

Canada releases draft framework for stablecoin regulation

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Key takeaways

- The federal government proposes the *Stablecoin Act* to establish a national framework for fiat-referenced stablecoins, overseen by the Bank of Canada.
- This Act defines issuer requirements relating to reserves and governance, while excluding closed loop stablecoins and certain financial institutions.
- A key amendment to the *Retail Payment Activities Act* will include activities involving encrypted or tokenized payment instruments.

Consistent with its commitments to support innovation in the financial sector, the federal government has released draft legislation within the *Budget 2025 Implementation Act, No. 1* (Budget Bill) that would establish Canada's first national framework for fiat-referenced stablecoins. The proposed *Stablecoin Act* (Act) is aimed at creating a prudential regime, overseen by the Bank of Canada, for permitted stablecoins, with requirements related to reserves, redemption rights, governance, custody and national security oversight. Regulations have not yet been published, and many details, including prescribed definitions and technical standards, will likely be confirmed in the future.

At the same time, the government proposed a key change to the *Retail Payment Activities Act* (RPAA) to scope in certain activities related to encrypted or tokenized payment instruments.

Below is an overview of the key features of the draft Act and the implications for issuers operating in Canada, including the important but limited securities law carve out, and the continued relevance of provincial securities regulation over fiat-backed stablecoins, as well as the change to the RPAA.

Draft Stablecoin Act

Scope

The draft Act applies to persons that issue a single fiat-referenced stablecoin capable of inter-provincial and international application, and make it available, directly or indirectly, to users in Canada. Several exclusions are set out:

- The Act does not apply to closed loop stablecoins. Closed loop systems will be defined by regulation, but this is expected to cover platform-restricted or single-merchant tokens.
- Federally-regulated financial institutions (FRFIs) are excluded from the ambit of the Act, subject to regulations, meaning that, to the extent FRFIs wish to issue stablecoins, they would need to do so under their existing regulatory frameworks. However, FRFIs would be permitted to invest in an entity that is subject to the Act. The Act includes some important carve-outs from the investment constraints FRFIs are subject to; namely that the issuance of stablecoins in accordance with the Act does not constitute dealing in securities or the acceptance of deposits for the purposes of the FRFI statutes.
- Other types of financial institutions are also excluded from the ambit of the Act, including provincially-incorporated trust, loan and insurance companies, credit unions and securities dealers, as well as foreign financial institutions.
- The Act does not apply to central-bank digital currencies, or “CBDCs”.

Application process

Issuers must apply to be included on a public registry maintained by the Bank of Canada. An issuer cannot operate without being listed. Among other things, an application must contain the following information

- information about the ownership of the applicant
- a description of how the applicant is organized and structured
- a description of the technological systems that are or will be used in relation to the stablecoin that the applicant plans to issue
- the issuer’s redemption policy
- a description of the measures that the applicant has taken or will take to comply with its obligations under the Act relating to the reserve requirements, along with a legal opinion that such measures will enable the applicant to comply with its obligations
- a statement from a certified accountant of the applicant’s financial condition
- the applicant’s governance policy, risk management policy, data security policy, and recovery and resolution policy
- information about any enforcement actions relating to anti-money laundering and terrorist financing, the provision of financial services, securities and derivatives, market conduct or consumer protection

Similar to the RPAA regime, the Act contemplates the possibility of a national security review by the Minister of Finance if the Minister is of the opinion that it is necessary to do so for reasons related to national security. The Minister may prohibit an issuer from issuing a stablecoin for reasons related to national security, or that it is in the public interest to do so.

Reserve and custody requirements

A central feature of the legislation is the reserve of assets maintained to back outstanding stablecoins.

Key requirements include

- the reserve must have a value equal to or greater than the par value of all outstanding stablecoins
- reserves may not be used for any purpose other than redeeming outstanding stablecoins, subject to the regulations
- reserves must consist exclusively of the reference currency or other high-quality liquid assets (undefined in legislation, but may be provided for in regulations or approved by the Bank of Canada)
- reserve assets must not be encumbered and must be held by a qualified custodian (a Canadian financial institution or other entity as provided in the regulations)
- the reserve arrangement must be structured to be bankruptcy remote, for example, through a trust or similar arrangement

Other key obligations

The Act sets out numerous other obligations and restrictions including the following:

- **Market conduct:** The Act includes limited provisions relating to misleading advertising, including representations that suggest a stablecoin is legal tender, a deposit, or insured under a government deposit-insurance scheme.
- **Prohibition on yield:** Issuers are prohibited from offering or providing any form of interest or yield on a stablecoin, as the regime is focused on payment functionality, not investment returns. Yield-bearing stablecoins may be securities and/or derivatives, and they likely will be regulated by Canadian securities laws.
- **Redemption obligations:** As noted above, issuers must establish and publish a redemption policy describing the conditions, manner and timing of redemptions, applicable fees and any third parties involved in the redemption process. Holders must be able to redeem their stablecoins at par value, and issuers must maintain adequate procedures to support timely redemptions.

Governance, risk management and data security

- issuers must maintain a comprehensive risk management framework addressing operational resilience, cybersecurity safeguards, business continuity, third party oversight and controls to mitigate money laundering and terrorist financing risks
- separate data security program is required, dealing specifically with protection of personal information and cybersecurity controls

Recovery and resolution

Issuers must maintain a resolution or wind-down plan that ensures the orderly redemption of outstanding stablecoins and preserves the claims of stablecoin holders on the reserve of assets.

Auditor and legal reporting

Issuers must file periodic reports that include

- a certified accountant's report covering the financial condition of the issuer, the number of outstanding stablecoins, and the composition and fair market value of the reserve
- a legal report confirming compliance with the reserve encumbrance prohibition and qualified custody and bankruptcy remote requirements

These reporting obligations are an important operational backbone to the Act's prudential approach.

Supervisory and enforcement powers

The Act grants the Bank of Canada extensive supervisory and enforcement authority, closely aligning these powers with those conferred on the Bank of Canada under the RPAA. Such powers include the power to impose undertakings or conditions on the applicant or issuer, administrative monetary penalties, public disclosure of non-compliance, compliance agreements, and the power to restrict or prohibit issuance where necessary for national security or for public interest reasons.

Narrow securities law carve out and continued application of provincial securities laws

As noted above, the Act includes a clarification that issuing a compliant stablecoin is not considered dealing in securities for specified sections of the *Bank Act*, the *Insurance Companies Act* and the *Trust and Loan Companies Act*. These FRFI statutes contain prohibitions that restrict when FRFIs may engage in securities dealing without using a specialized subsidiary.

The carve out is narrow and is aimed solely at ensuring that a FRFI may invest in an issuer that is subject to the Act and that does not otherwise engage in impermissible activities under the FRFI statutes. It does not

- exempt a stablecoin from provincial securities or derivatives laws
- alter the investment contract or business-trigger analyses applied by provincial regulators
- create a trading or marketplace framework for stablecoins

In practice, this means that the draft Act does not displace Canadian securities laws, which may apply to the distribution and secondary trading of stablecoins that meet the definition of a security or derivative under such laws. Whether a stablecoin, or related issuance and trading activities, are captured by securities laws depends on the features of the token and how it is distributed or traded.

Further, Canadian securities laws will likely remain relevant for

- stablecoins offering yield or exposure to a basket of different assets or currencies
- the distribution or solicitation of stablecoins in a manner that engages the business-trigger test
- platforms which facilitate secondary trading of yield-bearing or other stablecoins which are

likely to be securities or derivatives

- custodial, marketplace or intermediary services that fall within existing CSA guidance, including Staff Notices 21-332 and 21-333

Similarities between Act and previous CSA staff guidance

Interestingly, the Act appears to derive many of its provisions from prior guidance from Canadian securities regulator staff.

Canadian Securities Administrator (CSA) Staff Notice 21-333 *Crypto Asset Trading Platforms: Terms and Conditions for Trading Value-Referenced Crypto Assets with Clients* (SN 21-333) required stablecoin issuers seeking approval for trading on Canadian crypto asset trading platforms to commit to a rigorously defined “value referenced crypto asset” framework, including full fiat backing, high quality and liquid reserve assets, segregation and custody of reserves, clear and enforceable redemption rights at par, and robust public transparency through regular attestations and audit style reporting. Those same pillars now appear in the Act’s core issuer obligations, particularly the reserve composition and maintenance rules (including the 1:1 backing concept), the mandatory redemption regime, and the requirement for periodic accountant attestations and legal compliance confirmation.

In other words, what began as securities regulator conditions for market access has been carried forward almost intact into a Bank of Canada administered issuer regime.

Retail Payment Activities Act

The Budget Bill also makes a small, but significant change to the RPAA. Currently, payment service providers (PSPs) are captured under the RPAA if they perform one of five listed payment functions. The Budget Bill proposes to add a sixth payment function; namely “the transmission or maintenance of an end user’s encrypted or tokenized payment instrument or an end user’s private key, whether or not the private key is encrypted or tokenized”. We expect that, if the Budget Bill passes, the Bank of Canada will update its guidance document *Criteria for registering payment service providers* and provide a more fulsome description of the scope of this additional payment function. However, we expect that “maintenance” may be interpreted broadly and may include custodial activities, the safekeeping of the instrument or key, the ongoing operation or technical upkeep of the system that records transactions, and the management of access permissions.

While the federal budget that preceded the Budget Bill referred to amendments to the RPAA to enable the regulation of PSPs that carry out payment functions using prescribed stablecoins, the reference to an “encrypted or tokenized payment instrument” is technology neutral and may cover any digital representation of a payment credential, not only stablecoins when used as a means of payment. But given the statement in the federal budget, we expect regulations will be published that prescribe certain stablecoins for the purposes of the RPAA.

Next Steps

For stablecoin issuers that sought to follow CSA staff guidance in SN 21-333 by treating their stablecoins as securities and/or derivatives and pursuing compliance through prospectus filings and related registration relief, it remains uncertain how they will transition out of the provincial securities framework and into the new federal regime. Since securities oversight is constitutionally provincial and the *Stablecoin Act* is a federal statute, it is not immediately clear how issuers that previously qualified their stablecoins as securities can continue to

issue the same instruments solely under the Act. We expect CSA staff will publish guidance addressing this transition and, in particular, they will consider a tailored prospectus and registration exemption for stablecoin issuers that become authorized under the *Stablecoin Act* and operate in compliance with its requirements.

We currently expect that the Budget Bill will pass, and major changes to the Act or to the change proposed to the RPAA are not expected. In relation to the RPAA, we expect the in-force date of this amendment will allow for a transition period for PSPs that are not yet subject to the regime, to register with the Bank of Canada and update their compliance systems accordingly.

Regulations will be required to fully implement the Act and, as noted above, we expect additional regulations under the RPAA to confirm the extent to which the RPAA will apply to payment functions using stablecoins. We also expect that the Bank of Canada will issue guidance in respect of the Act and the changes to the RPAA.

We will continue to monitor all developments relating to stablecoin issuance and use.