



Payments System Modernisation: Regulation of payment services providers – Proposal Paper

Consultation Response

February 2024

Introduction

Piper Alderman welcomes the opportunity to provide a submission on Treasury's consultation on Payments System Modernisation: Regulation of payment services providers (the Paper) and provide input towards Australia's regulatory approach to the payment services industry, specifically on the proposed regulation of payment stablecoins and payment stablecoin issuers.

As one of Australia's oldest law firms with a national reach, Piper Alderman also operates one of the larger specialist teams in Australia focused on payments, blockchain and crypto-assets. We have deep technical and legal experience in the crypto-asset space, having served Australian and international projects over the last 7 years, and having provided numerous submissions to the Government's consultations concerning regulatory approaches to crypto-assets, including the recent Regulating Digital Asset Platforms consultation.

We advise start-ups, funds, digital currency exchanges and financial institutions, analyse crypto-asset related products and services, act in controversies, advise on taxation and assist in restructuring matters. Our lead partner, Michael Bacina, the principal author of our submission, has been ranked for 5 consecutive years as one of a select few Band 1 Fintech lawyers by the prestigious Chambers & Partners and is presently Chair of Blockchain Australia.

Our submission and comments are set out in the enclosed Appendix. This submission has been prepared by Michael Bacina, Partner and Steven Pettigrove, Special Counsel of the Blockchain Group and Financial Services and Fintech team at Piper Alderman. The views within are the authors' own and should not be taken as being representative of the views of the other partners of Piper Alderman.

We take a politically neutral position when considering policy, underpinned by a belief in the economic and social benefits of technology and innovation, and a focus on what regulation means at a practical level for both businesses and their customers and users.

We would be pleased to discuss any aspects of our submission further and participate in any parliamentary hearings concerning draft legislation.

Thank you for considering our submission.

Michael Bacina
Partner

Steven Pettigrove
Special Counsel

Payment System Consultation

The development of blockchain and distributed ledger technology continues to gather pace internationally and domestically, touching a wide range of industries including finance, social media, entertainment, ticketing and gaming, among others.

Against this backdrop, a number of jurisdictions, including the European Union (EU), United States, the United Kingdom (UK), Singapore and Hong Kong, are actively exploring and implementing new regulatory frameworks for the issuance and trading of digital assets and stablecoins. As a digital asset which purports to maintain a stable value relative to one or more assets or currencies, stablecoins have been a priority for focus for regulators and policy makers due to the rapid adoption of stablecoins, the potential consumer benefits, and risks of consumer harm.

The Paper is a welcome step in formulating draft legislation to reform existing payment services regulations, and we commend the Treasury's foresight in addressing the regulation of payment stablecoins as part of these reforms. We believe the proposals in the Paper are an important companion to the work being done to develop a fit for purpose regulatory regime for regulating digital asset platforms.

¹ *Response to Public Consultation on Proposed Regulatory Approach for Stablecoin-related Activities* published by the Monetary Authority of Singapore on 15 August 2023 (**MAS Consultation Response**), page 3.

² Reserve Bank of Australia, *Stablecoins: Market Developments, Risks and Regulation*, Bulletin – December 2022 (available here: <https://www.rba.gov.au/publications/bulletin/2022/de/c/stablecoins-market-developments-risks-and-regulation.html>).

³ See *Crypto-assets and Global "Stablecoins"* published by the FSB (available here:

The case for stablecoin regulation

Stablecoins, or specifically Payment Stablecoins (as defined in the Paper) are emerging as a new class of digital assets with the potential to become a widely used payment instrument.¹ According to the Reserve Bank of Australia, the total value of stablecoins on issue reached around US\$150 billion in May 2022.² Payment Stablecoins have strong use cases in cross-border remittance and payment applications, and enable broader digital innovation by permitting persons and entities to own and exchange value in a digitally native, well-understood and relatively stable asset.

The Financial Stability Board (FSB) has stated that stablecoins “have the potential to bring efficiencies to payments, and to promote financial inclusion”.³ According to the United States Federal Reserve⁴:

Stablecoins have the potential to spur growth and innovation in payment systems, allowing for faster, cheaper payments. Because stablecoins can be used to transfer funds near instantaneously peer-to-peer between digital wallets for potentially low fees, stablecoins may lower payment barriers and exert pressure on existing payment systems to provide better services.

In July 2023, the FSB recommended that authorities comprehensively regulate, supervise and oversee global stablecoin

<https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/crypto-assets-and-global-stablecoins/#:~:text=Stablecoins%20have%20the%20potential%20to,and%20to%20promote%20financial%20inclusion>).

⁴ Gordon Y Liao and John Caramichael, *Stablecoins: Growth Potential and Impact on Banking*, January 2022 (available here: <https://www.federalreserve.gov/econres/ifdp/files/ifdp1334.pdf>).

arrangements and their associated functions and activities, and enforce relevant laws and regulation effectively.⁵ It defines “global stablecoins” as follows:

A stablecoin with an existing or potential reach and use across multiple jurisdictions and which could become systemically important in and across one or many jurisdictions, including as a means of making payments and/or store of value.

Against this backdrop, we commend Treasury’s approach is seeking to establish a fit-for-purpose framework for Payment Stablecoins. The regulation of Payment Stablecoins has the potential to foster broader adoption of stablecoins and related innovation in digital finance by giving businesses and consumers confidence to adopt and use stablecoins more widely. Regulation is needed to address core consumer harms, such as the risk of de-peg events where a stablecoin’s market value diverges from the value of its reference asset, unbacked stablecoins, misuse of reserve assets, and redemption issues.

The need to establish a regulated class of stablecoins was highlighted by the Luna/Terra fiasco. In May 2022, Terra or UST, a so-called algorithmic stablecoin, which purported to maintain a stable value to the United States dollar by allowing holders to swap UST for its sister token, Luna, at any time for USD\$1.00. The value of the stablecoin collapsed to zero in May 2022 wiping out its USD\$18 billion market capitalisation effectively overnight.

In this submission, we offer our views with regards to the Paper’s proposal to regulate

Payment Stablecoins, focusing on the following aspects:

- a) definition of Payment Stablecoins in the proposed regulatory framework; and
- b) jurisdictional considerations and interaction with digital asset facilities.

Definition of Payment Stablecoin

The Paper adopts the following definition of Payment Stablecoin:

a) a digital representation of monetary value intended or purported to maintain a stable value relative to a fiat currency;

b) issued by a payment stablecoin issuer; and

c) capable of being redeemed for:

i) Australian dollars (AUD); or

ii) another fiat currency only where there is active marketing or selling in Australia,

at face value through a claim provided by a payment stablecoin issuer to a customer.

We note the following matters in relation to this definition:

(a) “Relative to a fiat currency”

We agree with the Paper’s proposal to focus on Payment Stablecoins that reference a single fiat currency at this stage, rather than a basket of fiat currencies or other commodities. This is consistent with the focus of regulatory proposals in Singapore⁶ and the UK⁷. The EU’s Markets in Crypto-Assets Regulation (**MiCA**) goes further in

⁵ Financial Stability Board, *High-level Recommendations for the Regulation, Supervision and Oversight of Global Stablecoin Arrangements: Final Report*, 17 July 2023 (available here: <https://www.fsb.org/wp-content/uploads/P170723-3.pdf>)

⁶ MAS Consultation Response.

⁷ *DP 23/4: Regulating cryptoassets Phase 1: Stablecoins* published by the UK Financial Conduct Authority published on 6 November 2023 (**DP23/4**).

seeking to regulate both “e-money tokens” referencing one single fiat currency and so-called “asset referenced tokens” which reference the value of an asset or combination of them, including multiple official currencies.⁸ This focus addresses both the main use case for stablecoins (i.e. as a digitally native means of payment which maintains a stable value) and the core risk of consumer harm (i.e. widespread commercial or consumer adoption of a purportedly fiat backed stablecoin which fails to maintain a stable value or de-pegs from its reference asset).

(b) “Capable of being redeemed for Australian dollars or another fiat currency only where there is active marketing or selling in Australia”

We recommend that Treasury confine its focus to Payment Stablecoins which reference a select group of highly liquid and widely used fiat currencies. An approach similar to the UK and Singapore’s should be preferred. The UK plans to focus first on fiat-backed stablecoins⁹, while Singapore’s MAS is seeking to regulate only Singapore issued single currency stablecoins (SCS) that reference its own and G10 fiat currencies.¹⁰

The meaning of the phrase “active marketing or selling in Australia” is unclear. For example, this could be taken to mean all currencies that are available to be exchanged over the counter at foreign exchange services, such as Travelex.

Alternatively, it could include all currencies that are available for exchange with a Westpac travel money card. It also poses the risk that certain stablecoins may become regulated as Payment Stablecoins overnight on the basis that “active marketing or selling” of the reference fiat currency changes overtime.

Focusing on the G10 fiat currencies (or G11 if one includes the Danish krone) offers the benefit of limiting the Payment Stablecoin regime only to the most heavily traded and liquid fiat currencies, which are most widely used internationally and which, as a reference asset, benefit from strong monetary oversight and are most likely to maintain a relatively stable value.

This approach would also exclude from regulation wrapped tokens or stablecoins referencing Bitcoin, which has been recognised as legal tender by El Salvador. It would also exclude any stablecoin which references the digital renminbi (e-CNY).

⁸ MiCA, Article 3.

⁹ DP23/4, page 3.

¹⁰ MAS Consultation Response, page 4.

(c) “Capable of being redeemed...”

We propose that the phrase “capable of being redeemed” is modified as this phrase may have the inadvertent effect of rendering a Payment Stablecoin issued under the regime outside the definition where it de-pegs or is no longer capable of being redeemed at its issue price (e.g. because the issuer has become insolvent). This would be contrary to Treasury’s intention in seeking to regulate Payment Stablecoins. In this context, it may be more appropriate to focus on the redemption rights granted or promoted by the issuer, such as stablecoins “which have, or purport to have, a right to redemption from the issuer”.

(d) “at face value through a claim provided by a payment stablecoin issuer to a customer”

Importantly, Treasury has identified that Payment Stablecoins are bearer assets and may be transferred to third parties by a customer of the issuer who first mints or purchases the Payment Stablecoin from the issuer. The stable value and use of a Payment Stablecoin is dependent on that third party (who may not be a customer of the issuer, at least until such time as they seek to redeem the Payment Stablecoin) being able to rely on the Payment Stablecoins’ asset backing. For this reason, we consider that the phrase “through a claim provided by a payment stablecoin issuer to a customer” is somewhat ambiguous as it does not obviously include claims by third parties who may seek to redeem a Payment Stablecoin for fiat currency from the issuer. In substance, the issuer represents that the Payment Stablecoin will adhere a right to redemption from the issuer by the holder regardless of whether they are a customer.

This limb of the definition may more appropriately focus on the holder’s right to redeem a Payment Stablecoin from the issuer at the issue price.

Jurisdictional considerations and interaction with digital asset facilities

The Paper contemplates that the regulatory framework for Payment Stablecoins will cover issuers that are “carrying on a financial services in Australia”, an approach which is consistent with the existing financial services regulatory framework and therefore well-understood by the financial services industry. The proposed reforms would also apply to overseas-based businesses that actively solicit business in Australia.

We agree with this approach which is somewhat similar to the UK’s proposed framework, although the EU and Singapore offer alternative approaches:

- a) The EU will regulate e-money token stablecoins that are offered to the public, or are sought to be admitted to trading within the EU. However, any e-money token that references an official currency of a EU member state shall be deemed to be offered to the public within the EU; and
- b) Given the difficulties in monitoring and establishing the adequacy and availability of reserve assets held overseas, Singapore proposes only to regulate stablecoins (that reference Singaporean dollars or a G10 currency) which are issued in Singapore. It does not plan to outlaw those stablecoins that fall outside of its currency list or geographic reach – stablecoins not regulated under the proposed framework will continue to be regulated by the Payment Services Act 2019. Accordingly, Singapore’s proposal would, similarly to Treasury’s proposal, establish a special class of digital currencies which are subject to more stringent regulatory requirements.

Treasury's proposal would leave open the possibility that unregulated stablecoins issued overseas could continue to circulate among Australian businesses and consumers. It is likely to be more difficult for Australian businesses and consumers to assess the risks of exchanging and using stablecoins which are either unregulated or regulated under overseas regulatory regimes. Importantly, these stablecoins would also offer no recourse to a domestic issuer for redemption or local asset backing. Depending on whether an overseas issuer actively solicits Australian users, it may fall outside Australia's jurisdiction, licensing and prudential standards.

Australia's limited jurisdictional reach offers significant scope for regulatory arbitrage or consumer harm, particularly in the context of stablecoins which purport to be backed by Australian dollars, but which are not subject to licensing and supervision in Australia and where any or all reserves are held offshore.

One option to address this risk is to permit financial services licensees including payment facilitators and digital asset facilities only to offer and deal in Payment Stablecoins issued by a regulated issuer in Australia. Alternatively, Australia could require digital asset facilities to assess overseas-issued Payment Stablecoins against the same regulatory standards before making them available as "Approved Stablecoins", similar to proposals under consideration in the UK.¹¹

¹¹ DP23/4, Chapter 11.



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