

**Submission to the Joint Canadian Securities  
Administrators / Investment Industry Regulatory  
Organization of Canada on Consultation Paper 21-402:  
Proposed Framework for Crypto-Asset Trading Platforms**

May 16, 2019



**Canadian Digital Asset Coalition**

## About the Canadian Digital Asset Coalition

The Canadian Digital Asset Coalition (CDAC) is an informal industry working group of people and organizations participating in the crypto-asset industry across Canada. CDAC includes crypto-asset platforms and dealers, industry associations, service providers (legal, compliance, audit), blockchain and fintech companies, crypto-asset investors, and software developers. Participants in CDAC share a common desire to kickstart industry dialogue, identify common priorities, concerns, and recommendations, and provide regulators with a feedback on this important consultation.

This submission has been prepared by the CDAC Steering Committee – a team of professionals with policy, industry, compliance, and legal expertise.<sup>1</sup> The submission represents broad stakeholder feedback on the Consultation Paper which was provided through a Canada-wide industry roundtable discussion, an online consultation feedback form, and conversations with crypto-asset industry participants.

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<sup>1</sup> The Steering Committee for CDAC is made up of Magdalena Gronowska (MetaMesh Group), Amber Scott (Outlier Solutions), Evan Thomas (Lawyer) and Tanya Woods (Chamber of Digital Commerce). In this process, Steering Committee members served as objective coordinators for collecting industry views, and the views expressed in this Paper reflect the views of the various organizations and individuals participating in the consultation.

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## Introduction

Digital- and crypto-assets and their underlying technologies have the transformative potential to generate enormous benefits for business, government, and consumers. Fundamentally, these technologies are reshaping how we transfer value, data and ownership, how we trust and interact with each other, how we structure our society and business models, and how we participate in global financial markets. Their broad potential for impact and accelerating pace of innovation have given rise to one of the most rapidly evolving sectors globally – and have equally have sparked tremendous activity in the global regulatory landscape.

Canada is increasingly competing globally in the innovation-based economy – this sector offers tremendous opportunity for Canada to capitalize on digitally-enabled and innovation-based economic growth and industry welcomes the opportunity to partner with government to further innovation, business and job growth, export potential, and economic diversification.

CDAC has prepared this response with the expectation that there will be ongoing and collaborative dialogue with industry as Canada works to chart a path forward on crypto-assets. This response is organized into two parts:

- Part 1: Overarching policy and regulatory development recommendations; and
- Part 2: Specific feedback in response to the Consultation Paper's twenty-two questions.

CDAC supports the views expressed in the response provided by the Chamber of Digital Commerce Canada. The following feedback offers additional insight collected through the discussions described above.

## Part I: Recommendations on the Development of Canada's Crypto-asset Policy & Regulatory Framework

### Overarching Recommendations:

**Recommendation 1:** Acknowledge crypto-asset types, the different functions, and different intermediaries.

**Recommendation 2:** Develop a regulatory framework that is responsive to rapid technology advancements.

**Recommendation 3:** Collaborate with industry experts to develop an appropriate policy and regulatory framework for crypto-assets in Canada.

**Recommendation 4:** Establish a government + industry Task Force with working groups on specific policy and regulatory areas in the crypto-asset space.

**Recommendation 5:** Improve coordination across provinces, territories and the federal government.

### Recommendation 1: Acknowledge crypto-asset types, the different functions, and different intermediaries.

Definitional clarity in regulation allows companies to operate in a compliant, open and transparent manner, and provides businesses the certainty they need in order to operate, conduct long-term business planning, and make capital investments. Similarly, regulatory certainty helps to de-risk the sector, paving the way for businesses to be able to develop banking relationships or better access banking services, or to secure insurance coverage or audit/assurance services.

There is significant diversity across digital asset types and their use-cases, which continue to evolve as regulators know. As the Chamber of Digital Commerce Canada has clearly stated, Canada's industry needs policymakers to acknowledge digital token differentiation and work with industry to establish a supportive framework around crypto-assets, and their related activities and intermediaries.

It was also stakeholders observed that the Consultation Paper does not consider that many crypto-assets do not "fit" with securities laws. They shared concerns that fitting crypto-assets into the existing regime may overlooks many crypto-asset specific issues and risks. There was general disappointment that the creation of a separate regulatory regime for crypto-assets was not an option presented and that industry was not engaged to assist with this.

Industry raised a number of concerns regarding the scope and approach of the regulation proposed by the consultation paper. Stakeholders noted that the consultation paper does not address an important use case where crypto-assets are purchased or converted and used as a payment or means of exchange –

further consultation is needed around payments and Money Service Business (MSB) activities and how the two regulatory regimes (MSB and securities) will intersect.

A number of stakeholders also shared concerns that regulators intend to capture a broad set of crypto-assets and related activities under a regulatory framework for securities in order to protect users. Not only could this be costly, burdensome, and harm Canada's Fintech and blockchain ecosystem, some stakeholders believe that addressing custody of crypto-assets solely in the context of securities regulation may not provide sufficient consumer protection, nor have the ability to mitigate systemic impacts across the industry. Some industry experts suggest that custody and asset verification may need to be applied to all crypto-assets more broadly – however, the approach proposed around custody in this consultation paper has many challenges (refer to the custody discussion of this submission as well as those in the Chamber of Digital Commerce Canada's submission) and significant collaboration with industry is needed to work through an appropriate approach.

Canadian regulatory authorities must work to strike an appropriate balance between consumer protection and creating a space that allows for innovation. The implementation of complementary enabling initiatives and burden reduction strategies alongside regulations are important pillars in formulating a more strategic policy response – one that can better support this nascent industry sector and foster innovation and business growth in Canada.

## Recommendation 2: Develop a regulatory framework that is responsive to rapid technology advancements.

Without a sufficient foundational assessment of the legal, regulatory, and economic landscape, Canadian regulators could introduce significant risk to Canada's growing blockchain ecosystem. Canada's crypto-asset market is small, both in terms of population size and daily global market volumes. Some stakeholders have voiced concerns that the proposed regulatory approach is onerous and will cause foreign exchanges to stop providing services to Canadians (e.g., by banning IP addresses) – in light of the risk that Canadian platforms may be locked out of their ability to source liquidity from global markets, consideration of systemic impacts is also needed. At the same time, there is a balance that needs to be struck between providing exemptive relief for foreign platforms and ensuring Canadian businesses are not at a competitive disadvantage due to high costs of domestic compliance they could face.

Some market participants are concerned about the high costs of compliance with the proposed framework (in particular around IIROC membership, insurance, and Type I and Type II SOC 2 Reports, and employee proficiency requirements) that may automatically remove smaller businesses from participating in the market, compromising competition and consumer choice.

As rapidly evolving crypto-asset technologies expand, it is important that regulatory approaches are mindful not to be too prescriptive and risk quickly becoming ineffective, obsolete, or unintentionally harmful to Canada's competitiveness. Flexible and function-based policy approaches are generally more responsive to evolving risks (e.g., cybersecurity threats), technology changes, and the changing nature and scope of crypto-asset companies. Some industry stakeholders suggest working with, or at minimum examining the practices of, industry leaders (like the world's top exchanges) to develop and adopt best practices or standards in the interim, and taking time to work through a more comprehensive regulatory framework in Canada.

The development of industry standards and/or guidelines is an alternative approach to the regulatory framework proposed – and it is prudent that regulators examine opportunities to apply standards to certain activities or operating procedures, such as platform custody and cybersecurity, and that they work with appropriate bodies like the Canadian Standards Association or the Canadian Center for Cybersecurity.

It is important to note that there is disagreement regarding timing across the industry – while some stakeholders advocate for taking a wait-and-see approach to overall regulation, others would prefer some clarity and regulatory certainty from government, particularly around less contentious areas (to be further determined by industry). Regardless of the pace, businesses will need sufficient lead time to be able to transition to a new framework, and there is an overall preference that the framework be coordinated with regulation constructed at a federal level (including around securities) to limit regulatory burden and confusion.

### **Recommendation 3: Collaborate with industry experts to develop an appropriate policy and regulatory framework for crypto-assets in Canada.**

Canada's crypto-asset stakeholders are strongly aligned in the view that policy makers and regulators need to work closely with industry experts and market participants. Dialogue, information sharing and collaboration between industry and government is essential to building a regulatory framework in Canada that balances innovation and ecosystem growth with protecting users and preserving market integrity.

Our industry has had only a limited opportunity to consider the Consultation Paper, consult with one another, and formulate responses to the twenty-two detailed questions set out in the Consultation Paper. In light of the brief 60-day consultation period and the complexity of the issues addressed in the Consultation Paper, CDAC encourages the CSA and IIROC to meaningfully consult with industry participants before enacting any regulatory framework applicable to crypto-asset platforms.

To appropriately support and regulate Canada's rapidly growing digital asset ecosystem, it is critical that policy makers and regulators thoroughly understand blockchain and distributed ledger technologies, their broad applications and use cases, opportunities and risks, and unique characteristics as well as potential regulatory challenges. We encourage dialogue with Canadian technical, policy and legal experts, as well the Chamber of Digital Commerce Canada, as they can assist with navigation around this rapidly evolving technology and regulatory space.

### **Recommendation 4: Establish a government + industry Task Force with working groups on specific policy and regulatory areas in the crypto-asset space.**

Globally, many regulators have set up internal teams, collaborative Working Groups or Task Forces to assess emerging crypto-asset-related activities, and are also working with industry to develop their economic strategies and regulatory frameworks. Our industry discussions support establishing expert working groups with policy makers and regulators to fully examine distinct topic areas relating to digital assets and crypto-asset platforms and markets. Specific topic areas of interest identified through roundtable consultations include custody, payments, securities, markets (integrity, infrastructure, and fairness), as well as enabling

policies to support businesses. Additional dialogue with industry experts is recommended to land on the appropriate Task Force areas of focus.

### Recommendation 5: Improve coordination across provinces, territories and the federal government.

There is industry support for a strategic approach to policy and regulatory development and one that minimizes regulatory burden, duplication or conflicting requirements. Given that crypto-assets may have multiple policy and regulatory touch points, it is recommended that governments better coordinate and collaborate on the development of regulations and standards.

In developing a governance structure, it is critical that appropriate Ministries (i.e., those overseeing finance, economic development, innovation, consumer protection, and privacy policy areas), policy leads, regulators (securities administrators, FINTRAC, IIROC, CRA, etc.) and trade associations (Chamber of Digital Commerce Canada, CPA, etc.) are brought to the table. Within Canada, the Chamber of Digital Commerce Canada can provide or facilitate the establishment of an intergovernmental forum for further discussion regarding digital assets.

Lastly, while beyond the scope of this consultation, it is worth noting that the international nature of crypto-assets necessitates collaboration and alignment across regulators and standard-setting bodies to mitigate potential regulatory conflicts and allow for coordination and sharing of information and best practices. A recent study by the University of Cambridge found that the absence of consensus over terminology, definitions, and classification of digital assets may hamper regulatory harmonisation across jurisdictions.<sup>2</sup> The study cautions that a lack of harmonised and coordinated regulatory responses allows crypto-asset market participants to exploit regulatory loopholes and circumvent stringent regulations. The International Organization of Securities Commissions (IOSCO), the Financial Stability Board (FSB), and the Organisation for Economic Co-operation and Development (OECD) have been identified as potential venues where Canada can collaborate on standards and guidance at an international level.

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<sup>2</sup> <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/cryptoasset-regulation/#.XN3vFshKhPa>

## Part II: Industry Feedback on the Consultation Paper Questions

This section of this submission highlights specific feedback in response to the Consultation Paper's twenty-two questions, including a summary of recommendations for consideration. Please note that the submission only addresses the subset of the questions where the Steering Committee received sufficient input to formulate a response and recommendation that could be of assistance to CSA and IIROC.

In light of the relatively brief 60-day consultation period and the complexity of the issues addressed in the Consultation Paper, CDAC encourages CSA and IIROC to continue to consult with industry participants before enacting any regulatory framework applicable to crypto-asset platforms.

### Crypto-asset Platform Specific Recommendations

1. CSA/IIROC should consider the confidentiality and privacy implications of regulations applicable to trading platforms that transact on public blockchains/ledgers. For example, requiring platforms to hold participants' crypto-assets in individually segregated wallets or to settle trades through delivery to participants could publicly reveal confidential and/or private information about individual participants' asset holdings, trades and counter-parties.
2. To the extent that securities legislation applies to crypto-asset trading platforms, of the various operational risks of crypto-asset trading platforms identified by CSA/IIROC, CSA/IIROC should prioritize addressing risks relating to the safeguarding of crypto-assets held or stored by platforms on behalf of participants.
3. To the extent that securities legislation applies to crypto-asset trading platforms, CSA/IIROC should align Canadian requirements applicable to crypto-asset trading platforms with requirements set by other jurisdictions to minimize the cost of compliance for platforms that operate transnationally and the likelihood of forum shopping to countries other than Canada.
4. CSA/IIROC should consult further regarding crypto-asset industry standards and best practices, and the ability and willingness of traditional assurance services providers to serve the crypto-asset industry before mandating any standards or practices for mitigating the risks relating to safeguarding crypto-assets or otherwise providing assurance to regulators.
5. CSA/IIROC should consider that there are potentially significant cost, security, risk management and privacy benefits to participants for platforms to hold or store crypto-assets on behalf of participants.
6. To the extent that securities legislation applies to crypto-asset trading platforms, CSA/IIROC should not mandate any insurance requirements for crypto-asset trading platforms unless and until insurance coverage is generally available at commercially reasonable cost.

7. To the extent that securities legislation applies to crypto-asset trading platforms, CSA/IIROC should conduct further analysis and consultation on the prevalence and significance of short-selling and margin trading on Canadian crypto-asset platforms before prohibiting these activities, even on a temporary basis.

## Risks Related to Platforms

**1. Are there factors in addition to [the following] that we should consider [when evaluating whether or not a security or derivative may be involved in trading on a Platform]?**

- *whether the Platform is structured so that there is intended to be and is delivery of crypto assets to investors,*
- *if there is delivery, when that occurs, and whether it is to an investor’s wallet over which the Platform does not have control or custody,*
- *whether investors’ crypto assets are pooled together with those of other investors and with the assets of the Platform,*
- *whether the Platform or a related party holds or controls the investors’ assets, 6*
- *if the Platform holds or stores assets for its participants, how the Platform makes use of those assets,*
- *whether the investor can trade, or rollover positions held by the Platform, and*
- *having regard to the legal arrangements between the Platform and its participants, the actual functions of the Platform and the manner in which transactions occur on it*
  - *who has control or custody of crypto assets,*
  - *who the legal owner of such crypto assets is, and*
  - *what rights investors will have in the event of the Platform’s insolvency*

Multiple respondents cautioned that if platforms are considered to be trading in securities or derivatives because of the manner in which their operations are structured (even if structured for valid technological, security or other reasons), platforms may exit, or choose not to enter, the Canadian market. This would tend to increase consumer costs, reduce consumer choice, and potentially reduce the availability of desirable services for Canadians. It may also drive Canadian consumers towards trading in crypto-assets through underground or foreign marketplaces, thereby reducing, rather than enhancing, the protection of Canadian crypto-asset users.

A number of respondents familiar with the operations of custodial trading platforms provided general comments based on today’s technological understanding regarding the factors referenced in Part 2.<sup>3</sup>

- Many platforms complete the sale of crypto-assets by updating their internal records of which customers own what amounts of the crypto-assets in the platform’s custody, not by transferring crypto-assets between wallets using an “on-chain” transaction.

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<sup>3</sup> Custody of crypto-assets cannot be viewed through the same lens as custody of traditional assets or traditional securities, as the means of control and the ability to transfer crypto-assets is different. The term “custody” is used here to describe the holding of customer crypto-assets at addresses/accounts/wallets for which the platform, not the customer, has control of the private keys.

- Taking custody of customers' crypto-assets can be a source of risk for trading platforms but they do so for a variety of business reasons, including that taking custody mitigates the risk that a customer selling crypto-assets will fail to complete a sale (i.e., entering into a trade but failing to send the crypto-asset to the buyer) and that some customers prefer to keep their crypto-assets in the platform's custody.
- Platforms can provide customers with the ability to transfer their crypto-assets to a wallet under their sole control and many customers do transfer their crypto-assets shortly after purchase.
- Some trading platforms pool customer crypto-assets in their custody, which has a number of advantages compared to maintaining segregated wallets for each customer:
  - Pooling allows trading platforms to hold the bulk (often over 90%) of crypto-assets in cold wallets, which are accessed infrequently. This reduces the risk of loss due to security breaches or technical/human error. Managing private keys for individual segregated wallets would be complex and increases risk for the platform and its customers.
  - Completing a sale of crypto-assets using an "on-chain" transaction to a wallet for each customer would increase transaction costs, which would be passed on to the customer.
  - When customer crypto-assets are pooled together, holdings and transactions on the platforms are recorded "off-chain" in a private database controlled by the platform. If transactions occur on the public blockchain/ledger, private/confidential information about each customer's assets, trades and counter-parties could be publicly available.
- Many platforms provide the custody function themselves. Using a third party's services for custody would increase costs for the platform and its customers and create counterparty risks.
- Consistent with holding the bulk of customer crypto-assets in cold wallets, there are a number of platforms do not make use of customer assets but hold all such assets on a 1:1 basis.
- Many platforms consider customer crypto-assets in the platform's custody to belong to their customers, not the platform.
- The structure of many platforms, whereby the platform operates as a custodian or bailee, does not give rise to a security or derivative interest. The crypto-assets in these cases are legally owned by the customer and not the platform. This means, critically, that the customer's interest is not derived from the underlying asset – it is the underlying asset. The application of a securities law framework, accordingly, is inappropriate to this structure.

***3. What best practices exist for Platforms to mitigate the risks outlined in Part 3? Are there any other significant risks which we have not identified? Do you believe that these accurately describe the current risk environment? Is there anything that should not be included here, or that is missing? Please explain.***

CDAC surveyed respondents regarding their perception of what best practices exist to mitigate risks identified by CSA/IIROC in Part 3 of the Consultation Paper. Respondents identified the following as some of the current best practices, noting that they are evolving and improving as the technology also evolves and improves:

- The use of cold wallets and multi-signature wallets;
- KYC collection and user identification;

- The implementation of formal anti-money laundering (AML) compliance programs;
- Transparent and accurate trade information and trade monitoring;
- Sanctions and terrorist list related screening;
- Segregation of user funds/assets from operating funds/assets held by the platform operator;
- Formalized security processes;
- Disaster recovery and business continuity planning;
- Compliance and security audits.

Platforms collect and retain large volumes of sensitive personal information about participants, including financial information about participants' bank accounts and crypto-asset transactions, which exposes participants to the risk of loss, theft or misuse of their information in the custody of platforms. This risk may be greater compared to the privacy risks applicable to marketplaces and dealers because loss, theft or misuse of personal information may have privacy consequences beyond transactions on the platform due to the public nature of most crypto-asset blockchains/ledgers.

**Recommendation #1:** CSA/IIROC should consider the confidentiality and privacy implications of regulations applicable to trading platforms that transact on public blockchains/ledgers. For example, requiring platforms to hold participants' crypto-assets in individually segregated wallets or to settle trades through delivery to participants could publicly reveal confidential and/or private information about individual participants' asset holdings, trades and counter-parties.

CDAC also surveyed respondents regarding their perception of the relative importance of the risks identified by CSA/IIROC in Part 3 of the Consultation Paper. Respondents identified the following risks as the most significant risks:

- Investors' crypto-assets may not be adequately safeguarded;
- Investors' crypto-assets may be at risk in the event of a bankruptcy or insolvency;
- Investors may not have important information about a platform's operations;
- System resiliency, integrity, and security controls may be inadequate;
- Processes, policies and procedures may be inadequate.

Respondents were less concerned about the following risks, compared to those identified above (note, this does not mean that should not be considered, just that they are perceived to be lower priority):

- Investors may purchase crypto-assets that are not suitable for them;
- Investors may not have important information about the crypto-assets that are available for trading on the platform;
- Conflicts of interest may not be appropriately managed;
- Manipulative and deceptive trading may occur;
- There may not be transparency of order and trade information.

These responses tended to show that respondents were more concerned about the safeguarding of crypto-assets held or stored on platforms than they were about risks arising from crypto-asset transactions on platforms. Investment risk regarding suitability and information gaps for crypto-assets (not digitized traditional securities) may be better addressed through education rather than regulatory enforcement. As described in the submission by the Chamber of Digital Commerce Canada, there is a broad benefit to developing objective investor and consumer education tools to help inform the public.

**Recommendation #2:** To the extent that securities legislation applies to crypto-asset trading platforms, of the various operational risks of crypto-asset trading platforms identified by CSA/IIROC, CSA/IIROC should prioritize addressing risks relating to the safeguarding of crypto-assets held or stored by platforms on behalf of participants.

## Global Approaches

### *3. Are there any global approaches to regulating Platforms that are appropriate to be considered in Canada?*

Respondents identified approaches taken in Bermuda, Malta, Mauritius, Switzerland, Gibraltar, Wyoming, Japan, Singapore, and France as potentially appropriate for consideration in Canada. The in-depth jurisdictional scan of the global crypto-asset regulatory landscape by the Cambridge Centre for Alternative Finance, released in April 2019, is a good resource for regulators and policy makers to refer to as it includes overviews of the regulatory space across various jurisdictions.<sup>4</sup> Key points relating to each of these jurisdictions are also described in the submission presented by the Chamber of Digital Commerce Canada (for expedience, these will not be repeated here).

A number of respondents emphasized that the largest global trading platforms operate from outside Canada, and may exclude Canadian participants if the cost of compliance with Canadian regulatory requirements is out of proportion to the size of the Canadian market. They noted that exclusion of Canadians by major global trading platforms could result in higher costs and other inferior outcomes for Canadians.

Access to banking services is a significant challenge facing crypto-asset companies worldwide and banking challenges contributed to liquidity and solvency issues at QuadrigaCX. With banks refusing to operate or outright closing accounts of Canadian companies due to regulatory barriers and risk aversion, businesses are leaving for more favourable international jurisdictions, like Liechtenstein, Malta, Bermuda and France which have amended their laws to help crypto-asset companies access banking services. Banking restrictions present a competitive disadvantage and an impediment to economic growth – a number of industry participants have voiced that Canada should also consider implementing enabling and complementary policies, such as those related to banking.

Respondents commented that restrictions on access to banking for crypto-asset trading platforms create risks for Canadian consumers using those platforms. Lack of access to banking may require platforms to use unregulated payment processors for accepting and making fiat currency payments, which may delay transactions with customers and increase the risk of loss.

<sup>4</sup> <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/cryptoasset-regulation/#.XNrHBY5KhPY>

Certain platform operators noted that they would prefer to be registered with FINTRAC because they expect it could improve banking relationships and consumer confidence, but they are currently unable to register because pending amendments and regulations under the Proceeds of Crime (Money Laundering) and Terrorist Financing Act are not yet in force. They suggested that bringing these requirements into force would reduce risks for crypto-asset trading platform users. There are also a few stakeholders that believe that Bitcoin should be considered money (as it is in Japan) and thus subject to foreign exchange rules and regulation under upcoming FINTRAC amendments – they further argue that Bitcoin, unlike the majority of digital assets, should not be covered under securities laws.

**Recommendation #3:** To the extent that securities legislation applies to crypto-asset trading platforms, CSA/IROC should align Canadian requirements applicable to crypto-asset trading platforms with requirements imposed by other jurisdictions to minimize the cost of compliance for platforms that operate transnationally and reduce the risk of Canadian companies being disadvantaged in the international market.

## Custody and Verification of Assets

**4. What standards should a Platform adopt to mitigate the risks related to safeguarding investors' assets? Please explain and provide examples both for Platforms that have their own custody systems and for Platforms that use third-party custodians to safeguard their participants' assets.**

Respondents identified various practices for mitigating risks related to safeguarding crypto-assets:

- Use of multi-signature wallets and other key management practices;
- Limits for hot wallet balances;
- Screening process (criminal background checks, etc.) for individuals (e.g., staff, officers, directors, and all beneficial owners) with crypto wallet handling responsibilities;
- Segregated addresses for different participants.

A number of respondents highlighted the Crypto Currency Security Standard (CCSS) published by the Crypto Currency Certification Consortium (C4).<sup>5</sup> According to C4, CCSS is designed to complement existing information security standards (i.e. ISO 27001:2013) by introducing guidance for security best practices with respect to cryptocurrencies.

Some respondents noted that Mauritius has taken one of the best approaches globally to custodial regulation, by working with industry experts to develop a regulatory framework for custodial services.<sup>6</sup>

Some respondents also noted that platforms could self insure by maintaining a reserve for customer losses using a portion of trading fees.

**5. Other than the issuance of Type I and Type II SOC 2 Reports, are there alternative ways in which auditors or other parties can provide assurance to regulators that a platform has controls in place to ensure that investors'**

<sup>5</sup> <https://cryptoconsortium.org/standards/CCSS>

<sup>6</sup> [https://www.fscmauritius.org/media/67493/consultation-paper-custody-of-digital-assets\\_final.pdf](https://www.fscmauritius.org/media/67493/consultation-paper-custody-of-digital-assets_final.pdf)

***crypto-assets exist and are appropriately segregated and protected, and that transactions with respect to those assets are verifiable?***

Certain respondents noted that due to the public nature of most blockchains, the amount of crypto-assets held by a trading platform could in theory be verified by anyone with knowledge of the platforms' hot and cold wallet addresses. It was also noted, however, that disclosure of platform wallet addresses, particularly cold wallet addresses, may affect customer privacy, increase security risks, and be competitively harmful for platforms.

Respondents identified various methods for trading platforms to provide cryptographic "proof of reserves" without necessarily disclosing hot and cold wallet addresses:

- Blockstream's "Proof of Reserves Tool"<sup>7</sup>;
- Coinfloor's "Provable Solvency Report"<sup>8</sup>;
- Kraken's "Proof-of-Reserves Audit Process"<sup>9</sup>;
- Bitbuy's "Proof of Reserve and Security Audit"<sup>10</sup>.

One respondent noted that the participation of CPA Canada is required to ensure SOC 2 Reports are "practically obtainable in Canada" for crypto-asset trading platforms.

Another respondent commented that considerations should be made for fewer requirements / reporting obligations for public blockchains, whose transactions are fully audited and available via the blockchain for any private entity's operations and consumers' transactions. In order to support innovative products on the blockchain, regulators are encouraged to explore low cost ways start-ups could become exempt market dealers or licensed broker dealers (with appropriate oversight).

**Recommendation #4:** CSA/IIROC should consult further regarding crypto-asset industry standards and best practices, and the ability and willingness of traditional assurance services providers to serve the crypto-asset industry before mandating any standards or practices for mitigating the risks relating to safeguarding crypto-assets or otherwise providing assurance to regulators.

***6. Are there challenges associated with a Platform being structured so as to make actual delivery of crypto assets to a participant's wallet? What are the benefits to participants, if any, of platforms holding or storing crypto assets on their behalf?***

Respondents noted that platforms could be structured to deliver crypto-assets to a participant's wallet (and certain platforms use this model of operation), but some respondents observed that confirming every trade to the blockchain or other public ledger to deliver crypto-assets to a customer's wallet can be complex and expensive, particularly where there is frequent trading. As it is less costly to record crypto-asset transactions "off-chain" (i.e., in a separate database maintained by the platform), these cost savings accrue

<sup>7</sup> <https://blockstream.com/2019/02/04/en-standardizing-bitcoin-proof-of-reserves/>

<sup>8</sup> <https://blog.coinfloor.co.uk/post/184391946481/provable-solvency-report-61-april-2019>

<sup>9</sup> <https://www.kraken.com/proof-of-reserves-audit>

<sup>10</sup> <https://bitbuy.ca/assets/documents/Bitbuy%20Proof%20of%20Reserve%20and%20Security%20Audit%20Report.pdf>

to the benefit of participants. Additionally, some prefer the platforms to hold or store the crypto-assets on their behalf for the reasons set out below.

Respondents identified certain other benefits to participants of platforms holding or storing crypto-assets on their behalf:

- Participants have a means of recovering their crypto-assets in the event of a lost or forgotten password. Participants who hold crypto-assets in their own wallets risk permanent loss in the event of lost or forgotten private keys. One respondent noted: “One benefit of holding assets on the behalf of investors is that many people find it challenging to manage their own keys. I feel very secure that I won’t lose my [on exchange] crypto-assets because I don’t control the private keys.”
- Participants can sell crypto-assets quickly in response to market developments (for example, by setting stop-loss orders), better allowing them to manage market risk.
- Platforms may take better security measures than participants, who may be more likely to store all of their crypto-assets in hot wallets (e.g., on mobile devices), increasing their exposure to theft.
- As records of platform participants’ ownership and trades are maintained “off-chain”, there may be greater protection against the disclosure of personal information about participants’ crypto-asset holdings, trades and counter-parties.

The platforms that perform on-chain transactions and do not store crypto-assets on behalf of users want to ensure that regulations will not require the storage of crypto-assets on behalf of users as this activity could increase the platform’s risk of losing customers’ assets (e.g., by theft, hack).

**Recommendation #5:** CSA/IIROC should consider that there are potentially significant cost, security, risk management and privacy benefits to participants for platforms to hold or store crypto-assets on behalf of participants.

## Insurance

**16. What type of insurance coverage (e.g. theft, hot-wallet, cold-wallet) should a platform be required to obtain? Please explain.**

There were differing views expressed by respondents regarding insurance requirements:

- One commenter suggested that “insurance should be optional [and] platforms should use it as a competitive advantage”. Another commenter suggested that insurance should be mandatory in order to exclude marginal platforms that “cannot afford or would not obtain such insurance”, leaving “legitimate platforms that have the means to be insured”.
- Two commenters contended that both hot and cold wallet insurance against theft or loss was optimal because of the significant consequences in the event of theft or loss with respect to cold wallets.

- One commenter suggested insurance for technological errors and omissions. The commenter cited the example of a reported software bug that allegedly resulted in the loss of millions of dollars worth of Ethereum by the now-bankrupt QuadrigaCX trading platform.<sup>11</sup>

**17. Are there specific difficulties with obtaining insurance coverage? Please explain.**

Respondents stated:

- There are very few insurers willing to underwrite crypto-related policies. There are only two underwriters globally.
- Where policies are available, premiums are very high (e.g., 1-2% annualized on the insurable asset).
- Technology errors and omissions coverage is prohibitively expensive for all but the largest organizations.
- There are limitations to insurance and how it's structured – notably, cold wallets are not insured by all insurers.
- Insurer knowledge of the business/asset class is insufficient to ensure appropriate coverage.

One commenter noted that the banking challenges for market participants contribute to the inability of platforms to obtain insurance coverage, noting “[f]inancial inclusion for the industry is a necessity”.

Another commenter noted that industry standards are welcome as they can help de-risk the sector and help companies access insurance. However, the insurance industry needs to be made a stakeholder in this conversation going forward, to ensure that any required insurance is practically obtainable in Canada.

Another commenter noted that the CSA should not restrict Canadian domiciled actors from competing internationally through the imposition of onerous capital reserve requirements.

**Recommendation #6:** To the extent that securities legislation applies to crypto-asset trading platforms, CSA/IIROC should not mandate any insurance requirements for crypto-asset trading platforms unless and until insurance coverage is generally available at commercially reasonable cost.

## Other Comments

A number of respondents commented on the Consultation Paper’s statement that “[t]o reduce the risks of potentially manipulative or deceptive activities, in the near term, we propose that Platforms not permit dark trading or short selling activities, or extend margin to their participants.” Comments included:

- “It is our belief that margin trading and short-selling are important activities that help crypto-assets become legitimate assets in the mainstream financial markets.”
- “[Margin and short-selling] also provide means of stability and risk mitigation in the market.”

<sup>11</sup> [https://www.reddit.com/r/ethereum/comments/6ettq5/statement\\_on\\_quadrigacx\\_ether\\_contract\\_error/](https://www.reddit.com/r/ethereum/comments/6ettq5/statement_on_quadrigacx_ether_contract_error/)

- “Banning short-selling prevents true price discovery in a healthy market (as it eliminates the downward price pressure), and effectively prevents market forces from operating to regulate the market itself.”
- “Additionally, as the asset is truly a global border-less asset, banning such activities on Canadian platforms will simply push such activities to other jurisdictions. We have the opportunity to draw participants to come into a regulated environment, but in banning such activities, participants will simply go jurisdiction shopping, thus pushing participants back to an unregulated space.”
- “Banning short-selling or margin trading in Canada will not stop such activity from occurring in the global crypto-asset market, and will simply incentivize clients to seek alternatives outside Canada.”

**Recommendation #7:** To the extent that securities legislation applies to crypto-asset trading platforms, CSA/IIROC should conduct further analysis and consultation on the prevalence and significance of short-selling and margin trading on Canadian crypto-asset platforms before prohibiting these activities, even on a temporary basis.

## In Conclusion

Through consultation with a broad diversity of entrepreneurs and community members, it is clear that while there is not consensus on all matters, there is a willingness to engage in a meaningful dialogue with regulators. We urge the readers of this submission to carefully consider the points raised here, in addition to the points raised by other industry participants in their submissions and the Chamber of Digital Commerce Canada. We urge the CSA and IIROC to establish an ongoing dialogue with the industry, in order to ensure effective outcomes for all stakeholders.

## Appendix 1: Consultation Participants <sup>12</sup>



Eric Kryski, CEO & Co-Founder



Cryptocurrency Exchange. Pamela Draper, President & CEO



Canadian Bitcoins – Cryptocurrency Brokerage. James Grant, Owner



Centigram International Ltd. Sameem Monzaviyan, Founder and President



CryptoChicks – Blockchain Educational Hub. Nataliya Hearn, Co-Founder



GraafOne – Non-Custodial Bitcoin Services. Pavel Dolzhenko, Founder



Grayblock Power. Chris Ciaravino, Founder & CEO



iComply Investor Services. Matthew Unger, CEO



Ledn – Credit & Savings Products for Bitcoin. Adam Reeds, Co-Founder & CEO; Mauricio Di Bartolomeo, Co-Founder & CSO



Metamesh Group. Magdalena Gronowska, Consultant



Outlier – AML Consulting Services & Strategies. Amber Scott, Founder



Shyft Network International Inc. Joseph Weinberg, Co-Founder; Chris Forrester, CTO



Toda Network. Toufi Saliba, CEO



Unitralis, Joseph Iuso, Advisor

<sup>12</sup> Note, CDAC consulted with a number of companies and individuals. The following companies have consented to being identified.



Canadian Digital Asset Coalition