Goodmans LLP Update

Cryptocurrency Exchanges to Fall Under Canadian Financial Reporting Regime

The Federal Government of Canada recently published amendments to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (the "**Act**"), revealing changes that will affect Canadian cryptocurrency exchange operations as of June 1, 2020 (the "**Amendments**").

The Amendments are part of Canadian regulators' overall efforts to address the novel features and risks posed by the emerging cryptocurrency sector. The Canadian Securities Administrator (CSA) recently released its 2019-2022 business plan, outlining that they would consider developing a regulatory regime for crypto assets and cryptocurrency trading platforms over the next three years. For more information on that initiative, see our June 18, 2019 Update, *Canadian Securities Administrator to Consider Regulatory Framework for Crypto Assets.*

Background

The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) is the federal agency tasked with countering money laundering and terrorist financing activities in Canada. FINTRAC imposes obligations, including record keeping and reporting requirements, on "money services businesses" (MSBs), as defined under the regulations of the Act. Currently, platforms dealing strictly in cryptocurrencies are not defined as MSBs, and are therefore not subject to the Act or FINTRAC's requirements.

In 2015, the Financial Action Task Force (FATF), an intergovernmental organization tasked with developing policies to combat money laundering, began evaluating Canada's anti-money laundering and anti-terrorist financing regimes, including the Act. The FATF review identified several deficiencies in the Act, including the lack of regulation of cryptocurrency trading platforms.

Amendments to the Act

To address the deficiencies identified by the FATF, the amended regulations will classify both Canadian and foreign cryptocurrency trading platforms as MSBs, meaning they will be required to fulfill all obligations of the Act, and register with FINTRAC.

The proposal sets out obligations that would broadly fall into four categories. Cryptocurrency trading platforms must:

1. Establish and implement an internal compliance program.
2. Keep proper records of all transactions.
3. Follow "know your client" policies, and verify the identity of clients with whom the reporting entities conduct business.
4. Report suspicious transactions and keep records in respect of every $10,000 or more in cryptocurrency that they receive from a person or entity in a single transaction (unless the amount is received from another financial entity or a public body or from a person who is acting on behalf of a client that is a financial entity or public body).

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Implications

The stated goal of the Amendments is to mitigate the money laundering and terrorist financing vulnerabilities specific to cryptocurrencies, while not unduly hindering innovation. It is for this reason that the Amendments are targeted at those engaged in the business of dealing in cryptocurrencies, as opposed to regulating the cryptocurrencies themselves. Nevertheless, there are conflicting views as to whether these goals will be realized by the Amendments.

On the one hand, the regulations aim to bolster the legitimacy of crypto trading platforms. Canadian financial institutions have been hesitant to provide bank accounts and other services to cryptocurrency trading platforms, as they pose a high risk of being used in connection with money laundering and terrorist financing activities. With enhanced reporting requirements and FINTRAC oversight, the regulations could influence further cooperation between financial entities and Canadian cryptocurrency trading platforms.

However, the heightened regulatory requirements could cause international exchanges to pull out of the Canadian marketplace. Canada has become a favourable market for cryptocurrency trading platforms due to the current regulatory regime. In a more stringent environment, the extent to which global players may be interested in the Canadian marketplace is uncertain.

Notwithstanding this concern, there is a growing awareness that the current regulatory regime must improve. Events such as the 2018 incident involving the Canadian cryptocurrency trading platform QuadrigaCX highlight the potential dire consequences of a lack of regulatory requirements. The Amendments represent an opportunity to address pressing oversight issues facing this nascent industry, but not without some challenges.

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