

Digital assets and blockchain: Trudging the road to greater clarity

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It was an interesting and challenging year for many players in the crypto space in 2022. There were consolidations and there were bankruptcies. And we received some welcome clarity on what the “final” cryptoasset trading platform regulatory framework will look like in Canada. Here is our summary of what will no doubt be considered a transformational year in crypto.

After “crypto winter,” warmer skies ahead

In the first half of 2022, cryptocurrencies hit a rough patch. The price of virtually every major cryptocurrency fell and some companies faced grave financial difficulties, including insolvency proceedings and even bankruptcy. In the cryptocurrency world, this market cool-off is colloquially referred to as “crypto winter.”

A few notable crypto-related issues contributed to the drop in prices and the prolonged chilly season we continue to endure.

One example was the collapse of the algorithmic stablecoin TerraUSD/UST, where UST completely lost its peg to the U.S. dollar and the sister coin that backed it. Terra rocked the global crypto industry and its crash resulted in the loss of nearly \$40 billion dollars’ worth of investor value tied to these coins. The liquidation dragged down the price of bitcoin and accelerated the loss of an estimated \$300 billion in value across the global crypto economy.

In early 2022, Three Arrows Capital (3AC), a crypto hedge fund that managed an estimated \$10 billion in assets, defaulted on billions’ worth of loans. The decline in crypto prices at the beginning of 2022 was detrimental to 3AC’s business, leading to its insolvency. Many other well-known companies in the crypto space that loaned 3AC hundreds of millions of dollars faced financial difficulty as a result of 3AC’s financial woes.

Another entity suffering from the “crypto winter” was Celsius Network, which operated as a centralized finance (CeFi) lending platform. Users were able to deposit crypto and earn rates of interest as high as 17%, according to the company. Celsius, in turn, loaned the deposits to borrowers. It was reported that in 2021, Celsius controlled assets worth \$20 billion and had one million customers. In June 2022, the company prohibited its users from withdrawing funds from the platform. By July, the company had filed for bankruptcy.

In July, crypto brokerage Voyager Digital filed for bankruptcy. Similar to Celsius Network, Voyager halted customer withdrawals prior to its bankruptcy filing. The company cited 3AC’s failure to make a \$350 million loan payment as a chief reason for its financial difficulties.

By November, the entire crypto community was turned on its head with the collapse of the FTX cryptocurrency exchange and the filing on November 11, 2022 of FTX and its affiliates for

bankruptcy in the State of Delaware. At the time of wrong, there remains a great deal to be learned about what led to the business failure and accompanying disruptive events and its impact on the wider crypto market. With allegations of significant debts, uncertainty regarding the assets of FTX and its market maker, Alameda Research, frozen and missing customer funds and a variety of unauthorized transactions (including up to \$4.1 billion in loans to related parties), there remains a great deal to be learned about the FTX situation and the impact on its creditors and the wider crypto market.

Even before FTX, capital market and financial sector regulators were subjecting cryptoasset trading platforms (CTPs) and businesses contemplating “novel” crypto-related products and cryptoassets to greater scrutiny. Regulators also pursued those with perceived insufficient registration status and risk of insufficient assets, as further discussed below. On November 21, 2022, the Canadian Securities Administrators (the CSA) issued a warning to investors about elevated risks of trading cryptoassets, as we reported [in our blog post](#). It remains to be seen how the regulatory landscape will be altered following the collapse of FTX.

Registrations – a relatively standardized framework emerges

By way of background, in 2021, the CSA and Investment Industry Regulatory Organization of Canada (IIROC) [published](#) Staff Notice 21-329 – Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements [PDF], which established a framework for CTPs to receive exemptive relief as a restricted dealer under applicable securities laws or an investment dealer under IIROC’s requirements. More information about this framework and registrations that occurred in 2021 can be found in last year’s [article](#).

As of December 1, 2022, four additional CTPs have registered as restricted dealers or investment dealers. These include [Bitvo](#), [Coinsquare](#), [Newton](#) and [Virgo CX](#). The terms and conditions of these registrations are largely consistent with the terms and conditions entered into by CTPs in 2021, demonstrating the emergence of a relatively standardized framework, as we explained in [our blog post](#).

Two registrations of particular note were obtained in October 2022. First, Coinsquare became the first retail-facing, IIROC-registered investment dealer and marketplace member in the Canadian crypto market. Coinsquare was granted interim relief (subject to renewal) from the acceptable securities location requirement on the condition that its Canadian-based custodian, Tetra Trust Company, meet certain operational thresholds.

Second, Wealthsimple Inc. became the first regulated CTP in Canada to offer staking. This will enable Wealthsimple’s users to make “passive income” from their cryptoassets and take advantage of the Ethereum and Solana crypto tokens moving to a proof-of-stake model. Osler acts for Wealthsimple.

Also in 2022, Canada’s securities regulators began requiring entities seeking registration to give a public pre-registration undertaking to their principal regulator to adhere to certain terms and conditions prior to becoming registered. As of December 1, 2022, Coinsquare, whose pre-registration undertaking was superseded by its registration as an investment dealer, and [Crypto.com](#) had publicly filed pre-registration undertakings. The terms of these undertakings were mostly consistent with the “standardized” set of terms and conditions that have been applied to registered CTPs under the restricted dealer framework, as we reported in our [blog post](#).

The pre-registration undertakings include a restriction on the offering of cryptoasset lending or staking services without the prior approval of the securities regulator. This may be a signal to the industry that the CSA does not consider such activities to fall outside the regulatory

perimeter of Canadian securities laws.

Enforcement: Stance hardens

As we reported [last year](#), the CSA has pledged to take increased enforcement action against crypto market participants. In 2022, this trend continued with Grant Vingo, CEO of the Ontario Securities Commission, repeatedly [warning](#) [PDF] that CTPs that had not “embark[ed] on the road to registration” with the CSA would face enforcement measures. True to this promise, in 2022, the CSA settled or successfully prosecuted many of the enforcement actions against unregistered CTPs, as we reported [in our blog post](#).

In some instances, the unregistered CTPs refused to engage in the CSA’s registration processes and were subject to substantial sanctions. Specifically, in May 2021, the OSC [published](#) [PDF] a Statement of Allegations (SOA) against Polo Digital Assets, Ltd., the operator of a CTP known as Poloniex. Although Polo Digital had initially retained counsel and cooperated with OSC Staff, [their counsel withdrew](#) [PDF] in April 2022 and Polo Digital ceased participation in the OSC process.

In October 2022, the OSC issued a [combined merits and sanctions decision](#) in which the Capital Markets Tribunal (Tribunal) found that the “crypto contracts” and “crypto futures contracts” offered by Polo Digital were securities and that it was therefore engaged in the “business of trading in securities without being registered” and in the “distribution of securities without a prospectus.” The Tribunal permanently prohibited Polo Digital from trading in or acquiring any securities and ordered it to pay \$1,500,000 as an administrative penalty, to disgorge US\$1,825,417.89 (the revenue it had made from Ontario accounts since the platform’s inception) and to pay investigation costs of \$138,371.50.

In June 2021, the OSC published an SOA against Mek Global Limited and a related entity, the operators of an unregistered CTP known as KuCoin. As with Polo Digital, this enforcement proceeding was unopposed. The Tribunal made a [similar determination](#) that the respondents had breached Ontario securities law, permanently barring them from acquiring or trading in securities. Mek Global was ordered to pay an administrative penalty of \$2,000,000 and investigation costs of \$96,550.35.

By contrast, in several other cases, the CTPs engaged with the CSA and entered into settlements that required the payment of penalties but left open the possibility that the CTP could become registered in order to continue trading.

For instance, in June 2021, the OSC published an SOA against Bybit Fintech Ltd., the operator of a CTP known as Bybit. In June 2022, the Tribunal [approved a settlement agreement](#) [PDF] which, among other things, permitted Bybit to continue serving existing Ontario clients (for existing products only) while it pursued registration, except for specified restricted products. Bybit was required to disgorge gross revenue (US\$2,468,910) to the OSC and pay investigation costs of \$10,000.

Similarly, in August 2021, the OSC published an SOA against Aux Cayes Fintech Co. Ltd., the operator of a CTP known as OKX. In October 2022, the Tribunal [approved a settlement agreement](#) [PDF] which, among other things, permitted Aux Cayes to continue serving existing Ontario clients (for existing products only) while it pursued registration with the CSA, except for specified restricted products, such as futures. The CTP was required to pay a \$600,000 administrative penalty, disgorge all gross revenue from the offending accounts of more than US\$500,000 to the OSC and pay investigation costs of \$25,000.

AML update

This year, Canada's AML rules were broadened to include crowdfunding platforms and the payment service providers they use. These changes cover all forms of transactions, including transactions involving digital assets such as cryptocurrencies. The changes were made in response to the use of crowdfunding platforms to fundraise both cash and cryptocurrencies in support of an illegal blockade in February 2022.

For further information about AML laws in Canada, see our [2022 Financial Services Year-In-Review](#) article and our [Anti-money laundering in Canada](#) guide.

In April 2022, the federal government released its annual budget which announced its intention to initiate a legislative review of the digitalization of money, together with other measures intended to bolster and maintain financial sector stability and security. The first phase of this initiative will target the security and stability risks posed by digital currencies, including cryptocurrencies and stablecoins, and will explore the potential for a central bank digital currency in Canada.

More information about the approach to AML put forward in the budget is available in our [budget briefing](#).

Banking and payments update

On November 16, 2022, a joint statement was released to federally regulated entities engaging in cryptoasset activities or crypto-related services by the Office of the Superintendent of Financial Institutions (OSFI), the Financial Consumer Agency of Canada and the Canada Deposit Insurance Corporation. The joint statement explicitly reinforces "the expectation that [...] federally regulated entities adhere to all applicable current regulatory requirements and any guidance when carrying out any crypto-related services or engaging in crypto-asset activities," as we reported in our [blog post](#).

The joint statement refers to OSFI's proposed Digital Innovation Roadmap, also published on November 16. The proposed roadmap lays out OSFI's digital priorities in the evolving digital finance ecosystem.

OSFI also published Interim Arrangements for the regulatory capital and liquidity treatment of cryptoasset exposures, which provides a capital and liquidity framework contemplating two categories of cryptoassets. "Group 1" assets are digital representations of traditional assets (e.g., a tokenized corporate bond or a tokenized bank deposit) which can be treated comparably to the underlying traditional assets (i.e., the corporate bond or bank deposit), as long as all of the criteria set out in the framework are met. "Group 2" assets represent a residual category that comprises all other cryptoassets that fail to meet the Group 1 criteria. This category includes cryptocurrencies like Bitcoin and Ethereum, which are subject to more conservative prudential treatment.

On the payments side, though the details remain uncertain, we continue to expect that the federal *Retail Payments Activities Act* that was introduced in April 2021 will apply to digital wallets and other crypto payment services, as we discussed [last year](#).

Looking ahead to 2023

The past year was challenging for many cryptoasset businesses as the industry consolidated and matured. By applying the lessons learned in 2022, and taking advantage of new revenue streams like staking, the Canadian crypto market is well-poised to outperform expectations in 2023.

In November 2022, the federal government announced a consultation on “cryptocurrencies, stablecoins and central bank digital currencies.” We hope that the consultation will lead to clarification of a number of regulatory issues, including

- expectations with respect to the practical operationalization of the terms and conditions prescribed by the registrations and pre-registration undertakings of CTPs, as we further discussed in our blog posts from [July 2022](#) and [August 2022](#)
- the treatment of fiat-backed stablecoins, including potential regulation as prudential deposits, money market funds or something new, as discussed further in our [blog post](#) from October 2021
- non-fungible tokens (NFTs), including fractionalization and marketplaces for trading NFTs. The NFT market is exploding, in part by latching on to established industries like gaming as we discussed further in this [Osler Update](#)
- decentralized finance protocols (also known as DeFi), which facilitate transactions in cryptoassets on blockchains such as Ethereum and which can operate autonomously and outside the ownership or control of any party, and potentially outside the scope of securities laws and AML laws
- the regulatory treatment of certain cryptoasset-backed financial products and retail investment products

We are watching to see which of these will receive the attention of regulators in 2023. We expect that 2023 will be another transformative year for the cryptoasset industry in Canada, and look forward to working with our clients on new business models and challenges in the space.