

## Securities and Technology Law

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### Regulatory Authorities to Know Before Doing Business in Crypto

In 2017, 235 initial coin offerings (ICOs) raised almost US\$3.7 billion dollars, an increase of 3700% from 2016. Unsurprisingly, regulators around the world have reacted to the explosive growth in ICOs, with regulators in China and South Korea going as far as issuing or considering an outright ban on ICO activity. Closer to home, the U.S. Securities and Exchange Commission has been actively monitoring and taking action against fraudulent and misleading ICO activity (see our January 17, 2018 Update, *Read This Before Your ICO: Minimizing the Risk of a Securities Token*). In Canada, we have not yet seen as strong a reaction from regulators, although the Canadian Securities Administrators have provided meaningful guidance on the applicability of Canadian securities laws to ICOs (see our August 30, 2017 Update, *Initial Coin Offerings in Canada: The CSA Weighs In*).

Other regulatory authorities also have watchful eyes on ICOs. In this Update, we look beyond securities regulators and securities regulations that might affect ICOs in Canada and discuss the potential for broader regulation. Before you distribute 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 (FINTRAC)

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* (the “Act”). 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 Act. 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 Act 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 Act 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*: “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 subsection (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, 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, 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 (OSFI)**

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 banks, insurance companies, trust companies, loan companies and 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”. As cryptocurrency becomes a more significant and integrated part of the financial system, through exchange traded funds, futures and large bank trading desks, OSFI may become more involved in its regulation.

## **Investment Industry Regulatory Organization of Canada (IIROC)**

IIROC is a non-profit, national self-regulatory organization 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. 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, an association of financial institutions (including the Bank of Canada) which 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. 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. To the extent you have questions or need guidance regarding the current status of regulation involving cryptocurrency, please feel free to contact any member of Goodman’s Tech Group.

# Goodman's Update

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## Goodmans Tech Group

To assist clients in the technology sector, Goodmans brings together our acknowledged expertise in corporate/commercial, private equity, corporate finance, mergers and acquisitions, outsourcing, licensing, intellectual property, privacy, regulatory and media, cleantech, tax, litigation, human resources, corporate restructuring and administrative law. We do so both for innovative businesses in their start-up phase and for well-established businesses of all types. Goodmans continues to lead in the technology sector and is partnered with the DMZ at Ryerson University. The DMZ is a leading business incubator (selected by UBI as the top-ranked university incubator in North America, and third in the world), which connects its start-ups with resources, customers, advisors, investors, and other entrepreneurs. Goodmans is also a proud partner of IDEABOOST, an initiative of the Canadian Film Centre's Media Lab; building the next generation of technology-based media entertainment products, services and brands. Through these partnerships, Goodmans provides legal advice, mentorship and networking opportunities to assist startups in maximizing their potential.

Goodmans is also an internationally recognized leader in other aspects of technology law and transactions. From our thought-leadership, through participation on the Boards of associations such as CanTech (Canadian Technology Law Association), CORE (Centre for Outsourcing Research and Education), CIEG (Canadian Institute for Exponential Growth, which organized the Summit) and iTechLaw (International Technology Law Association), to our involvement in major technology procurement, joint venture and outsourcing transactions, to our representation, in court proceedings and in arbitrations, of major technology providers, and users of technology, in ground-breaking cases, our Technology Group is consistently at the forefront of leading technology transactions and cases.

Members of our Technology Group are recognized as leading technology lawyers in Chambers Global, Lexpert, Legal 500 Canada, Legal Media Group's The Best of the Best, The Best Lawyers in Canada, Law Business Research's The International Who's Who of Business Lawyers, and The Lexpert /American Lawyer Guide to the Leading 500 Lawyers in Canada, teach internet and communications law at Canada's largest law schools, are regular lecturers at technology industry events and legal conferences, and have published articles in the technology law field.