Cryptocurrency and Blockchain — Charting Recent News and Developments

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Cryptocurrency and blockchain technology are burgeoning and disruptive areas. Almost daily, a new type of cryptocurrency or cryptocurrency-related product is announced or a new application for blockchain technology is found. Regulators are working hard to respond to these developments with rules, decisions, guidance and advisories.

Below are snapshots of some of the more interesting or significant developments in this space over the past few months.

Updates

CSA 2017/18 enforcement report highlights cryptocurrency

The Canadian Securities Administrators (CSA) continue to conduct ongoing research and analysis to monitor and mitigate fraud-related risks associated with cryptocurrency offerings and initial coin offerings. This includes: (i) establishing a taskforce in collaboration with other CSA committees; (ii) engaging with their international colleagues at the North American Securities Administrators Association; and (iii) working with global digital platforms to ban related advertising.

Cryptocurrency to be reflected in the report of exempt distribution (Form 45-106F1)

Information about an issuer's involvement with cryptocurrencies will be required to be provided in Form 45-106F1, once amendments to the form come into effect on October 5, 2018. Non-investment fund issuers, whose primary business is to invest all or substantially all of their assets in cryptoassets, will have to identify cryptoassets as their primary business. Investment fund issuers, in selecting their "type" of fund, will be required to select "cryptoasset" as their fund type if this accurately identifies the objective and strategies of the fund. The list of security codes in the general instructions to Form 45-106F1 will also be amended to introduce a new security code "DCT" for distributions of securities involving digital coins or tokens.

Ontarians' knowledge of cryptocurrency is low

According to research conducted by Innovative Research Group, on behalf of the Investor Office of the Ontario Securities Commission, while awareness of cryptocurrencies is high, knowledge is relatively low. For instance, while a large majority (81 per cent) of Ontarians have heard of Bitcoin, most are not very familiar with the concept of cryptocurrency. Five per cent of Ontarians currently own cryptocurrency and four per cent have done so in the past. Just over one-third of Ontarians believe that cryptocurrencies are unregulated.

Conversion/wrongful detention of cryptocurrency

An action is currently before the courts in British Columbia considering whether cryptocurrency is properly the subject of a claim in conversion/wrongful detention. This action relates to the mistaken transfer of a cryptocurrency to a purchaser during the initial coin offering of another cryptocurrency. After demands for the return of the mistakenly-transferred cryptocurrency were made and the action commenced, the purchaser stated his wallet had been hacked and the mistakenly-transferred cryptocurrency was gone. At issue is whether the purchaser will be liable for failing to return the mistakenly-transferred cryptocurrency.

Cryptocurrency and blockchain added as topics to CFA exams

According to a report in Bloomberg, the CFA Institute is adding both blockchain and cryptocurrency as topics to the CFA Level I and II exams for the coming year.

Still no cryptocurrency ETF in the U.S. or Canada

No cryptocurrency-based exchange-traded fund (ETF) has been approved by the CSA or by the U.S. Securities and Exchange Commission (SEC). On August 22, 2018, SEC staff rejected nine Bitcoin ETF proposals from three companies. This decision is under review by the commissioners of the SEC. SEC staff have delegated authority to make a decision on such applications, meaning the commissioners and the SEC chairman have the power to review the decision if they desire.

In July 2018, the SEC rejected the Winklevoss Bitcoin Trust, a proposed Bitcoin ETF, citing that it did not agree with the Winklevoss' premise that cryptocurrency markets are uniquely resistant to manipulation. The SEC also rejected the proposal due to concerns regarding fraud and investor protection.

On August 7, 2018, the SEC announced that it was delaying its decision on the VanEck/SolidX Bitcoin ETF until September 30, 2018. This VanEck/SolidX Bitcoin ETF proposal was filed with the SEC in June and is backed by the Chicago Board of Exchange BZX Equities Exchange (CBOE).

SEC examining firms' cryptocurrencies practices

According to reports, brokerage firms have been questioned in recent weeks by SEC examiners about their business practices and how they deal with clients in relation to cryptocurrencies. The SEC is apparently seeking specific information about fees generated from trading and financing initial coin offerings and is also gathering data on investment advisers' involvement.

The SEC's activities reflect the joint statement by the chairman of the SEC and the chairman of the U.S. Commodity Futures Trading Commission (CFTC) earlier in the year that both agencies are looking at cryptocurrency, particularly to bring transparency and integrity to these markets and to deter and prosecute fraud and abuse.

The SEC also recently appointed Valerie Szczepanik as Senior Advisor for Digital Assets and Innovation, a newly-created position. The responsibilities of this role include coordinating efforts across all SEC divisions and offices regarding the application of U.S. securities laws to emerging digital asset technologies and innovations, including initial coin offerings and cryptocurrencies.

Buyer beware according to the CFTC

The CFTC issued "Customer Advisory: Use Caution When Buying Digital Coins or Tokens" on July 16, 2018, alerting customers to exercise caution and conduct extensive research before purchasing cryptocurrencies. The CFTC warns of the factors that could impact a cryptocurrency's current or longer-term value, including, among others, the potential for forks in open-source applications that could split away market participants, increase the number of digital coins, or make coins obsolete. The CFTC also advises investors to thoroughly research cryptocurrencies and exercise caution, given the considerable risks and significant potential for fraud relating to cryptocurrencies.

Basel Committee examining banks' exposure to cryptocurrency markets

The Basel Committee on Banking Supervision is looking at how 45 central banks and global regulators treat exposure to the cryptocurrency market. The so-called "stocktake" will be used by the committee to clarify how members should factor in cryptoassets when assessing bank risk levels.

For further information, please contact any of the authors of this bulletin, or any member of BLG's Investment Management Group.

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