Cryptocurrency outlook in Canada – Where we are and where we are going

February 22, 2022

Last year will go down in history for a number of reasons, in part due to the explosion of the digital assets industry. In 2021, regulators across the country continued to provide guidance and respond to the massive growth this sector has seen. Below we discuss the ground rules set by Canadian regulators to help understand the impact on digital asset businesses and the cryptocurrency outlook in Canada.

Summary

- Regulators use the term “Crypto Asset” to refer to any crypto asset, digital or virtual currency or digital or virtual token that itself is not a security or a derivative.
- The contractual right of a user to a Crypto Asset is a “Crypto Contract,” which means that, depending on the delivery and type of Crypto Asset, Canadian securities law may apply to the trading of Crypto Assets (including bitcoin and ether).
- An operator of a crypto asset trading platform (CTP) that facilitates the trading of Crypto Contracts in Canada or to Canadians has to register with securities regulators.
- There is no global, unified approach to the regulation of digital assets, including Crypto Assets. Even within Canada, the provincial securities regulators are not adopting consistent regulations.

The lay of the land in Canada

The Canadian securities regulatory authorities (the CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) jointly issued a Consultation Paper 21-402 *Proposed Framework for Crypto-Asset Trading Platforms* that sets out the basic framework for the regulation of crypto assets in Canada. One of the key issues discussed in the consultation paper is whether a crypto asset constitutes a security and/or a derivative. Generally, the regulators use the defined term “Crypto Asset” to refer to any crypto asset, digital or virtual currency, or digital or virtual token that itself is not a security or a derivative. The regulators have not been willing, to date, to take a position as to whether a particular crypto or digital asset is a security, a derivative, or a

Crypto Asset. Instead, in the context of regulated CTPs, such analysis and determination has been left to the operators of such platforms. Nevertheless, it is clear that bitcoin, ether, bitcoin cash and litecoin are not considered to be securities and/or derivatives. These Crypto Assets are generally treated as commodities under securities and tax legislation; however, this position is not definitive, and could change.

Even though Crypto Assets are not securities and/or derivatives, the regulators take the position that securities legislation applies to the trading of instruments or contracts involving Crypto Assets because the user's contractual right to the Crypto Asset may itself constitute a security and/or a derivative. The regulators refer to this contractual right of the user to a Crypto Asset as a "Crypto Contract." This concept is discussed in Staff Notice 21-327 *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto-Assets* (SN 21-327). The creation of the concept of a Crypto Contract is, in effect, the basis by which securities regulators take jurisdiction over the trading of Crypto Assets that are not securities or derivatives. As far as we are aware, the Crypto Contract concept is currently unique to Canada.

Securities regulators have stated that a Crypto Contract does not exist, and securities legislation does not apply, in respect of the trading of a Crypto Asset if the Crypto Asset is immediately delivered to the end user. SN 21-327 explains that the determination as to whether and when delivery has occurred is fact specific and depends on the economic realities of the relationship as a whole, including evidence relating to the intention of the parties to the contract or instrument, with a focus on substance over form.

Generally, immediate delivery of a Crypto Asset is considered to have occurred if:

- there is the immediate transfer of ownership, possession and control of the Crypto Asset to the end user, such that the end user is free to use, or otherwise deal with, the Crypto Asset without
    - further involvement with, or reliance on, the CTP or its affiliates, or
    - the CTP or any affiliate retaining any security interest or any other legal right to the Crypto Asset; and
- following the immediate delivery of the Crypto Asset, the end user is not exposed to insolvency risk (credit risk), fraud risk, performance risk, or proficiency risk on the part of the CTP.

Delivery of the Crypto Asset directly into a digital wallet that is under the control of the end user constitutes immediate deliver.

In addition to clarifying the trading of Crypto Assets, in 2021 the CSA and IIROC provided further guidance relating to:

- steps CTPs need to take to comply with securities legislation (as set out in Staff Notice 21-329 *Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements* and further discussed in our article Countdown to April 19: crypto asset trading platforms need to comply | BLG);
- disclosure requirements for reporting issuers (as set out in Staff Notice 51-363 *Observations on Disclosure by Crypto Assets Reporting Issuers* and discussed in our article Crypto Asset Issuer Guidance from the CSA – The information investors need | BLG); and

- advertising and marketing (as set out in Staff Notice 21-330 *Guidance for Crypto Trading Platforms: Requirements relating to Advertising, Marketing and Social Media Use* and discussed in our article Registered and unregistered crypto asset trading platforms must comply with advertising and marketing rules | BLG).

The impact on companies operating in Canada

Investment dealers, restricted dealers and marketplace registrations

As of February 11, 2022 and as set out below, Fidelity Clearing Canada is the only IIROC member permitted to trade in Crypto Assets. In addition, five CTPs have obtained registration in the category of restricted dealer under securities laws. These registrations are subject to certain terms and conditions imposed under decisions granted by the CSA to address, among other things, certain investor protection issues associated with the trading of Crypto Assets by Canadian investors. BLG acts for a number of these entities.

Name	Category of registration	Date of exemptive relief (Most recent decision)
Bitbuy Technologies Inc. (Bitbuy)	Restricted Dealer (Dealer and Marketplace)	November 30, 2021
Coinberry Limited (Coinberry)	Restricted Dealer (Dealer)	August 19, 2021
Fidelity Clearing Canada ULC (Fidelity Digital Assets)	Investment Dealer (Dealer)	November 16, 2021
Netcoins Inc. (Netcoins)	Restricted Dealer (Dealer)	September 29, 2021
Simply Digital Technologies Inc. (carrying on business as CoinSmart)	Restricted Dealer (Dealer and Marketplace)	December 21, 2021
Wealthsimple Digital Assets Inc. (Weathsimple)	Restricted Dealer (Dealer)	June 18, 2021

Source: Registered crypto asset trading platforms:OSC

As part of the regulatory framework created by the CSA, a registered CTP is subject to terms and conditions that address:

- the custody of the Crypto Assets;
- insurance/bonding requirements for Crypto Assets held in hot and cold wallets;
- product due diligence on the Crypto Assets made available through the platform;
- specified disclosure to be provided to clients that addresses the risks associated with trading in Crypto Contracts, and provides plain language descriptions (referred to as “crypto asset statements”) of the Crypto Assets made available

through the platform; this disclosure also includes, among other things, the due diligence performed by the CTP with respect to each Crypto Asset and the risks specific to each Crypto Asset;
- for a CTP that has adopted an account appropriateness model, the prescribed know-your-client information required to evaluate whether it is appropriate for a client to use the platform to enter into Crypto Contracts and the establishment of client limits based on the client's risk tolerance;
- investment limits on certain Crypto Assets (although these limits do not apply in Alberta, British Columbia, Manitoba and Québec); and
- a two-year transition period to seek investment dealer registration and obtain IIROC membership.

Digital asset companies and the capital markets

2021 was a big year in the Canadian capital markets, and a number of new companies became publicly listed by way of a direct listing (an initial public offering), or through a business combination or qualifying transaction (often in the form of a reverse takeover). The number of exchange-traded funds (ETFs) and corporate listings that deal in bitcoin and ether has exploded since the first bitcoin ETF was approved in February 2021. As of January 2022, on the Toronto Stock Exchange (TSX) and TSX Venture Exchange (TSXV) there are 56 bitcoin and crypto listings (including corporate listings, ETFs and closed-end funds), the Canadian Securities Exchange (CSE) has 34 blockchain issuers and the NEO Exchange (NEO) has at least 10 digital asset issuers. Through the public markets, retail investors cannot only access Canadian bitcoin mining and blockchain technology companies, but can also obtain exposure to companies involved in decentralized finance (DeFi), the metaverse, NFT platforms, payment infrastructure (including the Lightening Network), and CTPs.

Token issuances

As set out in CSA Staff Notice 46-308 — *Securities Law Implications for Offering of Tokens* (and as further discussed in our article CSA Provides Guidance On Securities Law Implications For Token Offerings | BLG), issuers must tread lightly when contemplating initial coin offerings and token issuances. However, there has been a resurgence of token offerings that comply with Canadian securities laws. Some companies are issuing utility tokens to facilitate exchanges within their game or platform, and other companies are issuing securities that are represented on the blockchain.

Proposed federal bill

February 9, 2022 marked the first reading of Bill C-249 Encouraging the Growth of the Cryptoasset Sector Act in the House of Commons of Canada. This bill, if passed, "requires the Minister of Finance to develop a national framework to encourage the growth of the cryptoasset sector and, in developing the framework, to consult with persons working in the sector who are designated by provinces and territories." The bill also requires the introduction of legislation within three years.

Steps like this indicate the collaborative approach that is needed to adapt within this evolving space. We've helped businesses achieve some of the 'first' milestones in Canada, and we're excited to continue supporting the developing digital assets industry.

BLG's Cryptocurrency & Blockchain Group has been actively involved in the digital asset space since 2017. We have extensive experience in advising private and public investment funds and digital asset companies with public listings on all of the Canadian exchanges. We have firsthand experience assisting with mergers and acquisitions, subscription receipt financings, private placements and public offerings involving digital assets and distributed ledger technology. Reach out to the authors or any of the key contacts below to learn more about the growing digital assets market and how it may affect your business.

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Expertise

Capital Markets, Digital Assets, Financial Services Regulatory

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