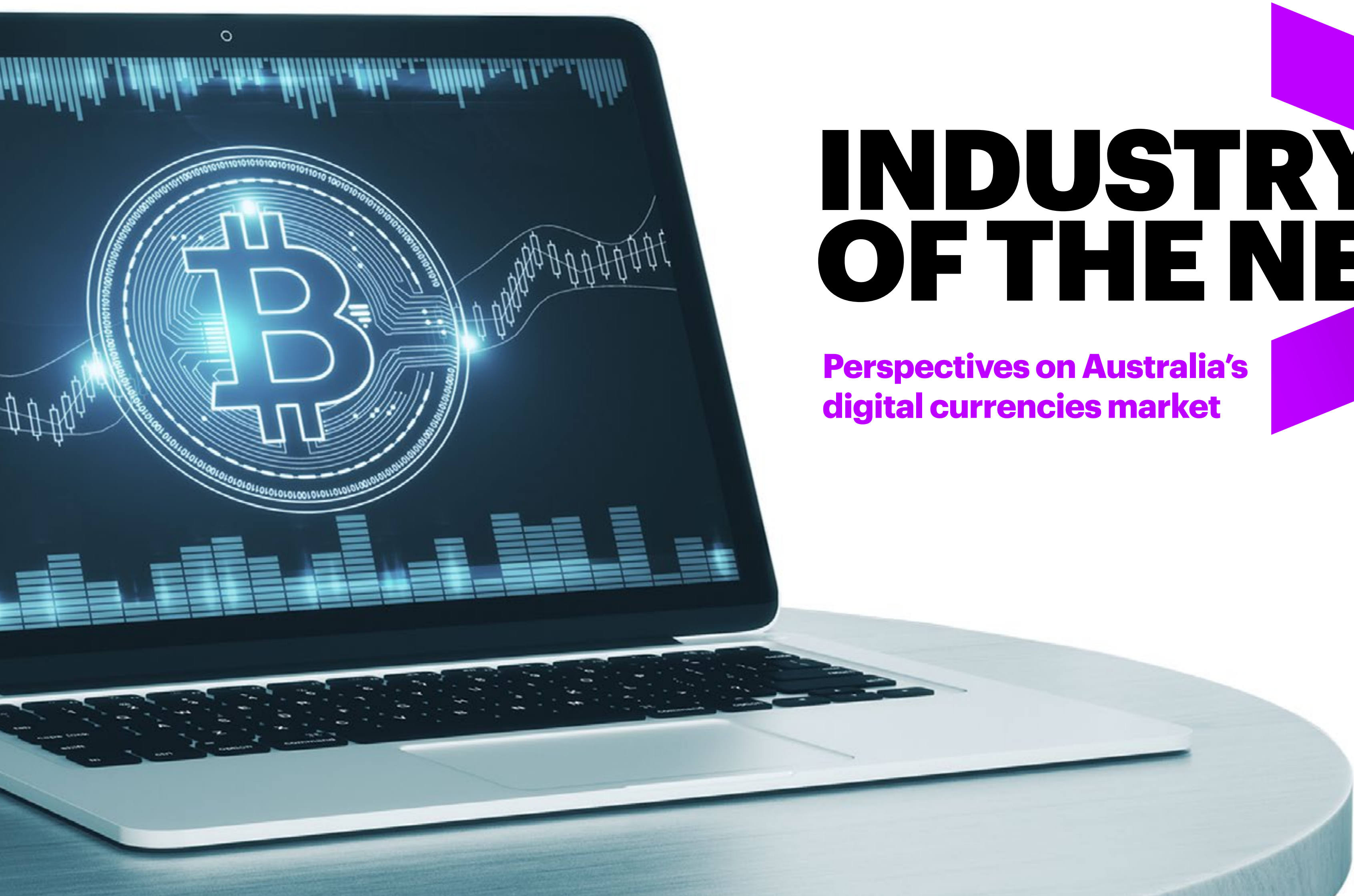
INDUSTRY OF THE NEW

Perspectives on Australia's digital currencies market



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DIGITAL CURRENCIES ENTER A NEW ERA

A Q&A WITH NICK GIURIETTO

Nick Giurietto is the Chief Executive Officer and Managing Director at the Australian Digital Commerce Association (ADCA), Australia's business council for organisations using blockchain technology. As a passionate champion for blockchain innovation, Nick has driven the creation of the Australian Digital Currency Code of Conduct, is a founding member of the Global Blockchain Forum and a member of Standards Australia's Technical Working Committee on Blockchain and Distributed Ledgers.

In this Q&A, we ask Nick about the current state of Australia's digital currencies market, including recent growth, regulatory change and the anonymity of digital currencies.

Digital currencies have grown significantly – both in value and adoption – over the past year. Joint research from Accenture and ADCA suggests $5.9bn was traded in Australia in 2017. Why do you think we are seeing this kind of growth?

Cryptocurrencies are certainly gaining traction. What we are seeing is the emergence of a whole new way of conducting a market, with some key advantages over traditional methods.

We've got an environment today where returns on traditional assets are pretty weak, and so people are looking for other opportunities, and this is within an underlying trend, where more and more people are beginning to understand the value of what the technology does, and so now want to get involved.

In early April 2018, it became mandatory for Digital Currency Exchanges (DCEs) to be registered with the Australian Transaction Reports and Analysis Centre (AUSTRAC). Many in the industry view this as a major positive, but is more regulation needed?

Yes, I do think there will be further important regulation in a few areas – chiefly around consumer protection. The ADCA Code of Conduct, on a self-regulatory basis, includes a whole range of consumer protections. But, in terms of national regulation, there is only the general law around deceptive and misleading conduct to protect people. Regulation needs to cover the whole market, not just one element of it.

A proper consumer protection regime via exchanges domiciled in Australia would act as an incentive to trade on an Australian-based exchange. That requires alignment between the regulators, which we're not so good at yet. But it needs to happen because there are people who don't understand the choices that they're making, and are perhaps tempted offshore by pricing or tax issues. Without consciously being aware of it, they could be trading away a whole lot of protection and safeguards.

Australia's banks have had a fractured relationship with local DCEs, at times refusing to provide services. Do you think regulation will change this?

The new regulations should completely transform the way the banks relate to the exchanges. Whether it will or not, is another question. Anti-money laundering (AML) and counter-terrorism financing (CTF) have been a threshold question for the banks, but now, from a compliance point of view, the exchanges operate in an AML/CTF regime that is essentially the same as the regime that the banks have. The idea is that if it's good enough for the banks themselves to operate to these standards for their own transactions, then they should have no problem working with an industry that has much the same standards.

Regulations are currently limited to the points at which digital and fiat currencies are exchanged. Does this still mean that, once exchanged, digital currencies can be used for nefarious purposes?

When cryptocurrencies have been used inappropriately, perpetrators were caught using forensic accounting that analysed the blockchain records in question. So from this perspective it is actually far less vulnerable to misuse than cash.

The interesting question to consider is whether there is a long-term future for cash, and as a society, whether we want to make digital currency flows more, or less, traceable. There are perfectly legal reasons why a person may want to keep their purchase history private. How much should this be allowed at the expense of reduced auditability of records that could help control crime? It is an interesting question, but more a social or ethical issue than a technology question.

Australia's digital currencies market has been growing at an exponential rate over the past 12 months. Joint research from Accenture and the Australian Digital Commerce Association (ADCA) has revealed the true scale of the market for the first time.

FIND OUT MORE

BUILDING AUSTRALIA'S DIGITAL CURRENCY MARKET

A Q&A WITH ADRIAN PRZELOZNY

Adrian Przelozny is CEO and co-founder of Independent Reserve, a digital currency exchange based in Sydney. Adrian's career spans more than 15 years in Information Technology, specialising in the design and development of critical business systems. In 2016 Adrian joined the Board of Directors of the Australian Digital Commerce Association (ADCA) to help progress the standing of Digital Currencies in Australia.

In this Q&A, we ask Adrian about the current state of Australia's digital currencies market, including recent growth, regulatory change and the skills needed to support the industry.

Digital currencies have grown significantly – both in value and adoption – over the past year. Joint research from Accenture and ADCA suggests $5.9bn was traded in Australia in 2017. How do you expect the market to develop from here?

On a long-term view, I'm very optimistic and positive. We've seen a strong growth trajectory over the last 12 months, and we probably won't continue a curve that's quite as steep, but we expect a long-term upward trend.

As regulators become more comfortable with the concepts, the industry and the technologies, there will be greater regulation. This should include consumer protection measures, which I think is very important. At the same time, as people get more educated about digital currencies, we'll see more people using it in their day-to-day lives, and more market penetration into different demographics.

On regulation, in early April 2018, it became mandatory for Digital Currency Exchanges (DCEs) to be registered with the Australian Transaction Reports and Analysis Centre (AUSTRAC). How did the industry consultation process work in the development of these regulations?

We actually lobbied AUSTRAC to regulate the industry, and they were a little bit surprised that we wanted to get regulated – most industries don't. However, we felt that it was very important for the industry to take it to the next level. It began as an educational process where we helped AUSTRAC understand how the industry works and what parts of the industry can be regulated. They too helped us learn more about the legislative and regulatory process. We're quite happy with how it ended up. It is a good start in terms of industry regulation and most of ADCA's recommendations were taken forward into the legislation.

Now we have AUSTRAC oversight, our practices are not just guaranteed by our word; we can point to the regulator, the audits, and that gives more confidence to our customers and our partners.

With digital currencies growing so fast, is it challenging to find all the skills you need within Australia?

The bulk of people that we have hired over the last few months are involved in 'know your customer' (KYC) processes, so they help us onboard new customers. We've got strict KYC conditions – even before AUSTRAC regulation, it was probably harder to open an account at Independent Reserve than a major bank.

It's not difficult to hire people to help with KYC processes because the skills are already in Australia and there are training courses available. The KYC process we use is similar to that used by banks, or any other industry regulated by AUSTRAC.

The biggest resourcing challenge is probably hiring software developers that know how our industry works. Digital currencies are still quite young so there aren't many people with experience. Those with experience are in high demand, so it is a struggle. At times, we've had to hire developers from overseas because we were not able to get the right skills here in Australia. That's just part of being in a fast-growing industry.

Do you expect the digital currency industry to become more integrated with the wider financial services industry?

Yes, we're seeing signs of this right now; we're seeing banks becoming more and more open to us. There are also new players interested in investing in digital currencies or accessing custodial services, including hedge funds, self-managed super funds, private banks and more sophisticated investors. We're seeing large, institutional investors looking to get involved too and I think that will be a major theme in 2018.

FIND OUT MORE

EVOLVING A NEW INDUSTRY

A Q&A WITH JONATHON MILLER

Jonathon Miller is managing director and co-founder of Bit Trade Australia, a digital currency exchange based in Sydney. Established in 2013, Bit Trade is Australia's longest-running bitcoin trading platform. Sister company, Bit Trade Labs, is dedicated to the creation of innovative, world-class blockchain solutions. Bit Trade is a founding member of the Australian Digital Commerce Association (ADCA).

In this Q&A, we ask Jonathon about the current state of Australia's digital currencies market, including recent growth, regulatory change and the next challenges for the industry to tackle.

Digital currencies have grown significantly – both in value and adoption – over the past year. Joint research from Accenture and ADCA suggests $5.9bn was traded in Australia in 2017. How has this impacted your business?

We've needed to greatly increase our capacity to cope with the recent growth. Capacity tends to lag demand in many businesses, but it has been challenging, and I'm sure that was true for a lot of the industry. The key bottleneck was around our own "know your customer" (KYC) processes, which included some very labour-intensive components. It was difficult to onboard new people fast enough to ensure capacity in that area.

But we've developed enough now that we are confident that we'll be able to meet that kind of challenge better next time there is a major demand spike.

Do you expect the digital currency markets to continue to be more volatile than other currencies or securities?

Yes, I think that there will be more volatility in this space, at least for the next few years, because most of the technologies are experimental. From a fundaments point of view, this is early days. As the technologies mature, and they start getting adopted, as people start using these technologies to issue securities (underpinned by other assets) then you'll start seeing less volatility. But in the short run, I see more volatility ahead because of the nature of the technology, being so new, and the nature of the investments, being more speculative.

In early April 2018, it became mandatory for Digital Currency Exchanges (DCEs) to be registered with the Australian Transaction Reports and Analysis Centre (AUSTRAC). How do you think this will impact the digital currency industry?

It is going to set the industry up for growth because it will open new portions of the market. Institutions, in particular, will now feel more comfortable in this space. But it will also increase consumer demand as they will gain confidence from the fact that a regulatory body is involved.

Regulations will also evolve and extend into other areas. The industry needs to continue to collaborate with regulators to help shape the future of the industry. I think it should be a continual dialogue so that we can learn from each other; that has been key to the successful creation of the AUSTRAC regulations.

What are the major challenges involved in further developing Australia's digital currency market?

Security is a major challenge. Almost every week you read about a hack or security breach involving cryptocurrency. We think it is very important to educate customers about how best to store and protect their currency. We have taken a deliberate move not to hold cryptocurrency on our customers' behalf, because this makes you a bigger target for hacking or attacks.

The next challenge is the pace of change and the incredible speed at which new technology is expanding. Keeping up is hard, even for a start-up. Our industry was very small just a few years ago and is now blooming into a large, regulated industry. Many companies which emerged as tech start-ups, must now become financial services businesses. All industry participants must now rise to the challenge of meeting new requirements and expectations and resourcing their businesses effectively.

FIND OUT MORE

REGULATING CRYPTOCURRENCIES

A Q&A WITH AUB CHAPMAN

Aub Chapman has over 42 years' experience in the banking sector, across a range of areas including audit, Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF), cash and ATM services and business continuity planning.

Aub has appeared as a technical expert before several Australian parliamentary committees, he is a founding member and Co-Chair of the Association of Certified Anti-Money Laundering Specialists (ACAMS) Australasian Chapter, and also a member of the Australian Digital Commerce Association (ADCA) AML Committee. Aub currently provides consulting services in relation to AML/Counter-Terrorism Financing (CTF).

In this Q&A, we ask Aub about the regulation of Australia's digital currencies market, including the impact on local exchanges, future regulation and the growth of digital currencies globally.

In early April 2018, it became mandatory for Digital Currency Exchanges (DCEs) to be registered with the Australian Transaction Reports and Analysis Centre (AUSTRAC). How do you think this will impact the local DCE industry?

I think it will help to legitimise what they do. Digital currencies have had some bad press, and so the major DCEs have welcomed regulation. Firstly, it makes them more part of the mainstream financial services industry, and secondly, it helps to demonstrate to their banks that they have the same obligations. This should make it easier for banks to provide services to DCEs.

Ensuring compliance will be a challenge for some DCEs. Like many fintechs, they are generally tech start-ups, operated by entrepreneurs who are tech savvy, but not compliance savvy.

Some will no doubt discover that the AML/CTF regime is more complex and demanding than they anticipated. But that is no different to what we saw in mainstream financial services in the early days of the AML legislation.

Australian DCEs are of course not only competing domestically, but with offshore exchanges too. Those offshore competitors may not have any regulatory processes, and this may allow them to deliver quicker, more anonymous services. This could be a competitive advantage internationally, though I'd expect most local customers to feel more secure on a domestic, regulated exchange.

Regulations are currently limited to the points at which digital and fiat currencies are exchanged. Are they sufficient or is more regulation needed?

I think they're a good start. I like the consistency with other sectors such as the main banks, in terms of how "know your customer" (KYC) processes work; what information you collect, what information you verify, how you do ongoing monitoring, reassessing of risk, reporting and so forth – all that is consistent.

Moving forward we need to determine what to do about issuers of virtual wallets. The challenge is that law is sovereign but commerce and technology have no such boundaries. So digital currencies are moved across borders instantly and it is not reported. This is because they are not currently classified as international funds transfers, so they're not reportable to AUSTRAC.

As the industry grows, and the values and volumes transacted increases, we're going to see additional requirements, or at least different data that needs to be held and reported.

How do you think digital currencies will impact the financial system globally?

Around the world, at the moment, there are two different camps: those countries that are banning or restricting digital currencies, and those that are embracing it, such as Japan. As a result, there's going to be some interesting challenges globally over the next few years. Not only for law enforcement, but also for tracking value movements, which central banks and the International Monetary Fund (IMF) will be concerned about. The values and volumes will need to grow even larger for this to be a major issue, but it could happen in the future.

Another interesting development is around futures contracts, with two exchanges in America now offering Bitcoin futures. This creates a challenge because new participants will now enter the market.

Many people have bought Bitcoin or other currencies as investments that they hope will appreciate over time, rather than using it for transactions, which is still relatively small-scale. We have also seen short-term traders in digital currencies, but with futures now available, people will be able to short the market. This adds a new dynamic and attracts new participants, such as hedge funds and other institutions.

FIND OUT MORE

BUILDING CONSUMER-FRIENDLY DIGITAL CURRENCY EXCHANGES

A Q&A WITH RUPERT HACKETT

Rupert Hackett is CEO of Bitcoin.com.au, a Melbourne-based digital currency exchange, with primary markets in Australia, the UK and Canada. Bitcoin.com.au is one of Australia's leading Bitcoin exchanges, dedicated to developing safe and convenient ways for people to buy and sell Bitcoin.

Rupert completed one of the first ever Master's degrees in Digital Currencies and was quick to see the disruptive potential of blockchain technologies.

In this Q&A, we ask Rupert about the evolution of Australia's digital currencies market, including new regulations and consumer protections within digital currency exchanges.

Digital currencies have grown significantly over the past year. Joint research from Accenture and ADCA suggests $5.9bn was traded in Australia in 2017. How would you describe the impact this growth has had on the industry?

It's a very strong time for the industry, with a significant amount of capital flowing into the market. Recent developments have changed the trajectory a bit for digital currencies. We are seeing a huge amount of interest from the institutional side and we now have a first set of regulations in place. This is all very positive for the industry. It suggests that we will see an increasingly fostering environment around us, including both government and wider financial services. For an exchange like ours, it allows us to plan for a larger business in future.

Over the next 12 months we are looking to build our platform, resources and infrastructure so that we can improve our scalability.

In early April 2018, it became mandatory for Digital Currency Exchanges (DCEs) to be registered with the Australian Transaction Reports and Analysis Centre (AUSTRAC). Is this a negative or a positive development for the industry and your exchange?

It is positive for the industry and for our exchange. The best thing about it is that it formalises guidance and standardises practices. The challenge before was that there was ambiguity in what companies should be doing and whether the right processes are followed. For example, you could have a policy that is very stringent and does a lot of due diligence, but without some independent recognition or validation of these processes, consumers and other participants would not be sure of what was required and what exchanges should be doing.

It is now easier for consumers to identify reputable and disreputable operators; effectively the licenced and unlicensed exchanges. This should help to build more trust into the ecosystem.

There is also a major perception difference once something falls under a set of rules, enforced by a government agency. It offers greater legitimacy and that's something most of the industry has welcomed.

What challenges do the new regulations pose? Do they demand a lot of change from DCEs, in terms of processes and systems?

Most big exchanges already operated above and beyond the new AUSTRAC regulations and so not much change is required.

There is a potential challenge in terms of the very small transactions, such as AUD$50 to AUD$100. These amounts are not really where the risk is from a money laundering or terrorism financing perspective, but the same processes apply. This is not an issue for our business process, but I am concerned about it as a barrier to entry for people who want to buy trivial amounts.

The full "know your customer" procedure is probably not needed for AUD$50 of digital currency. The problem is that the effort and time needed to get set up on a licensed exchange, may just lead small-value consumers to an unlicensed or overseas exchange, that is quicker and easier to register with, due to the lack of checks. That's my only concern with the regulation at present.

Do you think any further regulations are needed, for example, to protect consumers?

From my perspective, the two most undervalued areas in this ecosystem are security and consumer protection. There is little information being gathered about how an exchange properly secures digital currency and what type of policy they should have in place. This is important to fully protecting consumers.

Historically, we have seen digital currency exchanges going bust, generally for some misdemeanour in their processes. For example, in 2014, Mt. Gox somehow lost the private keys for 850,000 bitcoins.

The challenge is to write and implement the regulations for proper security standards for a digital currency exchange; rules to cover what an exchange should do with customer funds and how they should protect them. Getting these in place will be exciting, and ultimately rewarding, for this new industry.

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