October 31, 2022

ripple

Senator Andrew Bragg
Suite 23.03, Level 23
56 Pitt Street
Sydney, NSW, 2000

Email: senator.bragg@aph.gov.au

Dear Senator Bragg,

Ripple Labs Inc. ("Ripple") welcomes the opportunity to comment on the consultation on the draft Digital Assets (Market Regulation) Bill 2022 (the "Draft Digital Assets Bill") published by your office on September 19, 2022.[1]

Ripple would like to thank you for the in-depth and comprehensive analysis that has been undertaken in drafting the Draft Digital Assets Bill, as well as the opportunity to provide our comments. We respectfully request you take them into consideration as you consider the policy direction and scope of intended regulation for the digital assets sector. We welcome the opportunity for further engagement with you and your office on this Draft Digital Assets Bill, and any other related consultations as may be appropriate.

Ripple is also appreciative of the opportunity to comment on the Third Issues Paper ("the Discussion Paper") published by the Senate Select Committee on Australia as a Technology and Financial Centre ("the Committee") on May 18, 2021[2] under your leadership. Ripple responded to the Discussion Paper ("Ripple Committee Response") on June 30, 2021,[3] and we thank you and the Committee for considering our feedback in the final report published in October 2021.[4]

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[1] *See* https://www.andrewbragg.com/digital-assets-market-regulation-bill-2022, Digital Assets (Market Regulation) Bill 2022.
[2] See https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Financial_Technology_and_Regulatory_Technology/FinancialRegulatoryTech/Third_Issues_Paper, Senate Select Committee on Australia as a Technology and Financial Centre Third Issues Paper.
[3] *See* https://ripple.com/files/Ripple_Australia-Senate_Third-Issues-Paper_May-2021_final.pdf, Ripple response to Senate Select Committee on Australia as a Technology and Financial Centre Third Issues Paper.
[4] *See* https://parlinfo.aph.gov.au/parlInfo/download/committees/reportsen/024747/toc_pdf/Finalreport.pdf;fileType=application%2Fpdf, Senate Select Committee on Australia as a Technology and Financial Centre Third Issues Paper Final Report.

Introduction

Using blockchain technology, Ripple allows financial institutions to process payments instantly, reliably, cost-effectively, and with end-to-end visibility anywhere in the world. Our customers are financial institutions that want tools to effect faster and less costly cross-border payments, as well as to eliminate the uncertainty and risk historically involved in moving money using interbank messaging alone.

Some customers, in addition to deploying Ripple's blockchain solution RippleNet, leverage the digital asset known as XRP for an On-Demand Liquidity ("ODL") capability. Just as Bitcoin is the native asset to the open-source Bitcoin ledger, and Ethereum is the native asset to the open-source Ethereum ledger, XRP is the native asset to the open-source XRP Ledger. XRP, given its unique design, can serve as a near instantaneous bridge between fiat currencies (or any two representations of value), further reducing the friction and costs for commercial financial institutions to transact across multiple global markets.

Although Ripple utilizes XRP and the XRP Ledger in its product offerings, XRP is independent of Ripple. The XRP Ledger is decentralized, open-source, and operates on what is known as a "consensus" protocol. While there are well over a hundred known use cases for XRP and the XRP Ledger, Ripple leverages XRP for use in its product suite because of XRP's suitability for cross-border payments. Key characteristics of XRP include speed, scalability, energy efficiency, and cost efficiency, all of which benefits the consumer and helps reduce friction in the market for cross-border payments.

As highlighted in the Ripple Committee Response,[5] these benefits will be passed on to the Australian consumer and will help reduce friction in the market for cross-border payments, thereby removing barriers to Australia's growth as a technology and finance centre.

Cross-border Payments using RippleNet & ODL

Ripple believes that blockchain technology demonstrates the potential to transform many sectors of Australia's economy, including in cross-border payments. However, we also believe that for any technology, success is based on its use cases and ability to solve real-world problems.

Cross-border payments are costly, full of friction and slow. Much of this friction is the result of processes followed in cross-border payments, until now the domain of incumbent banks (referred to as correspondent banks). A definition cited by the Bank for International Settlements defines correspondent banking as *"the provision of current or other liability account and related services to other financial institutions (including affiliates), used for the execution of third-party payments and trade finance as well as its*

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[5] *See* Ripple Committee Response, page 2.

own cash clearing, liquidity management, short-term borrowing and investment needs in a particular currency."[6]

As this definition highlights, banks use correspondent relationships - a network of bilateral accounts-based relationships - spread across the world to process payments. Although widely proliferated, the market structure of correspondent-banking injects significant friction, delays, and costs in processing payments for the respondent banks, primarily due to the need to prefund accounts.[7]

RippleNet, the cross-border payments solution offered by Ripple, connects hundreds of financial institutions around the world via a single API which makes transferring money faster, cheaper and more reliable. It also helps to reduce, and even eliminate, the need to pre-fund accounts with ODL, a service that uses the digital asset XRP to source liquidity during cross-border transactions as an alternative to traditional funding mechanisms. RippleNet customers can use the digital asset XRP to bridge two currencies in a matter of minutes, ensuring payments are quickly sent and received in local currency on either side of a transaction. XRP is ideally suited for global payments because it is quicker, less costly, more scalable and sustainable than alternatives. The broad ODL flow is outlined in Figure 1 below.
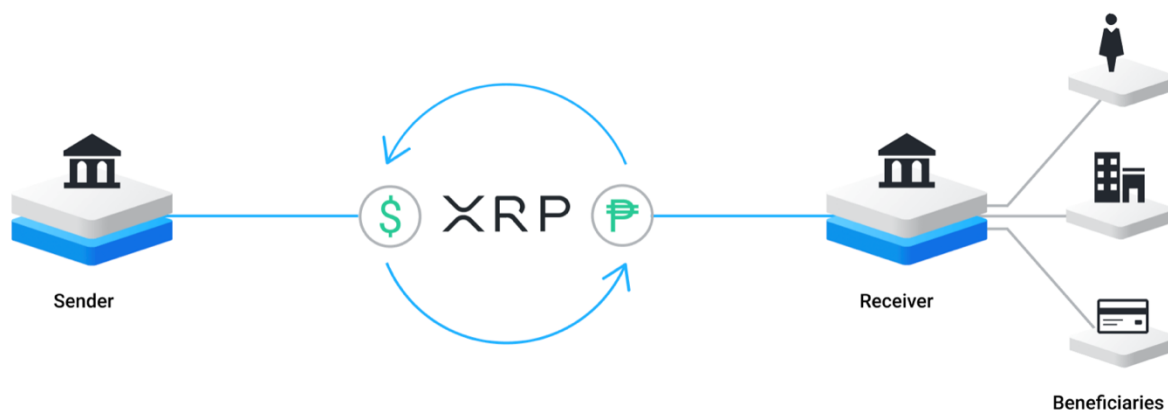

Figure 1: ODL Flow

Digital assets issued on blockchains that serve the same end-use as the incumbent correspondent banking model can offer a compelling alternative for end-users while still being compliant with anti-money laundering ("AML") & countering the financing of terrorism ("CFT") requirements. Global multilateral bodies have also recognized the potential digital assets and blockchain technology have in facilitating faster cross-border payments.[8]

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[6] *See* https://www.bis.org/cpmi/publ/d147.pdf, Committee on Payments and Market Infrastructures – Correspondent Banking.
[7] *See* https://www.bis.org/publ/qtrpdf/r_qt2003f.pdf, BIS Quarterly Review March 2020, page 31.
[8] *See* https://blogs.worldbank.org/psd/paying-across-borders-can-distributed-ledgers-bring-us-closer-together, World Bank blog.

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With this overview, Ripple respectfully submits the following feedback on the Draft Digital Assets Bill in the Appendix.

Ripple appreciates the opportunity to provide feedback on the Draft Digital Assets Bill as you study these important issues, and we would encourage and support further dialogue with all stakeholders. Should you wish to discuss any of the points raised in this letter, please do not hesitate to contact Rahul Advani (Policy Director, APAC) at radvani@ripple.com.
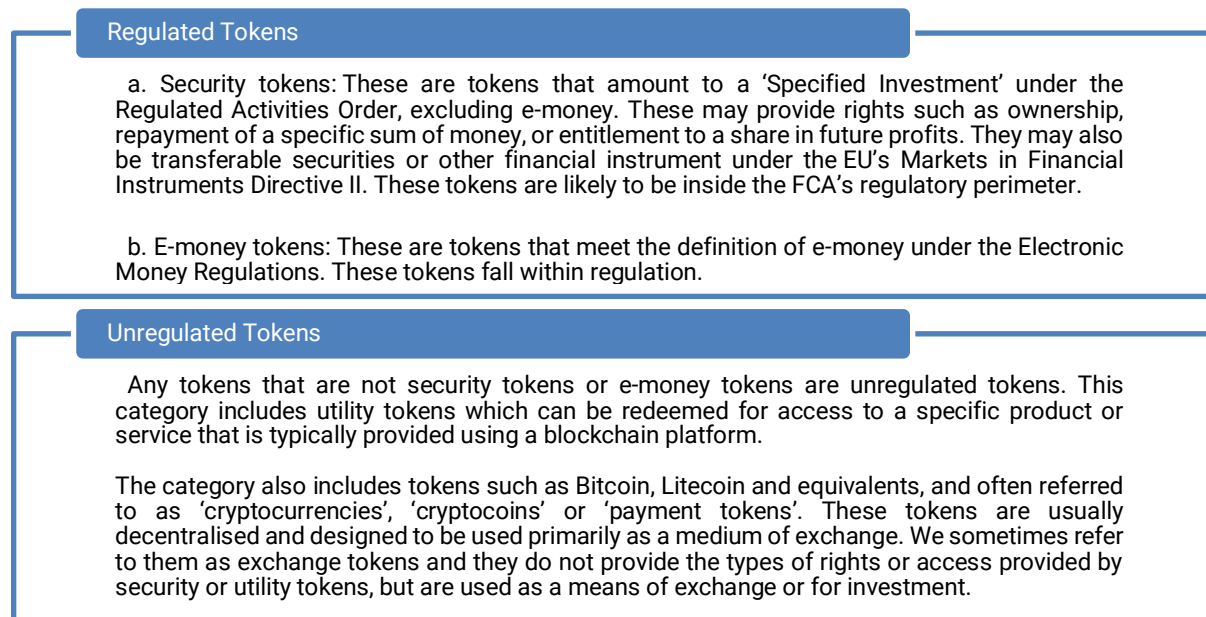
Sincerely,

Ripple Labs Inc.

APPENDIX

Ripple respectfully submits the following feedback to the proposals set forth in the Draft Digital Assets Bill[9].

1. Part 1, Section 5 - Definitions

Ripple is supportive of the Draft Digital Assets Bill using the term Digital Assets, as we believe that such assets should not be solely defined relative to a specific technology (e.g., cryptography). However, the existing definition of Digital Assets is far too broad to give the market comfort as to the legal nature of such assets. Therefore, for the purposes of regulation, Ripple respectfully submits that Digital Assets should subsequently be classified and defined depending on the particular economic function and purpose they serve. Such an approach is consistent with that taken by other jurisdictions like the United Kingdom ("UK") and Singapore, which have issued such classifications. We have summarised the taxonomies for the UK and Singapore respectively in Figure 2 & Figure 3 below.

Regulated Tokens

a. Security tokens: These are tokens that amount to a 'Specified Investment' under the Regulated Activities Order, excluding e-money. These may provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits. They may also be transferable securities or other financial instrument under the EU's Markets in Financial Instruments Directive II. These tokens are likely to be inside the FCA's regulatory perimeter.

b. E-money tokens: These are tokens that meet the definition of e-money under the Electronic Money Regulations. These tokens fall within regulation.

Unregulated Tokens

Any tokens that are not security tokens or e-money tokens are unregulated tokens. This category includes utility tokens which can be redeemed for access to a specific product or service that is typically provided using a blockchain platform.

The category also includes tokens such as Bitcoin, Litecoin and equivalents, and often referred to as 'cryptocurrencies', 'cryptocoins' or 'payment tokens'. These tokens are usually decentralised and designed to be used primarily as a medium of exchange. We sometimes refer to them as exchange tokens and they do not provide the types of rights or access provided by security or utility tokens, but are used as a means of exchange or for investment.

Figure 2: Summary of the UK Financial Conduct Authority taxonomy for digital assets

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[9] Unless otherwise defined, all terms in this section use the definitions provided in the Draft Digital Assets Bill.

Digital Payment Tokens
Refers to "any digital representation of value that is expressed as a unit; is not denominated in any currency, and is not pegged by its issuer to any currency; is, or is intended to be, a medium of exchange accepted by the public, or a section of the public, as payment for goods or services or for the discharge of a debt; and can be transferred, stored or traded electronically".

Digital tokens which constitute capital markets products
MAS will examine the structure and characteristics of, including the rights attached to, a digital token in determining if the digital token is a type of capital markets products under the Securities and Futures Act. This includes, but is not limited to a share, a debenture, a unit in a business trust, a securities-based derivatives contract, or a unit in a collective investment scheme, as defined under the Securities and Futures Act.

Figure 3: Summary of the Monetary Authority of Singapore taxonomy for digital assets

As highlighted in the Ripple Committee Response[10] and in line with global practices, we recommend that there be a clear distinction between payment tokens, utility tokens, and security tokens, as outlined below:

- *Payments or Exchange tokens*: to describe non-fiat native digital assets that are used as means of exchange and have no rights that may be enforced against any issuer;
- *Utility tokens*: to describe those digital assets that create access rights for availing service or a network, usually offered through a blockchain platform; and
- *Security tokens*: to describe tokens that create rights mirroring those associated with traditional securities like shares, debentures, security-based derivatives, and collective investment schemes.

Ripple also respectively submits that one definition of Digital Assets (and the categories of tokens) be developed to apply across all Australian regulatory frameworks. Accordingly, since Digital Assets that fall within the definition of a financial product (i.e., security tokens) under the financial products regime are already regulated by the Australian Securities and Investments Commission ("ASIC"),[11] any such amendments should also be made to the relevant ASIC regulations. Similarly, the Anti-Money Laundering and Counter-Terrorism Financing Act, 2006[12] defines Digital Assets as digital currencies, and will similarly need to be amended.

Ripple believes that such an approach will help provide clarity as to the legal character of digital assets in Australia.

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[10] *See* Ripple Committee Response, page 7.
[11] *See* https://asic.gov.au/regulatory-resources/digital-transformation/crypto-assets/, Information Sheet 225: Crypto-assets.
[12] *See* https://www.legislation.gov.au/Details/C2021C00243, Anti-Money Laundering and Counter-Terrorism Financing Act, 2006.

2. Part 2, Division 3 - Digital asset custody services and Part 7, Section 48 - Application to digital asset custody services

As currently drafted, the provisions of Part 2, Division 3 (Digital asset custody services) when read with Part 7, Section 48 (Application to digital asset custody services) appear to indicate that the Digital Asset Custody Service License requirement does not apply to those providers who provided Digital Asset Custody Services before commencement of the Draft Digital Assets Bill. We therefore welcome clarification around the grandfathering of the Digital Asset Custody Service License.

3. Part 2, Division 5, Section 27 – Recognition of foreign licenses etc.

Ripple is supportive of the proposal to recognise foreign licenses. We believe such recognition will make Australia an attractive destination for global firms, thereby supporting the growth and development of the Australian digital assets and payments ecosystem.

However, in making an equivalence decision for recognition of foreign licenses, we respectfully request that the Minister follow a principles-based approach for such a determination. An overly prescriptive and onerous process for an equivalence determination could disincentivise global firms from entering the Australian market, and thereby have the unintended consequence of moving this growing market offshore.

4. Part 2, Division 2, Section 11 – ASIC to supervise digital asset exchanges

Ripple is supportive of ASIC supervising Digital Asset Exchanges in Australia. However, as highlighted in our comments on Part 1, Section 5 (Definitions) of the Draft Digital Assets Bill, we respectfully request that one definition of Digital Assets (and the categories of tokens) be developed to apply across all Australian regulatory frameworks, including the financial products regime, and any such amendments be made to existing ASIC regulations.

5. Part 7, Section 47 – Transition period

Ripple is supportive of a transitional period to allow Digital Asset Exchanges and Digital Asset Custody Services sufficient time to make an application for a license.

However, Ripple also respectfully requests that in addition to a transition period, an exemption regime also be considered for Digital Asset Exchanges and Digital Asset Custody Services, and such exemption should be valid till the license application is approved, rejected, or withdrawn. It would also be beneficial for the list of exempted entities to be made public, to ensure consumers and end-users have a ready reference as to which entities are covered under the exemption regime.

An exemption regime, as outlined above, will ensure minimal disruption to Digital Asset services while license applications are being processed, and will therefore minimise disruptions to consumers and end-users during the transition to a licensing regime.