



**CBA Submission on CSA/IIROC Consultation  
Paper 21-402 *Proposed Framework for  
Crypto-Asset Trading Platforms***

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## Introduction

The Canadian Bankers Association (**CBA**)<sup>1</sup> appreciates the opportunity to comment on the Canadian Securities Administrators' (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) published consultation paper (**the Consultation Paper**) 21-402 *on the Proposed Framework for Crypto-Asset Trading Platforms*.

Banks are strong proponents of innovation and competition in the financial sector as innovation often leads to better products and services to customers. In the case of a framework for crypto asset trading platforms (**Platforms**), the CBA is supportive of greater regulatory clarity with respect to this market space that both contributes to the integrity of the financial services ecosystem and protects investors while fostering innovation. As the Consultation Paper recognizes, crypto assets may demonstrate characteristics of a currency, security or commodity, and these characteristics can change depending on the context in which a crypto asset is used. In addition, the number of Platforms that facilitate buying or trading these assets continues to grow with minimal or no regulatory oversight across the globe. Understanding that the emergence of new Platforms and the exchange of crypto assets is a relatively nascent market, providing regulatory clarity, while continuing to support innovation, would be beneficial for all industry stakeholders.

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<sup>1</sup> The CBA is the voice of more than 60 domestic and foreign banks that help drive Canada's economic growth and prosperity. The CBA advocates for public policies that contribute to a sound, thriving banking system to ensure Canadians can succeed in their financial goals. [www.cba.ca](http://www.cba.ca).

The need for regulatory clarity is clear, and we commend the CSA and IIROC for launching this consultation. However, determining the appropriate level and scope of regulation will require a deep understanding of a complex and rapidly-evolving industry. Therefore, we strongly recommend that CSA and IIROC continue to collaborate with other industry stakeholders in developing a regulatory framework for crypto assets, with the objective of sharing technical expertise.

We have chosen to focus our comments on certain important issues raised by the Consultation Paper with respect to regulatory clarity around Platforms, ensuring greater market integrity and facilitating innovation, rather than addressing each question in isolation. As such, our comments will focus on three underlying principles that should support the regulatory framework for Platforms, namely ensuring that:

- all participants in the financial services ecosystem are subject to effective regulation and meaningful oversight necessary for safety and soundness, investor protection, and the facilitation of innovation;
- the regulatory framework mitigates the potential for negative unintended consequences; and
- a regulatory framework that is consistent with the treatment of other financial products and market participants, and is aligned to developments globally

As the Platforms continue to evolve and mature, we would appreciate the opportunity going forward to continue the dialogue on the important issues raised by the Consultation Paper. We have set out below more detailed commentary on the principles noted above.

## **Ensure Stability, Investor Protection and Ongoing Innovation**

### **Flexible and principles-based approach to regulatory clarity and oversight**

A principles-based approach strikes a balance between the goals of effective oversight and fostering of innovation. As the Consultation Paper notes, crypto assets are not easily defined, are not necessarily amenable to specific categorization, and may change in nature depending on the context in which they are used. In addition, technology in the crypto asset sector continues to develop and change rapidly. Given these factors, we recommend a regulatory framework that is flexible and technologically neutral, that mirrors where appropriate existing regulatory frameworks, and that balances potential risks with the development of the crypto asset sector.

Further, we believe that this approach would be effective in minimizing the potential for avoidance schemes (e.g. the use of techniques to avoid the application of the regulatory framework to a particular technological representation of a crypto asset). We also believe it would avoid overly prescriptive requirements that may quickly become obsolete.

## **Investor Protection**

As the Consultation Paper highlights “global incidents point to crypto assets having heightened risks related to loss and theft compared to other assets” with evidence of these risks seen in Canada as well. As such, we believe that one of the key objectives in establishing a new framework for Platforms is that the framework should facilitate the evolution of the Platforms in a way that remains safe and reliable for all parties. Given the wide variety of crypto assets characteristics, and their associated risks, there is an increased level of uncertainty for investors wishing to participate in these Platforms, particularly in relation to issues such as investor protection in the event of insolvency of the crypto asset-issuing firm. Investors have come to expect a level of comfort when dealing with investment firms, in particular knowing that the investor’s funds are safe in the event of an insolvency, as a result of the coverage provided by programs and institutions like the Canadian Investor Protection Fund (CIPF). We encourage regulators to clarify whether membership in self-regulatory organizations extends the protections offered to investors, via programs such as the CIPF, to crypto asset investments. Further, enhancing transparency of the Platforms for all participants will be essential to investor protection, as will developing robust custody requirements for and financial literacy around crypto assets generally. In each case, regulators will have important roles to play with respect to accomplishing these objectives.

## **Comparable Regulations to Promote Consistency and a Global Outlook**

### **Consistency**

A consistent set of rules and regulations helps to foster innovation and competition in financial services and is essential to avoiding market fragmentation and facilitating a level playing field among market participants. Platform operators that are performing functions analogous to the functions performed by entities in the traditional capital markets should be subject to the same regulations. Where a crypto asset falls within an existing regulated asset-class (i.e. a currency, commodity, equity, etc...), the classification of such crypto asset should be clearly defined and consistently applied. Alternatively, where regulation does not exist in respect of a certain class of crypto asset, regulators should consider creating a working group to collaborate with industry stakeholders to provide clear guidance on which crypto assets will become subject to regulation, including which of those are subject to oversight by securities regulators.

Where a new approach is necessary, regulators should begin by working with existing market infrastructure participants to determine how current capabilities and regulatory controls can be adjusted to address certain crypto assets. This would ensure that new and existing market participants would be subject to the same expectations and requirements and would also avoid the inconsistency that would result from providing case-by-case exemptions. Most importantly, it would provide clarity to the market, increasing the likelihood of compliance and meaningful regulatory oversight.

In addition, we believe that the obligations and standards outlined by IIROC, such as anti-money laundering (AML) and know your client requirements, should equally apply to all participants. The application of such requirements would work towards eliminating gaps that could be exploited and ensure consistency for the financial sector. Overall, regulation should strike the appropriate balance between promoting innovation and ensuring financial stability and investor protection without creating inconsistencies amongst existing infrastructure and mitigating the potential for negative unintended consequences.

### **Global Outlook**

As the crypto asset market continues to mature, with different platforms in different jurisdictions becoming accessible to investors, we suggest a global outlook would be appropriate. We caution against regulation that is not aligned that in comparable jurisdictions, given that the nature of crypto assets allows individuals to transfer those assets outside of Canada at very low cost and largely without restrictions. Without domestic access, Canadian investors may increase their use of foreign-operated Platforms. Even if those Platforms are regulated and overseen by foreign authorities, those authorities may not share the objectives of the Canadian securities regulators. That could then result in heightened risks to Canadians transacting on those Platforms.

Some jurisdictions are taking steps to regulate Platforms. For example, since 2017 the Financial Services Authority in Japan has mandated that all crypto exchanges in the country obtain a license and, currently, there are 19 registered crypto exchanges in Japan.<sup>2</sup> As another example, the New York Department of Financial Services has required licensing of virtual currency business activities since 2013.<sup>3</sup> As the Consultation Paper notes, a regulatory framework is welcomed by Platforms and there may be benefits to reviewing approaches taken by other jurisdictions such as New York or Japan, including potentially consulting with regulators in those jurisdictions to highlight best practices and explore streamlined approaches to regulation.

### **Additional Commentary**

Set out below is our commentary responding to additional considerations raised in the Consultation Paper.

#### **Pricing Considerations**

Pricing issues relating to crypto assets can pose challenges. For example, recent evidence supplied to the U.S. Securities and Exchange Commission indicated that many exchanges potentially contain

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<sup>2</sup> Japan to require crypto exchanges to bolster internal oversight: source. <https://www.reuters.com/article/us-japan-cryptocurrency-idUSKCN1RS0YO>

<sup>3</sup> New York State Department of Financial Services. [https://www.dfs.ny.gov/apps\\_and\\_licensing/virtual\\_currency\\_businesses](https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses)

fraudulent or misleading trading activity.<sup>4</sup> An approach that simply aggregates pricing across all exchanges may not provide the diversification benefits that such an approach may typically be expected to provide.

To address this concern, regulators may want to consider creating a working group that could collaborate with industry stakeholders to identify “reference” platforms or exchanges through which reliable data could be obtained for the purposes determining fair pricing. As part of this approach, the working group could assess the possible development of standards against which prospective platforms or exchanges would be assessed before including pricing data as reference points from those platforms or exchanges.

### **Risks Associated with Clearing and Settlement Models**

We believe that care will need to be taken with respect to the treatment of clearing and settlement functions in relation to crypto assets. Clearing houses and agents are critical components of Canada’s resilient capital market infrastructure. These intermediaries have developed over time to reduce settlement and counterparty risks in transactions. One technique used by these intermediaries is Delivery Versus Payment (DVP), which effectively prohibits the same entity from performing both clearing and custody functions.

Concerns could arise if the regulatory framework were to allow Platforms to perform both clearing and custody functions (i.e. DVP would be impossible to achieve). If Platforms were to be permitted to engage in both activities, the result could be either the introduction of counterparty risk with associated risk-mitigating measures (e.g. the imposition of a requirement for participants to pre-fund trading accounts on the Platform with fiat currency prior to completing a trade on the Platform) or credit risk (i.e. by permitting participants to trade on margin, with settlement after).

To address these potential concerns, regulators may want to consider forming a working group to investigate creating market infrastructure, such as a clearing house, to facilitate DVP settlement of certain crypto assets, such as bitcoin, using technological innovations that include but are not limited to multi-signature wallets. Creating this infrastructure would enable agents of investors, acting as brokers and custodians (other than those controlled by the Platform), to participate in transactions on behalf of investors. This type of approach would increase innovation, competition, and growth in the overall marketplace while reducing the potential for systemic risk arising in the ecosystem.

## **Conclusion**

Canada’s financial services sector, including the crypto asset market, is undergoing significant transformation. In order to protect and enhance the integrity of Canada’s financial markets, it is critical to establish an effective regulatory framework that balances the objective of the safety and soundness of the

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<sup>4</sup> <https://www.investor.gov/additional-resources/news-alerts/investor-alerts/investor-alert-watch-out-fraudulent-digital-asset>

system with the objective of fostering innovation and growth through a regulatory model that adapts quickly to changes in the market. This will lead to more robust and competitive system and build on the strengths of existing framework, while maintaining investor protection. We appreciate having the opportunity to contribute to this consultation process and look forward to continuing to engage on this issue with the Canadian Securities Administrators and the Investment Industry Regulatory Organization of Canada.