Cassels

Outlook 2021: Key Developments in Cryptocurrency Regulation and Enforcement

Jessica L. Lewis, Danielle DiPardo

11/30/2021

As the cryptocurrency industry continues to grow in Canada, regulators are challenged to strike a balance between enforcing regulations and fostering innovation in a fast-paced, ever-changing market.

Cryptocurrency, while relatively new, is not an invention of the last couple of years. Bitcoin, considered by many to be the marquee crypto asset, became available more than a decade ago. Nevertheless, the concept still seems novel to regulators and investors alike. Regardless of one's own experience, understanding, or familiarity with the crypto market, it is undeniable that the continued growth of this market has been accompanied by a variety of difficulties for regulators. In response, Canadian regulatory authorities have been forced to apply creative and flexible solutions to the regulation of the cryptocurrency industry.

Regulatory Movement

In the past year, the Ontario Securities Commission (OSC), alongside the Canadian Securities Administrators (CSA), has doubled down on its commitment to regulate the cryptocurrency market, citing the intention of protecting investors as its focus. Following up from the Staff Notice 21-327 (SN 21-327), issued in January 2020 and addressed in our article last year,[1] the CSA has issued three additional Staff Notices: 21-329[2] (SN 21-329), 51-363[3] (SN 51-363), and 21-330[4] (SN 21-330 and, collectively, the Staff Notices).

SN 21-329: Guidance for Crypto Asset Trading Platforms: Compliance with Regulatory Requirements

SN 21-329 builds on the message espoused in SN 21-327 that securities legislation and registration requirements apply to crypto entities. In SN 21-329, the CSA provides further detail and clarity on its expectations that crypto entities satisfy these requirements. SN 21-329 also acknowledges the need for, and recommends adopting, an interim approach toward requiring crypto trading platforms (CTPs) to register as investment dealers with the Investment Industry Regulatory Organization of Canada (IIROC). The CSA recognizes that the registration process is lengthy and complex and has, therefore, proposed a phased approach which will allow entities to continue to operate while undergoing the registration process.

SN 51-363: Observations on Disclosure by Crypto Assets Reporting Issuers

Regulators also published SN 51-363 advising on the level of disclosure that is expected from these newly registered crypto entities at the time of their initial registration and on an ongoing basis. The discussion in SN 51-363 is tailored toward issuers dealing with crypto assets. The CSA noted that the disclosure in these entities' annual filings, concerning the issuer's engagement with crypto assets by way of mining, trading, or holding of those assets, contained a multitude of deficiencies. SN 51-363 provides guidance aimed at rectifying these deficiencies.

SN 21-330: Requirements Relating to Advertising, Marketing and Social Media Use

Most recently, the CSA issued SN 21-330 as a warning to CTPs that advertising activities and marketing strategies, which they had engaged in prior to registering as a public issuer, may be in breach of securities legislation. SN 21-330 points to broad public statement-making and social media use as examples of activity that, while previously a regular part of their operations, may contravene the applicable regulations.

Staff Notices: Trends & Takeaways

Each Staff Notice recognizes the need for securities regulatory authorities to adopt a flexible approach when regulating the crypto market. Further, each Staff Notice functions as a warning to issuers regarding the type of activity that can result in enforcement actions and provides guidance to issuers to ensure that they take the necessary steps to comply with applicable regulations.

Regulatory Exceptions: The CSA Regulatory Sandbox

The CSA continues to provide exemptive relief from some securities law requirements by way of its "regulatory sandbox," permitting two new temporary exceptions in the previous year:

- **Finhaven Capital Inc. (Finhaven)**: In November 2020, Finhaven was permitted to offer a secondary trading platform to certain investor clients who held a digital wallet with Finhaven, allowing those clients to privately negotiate secondary trades of digital securities. This exemptive relief was provided in British Columbia, Alberta, Saskatchewan, Manitoba, and Ontario, and is set to expire at the end of 2022; and
- **Blockfilm Inc. (Blockfilm)**: In March 2021, Blockfilm was granted exemptive relief to operate a digital platform across Canada that allows investors to invest in new film and film-like projects. The relief was provided Canada-wide for a two-year term.

Enforcement: Registration Requirement

On the same day as the CSA's publication of SN 21-329, the OSC published a news release stating that they expected CTPs to bring their operations in line with Ontario securities laws. The news release also

required CTPs to contact the OSC by April 19, 2021 to discuss the steps they would take to ensure compliance.[5] The OSC followed this release with swift action, bringing enforcement actions against four CTPs that failed to comply.[6]

No decisions with respect to these entities have been issued yet, but we expect that the outcome will provide insight into how CTPs may be regulated moving forward.

Other News & Developments

The crypto industry continues to expand in Canada as a whole. Wealthsimple Inc. (Wealthsimple), which was offered exemptive relief under the CSA's regulatory sandbox last year, was recently approved to offer trading of 14 new cryptocurrencies on its platform.[7] The decision also permitted Wealthsimple to move its clients' assets between various crypto wallets from other crypto exchanges.

Meanwhile in Alberta, Tetra Trust Company (Tetra Trust) became the first Canadian firm granted regulatory approval to provide custody services of cryptocurrency, making it the first regulated custodian based in Canada permitted to store digital assets. This provides some domestic comfort to Canadian investors, as crypto assets purchased through local sites, such as Wealthsimple, will now be stored by Tetra Trust in Calgary rather than by the American counterparts Gemini and Coinbase that previously served this role.[8]

There have also been market consequences to the increasing regulation – oversight and enforcement of crypto companies has given rise to negative outcomes, as some crypto companies forsake the Canadian market altogether rather than comply with the new regulations. For example, Binance, one of the world's largest cryptocurrency exchanges, is the most recent noteworthy entity to make this decision, ceasing operations in Canada after being called to register as a CTP.[9] This is a trend that Canadian investors may continue to see as long as other markets continue to be underregulated.

Looking Forward

The Canadian regulatory authorities continue to adopt a flexible approach while simultaneously calling for compliance with the applicable regulations. In the wake of SN 51-363, it is possible we will see enforcement actions against crypto-based companies for deficiencies in initial or ongoing disclosure. The OSC's approach following the issuance of SN 21-329 demonstrates its expectation that companies will take measures to comply immediately with Staff Notices.

Interested investors should monitor whether companies continue to leave the Canadian market in favour of jurisdictions with more lenient, or no, regulation. Until global regulation is at least comparable with the measures currently in place in Canada, the domestic market may not be attractive enough to justify the

costs of compliance for some companies. Unfortunately, the trade-off between investor protection and facilitating rapid growth in the crypto industry appears to be unavoidable at this time, and history has indicated that the Canadian regulatory authorities will prioritize investor protection.

---

[1] "Outlook 2020: Developments in Cryptocurrency Regulation and Enforcement," *Cassels, Brock & Blackwell LLP*, November 20, 2020, online: <https://cassels.com/insights/developments-in-cryptocurrency-regulation-and-enforcement/>.

[2] CSA Staff Notice 21-329, "Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements," March 29, 2021, online: <https://www.iiroc.ca/news-and-publications/notices-and-guidance/joint-csaiiroc-staff-notice-21-329-guidance-crypto-asset-trading-platforms-compliance-regulatory>.

[3] CSA Staff Notice 51-363, "Observations on Disclosure by Crypto Assets Reporting Issuers," March 11, 2021, online: <https://www.osc.ca/sites/default/files/2021-03/csa_20210311_51-363_observations-disclosure-crypto-asset.pdf>.

[4] CSA Staff Notice 21-330, "Requirements Relating to Advertising, Marketing and Social Media Use," September 23, 2021, online: <https://osc.ca/sites/default/files/2021-09/csa_20210923_21-330_crypto-trading-platforms.pdf>.

[5] "OSC Working to Ensure Crypto Asset Trading Platforms Comply with Securities Law," *OSC News Release,* March 29, 2021, online: <https://www.osc.ca/en/news-events/news/osc-working-ensure-crypto-asset-trading-platforms-comply-securities-law>.

[6] *In the Matter of Polo Digital Assets, Ltd.*, Statement of Allegations, May 25, 2021, online: <https://www.osc.ca/sites/default/files/2021-05/soa_20210525_polo-digital.pdf>; *In the Matter of Mek Global Limited and Phoenifxin PTE. LTD.*, Statement of Allegations, May 25, 2021, online: <https://www.osc.ca/sites/default/files/2021-05/soa_20210525_polo-digital.pdf>; *In the Matter of Bybit Fintech Limited*, Statement of Allegations, June 21, 2021, online: <https://www.osc.ca/sites/default/files/2021-06/soa_20210621_bybit.pdf>; *In the Matter of Aux Cayes Fintech Co. Ltd.*, Statement of Allegations, August 18, 2021, online: <https://www.osc.ca/sites/default/files/2021-08/oth_20210819_Aux_Cayes_Fintech_Co_Ltd.pdf>.

[7] "Wealthsimple Announces Plans to Offer Trading in 14 New Cryptocurrencies After Regulator Approves Expansion," *Globe and Mail*, June 24, 2021, online: <https://www.theglobeandmail.com/business/article-wealthsimple-announces-plans-to-offer-trading-in-14-new/>.

[8] "Calgary Fintech Startup Tetra Trust Becomes Canada's First Regulated Custodian of Crypto Assets," *Globe and Mail*, July 8, 2021, online: <https://www.theglobeandmail.com/business/article-calgary-fintech-startup-tetra-trust-becomes-canadas-first-regulated/>.

[9] "Crypto Platform Binance Ceases Operations in Ontario in Face of New Regulations," *Globe and Mail*, June 29, 2021, online: <https://www.theglobeandmail.com/business/article-crypto-platform-binance-ceases-operations-in-ontario-in-face-of-new/>.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.