



PRINCIPLES FOR CONSUMER PROTECTION FOR VIRTUAL DIGITAL ASSETS (VDAs)

A COMPENDIUM OF POLICY REFORMS IN G20 COUNTRIES TO SAFEGUARD INTEREST OF CONSUMERS & PRINCIPLES FOR ADOPTION IN INDIA

(October 2023)

Executive Summary

Over the past few years, Virtual Digital Assets (VDAs) have become a focal point of several conversations, including during G20 under India's Presidency. Consumers now have increased access to VDA assets through exchanges and wallets. The initial small size and novelty of the VDA market led authorities to adopt a wait-and-see approach when it came to regulating the sector. But with the rapid growth in consumers and market capitalization, several developed and emerging economies are now looking closely at how they should tackle the regulation of VDAs.

Consumers are always at the forefront of any regulation. Though the VDA sector is currently unregulated, consumers have limited exposure of rights and benefits available for regulated services. These include transparent and comprehensive disclosures, advertising and marketing standards, suitability assessments, complaints functions, and recourse mechanisms. Therefore, it is imperative to create awareness about the associated risks and provide better protection mechanisms to consumers, especially for those who are low-income and least able to weather losses related to market volatility in India.

In the last decade, the sheer number of VDAs, also referred to as crypto assets, has expanded vastly. As VDA platforms and services have become more commonplace, the risks may have become more salient for consumers. A number of consumer protection issues arise from the use of VDAs. The European Banking Authority (EBA) recently issued a warning stating that consumers who have bought VDAs through an exchange platform may lose their money if that exchange platform is hacked and subsequently goes out of business¹. There is no legal protection for losses arising from funds held on these platforms. Meanwhile, the Financial Services Compensation Scheme (FSCS) released a similar warning, highlighting that FSCS cannot protect customers if a platform that exchanges or holds VDAs goes out of business².

The Department of Consumer Affairs (DoCA) recently conducted a brainstorming session with the industry participants, with the aim of understanding emerging risks for consumers from VDAs and ensuring consumer protection through existing and evolving laws and regulation for VDAs. To further support the government's efforts, we have identified the common risks faced by VDA consumers, and some of the safeguard mechanisms being implemented by emerging and developed economies.

1. <https://www.eba.europa.eu/eba-warns-consumers-on-virtual-currencies>
2. <https://www.fscs.org.uk/news/protection/cryptocurrencies-risk-cover/>

The key risks for consumers are:

01

Exposure to loss from extreme price volatility in VDAs

02

Frozen accounts of customers and platform bankruptcies

03

Poor customer service or grievance redressal mechanism

04

Inadequate understanding of risks and suitability by consumers

05

Transaction issues when buying, selling or withdrawing VDAs

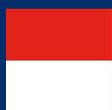
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Fraudulent transactions, theft, account hacks and scams

It is important that the risks are identified, and steps taken to prevent unfair trade practices and protect consumer interest at the earliest. As a step forward, this document can act as a guiding force for the Department of Consumer Affairs (DoCA) to frame appropriate policies and advisories based on the safeguards being implemented especially in the G20 countries. The identified measures can be discussed and integrated in the Indian context.



Exposure to Loss from Extreme Price Volatility in VDAs



Indonesia: The Commodity Futures Trading Regulatory Agency (BAPPEBTI) has laid down trading rules that provide protection to VDA consumers by requiring business actors to fulfil certain obligations to minimize losses in VDA transactions that arise from extreme price volatility.



South Africa: The Financial Sector Conduct Authority will supervise and monitor VDA exchanges under the Financial Advisory and Intermediary Services Act, 2020; to promote fair market practices.



Republic of Korea: The Republic of Korea's 'Virtual Asset User Protection Bill' mandates the operator to monitor unusual transactions and take necessary measures to correct price fluctuations.



Canada: As part of Regulation and Enforcement Actions for VDA Trading Platforms (CTPs), they are required to be registered with a provincial or territorial securities regulator and abide by certain conditions to help protect investors from a range of issues, including price volatility.



Turkey: Turkey witnesses price volatility in VDAs. There is no regulation to govern the sale or trading of VDAs in Turkey. It is covered under the general Turkish Code of Obligation No. 6098.



European Union: The Market in Crypto Assets (MiCA) has primarily been formulated to maintain the integrity of markets and ensure financial stability through practices such as explanation of price valuation and rejection of assets which cross price thresholds.



United Kingdom: The Financial Services and Markets Bill, 2022-23 regulates the VDA market in United Kingdom. It regulates extreme price fluctuations through intermediary liabilities.



United States*: The Commodity Futures Trading Commission (CFTC) asserts its regulatory authority over VDA in the US to ensure fair trading practices and market integrity.



Argentina: The Central Bank of the Argentine Republic (BCRA) banned payment service providers from facilitating transactions with unregulated digital assets to their customers. This is majorly to reduce the country's payment-system exposure to digital assets amid high fluctuation in their value.

Frozen Accounts of Customers and Platform Bankruptcies



Indonesia: The Government, through its regulatory Policy PP No. 5/2021 has implemented the risk-based licensing of business. This regulation identifies VDA transactions as risky business and VSAPs are accordingly subject to specific guidelines and standards to safeguard investors.



South Africa: The code of conducts under the FAIS Act requires that financial service providers maintain in force suitable guarantees or professional indemnity or fidelity insurance cover.



Republic of Korea: The 'Virtual Asset User Protection Bill' provides that digital asset service providers must separate user funds from their own and insure customer deposits.



Canada: In March 2021, the Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) published a Notice to provide guidance on how securities legislation applies to CTPs. This lists various measures for safeguarding investor interest/assets against bankruptcy, fraudulent activity, price volatility, etc.



Turkey: The Turkish government is working on an Unofficial Draft Legislation on VDAs and VDA service providers.



European Union: The Market in Crypto Assets (MiCA) mandates that those offering VDAs should have third-party safeguard for the funds or other VDAs raised during their offer to the public.



United Kingdom: The Consumer Rights Act 2015 and the Consumer Protection from Unfair Trading Regulations 2008 apply in relation to VDA consumers. Further, the Electronic Commerce (EC Directive) Regulations 2002 impose consumer safety requirements on businesses that offer or provide goods or services digitally.



Brazil: The government decree No. 11.563 authorizes the Central Bank of Brazil to regulate and supervise virtual asset service providers to protect consumers against bankruptcy.

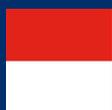


Germany: All VDA exchanges are required to obtain a licence from the Federal Financial Supervisory Authority (BaFin). Also, VDA custodians are required to hold a minimum amount of capital and ensure compliance with AML regulations.



Japan: Strict regulations have been introduced for the protection of user property. The exchanges that manage users' fiat currency and VDAs must segregate such property from its own property. Stringent rules have been put in place to protect users from leakages of VDAs and from the bankruptcy of an exchange.

Poor Customer Service or Grievance Redressal Mechanism



Indonesia: Protection for VDA consumers, in general, is regulated under the Consumer Protection Law No. 8/1999. This law protects consumer rights with special statutory provisions for consumer economic transactions in the trading sector, including VDA transactions.



South Africa: The code of conduct under the FAIS Act mandates the VDA service providers to increase the bandwidth for consumer protection through the formulation of an appropriate complaints management process.



United Kingdom: His Majesty's treasury in the UK has proposed to establish a regulatory framework for VDA, an important component of which is having appropriate procedure for consumer complaint.



Canada: Canadian Securities Law requires VDA-asset Trading Platforms (CTPs) to abide by certain conditions to help protect investors, including meeting their obligations to clients.



Australia: The Australian Financial Complaints Authority (AFCA), receives complaints about VDA-assets and is in-charge of grievance redressal. While VSAPs are not generally required by law to be AFCA members, most providers have voluntarily chosen to be members.



European Union: The Market in Crypto Assets (MiCA) mandates that VASPs should put in place a clear procedure for handling complaints received from the consumers.



Japan: The exchanges are required to establish internal control systems for responding to user complaints in a fair and appropriate manner, and to take measures to resolve disputes through alternative dispute resolution procedures.

Inadequate Understanding of Risks and Suitability by Customers



Republic of Korea: The Republic of Korea's 'Virtual Asset User Protection Bill' educates the investors about trade practices, sanctions and grievance redressal mechanisms.



South Africa: The code of conducts under the FAIS Act sensitises the VDA investors about service providers, available financial services, products and risks.



Italy: In June 2022, the Bank of Italy published a Communication urging banks, financial intermediaries and other operators to adopt the utmost caution when dealing with VDAs. The Bank of Italy and CONSOB (Companies and Exchange Commission) have issued warnings on the perils of VDAs and have highlighted the associated risks, for both, the investors and the overall banking system.



Canada: The Financial Consumer Agency of Canada provides guidance to investors and consumers on the risks of using VDAs, provides warnings about VDAs and informs them of ways to protect themselves when transacting in VDAs.



United Kingdom: VDA platforms under the CAP Code and the Advertising Standards Authority (ASA) sensitise the investors with material information on investment mechanisms, material information, and price volatility of VDAs,



European Union: The Market in Crypto Assets (MiCA) strictly mandates VDA offerors to educate investors about the risks pertaining to VDAs and liability of the consumers to bear any losses.



France: VDA service providers are prohibited from direct solicitation. They cannot engage in any direct or indirect electronic advertising nor engage in any sponsorship or patronage operation advertising digital asset services without authorization.



Japan: The exchanges are subject to regulations regarding advertising and solicitation. False and misleading representations, as well as representations promoting the trading of VDAs for the sole purpose of profit, are prohibited.



Australia: The government issues information and warnings about VDAs at their MoneySmart website.



Mexico: The National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF) warned that any person or business that uses or accepts any type of virtual assets as a form of payment, does so at their own risk and responsibility.

Transaction Issues when Buying, Selling or Withdrawing VDAs



Indonesia: Protection for VDA consumers in general, is regulated under the Consumer Protection Law No. 8/1999. This law protects consumer rights with special statutory provisions for economic transactions in the trading sector, including VDA transactions.



South Africa: The code of conducts under the FAIS Act mandates proper risk management measures and a system of internal control.



Republic of Korea: The ‘Virtual Asset User Protection Bill’ mandates safeguards such as segregation of user assets, maintenance of insurance, gold reserves in cold wallets and keep records on transaction issues.



Canada: Canadian Securities Law requires VDA Trading Platforms (CTPs) to abide by certain conditions to help protect investors, including managing risks arising from their business and meeting their obligations to clients.



United Kingdom: VDA platforms under the CAP Code and the Advertising Standards Authority (ASA) sensitise the investors with material information on investment mechanisms, material information, and price volatility of VDAs,



European Union: The Market in Crypto Assets (MiCA) mandates that service providers should have effective administrative arrangements to ensure that their systems and security protocols meet Union standards. It also mandates that individuals intending to purchase VDAs shall have a right to withdrawal within 14 days of their agreement to purchase VDA.



Japan: It has a “Green List System” to improve and streamline the process of listing VDAs. Under this initiative, VDAs that meet certain conditions will be registered in the Green List System. The exchanges will be permitted to handle VDAs registered in the Green List System based on their internal evaluation systems without having to undergo the review process.



Australia: The Corporations Act prohibits VASPs from engaging in misleading or deceptive conduct in the course of their business, including in trade or commerce, in connection with financial services, and in relation to a financial product.

Fraudulent Transactions, Theft, Account Hacks and Scams



Indonesia: Under the BAPPEBTI trading rules, VASPs are obligated to maintain the security of their systems and are responsible for any loss of assets belonging to customers.



South Africa: The code of conducts under the FAIS Act requires that financial service providers to develop proper risk management measures and a system of internal control against systemic mishaps.



Republic of Korea: The 'Virtual Asset User Protection Bill' obligates the service providers to safeguard users' deposits and provide insurance coverage to mitigate risks associated hacking and computer failures.



Canada: The authorities published a Notice to provide guidance on how securities legislation applies to CTPs. It includes measures for safeguarding investor interest/assets against bankruptcy, fraudulent activity, price volatility, etc.



United Kingdom: The Financial Service and Markets Bill, enforce the liability of fraudulent transactions on payment service providers and pushes them to take voluntary actions such as reimbursements to secure the users.



European Union: MiCA mandates that issuers of VDA should also have recovery and redemption plans to protect rights of token holders when issuers are unable to comply with their obligations.



Germany: VDA exchanges must report suspicious transactions to relevant authorities. They are also required to conduct due diligence in accordance with EU's Fifth Anti-Money Laundering Directive (5AMLD). Also, the BaFin publishes weekly warnings about VDA companies that must cease operations due to legal violations.



Brazil: The government decree No. 11.563 authorizes the Central Bank of Brazil to regulate and supervise virtual asset service providers.



France: A risk-based approach is followed in context to AML/CFT. The offer or acceptance of Anonymous Enhanced Coins or Mixer by service providers is prohibited. Also, the authorities have strict customer due diligence requirements without any transaction threshold.



Australia: VSAPs are required to register with AUSTRAC, identify and verify their users, maintain records and comply with the government AML/CTF reporting obligations.



Japan: There are stringent AML/CFT responsibilities, KYC checks, and record-keeping standards in order to ensure that VDA exchanges operate transparently and securely.

Countries with Effective Consumer Protection Measures Addressing the Identified Issues

Countries	Consumer Protection Issues					
	Exposure to Loss from Extreme Price Volatility in VDAs	Frozen Accounts of Customers and Platform Bankruptcies	Poor Customer Service or Grievance Redressal Mechanism	Inadequate Understanding of Risks and Suitability by Consumers	Transaction Issues when Buying, Selling or Withdrawing VDAs	Fraudulent Transactions, Theft, Account Hacks and Scams
Indonesia	✓	✓	✓		✓	✓
Canada	✓	✓	✓	✓	✓	✓
Italy				✓		✓
Australia			✓	✓	✓	✓
Brazil		✓				✓
Germany		✓				✓
Argentina	✓					
France				✓		✓
Mexico				✓		
Japan		✓	✓	✓	✓	✓
Republic of Korea	✓	✓		✓	✓	✓
South Africa	✓	✓	✓	✓	✓	✓
European Union	✓	✓	✓	✓	✓	✓
United States	✓			✓		
Turkey	✓	✓				
United Kingdom	✓	✓	✓	✓	✓	✓

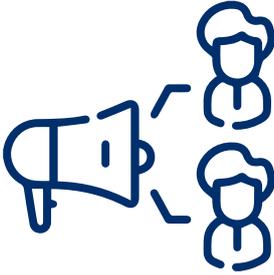
Recommendations / Way Forward

Amid the growth of the crypto asset sector, consumer awareness and protection has emerged as an area that needs to be considered by regulatory authorities. Identifying potential consumer risks and challenges associated with VDAs, analysing the role of consumer education and awareness, establishing consumer-centric regulations to prevent fraud and market manipulation, are among the key aspects that need immediate attention. In the present scenario, the existing regulations are not enough to cover the extent of protection that a crypto consumer would require. In the absence of any regulation, it is important to focus on how consumers can be safeguarded.

“ To ensure a conclusive way forward approach, it is highly recommended that the Department of Consumer Affairs (DoCA) should come up with a model advisory on the concern areas, specifying the guidelines for virtual asset service providers and consumers. The model advisory is to be drafted in consultation with the industry representatives, consumer groups and sectoral experts in order to enable close coordination between the government authorities and VDA ecosystem players. ”

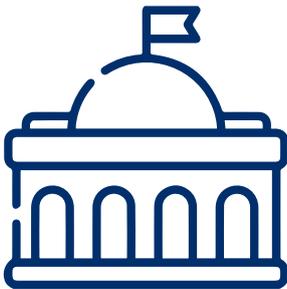
Industry players can play a pivotal role in drafting the model advisory by sharing best practices and providing technical expertise to address the consumer-centric concern areas. Similarly, consumer groups can undertake extensive awareness campaigns/initiatives to safeguard the consumers from any potential risk.

Below are some of the key recommendations for consideration by the Department of Consumer Affairs (DoCA) on key areas of consumer protection and awareness, governance and risk management and grievance redressal:



Consumer Awareness and Protection

- Provide accurate information on VDAs and their associated risk to the truest of their knowledge in accordance with the best interests of their customers.
- Engage in the fair-trade practice of providing clear information, in particular marketing communications, whether during business on its platform or otherwise.
- Ensure that the platform does not engage in bait or endorsements by celebrities or free claims advertisements.
- The VDA service providers to comply with all provisions of the 'Guidelines for Advertising of Virtual Digital Assets and linked services' (Guidelines) issued by ASCI in February 2022.



Governance and Risk Management

- Maintain a database of customers expressly acknowledging that they have received and accepted the policies of VDA service providers.
- Collect Know Your Customer (KYC) information about their existing customers and review it from time to time to check for infringers of the policies of VDA service providers.
- The VDA service provider shall ensure that the database of its consumer is safeguarded and shall upgrade the security measures for these databases from time to time.
- Provide custodial services for VDAs belonging to customers, shall ensure security safeguards to protect the interest of their customers.



Grievance Redressal

- Establish and maintain an effective and transparent grievance redressal mechanism for handling complaints received from customers. The grievances must be addressed as soon as received by the VDA service provider.
- Appoint a Grievance Officer and display their name and contact details on the platform or website.
- Establish internal control systems for responding to user complaints, and to take measures to resolve disputes through alternative dispute resolution procedures.
- Endeavour to become a partner in the convergence process of the National Consumer Helpline of the Government of India.

ABOUT AUTHORS

Avnika Nagar

Senior Associate

Chase India

avnikan@chase-india.com

Spriha Pandey

Senior Associate

Chase India

sprihap@chase-india.com

Gaurav Chaudhary

Account Director

Chase India

gaurav@chase-india.com

Kaushal Mahan

Vice President

Chase India

kaushal@chase-india.com

Ashim Sanyal

CEO and Secretary

Consumer VOICE

coo@consumer-voice.org

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