Cassels

CSA Provides Additional Guidance for Stablecoin Regulation

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Amidst a downturn in the crypto market, the Canadian Securities Administration (CSA) has recently released additional guidance to crypto issuers and crypto asset trading platforms (CTPs) on the regulation of "value-referenced crypto assets," which includes, but is not limited to, those digital assets commonly known in industry as stablecoins.[1]

Background

On February 22, 2023, the CSA released Staff Notice 21-332 *Crypto Asset Trading Platforms: Pre-Registration Undertakings – Changes to Enhance Canadian Investor Protection*.[2] In this notice, the CSA reaffirmed its view that some value-referenced crypto assets (VRCA) may constitute securities and/or derivatives. The CSA categorized VRCA as a crypto asset that is designed to "maintain a stable value over time by referencing the value of a fiat currency or any other value or right, or combination thereof."[3] A concern of the CSA in this notice is that VRCAs are primarily "used to facilitate the trading, borrowing and lending of other crypto assets," and thus can potentially create problems for investors who are unaware of their rights and risks.[4]

As such, the CSA decided to prohibit CTPs from allowing clients to buy or deposit VRCAs without the prior written consent of the CSA. Here, the CSA's focus was to restrict the unsanctioned trading of securities but recognized that there may be non-securities related uses for VRCAs by CTPs. Notice 21-332 specifically outlined that consent to transact in VRCAs may still be provided in the event the transaction did not involve the transaction of securities, and outlined various considerations relating to that determination. For more on Notice 21-332, please see our previously distributed Cassels Comment found here.

Current Development

After a few months of deliberation, on October 5, 2023, the CSA released Staff Notice 21-333 *Crypto Asset Trading Platforms: Terms and Conditions for Trading Value-Referenced Crypto Assets with Clients* (the Notice).[5] In the Notice, the CSA provided interim terms and conditions for issuers and CTPs to continue allowing the purchase or deposit of fiat-backed crypto assets, such as stablecoins, while leaving open the possibility that some may be subject to securities laws and require further regulatory considerations.

This decision to provide interim terms and conditions stems back to the CSA's recognition in Staff Notice

21-332 that VRCAs may have potential uses for Canadian clients of CTPs both for investing purposes and for other purposes that ought not to be subjected to securities regulations. The CSA chair Stan Magidson noted that the CSA intends to build upon this interim framework in the future, while using the same as a foundation to inform future regulation to protect investors and the integrity of the Canadian capital markets.[6]

Thus, this interim framework contains terms and conditions that are intended to protect investors and promote industry interests, as the framework was informed, in part, by comments from Canadian crypto market participants, as well as developing international standards and regulations. These terms and conditions require that, amongst other things:

- The issuer of the VRCA must maintain an appropriate reserve of assets with a qualified custodian, held for the benefit of the crypto asset holder;[7]
- The issuer of the VRCA, and CTP that enables their transaction amongst market participants, must make certain information related to governance, financial statements, operations and reserve of assets publicly available;[8] and
- Submission of a Crypto Asset Statement that includes, among other things, that "no securities regulatory authority or regulator in Canada has evaluated or endorsed the Crypto Assets made available through the platform."

The CSA has also undertaken to provide specific guidance to CTPs and VRCA issuers separately. CTPs are contemplated under Appendix A where the CSA outlined the terms and conditions CTPs are required to adhere to, in order to permit a client to trade a VRCA. Expectations for VRCA issuers are provided in two appendices: Appendix B, which is a template of an undertaking to issue a VRCA drafted by the CSA; and Appendix C which is a template of a "Submission to Jurisdiction and Appointment of Agent for Service for Issuer of a VRCA." Examples of requirements outlined for both CTPs and VRCA issuers are detailed below. We note that there is significant overlap between the clauses contained in Appendixes A, B and C, which we expect is informed by omnibus policy objectives relating to investor protection and market transparency.

(i) CTP VRCA Requirements

The following conditions, among others, must be met for a CTP to allow a client to trade a VRCA:

1. The CTP must establish that the VRCA references, on a one-for-one basis, the value of a single fiat currency, which must either be the Canadian or United States dollar.
2. A VRCA holder must be enabled to have a right of redemption against the issuer of the VRCA or the reserve of assets, subject only to reasonable and publicly disclosed conditions.
3. The issuer of the VRCA must maintain a reserve of assets held by a Qualified Custodian in trust for the benefit of VRCA holders, of which the fair value is at least equal to the aggregate nominal value of all outstanding VRCA units, calculated at least once a day.
4. The issuer of the VRCA must make certain information publicly available, including (but not limited

to):

- a. The details of each type, class or series of the VRCA;
- b. The details of how a VRCA holder can redeem the VRCA;
- c. An assurance report from an authorized public accountant within 45 days of the end of each month that certifies that the VRCA issuer has met their obligations under paragraphs (1)(d)-(f) under Appendix A; and
  d. Annual financial statements.

5. The CTP must make available a Crypto Asset Statement that includes:
   - a. A prominent statement that no securities regulatory authority in Canada evaluated or endorsed the crypto assets or crypto contracts provided by the CTP;
   - b. A prominent statement that although VRCAs are often referred to as “stablecoins”, this does not act as a guarantee that the VRCA will maintain a stable value on secondary markets or that the reserve of assets will be adequate to satisfy all redemptions; and
   - c. A prominent statement that in the event of the insolvency of the VRCA issuer, there is a possibility that the issuer’s creditors will outrank a VRCA holder’s right to access the reserve of assets.
6. The CTP must also ensure that the issuer of the VRCA has filed an undertaking that is acceptable to the CSA in substantially the same form as Appendix B attached to Notice 21-333.

(ii) VRCA Issuer Requirements

The VRCA issuer is expected to comply with all of the relevant, applicable sections of Appendix A, but is also required to complete and submit the Appendix B and C templates to the CSA. Pursuant to Notice 21-333 and Appendix B, VRCA Issuers are expected to agree to and comply with prescribed representations and undertakings.

Some of the representations required from VRCA Issuers include:

- That the applicable VRCA references, on a one-for-one basis, the value of a Canadian or United States dollar; and
- The Issuer has written policies, procedures and controls with respect to the prudent management of the reserve of assets; recovery and an orderly wind-up in case of crisis or failure on the part of the issuer or its representative; and identification, management, avoidance and public disclosure of conflicts of interest between relevant parties.

Some of the undertakings required from VRCA Issuers are:

- Obligations to make particular information publicly available, including (but not limited to): details of each type, class or series of the VRCA; annual financial statements that are compliant with Appendix B; and all fees charged by the Issuer for distributing, trading or redeeming the VRCA; and

- That the VRCA Issuer expressly acknowledge that the completion and submission of an undertaking does not mean that distributions of the VRCA, or the VRCA Issuer's activities otherwise, are in compliance with securities legislation.

Under Appendix C, the VRCA Issuer must also designate an Agent that will act as a representative of the VRCA Issuer for the purposes of serving a notice, pleading, subpoena, summons or other process in any related legal matter relating to Canadian securities legislation.

Alternative Regulatory Approaches

The focus on fiat-backed crypto assets (FBCA), and not the entire broader range of VRCAs (such as Algorithmic Stablecoins, as detailed in the aforementioned Cassels Comment), reiterates the CSA's stance from Staff Notice 21-332. Seemingly, this stance is informed by the CSA's presumption that FBCAs offer more stability/certainty than Algorithmic Stablecoins and non-fiat backed VRCAs that utilize non-fiat assets such as gold or other crypto assets.[9]

Moreover, the CSA has expressly specified that the framework described collectively in Notices 21-332 and 21-333 are focused on FBCAs pegged to Canadian or United States dollars. Despite this restriction, the CSA has claimed that they are open to considering "appropriate adjustments" to the terms and conditions and form of undertaking to accommodate different currencies, as long as the VRCA otherwise meets the substance of the terms and conditions outlined in the interim framework.

The CSA has also stated that they welcome submissions regarding the longer-term regulation of VRCAs that will better balance investor protection and industry practice. This coextends with the CSA's stated objective of continuing engagement with industry stakeholders in a collaborative manner to craft thoughtful "rules of the road."

Implementation

With respect to CTPs and VRCA Issuers, Notice 21-333 sets out a schedule for stakeholders to comply with the new VRCA framework. The CSA has outlined timelines for three scenarios:

- (i) ***Registered CTPs***: If a registered CTP does not intend to continue or begin allowing clients to trade in VRCAs, the CSA expects all activity related to VRCAs to be halted by December 29, 2023. Conversely, if a registered CTP wishes to begin allowing the trading in VRCAs, they must contact their Principal Regulator, halt trades of VCRAs that are not FBCAs by December 29, 2023, and no longer permit clients to directly or indirectly buy or deposit FBCAs that do not comply with Appendix A by April 30, 2024.

- (ii) ***PRU CTPs***: If a CTP provided a "Pre-Registration Undertaking", per SN 21-332, they have the same rights, obligations, and timelines as registered CTPs above.
- (iii) ***Issuers of FBCAs***: Per Appendix A and B, an Issuer of an FBCA should provide an undertaking acceptable to the CSA, but not later than December 1, 2023. It is important to note that this deadline does not preclude Issuers from giving an undertaking at a later date, but it does prevent CTPs in (i) and (ii) from trading in an Issuer's VRCA, if that Issuer does not conform with the described framework, after the December 29, 2023 or April 30, 2024 deadline as applicable.

Conclusion

The CSA's guidance in Notice 21-333 aims to progress a regulatory environment that is conducive to growth and practicality in the Canadian digital asset space, while balancing a necessary and integral sensitivity to investor protection. However, as expressly set out in this Notice, the CSA remains in the review process, as they continue engagement with provincial commissions and industry stakeholders to ensure that regulation matches the nature of the underlying asset. The Notice acknowledges that some, but not all, VRCAs may be transacted for investment purposes and therefore ought to fall under the ambit of securities laws, but other VRCAs may have utility for non-investment purposes (e.g., payments), and therefore ought to be outside of the scope of securities laws and under the authority of alternative rule-making agencies. As such, it is likely that stablecoins will be regulated by different federal and provincial agencies, and in potentially novel manners moving forward, to address the unique features of VRCAs on a case-by-case basis.

CTPs and VRCA Issuers that are considering offering or enabling the trading of VRCAs are encouraged to contact our Blockchain & Digital Assets Group for assistance in navigating the evolving Canadian crypto regulatory process and maintaining compliance with emerging criteria.

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[1] CSA, "Staff Notice 21-333: Crypto Asset Trading Platforms: Terms and Conditions for Trading Value-Referenced Crypto Assets with Clients" (5 October 2023).
[2] CSA, "Staff Notice 21-332: Crypto Asset Trading Platforms: Pre-Registration Undertakings – Changes to Enhance Canadian Investor Protection" (22 February 2023).
[3] Ibid.
[4] Ibid.
[5] CSA, supra note 1.
[6] CSA, "Canadian securities regulators clarify interim approach to value-referenced crypto asset" (5 October 2023).
[7] CSA, supra note 5.
[8] Ibid.
[9] CSA, supra note 2.

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