

2023 OSLER LEGAL OUTLOOK

Digital assets and blockchain: the year of maturation



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In years past, a series of industry failures and a lack of regulatory certainty threatened to chill the digital asset space. In 2023, the story changed. The digital asset market has stabilized as developers continue building new products and refining old ones. Meanwhile, Canadian regulators were busy publishing their views on existing regulations and their applicability to digital assets. The activity levels in 2023 are indicative of an industry and regulatory environment that is maturing.

However, despite 2023's flurry of staff notices and guidance, the industry still has several unanswered questions. Hopefully further clarity will emerge in 2024 on a number of fronts. These include the implications of proposed interim terms and conditions for stablecoin issuers, registration or other regulatory requirements for digital asset custodians and regulation of decentralized finance (DeFi). Market participants should look for further refinements to the framework for registration of cryptoasset trading platforms (CTPs). We also expect new guidance from federal regulators with respect to cryptoasset exposures for federally regulated financial institutions. In addition, digital asset businesses involved in payments will want to be alert to the impact of the implementation of the *Retail Payments Activities Act* on their businesses.

Crypto trading platforms put on notice and stablecoin issuers cautioned

On February 22, 2023, the Canadian Securities Administrators (CSA) [released](#) Staff Notice 21-332: *Crypto Asset Trading Platforms: Pre-Registration Undertakings Changes to Enhance Canadian Investor Protection* (SN 21-332). Staff's stated impetus for SN 21-332 was the calamity in the crypto market spurred by the collapse of Terra Luna and FTX, and the rampant contagion that followed. The fallout saw hedge funds, such as 3 Arrows Capital, and yield protocols, such as Celsius, follow suit. Staff put CTPs — those holding custody of cryptoassets (Crypto Contracts) — on notice to start the registration process and commit to a pre-registration undertaking (PRU) in the interim, or else face enforcement action. In 2023, 11 different CTPs committed to [PRUs](#).

We expect the CSA and the Canadian Investment Regulatory Organization (CIRO) to continue to refine their framework and for new CTPs to continue to register with the CSA, while others graduate to CIRO registration.

Following the release of SN 21-332, securities commissions brought enforcement actions against unregistered CTPs, some of whom were no longer operating in Canada at the time of enforcement, including most recently against [Phemex Ltd.](#) and [Phemex Technology](#). Canadian securities commissions note the assistance of foreign regulators during their enforcement actions, including the British Virgin Islands Financial Services Commission, a jurisdiction popular with cryptoasset operators. Not only are Canadian securities commissions making good on their enforcement promise, but they are also not relinquishing their hold on off-shore CTPs, even those with transient operations in Canada.

At the same time, the CSA in SN 21-332 offered further guidance regarding the regulatory treatment of what the CSA terms “Value Reference Crypto Assets” (VRCAs). The industry generally refers to VRCAs as “stablecoins” and there are various iterations of stablecoin arrangements in the market. The CSA considers that the use of the term “stablecoin” may be misleading in that stablecoins can experience price volatility. In SN 21-332, the CSA underscores that some stablecoins have failed to keep their value pegs to their respective currencies, causing loss to purchasers. However, not all stablecoins are inherently unstable. For instance, fiat-backed stablecoins such as USD Coin (USDC), Gemini Dollar (GUSD) and Pax Dollar (PAXD) have historically exhibited prices in secondary markets that align very closely with their reference values.

The terms and conditions outlined in SN 21-332 that would apply to CTPs wishing to trade stablecoins are premised on the assumption that the CSA members have jurisdiction over all fiat-backed stablecoins. CSA staff have expressed their view that most stablecoins are securities and/or derivatives without offering any legal reasons as to why they believe this to be the case. The CSA expects CTPs to only list stablecoins that are fully backed by fiat cash or cash equivalents at a 1:1 ratio. The CSA considers algorithmic stablecoins to be high risk and designated them as off-limits for CTPs.

The CSA releases further interim guidance on stablecoins

The much-anticipated Staff Notice 21-333: *Crypto Asset Trading Platforms: Terms and Conditions for Trading Value-Referenced Crypto Assets with Clients* (SN 21-333) was finally [released](#) on October 5, 2023. This staff notice represents further interim guidance. As was the case with SN 21-332, CSA staff do not elaborate on the basis for their conclusion that stablecoins may constitute securities and/or derivatives, and therefore fall within their regulatory purview.

In SN 21-333, the CSA set out additional expectations for both stablecoin issuers and CTPs who wish to trade stablecoins. Stablecoin issuers who commenced distributions through CTPs on or before February 22, 2023 are expected to provide an undertaking to the CSA by December 1, 2023 and stablecoin issuers who wish to have their stablecoins traded on Canadian CTPs after April 30, 2024 are expected to provide an undertaking to the CSA at a later date before their stablecoin can be offered by CTPs. The undertaking notably includes the commitment to publish annual audited financial statements, as well as a requirement to file monthly attestation reports on reserve assets, among other things. Unsurprisingly, the CSA effectively prohibits the offering of stablecoins backed by anything other than cash or cash equivalents denominated in CAD or USD on a one-for-one basis.

CTPs that deal in stablecoins are now waiting to see if prominent stablecoin issuers will file an undertaking in response to SN 21-333. Given the fluidity of this situation, it is possible that some stablecoin issuers will have provided undertakings by the time this article is published.

The CSA notes that it is open to receiving feedback on SN 21-333. Given some of the onerous and potentially unpalatable requirements for stablecoin issuers, such as the requirement to make public annual audited financial statements, we expect and are hopeful that many

industry players will express any concerns they have with the interim approach to stablecoin regulation espoused by the CSA staff. The CSA offers no indication as to when they intend to release a final framework. By contrast, other jurisdictions such as the European Union and Singapore have established a clear path or timeline to a clear path for stablecoins.

Notable development in the *Ripple Labs* case

The United States District Court ruled in July 2023 that Ripple Labs, Inc.'s (Ripple) XRP token was not a security when it was sold on a digital exchange or trading algorithm to the general public (the XRP Decision). Although the Ontario Capital Markets Tribunal released decisions in *Polo Digital Assets* and *Mek Global* in 2022, and the Québec Financial Markets Administrative Tribunal released its decision in XT.Com Exchange in September 2023 finding certain cryptoassets to be Crypto Contracts, Canadian courts have yet to opine on exactly when and under what circumstances a digital asset constitutes a security or derivative. No doubt many in Canada were hopeful that the reasoning in the XRP Decision may apply in Canada.

However, the XRP Decision has only persuasive value in Canada, if any, and will likely be appealed by the U.S. Securities and Exchange Commission (SEC). Further, less than a month after the XRP Decision was released, a fellow judge of the District Court refused to adopt the XRP Decision when considering a motion to dismiss the SEC enforcement action against Terraform Labs and its founder, Do Kwon. However, in October 2023, the SEC dropped its lawsuit against Ripple's executives over retail XRP sales, removing a major threat for the defendants. This is seen as a significant win for Ripple and the wider crypto industry against the SEC's attempt to characterize cryptocurrencies as securities.

When the dust settles, the United States may have some judicial clarity on when a digital asset constitutes a security, which in turn will define the scope of regulatory jurisdiction for securities regulators. In light of the parallels that exist between the securities regulatory frameworks of Canada and the United States, it is anticipated that successful legal outcomes in the U.S. could drive similar outcomes in the course of Canadian litigation.

International organizations weigh in

The International Organization of Securities Commissions (IOSCO) contributed two reports to the ongoing regulatory discussion surrounding global cryptocurrency regulation. First, in May 2023, IOSCO published a consultation report offering several recommendations regarding conflicts of interest, market manipulation, cross-border regulatory cooperation, custody of cryptoassets, operational risks and treatment of retail customers. Then, in September 2023, IOSCO published [PDF] its *Crypto-Asset Roadmap, Policy Recommendations for Decentralized Finance (DeFi)*. IOSCO offered recommendations to Canadian securities regulators on how to develop and apply their regulatory frameworks to DeFi and its varied group of market participants.

Notably, the Ontario Securities Commission and Autorité des marchés financiers both sit on the IOSCO working group responsible for IOSCO's DeFi report. IOSCO's "same activity, same risk, same regulatory outcome" approach to DeFi, which favours consistency in securities regulation within jurisdictions, potentially gives us some insight into how Canadian securities regulators may choose to regulate the DeFi market, next year and beyond. Regulation of DeFi is a subject that the CSA has yet to comment on.

The International Swaps and Derivatives Association, Inc. (ISDA) also made its own contribution in the form of its February 2023 publication that offers an approach to defining digital asset-based derivatives.

Provincial regulators move to regulate crypto custodians

On August 10, 2023, the Financial Services Regulatory Authority of Ontario (FSRA) initiated a consultation on proposed guidance regarding “Regulatory responsibilities for trust corporations, including crypto custodians operating in Ontario.” The guidance highlights to Ontario consumers that crypto custodians are subject to FSRA’s regulatory oversight and proposes a framework for compliance.

FSRA is taking the position that a crypto custodian offering digital asset trustee services or that safeguards private keys pursuant to a contract is a trustee or bailee under Ontario law and must register with FSRA as a trust corporation under the *Loan and Trust Corporations Act* (Ontario), provided such services are offered to the public of Ontario. Categorizing crypto custodians as trustees or bailees brings them within the scope of Ontario’s regulatory scheme for trust corporations.

Crypto custodians are closely monitoring FSRA’s consultation, and other provincial regulators’ initiatives, for developments in regulatory approach to digital asset custodianship.

Federal regulatory initiatives also on the horizon

Finally, we look forward to seeing how new federal guidance shapes the industry. We expect the Office of the Superintendent of Financial Institution’s guidelines on capital and liquidity treatment of cryptoasset exposures to influence regulated financial institutions’ decision to engage or not with digital assets.

Similarly, we hope to see how regulators interpret the forthcoming *Retail Payment Activities Act* as it applies to digital asset business, particularly those involved in payments. For more information on these topics see our [*Managing risks and meeting the future: financial services regulatory themes and trends*](#) article.