

# Cryptocurrencies and Canada

- July 9, 2018
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“And then there is the emergence of crypto assets. I do not consider these so-called currencies to be money, as they do not fulfill the three essential functions of money—to serve as a means of payment, a unit of account, and a store of value. This view is shared by most of my colleagues.”

— **Stefan Ingves, Governor of the Swedish central bank**

# What are we talking about?

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- Digital representations of value, issued by private developers and typically denominated in their own unit of account.
  - no paper counterpart, exist only electronically;
  - in general, no backing by a government or central bank;
  - decentralised DC not operated by specific institution; and
  - backed only by the users' confidence in the currency and expectation that others will be willing to exchange it for sovereign currency or goods and services.

**Store of value, where value is determined by users'/investors' confidence**

# What's the big deal?

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- 700 digital currencies; a total market value of around **\$106 billion**
- **US\$1.63 trillion** in circulation as of March 21, 2018
- No systemic risk concern
- Unlikely to account for a significant proportion of transactions in a jurisdiction in the near future
- In emerging economies with large rural areas with little or no access to physical banks, DCs allow free, or low-cost, mobile phone-based transactions
- DCs are designed to promote electronic exchange of value in a trustless environment; potentially support trade and improved financial inclusion in regions with a lack of trust for existing monetary arrangements

**Downside appears to be limited; upside potentially revolutionary**



# Why, then, regulate?

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**Christine Lagarde**  
**Managing Director, IMF**  
**March 2018**

How should regulators respond? Their task isn't an easy one. On the one hand, they must protect consumers and investors against fraud and combat tax evasion, money laundering, and the financing of terrorism, ensuring that risks are thoroughly understood and managed. They must also protect the integrity and stability of the financial system.

# Policy considerations

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- Premise: secure, anonymous, off-the-grid, easy to transfer/move about, incomprehensible to average investor, “stable enough”
- Crime: anonymous and secure, easy transferability, cryptocurrency increases potential for money laundering, terrorist financing, or other illegal activities.
- Tax: as secure cashless medium to facilitate the exchange of goods and services, increased numbers of transactions not reported for tax reasons.
- Consumer protection: individuals acquire cryptocurrency as, essentially, a store of residual value. Do purchasers/investors know enough about the product, the market, and the risks?
- Payment systems: “disintermediation”.
- Prudential supervision: run on DCs, “reputational contagion”, inability to supply DC-denominated liquidity.

**Regulatory concerns are no different from those about other instruments**

# Canada's regulatory framework

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- Canada is a federal state
- Responsibility for financial instruments is divided - and confusing
- Parliament (federal) has exclusive authority to regulate **currency and banks** (as institutions, not banking functions)
- Provinces have authority over **securities, non-bank financial institutions** (such as trusts, credit unions, insurance), and **contract law**
  - Yes, Virginia, Canada does not have a national securities regulator
- **Consumer protection** is divided
- **Prudential oversight** is ... well, it's complicated

**No single regulatory authority for cryptocurrencies in Canada; depends on characterization.**



# Senate review 2015

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- Digital currencies have three main roles in Canada:
  - a form of money;
  - a commodity; and
  - a payments system.
- A range of opportunities resulting from the use of digital currencies and their technologies, **but** potential criminality and its effects, losses, taxation, and access to information and protection for users.
- **Decentralized convertible digital currencies**, which are known as **cryptocurrencies** and of which Bitcoin is the most popular example, should be the focus for any potential regulations.

**How cryptocurrencies are characterized might well have an impact on who and how may regulate them.**



# Canada's regulatory framework

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- View of the Department of Finance
- A digital currency is defined by four key characteristics:
  - Its value can be held and exchanged without the use of banknotes or coins.
  - It is not the official currency of a country.
  - It has the intended purpose of being exchanged for real or virtual goods and services.
  - Its units can be transferred between individuals, between businesses, and between individuals and businesses.

**“Currency”, digital or otherwise, falls within exclusive federal competence.**

# Senate review 2015

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- Opportunities but also risks
- Proposes federal action in four areas
- The effect of regulation on innovation in the digital currency sector;
- the use of digital currencies to launder money and finance terrorist activities;
- protecting the users of digital currencies; and
- taxation challenges in relation to digital currencies.

**Recommended “light touch” regulation to avoid stifling innovation and development.**

# Senate review 2015

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- Concrete recommendations
- Digital currency exchanges, the “on and off ramps” of the digital currency system: any business that allows customers to convert state-issued currency to digital currency and digital currencies to state-issued currency or other digital currencies. They should be treated as any other money services business for money laundering reporting purposes.
- Consumer information and protection: the federal government to provide concise information to the public about the risks of digital currencies and alternative payment systems.
  - “While securities regulation is not within the federal jurisdiction, the Committee is confident that Canada’s securities regulators have expertise in assessing risk, and encourages them to continue to release relevant and timely information about digital currency-related risks.”

**Review within three years ... which brings up to today.**



# Canada's regulatory framework

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- View of the Department of Finance
- How does this fit within the federal regulatory framework:
  - currency legislation;
  - anti-money laundering;
  - consumer protection;
  - taxation; and
  - payment system oversight.

**Both exclusive and mixed competence.**



# Canada's regulatory framework

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- Defines the monetary unit of Canada as the dollar.
- Includes provisions governing legal tender and currency.
- Defines what constitutes a current coin (the Royal Canadian Mint) or “note” (the Bank of Canada): one for coins and one for notes.
- Nothing applies to or restricts the use of virtual currencies in transactions in Canada.
  - Nothing limits acceptance of other “currency” as means of payment.

**“Currency”, digital or otherwise, falls within exclusive federal competence.**

# “Bringing it in from the wild”

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- 2014 amendments to *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*
- Virtual currency exchanges not considered “money services businesses” under existing regime.
- Amendments include in the reporting requirements of the Act “persons and entities ... dealing in virtual currencies” whether they:
  - have a place of business in Canada; or
  - do not have a place of business in Canada, but who provide those services “directed at persons or entities in Canada” and “to their clients in Canada”.
- Gives Finance Minister authority to make regulations in respect of “dealing in virtual currencies”.

**The coverage amendments are not yet in force.**

# Canada's regulatory framework

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- Bank of Canada
- Money serves three functions.
  - generally accepted medium of exchange - general acceptance critical to role of money;
  - serves as unit of account: to compare the value of different goods; and
  - can be used as a store of value.
- VC has prospect of being cheaper than the way many of us pay for goods today through Visa and Mastercard and bank transfer fees.

**In current structure, it is best viewed as a payment system.**



# Canada's regulatory framework

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- Financial Consumer Agency of Canada
- You can use digital currencies to buy goods and services on the Internet and in stores that accept digital currencies.
- You may also buy and sell digital currency on open exchanges, called digital currency or cryptocurrency exchanges.
- Fewer protections, no insurance, high risk, lack of liquidity, potential for fraud.

**No major warnings.**



# Canada's regulatory framework

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- Role of the provinces
- Securities regulators are starting to look at these issues.
- Digital currencies are not securities under the law; no security regulator in Canada has categorized digital currencies as securities.
- Packaging digital currencies into investment schemes or products would lead to the regulation of that investment to the extent that it is deemed to be a security or a derivative:
  - a promoter solicits investments in digital currency in exchange for a promise, a benefit or a return; or
  - digital currency as an underlying principal.

**Not yet a perfect fit in Canada's securities regulatory framework.**

# Canada's regulatory framework

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- Role of the provinces
- Securities regulators are starting to look at these issues.
- August 2017: the Canadian Securities Administrators issued its policy on token offerings: case-by-case basis whether a particular coin offering constitutes a security and should be subject to investor protection laws.
- October 2017: Ontario Securities Commission, for the first time ever, gives the green light to an “initial token offering”: “It is a myth that regulation is in the way,” TokenFunder co-founder Laura Pratt said in a statement. “It's the right way.”

**Specific transactions and investment approaches could well be regulated as securities.**

# Canada's regulatory framework

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- Role of the provinces
- Where cryptocurrencies interact with the real economy
- Quebec
  - Digital currency not a currency; ATMs require registration.
  - Money services businesses that do virtual currency transfers and could be described as money services businesses are subject to registration requirements.
- Ontario
  - Not within the purview of the OSC
  - “Operation Cryptosweep”

**Something of a regulatory patchwork for now.**



# Canada's regulatory framework

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- Role of the provinces
- Where cryptocurrencies interact with the real economy
  - “Regulatory sandbox” for “genuine technological innovation in the securities industry”
  - No crypto-asset trading platforms recognized as an exchange or authorized to operate as a marketplace or dealer in Canada.
  - Investors should not expect to receive the same protections that are built into the securities regulatory framework applicable to exchanges or dealers, and should therefore be cautious.

**Council of the securities regulators of provinces and territories, co-ordinates and harmonizes regulation for capital markets.**



# Why, then, regulate?

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**Cole Diamond**  
**CEO, Coinsquare**  
**June 2018**

- “We want to be regulated because ultimately we want to be able to provide certainty to our customers that we’re not some fly-by-night trading platform, that they can trust us.”