

## CRYPTOASSETS

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# Decoding crypto – Providing regulatory clarity to cryptoasset businesses



In 2021, the Canadian Securities Administrators (CSA) brought much anticipated clarity to the regulatory landscape for crypto asset businesses offering services to Canadians and/or listed on Canadian securities exchanges. There have been a number of significant developments in regulation and enforcement by the Canadian Securities Administrators (CSA) that have materially changed the legal environment in which these businesses operate in Canada.

One key change consists of the adoption of a clear registration regime for crypto assets trading platforms (CTPs) that offer custodial services to Canadian clients, pursuant to which six CTPs, five restricted dealers and one Investment Industry Regulatory Organization of Canada (IIROC) member, have now registered. Regulatory guidance has now been provided with respect to the advertising and marketing practices of custodial CTPs that are registered under securities laws. Additionally, regulatory guidance has been issued regarding public disclosure for reporting issuers that engage materially with cryptoassets.

In 2021, we also witnessed aggressive enforcement action by the Ontario Securities Commission (OSC) against several unregistered foreign CTPs. At the same time, the first Bitcoin and Ether exchange-traded funds (ETFs) in the world were launched on the Toronto Stock Exchange (TSX). Updated anti-money laundering (AML) requirements for cryptoasset businesses were imposed. Finally, the proposed retail payments framework was introduced which may apply to crypto payment services.

## Registration regime for CTPs under securities legislation

Cryptoassets present novel challenges to capital markets regulators because they are structured to have the utility of commodities, but pose many investor protection risks that are traditionally associated with securities. As a result, the extent to which securities regulators have jurisdiction to regulate cryptoassets is often unclear. CSA Staff have attempted to solve this problem by exerting jurisdiction over custodial CTPs, even if the cryptoassets traded on the platform may be commodities and not securities, on the basis that the relationship between a CTP and its client is itself a security or derivative called a “Crypto Contract”.

On March 29, 2021, the CSA and Investment Industry Regulatory Organization of Canada (IIROC) published [Staff Notice 21-329 Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements](#) (Staff Notice 21-329). Staff Notice 21-329 clarifies that dealer registration under securities laws is required for CTPs that facilitate the trading of: (i) cryptoassets that are securities (Security Tokens), and (ii) Crypto Contracts, which the CSA considers to be securities and/or derivatives when the CTP retains custody of the private keys to the cryptoassets on behalf of its clients, as opposed to immediately delivering the cryptoassets to a blockchain address specified by the client.

More information about Staff Notice 21-329 can be found in our [blog post](#).

As of December 1, 2021, five Canadian CTPs have registered as restricted dealers under securities laws. These include [Wealthsimple Crypto](#), [Coinberry](#), [Netcoins](#), [CoinSmart](#) and [Bitbuy](#). Osler acts for Wealthsimple and Coinsmart. Restricted dealer registration is available on an interim basis to CTPs that do not provide margin or leverage to their clients.

The terms and conditions imposed upon restricted dealer CTPs indicate how the CSA are addressing key investor protection issues associated with cryptoassets:

- **Custody:** At least 80% of client cryptoassets must be held in cold storage with a “qualified custodian”, such as Gemini Trust Company, LLC or Bitgo Trust Company.
- **Insurance:** The CTP must obtain a financial institution bond insurance policy that satisfies the regulatory requirements applicable to securities dealers. CTPs must arrange for third party guarantees and/or self-insurance of hot wallet losses, which are generally excluded from such policies.
- **Know your product (KYP):** CTPs must conduct diligence to satisfy themselves that none of the cryptoassets available for purchase on their platform are securities or derivatives, obtaining legal advice if necessary to make this determination.

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- **Risk disclosure:** Clients must be provided with (i) a risk statement setting out general disclosure of the risks associated with trading in cryptoassets; and (ii) a cryptoasset statement setting out a plain language description of the cryptoasset, the due diligence performed by the CTP with respect to the cryptoasset, risks specific to the cryptoasset and other specified matters.
- **Account appropriateness model and recommended loss limits:** CTPs that received an exemption from the suitability requirement must gather know-your-client (KYC) information about their clients and determine that an account is appropriate. They must also recommend a loss limit for the account based on the client's risk tolerance.
- **Specified cryptoassets and purchase limits:** In CSA jurisdictions other than Alberta, British Columbia, Manitoba and Quebec, the securities regulatory authorities have identified Bitcoin (BTC), Ether (ETH), Bitcoin Cash and Litecoin as "Specified Cryptoassets" which can be offered on an unlimited basis by registered CTPs to retail clients. All other cryptoassets are subject to an annual purchase limit of \$30,000 on CTPs that have adopted an account appropriateness model.
- **Two-year transition to IIROC:** Restricted Dealer CTPs are expected to transition to investment dealer registration and obtain membership with the Investment Industry Regulatory Organization of Canada (IIROC) within two years of registration.

Bitbuy also obtained an exemption from the requirement to be recognized as a marketplace under securities laws. As a result, Bitbuy is allowed to offer automated order-matching functionality on its CTP, as well as API access by sophisticated market participants.

In addition to the five restricted dealer CTPs, Fidelity Clearing Canada is the first investment dealer and IIROC member to obtain approval to offer cryptoasset trade execution and custody services to institutional clients, including other IIROC members. This approval signals that IIROC is prepared to regulate cryptoasset dealers, and that it is permissible for one IIROC member to operate both a traditional securities business and a crypto trading business. More information on Fidelity's regulatory approval is available in our [blog post](#) on osler.com.

## Advertising and marketing standards for CTPs

On September 23, 2021, CSA and IIROC staff published [Staff Notice 21-330 Guidance for Crypto-Trading Platforms: Requirements relating to Advertising, Marketing and Social Media Use](#) (Staff Notice 21-330).

Staff Notice 21-330 reminds CTPs that have registered or have applied for registration as a securities dealer that they are prohibited from using false and misleading advertising and from making unsubstantiated claims. They are also required to monitor and keep records of social media usage by personnel. Such internal controls must extend to the directors, shareholders, officers, employees and other third parties acting on behalf of the CTP.

More information on Staff Notice 21-330 is available in our Risk Management and Crisis Response [blog post](#).

## Guidance on disclosure obligations for cryptoasset reporting issuers

On March 11, 2021, staff of the CSA published [Staff Notice 51-363 \*Observation on Disclosure by Crypto Asset Reporting Issuers\*](#) (Staff Notice 51-363). A cryptoasset reporting issuer is a reporting issuer that engages materially with cryptoassets through mining and/or holding or trading of those assets.

Staff Notice 51-363, at the time of its publication, notes that there were 49 cryptoasset reporting issuers listed on Canadian stock exchanges. These exchanges are expected to provide adequate disclosure relating to custody, risk factors and audit.

More information on Staff Notice 51-363 is available [here](#).

## OSC crackdown on foreign CTPs offering services to Ontarians

Following the publication of Staff Notice 21-329 in March 2021, OSC staff warned CTPs offering services in Ontario that they must contact OSC staff by April 19, 2021 to discuss how to bring their operations into compliance. Otherwise, they would face regulatory action.

Beginning in May 2021, the OSC commenced enforcement proceedings against four large, non-Canadian based platforms that did not engage with the OSC within the prescribed timeline. Some large foreign CTPs such as Hong Kong-based Binance and Seychelles-based Bitmex have announced that they are not accepting new Ontario clients, or are shutting down accounts of their existing Ontario clients, within prescribed timelines.

For further details on the OSC's crypto enforcement efforts in 2021 see [A dynamic year for capital markets enforcement](#).

## Cryptoasset ETFs

In 2021, we witnessed the arrival of new regulated investment products for Canadian retail investors seeking to invest in Bitcoin and Ether.

In February 2021, with the approval of the OSC, Purpose Investments launched the Purpose Bitcoin ETF on the TSX as the world's first Bitcoin ETF. This was soon followed by the launch of the Purpose Ether ETF in April 2021. There are now 27 ETFs and closed-end funds based on Bitcoin and Ether listed on the TSX.

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## AML update

On June 1, 2021, [substantial amendments](#) to the regulations issued under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* came into force along with updated guidance from the Financial Transactions and Reports Analysis Center of Canada (FINTRAC). Both of these regulatory initiatives imposed new AML requirements relating to virtual currencies, including:

- the “travel rule” that requires money service businesses (MSBs) and other reporting entities to include identifying information about the transferor and the beneficiary when they send a virtual currency transfer, as well as to take reasonable measures to ensure that this information is included on receipt of a virtual currency transfer;
- reporting of suspicious virtual currency transactions to FINTRAC; and
- large virtual currency transaction reporting obligations that require all reporting entities to report receipts of an amount in virtual currency equivalent to \$10,000 or more in a single transaction, or series of transactions, within 24 hours.

For further information on the amendments, see our [Financial services regulation in 2021: Back to business](#) article and our [Anti-money laundering in Canada](#) guide on osler.com.

Canada is also watching new Financial Action Task Force (FATF) [guidance](#) published on October 28, 2021 which updates the Guidance for a Risk Based Approach to Virtual Assets (VAs) and Virtual Assets Service Providers (VASPs). The FATF suggests circumstances in which AML requirements may apply to non-fungible tokens, CTPs, stablecoins and peer-to-peer transactions. Canada’s Department of Finance will need to consider the extent to which Canadian AML laws should be updated to reflect the new FATF guidance.

## Retail payments framework

On April 30, 2021, the federal government introduced the [Retail Payments Activities Act](#) (RPAA) which establishes a framework for payments services providers (PSPs) that will be overseen by the Bank Of Canada.

These payment services providers include a variety of entities that perform electronic payment functions, such as payment processors, digital wallets, currency transfer services and other types of payment technology companies. While not certain at this time, it is expected that crypto payment services provided by regulated PSPs will be regulated under the RPAA.

For further information on the RPAA, see [Financial services regulation in 2021: Back to business](#).

## Looking ahead to 2022

2021 was a year of many firsts for cryptoasset businesses. We expect 2022 to be another year of significant growth and maturation of the industry.

A number of regulatory issues remain to be clarified, including:

- treatment of fiat-backed stablecoins, including potential regulation as prudential deposits, money market funds or something new, as discussed further [here](#);
- the extent to which securities laws may apply to proof of stake blockchain networks and/or “staking as a service” arrangements;
- non-fungible tokens (NFTs), including fractionalization and marketplaces for trading NFTs;
- decentralized finance protocols (also known as DeFi), which facilitate transactions in cryptoassets on blockchains such as Ethereum and which can operate autonomously and outside the ownership or control of any party, potentially outside of scope of securities laws and AML laws; and
- retail investment products beyond BTC and ETH.

We are watching to see which of these will receive the attention of regulators in 2022. We expect that 2022 will be another transformative year for the cryptoasset industry in Canada, and look forward to working with our clients on new business models and challenges in the space.

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