Association of Financial Advisers Ltd
ACN: 008 619 921
ABN: 29 008 619 921
PO Box Q279, Sydney 1230
1800 656 009
afa.asn.au

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Director – Crypto Policy Unit
Financial Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: crypto@treasury.gov.au

AFA Submission: Crypto Asset Secondary Service Providers: Licensing and Custody Requirements – Consultation Paper

The AFA welcomes the opportunity to provide feedback on the Crypto Asset Secondary Service Providers: Licensing and Custody Requirements – Consultation Paper.

The AFA has not addressed all of the questions in this submission. We have placed a focus on the questions most relevant to financial advice.

Introduction

The AFA supports the introduction of a regulatory regime for Secondary Service Providers in the crypto assets market.

The financial advice sector has become increasingly concerned as the Crypto market has grown so rapidly and an increasing number of Australians have entered the market with the objective of investing in these assets. We support a level playing field in the investment space and are very conscious that completely different obligations apply to crypto investments as opposed to financial products.

The management of risk and the sensible protection of consumers are key considerations. The market volatility in the crypto space over a long period of time, however particularly recently, highlights the level of risk involved in the crypto market. There is also a lack of consumer protection outside of the financial product market.

Thus, we support the introduction of a regulatory framework for the Crypto asset secondary service provider market, however we make the important point that this proposal is only to regulate service providers, including intermediaries and custodians, and does not have any impact on the actual providers of these products. This presents a huge gap, where consumer protection is fundamentally missing.

Seemingly no jurisdiction is willing to appropriately regulate the underlying assets and is instead focussed upon growth opportunities that this new market may create. Seemingly each of the international jurisdictions are taking the same approach and backing this market from a momentum perspective. We fear that this approach could increase the risks for consumers in the long term, if prices continue to go up in the absence of growth in the underlying value.

Crypto Assets and Financial Advice

As crypto assets are considered by clients as a new asset class, they will often consider seeking financial advice to help them in making decisions related to investment in these assets. Financial advisers have in large part been excluded from providing financial advice on crypto assets for the following reasons:

- It is very difficult to assess what the underlying value of a crypto asset is, which is an essential part of crypto assets being rated by research houses, who might then provide research reports that could possibly be then leveraged by an advice licensee to approve these products.
- Most financial advice licensees do not authorise their advisers to provide financial advice on crypto assets. As such, they are unlikely to be on the approved product lists (APL) for these licensees.
- Most professional indemnity insurance policies do not include crypto assets and otherwise if they were not on the APL, or subject to a licensee assessed non-approved product process (which would require research), then they will not be covered for providing financial advice on these products. Thus, the risk is too great for the licensee and the adviser.

This leaves financial advisers in the difficult position of often needing to discuss crypto assets with their clients, so that they better understand the risks involved, however being limited from doing so. This means that Australians, in large part, get a form of “advice” from social media channels and influencers on crypto assets. This is a source of information that is less likely to include any form of consumer protection.

This serves to highlight the risks involved for consumers who choose to make their own decisions on crypto assets and why we are increasingly hearing of Australians losing large amounts of money investing in crypto assets, without any understanding of the key principles of investing such as diversification and the risk/return trade-off.

Responses to Consultation Questions

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

The AFA agrees with the proposal that one definition for crypto assets should be developed to apply across all Australian regulatory frameworks to ensure consistency across various jurisdictions and to minimise confusion for all stakeholders.

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

CASSPrs who provide services for all types of crypto assets ought to be included in the licensing regime, with no carve outs for specific crypto assets. This is to ensure consistency and to reduce confusion for consumers who can have greater confidence when they are dealing through a CASSPr. The CASSPr should have a minimum set of regulatory standards that ought to be met regardless of the type of crypto asset that the CASSPr deals with or in. The proposed obligations for CASSPrs are largely principles based and can be administered with flexibility to ensure they achieve the dual objectives of consumer protection, whilst also ensuring that regulation does not unnecessarily stifle or overly complicate the operations of these entities.

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?

Consistent with our response to question 5, CASSPrs that engage with any crypto assets ought to be licensed. We acknowledge that there are arguments for a flexible approach being taken in administering the obligations of the proposed licensing regime, to provide a lighter touch regulatory approach to CASSPrs that deal with crypto assets that are lower risk, when compared to higher risk crypto assets.

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)?

The AFA strongly believes that CASSPrs should 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. Regulations apply to the provision of personal financial product advice to protect consumers. This also serves to maintain the integrity of the advice profession and to elicit higher trust from consumers, who engage professional financial advisers for the purpose of personal financial product advice. We do not accept the prospect of an alternative regime, where personal financial advice could be provided, without the consumer protections and other obligations that apply to licensed financial advisers.

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 AFA accepts that there are arguments for the regulatory regime for crypto assets or CASSPrs to be simpler, lighter touch, technology neutral and risk focused. Further, the AFA sees the benefit of recognising the unique nature of crypto assets and the need to avoid excessive restrictions in formulating a regulatory regime for crypto assets and CASSPrs. Whilst the AFA does not necessarily support bringing all crypto assets into the financial product regulatory regime, we are open to an approach where the underlying asset might determine the extent to which crypto assets are drawn into the financial product regulatory regime. However, given the proliferation and growing involvement of Australians in investing with crypto assets, the AFA wants to ensure that financial advisers in Australia, who are competent and wish to advise their clients on crypto assets, are afforded the opportunity to do so without unnecessarily jeopardising or increasing the risk profile of their financial services license.

It is imperative that the ability to procure professional indemnity insurance, for advice relating to crypto assets be considered in designing a regulatory framework, as this is a significant barrier to overcome if financial advisers in Australia are to provide their clients with advice relating to crypto assets, even potentially if that advice is to avoid investing in this new asset class or to divest existing holdings. Australians will benefit from the professional advice of experienced and competent financial advisers in relation to crypto assets and encouraging Australians to seek such advice by providing the necessary mechanisms for financial advisers to deliver this service is critical and may reduce the risk of significant consumer harm.

The key benefit of capturing all products under the same regime is to provide a consistent level of consumer protection across all products. This will result in greater understanding by consumers.

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?

The AFA does not support a voluntary code of conduct and advocates for a legislated regime. There is a lack of evidence to suggest that a self-regulation model would be an adequate solution. We would also question why this would be deemed an acceptable outcome, given the level of risk for consumers, if self-regulation was not the permitted model more broadly in the financial services sector.

We would also support access to an external dispute resolution body, to ensure adequate levels of consumer protection and enhanced accountability.

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

The AFA does not support an industry self-regulatory model as being appropriate for custodians for crypto assets in Australia, given the potential client detriment, the complexity and the breadth of crypto investments available to consumers. There is a lack of evidence to suggest that this would be a workable model and the design should take into consideration that this is a market that is likely to grow and would therefore be more likely to attract those who are less inclined to prioritise the interests of consumers.

Concluding Comments

The AFA supports the regulation of the crypto asset service provider market. The crypto asset market has grown rapidly in recent years and there are significant risks that consumers are exposed to. The introduction of a regulatory framework in this space must now be a priority.

We would be happy to discuss this matter further, or to provide additional information if required. Please contact us on [redacted].

Yours sincerely,

Phil Anderson
Chief Executive Officer
Association of Financial Advisers Ltd

About the AFA

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 75 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

With the exception of Independent Directors, the Board of the AFA is elected by the Membership and Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.