Australian Banking Association

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The Committee Secretary
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Dear Committee

Senate Select Committee on Australia as a Technology and Financial Centre – Issues Paper

The Australian Banking Association (**ABA**) advocates for a competitive, and innovative banking industry that delivers excellent and equitable outcomes for customers. We promote and encourage policies that improve banking services for all Australians.

The ABA is very supportive of the ongoing work of the Committee, particularly the whole-of-economy approach taken and the focus on removing more barriers to facilitate growth in the financial and technology sectors thereby attracting investment and creating jobs.

The Committee is currently examining:

- the regulation of cryptocurrencies and digital assets;
- issues relating to 'debanking';
- the policy environment for neobanks in Australia;
- instances of corporate law holding back investment; and
- options to replace the Offshore Banking Unit.

Cryptocurrency and digital assets

The ABA recognises the real risks[1] that virtual assets present, but also the opportunity for Australia. The ABA agrees with the World Economic Forum statement that '*the advent of cryptocurrencies has led to the creation and operation of new global, decentralized networks that have been used by over 100 million people across the world to transfer trillions of dollars of value. Bitcoin, for example, is more than just a technology – it is a powerful social, political and cultural movement that asks us to imagine money, banking and payments in new and novel ways*[2]'.

The key risk across the global financial system, is that the identity of users of virtual assets are often unknown to banks and sometimes not adequately known to the operators of the exchanges where virtual assets are traded. Though banks can conduct due diligence on the markets-operators; there remains the question, given the anonymity, as to how exchanges can effectively conduct Know Your Customer (KYC) and Customer Due Diligence (CDD) on individuals and entities using virtual assets. Without improved global regulation and oversight (and potentially even then) governments, banks and the community remain exposed to risks arising from virtual assets, particularly if the difficulty in identifying the owner and the end-use of virtual asset transactions remains unresolved.

[1] Collapse of crypto platform a cautionary tale, https://www.afr.com/companies/financial-services/collapse-of-crypto-platform-a-cautionary-tale20210228-p576hn
[2] World Economic Forum, Global Future Council on Cryptocurrencies, Crypto, What Is It Good For? http://www3.weforum.org/docs/WEF_Cryptocurrency_Uses_Cases_2020.pdf

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The Financial Action Task Force & virtual assets

The Financial Action Task Force (**FATF**) is the global money laundering and terrorist financing watchdog. This inter-governmental body sets international standards that aim to prevent these illegal activities and the harm they cause to society. As a policy-making body, the FATF works to bring about national legislative and regulatory reforms in these areas.

The term 'virtual asset' refers to any digital representation of value that can be digitally traded, transferred, or used for payment. It does not include the digital representation of fiat currencies. The ABA agrees with the FATF that virtual assets have many potential benefits[3]. They could make payments easier, faster, and cheaper; and provide alternative methods for those without access to regular financial products. That said, without proper regulation, they risk permanently becoming a virtual safe haven for the financial transactions of criminals and terrorists.

The FATF has been closely monitoring the developments in the CryptoSphere and in recent years has seen the first countries start to regulate the virtual asset sector, while others have prohibited virtual assets altogether. However, as yet, the majority of countries have not taken any action. These gaps in the global regulatory system have created significant loopholes for criminals and terrorists to abuse. Yet, across the globe, banks sit at the front-line in detecting, deterring, and disrupting criminal activity, as required by the current AntiMoney Laundering regimes in place in the FATF jurisdictions including Australia.

In June 2019, with support from the G20, FATF issued[4] global, binding standards to prevent the misuse of virtual assets for money laundering and terrorist financing. The 2019 FATF Standards seek to ensure that virtual assets are treated fairly, applying the same safeguards as in the financial sector.

The June 2019 revisions to the FATF Standards clearly placed anti-money laundering and counterterrorism financing requirements on virtual assets and virtual asset service providers (**VASPs**). The FATF also agreed to undertake a 12-month review to measure how jurisdictions and the private sector have implemented the revised Standards, as well as monitoring for any changes in the typologies, risks and the market structure of the virtual assets sector. The report from that 2020 FATF review[5] had a number of findings.

The 2020 report found that, overall, both the public and private sectors have made progress in implementing the revised FATF Standards. 35 out of 54 reporting jurisdictions advised that they have now implemented the revised FATF Standards, with 32 of these regulating VASPs and three of these prohibiting the operation of VASPs. The other 19 jurisdictions have not yet implemented the revised Standards in their national law.

Australia is one of those 19 jurisdictions that have not yet implemented the 2019 FATF Standard on virtual assets and VASPs into national law. Importantly, the ABA understands that FATF is currently reviewing that 2019 Standard with a view to updating the rules given the speed of how this sector is evolving (e.g., the advent of Stablecoins).

During 2021, FATF has also been working on updated guidance on the FATF Standards relating to VASPs. The guidance will give an indication of the direction of AML/CTF regulation of the sector around the world and provide further insights into evolving money ML/TF risks.

The ABA supports responsible innovation across the Australian financial services sector for digital currency exchange and virtual assets and supports the FATF pathway for Australia which has the potential to mitigate some of the associated money laundering and terrorist financing risks inherent in virtual assets. Banks, as AUSTRAC reporting entities, will continue their work to detect, deter and disrupt serious financial crime, and offer products and services in accordance with their skills, capability, risk-appetite, and risk-profile.

[3] Virtual Assets, https://www.fatf-gafi.org/publications/virtualassets/documents/virtual-assets.html?hf=10&b=0&s=desc(fatf_releasedate)
[4] Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers, https://www.fatfgafi.org/publications/fatfrecommendations/documents/guidance-rba-virtual-assets.html
[5] 12 Month Review of Revised FATF Standards - Virtual Assets and VASPs, https://www.fatfgafi.org/publications/fatfrecommendations/documents/12-month-review-virtual-assets-vasps.htm

ABA recommendation:

> The ABA welcomes the G20 support for FATF action on the regulation and oversight of virtual assets and virtual asset service providers. The ABA supports Australia's adoption of FATF Standards to support responsible innovation across the financial services sector by regulating and supervising virtual asset activities and related service providers in order to mitigate the associated money laundering and terrorist financing risks.

The Basel Committee on Banking Supervision (BCBS / Basel Committee)

In June 2021, the BCBS released a consultative document[6] setting out preliminary proposals for the prudential treatment of banks' cryptoasset exposures.

The Basel Committee acknowledged that while banks' exposure to the nascent crypto industry was limited, *"the growth of cryptoassets and related services has the potential to raise financial stability concerns and increase risks faced by banks".* The risks BCBS cited included market and credit risk, fraud, hacking, money laundering and terrorist financing risk.

The proposed prudential treatment divides cryptoassets into two broad groups:

> **Group 1 cryptoassets** - these fulfil a set of classification conditions and as such are eligible for treatment under the existing Basel Framework (with some modifications and additional guidance). These include certain tokenised traditional assets and stablecoins (e.g. cryptocurrencies pegged to traditional assets such as currencies).
>
> **Group 2 cryptoassets** - are those, including bitcoin and ethereum, that do not fulfil the classification conditions. Since these pose additional and higher risks, they would be subject to a proposed new prudential treatment.

The standards would apply to assets created for decentralised finance (DeFi) and non-fungible tokens (NFTs), but potential central bank digital currencies are outside the scope of the consultation.

The proposed prudential treatment is based around three general principles:

1. **Same risk, same activity, same treatment**: While the Basel Committee does see the potential for the growth of cryptoassets *"to raise financial stability concerns and increase risks faced by banks",* it is attempting to chart a path that is agnostic on the use of specific technologies related to cryptoassets while accounting for those additional risks arising from cryptoasset exposures relative to traditional assets.
2. **Simplicity**: Given that cryptoassets are currently a relatively small asset class for banks, the Basel Committee proposes to start with a simple and cautious treatment that could, in principle, be revisited in the future depending on the evolution of cryptoassets.
3. **Minimum standards**: Jurisdictions may apply additional and/or more conservative measures if they deem it desirable including outright prohibitions on their banks from having any exposures to cryptoassets.

The proposals set out conditions that Group 1 cryptoassets need to satisfy in order to qualify for the "equivalent risk-based" capital requirements, a cryptoasset must meet all of the conditions set out, namely:

1. The cryptoasset either is a tokenised traditional asset or has a stabilisation mechanism that is effective at all times in linking its value to an underlying traditional asset or a pool of traditional asset.
2. All rights obligations and interests arising from cryptoasset arrangements that meet the condition above are clearly defined and legally enforceable in jurisdictions where the asset is issued and redeemed. In addition, the applicable legal frameworks can ensure settlement finality.

[6] Basel Committee consults on prudential treatment of cryptoasset exposures, https://www.bis.org/press/p210610.htm

3. The functions of the cryptoasset and the network on which it operates, including the distributed ledger or similar technology on which it is based, are designed and operated to sufficiently mitigate and manage any material risks.
4. Entities that execute redemptions, transfers, or settlement finally of the cryptoasset are regulated and supervised.

Group 1 is further broken down to distinguish tokenised traditional assets (**Group 1a**) and cryptoassets with effective stabilisation mechanisms (**Group 1b**). Capital requirements applied to Group 1a are "*at least equivalent to those of traditional assets*" while Group 2a will be subject to "*new guidance of current rules*" that is intended to "*capture the risks relating to stabilisation mechanisms*". In both cases (Group 1a and 1b), the BCBS reserved the right to apply further capital add-ons.

Cryptoassets that fail to meet any of the conditions above will be classified as Group 2 cryptoassets and subject to 1250 per cent risk weight. That would mean banks would in effect have to hold capital equal to the exposure they face. Effectively, a $100 exposure in bitcoin would result in a minimum capital requirement of $100.

Debanking

The issue of de-banking has often been examined by the Australian Competition & Consumer Commission (ACCC). Their 2019 inquiry[7] into foreign currency conversion services also looked at debanking and concluded:

> *Some non-bank suppliers have been denied access or find access to bank services under threat. The need to comply with Australia's anti-money laundering and counter terrorism financing (AML/CTF) laws has been a factor in the banks' decisions to withdraw access to banking services for non-bank rivals (known as de-banking).*

Across the globe, banks offer services in accordance with their risk-appetite, risk-profile, and their skills and capability to manage the legal obligations and risks associated with customers operating in certain sectors.

Council of Financial Regulators

The Council of Financial Regulators (CoFR) is the coordinating body for Australia's main financial regulatory agencies. There are four members – the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), the Reserve Bank of Australia (RBA) and The Federal Treasury.

The Council of Financial Regulators (the Council) held its quarterly meeting[8] on Friday, 11 June 2021. The Council discussed the withdrawal of banking services from payments and other financial service providers. The Council discussed the drivers of decisions to 'de-bank' these providers. The Council agreed[9] that agencies would undertake further work to explore the underlying causes and examine possible policy responses.

The ABA welcomes and supports the Council undertaking further work to explore the underlying causes and examine possible policy responses and will assist the Council's research as this issue is explored.

[7] ACCC Foreign currency conversion services inquiry, Final Report, 2019, https://www.accc.gov.au/focus-areas/inquiries-finalised/foreign-currency-conversion-services-inquiry/final-report
[8] https://www.cfr.gov.au/news/2021/mr-21-03.html
[9] ibid

Growth of Neobanks in Australia

In March 2021, APRA published an Information Paper[10] outlining their revised approach for new entrants, providing guidance on a pathway to sustainability. APRA recognised that new Authorised deposit-taking institution (**ADIs**) have unique challenges and their risk profiles differ when compared to established ADIs. APRA's approach to new entrant ADIs seeks to strike an appropriate balance between supporting entities to enter and thrive in the banking sector, while ensuring financial system stability and protecting the interests of depositors.

To encourage a wide variety of potential applicants, APRA has two pathways available to become an ADI, the direct pathway and the restricted pathway.

The restricted pathway facilitates entry into the banking sector for a wider variety of applicants. The restricted pathway is suitable for applicants that do not have the resources and capabilities to establish an ADI and need time to develop these. This pathway allows applicants to conduct limited banking business as a 'Restricted ADI' before meeting the requirements of the full prudential framework. APRA's approach is to assist applicants in seeking the investment required to operationalise their business, test their business model, progress their compliance with the prudential framework and ultimately their application for an ADI licence.

The restricted ADI licence allows an entity time to develop resources and capabilities and to conduct limited, low risk or traditional banking business during its start-up phase. The ABA considers the APRA approach best-practice and the paths efficiently facilitate the entrance of new players into the market.

Instances of corporate law holding back investment

In September 2020, the Australian Law Reform Commission (**ALRC**) commenced a *Review of the Legislative Framework for Corporations and Financial Services Regulation.* The focus of the review is financial services regulation. The Terms of Reference set out three sub-topics, each of which is to be the subject of a separate Interim Report:

- the use of definitions;
- regulatory design and hierarchy of laws; and
- the framing or structuring of Chapter 7 of the Corporations Act 2001 (Cth).

The Review will release three interim reports prior to a final report due in November 2023.

The ALRC review presents an opportunity to simplify laws applying to financial corporations and investments. Early work of the review has, consistently with the Hayne Royal Commission before it, identified a high level of complexity in Australia's corporations and financial services laws. The results of inquiries such as that of the Senate Select Committee on Australia as a Technology and Financial Centre should be passed through to the ALRC process, so that the latter can have regard to them to any relevant extent.

Simplification of Australia's relevant laws is likely to bring our regulatory regime close to alignment with international best practice, which can only enhance our attractiveness as a financial centre.

Options to replace the Offshore Banking Unit

On 17 March 2021, the Government introduced *Treasury Laws Amendment (2021 Measures No 2) Bill 2021* into Parliament with the effect of removing the concessional tax treatment for offshore banking units.

The ABA understands the Government intends to consult with industry on alternative approaches to the now grandfathered offshore banking unit regime to support the industry and ensure activity remains in Australia. The ABA will be a participant in that process and looks forward to working with the Government on options to maintain and enhance Australia's global position.

[10] https://www.apra.gov.au/sites/default/files/2021-03/Information%20paper%20-%20ADI%20New%20entrants%20-%20a%20pathway%20to%20sustainability_0.pdf

If you have any questions, please contact me at aidan.oshaughnessy@ausbanking.org.au or on 0477 795 827.

Yours sincerely

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