standards are unnecessary*
3. *Ensure that language and intended use are precise*
4. *Proactively plan for the role of decentralization in standards creation and implementation – and innovate accordingly*
5. *Continue to seek diverse input in the development and roll-out of standards*
6. *Educate industry and policy-makers on the best techniques for standards implementation*

Source: [World Economic Forum Mapping Initiative: An overview of blockchain technical standards White Paper October 2020](#)

These recommendations reinforce the importance of eliminating uncertainty and the development of regulatory frameworks can give confidence to those who seek to invest in building or implementing using this technology.

This outcome cannot be achieved without government taking an active role in both elevating innovation using this unique intersection of technologies as well as fostering both resource allocation and a prioritisation of adoption across existing industries.

The role of Government

The support of the government is critical to confidence in the blockchain sector.

The development of the [National Blockchain Roadmap - Department of Industry, Science, Energy and Resources](#) has been instrumental in giving credibility to the sector.

We commend the Department of Industry (“DISER”) for its efforts to address misconceived narratives, including that blockchain is a solution looking for a problem.

The infrastructure lens considers blockchain alongside the applicability of frameworks that are defining and articulating machine learning, artificial intelligence, cybersecurity, IoT and quantum computing.

The National Blockchain Roadmap use case and working group initiatives are a promising start in developing understanding of the intersections between - .

- Supply Chains
- Credentials
- Regtech
- Cybersecurity

Discussions across groups involve similar themes of regulation, compliance, cross border opportunities, sovereign capability and identity.



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Reports are currently being prepared by working groups with an anticipated delivery to DISER at the end of the first quarter of 2021.

The global regulatory environment

Regulatory interest has arrived in earnest. The ‘wild west’ narrative in the sector has passed.

It is our observation that the challenges of COVID-19 have in large part inadvertently obfuscated the rapid development of regulatory considerations and interventions being considered across the globe in jurisdictions other than our own.

In the period since the Senate Select Committee has commenced its consideration of the Regtech and Fintech sector the following sovereign government, supra national bodies and regional initiatives have been undertaken.

Definitions

We first bring to your attention the definition of virtual assets and virtual asset service providers set out by the [Financial Action Task Force](#) (“FATF”). The language of the terms “Virtual Asset: and “Virtual Asset Service Providers” inform much of the discussion in the subject matter -

Virtual Asset

A virtual asset is a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat currencies, securities and other financial assets that are already covered elsewhere in the FATF Recommendations.

Source: [Glossary of the FATF Recommendations](#)

Virtual Asset Service Providers

Virtual asset service provider means any natural or legal person who is not covered elsewhere under the Recommendations, and as a business conducts one or more of the following activities or operations for or on behalf of another natural or legal person:

- i. exchange between virtual assets and fiat currencies;*
- ii. exchange between one or more forms of virtual assets;*
- iii. Transfer [1] of virtual assets;*
- iv. safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and*



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v. participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset.

[1.] In this context of virtual assets, transfer means to conduct a transaction on behalf of another natural or legal person that moves a virtual asset from one virtual asset address or account to another.

Source: [*Glossary of the FATF Recommendations*](#)

Example: Regulatory activity

The following (sample) summary serves as the backdrop for what is an extraordinarily rapid rate of change globally with respect to the treatment of digital assets, blockchain and the implications for individuals, business and government.

Financial Action Task Force - The Financial Action Task Force (FATF) is the global money laundering and terrorist financing watchdog.

Activity - The "Travel Rule" - Recommendation 16 creates "obligations to obtain, hold, and transmit required originator and beneficiary information in order to identify and report suspicious transactions, monitor the availability of information, take freezing actions, and prohibit transactions with designated persons and entities.

Report: [*12 Month Review of Revised FATF Standards - Virtual Assets and VASPs*](#)

Activity - Guidance to help countries and virtual asset service providers understand their anti-money laundering and counter-terrorist financing obligations, and effectively implement the FATF's requirements as they apply to this sector.

Report: [*Guidance for a risk based approach virtual assets and virtual asset service providers*](#)

Financial Crimes Enforcement Network (FinCEN) - FinCEN is a bureau of the U.S. Department of the Treasury whose role is to safeguard the financial system from illicit use and combat money laundering and promote national security.

Activity: Invited comment on a proposed rule that would amend the recordkeeping and travel rule regulations under the Bank Secrecy Act. Proposing amendments to the travel rule.

Report: [*Bank Secrecy Act Threshold Amendment*](#) 23 October 2020



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Activity: FINCEN issued a request for public comment on a proposed rule that would require banks and money services businesses (“MSB”) to verify the identity of customers and to collect and report information in connection with certain transactions involving convertible virtual currencies (“CVC”) or digital assets with legal tender status (“LTDA”).

Report: ["Requirements for Certain Transactions Involving Convertible Virtual Currency or Digital Assets."](#) - 23 December 2020

United States Congress - Stablecoin Regulation

Activity: Proposed Bill which seeks to protect consumers from the risks posed by emerging digital payment instruments, such as Diem (formerly known as Libra and associated with Facebook) and other Stablecoins currently offered in the market, by regulating their issuance and related commercial activities.

Report: [Media Release](#) - The Bill - The Stable Act - 2 December 2020

European Union - Markets in Crypto-assets

Activity: A regulatory framework for crypto-assets, called Markets in Crypto-assets (“MiCA”), that was developed to help streamline distributed ledger technology (“DLT”) and virtual asset regulation in the European Union (“EU”) while protecting users and investors.

Report: [Regulation of the European Parliament and the of the Council on Markets in Crypto-assets, and amending Directive \(EU\) 2019/1937](#) 24 September 2020

Asia Pacific - Jurisdiction

Examples of regulatory activity within our region include;

Singapore - [Monetary Authority of Singapore](#)

Activity: General guidance on the application of securities laws administered by MAS in relation to offers or issues of digital tokens in Singapore.

Report: [MAS A Guide to digital token offerings](#) - 26 May 2020



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Hong Kong - [Financial Services and Treasury Bureau](#)

Activity: Consultation on legislative proposals to enhance anti-money laundering and counter-terrorist financing regulation in Hong Kong through the introduction of a licensing regime for virtual asset services providers.

Report: [Public Consultation on Legislative Proposals](#) A licensing regime for virtual asset services providers - 3 November 2020

Financial Service Industry Bodies

Examples of regulatory guidance by industry bodies include:

Financial Stability Board (“FSB”) - The FSB is an international body that monitors and makes recommendations about the global financial system.

Activity: Stablecoins are a specific category of crypto-assets which have the potential to enhance the efficiency of the provision of financial services, but may also generate risks to financial stability.

Report: [Regulation, Supervision and Oversight of “Global Stablecoin” Arrangements](#) 13 October 2020

Bank for International Settlements (“BIS”) - The BIS serves central banks in their pursuit of monetary and financial stability, to foster international cooperation in those areas and to act as a bank for central banks.

Activity: The Bank of Canada, European Central Bank, Bank of Japan, Sveriges Riksbank, Swiss National Bank, Bank of England, Board of Governors of the Federal Reserve and Bank for International Settlements have collaborated on a report setting out common foundational principles and core features of a CBDC.

Report: [Central banks and BIS publish first central bank digital currency \(CBDC\) report laying out key requirements](#) 9 October 2020

Activity: DLT and rapid advances in traditional centralised systems are moving the technological horizon of money and payments. Trends are embodied in private “stablecoins”: This looks at the potential role of stablecoins and what this implies for their regulation.

Report: [Stablecoins risks, potential and regulation](#) 24 November 2020



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The breadth of these developments, when considered at an international and cross border perspective have the potential to and we posit are transformational with respect to the movement of assets and the unlocking of value.

Conclusions

Many of the regulatory initiatives referenced in this submission have not been well received by the industry and those who seek to invest in the sector. The growth in jobs and high value innovation involving Blockchain and DLT continues and will gravitate towards those jurisdictions which provide certainty to participants. The matter is not one of “jurisdiction shopping” but rather sensible and practical guidance being provided to participants and public support from the government to combat the historical myths which have faced this new technology.

An example from the US of an approach to Bank Secrecy and AML compliance is the rushed consultation on FinCENs recent proposed changes, with a fraction of the usual time provided.

Kathryn Haun - General Partner @a16z

“...There’s a reason the regulatory rulemaking process provides 30-60 days for notice & comment. So that those outside govt - consumers, industry, public interest orgs, academics, etc - have a meaningful opportunity to weigh in & provide viewpoints govt may not have considered”

“...In fact, agencies are encouraged to consider a longer comment period for complex areas. The global and distributed nature of crypto is nothing if not complex. The reason for this amount of time is simple: it’s about due process. The opportunity to be meaningfully heard.”

Source: https://twitter.com/katie_haun/status/1340521235264860161

The lack of consultation in jurisdictions other than our own are at odds with an industry that seeks to be involved in dialogue with government and regulatory bodies. While our members are grateful at the key members of the public service and regulators who take time to understand this technology and seek to assist, the lack of clear support from the top and requirements which appear inconsistent with the way blockchains operate, is a blocker to faster growth in jobs in the sector.

Indeed regulatory uncertainty is often cited by projects relocating offshore, many of which would prefer to remain in Australia but cannot attract investment or take on regulatory risk when other jurisdictions are actively courting Blockchain business. An example of this is the lack of regulatory certainty around when a project can pre-sell a service without being construed as a managed investment scheme. Clear regulatory guidance on when the



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pre-sale of a service is not a managed investment scheme (as compared to when it would be a managed investment scheme) would go a long way towards providing projects with the certainty they require so as not to relocate offshore.

The rate of change in the development of blockchain and distributed ledger technology is so fast that a prescriptive or onerous regulatory regime that seeks to place controls over technology itself will quickly be outdated. Thankfully the Australian Government's approach has been to adopt a technology-neutral stance which sensibly avoids seeking to "pick the winners" from competing technologies.

However, a technologically neutral stance also is inherently in favour of incremental improvements in centralised technology which meets existing static legal frameworks. The challenge of Blockchain is in the very collaborative nature of such distributed systems, and as such it stands apart from most prior technology and policy settings should reflect this difference while not building in a "used by" date by being overly technically focused.

The influence that regulatory frameworks will have on innovation, jobs and growth in the sector cannot be overstated. The foundations of regulatory support for the Blockchain industry must be links that will lift up the Australian economy, and not become the chains that bind.

It is our strong view that Australian Government can, and should, send a strong message, building on the upcoming Blockchain Roadmap pilots and actively pursuing the efficiencies and automation which Blockchain can bring to deliver government services with a "one touch" approach as the Committee Chair recently said. With positive support for the sector from the Government and continued R+D grants availability, Australia can be positioned as a "fast follower" which retains and grows Blockchain jobs and businesses.

We would be pleased to discuss any aspect of our submission with you.

Steve Vallas

Chief Executive Officer

Blockchain Australia