
The Australian Digital Currency Commerce Association

Submission to the Financial System Inquiry

*Digital currencies and Bitcoin –
A proposed self-regulatory model for Australia*

29 August 2014

Contents

	Page	
1	Executive summary	1
2	What is Bitcoin?	2
2.1	A digital currency	2
2.2	An integrated currency and payment system	3
2.3	In Australia – characterised as an asset, not money or foreign currency	3
3	What is ADCCA?	3
4	A sound regulatory approach to digital currencies	4
5	Proposed regulatory architecture	5
5.1	The importance of a self-regulatory, voluntary model	5
5.2	Objectives of the proposed voluntary model	6
6	Proposed governance framework	7
6.1	ADCCA as the self-regulatory body	7
6.2	Member obligations	7
6.3	Enforcement	9
6.4	Resolution of disputes	9
7	Conclusions	9

1 Executive summary

The Australian Digital Currency and Commerce Association (**ADCCA**), the leading Australian industry association promoting efficiency, integrity and professionalism in Australia's digital currency markets, is pleased to provide this submission to the Financial System Inquiry (**FSI**).

Digital currencies such as Bitcoin offer a range of economic benefits. These include lower transaction costs compared with other means of payment due the absence of intermediaries, faster transaction processing times and certainty of payments received. These advantages are particularly evident for cross border transactions. Digital currencies are also contributing to economic growth through spawning new types of digital currency-related businesses that did not previously exist, particularly in the IT and financial sector.¹

The potential for “digital disruption” of the payments sector by digital currencies is obvious – it offers a fundamentally better alternative (to the present approach) for solving a customer problem, in a cheaper, quicker and more convenient manner with technology playing a key enabling role. It is not evolutionary change, but radical in the way it changes businesses and societies.² Digital currencies are innovations that have the potential to break through the ranks of the status quo in the payments industry.

The growth of digital currencies is supported by other disruptive trends immediately evident worldwide – the use and growth of the internet worldwide and the ever increasing penetration of mobile / smart phones which support the effective use of digital currencies by individual consumers.

The enormous momentum behind digital currencies means that globally, individuals, businesses and government entities are sitting up and taking notice. Australia is no exception – indeed, the Australian Taxation Office (**ATO**) recently issued draft guidance confirming that Bitcoin was a legitimate asset for capital gains tax purposes,³ and even the Australian Government’s “business.gov.au” portal now has a page dedicated to “Bitcoin for businesses”.⁴

However, the nascent nature of digital currencies (for example, Bitcoin did not exist prior to 2008), has meant that there is a level of uncertainty within the broader community regarding potential risks arising from the use of digital currencies - as expressed in submissions to the FSI and duly noted in the FSI Interim Report itself.

Digital currencies are clearly here to stay, in one form or another, as adoption rates increase and usage moves from the core technologically sophisticated “early adopters” out into the mainstream.

Against this backdrop, this submission proposes a “way forward” in the form of a self-regulatory framework, the details of which are in the process of being finalised in consultation with the industry. ADCCA considers that this framework will provide a

¹ See further the discussion in the European Banking Authority (**EBA**)’s Opinion on “digital currencies”, 4 July 2014.

² See the definition of “Digital Disruption” outlined by Sarv Girm, CIO Reserve Bank of Australia <http://www.rba.gov.au/speeches/2014/sp-so-110614.html> , 11 June 2014.

³ See further ADCCA’s press release, “ATO paper confirms Bitcoin as an asset for CGT purposes – important first step for Bitcoin and tax”, accessible online at <http://www.adcca.org.au/documents/Press-Release-ADCCA-ATO-200814.pdf>.

⁴ See <http://www.business.gov.au/news-and-updates/News-and-features/Pages/Bitcoin-for-businesses.aspx>.

sound basis for interactions between Bitcoin participants, their customers and the broader financial ecosystem. The framework will foster Australian led innovation and development of the Bitcoin technology, which will improve security, customer experience and consumer protection. In particular, ADCCA considers that the implementation of a sound regulatory regime will enable customers to have a greater confidence in the entities providing digital currency and related services, while ensuring that the regulatory framework is sufficiently flexible to accommodate developments in technology over time.

ADCCA looks forward to continuing to engage with stakeholders and the broader financial industry as it seeks to introduce and implement its self-regulatory model for the future regulation of digital currencies in Australia.

2 What is Bitcoin?

2.1 A digital currency

Bitcoin is a type of “digital currency” –a digital bearer instrument that has an asset value that can be redeemed by the holder. It is one of a number of “crypto-currencies,” being digital currencies that have been deliberately encrypted or encoded in order to make them impossible to counterfeit.⁵ Bitcoins can be used by natural or legal persons as a means of payment that can be transferred, stored and traded electronically.⁶

Bitcoin is decentralised, in that it is not issued either by a central bank or public authority, and is not associated with a “fiat” (conventional) currency.

Bitcoin operates at a peer-to-peer level. That is, unlike other digital currency transactions which typically occur through an intermediary with monitoring responsibilities, Bitcoin transactions are “monitored” through an algorithm written into the currency. This algorithm is solved/encrypted en masse by a host of private computers through which Bitcoin’s transaction history (known as the “block chain”) is managed.

Although the transaction history is publicly available, the identity of those involved in the transaction remains private because each “wallet” (which holds one or more bitcoin addresses, which are analogous to bank accounts) is pseudonymous.⁷ However each of the transactions of each address remains permanently and publically available for inspection, such that when a specific address is tied to a specific natural person, the complete transaction history of that address can be made publically available.

Bitcoins already in circulation can be acquired by exchanging “fiat” currencies for Bitcoins through an online exchange or a Bitcoin ATM, by accepting them as a gift, or in exchange for goods and services.

Issuing “new” Bitcoins occurs through Bitcoin “mining”. Mining is the process of including outstanding transactions on the public ledger (blockchain). In order for a transaction to be included in a block that will be added to the blockchain, a

⁵See <http://www.business.gov.au/news-and-updates/News-and-features/Pages/Bitcoin-for-businesses.aspx>.

⁶ These characteristics of digital currencies are considered in the European Banking Authority (EBA)’s Opinion on “digital currencies”, 4 July 2014.

⁷ <http://www.coindesk.com/information/how-do-Bitcoin-transactions-work/>

computationally intensive algorithm must be solved. The first miner to solve and publish the solution to the cryptographic challenge wins a reward of several Bitcoins.

A miner may arbitrarily include outstanding transactions for inclusion onto a block.

The Bitcoin protocol is designed so that a mining block will be added to the block chain approximately every 10 minutes.

The number of Bitcoins issued to miners for solving the algorithm halve every 4 years, thus limiting the total number of Bitcoins that will ever be issued to 21,000,000.

2.2 An integrated currency and payment system

Bitcoin can also be considered an integrated currency and payment system. In fact, the combined effect of creating Bitcoins (through “mining”), digital transfer of Bitcoins into wallets and the monitoring of transactions through the algorithmic system makes Bitcoin a form of self-executing payment system where transactions are completed and settled (ie become final) within minutes.

2.3 In Australia – characterised as an asset, not money or foreign currency

On 20 August 2014, the ATO issued a draft tax ruling and a number of draft tax determinations. At a high level, this material provided that Bitcoin was neither money nor a foreign currency, but was instead:

- property for capital gains tax and fringe benefit tax purposes; and
- “trading stock” when held for the purpose of sale or exchange in the ordinary course of a business.⁸

This approach can be contrasted with that taken by the UK’s taxation department, HM Customs and Revenue, which considers Bitcoin to be a currency.⁹ As a result, VAT is not applied to Bitcoin transactions in the UK.

Other jurisdictions have taken a variety of other approaches, potentially reflecting the “comfort level” that those jurisdictions have in relation to Bitcoin and digital currencies more generally.¹⁰

3 What is ADCCA?

ADCCA is the leading Australian industry association promoting efficiency, integrity and professionalism in Australia's digital currency markets, including Bitcoin.

⁸ See ATO, “Tax treatment of crypto-currencies in Australia – specifically Bitcoin”, accessible online at <https://www.ato.gov.au/General/Gen/Tax-treatment-of-crypto-currencies-in-Australia---specifically-Bitcoin/>.

⁹ <http://www.hmrc.gov.uk/briefs/vat/brief0914.htm>. Note that the Monetary Authority of Singapore takes a similar position in classifying Bitcoin as a currency rather than an asset (See further <http://www.techinasia.com/singapore-government-mind-decides-regulate-Bitcoin/>).

¹⁰ By way of illustration of the level of regulation in other countries, within the US, the Internal Revenue Service taxes Bitcoin as property (such that it is subject to capital gains tax). In the EU, the European Banking Authority advised lenders to refuse Bitcoin in July 2014. In China, private individuals may trade Bitcoin (although the Chinese Central Bank has barred financial institutions from doing so, and the People's Bank of China has said financial institutions and payment companies are unable to give pricing in Bitcoin, buy or sell the digital currency, or insure Bitcoin-linked products).

ADCCA was established in April 2014. It intends to offer a forum for facilitating discussions between industry participants, government, regulators, financial institutions, key trade associations, and other stakeholders.

Currently, ADCCA's main focus is on developing a framework for industry self-regulation with an emphasis on:

- industry standards and a Code of Conduct;
- working with Government to inform policy developments and other initiatives for the effective regulation of Australia's digital currency markets; and
- implementing professional development and accreditation programs.

Further details on the regulatory model that ADCCA is developing are set out in section 5 below.

4 A sound regulatory approach to digital currencies

Digital currencies such as Bitcoin are becoming better known and well established within the broader financial industry. Within the Australian landscape, guidance issued by the Australian Taxation Office (**ATO**) as recently as 20 August 2014 confirmed that Bitcoin was considered a legitimate asset for capital gains tax purposes.¹¹

The increasing use of Bitcoin is consistent with Bitcoin being not merely a "digital fancy", but a serious means of payment. However, despite the fact that digital currencies are becoming increasingly important, the existing regulatory framework is ill equipped to deal with the opportunities and challenges brought about by the use of this new form of payment. Indeed, a number of the submissions to the FSI have already noted some of these challenges, as summarised in the FSI Interim Report and set out in the table below.

Table 1: Potential challenges identified in the FSI Interim Report¹²

Challenges identified	Further details
The potential risk to the safety of funds.	This may arise as a result of system collapse or fraud.
The potential for investor protection issues.	This may arise because of the speculative nature of digital currencies.
The potential for illegal activities to occur using digital currencies.	This may arise because of the pseudonymity of digital currency payments.
The potential uncertainty of	This may arise because of the cross-jurisdictional

¹¹ See further ADCCA's press release, "ATO paper confirms Bitcoin as an asset for CGT purposes – important first step for Bitcoin and tax", accessible online at <http://www.adcca.org.au/documents/Press-Release-ADCCA-ATO-200814.pdf>.

¹² FSI Interim Report, pages 4-45 to 4-46.

Challenges identified	Further details
regulation.	nature of digital currencies.

ADCCA considers that the growth of digital currencies in Australia, in particular Bitcoin, is likely to increase dramatically in the near future. To that end, ADCCA supports comments in submissions to the FSI which recognise the desirability for increased regulatory focus on digital currencies.

An increased regulatory focus will help to facilitate certainty, transparency and economic growth. However, so as not to “chill” the future development of this nascent industry, it is necessary to ensure that an appropriate balance is achieved between certainty of regulation and future innovation.

The question, then, is – *what* model of regulation should be adopted? And, once a model is decided upon, *how* should that model be implemented?

5 Proposed regulatory architecture

5.1 The importance of a self-regulatory, voluntary model

(a) *Why self-regulation?*

Self-regulation involves individual firms or industries regulating their own conduct.¹³ ADCCA considers that this model of regulation is key to the regulation of digital currencies because the industry in Australia is still relatively nascent, yet also rapidly changing.

Given this context, ADCCA is seeking to implement regulatory architecture which:

- is capable of managing and addressing risk in a rapidly changing environment;
- allows regulators to draw on the expertise, experience and industry-specific knowledge of industry participants; and
- critically, does not stifle innovation.

This self-regulatory approach is not, by any means, a novel concept. For example, a similar framework has been in place in the payments industry under the auspices of the Australian Payments Clearing Association (**APCA**).¹⁴ APCA’s work over the years demonstrates that a self-regulatory model can be implemented so that it is both:

- sufficiently robust, in being able to regulate what is, and what is not, acceptable conduct; and
- sufficiently flexible, in being able to accommodate and respond to developments which affect the industry.

¹³ I Bartle & P Vass, *Research Report 17: “Self-regulation and the regulatory state – a survey of policy and practice”*, 2005 at 19.

¹⁴ <http://www.apca.com.au/about-apca/what-we-do>.

This flexibility is particularly demonstrated in the recent establishment of the Australian Payments Council, a new coordinating body for the payments industry.¹⁵ The Council will aim to foster the ongoing development of the Australian payments system to ensure it continues to meet the changing needs of its users with innovative, safe and competitive payment services. Its work will complement the oversight of the payments system by the Reserve Bank and its Payments System Board (**PSB**). When commenting on the future work of the Council, APCA has noted that:

*“... 15 plus years of formal payments regulation has taught the Government regulator AND the industry that “guided collaboration” works a lot better than black-letter law... in networks, there is simply no substitute for cooperation”.*¹⁶

Similarly, the self-regulatory model proposed by ADCCA seeks to combine the relevant knowledge and expertise of those who are involved in digital currency industry on a daily basis with the knowledge and expertise of other relevant stakeholders including government and regulators.

(b) Why a voluntary model?

The model proposed by ADCCA is voluntary and will effectively require that industry participants “opt-in” to be self-regulated.

In order to incentivise industry participants to opt in, the benefits arising from compliance with the regulatory framework (in terms of best practice and customer confidence) will need to outweigh compliance costs. ADCCA considers that the model proposed will meet these requirements, and there is likely to be a large number of digital currency industry participants who will be keen to comply with this self-regulatory framework. Indeed, an incentive for industry participants to seek to comply with the ADCCA self-regulatory framework will be their ability to differentiate themselves from non-certified industry participants.

5.2 Objectives of the proposed voluntary model

ADCCA’s model seek to achieve the following objectives:

- **certainty and transparency** – that is, certainty as to the objectives, processes and actions that will underpin the regulatory model, and transparency as to what these are and how they will be implemented;
- **flexibility** – that is, the ability to respond appropriately and in a timely manner to changes as they arise, whether in relation to the types of participants involved in digital currency transactions and their changing requirements, or changing technology; and
- **efficiency** – that is, ensuring that the level of regulation is proportionate to the objectives sought to be achieved, and not unduly onerous. The self-regulatory nature of the proposed model will ensure that feedback in relation to this aspect can be obtained very rapidly.

¹⁵ <http://www.rba.gov.au/media-releases/2014/mr-14-14.html>.

¹⁶ See <http://www.apca.com.au/pm/2014/q22014-print-friendly.html>.

6 Proposed governance framework

6.1 ADCCA as the self-regulatory body

The model proposed in this submission relies on ADCCA becoming the industry body responsible for self-regulation of Australian digital currency users, traders and merchants.

Membership in ADCCA will be open to all participants in the digital currency industry which are willing and able to comply with the regulatory framework set out by ADCCA and its members. Different levels of membership may be available, depending on the degree of compliance sought.

Generally speaking, it is expected that members will be required to:

- meet certain criteria;
- commit to comply with the Code of Conduct, which would set out certain expected norms of behaviour (see further section 6.2(b) below); and
- comply with certain certification requirements.

Membership of ADCCA is likely to last for a defined period of time (eg a year) and would be subject to a condition that any breaches of the Code of Conduct would need to be self-reported and remedied as appropriate. In order to renew their membership, ADCCA might require members to demonstrate that they continue to meet the necessary criteria.

6.2 Member obligations

(a) Overview

ADCCA is committed to ensuring that the member obligations include robust measures and mechanisms to ensure that the model of regulation proposed meets the objectives of certainty, transparency, flexibility and efficiency. Key elements of the model are set out below.

(b) Compliance with the Code of Conduct

It is intended that the Code of Conduct will cover issues including (but not necessarily limited to) the following:

- ensuring that the reputation of the digital currency industry is not brought into disrepute by inappropriate conduct;
- respecting and adhering to applicable rules and procedures;
- conducting activities in an honest manner;
- maintaining confidentiality and privacy;
- operating in a fair, respectful manner;
- continual self-improvement, particularly in relation to education;
- ensuring that no conflict of interest arises from actions undertaken; and

- accepting responsibility for decision-making processes.

(c) Compliance with minimum competencies

In order to be a member of ADCCA, it will be necessary for an entity to comply with certain minimum competencies (for example, in relation to solvency and education requirements, and Know Your Customer (**KYC**) obligations – see further *Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth)* (**AML/CTF laws**)). Meeting these minimum competencies will give end customers confidence that ADCCA members are legitimate businesses that have appropriate business practices in place. It will also ensure that the individuals that run these businesses are able to demonstrate appropriate levels of “fitness and propriety”.

(d) Compliance with record keeping requirements

ADCCA members will also be required to meet record keeping requirements that will increase transparency of digital currency transactions.

(e) Compliance with legal obligations

ADCCA is also considering requiring its members to undertake compliance training on areas such as consumer protection law and privacy. This would ensure that members understand their obligations under Australian law and provide appropriate levels of disclosure to consumers.

Additionally, ADCCA is considering whether it would be appropriate to require ADCCA members to have the capability to comply with KYC and reporting obligations under the AML/CTF laws. Although AML/CTF laws do not currently apply to digital currency transactions compliance with these laws is considered a priority to minimise the risk that digital currencies may be used for money laundering and/or terrorism finance. In fact, some of ADCCA’s members have already implemented KYC measures as a preventative mechanism to minimise AML/CTF and fraud risk.

(f) Compliance with relevant industry standards

ADCCA is considering requiring its members to acknowledge their obligation to comply with relevant industry standards, and to certify that an audit had been undertaken to confirm their compliance with those standards.

For example, ADCCA is considering whether it would be appropriate for its members to subscribe to the voluntary ePayments Code, which is administered by the Australian Securities and Investments Commission (**ASIC**) and regulates electronic payment transactions in Australia (including ATM, EFTPOS and credit card transactions, online payments, internet and mobile banking, and BPAY). Among other things, the ePayments Code requires subscribers to give consumers clear and unambiguous terms and conditions, sets out the rules for determining who pays for unauthorised transactions; and establishes a regime for recovering mistaken internet payments.¹⁷

¹⁷ See <http://www.asic.gov.au/epaymentscode#what-is-code>.

6.3 Enforcement

ADCAA is considering a number of enforcement mechanisms, including, for example, suspension of a member and removing a member's certification (and requiring the member to remove all indicia of ADCCA certification from their public branding).

More significant breaches might also result in the payment of compensation for any losses caused and termination of membership altogether (with no application for re-entry to ADCCA capable of being considered for a given period of time).

6.4 Resolution of disputes

The regime will also include a mechanism for the resolution of disputes between members and between ACDDA and members.

It will also require that members have available a mechanism to resolve disputes with their own customers.

7 Conclusions

While technology is changing rapidly and it is difficult to "pick winners" in the digital currency space, it is clear that digital currencies such as Bitcoin are here to stay and have the potential to dramatically change the payment landscape. The economic benefits that digital currencies can offer, and the momentum that is already behind digital currencies across the world, means that Australia simply cannot afford to "wait and see".

Accordingly, there is a need for a regulatory framework that can:

- encourage and facilitate the operation of legitimate digital currency businesses;
- educate customers on the use of digital currencies and the risks associated with it, as well as making it easier for them to recognise legitimate digital currency businesses; and
- remain sufficiently flexible and technologically neutral so as to be able to adapt to developments as required.

ADCCA considers that its proposed self-regulatory, voluntary model will be well-placed to address the concerns identified in earlier submissions to the FSI and also to achieve ADCCA's goal of providing a means through which the shared interests of Australian digital currency users, traders and merchants can be advanced effectively.

ADCCA looks forward to continuing to work with the digital currency industry and the broader community to formulate a self-regulatory model that can achieve the stated objectives of certainty and transparency, flexibility and efficiency.