

Digital Currency Bytes the Dust: Canada Shelves the CBDC

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In September 2024, the Bank of Canada announced that it was shelving the idea of a retail central bank digital currency (CBDC) after years of research that began in 2017. This research included a public consultation process in 2022, which totaled nearly 90,000 consultation responses.¹ As recent as summer 2024, the Bank of Canada argued that Canada would need to stay at the forefront of innovation of digital currencies to maintain monetary and regulatory sovereignty.² However, even as Canadians continue to move away from a cash-based economy towards digitalization, the Bank of Canada has decided to shift its efforts to broader payments system research and policy development.

Across the globe, more than 130 countries have begun to explore the idea of a CBDC, but so far, only the Bahamas, Jamaica, and Nigeria have successfully launched one. With Canada putting its CBDC project on hold – but implying that it was prepared to resurface the concept in the future – this article discusses how this will affect banking and digital assets in Canada.

What is a Central Bank Digital Currency?

CBDCs blend blockchain technology with legacy financial institutions to build, in theory, a more reliable and efficient monetary system. While there are proposed models of CBDCs that do not involve the use of blockchain technology, these projects tend to be outliers in the CBDC world. The CBDC system requires central economic banks to mint digital tokens, instead of or in conjunction with, printing fiat currency. These digital tokens would also create a manner of digitally transacting that would be safer, more efficient, and traceable.

The use of blockchain technology with CBDCs involves the use of an immutable ledger, that can be decentralized or centralized depending on the needs of the central bank, to validate transactions. Having the underlying blockchain technology act as an intermediary creates a safer and more efficient transacting environment than having individuals and banking institutions validate transactions, both of whom are susceptible to human error. Further, this technology allows a central bank to record transactions on the blockchain, reducing the risk for fraud and allowing nearly instantaneous transactions.

CBDC vs Cryptocurrency

The phrase “digital tokens” often creates a comparison or a likening to cryptocurrency, but CBDCs are distinct from conventional blockchain tokens. CBDCs are a digital version of a country’s fiat currency,

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meaning that the value of the asset is equivalent to an equal proportion of fiat currency. For example, a fungible physical Canadian dollar (or a Loonie) would be equivalent to a hypothetical fungible Canadian digital dollar (or what we'll call an "eLoonie"). This contrasts with cryptocurrencies which tend to derive their value from multiple factors, such as, their rarity, utility, and investor confidence in the cryptocurrency project.

CBDC & the Digital Economy

Certain forms of digital currency are not foreign to modern economic jurisdictions, where large portions of the consumer population and businesses have transitioned to a cashless economy. This does, however, invite the question of what the difference would be between the introduction of a CBDC and the way the economy currently operates in Canada. The key difference would not be in the manner that consumers make online payments, but rather in the manner that payments on the backend occur.

In a traditional banking system, even with the transition to a more digital economy, intermediaries are required to validate transactions. On a smaller, retail-scale, this would be exemplified by credit card companies validating online transactions between the consumer and the retailer. On a larger, institutional scale, this would be exemplified by banks holding funds from a transaction in escrow, only releasing funds multiple business days after the transaction has closed. In turn, the use of intermediaries in the traditional monetary system requires a series of checks and balances across multiple parties which increases transaction costs and time.

Alternatively, CBDCs can leverage blockchain technology to eliminate the need for multiple intermediaries to validate transactions, which increases the security of transfers, makes transactions nearly instantaneous, and decreases transaction costs. Both of these processes are possible due to the nature of blockchain as a ledger that auto-authenticates transactions.

Fewer Intermediaries vs No Intermediaries

Importantly, not all CBDCs are identical. For example, the level of intervention a central bank has of its digital currency is unique to the framework used to establish the CBDC. For example, if a CBDC is operated on a centralized approach where the central bank hosts the transaction ledger, then the central bank becomes the intermediary that needs to validate transactions. On the other hand, if a CBDC is operated on a decentralized ledger, then the transactions are validated via the users of the digital currency or a third-party intermediary that hosts the blockchain.³ While some forms of CBDCs still involve the use of intermediaries, the validation of transactions is still significantly more efficient through a CBDC than by the traditional forms of digital transactions, regardless of whether the central bank takes a centralized or decentralized approach. This is because the blockchain ledger that underlies either approach can auto-validate transactions based on the protocol it is provided, meaning that the transaction is merely recorded by the bank instead of being manually approved.⁴ Thus, the significance of the centralized/decentralized

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approach largely depends on the level of control and oversight the central bank wishes to exert over the CBDC.

The Difference Between CBDC and Stablecoins

What about Stablecoins?

With the proliferation of blockchain technology since Bitcoin launched in 2009, decentralized financial (DeFi) platforms have leveraged the same process proposed by CBDCs to actualize faster and more secure transactions. A common question posed by opponents of CBDCs is why there needs to be a state-controlled form of digital currency, as the technology that underlies this process was created with the intention to create stateless, decentralized currency. Instead, the opponents posit that stablecoin projects could fill this gap. Stablecoins are cryptocurrency tokens that aim to have a fixed value by having their value pegged to an underlying reference asset. Generally, stablecoins peg themselves to popular fiat currency such as the US dollar, or to popular exchange-traded commodities such as gold. For example, one of the most popular and well-known stablecoins is USDT, which was launched by Tether in 2014.

Although stablecoins can vary widely in their collateralization and the underlying pegged asset, the general difference between stablecoins and CBDCs is that stablecoins tend to have a greater scope of decentralization because they are operated by private companies who prefer to not act as intermediaries. This is appealing to members of digital asset communities, as it aligns closely with the values that they believe digital assets and DeFi platforms should contain – namely, self-governance, privacy, and efficiency.

Stablecoin Regulation

On the other hand, proponents of CBDCs argue that there is an implicit danger in allowing DeFi platforms with privately backed and owned stablecoins to become the default method of digital currency payments. This is because the lack of regulation in this space can cause volatility that can harm investors, users, and the asset that underlies the stablecoin. This argument is currently under review in the United States, with the US Senate aiming to regulate stablecoin as a digital payment method rather than opt for CBDCs. Given the close proximity between regulatory jurisdictions, it is possible that Canada will follow suit.

In April 2024, the US Senate introduced bipartisan legislation to regulate stablecoins.⁵ This bill proposes a comprehensive regulatory scheme that targets the regulation of stablecoin issuers, putting the responsibility for safe trading in the hands of crypto trading platforms (CTPs). The hope is that this top-down approach will prevent fraud in the space and prevent foreign actors from influencing US economics through the use of digital currency that is pegged to the US dollar. The impetus for this regulation likely arose through controversies in the digital asset space, such as when a stablecoin called TerraUSD, which was pegged to the US dollar, depegged in 2022 and erased over \$50 billion of value.⁶ This concern appears to continue to

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be top of mind for US regulators when considering the popularity of USDT and its creator Tether, which has faced sanctions in the past from US regulators for inaccurately stating their stablecoin backing.⁷

The US proposed stablecoin regulatory scheme is also in staunch opposition of the Securities and Exchange Commission's (SEC) current approach to digital asset regulation, which is "[regulation through enforcement](#)" or piecemealing regulation together through the course of various legal proceedings against digital asset platforms. As such, this proposed stablecoin regulation would be a landmark form of digital asset regulation in the US.

Future of CBDCs and Digital Currencies

Given the regulatory push for stablecoins in the US, alongside Canada's recent shelving of a CBDC after nearly seven years of inquiries, it appears that the future of the digital economy in Canada will not involve CBDCs. Instead, Canada may follow the US in issuing regulation for stablecoins and adopt these regulated DeFi tokens as the primary catalyst for actualizing a more efficient, and more safe, online economy.

However, Canada's adoption of stablecoin regulation is not dependent on the US successfully passing their proposed stablecoin legislation. As opposed to the SEC's regulation by enforcement scheme as discussed above, Canadian provincial securities regulators have opted to create comprehensive regulatory guidelines for CTPs, which abstractly resemble the form of regulation that the proposed US stablecoin bill aims to impose on stablecoin issuers.

Moreover, Canadian provincial securities regulators have already turned their mind to stablecoin regulation at home. In October 2023, the Canadian Securities Administration (CSA), a conglomerate of all Canadian provincial securities regulators, released [Staff Notice 21-333](#) (the Notice). In this Notice, the CSA provided CTPs with terms and conditions regarding the trading of "value-referenced crypto-assets" which includes stablecoins. In the Notice, the CSA also highlighted to CTPs that stablecoins could be subject to further securities law and regulatory considerations, leaving the door open for a comprehensive stablecoin regulatory scheme similar to the proposed US scheme.

Next Steps

With the digital economy growing at an unprecedented rate over the past five years, regulatory frameworks have struggled to keep pace with technological advancements. As the US shifts its focus towards stablecoin regulation rather than CBDCs, and with Canada seeming to be following suit, DeFi platforms and CTPs should prepare for potential regulatory oversight and compliance requirements in Canada. Moreover, banking institutions need to stay informed about these regulatory changes and understand how they might affect their intermediary role in financial transactions.

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For more information on how these changes may impact you or your organization, please reach out to the experts in our [Blockchain & Digital Assets](#) Group and/or our [Banking & Specialty Finance](#) Group.

¹ See Bank of Canada, "Digital Canadian Dollar Public Consultation Report" (November 2023), online (pdf): <bankofcanada.ca/wp-content/uploads/2023/11/Forum-Research-Digital-Canadian-Dollar-Consultation-Report.pdf>.

² Bank of Canada, "The Role of Public Money in the Digital Age" (10 July 2024), online (pdf): <bankofcanada.ca/wp-content/uploads/2024/07/sdp2024-11.pdf>.

³ European Data Protection Supervisor, "Central Bank Digital Currency" (last accessed 10 October 2024), online: <edps.europa.eu/press-publications/publications/techsonar/central-bank-digital-currency_en>.

⁴ IBM, "Central Bank Digital Currency (CBDC) and blockchain enable the future of payments" (17 August 2023), online: <ibm.com/think/topics/blockchain-for-cbdc#:~:text=CBDC%20operates%20on%20a%20secure,or%20tamper%20with%20the%20data>.

⁵ Turner Wright, "US senators introduce new stablecoin bill" (17 April 2024), online: <cointelegraph.com/news/stablecoin-bill-united-states-senate-lummiss-gillibrand>.

⁶ Unchained, "What Is the Newly Proposed US Stablecoin Bill?" (8 May 2024), online: <unchainedcrypto.com/us-stablecoin-bill>; For more information on controversies in the digital asset space please see our [Cassels Comment on FTX](#).

⁷ See for example, Chris Prentice, "Crypto firms Tether, Bitfinex to pay \$42.5 mln to settle US CFTC charges" (15 October 2021), online: <reuters.com/technology/tether-bitfinex-agree-pay-425-mln-fines-settle-us-cftc-charges-2021-10-15/#:~:text=Oct%2015%20(Reuters)%20-%20Cryptocurrency,statements%20and%20making%20illegal%20transactions>.

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