



MAY 2022

Submission to Commonwealth Treasury
**Crypto asset secondary service providers:
Licensing and custody requirements -
Consultation Paper**

Contents

INTRODUCTION	3
RECOMMENDATIONS	6
Regulating all crypto assets as financial products.	8
Part 1: The current state of the crypto asset ecosystem.	11
Proposed terminology and definitions: Consultation questions 1, 3-5.	11
Proposed principles, scope and policy objectives of the new regime: Consultation questions 6-10.	13
Part 2: Proposed obligations on crypto asset secondary service providers.	17
Proposed obligations: Proposal questions 11-13.	17
Alternative options: Proposal questions 15 and 17.	26
Part 3: Proposed custody obligations to safeguard private keys.	27
Proposed obligations: Consultation question 19-22.	27
Alternative option: Industry self-regulation: Consultation question 25.	29
Additional resourcing for ASIC	30

ABOUT

About CHOICE

CHOICE is the leading consumer advocacy group in Australia. CHOICE is independent, not-for-profit and member-funded. Our mission is simple: we work for fair, just and safe markets that meet the needs of Australian consumers. We do that through our independent testing, advocacy and journalism.

INTRODUCTION

Australian consumers are increasingly using or purchasing crypto assets without a strong consumer protection framework in place. CHOICE welcomes the Commonwealth Treasury's ('the Treasury') proposal to regulate digital currency exchanges ('exchanges') or crypto asset secondary service providers ('CASSPrs'). Digital currency exchanges must be subject to stronger legal obligations to ensure that they operate fairly and in the interests of consumers.

The Federal Government should strongly consider regulating all crypto assets under the existing financial product regulatory regime for better outcomes for consumers and the community. However, if the Government chooses to regulate all crypto assets under a new regulatory regime, the proposal needs to have stronger consumer protections for people who purchase crypto assets or entrust control of their crypto assets to exchanges.

CHOICE's nationally representative survey of consumers found that 12% of Australians have purchased cryptocurrency, and 11% are interested in purchasing cryptocurrency.¹ A majority of consumers believe cryptocurrency trading should have consumer protections similar to trading on the stock market, while only 11% think they should not. CHOICE notes that the Treasury's Consultation Paper identified that more than 28% of Australians surveyed own crypto assets.²

The most common reasons that consumers purchase digital currencies are financial; viewing the purchase as a long term investment or to diversify their portfolio. Consumers who are interested in purchasing crypto cited scams as a second largest reason for not following it through, after the fear of losing money.³

Crypto assets are complex, volatile and high-risk products that can cause harm to Australian consumers. In speaking directly with consumers, academics, and regulators, CHOICE has observed a significant rise in harms when people engage with unregulated CASSPrs, including:

- **A significant increase in scams on digital currency exchanges.** In 2021, the Australian Competition and Consumer Commission ('ACCC') received 10,412 reports of crypto scams from consumers with losses totalling around \$129 million.⁴
- **Market manipulation of the pricing of digital currencies.** Research by the University of Technology Sydney found over 350 examples of "pump and dump" events on two exchanges over a seven-month period.⁵ This market manipulation generated price

¹CHOICE Consumer Pulse March 2022 is based on a survey of 1,034 Australian households. Quotas were applied for representations in each age group as well as genders and location to ensure coverage in each state and territory across metropolitan and regional areas. Fieldwork was conducted from the 22nd of March to 7th of April 2022.

²The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p.4

³CHOICE Consumer Pulse March 2022

⁴Kollmorgen, A 2022, *Cryptocurrency scams cost Australians \$129m*, CHOICE, 4 March 2022, accessed on 2 May 2022, <https://www.choice.com.au/money/financial-planning-and-investing/stock-market-investing/articles/cryptocurrency-scams>

⁵Dhawan, A and Putnins, T. J., 2021, *A new wolf in town? Pump-and-dump manipulation in cryptocurrency markets*, SSRN, 12 November 2021, accessed on 2 May, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3670714

distortions of on average 65%. Currently, exchanges are not subject to any market integrity rules that prevent this kind of misconduct from occurring.

- **More collapses of Australian digital currency exchanges as more consumers engage with CASSPrs.** There is a lack of protection when exchanges go into liquidation. In December 2021, the Australian exchange MyCryptoWallet collapsed leaving over 20,000 consumers out of pocket over \$21 million.⁶ In January 2019, Australian exchange ACX.io suddenly collapsed, losing consumers approximately \$10 million.⁷ In both these collapses, consumers have no recourse for compensation. The Australian Securities and Investment Commission ('ASIC') has limited jurisdiction to take legal action against the company.

Strong consumer protection laws are urgently needed to protect people from the significant harms that people are facing, instead of consumers acting as “policy guardrails”.⁸ The Government can achieve this by either bringing crypto assets within the existing financial product regulatory regime or by creating a new strong regime that regulates crypto assets. Underpinning the recommendations made in this submission, CHOICE is advocating for three overarching changes needed across the proposed regulatory regimes to ensure people are protected. These are:

1. **The obligations on CASSPrs needs to be significantly strengthened.** CASSPrs should be subject to market integrity rules and stronger accountability obligations. At a minimum, these obligations should mirror ASIC's existing obligations on Australian financial services ('AFS') licensees and market participants. CASSPrs should be subject to strong penalties for breach of these obligations.
2. **People should have stronger consumer protections.** Existing consumer protection provisions that apply under the *Australian Securities and Investments Commission Act 2001* ('ASIC Act') and the *Competition and Consumer Act 2010* ('Australian Consumer Law') including prohibitions on unconscionable conduct, misleading and deceptive conduct, and unfair contract terms, should also explicitly apply to the regime that regulates crypto assets. CHOICE also strongly supports a market-wide prohibition on unfair trading practices. This should also apply to the conduct of CASSPrs.
3. **The regime should apply to all digital assets.** Consumers must be confident that their chosen CASSPrs will be responsible for any crypto assets including digital currencies and non-fungible tokens ('NFT') that they entrust to them. The assets must design a regulatory regime that includes all crypto assets and has no exclusions.

⁶Whitson, R 2021, *Digital payments, cryptocurrency regulation flagged by Treasurer Josh Frydenberg*, ABC News, 8 December 2021, accessed on 2 May 2022,

<https://www.abc.net.au/news/2021-12-08/government-plans-for-cryptocurrency-digital-payments-regulation/100682714>

⁷Frost, J 2021, *Collapse of crypto platform a cautionary tale*, Financial Review, 1 March 2021, accessed on 12 May 2022, <https://www.afr.com/companies/financial-services/collapse-of-crypto-platform-a-cautionary-tale-20210228-p576hn>

⁸The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p. 14.

The unregulated digital currency market causes significant harm to Australians and needs to be urgently regulated by the Federal Government.

RECOMMENDATIONS

CHOICE recommends that the Government consider regulating all crypto assets under the existing financial services regime by defining crypto assets as financial products under section 764A of the *Corporations Act 2001* ('**Corporations Act**'). If this option is adopted, the Government must ensure that there are no carve-outs or loopholes for certain crypto assets from the existing regime.

If the Government instead proposes a new regime to regulate crypto asset secondary service providers it should:

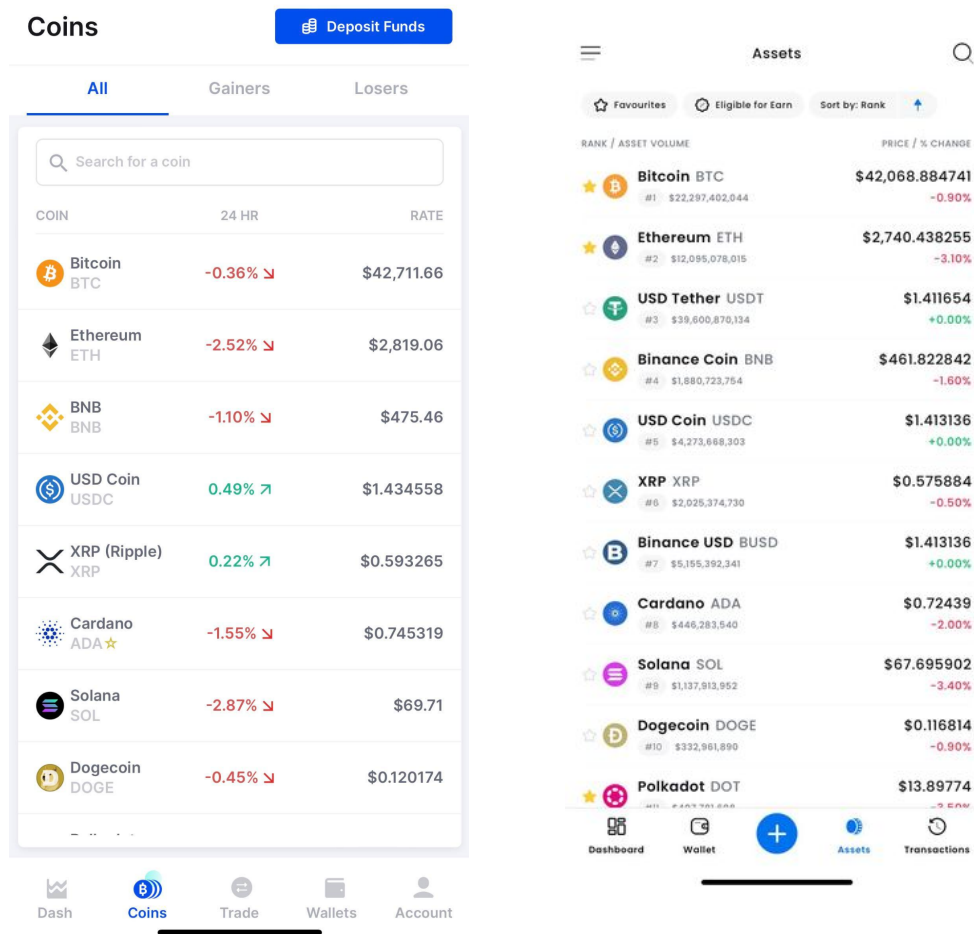
1. replace the term 'digital currency exchange' with Crypto Asset Secondary Service Provider .
2. adopt the 'crypto asset' definition proposed by ASIC as 'a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof'.
3. introduce one definition for crypto assets that should apply across all Australian regulatory frameworks.
4. include all CASSPrs who provide any services and are in control of crypto assets on behalf of consumers in the regulatory regime.
5. make the object of the regulatory regime to be promoting the long-term interests of consumers. This could mirror the *Competition and Consumer Act 2010* (Cth) and *Telecommunications Act 1997* (Cth).
6. create a licensing framework for entities providing retail consumers with access to crypto assets which are not financial products.
7. establish a broad-based licensing regime that includes all CASSPrs that engage with any crypto assets.
8. ensure that as a minimum, CASSPrs should be subject to the same obligations as Australian Financial Service licensees. There should be strong penalties for CASSPrs who breach these obligations.
9. establish an explicit requirement for all CASSPrs to be subject to consumer protection provisions including a prohibition on misleading and deceptive conduct, unconscionable conduct, and unfair contract terms.

10. establish a market-wide prohibition on unfair trading including explicitly the conduct of CASSPrs.
11. establish that CASSPrs must be required to provide consumers with information about their rights, including access to internal and external dispute resolution schemes.
12. establish that CASSPrs should be required to do all things necessary to reduce fraudulent payments from occurring on its platforms. If they fail this obligation, CASSPrs should be required to reimburse consumers for fraudulent payments.
13. grant powers for the responsible regulator to make and administer market integrity rules for CASSPrs. These rules should mirror ASIC's rules for financial markets and participants.
14. require CASSPrs to be subject to the production intervention powers.
15. require CASSPrs to be subject to the design and distribution obligations.
16. introduce a ban on CASSPrs airdropping crypto assets through the services they provide.
17. introduce a prohibition on CASSPrs providing advice which takes into account a person's personal circumstances in respect of crypto assets available on a licensee's platform or service.
18. establish new custody obligations on CASSPrs for the safeguarding of private keys, with strong penalties for CASSPrs who breach these obligations.
19. introduce stronger obligations on CASSPrs with custody obligations, including having a requirement to:
 - a. compensate a consumer if a CASSPr loses an individual's private key;
 - b. have appropriate insurance and capital reserves to compensate consumers; and
 - c. be responsible for third-party custodians who act on behalf of the CASSPrs.
20. mandate that all CASSPrs that provide their services to consumers in Australia, including having custody of private keys should be subject to obligations
21. include additional resourcing for ASIC to oversee the regulatory regime, given the growing size of crypto markets and the complexity involved in surveillance of them.

Regulating all crypto assets as financial products.

CHOICE recommends that the Government consider regulating all crypto assets under the existing financial services regime by defining crypto assets as financial products under section 764A of the Corporations Act. This approach will likely lead to better outcomes for consumers and to the Australian community than creating a separate regime that only covers certain types of crypto assets.

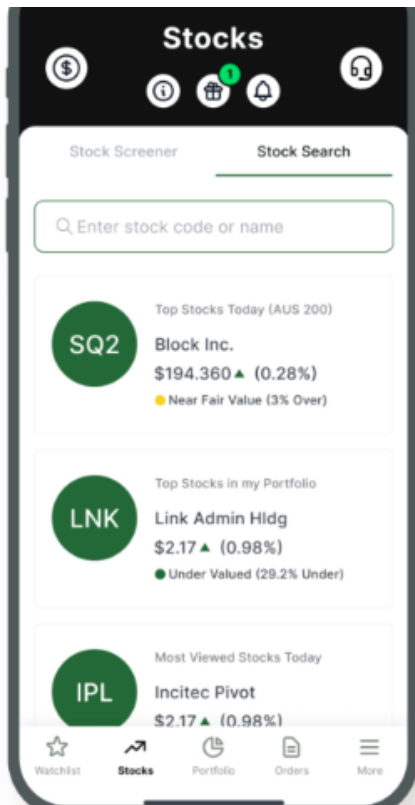
Crypto assets share many characteristics with financial products such as shares and derivatives. Crypto exchanges actively market crypto assets they sell as financial products. Below are the homepages of two popular crypto asset exchanges:⁹



This is almost identical to the way that stocks are displayed in online trading platforms¹⁰:

⁹Coinspot app and Swyftx app, accessed 26 May 2022

¹⁰Selfwealth, 2022, <https://www.selfwealth.com.au/>



Digital currency exchanges market their products to imitate financial market exchanges. Digital currency exchanges use financial phrases such as ‘trade’, ‘wallets’, ‘transactions’, ‘price’, and ‘profit’. Most consumers use these exchanges with the expectation that they are financial products. CHOICE’s nationally representative survey found the leading reason why consumers purchased crypto assets in the past 12 months was because they viewed it as a “long-term investment”.¹¹ Australian consumers expect the same level of consumer protection and regulatory oversight for crypto assets as they do with other financial products.

There is a detailed history of jurisprudence and established laws under the current financial services regime that means consumers would have a clear baseline level of consumer financial protection if this regime was extended to include all crypto assets. For example, CASSPrs would be required to adhere to:

- general obligations to do all things necessary to “act efficiently, honestly, and fairly”;
- consumer protection provisions, including prohibitions on unconscionable conduct, misleading and deceptive conduct, and unfair contract terms;
- the requirement to have an internal dispute resolution and external dispute resolution scheme in place;
- the requirement to have compensation arrangements in place for loss or damage suffered by breach of the law;

¹¹CHOICE Consumer Pulse March 2022

- market integrity rules, including a prohibition on market manipulation and market rigging;
- financial advice protections, including a best interests duty obligation;
- product intervention powers; and
- design and distribution obligations.

These are important legal protections that ensure that financial marketplaces are operating in the interests of consumers.

If the Government decides to bring crypto assets into the financial product regulatory regime, it must ensure that there are no carve-outs or loopholes for certain crypto assets. All crypto asset secondary service providers must be subject to regulatory oversight.

There may be a small range of crypto assets that will not neatly fit the existing definition of financial products but the Consultation Paper acknowledges that the Government or the regulator could be provided with powers to exempt particular crypto assets that do not warrant regulation under the financial services regime. CHOICE supports this proposal provided there are clear guardrails to ensure there are no carve-outs provided to crypto assets that are financial products.

Treating all crypto assets financial products, with a tightly defined exemption mechanism, would involve less regulatory cost and complexity, and provide stronger protection for consumers, than creating an entirely different regulatory regime for particular classes of crypto assets.

CHOICE will now respond to the questions put by the Treasury about creating a new licensing framework. Many of the issues raised below would be mitigated by bringing crypto assets and CASSPrs within the existing financial regulatory framework.

Part 1: The current state of the crypto asset ecosystem.

Proposed terminology and definitions: Consultation questions 1, 3-5.

Question 1 - Do you agree with the use of the term Crypto Asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'?

CHOICE supports the Treasury's proposal to replace the term 'digital currency exchange' with Crypto Asset Secondary Service Provider (CASSPrs).¹² This will more accurately define and cover all crypto asset secondary service providers, including brokerage services, dealers, custody services and any other actors who control crypto assets on behalf of consumers. CHOICE supports the definition being as broad as possible to capture all intermediaries who sell, hold or can pose direct risks to consumers' crypto assets.

CHOICE also recognises that CASSPrs is a technical term. We recommend the Government consider consumer testing this definition to ensure that consumers can easily understand the term.

Recommendation 1

CHOICE recommends that the Government replaces the term 'digital currency exchange' with Crypto Asset Secondary Service Provider.

Question 3 - Is the above definition of crypto asset precise and appropriate? If not, please provide alternative suggestions or amendments.

CHOICE supports the 'crypto asset' definition proposed by ASIC.¹³ CHOICE recommends that any definition of crypto asset should be clear and adaptive that captures the changing nature of the cryptocurrency industry.

Recommendation 2

CHOICE recommends that the Government adopts the 'crypto asset' definition proposed by ASIC as 'a digital representation of value or contractual rights that can be transferred, stored or traded electronically, and whose ownership is either determined or otherwise substantially affected by a cryptographic proof'.

¹²The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p.10.

¹³The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p.10.

Question 4 - Do you agree with the proposal that one definition for crypto assets be developed to apply across all Australian regulatory frameworks?

CHOICE supports one definition for crypto assets that should apply across all Australian regulatory frameworks. A single definition will create certainty for consumers, the industry, and the marketplace. Further, a broad and clear definition will mitigate the risks of any crypto asset businesses who try to evade regulation or commit regulatory arbitrage by avoiding the law.

Recommendation 3

CHOICE recommends that the Government introduces one definition for crypto assets that should apply across all Australian regulatory frameworks.

Question 5 - Should CASSPrs who provide services for all types of crypto be included in the licensing regime, or should specific types of crypto assets be carved out (e.g. NFTs)?

CHOICE strongly supports the inclusion of all CASSPrs who provide any services and are in control of crypto assets on behalf of consumers to be included in the regulatory regime, including the small number of CASSPrs that may already be regulated under the ASIC Act.

Carving out specific types of crypto assets creates unnecessary complexity and confusion for consumers. It is unrealistic to expect that consumers will understand that certain types of CASSPrs or crypto assets are regulated and others are not. Regulating only CASSPrs that provide services in relation to certain types of crypto assets could increase risks to consumers, because regulation of one part of the sector would create an impression that the Government has taken action to ensure that the market is safe and well regulated. Many consumers dealing with unregulated CASSPrs would assume that the service provider is regulated when in reality it is not.

Most importantly, as the crypto industry evolves and new innovations will be developed, CASSPrs may be incentivised to use any loopholes to their own advantage to avoid regulatory oversight. A piecemeal regime would create opportunities for regulatory arbitrage, with strong incentives from CASSPrs to be designed in a way that evades regulation - in a similar way to which buy-now-pay-later products have been designed to avoid credit regulation. This will lead to the exploitation of consumer protections by some CASSPrs, leaving many Australian consumers with significant loss of funds.

Recommendation 4

CHOICE recommends that the Government includes all CASSPrs who provide any services and are in control of crypto assets on behalf of consumers in the regulatory regime.

Proposed principles, scope and policy objectives of the new regime: Consultation questions 6-10.

Question 6. Do you see these policy objectives as appropriate?

The Treasury's proposal policy objectives need to be strengthened in order for the regulatory regime to be effective.

There are five primary consumer risks associated with CASSPrs.¹⁴ They are:

1. operational risks including business continuity, illiquidity and inadequate capital;
2. insolvency and disorderly wind down;
3. fraud and key personnel risks;
4. misleading or deceptive conduct; and
5. cybersecurity.

The proposed regulatory objectives are insufficient as they do not address the risks faced to consumers who purchase crypto assets. CHOICE strongly recommends that consumer protection be included in the regulatory framework, as the main aim of this consultation is to protect consumers from the increasing risks of the crypto industry.

Additionally, CHOICE has concerns with the first proposed policy objective of the new regime 'minimising operational, custodial, and financial risks that consumers are facing when using CASSPrs through mandating minimum standards of conduct for business operations and for retail consumers to act as policy guardrails'.¹⁵ As CHOICE's investigation on privacy policies showed, policies can often be complicated and lengthy, which companies use to their advantage.¹⁶ It is simply unrealistic to expect consumers to act as policy guardrails in a highly complex market. CASSPrs regularly may use complex technical terms such as 'airdrop', 'blockchain' and 'token' - meaning similar harms are likely if consumers are expected to act as policy guardrails. It is the role of government to provide appropriate guardrails to protect consumers. CHOICE would strongly oppose a regulatory approach that seeks to outsource this obligation and any consequent risk to individual consumers.

CHOICE supports the second policy objective on anti-money laundering and counter terrorism financing ('**AML/CTF**') and protecting the community from the harms arising from criminals and their associates using, owning or controlling CASSPrs.¹⁷ Money-laundering is facilitated on cryptocurrency exchanges. It is estimated that over USD \$8.6 billion was laundered using

¹⁴The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p.5.

¹⁵The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p.14.

¹⁶Blakkarly, J, & Graham, D 2022, *Privacy policy comparison reveals half have poor readability*, CHOICE, 28 January 2022, accessed on 6 May 2022,

<https://www.choice.com.au/consumers-and-data/protecting-your-data/data-laws-and-regulation/articles/privacy-policy-comparison>

¹⁷The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p.14.

cryptocurrency in 2021.¹⁸ This is an increase of 30% from 2020. It is vital to have a strong AML/CTF regime in place to protect the community from misconduct.

CHOICE is also in support of the third policy objective providing regulatory certainty about the policy treatment of crypto assets and CASSPrs, and providing a signal to consumers to identify high quality, operationally sound businesses.¹⁹ Unscrupulous crypto industry operators profit from confusion and a lack of regulation. Particularly, clearly signaling differences between high quality, operationally sound businesses, and those who are not to consumers will promote good industry conduct and mitigate bad conduct.

Question 7. Are there policy objectives that should be expanded on, or others that should be included?

CHOICE recommends the Government establish a policy objective for the regulatory regime to promote the long-term interests of consumers.

We encourage the Government to look at the object of *Competition and Consumer Act 2010* (Cth) to drafting guidance, which states that:

*'The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection'*²⁰

This is also consistent with the object of *Telecommunications Act 1997* (Cth), which is to provide a regulatory framework that promotes:

'The long-term interests of end-users of carriage services or services provided by means of carriage services'.²¹

It is clear from the introduction to the Consultation Paper that the major reason behind the proposed regulation of CASSPrs is to protect consumers, so this should be reflected in the objects of any legislation. In the discussion with CHOICE members and supporters a month after the national representative survey, we found that of 303 consumers who purchased crypto assets in the last 12 months, around 72% of consumers agree that there should be stronger consumer protections.²²

¹⁸BBC News 2022, *Crypto money laundering rises 30%, report finds*, 26 January 2022, accessed on 16 May 2022, <https://www.bbc.com/news/technology-60072195>

¹⁹The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p.14.

²⁰Competition and Consumer Act 2010, s2.

²¹Telecommunications Act 1997, s3.

²²In May 2022, CHOICE asked 4000 of its members and supporters about their experiences on cryptocurrency and thoughts on cryptocurrency regulation.

In May 2022, CHOICE asked members of the community about their experiences of purchasing cryptocurrency.*

Graeme's story:

'[I had problems with]... this particular crypto trader after many complaints refused to release my investment then without warning closed my account & stole my \$5700!'

Damien's story:

'Well, I just experienced the collapse of Terra Luna and UST and the whole market is well down, so at the moment it's all mainly negative!!'

Magdalena's story:

'I purchased cryptocurrency a few years ago and the company I was dealing with collapsed and I lost everything I had put into it.'

**names are changed for privacy reasons*

Recommendation 5

CHOICE recommends that the Government makes the object of the regulatory regime to be promoting the long-term interests of consumers. This could mirror the *Competition and Consumer Act 2010* (Cth) and *Telecommunications Act 1997* (Cth).

Question 8. Do you agree with the proposed scope detailed above?

CHOICE strongly recommends the Government to consider bringing all crypto assets under financial products. However, if the Government chooses to introduce a new regulatory framework, CHOICE supports the proposal of a licensing framework for entities providing retail consumers with access to crypto assets which are not financial products. In addition to the licensing framework, CHOICE supports non-financial crypto assets being subject to the Australian Consumer Law and the AML/CTF Act, which would then be regulated by ACCC and Australian Transaction Reports and Analysis Centre ('**AUSTRAC**'). This would minimise the risk of loopholes in a consumer protection law as new innovations in the crypto industry are introduced.

Recommendation 6

CHOICE recommends that the Government creates a licensing framework for entities providing retail consumers with access to crypto assets which are not financial products.

Question 9. Should CASSPrs that engage with any crypto assets be required to be licenced, or should the requirement be specific to subsets of crypto assets? For example, how should the regime treat non-fungible token (NFT) platforms?

CASSPrs that engage with any crypto assets should be required to be licensed. Regardless of the subset of crypto assets, consumers must be confident that their chosen CASSPrs will be responsible for any crypto assets that they entrust to them. If something goes wrong, consumers need to have trust that there are systems in place to assist them.

Consumers still face significant harms when purchasing crypto assets including NFTs on platforms. Like other crypto assets, NFTs can be controlled by CASSPrs, which can be lost in the event of scams or hacker attacks. For example, in February 2022, \$1.7 million of NFTs were stolen from seventeen OpenSea consumers.²³ Further, NFTs stored on secondary service providers are subject to the same risks of collapse as other digital currencies. It is unrealistic to expect consumers to differentiate between regulated and unregulated CASSPrs. The Government must regulate all CASSPrs in control of any type of crypto assets on behalf of consumers without any carve-outs

Recommendation 7

CHOICE recommends that the Government establishes a broad-based licensing regime that includes all CASSPrs that engage with any crypto assets.

Question 10. How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g. in financial services)?

The main purpose of regulating CASSPrs is to protect Australian consumers from significant consumer risks. This regulatory regime should focus on consumer outcomes, rather than minimising regulatory duplication. This decreases the risk of loopholes in the law that CASSPrs can take advantage of to exploit consumer protection.

Recommendation 8

CHOICE recommends that the Government ensures that as a minimum, CASSPrs should be subject to the same obligations as Australian Financial Service licensees. There should be strong penalties for CASSPrs who breach these obligations.

²³Brandom, R 2022, *\$1.7 million in NFTs stolen in apparent phishing attack on OpenSea users*, The Verge, 20 February 2022, accessed on 6 May 2022, <https://www.theverge.com/2022/2/20/22943228/opensea-phishing-hack-smart-contract-bug-stolen-nft>

Part 2: Proposed obligations on crypto asset secondary service providers.

Proposed obligations: Proposal questions 11-13.

Question 11. Are the proposed obligations appropriate? Are there any others that ought to apply?

We recommend that the Treasury's proposed obligations on CASSPrs be strengthened. CHOICE understands that these obligations are modeled on the obligations that AFS license providers face under the Corporations Act. However, there are some important gaps where proposed obligations do not match AFS licensees obligations. As a minimum, CASSPrs should be subject to the same obligations as AFS licensees.

CHOICE supports the proposed requirement on CASSPrs to 'do all things necessary to ensure that the services covered by the license are provided efficiently, honestly and fairly; and any market for crypto assets is operated in a fair, transparent and orderly manner'.²⁴ This proposed obligation will help to protect consumers from unfair practices in the industry. However, CHOICE recommends separating 'efficiently, honestly and fairly' into three separate obligations to provide clarity to these terms. This will not only increase consumer confidence when dealing with CASSPrs, but also better protect them from unfair practices of some CASSPrs.

CHOICE supports the proposed obligation to have adequate dispute resolution arrangements in place, including internal dispute resolution (**IDR**) and external dispute resolution (**EDR**).²⁵ EDR schemes are an effective dispute resolution mechanism that promotes access to justice. They provide important benefits to consumers including, but not limited to, independent and free dispute resolution services, negotiation opportunities, and flexibility for consumers to not accept the decision of EDR.

CHOICE recommends the Government consider providing access to consumers to either an existing ombudsman for complaints, such as Australian Financial Complaint Authority ('**AFCA**'), or establishing a new body. This is important as it provides access to justice in cases where consumers have not been treated fairly by CASSPrs. An ombudsman should be available for all consumers using CASSPrs regardless of what type of crypto assets have been entrusted by consumers to them. CHOICE also recommends obligating CASSPrs to make sure that the information on dispute resolution is easily available and can be easily understood.

In addition to the proposed obligations, CHOICE also recommends that the Government establish an explicit requirement for consumer protections to apply. CASSPrs should be

²⁴The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p. 16.

²⁵The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p. 16.

explicitly subject to consumer protection provisions including a prohibition on misleading and deceptive conduct, unconscionable conduct, and unfair contract terms. This should mirror the consumer protection provisions in Division 2 of the ASIC Act. Further, given the harms that consumers face when buying crypto assets, CASSPrs should be subject to an unfair trading prohibition. CHOICE supports a market-wide prohibition of unfair trading.

All CASSPrs regardless of what type of crypto assets have been entrusted to them, must not be free to breach important consumer protection provisions. Consumers must be confident that they are protected by the law regardless of the CASSPrs they choose to entrust any type of crypto assets.

In May 2022, CHOICE asked members of the community about their experiences of purchasing cryptocurrency.

Ratan's* story:

'The exchanges charge a large amount of fees for each transaction. If any of the crypto coins liquidate, the customers are informed at the last moment and that's dead money. This happened to me when I bought WePower crypto for \$100. Suddenly this was liquidated and now I can't transfer it or sell it anywhere and it's dead money which I can't do anything with.'

Max's story:

'Mine was negative. The bitcoins went up in value for a short time after I purchased a small amount, but then quickly retreated to a value lower than the purchase price. I decided to leave my small amount in place as I thought it would go up again. What I didn't and could know was that the company that held my bitcoins was in trouble was taken over by another company. I was told of this takeover and that I should consider leaving my bitcoins with the new entity. However I decided to accept my losses and retrieve what I could. When I approached the new entity to do this I did not receive a reply. I tried again only to be told the email address no longer existed. So I never made any money out of my bitcoins, which I believe are still out there somewhere, if I could only find them!'

**names are changed for privacy reasons*

CASSPrs need to have stronger obligations for preventing scams

Scams that occur on CASSPrs cause widespread harm to the Australian consumers and the community. In 2021, the ACCC received 10,412 reports of crypto scams from consumers with losses totalling around \$129 million.²⁶

CASSPrs play an important role in facilitating scams and need to take more responsibility for fraudulent payments. The proposed obligations on CASSPrs is to “respond in a timely manner to ensure scams are not sold through their platform”.²⁷ This obligation is too weak given the widespread harms of scams facilitated by CASSPrs. A CASSPr that is doing all things necessary to ensure products are sold “efficiently, honestly and fairly” needs to be alert to higher risk transactions, and not allow sales on its platform until it is satisfied that the transaction is not fraudulent. The Consumer Action Law Centre notes there are a number of ‘red flags’ that identify fraudulent transactions, including:

- the size and uniqueness or otherwise of the transaction;
- the transaction being significantly out of pattern with usual transactions;
- the jurisdictions to where the transfer is being made to is known for scams;
- customer vulnerability; and
- whether there are indicators the customer is being pressured by a third party.²⁸

CASSPrs should be required to do all things necessary to reduce fraudulent payments from occurring on its platforms. They should have a proactive obligation to monitor, prevent, and report scams to relevant authorities. CASSPrs should also be responsible for reimbursing consumers if they fail to adequately prevent scams from occurring on their platforms. Without these legal requirements, CASSPrs will continue to be incentivised in facilitating fraudulent transactions on its platforms.

In May 2022, CHOICE asked members of the community about their experiences of purchasing cryptocurrency.

Dallas’ story:

‘We were scammed hugely. We lost \$330,000 from all our allocated pensions. It was very well set up. The company had a website and was OK’d by the checking app and had an imitation currency graph which purportedly showed how much the money grew each day. This was in May 2020 during the first month’s of Covid-19. [The person we spoke with]... who was supposed to be training us how to do it yourself got Covid and was hospitalized, as we were told. We didn’t hear from him again and another person was assigned to us. This man was not very well understood and he told us that Bitcoin dropped through the floor and we needed to invest more money. We said we didn’t have any more! He kept ringing and asking us for more.

²⁶Kollmorgen, A 2022, *Cryptocurrency scams cost Australians \$129m*, CHOICE, 4 March 2022, accessed on 2 May 2022, <https://www.choice.com.au/money/financial-planning-and-investing/stock-market-investing/articles/cryptocurrency-scams>

²⁷ The Treasury 2022, *Crypto asset secondary service providers: Licensing and custody requirements*, accessed on 12 May 2022, <https://treasury.gov.au/sites/default/files/2022-03/c2022-259046.pdf>, p.16

²⁸ Consumer Action Law Centre, 2022, ‘More than \$2billion lost as redress system fails scammed Aussies’, <https://consumeraction.org.au/more-than-2billion-lost-as-redress-system-fails-scammed-aussies/>

We kept reiterating no more money. Finally we blocked his calls. Then another man rang us who was supposedly from a firm who got money back from scammers. It was also a scam and we lost a further \$10,000 on our credit cards. We did get back \$2,000 via the bank who we have our credit cards with. A very big lesson in trust. Sadly.'

Recommendation 8

CHOICE recommends that the Government ensures that as a minimum, CASSPrs should be subject to the same obligations as Australian Financial Service licensees. There should be strong penalties for CASSPrs who breach these obligations

Recommendation 9

CHOICE recommends that the Government establishes an explicit requirement for all CASSPrs to be subject to consumer protection provisions including a prohibition on misleading and deceptive conduct, unconscionable conduct, and unfair contract terms.

Recommendation 10

CHOICE recommends that the Government establishes a market-wide prohibition on unfair trading including explicitly the conduct of CASSPrs.

Recommendation 11

CHOICE recommends that the Government establishes that CASSPrs must be required to provide consumers with information about their rights, including access to internal and external dispute resolution schemes.

Recommendation 12

CHOICE recommends that the Government establishes that CASSPrs should be required to do all things necessary to reduce fraudulent payments from occurring on its platforms. If they fail this obligation, CASSPrs should be required to reimburse consumers for fraudulent payments.

CASSPrs should be subject to market integrity rules

Market integrity rules are a key pillar of Australia's financial regulatory architecture.²⁹ These rules apply to certain market operators and their participants in securities markets, futures markets and capital markets. The rules help promote efficiency, confidence, and fairness in domestic financial markets. ASIC is responsible for making and supervising compliance with market integrity rules.³⁰ These powers should apply to crypto asset exchanges as well. Key market integrity rules include:

- a prohibition on market manipulation;³¹

²⁹Corporation Act 2001 (Cth), Part 7.2A

³⁰ASIC, 2022, 'Market integrity rules', <https://asic.gov.au/regulatory-resources/markets/market-integrity-rules/>

³¹Corporation Act 2001 (Cth), s1041A

- a prohibition on false trading and market rigging;³²
- an obligation for market participants to “not do anything which results in a market for a financial product not being both fair and orderly, or fail to do anything where that failure has that effect”;³³
- an obligation to not give a false or misleading appearance. Participants are prohibited from giving “false or misleading appearance of active trading in any financial product or with respect to the market for, or the price of, any financial product”;³⁴
- a notification requirement to report to ASIC any suspicious activity, including insider trading or market manipulation;³⁵ and
- a requirement to prevent extreme price movements.³⁶ This prevents ‘flash crashes’ and sudden collapses in marketplaces.

Market manipulations that are prohibited in financial markets such as ‘pump and dump’ activities would likely be allowed in digital currency exchanges in Australia. Under the Treasury’s proposal, ASIC will not have the powers to make, administer, and enforce market integrity rules in digital currency markets.

CHOICE strongly argues CASSPrs should be subject to market integrity rules overseen by ASIC. A consumer does not differentiate between markets that sell cryptocurrencies such as Bitcoin and Ethereum, with a market that trades securities. Investors should receive similar protections. They should be able to trust that they are investing in markets that are fairly, orderly and not designed to lose them money from misleading and deceptive conduct.

As CHOICE’s national representative survey found a majority of consumers believe cryptocurrency trading should have consumer protections similar to trading on the stock market.³⁷ Consumers are investing with an expectation that these investments have similar consumer protections to investing in the traditional financial marketplaces.

ASIC’s market integrity rules prohibit certain market manipulations. Market manipulation can attract a fine of over \$1 million and up to 15 years imprisonment for individuals.³⁸ The same does not apply to crypto markets. NASDAQ has observed three main types of market manipulations in crypto markets:

- ‘wash trading. When a trader excessively buys and sells securities in order to feed misleading information into the market and generate false volumes. Often focused on

³²Corporation Act 2001 (Cth), s1041B and S1041C

³³ASIC Market Integrity Rules (Securities Markets) 2017, Part 5.9.1

³⁴ASIC Market Integrity Rules (Securities Markets) 2017, Part 5.7.1

³⁵ASIC Market Integrity Rules (Securities Markets) 2017, Part 5.11

³⁶ASIC Market Integrity Rules (Securities Markets) 2017, Part 8.2.2.A

³⁷CHOICE Consumer Pulse March 2022 is based on a survey of 1,034 Australian households. Quotas were applied for representations in each age group as well as genders and location to ensure coverage in each state and territory across metropolitan and regional areas. Fieldwork was conducted from the 22 nd of March to 7 th of April 2022.

³⁸ASIC, 2022, Fines and penalties, <https://asic.gov.au/about-asic/asic-investigations-and-enforcement/fines-and-penalties/>

instruments that are traded less or by smaller trading platforms looking to attract attention;

- layering and spoofing. When a trader places orders to give misleading indication of supply and demand, with no intention of trading;
- pump and dump. When a trader attempts to increase the price through buying activity or misleading information. Normally the trader has an existing position which they sell at the higher price.³⁹

In the Australian market, researchers at the University of Technology Sydney have found 355 cases of “pump and dump” market manipulations over a seven month period on two cryptocurrency exchanges.⁴⁰ These pumps generated price distortions of 65% on average, abnormal trading volumes and large transfers of wealth between participants. Under Treasury’s proposal, none of these forms of manipulation would be explicitly prohibited. CHOICE recommends that the Treasury grants ASIC powers and appropriate funding to create market integrity rules for all CASSPrs.

Recommendation 13

CHOICE recommends that the Government grants powers for the responsible regulator to make and administer market integrity rules for CASSPrs. These rules should mirror ASIC’s rules for financial markets and participants.

CASSPrs should be subject to the product intervention powers

CHOICE strongly recommends that all CASSPrs should be subject to product intervention powers (**‘PIPs’**). The product intervention powers allows ASIC to intervene in the market when a product or class of products is likely to result in significant consumer detriment.⁴¹ This allows ASIC to take a more proactive and timely approach to regulating consumer harms in the market. It is an important power in ASIC’s regulatory toolkit that would not currently apply to the regulation of CASSPrs.

ASIC’s use of the product intervention powers in the contracts for difference (**‘CFD’**) market is an useful illustration of how ASIC could regulate crypto assets sold on crypto exchanges. Contracts for difference are a type of ‘over-the-counter’ derivative. They are a complex, leveraged derivative contract that allows investors to trade on the change of value of an underlying asset. They are harmful and high-risk financial products that overwhelmingly lose consumers’ money.

³⁹NASDAQ, 2022, *Crypto Surveillance for Market Manipulation*, <https://www.nasdaq.com/crypto-surveillance>

⁴⁰Dhawan, A and Putniņš, T. 2022, ‘A New Wolf in Town? Pump-and-Dump Manipulation in Cryptocurrency Markets’, *Review of Finance*, Forthcoming, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3670714

⁴¹Part 7.9A, Corporations Act (2001)

In August 2019, ASIC released a report REP626 into the consumer harm from OTC binary options and CFDs.⁴² The report found widespread significant consumer detriment. The report found:

- 72% of people who trade CFDs lose money, with many losses exceeding initial investment;
- there was 9 million CFD margin close-outs in 2018;
- 32% of OTC clients have annual incomes of less than \$37,000 per annum;
- over 225,000 OTC clients were given inducements to trade which attracted “financially vulnerable consumers”;
- complaints about operators who sold CFDs dramatically increased and accounted for over one third of markets-related complaints to ASIC and AFCA; and
- there was unclear or confusing presentation of information about risks, pricing and costs.⁴³

In October 2021, ASIC analysed “data obtained from licensed CFD issuers for a 15-month period that spans the period before and after the measures in the CFD Order”.⁴⁴ ASIC’s analysis found that there is a significant reduction in consumer harm since the introduction of the CFD order. This includes a:

- 94% reduction in retail clients net losses from \$377m to \$22m;
- 50% reduction in the average loss per retail loss-making account from \$1962 to \$986; and
- significant decline in negative balances and margin close-out for retail clients.⁴⁵

Crypto assets and CFDs share many similar characteristics. Both products are complex, poorly understood by many retail consumers and are highly volatile. ASIC’s use of the PIPs in the CFD market is a useful example of how a product intervention order can mitigate harm in an online trading marketplace. CHOICE strongly recommends that the product intervention powers apply to the regulation of crypto assets on CASSPrs.

Recommendation 14

CHOICE recommends that the Government require CASSPrs to be subject to the production intervention powers.

CASSPrs should be subject to the design and distribution obligations

CHOICE strongly recommends that all CASSPrs be required to adhere to the design and distribution obligations (‘**DDOs**’). They are an important consumer protection that requires product issuers and distributors to design and distribute financial products that meet the needs of consumers.

⁴²ASIC 2019, REP626, Consumer harm from OTC binary options and CFDs, <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-626-consumer-harm-from-otc-binary-options-and-cfds/>

⁴³ASIC 2019, REP626

⁴⁴ASIC 2021, CP348, Extension of the CFD product intervention order, <https://download.asic.gov.au/media/2v2br3vw/cp348-published-18-october-2021.pdf>

⁴⁵ ASIC 2021, CP348.

Under the design and distribution regime, financial product issuers and distributors must take reasonable steps that are reasonably likely to result in financial products reaching consumers in the target market defined by the issuer.⁴⁶ This is an important safeguard to prevent the mis-selling of financial products to people.

Under the Treasury's proposal, CASSPrs will be exempt from this consumer protection. We strongly recommend that the DDO regime applies to CASSPrs. This will ensure that CASSPrs are responsible for crypto assets that they sell on their platform.

Recommendation 15

CHOICE recommends that the Government require CASSPrs to be subject to the design and distribution obligations

Question 12 - Should there be a ban on CASSPrs airdropping crypto assets through the services they provide?

CHOICE supports a ban on CASSPrs airdropping crypto assets through the services they provide. Airdropping is a marketing tactic where crypto industry participants send free crypto assets to consumers as an incentive to increase awareness in a specific product. It is typically used in the early stages of a new asset's product development. Some consumers that receive airdropped crypto are required to perform tasks such as write a blog about a crypto asset that they received, in a way promoting the product.⁴⁷ This may lead more consumers being misled to invest into something that is highly risky and may not even be legitimate. While people may receive free assets, the conduct has similar characteristics with unsolicited hawking, which is prohibited in financial services law.

Airdrops are often used by crypto scammers.⁴⁸ Scammers require a consumer to either send funds or personal information, or an attacker to send a small amount of coins to a consumer without their knowledge to link the accounts and withdraw funds later. This puts more Australian consumers at a high risk of being misled into investing into crypto assets that may not even be legitimate and to become a target for scammers. CHOICE supports a ban on CASSPrs airdropping crypto assets through the services they provide.

Recommendation 16

CHOICE recommends that the Government introduces a ban on CASSPrs airdropping crypto assets through the services they provide.

⁴⁶ Pt 7.8A of the Corporations Act 2001.

⁴⁷Bridgett, S and Bauer, Esq. 2020, *Airdrops: "Free" Tokens Are Not Free From Regulatory Compliance*, 28 U. Miami Bus. L. Rev. 311, accessed on 23 May 2022, <https://repository.law.miami.edu/cgi/viewcontent.cgi?article=1360&context=umblr> p.322

⁴⁸Williams, M. 2022, *NFT airdrop scam - another bored ape act*, Business 2 Community, 25 March 2022, accessed on 23 May 2022, <https://www.business2community.com/nft-news/nft-airdrop-scams-02461554>

Question 13 - Should there be a ban on not providing advice which takes into account a person's personal circumstances in respect of crypto assets available on a licensee's platform or service? That is, should the CASSPrs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto asset)?

CHOICE supports a prohibition on CASSPrs providing advice which takes into account a person's personal circumstances in respect of crypto assets available on a licensee's platform or service. Without this prohibition, CASSPrs would be able to provide advice to people without any consumer protections that exist in the financial advice regulatory regime. This is especially important given the complexity and volatility of crypto assets.

Australia's financial advice framework has a number of important consumer protections to ensure that consumers receive high-quality advice. When providing personal advice, financial advisers must:

- act in the best interests of the client;
- provide the client with appropriate advice; and
- warn the client if their advice is based on incomplete or inaccurate information; and
- where there is a conflict with their own interests, or those of one of their related parties, prioritise the interests of the client.⁴⁹

Most crypto assets are not captured in the existing definition of financial products and are excluded from the financial advice framework. It has also been reported that some financial advisers in Australia are unable to provide advice on crypto assets as a condition of their professional indemnity insurance.⁵⁰ This has left a loophole where any advice provided to consumers about crypto assets is exempt from important financial advice laws. The rise of 'influencers' providing unregulated advice on crypto assets is an example of this vacuum. This is a poor outcome for consumers that risks exposing people to poor-quality advice.

CHOICE encourages the Government to consider introducing a positive duty on CASSPrs who provide advice on crypto assets to be subject to the above consumer protections, including the best interests duty. Crypto assets are not defined as financial products but they functionally perform the same role for most consumers. When providing advice, CASSPrs should be acting in the best interest of a consumer, not seeking to increase their own profits.

⁴⁹Corporation Act 2001, PART 7.7A

⁵⁰Kirby, J 2021, *Commonwealth Bank cryptocurrency is a no go for financial advisers*, 8 November 2021, accessed on 17 May 2022, <https://www.theaustralian.com.au/business/wealth/commonwealth-bank-cryptocurrency-is-a-no-go-for-financial-advisers/news-story/b7939688480ec56d6b4bc2647e0b0749>

Recommendation 17

CHOICE recommends that the Government introduces a prohibition on CASSPrs providing advice which takes into account a person's personal circumstances in respect of crypto assets available on a licensee's platform or service.

Alternative options: Proposal questions 15 and 17.

Question 15: Do you support bringing all crypto assets into the financial product regulatory regime? What benefits or drawbacks would this option present compared to other options in this paper?

The Government should strongly consider whether bringing all crypto assets into the financial regulatory regime leads to better outcomes for consumers and the community. There is a detailed history of jurisprudence and established laws that means consumers will likely have a baseline level of consumer financial protection. If crypto assets were brought into the financial product regulatory regime, the Government must ensure that there are no carve-outs or loopholes for certain crypto assets. All crypto assets must be subject to strong regulatory oversight, irrespective of the choice of the regulatory regime.

Question 17: Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia?

CHOICE does not support self-regulation by the industry as the primary means of regulation. As the Financial Services Royal Commission showed, self-regulation as a first response in financial services has demonstrably failed, leading to widespread consumer harm.

We remain deeply concerned that continued self-regulation of the crypto asset industry will perpetuate harms to consumers. Around 94% of consumers who participated in CHOICE's survey of members conducted in May 2022 agree that CASSPrs that sell crypto assets should be subject to stronger consumer protection laws.⁵¹ The Australian community expects strong regulation of the crypto industry with an empowered regulator, not an industry code written for industry.

Self-regulation is also not appropriate due to the regular emergence of new industries, products and marketplaces. This is a broad and disaggregated industry that is not appropriate for self-regulation.

⁵¹In May 2022, CHOICE asked 4000 of its members and supporters about their experiences on cryptocurrency and thoughts on cryptocurrency regulation.

Part 3: Proposed custody obligations to safeguard private keys.

Proposed obligations: Consultation question 19-22.

Question 19: Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets?

CHOICE welcomes new custody obligations on CASSPrs for the safeguarding of private keys. The loss of a private key by a CASSPr may mean the loss of the consumer's funds in it. Further, insufficient safeguarding by CASSPrs have opened consumers to cyber security threats and scams. It is estimated that consumers need to have utmost trust that CASSPrs who store their private keys have appropriate safeguards in place and are acting in their best interests.

CHOICE supports the Treasury's proposed mandatory, principles-based obligations. There needs to be strong penalties for CASSPrs if they fail to adhere to these custody obligations. CHOICE recommends that the penalties regime mirror the newly-imposed maximum penalty framework under the *Corporations Act 2001* (Cth), *ASIC Act*, *National Consumer Credit Protection Act 2009* (Cth) and *Insurance Contracts Act 1984* (Cth).

CHOICE recommends defining and providing criteria for terms like 'appropriately' in point two, 'expertise and infrastructure' in point four and 'robust' in point seven for clear minimum standards that CASSPrs should follow. These are subjective terms and the interpretation of each term can vary greatly, thus the level of protection of private keys will fluctuate from one CASSPr to another - meaning that the level of consumer protection will also vary.

Recommendation 18

CHOICE recommends that the Government establishes new custody obligations on CASSPrs for the safeguarding of private keys. There should be strong penalties for CASSPrs who breach these obligations.

Question 20: Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above?

CHOICE recommends imposing additional obligations in relation to the custody of crypto assets that are not identified in the proposed obligations in order to better strengthen the minimum custody standards. The recommended obligations are:

- a) A CASSPr must compensate a consumer in the event the CASSPr loses the individual's private key. CASSPrs must be held to high standards to ensure that they have appropriate safeguards in place to keep private keys safe.

- b) CASSPrs must be insured and have appropriate capital reserves to compensate consumers.
- c) CASSPrs must be responsible for the third-party custodians, as they would be responsible for themselves. If a third-party fails to keep consumers' crypto assets/private keys safe, CASSPrs must take the full responsibility for the loss and compensate consumers according to minimum standards.

Recommendation 19

CHOICE recommends that the Government introduces stronger obligations on CASSPrs with custody obligations, including having a requirement to:

- a. compensate a consumer if a CASSPr loses an individual's private key;
- b. have appropriate insurance and capital reserves to compensate consumers; and
- c. be responsible for third-party custodians who act on behalf of the CASSPrs.

Question 21: There are no specific domestic location requirements for custodians. Do you think this is something that needs to be mandated? If so, what would this requirement consist of?

Regardless of a geographical location, all CASSPrs that provide their services to consumers in Australia must be subject to the proposed obligations and any other additional recommended obligations that strengthen consumer protections.

CHOICE recognises that a different geographical location of CASSPrs may be subject to regulations of that country. In cases where other countries' regulations contradict Australian regulations, CASSPrs must follow Australian regulations or be prohibited from providing their services in Australia.

Recommendation 20

CHOICE recommends that the Government mandates that all CASSPrs that provide their services to consumers in Australia, including having custody of private keys should be subject to obligations.

Question 22: Are the principles detailed above sufficient to appropriately safekeep client crypto assets?

If all crypto assets cannot be regulated under financial products, the proposed principle-based obligations in addition to recommended obligations by CHOICE are sufficient to appropriately safekeep consumers' crypto assets. However, these obligations are only appropriate if they remain flexible and adaptive to match innovations in the crypto industry as they are introduced to consumers in order to minimise any new protection risks that these innovations may pose to Australian consumers.

Alternative option: Industry self-regulation: Consultation question 25.

Question 25: Is an industry self-regulatory model appropriate for custodians of crypto assets in Australia?

CHOICE does not support industry self-regulation for the same reasons outlined in the answer to question 17.

Additional resourcing for ASIC

CHOICE strongly supports additional resourcing for ASIC to oversee the regulation of CASSPrs. The crypto industry is growing and highly complex. ASIC will need to invest in specialist regulatory experience to monitor and regulate this industry. Additional funding will also allow ASIC to perform key regulatory functions, such as conducting surveillance activities and launching enforcement action.

Recommendation 21

CHOICE recommends that the Government includes additional resourcing for ASIC to oversee the regulatory regime, given the growing size of crypto markets and the complexity involved in surveillance of them.