Reserve Bank of New Zealand
Te Pūtea Matua

Summary of Submissions and Next Steps

on the Private Innovation in Money Issues Paper

Contents

Background

The Reserve Bank of New Zealand – Te Pūtea Matua (we/RBNZ) published an Issues Paper (the Issues Paper) on Private Innovation: Te Auahatanga on 7 December 2022, with submissions closing on 3 April 2023. This Issues Paper forms part of our broader consultation package on the Future of Money – Te Moni Anamata, including on stewardship, central bank digital currency (CBDC) and cash system redesign previously released.

The Issues Paper discussed the development of the cryptoasset (including stablecoin) market and outlined our high-level thinking about how RBNZ could respond to the challenges. It outlined:

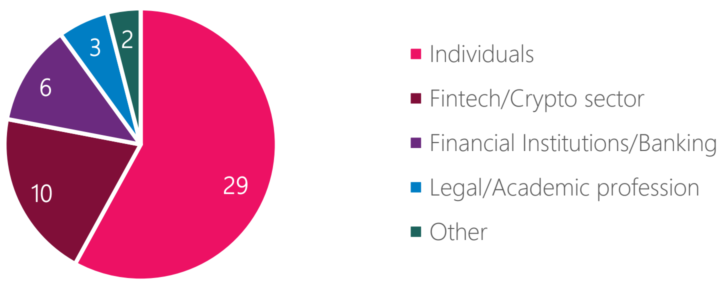
- our stewardship role regarding private money, including the objectives, approach, focuses and scope;
- the opportunities we see in a level playing field for existing and new forms of money and payments;
- the risks to be managed if new forms of private money become more widely used; and
- our initial response, including establishing a monitoring regime.

Consultation process

We undertook an extensive campaign to publicise the Issues Paper. We emailed more than 3000 email subscribers, including submitters on our previous Future of Money Issues Papers, with information and reminders. We also invited submissions through several social media channels. We held one workshop, two public webinars, and several discussions with individual stakeholders throughout the process.

We received 50 submissions when the consultation closed. These submissions came from a cross-section of stakeholders, including financial institutions, cryptoasset/fintechs industry participants, academic and legal experts, other organisations, and individuals. Graph 1 below illustrates the make-up of the submitters.

Graph 1:Make-up of submitters



Out of scope issues

Several issues raised in the submissions are out of scope for this Issues Paper.

Some submitters discussed alternative monetary policy options, that is, imposing a fixed supply limit of base money.[1] Whether to adopt such a policy is beyond the scope of the Issues Paper. So is the further choice of whether such a limit on the money supply should be codified in law, in a manner similar to, for example, the bitcoin supply cap.

Other out-of-scope discussions were primarily about the merits of decentralisation, in the context of bitcoins. The advantages and drawbacks of decentralisation (or the alternative of representative democracy) are fundamental issues about social and political governance.

Several submitters expressed concerns about the potential displacement of cash, or the introduction of a CBDC. We reiterate that cash will continue to be available as long as New Zealanders need and want it. While we are exploring a potential CBDC, we have not made any decision about the need for one. If we do introduce a CBDC, this would not be to displace cash which would remain available. This feedback has been referred to our cash and CBDC work streams.

Related to the above, several submitters also argued that bitcoins are not private money, but public money. To clarify, when we speak of 'public' money, we mean money that the public have control over through the political/institutional process. Such control is not contingent on their roles as consumers, or owners of certain tokens. By contrast, cryptoasset holders (or system participants like miners) generally derive their stake in the system from private ownership/interest.

Main messages

In this section we highlight some key messages from the submissions. This is not exhaustive. The submissions, subject to necessary redactions, can be found alongside this document on the Private Innovation consultation page.

Risks and opportunities cut across sectors, and need a whole-of-public-sector response

The focus of the Issues Paper was on the potential uses of cryptoassets as money. There are clearly a wider range of risks and opportunities beyond this focus on money. The risks include: fraud and theft, anti-money laundering and counter-financing of terrorism (AML/CFT) non-compliance, technology and cyber-security, privacy, market conduct, governance and legal, taxation, and financial stability risks. There may be others, such as economic development considerations, as raised by some submissions. Similarly, opportunities are not limited to enhanced competition in money and banking. Better integration between money and the so-called Web3 services may be another.

[1] The choice of fixing the quantity of (base) money is a well-traversed area of debate. For a New Zealand perspective, see Bloor, Hunt, Ng & Pepper (2008) 'The use of money and credit measures in contemporary monetary policy' in *Reserve Bank of New Zealand: Bulletin*, Vol. 71, No. 1, March 2008

It is clear that, for many submitters, these wider opportunities and risks posed by the cryptoasset market to consumers and investors are more immediate and significant. They suggest such opportunities and risks are not separable from those related to the use of cryptoassets as money.

A holistic approach is clearly needed when considering the regulatory approach to specific cryptoasset issues. Submitters said, for instance, that regulators of new forms of money may need to pay particular attention to issues such as privacy and security that may not have featured as prominently before with other forms of money. Submitters also suggested that regulators should not overlook the significant change in the broader context, such as the potential growth of decentralised finance, in which new forms of money can be used.

Coordination across public agencies is essential to support a holistic approach. A number of submitters noted a natural role for the Council of Financial Regulators (CoFR) in driving coordination and providing a common vision. Such an oversight would also work well, as some submitters suggested, in capturing overall regulatory burdens and collective impact. To this point, we note that CoFR is developing a common vision for the Future of Payments, which will be published shortly.

The need for a holistic approach over the money and payment ecosystem underpins our stewardship role. This role is acknowledged in the submissions. A couple of submitters believed that RBNZ should simply focus on reducing inflation and ensuring financial stability.

Many submitters support enhancing competition in banking and financial services

The majority of submitters agreed that innovation in new forms of money can potentially enhance competition in money and payments, and support further innovation. For some, the open nature of cryptoassets means more competition, as consumer choices are unconstrained by traditional intermediaries or national authorities.

Others talked about barriers to entry in the existing ecosystem for cryptoasset providers and other fintechs. The lack of access to banking services such as having a bank account to manage funds, was raised as a key problem for fintechs and particularly cryptoasset providers. They saw this problem as stemming from the concentration of the banking sector, and perceived bias from incumbents that they potentially compete against.

They spoke of regulatory uncertainty and compliance burden, particularly AML/CFT regulatory regime. We heard that AML/CFT risks are sometimes cited as a reason to deny banking access to cryptoasset providers and fintechs, which reinforced the perceived bias towards the incumbent.

Other factors were also noted. For example, there are currently limits on accessing RBNZ's wholesale settlement systems. Such limits are an essential safeguard for financial stability, but they do place new entrants at disadvantage for not having access to central bank money, particularly if they are already 'unbanked'. In June 2023 the RBNZ issued an initial consultation paper on opening up access to our wholesale settlement system.[2] This paper sets out the risks assessment framework for assessing new applicants to the wholesale.

Given these trade-offs, submitters suggested that, to support competition, start-ups should be given the opportunity to 'grow into regulation'. To support such growth, submitters said that regulatory sandboxes, or a tiered compliance approach e.g. with exemptions for small-scale experiments, should be considered.

By contrast, the case for enhancing competition is not compelling enough for some submitters. They considered that the existing system is sufficiently efficient and effective for most users. They believed that unmet needs could be addressed by improvements of the existing system, such as through consumer data rights/open banking, or real time payment systems, or adopting tokenisation technologies.

For others, it is precisely the lack of progress on these enhancements that propels the search for alternatives.

Submitters recognised the risks described, particularly regarding monetary sovereignty and around centralised/intermediated services

Although discussions about risks and opportunities were often broad, submitters generally appreciated that the use of cryptoassets as money, rather than as an investment, would create particular risks including the following:

Risks to monetary sovereignty

The agreement was strongest regarding the risks to our monetary sovereignty, if the New Zealand dollar is displaced by another currency.[3] Submitters agreed with the Issues Paper's assessment that the probability of such an event is currently small, particularly if they are driven by technological changes alone. However if they do occur the consequences are serious.

A couple of submitters said that the lack of innovation and improvements under the *status quo* should also be considered as a key risk. New Zealanders could well miss out on better, and more efficient, money and payment services compared to others globally. And this would only increase the risks to our monetary sovereignty if the alternatives become readily available.

Risk to competition

Submitters thought that the Issues Paper correctly framed the issues around Big-Tech and competition. They noted the important role of the Commerce Commission in this regard. One submitter said that supporting compliant local innovation can alleviate the risk of Big-Tech dominance. Another submitter cautioned that overly strict regulations aimed at larger global entities might risk stifling local innovation.

[2] The consultation paper can be found here. This paper sets out the risks assessment framework for assessing new applicants to the wholesale settlement system that RBNZ needs to consider, so that it can safely open up access to a wider range of participants with a view to improving financial stability of the monetary system in NZ.
[3] Some submitters argued that New Zealand dollars could be backed by bitcoin and would be stronger for it (given the latter's entrenched issue cap). However, we do not see any difference between such a substitution and a fixed-exchanged-rate currency or straightforward dollarization. In both cases stability of another currency is gained by the adoption or hypothecation precisely because monetary sovereignty is given up. Domestic institutions cannot influence – both expanding and contracting – the supply of money. Whether or not this is better is another question.

Risks to trust

Submitters were divided about the need for a uniformly high level of trust in money. For some, the 'singleness of money i.e. private and central money operating at par' is paramount, although not all agreed that there *is* a high level of trust in existing (bank) money.[4] For others, trust is a matter of consumer choice and market discipline is sufficient to incentivise the preservation of trust by providers.

The need for uniformity depends on usage, one submitter point out. Stored value/prepaid cards[5] are one alternative form of money. They do not carry the same extent of trust as bank money, but currently pose little harm – although they could raise AML/CFT risks – and are fairly widely used.

Submitters also pointed out that there is a cost in supporting a uniform level of trust in bank money, which entail close supervision and regulation. The costs for these regulatory safeguards may be considerable for existing players and could be prohibitive for some new entrants.

Risk to holders

Submitters generally agreed with the risks to holders highlighted in the Issues Paper, such as the lack of a contractual right to redemption for stablecoin holders. However there were also disagreements.

Some submitters believed some cryptoassets such as bitcoins are better forms of money, because there is no risk of over-issuance, or that further improvements (e.g. L2 protocols) can address their short comings. Others questioned whether the risks would ever be significant enough to warrant regulatory action.

For some submitters, any risks can and should be managed by holders themselves. It is therefore critical to preserve the 'buyer-beware' principle when money is concerned, just as for other goods and services provided by the market. Other submitters, by contrast, were concerned about the potential lack of transparency of providers and knowledge of users due to information asymmetry. Both factors may limit the latter ability to choose.

Risks of intermediated or centralised services

Several submitters also argued that intermediated services such as centralised exchanges need to be regulated, even if some are otherwise opposed to regulation. Submitters saw these services as carrying similar risks as conventional intermediaries – and potentially more risks as the latter are regulated for their intermediation role – even if they are dealing with decentralised products.

Some submissions also drew a distinction between bitcoins to other cryptoassets that they see as subject to some form of centralised control.[6] They argued that the latter should be banned.

[4] Submitters often expressed concerns about the over-concentration in the banking sector as the cause of distrust.

[5] We do not consider these stored value cards to be significant forms of money. Nevertheless some of them may well be captured by the so-called e-money regulatory regimes in other countries.

[6] As discussed previously, the merits of centralised or decentralised systems, or the varieties of either, are outside the scope of our consultation. However, it may be more apparent that centralised cryptoassets function the same way as conventional financial products, and so the same regulatory control should apply. This does not mean that decentralised designs are necessarily superior, nor devoid of other problems.

Submitters see the need for regulators to be cautious in a fast moving areas

Submitters generally saw a role for regulation in the cryptoasset sector. Appropriate regulations, in their view, can balance risks and opportunities, and support beneficial growth and innovation. Nevertheless some submissions implied strongly that market mechanisms, rather than regulations, are necessary and sufficient.

Some submitters, including some from the cryptoasset sector, regarded regulatory measures as overdue. Some saw regulations as a way to distinguish good actors from bad. The recent failures of FTX highlighted the need for certain basic protections in good corporate governance that are not technology-specific. Others perceived more fundamental issues, such as the lack of asset-backing and convertibility.

However, many submitters also said that RBNZ should err on the side of caution when it comes to regulation. This is because the sector's growth trajectory remains uncertain, and regulatory developments are ongoing globally. It is important that regulations remain sufficiently open and flexible so that they do not stifle innovation, and that regulators minimise unintended consequences from regulatory measures.

A couple of submitters argued that RBNZ should be cautious in supporting private innovation. Premature introduction of regulations could be perceived as legitimising the cryptoassets and related products generally. Such perceptions might cause harm to the current or future holders.

At the same time, a cautious approach means prolonging the uncertainty for the innovators, as some submissions noted, which can itself create a material cost for long term planning and investment. Regulatory initiatives being progressed elsewhere adds to this uncertainty, opening up risks of inconsistent treatment and regulatory arbitrage.

Submitters generally support a balanced, principle-based, approach

The submissions confirmed that the trade-offs are complex and varied, and finding the optimal balance will take time and care. Potential trade-offs include those between:

- protecting consumers and supporting innovation;
- maintaining market stability and enabling disruptive innovation/competition;
- enhancing efficiency and ensuring accessibility/managing risks;
- upholding trust that exists in the current system versus enhancing competition;
- protecting privacy and complying with regulatory requirements or supporting commercial use;
- relying on a 'buyer beware' approach versus implementing proactive regulation;
- focusing on fixing the problems of today versus building tomorrow's monetary ecosystem.

Submitters generally agreed that a principle-based approach is best to strike the right balance. Moreover such an approach supports flexibility and technological neutrality, given the evolving technology and market context. Several submissions also argued that, while being principle-based, regulations should also have a clear focus on risks and objectives, and on giving certainty for market participants.

Submitters also supported broadly the principle of 'same risks, same regulation'. They recognised the importance of regulation to enforce a level-playing field to support beneficial competition. For example robust disclosure standards (e.g., about reserve holding or vulnerabilities) akin to requirements for conventional financial institutions are arguably essential to support informed choice and free competition.

Some cautioned that it should be made clear that what matters is the same regulatory *outcomes*, rather than the specific measures. They felt a short-hand approach of 'same regulation' could risk baking in existing rules and defeat its purpose. Where risks differ or create ambiguities, specific regulations should be considered.

Aligning with regulators in similar jurisdictions is crucial, submitters said

Submitters agreed strongly that collaboration with regulators in similar jurisdictions (and international bodies) is crucial.

Submitters also noted that most jurisdictions strive for balance, rather than banning cryptoassets or promoting them. There are also similarities, such as with a principle-based approach to regulations. Nevertheless differences remained, and there was no obvious consensus as to the best approach. Several submitters expressed concerns about taking a regulation-by-enforcement approach.

The differences could open up the possibility for regulatory arbitrage[7], all the more real given the cross-border nature of cryptoassets. And there may be consequent pressure that incentivises a race-to-the-bottom in standards. While such problems may not be entirely eliminated, global cooperation could go some way to limit them. Some submitters also pointed out that cross-border enforcement is likely to be difficult, if not impossible without a global regulatory framework.

Submitters strongly supported RBNZ's proposal to monitor the sector closely

Submitters supported the proposal to strengthen our monitoring regime, including monitoring international regulatory development. They made helpful suggestions about what should be monitored and how.

For instance, some submitters suggested that the scope of monitoring should be widened to include the growth of decentralised finance (DeFi) that may shape the future development of the sector. A wider set of metrics, than those applied in the conventional financial sector (e.g. market cap), may also be useful to capture the novel aspects of the benefits and risks of cryptoassets.

Other submitters said that it is important not to focus narrowly on risks, and the delivery of benefits in terms of competition and consumer/user outcomes should be considered fully. They

[7] Regulatory arbitrage refers to the situation where regulatory requirements differ across jurisdictions and entities seek out jurisdictions with least regulatory requirements, but often still providing the services to certain markets where regulatory requirements are more stringent (as opposed to existing the market given the compliance costs).

suggested that RBNZ should monitor and quantify these benefits, so that they can be balanced against potential risks.

Some submitters recommended that RBNZ invest in advanced analytics to support better monitoring, and develop capabilities to engage with the technology itself (as opposed to the financial or monetary uses).

Submitters also agreed that an initial focus on stablecoins is right

Submitters generally considered that RBNZ is right to focus on stablecoins initially, because stablecoins are most similar to existing forms of money and therefore more readily accepted as equivalent substitutes.

However, some argued that cryptoassets warrant more attention from regulators, precisely because they are unbacked, different, and potentially more disruptive.

A number of submitters also reiterated the importance of not losing sight of the wider crypto-ecosystem (e.g., DeFi), and how such a system might interact with money in new ways.

The issue of decentralisation, and the role of Decentralised Autonomous Organisations (DAOs), was raised in several submissions. However, there were differences. Some perceived DAOs as a matter fundamentally outside a central bank's purview. Conversely, others saw in DAO a potential to transform the financial market, and therefore warrant RBNZ's close attention.

Our response

We thank the submitters for their thoughtful contributions to our consideration, refinement and response to the issues raised by private innovation in money.

The submissions reinforced our view that there are significant risks and opportunities, but also significant uncertainties about how the sector will develop and where the optimal balance will lie. We agree with the view that caution is needed. This is why we are not proposing a regulatory response at this point.

Another reason for taking a cautious approach lies in regulatory developments globally. There is likely to be real advantages to harmonising cryptoasset regulation. As various overseas regimes are implemented, best practice for regulating cryptoassets may become clearer. This will inform our optimal regulatory design and the assessment of any need for alignment.

We also note that implementation of other regulatory regimes, such as the Financial Market Infrastructure Act may also have a secondary impact on the cryptoassets market.[8] We agree that regulatory measures also need to be comprehensively monitored for their flow-on impact.

Issued raised by cryptoassets and other innovations do not fall neatly within the existing agency boundaries. Issues such as consumer and investor protection, or perceived regulatory barriers to entry, can have an impact on the collective vision we have for a reliable and efficient money and payment system that better meet New Zealanders' evolving needs. These issues matter also

[8] Financial Market Infrastructure Act requirements do not preclude crypto-based schemes that are for instance used to record payments between multiple parties.

because how we respond now could shape how they evolve from their current use, for example, to become new forms of money.

We will continue to work with other agencies, particularly through CoFR, to support healthy growth in the financial ecosystem, as well as continuing to engage with industry and other stakeholders on issues as they arise.

More immediately, we intend to strengthen our monitoring capability in a more systemic, robust, way. Currently our data is limited and varies in quality, which limits our ability to assess potential issues and then respond in a timely and effective manner.

Monitoring global regulatory developments, particularly in similar jurisdictions and with key global organisations such as the Bank for International Settlements, will be an integral part of the monitoring framework.

We need to take a cross-agency approach to monitoring as well as future regulation. RBNZ is already working with other CoFR agencies to identify gaps in data and metrics. Building on this work we propose a staged process to enhance our capability, as outlined in the Graph 1 below.

Graph 1: Monitoring roadmap