KING IRVING

Payments System Modernisation (Licensing: Defining Payment Functions)

Submission to the Treasury

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BACKGROUND

On 7 June 2023 it was announced that the Treasury would commence a consultation on proposed reforms to Australia's payments service providers (**PSPs**).

The Government is committed to protecting the integrity of the Australian financial system and improving the regulation of PSPs to ensure regulation is fit-for-purpose and consumers are protected.

The consultation has invited feedback on the foundations of a new tiered, risk-based licensing framework for PSPs, based on a defined list of payment functions and reflecting the recommendations of the Review of the Australian Payments System (**Payments System Review**).

The objectives of the proposed payments licensing framework include:

1. Ensuring consistent and appropriate regulation of PSPs.
2. Improving regulatory certainty for PSPs.
3. Supporting a more level playing field for PSPs seeking to access payment systems.
4. Better targeting regulatory obligations based on the level of risk posed to end users by PSPs.
5. Streamlining the process for businesses that require multiple licenses.
6. Better aligning Australia's payments regulatory framework with international jurisdictions.

Further consultation on the regulatory obligations under the new licensing framework will take place later in 2023 with introduction of legislation for the new payments licensing regime in 2024.

RESPONSE SUMMARY

Our submission contains answers to the following proposed questions where Treasury has sought feedback:

4. Does the term 'payment stablecoins' accurately describe the types of stablecoins this paper seeks to capture for regulation or are there other terms that may be appropriate?
5. Does the proposed definition of 'payment stablecoins' adequately distinguish itself from other stablecoin arrangements?
6. Is regulation as an SVF an appropriate framework for the regulation of payment stablecoin issuers? If not, why? What would be an appropriate alternative?
11. Which existing exclusions and exemptions applicable to non-cash payment facilities should be amended or removed to support regulation of the proposed payment functions? Do any existing exclusions or exemptions require updating, such as the relief for low-value facilities?
14. Should the exclusion for law value facilities apply to any PFS, such as money transfer services? If so, what thresholds should be considered a low value PFS?
16. Are there any other risk characteristics of a payment function that should be considered?
18. While having regard to the obligations proposed to be imposed on the payment functions (outlined in Section 7), are the risks posed by the performance of each payment function appropriately mitigated by the payments licensing regime? Or are they more appropriately addressed by a framework outside of the payments licensing regime such as *PRSA* or *AML/CTF Act*?
19. Is the proposed risk-based approach to applying regulatory obligations appropriate?
20. Should payment functions that are not customer facing be required to hold a payments licence? Should providers of these non-customer facing payment functions have different regulatory obligations, such as only having to comply with relevant industry standards?
21. Should the common access requirements and industry standards be linked to the payments licence? for example, would it be appropriate for some entities to only be required to comply with mandatory industry standards but not be required to hold an AFSL or comply with the ePayments code?
24. How can the payments licensing processes across regulators be further streamlined?
25. Is the proposal to provide central guidance and a website portal for PSP licensing processes a good alternative to the single point of contact proposal recommended by the Payments System Review?

RESPONSES

Question 4

Does the term 'payment stablecoins' accurately describe the types of stablecoins this paper seeks to capture for regulation or are there other terms that may be appropriate?

The definition of 'payment stablecoins' as conferred by the Reserve Bank of Australia in the December Bulletin on '*Stablecoins: Market Developments, Risks and Regulation*', is "a type of crypto asset designed to maintain a stable value relative to a specified unit of account or store of value … or a commodity (e.g. gold)." Taking this into account, it can be understood that the term 'payment stablecoins' is not limited to stablecoins that are collateralised by fiat currencies such as the Australian dollar. These crypto assets can be collateralised by commodities, algorithms, and other cryptocurrencies. Therefore, when considering this term within the scope of the Consultation Paper, our view is that this term as used is too broadly defined.

The Consultation Paper defines a *payment stablecoin* as being a digital representation of a fiat currency, issued by a payment stablecoin issuer which is capable of being redeemed for Australian dollars or another fiat currency (where there is active marketing or selling in Australia) through a claim provided by an issuer to a customer. This definition of a payment stablecoin is consistent with the definition of a '*fiat-collateralised stablecoin'* and it is our recommendation that this term is preferable to the broader term '*stablecoin*'.

Recommendation:
Our recommendation to use the term 'collateralised' within this regulation is essential. As conferred by a Senior Managing Legal Counsel at Mastercard in the article *'Stablecoins explained: An FAQ on these digital assets*', the term collateralisation infers that a "stablecoin issuer essentially has enough reserves set aside". If stablecoins are not collateralised and do not have sufficient reserves to ensure that issuance and redemption are complied with, the crypto asset can lose its value and cause a variety of issues for investors and those involved.

The Consultation Paper additionally recognises this issue through stating that stablecoin issuers will be subject to regulatory obligations to ensure reserve assets are managed that support stability of the coins and it is therefore recommended that this change to the term be made.

Question 5

Does the proposed definition of 'payment stablecoins' adequately distinguish itself from other stablecoin arrangements?
The proposed definition does not adequately distinguish itself from other stablecoin arrangements. The distinguishment of the proposed stablecoin definition from other stablecoins is primarily conferred through subsection (a) of the definition in which it is stated that a 'payment stablecoin' is a "digital representation of monetary value intended or purported to maintain a stable value relative to a fiat currency".

However, within the differing types of stablecoin arrangements that exist within the market, there are hybrid stablecoin arrangements. This is often shown through stablecoins that are fiat backed but also algorithmic and rely upon certain cryptocurrencies in addition to fiat currencies to provide 'stability'.

Recommendation:

Taking this into account, we propose that subsection (a) of the definition be changed to include:

"a digital representation of monetary value intended or purported to maintain a stable value relative only to a fiat currency".

Question 6

Is regulation as an SVF an appropriate framework for the regulation of payment stablecoin issuers? If no, why? What would be an appropriate alternative?

We are of the opinion that regulation as a Stored Value Facility (**SVF**) is an appropriate framework for the regulation of payment stablecoin issuers. However, there are certain aspects of the proposed SVF framework that we believe should be amended for payment stablecoin issuers.

Within the CFR's report on the *Regulation of Stored-value Facilities in Australia*, recommendation 2 states that "SVFs (and other payment products) that posed limited risk to consumers – such as small and/or limited-purpose facilities – should continue to be largely exempt from regulatory requirements." We believe that for stablecoin issuers and due to the additional factors of classification and the risk elements that may be encountered, regulatory requirements should be established at all levels. In stating this, we accept that fewer regulatory requirements can be imposed on certain small and/or limited-purpose facilities. However we believe that regulation should still exist in terms of how these entities are classified and what reserves are maintained by these issuers.

Recommendation:

A potential resolution to this issue and our recommendation is an expansion of the CFR's recommendation 3 that "issuers of payment products that hold client funds for only a short period of time for the purpose of facilitating a payment should be required to hold an Australian Financial Services (AFS) licence. We believe that in the case of stablecoin issuers, there should be an expansion of this to enforce an ongoing requirement to hold an AFS licence regardless of size which will ensure regulation through all aspects of the system due to additional compliance procedures that would be implemented because of this.

This proposed alternative would reinforce security and confidence within the stablecoin industry and issuers of these products, while allowing for other forms of regulation and requirements to be scaled depending upon the size of the issuer.

Question 11

Which existing exclusions and exemptions applicable to non-cash payment facilities should be amended or removed to support regulation of the proposed payment functions? Do any existing exclusions or exemptions require updating, such as the relief for low-value facilities?

The exception relating to Low-value payment facilities should take into account the consultation launched by the government in November 2022 and the subsequent new regulations announced by the Assistant Treasurer, Stephen Jones, in May 2023 for buy now pay later (**BNPL**) arrangements.

The government launched the consultation with the intention to protect consumers from the potential risks deriving from the BNPL arrangements not being regulated under the *National Consumer Credit Protection Act 2009* (Cth). Three options were presented to the Government by Treasury to regulate the BNPL arrangements and that the option chosen by the Government should include: fee caps on charges for missed payments; an obligation for - providers to comply with the design and distribution obligations regulated by ASIC; an obligation for internal and external dispute resolution procedures; and more importantly, but also a requirement for the BNPL players to hold an ACL.

Recommendation:

The new regulations should make it clear that in the circumstances of a low value payment facility involving a BNPL arrangement, even though the provider will not be required to hold an AFSL, an ACL may be required.

Question 14

Should the exclusion for low value facilities apply to any Payment Facilitation Service (PFS), such as money transfer services? If so, what thresholds should be considered a low value PFS?

Currently, ASIC takes a flexible approach to administering its obligations for payment products, including granting exemptions for "low value facilities" in which funds held by any one client do not exceed $1,000 and the total stored value held by all consumers in the same facility is less than $10 million.

Recommendation:

We are of the view that a similar exclusion should apply to any PFS, such as money transfer services. The implementation of this exclusion to PFS would significantly reduce the regulatory burden on providers and users as PFS are considered to pose lower risks in terms of consumer protection, illicit activities such as money laundering and terrorist financing. An exclusion for low value PFS would recognise that applying the same level of regulation to all types of a PFS, regardless of transaction may be unnecessary or disproportionate.

As this service captures a wide range of payment service providers, we are of the view that the threshold should contemplate the AML/CTF risk that the PFS poses. For example, a threshold above $10,000 per transaction for a remittance provider would pose a high risk of AML/CTF and therefore, transactions under $10,000 per customer for a remittance service provider would be considered a low value PFS.

As not all services are created equal, the threshold would need to vary depending on the AML/CTF that the service may potentially pose. This can be assessed through the AML/CTF Act in collaboration with AUSTRAC.

Question 16

Are there any other risk characteristics of a payment function that should be considered?

Recommendation:

Cross jurisdiction and currency risks are significant considerations in payment functions that involve transactions that move between different jurisdictions. These risks are a result of the complexities surrounding international trade, varying exchange rates, regulatory frameworks, and geopolitical factors. Understanding and effectively managing these risks will enable PSPs to facilitate seamless international transactions and mitigate financial losses for consumers.

Question 18

While having regard to the obligations proposed to be imposed on the payment functions (outlined in Section 7), are the risks posed by the performance of each payment function appropriately mitigated by the payments licensing regime? Or are they more appropriately addressed by a framework outside of the payments licensing regime such as the *PRSA* or *AML/CTF Act*?

Recommendation 1:

The risks posed by the performance of each payment function should be addressed by the payments licensing regime, rather than frameworks outside the regime (such as the PSRA or AML/CTF Act). Creating a new regulatory framework dedicated solely to payment system regulation will provide greater clarity around PSP obligations rather than incorporating new rules into existing legislative frameworks that are not solely dedicated to the regulation of the payment system. This should also simplify how the legislation is read, rather than adding complexity by having obligations scattered through different legislation. However, certain obligations, such as threshold transaction report related matters, should remain within the AML/CTF Act.

Recommendation 2:

The proposed payments licensing regime appears to appropriately address the risks posed by the performance of each payment function outlined in Section 7. However, it does not seem appropriate to subject all PFS providers, regardless of their size, to the same regulatory obligations. We agree on a *graduated risk* approach according to the size of, and the activities undertaken by the PSP, eg where common access is sought.

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Question 19

Is the proposed risk-based approach to applying regulatory obligations appropriate?

Recommendation:

The proposed risk-based approach to the obligations under the payments licensing regime is appropriate. As a key objective of this regulation should be to mitigate risk, it is appropriate to impose obligations on PSPs according to their risk profiles. Adopting a risk-based approach ensures that PSPs are subject to obligations that are proportionate to the risks they pose to the system and to consumers. This ensures PSPs with relatively low risk profiles are not subject to unduly onerous obligations, while allowing PSPs with higher risk profiles to be subject to more stringent regulation. It is our recommendation that the proposed risk-based approach to applying regulatory obligations should be adopted.

Question 20

Should payment functions that are not customer facing be required to hold a payments licence? Should providers of these non-customer facing payment functions have different regulatory obligations, such as only having to comply with relevant industry standards?

Recommendation:

Providers of non-customer facing payment functions, particularly those that do not store value, may pose a lower risk than PSPs that provide customer facing payment functions, however this does not necessarily mean they should not hold a payments licence. It is prudent to ensure the integrity and security of payments data regardless of whether or not it is customer facing due to the potential impact it could have on end users and participants in the payments ecosystem. A base licence at minimum should be implemented for all PSPs to ensure consistency and avoid enforceability issues that may arise if some PSPs are licensed while others are not. Additionally, some obligations and risks relating to payment technologies may not be adequately addressed the relevant industry standard, particularly financial services related risk. Having regulatory obligations via the AFSL regime will provide clarity on the PSP licensing, centralise compliance and ensure payment services of all types are regulated in a manner consistent with other financial services. We note that the different level or risks could be addressed by implementing different category of licensing link to the different payment functions to ensure obligations are appropriate.

Question 21

Should the common access requirements and industry standards be linked to the payments licence? For example, would it be appropriate for some entities to only be required to comply with mandatory industry standards but not be required to hold an AFSL or comply with the ePayments code?

Recommendation:

The common access requirements and industry standards should be incorporated into the payments licence. This would facilitate transparent access for non-ADI licensees to payment systems. However, as discussed above (see Question 18), whilst the common access requirements should only apply to large PFS and SVF providers, all providers should still be subject to the licensing regime as the technical industry standards may not be adequate to address all operational (processes and people) and financial services risks. Having a payments licence in place will ensure a high level of compliance which is a requirement of all licensees. We believe complying with industry standards alone lacks sufficient the incentive for PSPs to have a detailed system to manage risk or continuously improve their risk management system.

Question 24

How can the payments licensing processes across regulators be further streamlined?

In some cases, different regulatory regimes may impose similar obligations on the same entity. Where this occurs, it may be unnecessary to require the entity to be licenced under both regimes.

Recommendation:

The licensing process could be streamlined by providing a centralised portal for PSPs and for reporting or lodgements to the regulators to be made through one central register, relieving the licensee from providing the same information twice. However, we note the innate complexity of this in practice where each regulator remains responsible for ensuring compliance within their control/regime. An option following the United Kingdom example is a dedicated payments system regulator as an appealing solution to streamlining processes.

Question 25

Is the proposal to provide central guidance and a website portal for PSP licensing processes a good alternative to the single point of contact proposal recommended by the Payments System Review?

Recommendation:

The proposal to provide central guidance and a website portal for PSP licensing processes is a good alternative to the single point of contact proposal. As noted in the paper, the benefits of ASIC acting as a single point of contact may be limited, as the majority of information provided by applicants for AFSLs may be irrelevant to other regulatory processes. Using ASIC as a point of contact for applicants who wish to be licensed by APRA may cause delays, for example with respect to APRA's discussion process with applicants. The proposal to provide prospective payment licensees with a single source of guidance or website portal however could achieve a similar clarity and user-friendliness to the single point of contact proposal, while avoiding delays. Although developing this guidance would require cross-agency coordination across PSP regulators, it appears that a similar level of coordination would likely be required for the single point of contact proposal. The proposal to provide a single source of guidance and a website portal for all PSP licensing processes therefore seems preferable to the single point of contact proposal.