Foreword

We write on behalf of Novatti Group Ltd, the parent company of the issuer of AUDD (AUDC Pty Ltd), an Australian Dollar Stablecoin that maintains a 1:1 backing with Australian Dollars. Our objective has always been to provide a safe, secure, and compliant stablecoin that retains its value through adequate backing.

Since our inception, we have endeavoured to remain versatile in an ever-evolving market. AUDD was launched on the Stellar Blockchain on November 1, 2022, expanded to the XRP Ledger in June 2023, and we anticipate launching on Ethereum in the first quarter of the forthcoming financial year. Our vision is to maintain a blockchain-agnostic solution, and we have plans to accommodate additional blockchain protocols in our ongoing quest for innovation.

Our recommendations in this submission are informed by a wealth of experience; not only from the development and launch of our stablecoin, but also as a result of our 25-year tenure as a FinTech company within the Australian market. Consequently, the insights shared herein are derived from our unique perspective as an Issuer. While we focus on the operational aspects of AUDD within our control, we respectfully defer to industry participants regarding the management of our stablecoin beyond our environment.

We commend the government's ongoing efforts to ensure that Australia's payment policy remains robust and up to date. We believe that it is essential to enhance its resilience and foster its ability to accommodate emerging forms of payment, including those enabled by blockchain technology. Our submission is intended to contribute to these important discussions by offering insights from our firsthand experience.

However, it is our anecdotal view that Australia has slipped as a preferred jurisdiction for innovation and deployment of digital finance technologies and services. The long-term benefits of efficiency for trade and commerce, employment and digital transformation may be only partially achieved. We see that these risks are in part due to the need for confirmation of regulatory oversight and debanking.

We would greatly appreciate the opportunity to further engage with the Treasury post-submission. We are eager to delve deeper into the topics discussed in this submission and look forward to future discussions that will help shape the regulatory landscape of payment stablecoins like AUDD.

Our Ethical Framework

While the current regulatory framework and policies in Australia do not explicitly encompass 'digital currencies', we recognise this regulatory gap as a significant risk factor. Until formal policy guidance is introduced, we are addressing these risks through an internal 'Ethical Framework'. This framework guides our conduct in areas such as governance, compliance, treasury functions, and risk management, providing an interim solution to the evolving regulatory landscape.

Our Ethical Framework has been developed - and is constantly refined - based on observation of or input from similar national, and international regulatory regimes and recommendations, academic institutions, industry groups, and professionals to ensure impartiality and relevance. As such, it incorporates the following key policies:

- **Treasury Management:** To ensure that AUDD remains stable, AUDC Pty Ltd will maintain highly liquid, low-risk reserves backing the stablecoin's value. Regular review will be conducted on the reserves, ranging from internal reconciliation processes to independent audits conducted to confirm the sufficiency of these reserves.
- **AML/CTF Compliance:** AUDC Pty Ltd will adhere to Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) laws. Transaction monitoring will be in place to prevent illegal activities, and any suspicious activities will be reported to relevant authorities.
- **Consumer Protection:** AUDC Pty Ltd will have clear and transparent terms and conditions and will provide ample educational material to inform users about the risks associated with using stablecoins, as well as the broader digital asset network. Procedures for handling complaints and disputes will be fair and unbiased.
- **Operational Resilience:** In the event of technological failures or cyber threats, AUDC Pty Ltd has established plans to address operational risks. This includes redundancy systems, secure data storage, key and signatory management, and robust cybersecurity measures.
- **Interoperability:** AUDC Pty Ltd will ensure that AUDD is interoperable with other blockchains and payment systems, promoting competition and preventing any one protocol or entity from gaining excessive influence.
- **Data Privacy and Security:** The protection of users' personal and financial data is paramount. Sensitive data will be encrypted, data sharing will be limited, and users will be notified of any data breaches.
- **Cooperation with Domestic and International Regulators:** As an industry innovator, AUDC Pty Ltd will closely work with domestic and international regulators to help shape a policy framework that embodies the key principles listed above.

Critically, we consider these ethical principles to be in alignment with current best practice principles endorsed by international policy leaders and institutions. Similarly, we encourage the Treasury to consider international and industry best practices that consider the pragmatic reality of how stablecoin innovations are evolving, given the need for interoperability and the rapid integration of technology and finance that is underway globally.

Definitions

Payment Stablecoins

After thorough consideration, we've determined that we cannot agree with the terminology or definition as it is currently formulated in the Treasury's consultation paper.

More broadly, we believe that this terminology could potentially limit the versatility of such stablecoins, downplaying their full range of applications. Stablecoins are not only used for payment, but also as a means of preserving wealth, as a hedge against local currency volatility, and as a mechanism to access other Decentralised Finance (DeFi) applications. Identifying them as such in an official capacity may be misinterpreted by the broader international ecosystem, thus limiting its adoption into a diverse range of use cases.

In relation to the direct nature of the stablecoin, we believe the classification of stablecoins should be primarily based on what supports their value. This could include fiat-backed stablecoins, crypto-backed stablecoins, and others. This approach presents a more comprehensive picture of the nature and risks associated with each type of stablecoin.

As such, we recommend the adoption of a more consistent naming convention to promote clarity and understanding for all parties involved. This should follow the initial naming convention proposed during the Token Mapping paper released in February (Fiat-Backed Stablecoins). Alternatively, we recommend adopting terminology that aligns with Internationally accepted definitions, in order to remain consistent and enable consistency with major financial centres such as the UK, EU and Singapore (i.e.: Asset-Referenced Token, or E-Money Token).

However, we note that the term 'Fiat-Backed Stablecoins' may become misaligned, as the proposed definition overlooks the reality of stablecoin that match the defined characteristics but are supported by a diversified treasury of assets. This is a key consideration, which, for instance, the European Union's Markets in Crypto-assets MiCA regime accounts for, suggesting that Issuers maintain at least 30% of their treasury in the referenced asset. In this case, the terminology of 'Fiat-Backed Stablecoin' may be confusing or misleading for consumers.

Issuers

While we agree with the proposed terminology of "Issuer", the definition provided within this paper is unclear as to the identified roles and responsibilities of the entity.

For instance, the proposed definition lacks clarity on the characteristics that qualify an entity as an issuer of a payment stablecoin. Is it the ability to technically manage the 'minting' and 'burning' of tokens? Is it the capacity to hold the backing cash or cash equivalents? Or is it a combination of both? A more explicit articulation of the factors that define an 'issuer' would greatly benefit this discourse.

Further to this, the assertion that the issuer is responsible for the 'stability mechanism which maintains the value of the payment stablecoin' is ambiguous and possibly unrealistic. While issuers can engage third party services (i.e: Market Makers) to provide "stability" over their stablecoin's value in DeFi and secondary markets (as it relates to fiat denominated markets), it's practically impossible for this level of management over every single market where their stablecoin exists. A more nuanced understanding of this complex ecosystem is needed in order to accurately attribute responsibilities to issuers.

To illustrate these challenges in practice, we draw to your attention the forthcoming research paper edited by Michi Kakebayashi of the Policy and Markets Bureau at the JFSA (Japan Financial Services Agency) shortly to be published by BGIN (the Blockchain Governance Initiative Network) which details the systemic linkages that caused USDC, a regulated and fully-backed payment stablecoin, to lose its peg in a number of markets in March 2023. Notably, USDC's issuer Circle is licensed as an e-Money issuer by the FCA (UK), as a money transmitter in the United States, and as a Major Payment Institution by MAS (Singapore). We will happily share a copy of this research paper with you when it is publicly available.

More broadly, the definition currently proposed by the Treasury seems to imply that the issuer has unilateral control. In reality, some stablecoin projects operate under consortium-based governance models where control over the 'minting' and 'burning' mechanism is shared among members of that consortium. For instance, Centre – the entity that has control over the technological functions of USDC – is a consortium that consists of two 'Issuers', Circle and CoinBase. While both inherently have the power to issue new USDC, this authorisation is granted to them through the consortium itself.

Wrapped Payment Stablecoins

In regard to what defines an 'Issuer' and a 'Payment Stablecoin', we would like to acknowledge the following quote from the consultation paper:

"It is not intended to capture stablecoins collateralised by other crypto assets, stabilised via other crypto assets (i.e. via algorithmically driven processes related to other crypto assets), or redeemable for commodities such as gold or another deliverable asset that is not an Australian or foreign currency."

We believe this overlooks an additional and equally important category of stablecoins: bridged or wrapped stablecoins, which would potentially meet the definition of a 'payment stablecoin' within itself, due to the class of asset backing it, and which also presents an opportunity for industry self-regulation.

In the case of wrapping a stablecoin, an independent entity locks a stablecoin on one blockchain as collateral to issue a token of the same value on another blockchain. This function is often completed with the use of a smart contract, or with the assistance of other off-chain technologies or processes. The operational model for these stablecoins is essentially the same as the model defined within this paper - Instead of holding AUD 1:1, they hold the payment stablecoin 1:1.

As previously identified during the Token Mapping consultation, we agree that it is not the role of regulators to govern decentralised ecosystems or 'open source' software – the effort to undertake such an activity would not be feasible nor efficient.

In saying this, we support self-driven industry objectives to influence developers and providers of such solutions to be held to the same standards as issuers, in that they follow the overarching themes of adequate backing and follow best practices for risk management. We note that this view is consistent with the view put forth by Blockchain Australia in their response to the Treasury's consultation paper.

Further to this, we recommend guidance be provided to ensure that the liability of losses potentially incurred by the holders of the bridged payment stablecoin (i.e: due to catastrophic failure of the contract holding the backing payment stablecoin in custody) should be transferred to the entity issuing the wrapped asset, and not that of the 'primary Issuer'.

Distributors

We would like to highlight an important aspect of the payment stablecoin ecosystem that has not been adequately represented in the proposed definitions - the role of 'Distributors'.

'Distributors', as we define them, play an integral part in the stablecoin landscape. They serve as intermediaries between the issuer and the broader market, including consumers, businesses, and institutions, and have the authority to request the 'minting' (or issuance) or 'burning' (destruction) of tokens from the issuer. Within the paper, this is referenced as a 'customer' of the issuer which we believe does not capture the appropriate interaction in this manner.

Distributors can include a diverse range of entities such as Digital Currency Exchanges (DCEs), Brokers, Market Makers, FX providers, and other financial service providers that facilitate domestic or international payments, and cross-border settlements.

The recognition of 'Distributors' as a participant would provide a more comprehensive understanding of the key stakeholders within the stablecoin ecosystem. We also believe this recognition could assist in better designing regulatory

frameworks by identifying the roles and responsibilities of all entities involved, thereby contributing to the overall stability, transparency, and integrity of the system.

Policy Recommendations

In line with the structure of our internal framework detailed above, we have put forth the following recommendations, designed to enhance the regulatory context for stablecoins and ensure an environment that encourages innovation while maintaining safety and security.

Treasury Management

Access to Banking and Payment Services

We firmly believe that ensuring reliable and consistent access to banking and payment services is a fundamental requirement for stablecoin issuers. As part of our recommendation, we suggest that the Reserve Bank of Australia (RBA) be authorised to provision its accounts and services to stablecoin issuers, including direct access to payment rails.

This step will be instrumental in promoting competition and eliminating potential conflicts of interest for issuers who depend on Authorised Deposit-taking Institutions (ADIs) for banking access. It is of note that a number of Australian banks that currently will not offer bank accounts to stablecoin issuers are offering their own stablecoins.

We endorse the ongoing work on addressing de-banking concerns, as mentioned in the "Government response to Potential Policy Responses to De-banking in Australia" published on 28th June 2023. We urge the Australian Government to continue prioritising this issue.

Separation of Funds

We recommend further exploration of insolvency hierarchies for payment stablecoins. We believe that the separation of reserve assets and operating funds is essential. A comparable legal structure could be a Trust, but we do not propose that Trustees would necessarily be the identified beneficiaries in the event of insolvency, as the stablecoin is not issued to Trusts but to users.

Management of Backing Assets

We advocate for regulatory measures to mandate all issuers to fully back their payment stablecoins with highly-liquid, low-risk assets, maintaining a collateralisation ratio of at least 1:1 at all times.

Where assets are diversified, we encourage the development of a more simplified capital adequacy requirement, to ensure fiat funds for disbursement are available ‘at call’. As previously highlighted, the MiCA regime, specifies a minimum threshold of 30% of the issuer's treasury to be held in the referenced asset.

Furthermore, it is crucial to provide consumers with accurate risk assessments regarding private stablecoins. This transparency can be achieved by granting them access to the issuer's proof of reserves and proof of liabilities. We also advise that proprietary trading should only be permitted if it is transparently reported to the token holders.

Capital Adequacy of Backing ADIs

We advise giving due consideration to the impact of newly designed regulations on payment stablecoins on the prudential requirements of ADIs.

Drawing from the Financial Stability Board's (FSB) recommendations on Global Stablecoins, particularly concerning risk management frameworks (Recommendation 5) and prudential requirements (Recommendation 9), we emphasise that prudential requirements and capital buffers should be proportionate to the risks and size of the undertaking. We urge the Treasury to contemplate how prudential policy can be balanced against the objectives of fostering growth and innovation.

Insurance Coverage

Where insurance requirements are necessary, we propose that they should be implemented only when a market for the respective insurance product exists and is accessible in practice by the virtual asset sector. We acknowledge the current absence of a comprehensive and competitive insurance market for virtual asset businesses.

Payment Stablecoin Issuance as a Result of a Blockchain Fork

In instances where a "hard fork" occurs in the blockchain protocol utilised by the issuer, we recommend that the duplication of the stablecoin to the 'new' blockchain should not be considered a liability for the issuer.

AML/CTF Compliance

AUSTRAC Compliance

We recommend issuers should adhere stringently to the compliance requirements set forth by the Australian Transaction Reports and Analysis Centre (AUSTRAC), as observed by Digital Currency Exchanges (DCEs). This will ensure the upholding of the highest standards of integrity, and legal compliance within the issuer's operations.

We advocate for the practice of strict due diligence before accepting funds for backing stablecoins, as well as the acceptance of tokens originating from questionable wallets for the purpose of burning with the disbursement of relevant funds.

Application of Token Restrictions

We recommend that the concept of permissions or constraints, which can be applied on a technological level by the payment stablecoin Issuer, be considered. This can provide the Issuer with a number of controls over the asset held by external wallets that the issuer would not otherwise have. However, the issuer's functional ability to do so and the implementation method will vary between blockchain protocols. Such permissions or limits include the ability to "freeze" the stablecoin balance of a wallet owner, recall the stablecoin back to the issuer, and reverse a stablecoin payment.

While such authoritative capabilities might be extremely advantageous for compliance and governance purposes, they pose a substantial danger if they are exploited or not disclosed to stablecoin holders.

For example, the Centre Consortium (issuers of USDC) can "blacklist" Ethereum wallet addresses, preventing them from receiving future USDC transactions or withdrawing their existing USDC balance on-chain. Their "Blacklisting policy"[1] governs the circumstances under which they can take action.

Consumer Protections

Protection in Event of Insolvency

We recommend that payment stablecoin holders be given priority in the event of an issuer's insolvency. This measure is imperative for protecting consumer interests. To achieve this, we advise the strict separation of reserve assets from operating funds.

Adequate Access to EDR Facilities

[1] Centre Blacklisting Policy: http://www.centre.io/hubfs/PDF/Centre_Blacklisting_Policy_20200512.pdf

We recommend that all issuers, where retail involvement is significant, should have access to an appropriately resourced External Dispute Resolution (EDR) regime. Such regimes would offer an adequate support structure to handle customer complaints and disputes, thereby providing an additional layer of consumer protection.

Public Register of Approved Issuers

We recommend that the Australian Securities and Investments Commission (ASIC) create and maintain a public register of approved issuers of payment stablecoins. As part of this measure, we also recommend enforcing stringent naming conventions to prevent issuers from misleading the public through their branding, suggesting an association with the Treasury, RBA, Royal Mint etc.

During the registration process, ASIC could consider requiring the disclosure of issuing addresses or contracts related to native issuance. This step would serve as a safeguard against consumer scams and deceptive conduct perpetrated through the issuance of 'counterfeit' tokens.

Standardised Public Disclosure

We recommend the implementation of standardised public disclosure requirements for all payment stablecoin Issuers. This should, at a minimum, include the assets backing the payment stablecoin, redemption policies, and attestations from registered public accounting firms.

Further to this, Issuers should be required to clearly outline consumers' legal rights in case of disputes, including internal resolution policies, and their right to seek external dispute resolution. Consumers should be aware of their rights and the process to execute them, should the need arise.

Operational Resilience

Risk Management in Payment Stablecoin Issuance

It is essential to develop a robust risk management framework that covers minting and burning processes of payment stablecoins. We recommend releasing guidance on how to effectively manage the risks surrounding payment stablecoin issuance, with key considerations around issuance authorisation requirements such as single signing or multi-signature protocols.

Signatory management should also be included within this guidance, with clear standards to determine whether the authority to mint (or burn) stablecoins is fit and proper, along with checks and balances to prevent any misuse of these functions.

Large Exposures and Risk Concentrations

To safeguard the stability of the payment stablecoin, we recommend implementing a framework that routinely monitors and limits large exposures and risk concentrations. Establishing caps on large single-holder amounts could prevent undue concentration of risk.

Additionally, regular risk assessments should be performed to identify and mitigate potential sources of concentration risks, such as a substantial reliance on a particular technology or a third-party service provider.

Interoperability

Blockchain Neutrality

In our view, it is essential that regulations pertaining to payment stablecoins fully consider the underlying blockchain technology and how stablecoins are made available on these platforms. Since AUDC Pty Ltd has opted for a blockchain

agnostic approach, we suggest that any regulations should be flexible enough to accommodate different blockchain protocols.

While extenuating circumstances may make this unfeasible, it is important to highlight that the reliance on one blockchain can open an Issuer to several risks, stemming from creating a single point of failure. Hence, we propose that the regulatory framework should support diverse blockchain technologies to ensure broad compatibility and resilience.

Guidance on Blockchain Technologies

Although the principle of technological neutrality is important to maintain, we believe that there could be circumstances where certain blockchain technologies or protocols pose an elevated risk for payment stablecoin issuance. In these instances, we recommend that the Reserve Bank of Australia (RBA), in its role as a regulator of payment systems, should provide clear guidance to payment stablecoin issuers on these potential risks. This approach would strike a balance between technological freedom and necessary oversight, leading to a safer and more robust market.

Data Privacy and Security

Update Data and Privacy Governance

We recommend the swift implementation and regular updating of data and privacy governance measures, protections, and standards to incorporate Payment Stablecoin and Issuers. This should include specific terminology relating to digital assets, ensuring that such regulations remain pertinent and comprehensive in safeguarding both user information and the integrity of the stablecoin system.

Guidance on Balancing Transparency and Privacy

We recommend that robust guidance on how to navigate the delicate balance between leveraging the transparency offered by stablecoins issued on public blockchains for compliance purposes, and the need to ensure robust privacy protections for users. This guidance can provide a benchmark for best practices in maintaining this equilibrium.

Further to this, privacy concerns inherent to blockchain technology should be addressed through initiating comprehensive education and awareness campaigns on the potential risks of unnecessary disclosures of customers' Personally Identifiable Information (PII) during on-chain transactions.

Open Exploration on Leveraging Cryptographic Technologies

We advocate for the exploration and integration of digital asset native technologies like zero-knowledge proofs (ZKPs), decentralised identifiers, and soulbound tokens as a method to strengthen user privacy. Such technologies can play a pivotal role in improving privacy standards without compromising the utility and functionality of the payment stablecoin or the Issuer.

By supporting payment stablecoin issuers to actively enable the use of ZKPs and other cryptographic technologies, user privacy and data can be preserved, without having to forego oversight of risks, imperative to Anti-Money Laundering (AML) and Counter-Terrorist Financing (CTF) obligations.

Cooperation with Domestic and International Regulators

Promoting Stablecoin Growth

We recommend that regulatory policies promote the growth and acceptance of stablecoins issued in Australia, both domestically and internationally, rather than inhibiting it. Regulations should not unreasonably restrict an entity's ability to adopt or interact with a stablecoin, provided that the entity possesses the necessary licences or registrations to

conduct business activities. This will allow stablecoin innovations to realise their full potential and positively impact the economy.

Role of ASIC

While it would be preferential to have a specialised regulatory body that could be established for the broader Crypto Asset and Blockchain industry, we support the proposal that ASIC act as a single point of contact for matters concerning payment stablecoins. However, we recommend that adequate resources and training be allocated to ASIC to ensure they are well-equipped to handle this emerging sector and its unique nuances.

APRA Supervision Threshold

We propose a higher threshold for triggering APRA supervision. We believe that the current threshold of $50 million is too low and suggest a range of $250-$500 million as a more appropriate figure. Given that funds in the context of payment stablecoins are intended to be held 1:1 and not lent out, the inherent risk in Major Stored Value Facilities (as a "special class of ADI") is materially lower than that of traditional ADIs. This modification will help target regulation to the risk posed, ensuring a more efficient and effective supervisory approach.

Clarification of Threshold Implications

We recommend that the Treasury should clarify what occurs once the supervision threshold is met, specifically whether meeting the threshold automatically triggers a halt to further issuance. Clear guidelines on this matter will provide stablecoin issuers with better visibility and predictability, fostering a more secure and dependable environment.