Cassels

Outlook 2020: Developments in Cryptocurrency Regulation and Enforcement

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Canadian regulators continue to take a collaborative and cautious approach to regulating the cryptocurrency industry. Due to the ever-evolving landscape of the industry, regulators have taken it upon themselves to clarify the regulatory framework, to better support businesses seeking to offer innovative products, services and applications, and to protect Canadian investors. This may be a welcome approach insofar as it fosters increased stability and predictability, which will serve the industry well in the long run.

By way of example, the Canadian Securities Administrators ("CSA") has published Staff Notice 21-327 *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto-assets*[1] ("Staff Notice"). The Staff Notice describes situations where securities legislation will and will not apply to platforms facilitating crypto-asset transactions. In particular, it confirms that securities legislation governs not only trading in crypto-assets that are clearly securities, but also trading in contracts or instruments that are derivatives based on crypto-assets. Securities legislation will therefore apply to platforms that facilitate the trading of crypto-assets as commodities, whereby the user's contractual right to the crypto-asset may constitute a derivative.

Conversely, the Staff Notice sets out the following conditions under which securities legislation will not apply:

- The underlying crypto-asset itself is not a security or derivative; and
- The contract or instrument for the purchase, sale or delivery of a crypto-asset results in an obligation to make immediate delivery of a crypto-asset, and is settled by the immediate delivery of the crypto-asset to the Platform's user according to the Platform's typical commercial practice.

Overall, the Staff Notice can be seen as a part of an ongoing effort to help stakeholders better navigate the evolving regulatory regime.

As another example and in a further attempt to foster increased transparency, reliability and security in the cryptocurrency space, amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act 2019* now require all dealers in virtual currency that service Canadian customers to register with the Financial Transactions and Reports Analysis Centre of Canada ("FinTRAC"). These entities are now subject to similar due diligence, record keeping, monitoring, and reporting requirements as other reporting entities. Some of these requirements include identifying all clients, appointing a compliance officer, and

maintaining records of clients and transactions. In addition, any “reporting entity” that receives $10,000 CAD or more in cryptocurrency must now identify the sender, record details of the transaction, and report the transaction to FinTRAC. In order to ensure compliance, FinTRAC is authorized to impose Administrative Monetary Penalties (“AMPs”) on any entity that does not comply and can revoke registrations where entities have failed to pay the AMPs.

Collaborative Approach with Industry Stakeholders

Wealthsimple Digital Assets Inc. has been granted permission to operate Canada’s first regulated crypto trading platform under CSA’s “regulatory sandbox,” an initiative designed to allow firms to test innovative ideas with exemptive relief from securities laws requirements.[2] Wealthsimple plans to operate on a beta testing basis and solicit feedback from early users to improve the platform before it transitions to normal operation. Wealthsimple’s successful application to the regulatory sandbox represents another example of the CSA’s collaborative approach to developing regulatory requirements with the input of industry stakeholders.

Increased Enforcement Efforts

On the flipside to industry collaboration, recent events indicate that provincial securities commissions are using the registration requirement to bring enforcement proceedings against, and protect investors from, fraudulent parties.

This approach was adopted by the OSC in the Matter of *Miner Edge Inc. et. al.*,[3] where the accused is alleged to have falsely promised investors that their funds would be used to invest in a crypto mining venture. The OSC has made allegations of fraud, alongside allegations that the accused engaged in trading and distributing securities while not being registered to do so. This approach was also adopted in the Matter of *ASBC Financial and Walter Turner*,[4] where the accused were prosecuted for having engaged in the business of trading and advising in securities of underlying crypto-assets without being registered to do so, rather than the more serious alleged infraction of defrauding an investor out of $190,000.

The motivation to adopt this approach is likely due, at least in part, to the significantly less onerous proof requirements involved in prosecuting alleged failures to comply with the applicable registration requirements. We would expect regulators to continue utilizing this approach as the regulatory framework continues to mature and as long as it continues to serve as a uniquely efficient means of enforcing breaches of the *Securities Act* committed by actors in the crypto industry.

1 CSA Staff Notice 21-327, *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto-assets*.

2 2020 OSCB 6548.

3 2019 SECPOLY 631032676005.

4 2020 SECPOLY 636747441005.
