

Cryptocurrency in Canada

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This Note discusses cryptocurrency and blockchain technology in Canada. It focuses on the application of Canadian securities laws to initial coin offerings (ICOs). Other Canadian regulatory aspects of cryptocurrency and important regulatory developments related to cryptocurrency outside of Canada are also discussed.

What Is Cryptocurrency?

Cryptocurrency is a type of digital asset that uses blockchain technology (see [Blockchains](#)) to record transactions and manage the issuance and transfer of the cryptocurrency in a decentralized manner that prevents fraudulent transactions.

[Bitcoin](#), which was introduced in 2009, has become the most widely used and accepted cryptocurrency (see [Bitcoin](#)). Other widely used cryptocurrencies include [Ethereum](#), [Ripple](#), [Bitcoin Cash](#) and [Litecoin](#), but there are currently well over 1,000 different cryptocurrencies that have been created for various purposes. Cryptocurrencies are widely traded through online exchanges (see [Cryptocurrency Exchanges](#)).

Blockchains

Blockchains are a distributed ledger technology, which means that copies of the ledger are maintained by many people or organizations simultaneously and no copy is the master or lead copy (therefore, distributed and decentralized). It is an immutable way to send and receive data in various forms. This means that a permanent record that can't be changed or removed is created. Blockchains may be publicly or privately distributed and publicly or privately owned.

Blockchain transactions are governed by consensus and verification mechanisms involving the participants in the blockchain, removing the need for any central authority or third-party intermediary, such as a financial institution or clearinghouse. Every record in the blockchain (called a “block”) has a timestamp and a unique cryptographic code and is digitally linked to the immediately preceding block by a unique “hash” code, making the ledger an auditable, immutable record of the history of all transactions that have occurred since the very beginning of the ledger. This allows users to verify whether blockchain data is correct or may have been tampered with.

A blockchain has many applications and is best known as the technology behind bitcoin. However, its uses in the capital markets and financial services worlds are rapidly developing and applications are expected to continue to expand into many other areas.

For more information on blockchain and regulatory investigations into blockchain technology, see [Practice Note, Blockchain Technology and Regulatory Investigations](#).

Smart Contracts

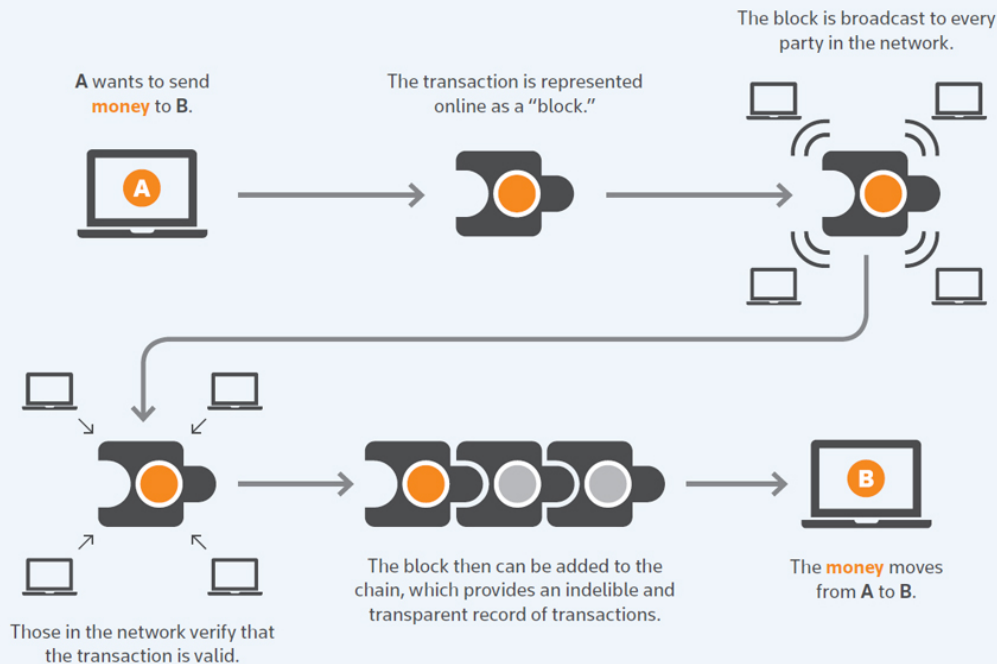
Smart contracts are applications on a blockchain where terms and conditions are programmed and executed autonomously. Smart contracts enable the automation of transactions, which can significantly cut costs, increase efficiency and prevent fraud. Smart contracts often need to receive information about the triggering events from external trusted bodies called oracles. For more information about smart contracts, see [Practice Note, Understanding Smart Contract Mechanics](#).

Cryptocurrency Mining

In the case of cryptocurrencies, the users that verify the "block" transaction (i.e., a proposed transfer of the cryptocurrency from one user to another) are referred to as "miners", because they "mine" the cryptocurrency by attempting to solve complex math problems associated with the block. These problems have answers that are difficult to find but easy to verify. Once a transaction is proposed, the first miner who successfully finds the solution and has it verified by the network is given a certain number of newly created units of the cryptocurrency in question as a reward (in addition to any fees payable by the parties to the transaction). The size of the mining award is determined by an algorithm that is designed to regulate the amount of cryptocurrency issued to miners over time relative to the remaining supply of that cryptocurrency. Any participant in a cryptocurrency blockchain can mine that cryptocurrency, but, at least in the case of blockchains that use "proof-of-work" consensus mechanisms, the amount of computing power and energy required to successfully mine a cryptocurrency increases over time as the blockchain algorithms automatically make the math problems harder and harder to solve in order to regulate the distribution of mining rewards and the amount of time it takes to validate transactions.



A Visual Representation of Blockchain



Source: Financial Times

Coins and Tokens

"Coin" is short for "altcoin", which refers to alternative cryptocurrency coin other than bitcoin. Examples are [ether](#), [dash](#), [ripple](#) and [monero](#). They have similarities to bitcoin but are on their own platforms and use different processes that are a type of blockchain but not the same as the one used by bitcoin.

"Tokens" represent digital assets that are not on their own blockchain platform. They are usually created using templates on another existing blockchain platform, such as Ethereum or [Waves](#).

Coins or tokens typically give the holder a right to participate in a given project or technology. For example, a company might issue tokens that can be used to access a decentralized file storage network over the internet once the network has been developed. The value of these tokens will often increase or decrease based on the success of the underlying project or technology and are frequently traded over online exchanges (see [Cryptocurrency Exchanges](#)).

Utility Tokens v. Security Tokens

To date, tokens are most often intended to represent the right to a certain value of the future goods or services the issuer plans to develop (such tokens are usually known as "utility tokens"). Unlike utility tokens, "security tokens" or "investment tokens" provide investors with economic and voting rights akin to shares.

Initial Coin Offerings and Initial Token Offerings

Cryptocurrency offerings distributed via blockchain technology, such as initial coin offerings (ICOs) and initial token offerings (ITOs) (collectively, ICOs), have quickly become a significant source of funding for early-stage technology companies.

An ICO is a new way for early-stage companies to attract investment in which the issuer designs and sells digital currency. Unlike a traditional [initial public offering](#), the tokens sold in an ICO usually do not represent an ownership stake in the organization. Instead, they are digital assets used in connection with applications and communities (Token Networks).

Growth in ICOs

According to [2017 Token Sales in Review: Part I](#) by research firm [Smith + Crown](#), ICO financings are growing exponentially. In 2017 there were over 525 completed sales raising more than USD25,000, for a cumulative amount of over USD6.5 billion, and an average raise amount of approximately USD13 million, compared to a collective raise of USD100 million in 2016.

The rise of ICOs was fuelled, at least in part, by lack of regulatory oversight. Many businesses selling cryptocurrencies assume that the coins or tokens they are distributing are not [securities](#) and, therefore, not subject to traditional securities law requirements, such as the obligation to provide purchasers with a detailed disclosure document like a [prospectus](#) with statutory liability for [misrepresentations](#) or, alternatively, to sell only in reliance on an exemption from those disclosure requirements.

Technology startups are attracted to ICO fundraising because the process can be completed quickly over the internet, with minimal documentation and without providing any meaningful rights or ongoing disclosure to purchasers. For example, the former CEO of Mozilla reportedly raised USD35 million via an ICO to fund development of a new web browser in less than 30 seconds.

Securities regulators quickly became concerned about the growth in ICOs (see [CSA Staff Notice 46-307 Cryptocurrency Offerings](#)). Without legally mandated disclosure or investor protections, cryptotechnology financings carry significant risks that may not be understood by those who are purchasing the coins or tokens, while the openness of blockchain technology and the often anonymous (or at least pseudonymous) nature of the participants make these financings ripe for abuse.

Notable ICOs

[Filecoin](#), a decentralized storage network that will use the peer-to-peer InterPlanetary File System to secure and store data, secured USD186 million in the first hour of its offering and raised over USD257 million in total funding over a month of activity that ended in September 2017. The Filecoin ICO is also notable as being one of the first

cryptocurrency offerings that has been structured to comply with US securities laws and was available only to accredited investors. It was also offered over a know your client (KYC)-enabled platform ([CoinList.co](#)) that will allow accredited investors to access a variety of ICOs, another important step in the evolution of cryptocurrency financings.

[Telegram](#) had planned to launch the largest ICO in early 2018. In its pre-ICO sale of Telegram tokens (TON), only accredited investors could purchase, friends had to invest at least USD500,000, while others had to make a minimum investment of USD20 million. The tokens purchased would also be subject to a two-year hold period. According to [Telegram Messaging App Scraps Plans for Public Coin Offering](#), The Wall Street Journal, May 2, 2018, more than USD1.7 billion was raised in the pre-ICO to fewer than 200 private investors, so no ICO was required.

In Canada, [Kik Interactive](#), a Waterloo, Ontario-based company that developed a popular messaging app, created its own cryptocurrency called [Kin](#) that will be used as the application's primary transaction currency. Kik had planned to raise a total of USD125 million by way of an ICO. USD50 million was received from investors who participated in a "presale" round and a total of approximately USD97.5 million was raised by September 2017. Although Kik required purchasers to provide basic personal information to participate in the ICO, the offering was not structured to comply with US or Canadian securities laws. According to [Kik bans Canadians from investing in new crypto-token cites 'weak guidance' from regulators](#), Financial Post, September 8, 2017, Kik decided to exclude Canadians from the Kin ICO due to "weak guidance" from the [Ontario Securities Commission](#) (OSC) as to whether Canadian securities law would apply to the offering (see [CSA Staff Notice 46-307 Cryptocurrency Offerings](#)). While few details regarding Kik's interactions with the OSC are publicly known, Bloomberg reported an OSC representative had confirmed to it that the OSC viewed the Kik ICO as an offering of securities and had been discussing options with Kik for allowing the ICO to proceed in Canada with appropriate investor protections.

This outcome was no doubt disappointing to Kik, which had taken great pains to characterize Kin as a common currency and its offering not as an ICO but as a token distribution event (TDE). It is clear there are no "magic words" that can be used (or avoided) to describe a cryptocurrency that will determine whether it will be characterized as a security (see [Application of Canadian Securities Laws to Cryptocurrency](#)).

Application of Canadian Securities Laws to Cryptocurrency

CSA Staff Notice 46-307 Cryptocurrency Offerings

On August 24, 2017, the [Canadian Securities Administrators](#) (CSA) published [CSA Staff Notice 46-307 Cryptocurrency Offerings](#) (the Staff Notice), which outlines how the requirements of [Applicable Securities Laws](#) in Canada may apply to ICOs, cryptocurrency [investment funds](#) and the cryptocurrency exchanges trading these products. The Staff Notice was the CSA's first official pronouncement on the application of Canadian securities laws to ICOs and other cryptocurrencies and followed a press release, [OSC Highlights Potential Securities Law Requirements for Businesses Using Distributed Ledger Technologies](#), OSC, March 8, 2017, in which the OSC cautioned that products or other assets that are tracked and traded as part of a distributed ledger may qualify as securities, even if they do not represent shares of a company or similar ownership interests.

Cryptocurrencies as Securities

The Staff Notice notes that ICOs can be very similar to traditional initial public offerings and summarizes the well-established four-prong test based on the Supreme Court of Canada's decision in *Pacific Coast Coin Exchange of Canada v. Ontario (Securities Commission), 1977 CarswellOnt 50 (S.C.C.)* (Pacific Coin Test) that will determine whether a coin or a token qualifies as a security, or investment contract, under Canadian law. Under the Pacific Coin Test, a coin or token is a security if it involves:

- An investment of money
- In a common enterprise
- With the expectation of profit that
- Is to come significantly from the efforts of others.

In considering whether securities laws apply, the CSA will look at the substance of the transaction with the objective of investor protection in mind. Using a new technology and new terminology (i.e., selling a coin or token instead of shares or equity) to raise money does not determine whether securities laws apply.

Tokens do not fit neatly into the judicial framework for determining whether something is a security, and other factors, including policy considerations, may be taken into account. The Staff Notice suggested it is possible some kinds of Utility Tokens would not be considered securities when it said that "...if an individual purchases coins/tokens that allow him/her to play video games on a platform, it is possible that securities may not be involved." In contrast, "...if an individual purchases coins/tokens whose value is tied to the future profits or success of a business, these will likely be considered securities."

The CSA's conclusion that ICOs are potentially subject to regulation in Canada as securities offerings is consistent with a global trend toward increased regulatory scrutiny of this new form of fundraising (see [Notable Cryptocurrency Developments Outside of Canada](#)).

If a cryptocurrency is a security, its [distribution](#) in Canada will be subject to the full panoply of requirements that apply under securities law. These include an obligation to sell securities under a prospectus or pursuant to an exemption from the prospectus requirement, such as [private placements](#) selling only to accredited investors in compliance with the [Accredited Investor Exemption](#) or providing investors with an [offering memorandum](#) containing prescribed information to which liability attaches for misrepresentations. For more information on all the securities laws requirements, see [Practice Note, Securities Laws in Canada: Overview](#).

The CSA notes that many businesses publish white papers in connection with ICOs that provide some disclosure regarding the offering and the proposed business but that these documents do not comply with Canadian securities law requirements. Furthermore, coins or tokens that qualify as securities and are distributed in Canada will be subject to [resale restrictions](#) under Canadian securities laws. For more information on private placement prospectus exemptions and resale restrictions, see [Private Placements in Canada Toolkit](#).

Dealer Registration Requirements

If an ICO involves the distribution of securities, businesses involved in the distribution may need to be registered as a [dealer](#) in Canada or qualify for an exemption from the dealer [registration](#) requirement. This will depend on whether the business is trading in the coins or tokens for a "business purpose". The Staff Notice highlights the fact that issuers conducting ICOs may engage in various activities that could trigger a registration requirement, such as soliciting a broad base of investors, including retail investors, through the internet or at public events like conferences. Registering as a dealer involves compliance with a wide range of obligations, including know your client

rules and investor suitability screening. For more information on these requirements, see [Practice Note, Registration Requirements: Overview](#).

On October 17, 2017, the OSC granted an exemption from the dealer registration requirements to [Token Funder Inc.](#) operating a blockchain business in Toronto, Ontario. TokenFunder was established for the purposes of creating a platform, known as the smart token asset management platform (STAMP), which is intended to, among other things, facilitate third-party issuers raising capital through the offering of blockchain-based securities, including tokens and coins. The company required the exemption to complete a private placement of TokenFunder Tokens (FNDR Tokens) by way of an ITO to fund the completion of the STAMP and to facilitate subsequent transfers of FNDR Tokens pursuant to available prospectus exemptions. The exemption order requires the company to use the proceeds of the ITO to become a registrant prior to using the STAMP to raise capital. See [Token Funder Inc., Re, 40 O.S.C.B. 8665 \(Ont. Securities Comm.\)](#).

Cryptocurrency Exchanges

There are a number of online exchanges that facilitate secondary trading in cryptocurrencies, where investors can buy and sell a variety of cryptocurrencies (including those that were originally issued in an ICO) in exchange for other cryptocurrencies (for example, bitcoin or ether) or for fiat currency (for example, USD or CAD). The Staff Notice points out that these exchanges are generally unregulated and may not be efficient markets. If a cryptocurrency exchange facilitates trading in securities and operates in Canada, it would have to be recognized as a [marketplace](#) under Canadian securities law or be exempt from recognition (to date, no cryptocurrency exchange has been recognized or exempt from recognition in Canada).

Cryptocurrency Investment Funds

The Staff Notice also highlights a range of potential regulatory issues associated with investment funds that have been established to invest in cryptocurrencies, including whether such funds can be sold to retail investors in Canada without a prospectus, valuation, registration and custody requirements, as well as the use of cryptocurrency exchanges by such funds. The CSA expects cryptocurrency investment funds to be prepared to discuss these issues, amongst others, with staff.

The [British Columbia Securities Commission](#) (BCSC) announced in [B.C. Securities Commission grants landmark bitcoin investment fund manager registration](#), BCSC, September 6, 2017 that [First Block Capital Inc.](#) has been approved as an [investment fund manager](#) and [exempt market dealer](#) in order to operate a bitcoin investment fund. This represents the first registration in Canada of an investment fund manager dedicated solely to cryptocurrency investments.

On February 1, 2018, the OSC approved the initial public offering of [Blockchain Technologies ETF](#), the first Canadian blockchain fund. For more information, see [OSC approves Canada's first blockchain ETF](#), The Globe and Mail.

CSA Regulatory Sandbox

The Staff Notice points out that the CSA Regulatory Sandbox (Sandbox) can help financial technology (fintech) businesses contemplating ICOs and summarizes key issues that businesses should be prepared to discuss with CSA staff. The launching of the Sandbox was announced in [The Canadian Securities Administrators Launches a Regulatory Sandbox Initiative](#), CSA, February 23, 2017.

The Sandbox can be used to register or obtain exemptive relief from securities law requirements under a faster and more flexible process than under traditional applications. On August 16, 2017, an exemption order was issued to [impak Finance Inc.](#), a fintech start-up company that intended to issue Impak Coins, a new digital currency based on the Waves blockchain platform, to fund the development of [impak.eco](#), an online social network entirely dedicated to the impact economy. In the context of the Sandbox, the company obtained prospectus and registration exemptions intended to be relied upon in British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia and Ontario. The exemptions were subject to a number of conditions, including:

- Delivery of an offering memorandum and certain ongoing information to investors.
- Implementation of various know-your-client, suitability, anti-money-laundering and anti-terrorist financing procedures.
- A maximum investment limit of \$2,500 for non-[accredited investors](#).
- Limits on secondary trading of the cryptocurrency.

See [Impak Finance Inc., Re, 40 O.S.C.B. 7244 \(Ont. Securities Comm.\)](#).

BC Notice 2018/01 Consulting on the Securities Law Framework for Fintech Regulation

The BCSC issued [BC Notice 2018/01 Notice and Request for Comment Consulting on the Securities Law Framework for Fintech Regulation](#) on February 14, 2018. The notice sets out the results of consultations and seeks comment on potential regulatory action to clarify or modernize securities laws to benefit all stakeholders. The following subjects were identified:

- Crowdfunding and online lending business models.
- Online adviser business model.
- Cryptocurrency funds.
- Initial coin offerings and cryptocurrencies.
- The future of fintech regulation.

In relation to cryptocurrency, the areas of concern included:

- Risks associated with using specific cryptocurrency exchanges, cryptocurrency wallets and custodians.
- Difficulties in determining a fair price for a cryptocurrency transaction.
- Lack of regulation of cryptocurrencies overall.
- Lack of transparency in cryptocurrency trading.
- Determining whether coins or tokens are securities (includes a list of factors that will be considered).
- Types of exemptions that should be given.
- Whether investment funds holding cryptocurrency must have fund managers and comply with custody and know-your-client obligations.

Cryptocurrency Futures Contracts

[Investment Industry Regulatory Organization of Canada \(IIROC\)](#) published [Rule Notice 17-0238](#) prescribing greater margin requirements for cryptocurrency futures contracts that trade on [commodity futures](#) exchanges than the margin requirements prescribed or referred to in [Dealer Member Rule 100.8 Commodity Futures Contracts and Futures Contract Options](#) effective December 11, 2017.

On December 18, 2017, the CSA issued a news release, [Canadian Securities Administrators Remind Investors of Inherent Risks Associated With Cryptocurrency Futures Contracts](#).

The SAFT Framework

Based on the [Simple Agreement for Future Equity \(SAFE\)](#) commonly used in [venture capital](#), the Simple Agreement for Future Tokens (SAFT) model attempts to mitigate the risk of utility tokens being deemed securities. A SAFT transaction operates as follows:

- The developers of the token network publish an operational plan for their network, usually in a peer-reviewed white paper.
- Instead of distributing tokens to the general public, the developers seek investment from accredited investors who are eligible to purchase securities on a prospectus-exempt basis.
- The SAFTs operate as investment contracts between the developers and accredited investors, providing investors with the right to receive utility tokens in the future when the network becomes operational.
- The developers use the funds raised through the SAFTs to create a functional network.
- When the network becomes operational, the network distributes utility tokens to its investors as specified in the SAFTs.
- Once the network is functional, investors and developers expect that they may then be able to freely trade the tokens on the assumption that they will not be viewed as securities at that point.
- Unlike a traditional ICO, the SAFT framework aims to separate the investment contract (security) and utility token (non-security) components of the transaction. The developers initially raise money in compliance with securities laws through an investment contract (the SAFT) with accredited investors, with an expectation that when the tokens are ultimately distributed they will not be securities and, therefore, freely tradeable over trading platforms or otherwise.

Many notable ICOs have used the SAFT model in an attempt to avoid the perceived risks of the traditional ICO process. Filecoin incorporated the SAFT into its ICO process in raising over USD257 million (see [Notable ICOs](#)). Purchasers entered into SAFTs that entitled them to receive tokens that would be redeemable for electronic storage space provided through the Filecoin platform in the future, while being immediately tradeable on cryptocurrency exchanges. Similarly, [tZERO](#), a company developing blockchain technologies for capital markets applications, began a SAFT-modeled ICO on December 18, 2017, expecting to raise over USD200 million.

Concerns with the SAFT Framework

It has not yet been established that utility tokens issued under the SAFT model will necessarily be exempt from regulation as securities.

As indicated in the Staff Notice, application of Canadian securities laws to tokens will depend on the particular characteristic of each token and the circumstances in which it was issued. While it may be the case that some utility

tokens could be exempt from regulation, it does not necessarily follow that all of them will be. Therefore, using a SAFT to ensure tokens are only issued as utility tokens with immediate functionality may not be determinative of whether regulators believe the tokens are securities.

It also seems the details and context of the use of SAFTs will likely play a role in the characterization of its tokens. The following may increase the risk that tokens sold under a SAFT framework would be deemed securities:

- Embellished promotional materials.
- A prevalence of speculators.
- Unreasonable token pricing (for example, at a deep discount to enhance the expectation of profit).

The bifurcation of the SAFT investment and the sale of utility tokens may be more complicated than expected. A token network's developers may unintentionally promote their platform to both accredited investors and potential token users. For instance, promotional material and messages targeted at accredited investors may be received by potential purchasers of utility tokens, creating an expectation of profit and influencing their buying decisions. Furthermore, while the lion's share of developer efforts may typically occur before the distribution of utility tokens, many developers continue to maintain, improve and further develop the token network throughout its lifetime. These activities may be necessary for a successful network and may trigger the fourth prong of the Pacific Coin Test, relating to the efforts of others, with regard to the utility tokens.

SAFTs may hinder liquidity and create perverse incentives. Reliance on the accredited investor exemption subjects investors to a "closed system" of securities regulation and restrictions on trading, precluding the resale of SAFTs to retail investors and eliminating many of the most appealing characteristics of ICOs generally. The SAFT structure may also encourage initial investment from speculators who are solely interested in short-term gains. After holding the relatively risky and illiquid SAFT investment contract during the development phase, investors may be eager to sell utility tokens quickly and pressure developers to focus on a profitable token sale rather than a high-quality network.

All of these factors underline the biggest potential problem with SAFTs, that the attempted bifurcation of the security and non-security portions of the transaction will not necessarily affect how regulators will assess the transaction. An issuer could follow the SAFT framework only to find that regulators conclude that the utility token is a security, even if it can be immediately used on a functional network at the time it is issued.

Selling Tokens Using Existing Securities Exemptions

Issuers may choose to delay distributing tokens to the general public until regulators provide clearer guidance on when tokens will or will not be deemed securities (or issue new regulations aimed specifically at cryptocurrencies). In the meantime, issuers eager to raise funds for their new projects could do so now by selling tokens (or future tokens) through existing securities law exemptions, such as selling to accredited investors, utilizing the offering memorandum exemption, or by seeking specific exemptive relief to facilitate the offering through programs like the OSC's [LaunchPad](#) initiative that engages with fintech businesses, assists them in navigating the requirements and strives to keep regulation in step with digital innovation.

Other Canadian Regulatory Authorities to Know Before Doing Business in Cryptocurrency

In Canada, regulatory authorities other than the CSA may also be involved with aspects of ICOs. Before distributing tokens (or before working in cryptocurrency more generally) it is prudent to consider the potential future involvement of other regulators.

Financial Transactions and Reports Analysis Centre of Canada

[Financial Transactions and Reports Analysis Centre of Canada](#) (FINTRAC) is the federal agency responsible for facilitating the detection, prevention and deterrence of money laundering and terrorist financing in Canada.

FINTRAC imposes regulations on "financial entities", "casinos" and, most relevant to entities involved in cryptocurrency activities, "money services businesses", each as defined in the regulations of the [Proceeds of Crime \(Money Laundering\) and Terrorist Financing Act](#), S.C. 2000, c. 17 (PCMLTFA). Organizations that meet these definitions must comply with numerous obligations, including record keeping, know-your-customer requirements, registration, and reporting of certain electronic funds transfers and suspicious transactions.

"Money services businesses" currently do not include entities dealing solely in virtual currency and, therefore, such entities may not be subject to obligations under the PCMLTFA. However, once an entity is engaged in money services business activities, such as foreign exchange dealing, remitting or transmitting fiat funds, or issuing or redeeming fiat money orders, all of the entities' activities, including those relating to cryptocurrency, become subject to the suspicious reporting obligations of the PCMLTFA and its regulations.

Furthermore, the federal government is considering new rules to categorize cryptocurrency exchanges, and all ventures "dealing in virtual currencies", as money services businesses. Once these regulations are drafted and in force, such entities may be subject to additional obligations under the PCMLTFA and its regulations.

Department of Justice and the Criminal Code

Even if an entity does not fall within the purview of FINTRAC, those involved in cryptocurrency transactions should be aware of the laundering offence in section 462.31 of the [Criminal Code](#), R.S.C. 1985, c. C-46:

"[Anyone who] uses... [or] transfers..., or otherwise deals with... any property or any proceeds of any property with intent to conceal or convert that property or those proceeds, knowing or believing that all or a part of that property or of those proceeds was obtained... as a result of (a) the commission in Canada of a designated offence; or (b) an act or omission anywhere that, if it had occurred in Canada, would have constituted a designated offence [is guilty of money laundering]."

A conviction may carry a prison sentence of up to 10 years.

The broad language of "any property" includes cryptocurrency and section 462.31(b) incorporates proceeds of crimes committed abroad. Companies operating trading platforms or similar ventures in the space should be aware of the potential implications of any criminal activities being conducted on their platforms.

Financial Consumer Agency of Canada

The [Financial Consumer Agency of Canada](#) (the Agency) is a federal agency that oversees compliance of federally regulated financial entities with consumer protection rules. While the agency is monitoring cryptocurrency, as reflected by a digital currency information page on its website (see [Digital currency](#), January 19, 2018), it has not yet released an official position on how or if it intends to further regulate the space. However, it is possible that as larger Canadian financial institutions begin investing in blockchain and cryptocurrency in their retail operations, the Agency will respond with new rules to satisfy its mandate and protect financial consumers. For instance, if Canadian banks follow the path of major banks in Singapore, the United Arab Emirates (UAE), and India, and adopt the use of a cryptocurrency for retail operations, the Agency may become involved.

The Office of the Superintendent of Financial Institutions (Canada)

The [Office of the Superintendent of Financial Institutions \(Canada\)](#) (OSFI) is a federal agency reporting to the Minister of Finance and mandated with the safety and soundness of the Canadian financial system. OSFI regulates federally regulated entities (FREs), which include Canadian:

- Banks.
- Insurance companies.
- Trust and loan companies.
- Co-operative credit associations.
- Pension plans.

While OSFI has not issued specific guidance related to cryptocurrency or ICOs, in an interview with CoinIdol, an OSFI representative claimed it was monitoring cryptocurrency and “expect[s] federally regulated financial institutions to be aware of the risks of engaging in financial activity, including activities that may be linked to Bitcoin, and to take appropriate measures if the activity is assessed to be higher risk” ([Regulation in Canada for Disruptive Bitcoin and Blockchain Technology](#), January 27, 2017). As cryptocurrency becomes a more significant and integrated part of the financial system, through [exchange traded funds](#)(ETFs), futures and large bank trading desks, OSFI may become more involved in its regulation.

Investment Industry Regulatory Organization of Canada

Investment Industry Regulatory Organization of Canada (IIROC) is a non-profit, national [self-regulatory organization](#) (SRO), which oversees [investment dealers](#) and securities trading in Canada. It creates rules for the investment industry and has quasi-judicial authority in enforcing these rules, by way of fining, suspending and expelling transgressing members. Recently, IIROC imposed higher-margin requirements for trades in cryptocurrency futures compared to trades in other futures contracts (see [Cryptocurrency Futures Contracts](#)). Further regulation may be on its way.

Provincial Consumer Protection Agencies

Tokens issued on functional networks with established, redeemable values may be analogized to gift cards. Transactions with such tokens may fall under the realm of consumer contracts regulated by the various provincial consumer protection agencies across Canada. For example, the statutes and regulations enforced by these agencies may impose implied legal warranties on the sale or redemption of tokens.

Bank of Canada, Minister of Finance and Payments Canada

Among other responsibilities, the [Bank of Canada](#) regulates clearing and settlement systems and controls systemic or payments system risk. The Minister of Finance oversees [Payments Canada](#) (formerly the Canadian Payments Association), an association of financial institutions (including the Bank of Canada) that operates and maintains Canada's clearing and settlements system and facilitates the development of new payment methods and technologies. Payments Canada is currently involved in Project Jasper, a research initiative exploring various applications of blockchain technology for settling payments (see [Project Jasper: A Canadian Experiment with Distributed Ledger Technology for Domestic Interbank Payments Settlement](#)). Presumably, as such blockchain technologies and cryptocurrency are adopted in Canada's clearing and settlement system, both the Bank of Canada and the Department of Finance would be mandated with their regulation.

It will be important to monitor the developments of these various regulators as the cryptocurrency market evolves.

Notable Cryptocurrency Developments Outside of Canada

There has been a global trend toward increased regulatory scrutiny of cryptocurrency and ICOs. Since it is likely Canadian regulators will look to other jurisdictions when establishing its own guidelines around cryptocurrency, it is worth noting important developments outside of Canada.

The UK [Financial Conduct Authority](#) (FCA) published [Consumer warning about the risks of Initial Coin Offerings \('ICOs'\)](#), September 12, 2017 to provide some guidance on ICOs in the UK market. FCA's [DP17/3 Discussion Paper on distributed ledger technology](#) (DLT) regarding the potential benefits and challenges of the underlying technology that facilitates ICOs was published in April 2017. The FCA is currently reviewing responses to this discussion paper and plans to publish its findings.

On July 25, 2017 the US [Securities and Exchange Commission](#) (SEC) published [Investor Bulletin: Initial Coin Offerings](#) and its [Report of Investigation Pursuant to Section 21\(a\) of the Securities Exchange Act of 1934: The DAO](#). The DAO is one example of a Decentralized Autonomous Organization, which is a term used to describe a virtual organization embodied in computer code and executed on a distributed ledger or blockchain. The DAO was created with the objective of operating as a for-profit entity that would create and hold a corpus of assets through the sale of DAO Tokens to investors, which assets would then be used to fund projects. The investigation raised questions regarding the application of the US federal securities laws to the offer and sale of DAO Tokens, including the threshold question whether DAO Tokens are securities. Based on the investigation, and under the facts presented, the SEC determined that DAO Tokens are securities under the [Securities Act of 1933](#) and the [Securities Exchange Act of 1934](#). This means that market participants giving advice or involved in capital-raising and exchange platforms trading them would have to comply with applicable securities laws that may require registration or exemptions.

A statement by SEC Chairman Jay Clayton, [Statement on Cryptocurrencies and Initial Coin Offerings](#), SEC, December 11, 2017, provided a general view on the cryptocurrency and ICO markets and addressed concerns and considerations for investors and market professionals. On the same date, the SEC also issued a cease-and-desist

order against Munchee Inc. (Munchee) to stop Munchee's ICO and require it to return to investors the funds it collected through the sale of its MUN token (the Munchee Order), which the SEC deemed to be securities. The Munchee Order provides insight into some of the token issuer activities the SEC will consider in determining whether tokens issued during ICOs are securities. The SEC employs a four-part test (the Howey Test), on which the Pacific Coin Test is largely based, to determine whether a financial instrument or investment contract is a security (see *Securities & Exchange Commission v W.J. Howey Co.*, 328 U.S. 293 (U.S. Sup. Ct.)). In the context of tokens, the crucial elements of this test are whether the tokens represent "an investment of money in a common enterprise with profits to come solely from the efforts of others". The key issues with the Munchee ICO were that Munchee:

- Made statements that suggested investors would profit from purchasing MUN tokens.
- Endorsed other commentators' public statements that touted the opportunity for profit through the purchase of MUN tokens.
- Did not specifically target current users of the Munchee restaurant review app in which users would use MUN tokens or stakeholders in the restaurant industry.
- Indicated that a secondary market for MUN tokens would be available shortly after the completion of the offering.
- Highlighted the credentials, abilities and management skills of its agents and employees, suggesting investors would profit from their efforts in building the Munchee marketplace.
- Indicated that the value of the MUN tokens would depend on Munchee's ability to create an effective "ecosystem" for its restaurant review app, suggesting the Munchee team would continue substantial work on its marketplace after the ICO.

Since the Munchee order, the SEC has halted the ICO of [AriseBank](#) and suspended trading of other cryptocurrencies for violations of securities laws, including misrepresentations in disclosure.

On January 4, 2018, the US [Commodity Futures Trading Commission](#) (CFTC) published a statement by Chairman Christopher Giancarlo on virtual currencies, [CFTC Also Releases Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets](#). In his [Opening Remarks at the Securities Regulation Institute](#), January 22, 2018, the SEC Chairman described his expectations for members of the securities bar when advising companies on ICOs. For more information, see [Legal Updates, SEC and CFTC Issue Statements on Cryptocurrencies and Initial Coin Offerings](#) and [SEC Chairman Warns Legal Advisors on ICOs](#).

A September 4, 2017 article published by Reuters announced [China just banned initial coin offerings, calling them illegal fundraising](#). The article indicated that the state news agency Xinhua cited data from a government organization that monitors online financial activity to report that there had been 65 ICOs so far during 2017 raising a combined CNY2.62 billion (USD394.6 million) from 105,000 individuals in the country.

On February 16, 2018, the [Swiss Financial Market Supervisory Authority](#) (FINMA) issued a press release, [FINMA publishes ICO guidelines](#) regarding [Guidelines for enquiries regarding the regulatory framework for initial coin offerings \(ICOs\)](#) for enquiries from ICO organizers, which complement its earlier [FINMA Guidance 04/2017 Regulatory treatment of initial coin offerings](#), September 29, 2017, which define the information FINMA requires to deal with such enquiries and the principles upon which it will base its responses, creating clarity for market participants. FINMA indicated that financial market law and regulation are not applicable to all ICOs so circumstances must be considered on a case-by-case basis. As set out in [FINMA Guidance 04/2017](#), there are several areas in which ICOs are potentially impacted by financial market regulation. FINMA categorizes tokens into three types, but hybrid forms are possible:

- Payment tokens are synonymous with cryptocurrencies and have no further functions or links to other development projects. Tokens may in some cases only develop the necessary functionality and become accepted

as a means of payment over a period of time. For payment ICOs, FINMA will require compliance with anti-money-laundering regulation but will not treat such tokens as securities.

- Utility tokens are tokens which are intended to provide digital access to an application or service. These do not qualify as securities only if that is their sole purpose, and they can already be used in this way at the point of issue. If it functions solely or partially as an investment in economic terms, they will be treated as securities.
- Asset tokens represent assets, such as participations in real physical underlyings, companies, or earnings streams, or an entitlement to dividends or interest payments. In terms of their economic function, the tokens are analogous to [equities](#), [bonds](#) or [derivatives](#) and will be treated as securities.

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