

Article Information

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Service: Blockchain, FinTech

Sector: Financial Services, IT & Telecommunications

Blockchain Bites: Time for a safe harbor?, Central Banks continuing to progress CBDCs internationally with recent dialogue and projects, Recent proposals on prudential treatment of crypto-assets

Michael Bacina, Alexa Bowditch and Barbara Vrettos of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

Time for a safe harbor?

While the [Senate Select Committee's final submissions](#) and [ASIC's consultation on crypto-asset exchange traded products](#) are underway, Australia's regulatory framework for crypto-assets should be heading for a 'light touch' approach.

One light touch approach worth considering, and under increasing support, is a "safe harbor". Safe harbors are regulatory provisions which specify that if an individual or entity undertakes specific conduct they will be deemed not to have violated specific rules. It is commonly accepted that the guidance on, and absence of rules and regulations regarding digital assets, do not provide sufficient clarity for those wishing to harness Blockchain and crypto technologies, increasingly leading to businesses leaving Australia for jurisdictions which have adopted better regulatory approaches.

This appears to have been recognised by the Senate Select Committee's inquiry and ASIC's recent consultation on crypto-assets. A safe harbor down under could set up standards of conduct which would allow innovation to flourish while regulators take a considered and measured approach to amending legislation.

The US Securities and Exchange Commission (SEC) has already started towards a safe harbor. In April of this year Commissioner Hester M. Peirce of the US SEC released a '[Token Safe Harbor Proposal 2.0](#)'. This is intended to:

provide network developers with a three-year grace period within which, under certain conditions, they can facilitate participation in and the development of a functional or decentralized network, exempted from the registration provisions of the federal securities laws.

Pursuant to the safe harbor proposal Wyoming has approved the first legally recognised DAO in the US, the '[American Cryptofed DAO](#)' showing how innovative approaches to digital assets can develop successfully under a safe harbor.

The safe harbor does not provide 'a free pass' for digital asset projects to do any crazy thing and can lay down variety of requirements for regulatory comfort. For example, the [SEC approach requires](#):

- semi-annual updates to the plan of development disclosure and a block explorer;
- an exit report requirement with either:

- an analysis by outside counsel explaining why the network is decentralized or functional; or
- an announcement that the tokens will be registered under the Securities Exchange Act of 1934.

The area of digital asset law rightfully requires a considered approach which cannot necessarily be done with the speed at which innovation runs. We hope that such a safe harbor will be considered in Australia to potentially assist those locally in the digital asset space and attract international investment with smoother sailing.

Central Banks continuing to progress CBDCs internationally with recent dialogue and projects

While we wait for the Reserve Bank of Australia's (**RBA**) report on its [wholesale Central Bank Digital Currency \(CBDC\) research project](#), which is exploring the implications of a CBDC for efficiency, risk management and innovation in wholesale financial market transactions, the Bank of International Settlements (**BIS**) and a number of international central banks have made announcements in relation to CBDC in the last month.

Bank of International Settlements

[The Annual Report](#) from BIS details its work in CBDC innovation projects and the status of CBDC projects internationally (albeit with a curious choice of colour coding)

[The Annual Economic Report](#) from BIS devotes a whole chapters to the opportunities for innovation using CBDC for the monetary system, including:

- Unique benefits of settlement finality, liquidity and integrity;
- Open payment platforms and a competitive level playing field that is conducive to innovation; and
- CBDCs built on digital identification could improve cross-border payments and limit the risks of currency substitution.

Bank of England (BOE)

The BOE has released a [Discussion Paper](#) on new forms of digital money including CBDC and stablecoins. Although the BOE has not yet made a decision on whether to introduce a retail CBDC in the UK it is actively exploring the opportunity and risks of doing so, saying:

A Central Bank Digital Currency (CBDC) could play an important role in sustaining, and potentially expanding, retail access to central bank money. Unlike cash, CBDC would be a new form of central bank money that is digital in nature.

The Bank has not yet made a decision around CBDC but is actively exploring the opportunities and risks of doing so. A CBDC would be a public liability backed by the security and resources of the state. Where coupled with innovations such as programmable money and micropayments, a CBDC may increase the utility of central bank money when compared to cash. And it could support a resilient, innovative and competitive payments landscape.

Bank of Jamaica (BOJ)

The Bank of Jamaica will begin a [CBDC pilot](#) from August to December of this year, which will be implemented and integrated with existing systems of financial institutions. The CBDC will be issued to commercial banks, building societies, merchant banks and other authorised payment service providers licensed or authorised by the BOJ. These entities will distribute CBDC to the retail market. Consumers will be able to access download and deploy their CBDC wallets on their mobile devices and will be able to top up their wallets with CBDC through authorised agents or smart ABMs and do business using CBDC phone-to-phone with merchants. Once the pilot ends, a national roll-out of CBDC is expected in Q1 2022.

France and Singapore pilot

Banque de France and the Monetary Authority of Singapore (**MAS**) have announced the successful completion of a [wholesale cross-border payment and settlement experiment using CBDC](#). The experiment simulated cross-border transactions involving multiple CBDCs on a common network between Singapore and France. This was the first multiple CBDC experiment that applied automated market making and liquidity management capabilities to reap cross-border payment and settlement efficiencies.

Hong Kong Monetary Authority (HKMA)

In its [Fintech 2025 strategy](#), the HKMA has announced it will strengthen its research to increase Hong Kong's readiness in issuing CBDCs (to both wholesale and retail markets). In particular, HKMA:

- has been working with the BIS Innovation Hub Hong Kong Centre to research retail CBDCs;
- will begin a study on e-HKD to understand its use cases, benefits, and related risks; and
- will continue to collaborate with the People's Bank of China in supporting the technical testing of e-CNY in Hong Kong with a view to providing a convenient means of cross-boundary payments for both domestic and mainland residents.

Reserve Bank of New Zealand (RBNZ)

The RBNZ has announced it will be consulting extensively over the remainder of this year, releasing a [series of money and cash issues papers](#) for feedback from August to November, saying:

The first consultation will introduce and seek feedback on the broad concepts of money and cash stewardship, and outline specific topics to be covered in the rest of the series. Subsequent papers will look at the potential for a Central Bank Digital Currency (CBDC) to work alongside cash as government-backed money, issues arising from new electronic money forms including crypto assets (such as BitCoin) and stable coins (such as proposed by a Facebook-led consortium), and how the cash system might need to change to continue to meet the needs of its users.

Implications for Australia

The above provides the RBA with a clear signal that CBDCs are only going to increase in prominence and, if the RBA report follows the trends in other countries, we would expect to see the RBA take a positive stance towards an eventual Australian CBDC. However we expect the RBA will remain focused on the wholesale CBDC space given the nature of the RBA itself. Nevertheless, the more countries that undertake successful trials of CBDCs, the more likely Australia is to join that club and start considering where CBDC advantages take payments beyond our current framework. Those countries still on the fence about CBDC may need play catch-up very quickly, including considering regulatory changes needed to support a CBDC.

Recent proposals on prudential treatment of crypto-assets

The Basel Committee on Banking Supervision of the Bank of International Settlements (BIS) recently released a Consultative Document on the [Prudential treatment of crypto asset exposures](#). This Consultative Document sets out proposed capital requirements for banks holding crypto assets on their balance sheets (i.e. not in custody but as part of fractional reserve banking).

The proposal splits crypto assets into two kinds, Group 1 and Group 2.

Group 1 crypto assets are tokenised traditional assets and crypto assets with effective stabilisation mechanism (i.e. stablecoins).

Group 2 crypto assets include all other crypto assets that are not Group 1 crypto assets, and would include, for example, cryptocurrencies without an issuer, such as Bitcoin.

We agree with the views of Caitlin Long in her recent [Forbes article](#) that:

The proposal treats stablecoins prudently, rightly suggesting they can more or less fit into the existing Basel framework.

We also agree with Long's position that the proposed treatment of Group 2 crypto assets is not appropriate.

Banks should not be holding risk-based capital as BIS propose. Activities undertaken by the banks should be ring-fenced and not integrated with its other assets.

If a bank holds \$1 million of Bitcoin, that should be the subject of custody, in the same way if the bank was holding a commodity or security over an asset. This is supported by the increasingly accepted view that Bitcoin and Bitcoin-like tokens are commodities and not money.

In its [submission](#) to the Senate Inquiry into Digital Currency in December 2014, ASIC stated:

ASIC... considers that digital currencies are not a currency or money for the purposes of the Corporations Act. Digital currencies such as bitcoins are more akin to a commodity.

In ASIC's recent [Consultation Paper 343](#): Crypto-assets as underlying assets for ETPs and other investment products, ASIC also describes crypto assets as having similar features to commodities.

Any submissions from APRA, other prudential regulators or prudentially regulated entities in response to the Consultative Document will be something to follow over the next few months. In the longer term, APRA may adopt prudential regulation of crypto assets held by banks in line with BIS guidance.