

The Spectre of Regulation Looms for Crypto Asset Trading Platforms

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On March 14, 2019, the Canadian Securities Administrators (CSA) and Investment Industry Regulatory Organization of Canada (IIROC) published Consultation Paper 21-402: Proposed Framework for Crypto-Asset Trading Platforms (the Consultation Paper), a consultation paper seeking stakeholder input regarding a regulatory framework for crypto asset trading platforms (Platforms).

Key Takeaways

- The Consultation Paper is representative of the continued and welcomed efforts by regulators to seek stakeholder collaboration in developing a regulatory framework for the rapidly evolving crypto industry.
- The developing securities regime is expected to apply to not only Platforms that offer trading of crypto assets, which, themselves, constitute securities, but also to Platforms that offer trading of crypto assets “where the investor’s contractual right to the crypto asset may constitute a security.”

Summary and Background

There are currently more than 2000 crypto assets that may be traded on no less than 200 Platforms that facilitate the buying and selling or transferring of crypto assets. As a result of the rapid development of the crypto asset market, many of these Platforms operate globally and without any regulatory oversight.

It is clear, however, that many of these Platforms may be subject to securities and/or derivatives regulation and, depending on their structure, may introduce novel features that create risks to investors and Canada’s capital markets without being fully addressed by the existing regulatory framework.

The Consultation Paper makes particular note of the following risks that are heightened in respect of Platforms:

- inadequate safeguarding of investors’ crypto assets (as occurred with QuadrigaCX, for example);
- insufficient processes, policies and procedures in place to establish an internal system of controls;
- investors’ assets may be at risk in the event of a Platform’s bankruptcy or insolvency (particularly where Platforms don’t segregate investors’ assets from their own);
- deficient disclosure relating to the Platform’s operations and the assets that are available for trading thereon; and
- susceptibility to manipulative and deceptive trading.

Where securities legislation applies to Platforms, the CSA and IIROC are considering, and soliciting input in respect of, a tailored regulatory framework to address these novel features and risks.

Application of Securities Legislation

Given the unique and varying functions, structures and rights that may arise across the spectrum of crypto assets, classifying particular assets as securities has remained a difficult task for securities regulators globally. Nonetheless, and as one might expect, the Consultation Paper confirms that any Platforms on which crypto assets that are securities and/or derivatives are traded would be subject to securities and/or derivatives regulatory requirements.

Interestingly, the Consultation Paper notes that securities legislation may still apply to Platforms that offer trading of crypto assets that are not, in and of themselves, securities, (such as Bitcoin, which more closely resembles a commodity), including where the investor’s contractual right to the crypto asset may constitute a security. The Consultation Paper cites certain factors that may suggest a Platform is subject to securities legislation, such as:

- if the Platform retains control of crypto assets after they are acquired by investors;
- if multiple investors’ crypto assets are pooled together;
- if investors can trade or rollover positions held by the Platform; and

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- the nature of investors' rights in the event of the Platform's insolvency.

The Consultation Paper invites input as to additional factors that ought to be considered. At this juncture, it remains largely unclear as to the manner in which these factors would be balanced and which Platforms that would consequently be subject to the onerous requirements imposed under Canada's securities regime.

Proposed Framework

The proposed framework will apply to Platforms that operate in Canada or that have Canadian participants, and that are subject to securities legislation and may not fit within the existing regulatory framework, as set out above.

The Consultation Paper acknowledges that many Platforms are hybrid in nature and may perform functions typically performed by one or more conventional market participants, including exchanges, dealers, alternative trading systems, clearing agencies and custodians. Accordingly, in developing the proposed framework, the CSA and IIROC intend to incorporate the regulations governing these market participants, including customary registration requirements.

Conclusion

The Consultation Paper, which invites feedback on 22 questions relating to the regulation of Platforms, is emblematic of the cautious and collaborative approach that has been taken by Canadian Securities Regulators in connection with the crypto industry. Given the technical, novel and evolving nature of the crypto assets and the Platforms on which they are traded, the emphasis on information gathering and stakeholder engagement is prudent.

Comments on the Consultation Paper should be submitted by May 15, 2019. We encourage all interested parties to participate in this opportunity to contribute to developing the regulatory regime governing Platforms in Canada.

For further information regarding the regulatory environment for Platforms, or for assistance in responding to the Consultation Paper, please contact Brigeeta Richdale, David Kelman, or any other member of our Securities Litigation Group.

For further information regarding the unique opportunities and challenges in the insurance industry that are engaged by the Consultation Paper, please see [Risky Business - Opportunities and Challenges for Growth in the Crypto Insurance Market](#) by Marisa Coggin.

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