
2022

The View from the Border: A Comparative Analysis of Securities Regulations for Cryptocurrencies in the United States and Canada

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Rose Lewis, *The View from the Border: A Comparative Analysis of Securities Regulations for Cryptocurrencies in the United States and Canada Student Articles and Notes*, 46 Can.-U.S. L.J. 167 (2022)

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THE VIEW FROM THE BORDER: A COMPARATIVE ANALYSIS OF SECURITIES REGULATIONS FOR CRYPTOCURRENCIES IN THE UNITED STATES AND CANADA

Rose Lewis†

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OVERVIEW

This article compares how securities regulators in Canada and the United States have considered their jurisdictions to regulate cryptocurrency. Broadly construed, securities law concerns itself with the issuance and trading of stocks, bonds and other instruments considered securities. Beyond the threshold question of whether cryptocurrencies constitute a security, there are a range of implications for parties who sell digital currencies to the general public in light of the requirements securities regulations impose on reporting issuers. These requirements include obligations to register, to complete periodic filings, to avoid making statements that materially mislead the general public, and to satisfy a wide range of corporate governance prescriptions. Extending the reach of securities regulation into the cryptocurrency arena merits considering when offering currencies for sale should trigger regulatory scrutiny.

This is a timely discussion given the core features of cryptocurrency and its growing presence in financial markets where digital currencies are issued and traded in a manner similar to traditional securities. While leading cryptocurrencies like Bitcoin are not a popular means of payment among the general public, they have attracted speculative investors, causing a dramatic increase in their value. These dynamics continue to fuel debates about whether cryptocurrencies are not merely currencies, but securities or commodities. These debates will shape policy choices rooted in the legal classification of the marketplace where digital currencies are issued and sold.

This article contributes to existing discourse by: (i) examining the posture towards cryptocurrencies adopted by securities regulators in Canada and the United States; and (ii) outlining a set of shared norms both countries might adopt to support investor protection without unduly interfering with cryptocurrency markets. The discussion below is outlined as follows: Part I offers an overview of cryptocurrency, with a particular emphasis on Bitcoin. Building on the general rationale for regulating securities, Part II discusses the U.S. Securities and Exchange Commission’s (SEC) increasingly aggressive signals to the cryptocurrency industry, which the SEC’s Chair considers “the wild west of our financial system” that requires “rules of the road.”¹ Part III looks at the Canadian law’s approach to cryptocurrency—based on the Canadian Securities Administrator’s release of a January 2020 consultation paper²—which relies on staff comment rather than litigation posture to devise prospective rules of engagement. Part IV discusses the applicability of securities law to cryptocurrencies, analyzes the different approaches to creating the existing securities regulation for cryptocurrencies, and proposes considerations for the implantation of global securities regulation for cryptocurrencies.

I. INTRODUCTION—THE CREATION OF CRYPTOCURRENCY

In 2008, the world was revolutionized when an individual, or group, acting under the pseudonym Satoshi Nakamoto, released a whitepaper to a cryptography mailing list.³ Through this simple act of publication, which occurred on March 24, 2009, Nakamoto changed the landscape of financial transactions with the release of bitcoin,⁴ a digital form of currency with no intrinsic value.

A. What Is Cryptocurrency?

Cryptocurrency is a portmanteau of *cryptography*, the practice of securing a message’s content through disguise as something arbitrary, and *currency*. Data encryption is a form of cryptography where sensitive information is scrambled into a seemingly nonsensical alphanumeric arrangement that requires a key to unscramble and ascertain the content. Money comes in many forms, including currencies. The common conception of money, government minted dollars and

¹ Benjamin Bain & Matt Robinson, *Coinbase Threat Shows There’s a New Crypto Sheriff in Town*, BLOOMBERG (Sept. 8, 2021), https://www.bloomberg.com/news/articles/2021-09-08/coinbase-threat-shows-there-s-a-new-sheriff-in-town-on-crypto?fbclid=IwAR33qXBIAZlwPnofTDlovWYHyroZ_sghh4LpccbKTLgp6boIa3ve5ZQXad8.

² CSA Staff Notice 21-327, *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets*, CSA/ACVM (Jan. 16, 2020), https://www.osc.ca/sites/default/files/pdfs/irps/csa_20200116_21-327_trading-crypto-assets.pdf [hereinafter Staff Notice 21-327].

³ Tom Huddleston, Jr., *Bitcoin Turns 13—and Its Creator Is Still Shrouded in Mystery. Here’s Why*, MAKE IT (Apr. 24, 2021), <https://www.cnbc.com/2021/04/24/uk-bitcoin-copy-right-lawsuit-the-mystery-behind-bitcoins-creation.html>.

⁴ Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN.ORG, bitcoin.org/bitcoin.pdf.

cents used to buy and sell goods and services, is a specific type of currency, “fiat.” Legally, money is anything that can function as a medium of exchange, unit of account, and store of value.⁵ When the combination of cryptography and currency is interpreted through a global network of computers, the result is a form of purely digital money that is encrypted for user security.

Cryptocurrency was initially a digital form of money unconnected to the government or any other central authority. Utilizing data encryption, users could anonymously send digitally generated money in the form of cryptocurrency to each other. To give cryptocurrency “relevant” value, the currency’s exchange rate against the U.S. Dollar or Canadian Dollar is often used. The value of different cryptocurrencies varies greatly, with one “coin” of a particular currency, for instance one bitcoin, being equivalent to thousands of U.S. Dollars while a single coin from another currency can be worth fractions of a cent. Higher value coins are virtually ineffective for day-to-day transactions with peers; however, coins can be divided into infinitesimally small fractions for transactions of any size as the coins’ value rises against a country’s fiat.

In the bitcoin whitepaper, Nakamoto explains the gap and inefficiency in the current monetary framework and the intention behind bitcoin’s creation:

Commerce on the Internet has come to rely almost exclusively on financial institutions serving as trusted third parties to process electronic payments. While the system works well enough for most transactions, it still suffers from the inherent weaknesses of the trust based model [. . .] These costs and payment uncertainties can be avoided in person by using physical currency, but no mechanism exists to make payments over a communications channel without a trusted party.

What is needed is an electronic payment system based on cryptographic proof instead of trust, allowing any two willing parties to transact directly with each other without the need for a trusted third party. Transactions that are computationally impractical to reverse would protect sellers from fraud, and routine escrow mechanisms could easily be implemented to protect buyers. In this paper, we propose a solution to the double-spending problem using a peer-to-peer distributed timestamp server to generate computational proof of the chronological order of transactions. The system is secure as long as honest nodes collectively control more CPU power than any cooperating group of attacker nodes.⁶

Nakamoto’s intention was to address the inefficiencies created by using a single, trusted centralized authority to verify transactions through proliferation of a purely decentralized cryptocurrency. Instead, the transaction would be recorded publicly and verified through mass user input. Ideally, the system is infallible once the number of users, represented by nodes, is large enough to ensure honest nodes will outnumber and out speed any group of attacker nodes.

⁵ Stephen C. Wilks, *The Reimagined Schoolyard: Cryptocurrency’s Adoption in Tomorrow’s International Monetary Order*, (June 4, 2020). 2020 B.C. INTELL. PROP. & TECH. F. 1 (2020), available at <https://ssrn.com/abstract=3632014>.

⁶ Nakamoto, *supra* note 4.

B. An Introduction to Decentralization

In 1950, cooperative behavior in humans was examined from an economic standpoint. Often referred to as the “prisoner’s dilemma,” the problem presents two options to two imprisoned individuals. Either: betray the other to lessen one’s own sentence; or, both remain silent and receive the lightest possible sentence.⁷ However, if both prisoners betray the other, both receive a moderate prison sentence.⁸ If humans were purely rational beings, serving one’s self-interest would always be the ultimate option, and always lead to a moderate prison sentence. Humans, though, or not purely rational. Innate altruism in humans⁹ produces a variable result and can lead to cooperation through the inclination to trust others.¹⁰ Decentralization exploits this altruistic tendency by assuming that all actors will cooperate.

1. Decentralization for Cryptocurrency

Decentralization removes exclusive control from one party and, instead, spreads it amongst many. Applied to cryptocurrency, decentralization occurs through the elimination of a centralized, third-party verifier, instead allowing crypto users to exchange currency directly on a peer-to-peer basis. Each transaction is recorded on a “blockchain,” a publicly available, real-time, encrypted ledger of all peer-to-peer digital currency exchanges.¹¹ Financial transactions and their related recordings are synergistic, allowing trust to exist as an effect of their interaction. Without recording, transactions are unverifiable. Without verifiability, there can be no trust. The transparency of the blockchain replaces the need for a regulated third-party verifier, allowing any node on the network to access a copy of the blockchain and instantaneously review the transaction firsthand.¹² A node is anyone who contributes data to the blockchain, including both miners, who are awarded cryptocurrency for validating transactions, and wallet holders, who are participating in the transactions.¹³ Decentralizing control of the ledger not only diminishes the risk of errors or manipulation from a centralized verification party but increases security.¹⁴ A centralized verifier creates a single point of failure for a system and a single

⁷ Steven Kuhn, *Prisoner’s Dilemma*, THE STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Edward N. Zalta ed. 2019), <https://plato.stanford.edu/entries/prisoner-dilemma/>.

⁸ *Id.*

⁹ *Altruism May Be Universally and Uniquely Human*, AM. PSYCH. ASS’N (June 25, 2015), <https://www.apa.org/pubs/highlights/peeps/issue-48>.

¹⁰ KEVIN WERBACH, THE BLOCKCHAIN AND THE NEW ARCHITECTURE OF TRUST, —ch. 1, at 719 (Amazon Kindle edition, 2018).

¹¹ Ross Mauri, *Blockchain for Fraud Prevention: Industry Use Cases*, IBM (July 12, 2017), <https://www.ibm.com/blogs/blockchain/2017/07/blockchain-for-fraud-prevention-industry-use-cases/>.

¹² *Id.*

¹³ WERBACH, *supra* note 10.

¹⁴ Sue Troy, *Distributed Ledger Technology (DLT)*, TECHTARGET (Last updated June 2021), <https://searchcio.techtarget.com/definition/distributed-ledger>.

target for hackers.¹⁵ Spreading risk of failure or hacking over an unlimited number of parties exponentially increases the safety of the system. A hacker may be able to take down one or multiple nodes, but by using thousands of nodes to record, replicate, and verify data, theoretically, the data will be replicated *ad infinitum* and resist hacking attempts.¹⁶ Decentralization also allows the network to be spread globally, instead of centralizing in a single country, creating a truly global network of financial transactions.¹⁷ Finally, allowing each of the network's nodes to be a verifying authority negates inefficiencies stemming from a volume-driven bottleneck in a central verification setting and maintains trust through transparency. The preoccupation with trust in relation to money has created a variety of unnecessary inefficiencies and complexities in the financial regulatory landscape at large.

C. Cryptocurrency as a Commodity

A commodity is a basic commercial good that can operate as a medium of exchange, store of value, and unit of account, like money, and is often a raw material used to produce secondary goods.¹⁸ Producers of commodities adhere to a wider regulatory scheme than strictly finance, including mining safety regulations for precious metals, and environmental standards for oil drilling. Financially, commodities are not regulated as stringently as securities, nor do they carry the same reporting responsibilities.¹⁹ Less financial regulation increases the commodity's volatility, seen easily in gasoline prices, which fluctuate constantly.²⁰ Commodities and their prices are regulated in part through reporting requirements for derivatives products derived from commodities, such as futures and swaps.²¹ Derivatives are one of the three categories of securities, along with equity securities (like shares) and debt securities (like bonds).²² Broadly, securities are defined as a financial asset that can be traded.²³ As a result, commodities futures, a type of security, are regulated and traded as a speculative investment.

Notably, commodities are not regulated by a securities commission. Investors believe bitcoin's limited supply and pure decentralization drives its potential as a long-term investment, coining bitcoin as the new "gold standard"

¹⁵ *Id.*

¹⁶ *The Ultimate Guide to Decentralized Prediction Markets*, AUGUR (2019), <https://augur.net/blog/prediction-markets/>.

¹⁷ Troy, *supra* note 14.

¹⁸ Wilks, *supra* note 5, at 11–12.

¹⁹ Is Crypto a Commodity or Security?, SoFi (Apr. 27, 2021), <https://www.sofi.com/blog/crypto-commodity-vs-security/> BLOG.

²⁰ Eustance Huang & Pippa Stevens, *An Oil Futures Contract Expiring Tuesdy Went Negative in Bazarre Move Showing a Demand Collapse*, CNBC (Apr. 20, 2020), <https://www.cnbc.com/2020/04/20/oil-markets-us-crude-futures-in-focus-as-coronavirus-dents-demand.html>.

²¹ Commodity Exchange Act, 17 C.F.R. § 1.3 (2017).

²² *What Is a Security?*, CORP. FIN. INST., <https://corporatefinanceinstitute.com/resources/knowledge/finance/security/> [hereinafter *What Is a Security?*].

²³ *Id.*

for commodities investments.²⁴ Research has drawn parallels between bitcoin's value performance and gold's value performance during stock market crashes and booms, indicating that bitcoin holders treat the coin as a hedging instrument to protect their portfolios during uncertain times.²⁵ However, the appeal of the cryptocurrency is its simultaneous downfall—its restriction to the online marketplace.²⁶ The global prevalence of the internet creates both a reliance on its accessibility and technology-dependent innovations at lightning-fast speeds. While high accessibility and steady reliability currently creates a near necessity for the internet in modern life, complete destruction is still a possibility. Such fragility creates an inherent risk with solely online-based commodities. If the internet were to disappear, so would all of the available bitcoins, worth billions of U.S. Dollars total.²⁷ Conversely, commodities with intrinsic values, such as gold, can survive indefinitely and continue to be used for trading, even in a hypothetical post-apocalyptic scenario.²⁸ While investors hedge with both bitcoin and gold, warranting the comparison of bitcoin to be the “new gold standard,” the inherent risk of total disappearance separates the potential long-term application of the two commodities.

The intersection of cryptocurrencies as an investment vehicle, an actual currency, and a commodity places cryptocurrencies in a unique position for securities regulators and expands the discussion regarding regulation, generally. Cryptocurrency's shared aspects with commodities, such as volatility and hedging, as well as concrete impact outside of the financial industry, pose a threshold question about the jurisdictional extent of securities regulators.

D. Volatility

Another similarity that gold and bitcoin and most other cryptocurrencies share is their volatility. Volatility is the range in which an investment's value will fall.²⁹ Higher volatility indicates a wider fluctuation between the value's lowest low and highest high, increasing the investment's risk.³⁰ Volatility impacts cryptocurrency as both an investment and as a currency. As a speculative investment, put and call options for cryptocurrencies may not be profitable if the

²⁴ Panos Mourdoukoutas, *Bitcoin Is the New Gold*, FORBES (Jan. 15, 2020), <https://www.forbes.com/sites/panosmourdoukoutas/2020/01/15/bitcoin-is-the-new-gold-study/?sh=4fc9490946e0>; Nathan Reiff, *Bitcoin v. Ripple: What's the Difference*, INVESTOPEdia (July 27, 2021), <https://www.investopedia.com/tech/whats-difference-between-bitcoin-and-ripple/> [hereinafter Reiff, *Bitcoin v. Ripple*].

²⁵ Mourdoukoutas, *supra* note 24.

²⁶ *Id.*

²⁷ *How Many Bitcoins Are There Now in Circulation?*, BUY BITCOIN WORLDWIDE, <https://www.buybitcoinworldwide.com/how-many-bitcoins-are-there/>.

²⁸ Mourdoukoutas, *supra* note 24.

²⁹ For a definition of “volatility,” see SUNSHINE PROFITS, <https://www.sunshineprofits.com/gold-silver/dictionary/volatility/>.

³⁰ *Id.*

value per coin swings too much in one direction or the other.³¹ As a currency, the volatility poses a risk for vendors and buyers. A vendor who chooses to use cryptocurrency as a cash-emulating system may be setting itself up for anxiety when it comes time to balance its books at the end of the month. Consistently accepting cryptocurrencies for low-cost items, such as a pack of chewing gum or cup of coffee, exposes the vendor to risk through the possibility of a violent swing downward in value.³² Volatility's effect is profound when thousands of transactions are aggregated. Retail giants who are geared to a high volume of low-cost transactions, such as Walmart,³³ may be hesitant to use the technology because of its volatility, impact on profits, and friction with traditional accounting systems. The reluctance of massive corporations to adopt cryptocurrencies³⁴ trickles down to the consumer marketplace as it can indicate the currencies are intended for speculation, rather than basic transactional use. However, should retail chains choose to invest in and widely implement cryptocurrency technology, both consumers and the commercial arena at large may experience a shift to more common use of cryptocurrencies.

A lack of a stable backing drives the volatility of cryptocurrencies.³⁵ Using fiat as currency ensures that two dollars yesterday is the same value as two

³¹ Marcel Pechman, *Here's Why Bitcoin Bulls Might Trample \$50K Ahead of Friday's \$2B BTC Options Expiry*, COINTELEGRAPH (Aug. 24, 2021), <https://cointelegraph.com/news/here-s-why-bitcoin-bulls-might-trample-50k-ahead-of-friday-s-2b-btc-options-expiry>.

³² Ryan Haar, *What Is Bitcoin?*, NEXTADVISOR (Aug. 12, 2021), <https://time.com/next-advisor/investing/cryptocurrency/what-is-bitcoin/>.

³³ Tanaya Macheel, *Walmart Says Crypto Payments Announcement Is Fake. Litecoin Tumbles After Spike*, CNBC (Sept. 13, 2021), <https://www.cnbc.com/2021/09/13/walmart-to-accept-payments-with-cryptocurrencies-using-litecoin.html>.

³⁴ Ofir Beigel, *Who Accepts Bitcoin as Payment?*, 99BITCOINS (last updated Jan. 9, 2022), <https://99bitcoins.com/bitcoin/who-accepts/>.

³⁵ The stable-backing problem has been addressed through stablecoins. A stablecoin is a cryptocurrency that is backed by a stable fiat, predominantly, the U.S. dollar. See Matt Hussey & Scott Chipolina, *What Are Stablecoins and How Do You Use Them?*, DECRYPT (July 30, 2021), <https://decrypt.co/resources/stablecoins>. Backing the cryptocurrency with a physical reserve of a strong fiat combines the appeal of digital assets with a lower level of volatility, making the asset more appealing to some investors, as well as established payment companies, since the value of the digital coin will be relatively in line with the value of the physical coin. *Id.* For instance, to offer crypto payment services, Visa partnered with Anchorage Digital Bank, the first federally chartered, American, digital asset bank to provide settlement availability to customers and merchants in USD Coin ("USDC"), a U.S. dollar backed stablecoin. *Visa Becomes First Major Payments Network to Settle Transactions in USD Coin (USDC)*, BUSINESSWIRE (Mar. 29, 2021), <https://www.businesswire.com/news/home/20210329005171/en/Visa-Becomes-First-Major-Payments-Network-to-Settle-Transactions-in-USD-Coin-USDC> [hereinafter *Visa Becomes First*]. For more information on Anchorage Digital, see <https://www.anchorage.com/>. Settling with a stablecoin negates the problem presented in this article where a vendor wants to accept cryptocurrencies as payment without conversion. Reversed, using a stablecoin also allows crypto-based companies to seize opportunities that come with regular fiat, but would be limited with crypto due to the volatility and hesitance on acceptance. *Id.* The use of stablecoins as a settlement agent allows the fintech industry to expand and grow, strengthening the global fintech network at large, and furthering the possibility of using digital assets as a true currency.

dollars tomorrow (save for unexpected, catastrophic events that drastically alter inflation). At the end of a financial year quarter, it is straightforward to do accounting on the balance sheet using fiat—a dollar is a dollar. When accepting bitcoin and fiat, conversion and volatility pose a challenge for reconciliation, especially when a simple action such as a celebrity tweeting a meme³⁶ causes crypto prices to fall quickly and drastically.

E. Initial Offerings: Crypto ICOs and ITOs

Most cryptocurrencies operate on their own decentralized ledger which records all transactions of its native currency.³⁷ For example, bitcoin and ether, two of the most popular cryptocurrencies, each run on the “bitcoin blockchain” and “Ethereum blockchain,” respectively. To make a decentralized ledger usable and profitable, and in distinct contrast to government-controlled fiat, crowdfunding is utilized. In an Initial Coin Offering (ICO) or Initial Token Offering (ITO), in exchange for crowd-raised funds, developers of the blockchain release a specified amount of coins or tokens that represent units of currency and may hold voting powers.³⁸ Initial offerings occur after the release of a whitepaper describing the software,³⁹ but before the actual cryptocurrency and associated blockchain are released.⁴⁰ The developers utilize the funds raised in the initial offering to program their blockchain software, allowing the pre-sold coins or tokens to ascertain an actual value once the product is released for public use.⁴¹ If a development team has decided on a minimum initial fundraising goal and it is not met, then all invested money is returned, and the cryptocurrency does not enter the market.⁴² If the ICO or ITO succeeds and the coins or tokens are given to the investors, there are four main actions a cryptocurrency holder can take: (1) keep the coin as a long-term investment; (2) exchange the coin for a different cryptocurrency; (3) redeem the coin for fiat; or (4) use the coin to pay for a good or service.⁴³ Cryptocurrency developers have two options when assigning an actual value to the coins at their release: (1) release a set number of coins, each holding an equal portion of a predetermined

³⁶ Ryan Browne, *Bitcoin Falls After Elon Musk Tweets Breakup Meme*, CNBC (June 4, 2021), <https://www.cnn.com/2021/06/04/bitcoin-falls-after-elon-musk-tweets-breakup-meme.html>.

³⁷ Some cryptocurrencies are built on pre-existing blockchains, such as the DAO which runs on the Ethereum blockchain, discussed later in this article. Here, the Ethereum blockchain would record of all DAO transactions.

³⁸ Andrew Marshall, *ICO, Explained*, COINTELEGRAPH (Mar. 7, 2017), <https://cointelegraph.com/explained/ico-explained>.

³⁹ Jake Frankenfield, *Initial Coin Offering (ICO)*, INVESTOPEDIA (last updated Jan. 3, 2022), <https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp> [hereinafter Frankenfield, *Initial Coin Offering*].

⁴⁰ Marshall, *supra* note 38.

⁴¹ *Id.*

⁴² Frankenfield, *Initial Coin Offering*, *supra* note 39.

⁴³ Shaun Rosenthal, *S.E.C. Regulates Initial Coin Offerings*, SANFORD HEISLER SHARP, LLP (Feb. 24, 2020), <https://www.sanfordheisler.com/media/2020/february/s-e-c-regulates-initial-coin-offerings/>.

value derived from the crowdfunding goal, or (2) release a set number of coins, but allow their initial value and the crowdfunding goal to remain dynamic.⁴⁴ To distribute the coins on the release date, all the coins have to be mined and available.⁴⁵ Initial cryptocurrency offerings share similarities with Initial Public Offerings (IPO) of shares in a company.

1. Traditional IPO

When a domestic or foreign company is preparing to be listed on an American or Canadian stock exchange, it must comply with regulation requirements⁴⁶ (discussed further in the next section). Part of the IPO procedure is to pre-market the share issuance during a “roadshow” to determine the level of interest and establish the initial offering price.⁴⁷ The roadshow is primarily presented to large-scale, aggregate investment vehicles, such as hedge funds, and institutional investors, such as pensions.⁴⁸ However, a crucial difference between IPOs and ICOs is the timing of when capital is raised. Capital for a company is raised at the time of the IPO, rather than during the marketing phase; shares are released on a stock exchange on a specified day, available to the public for purchase. Unlike failed crypto projects, if an IPO fails due to lack of interest or insufficient funding, the company withdraws during the roadshow phase before capital is invested,⁴⁹ and the company will remain unlisted on a stock exchange and under private ownership.

F. Stock Exchanges and Regulators

In a typical IPO, the company will choose one or more centralized stock exchanges on which to list itself. The United States has control of multiple stock exchanges” the New York Stock Exchange (NYSE) and NASDAQ are the two most notable, being the first and second largest stock markets in the world by capital marketization.⁵⁰ Canada also has multiple stock exchanges. The Toronto Stock Exchange (“TSX”) is the largest in Canada, third largest in North America (after NYSE and NASDAQ) and seventh largest in the world by market capitalization.⁵¹ On any of these exchanges, an investor can view the current and historical stock prices for listed companies and have a stockbroker purchase or sell such stocks to adjust the investors’ amount of ownership in a company. The

⁴⁴ Frankenfield, *supra* note 39.

⁴⁵ Mining is explained on page 17.

⁴⁶ Foley & Lardner LLP, *Application of SEC Rules to Foreign Companies*, LEXOLOGY (July 9, 2013), <https://www.lexology.com/library/detail.aspx?g=6dd69a65-283f-4099-9878-e936f4452eba>.

⁴⁷ Jason Fernando, *Initial Public Offering (IPO)*, INVESTOPEDIA (updated Nov. 30, 2021), <https://www.investopedia.com/terms/i/ipo.asp>.

⁴⁸ Chris B. Murphy, *Roadshow*, INVESTOPEDIA (last updated Nov. 1, 2020), <https://www.investopedia.com/terms/r/roadshow.asp>.

⁴⁹ For a definition of “failed IPO,” see Dictionary at LAW INSIDER, <https://www.lawinsider.com/dictionary/failed-ipo>.

⁵⁰ See *List of Stock Exchanges*, ASIA FOREX MENTOR, <https://www.trade.education/list-of-stock-exchanges/>.

⁵¹ *Id.*

exchanges are regulated by various commissions including the SEC in the United States,⁵² and provincial regulators in Canada, such as the Ontario Securities Commission (OSC). Canada’s separate securities regulators work together under the Canadian Securities Administration (CSA) framework to ensure the divided Canadian markets are regulated harmoniously.⁵³ Further, stock exchanges only operate during certain hours. The NYSE,⁵⁴ NASDAQ,⁵⁵ and TSX⁵⁶ all have core trading hours of 9:30AM until 4:00PM on weekdays. Stock exchanges do not operate on weekends, nor are they open on predetermined statutory holidays.⁵⁷

In contrast, cryptocurrencies use different methods to “list” themselves because they are not traded on a traditional exchange. Instead of using a broker-dealer to trade on their behalf, investors must personally register with an exchange that supports the desired cryptocurrency blockchain. At any hour, investors may purchase cryptocurrency supported by the exchange for fiat or other cryptocurrencies and keep their new coins in their “wallet.” However, most exchanges do not allow the users to convert their cryptocurrency holdings back to fiat.⁵⁸ Each trade on an exchange has associated fees, including exchange fees, to recover operation costs for the exchange, and transfer fees, which are collected to maintain each cryptocurrency blockchain.⁵⁹ The collection of fees mirrors the traditional commission earned by a human broker-dealer. Essentially, each cryptocurrency exchange operates a boutique, twenty-four-hour, self-serve market for a selection of cryptocurrencies.

G. Auxiliary Components of Cryptocurrencies

1. Cryptocurrency Exchanges/Cryptocurrency Trading Platforms (CTPs)

Cryptocurrency exchanges, also called Cryptocurrency Trading Platforms (CTPs), are a perpetually accessible nexus for cryptocurrency blockchains that offer “wallets” to hold cryptocurrency. Exchanges differ in availability of cryptocurrencies, and cryptocurrency holders may have to operate multiple wallets through multiple exchanges to hold all their desired currencies. Holding multiple wallets subjects the cryptocurrency holders to a greater risk of hacking

⁵² *What We Do*, U.S. SECURITIES & EXCHANGE, <https://www.sec.gov/about/what-we-do>.

⁵³ CANADIAN SECURITIES ADMINISTRATORS, *About Us*, [https://www.securities-administrators.ca/aboutcsa.aspx?id=45#:~:text=The%20Canadian%20Securities%20Administrators%20\(CSA,of%20the%20Canadian%20capital%20markets](https://www.securities-administrators.ca/aboutcsa.aspx?id=45#:~:text=The%20Canadian%20Securities%20Administrators%20(CSA,of%20the%20Canadian%20capital%20markets).

⁵⁴ Markets: Holidays & Trading Hours, NEW YORK STOCK EXCHANGE, <https://www.nyse.com/markets/hours-calendars>.

⁵⁵ Michael DeSenne, *Stock Market Trading Hours: What Time is the Stock Market Open Today?*, KIPLINGER (Dec. 15, 2021), <https://www.kiplinger.com/investing/602886/stock-market-trading-hours>.

⁵⁶ Trading Hours, TORONTO STOCK EXCHANGE & TSX VENTURE EXCHANGE, <https://www.tsx.com/trading/calendars-and-trading-hours/trading-hours>.

⁵⁷ Markets: Holidays & Trading Hours, NEW YORK STOCK EXCHANGE, <https://www.nyse.com/markets/hours-calendars>.

⁵⁸ Hussey & Chipolina, *supra* note 35.

⁵⁹ Kelli Francis, *Crypto Fees: A Full Breakdown and How to Minimize Costs*, GOBANKINGRATES (June 14, 2021), <https://www.gobankingrates.com/investing/crypto/how-to-minimize-crypto-fees/>.

or fraud than if they were to just use one. As well, unlike a traditional, physical wallet, a traditional cryptocurrency wallet is digital, with the option of also holding a physical wallet. Cryptocurrency wallets can be separated into two main categories, “hot” wallets, which connect to the internet, and “cold” wallets which do not.

2. Cryptocurrency Wallets

A variety of cryptocurrency wallets have been formed since crypto’s inception, including three types of hot and cold digital, or “software,” wallets and two types of physical, or ‘hardware,’ wallets.⁶⁰ Digitally, cryptocurrency is held in one or more of the following: a web wallet, cryptocurrency holding software hosted by the exchange on its servers; a desktop wallet, cryptocurrency holding software that requires the users to download and store their coins in an offline application; and a mobile wallet, an application on the holder’s smartphone which offers cryptocurrency storage and trading.⁶¹ Each type of digital wallet has its strengths and weaknesses. All are susceptible to viruses and malware due to their digital nature; however, the larger safety distinction comes from the accessibility of the coins being offline or online. Wallets provided by an exchange offer two access points, the crypto-holder, and the hosting exchange. While an additional access point increases risk of loss for the user (through hacks or other malevolent schemes), fortunately, if the holder dies, the coins can be recovered by the host and added to the deceased’s estate. If the deceased was the only one to know their password or key to an offline desktop wallet, the coins would be lost forever upon death. Another downfall of an offline desktop wallet is the possibility of lost data due to water or other physical damage. If information is unrecoverable, then, just like the sole keyholder dying, the coins are lost forever.

The use of hardware wallets helps to combat some of the previously mentioned issues. The typical hardware, a cold wallet, is similar to a USB drive and stores cryptocurrency entirely offline.⁶² Should the wallet become lost, damaged, or otherwise inaccessible, it will often come with a remote access feature to recover the cryptocurrency, triggered by a seed phrase⁶³—a list of personalized, secret words that the holder will enter into the new software.⁶⁴ The holder is encouraged to record these words and their key in handwriting on a piece of paper, which is stored somewhere secure, such as a traditional safety deposit box at a bank.⁶⁵ The handwritten backup becomes a “paper wallet,” to be used in the case of death or other time of need, so long as it, and the coins it provides access to, are not lost.

⁶⁰ Lauren Holly, *The Different Types of Crypto Wallets, Explained*, BUS. NEWS (June 25, 2021), <https://azbigmedia.com/business/the-different-types-of-crypto-wallets-explained/>.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *What Is Seed Phrase?*, ALPHAWALLET, <https://alphawallet.com/faq/what-is-seed-phrase>.

⁶⁵ This author appreciates the irony. See Holly, *supra* note 60.

3. Mining

Mining is an alternate way for users to obtain cryptocurrencies without purchasing the coins through an exchange or initial offering. By March 2020, 2329 ICOs had occurred in the cryptocurrency realm,⁶⁶ with 981 ICOs taking place in 2019 alone.⁶⁷ Mining is the process of using a coded program to solve complex mathematical problems and algorithms (a “hashing puzzle”).⁶⁸ The first miner to solve the puzzle is rewarded with some of the currency for their work, and the process also releases more coins onto the blockchain for other users.⁶⁹

All transactions on the blockchain are verified by a third party node on the blockchain. The act of verification is another form of mining, and the verifier is rewarded with coins for the work performed.⁷⁰ Mining allows interested parties to obtain cryptocurrencies by investing time and energy, but not fiat, making it an attractive option to those who do not want to play with their own assets. As well, mining cryptocurrencies is correlated to the value of the coin as it affects the supply and demand of the coins. Notably, the act of mining to produce more cryptocurrency differentiates crypto from traditional securities, which strictly rely on issuance by the company. Miners can obtain the cryptocurrency without purchase, which narrows the space for potential securities jurisdiction if pursued through traditional channels.

Part of the appeal of bitcoin is that there is a limited supply of coins to be mined — 21 million.⁷¹ Since the release of the cryptocurrency in 2009, approximately 90% of all available coins have been mined.⁷² Combined with its popularity and notoriety of being the first cryptocurrency, the demand for bitcoin has significantly increased since its release. As demand continues to increase, and supply continues to dwindle, the value of a bitcoin may continue to rise indefinitely, following traditional capital market trends. The question then becomes: what happens to the value of a bitcoin when the entire supply has been mined? Is there less risk because there is a finite number of coins? As well, how does a fixed number of coins affect securities regulation, if at all?

⁶⁶ Raynor de Best, *Number of Cryptocurrency Initial Con Offering (ICO) Projects Worldwide as of March 2020, by Industry*, STATISTA (Dec. 6, 2021), <https://www.statista.com/statistics/802931/worldwide-share-of-cryptocurrency-ico-projects-by-industry/>.

⁶⁷ Lars Haffke & Mathias Fromberger, *ICO Market Report 2019/2020—Performance Analysis of 2019’s Initial Coin Offerings* (Dec. 30, 2020), available at <https://ssrn.com/abstract=3770793> or <http://dx.doi.org/10.2139/ssrn.3770793>.

⁶⁸ Euny Hong, *How Does Bitcoin Mining Work*, INVESTOPEDIA (Jan. 17, 2022), <https://www.investopedia.com/tech/how-does-bitcoin-mining-work/>.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ Madana Prathap, *Nearly 90% of All Bitcoin Has Already Been Mined—Here’s How Its Limited Supply Has Driven Up Its Value*, BUS. INSIDER (Dec. 24, 2021), <https://www.businessinsider.in/investment/news/bitcoin-limited-supply-has-driven-up-its-value-nearly-90-percent-has-be/articleshow/85349471.cms>.

⁷² *Id.*

The United States has structured its approach to regulation through two prongs—The Securities Act of 1933⁷³ (the “1933 Act”) governing the issuance of a security, and The Securities Exchange Act of 1934⁷⁴ (the “1934 Act”) governing the exchange of securities between parties. While both the issuance and exchange of a security involve the purchase of an underlying contract that holds value, the two purchase options of a security are vastly different and require individually tailored rules to provide investor protection. For instance, the 1933 Act targets issuers,⁷⁵ while the 1934 Act primarily targets secondary markets and those unrelated to the issuer, such as exchanges and broker-dealers.⁷⁶ The commonality between the 1933 Act and the 1934 Act is governing *something* or *someone*. In complete juxtaposition, decentralized cryptocurrencies are, by their nature, entirely public. To exemplify bitcoin, Satoshi Nakamoto remains anonymous to this day.⁷⁷ If the SEC wanted to pursue an action against bitcoin under either Act, there would be no identity on which to serve the documents. Regulating the different auxiliary components of cryptocurrencies through tailored collections of regulations both aligns with a functional existing regulatory framework and allows regulatory bodies to properly address unique qualities such as mining; however, the decentralized nature of cryptocurrencies poses the threshold problem of *how* to regulate.

H. Uses of Cryptocurrency

While bitcoin is described by its creator as a “peer-to-peer electronic cash system,” its use as a payment method in conjunction with the existing vendor model is problematic.⁷⁸ Typically, making a payment in cash is the most straightforward and efficient way to exchange funds. Unlike a credit card, there are no overhead costs associated with physically accepting a \$5 bill from a customer, allowing the vendor to keep the entire profit. Hypothetically, if a vendor chooses to operate solely in bitcoin, or another cryptocurrency, there are no guarantees for their profits. In fact, the volatility threatens to negate or inflate all profits, regardless of the vendor’s actual sales. Infamously, the volatility was tolerated on the darknet in an indiscreet marketplace called *Silk Road*.⁷⁹ Bitcoin’s anonymity and encryption seemingly made it the perfect payment medium for illicit goods (though complete transparency became an anonymity downfall).⁸⁰

⁷³ Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa (1982 & Supp. IV 1986)) [hereinafter Securities Act of 1933].

⁷⁴ Securities Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78kk (1982 & Supp. IV 1986)) [hereinafter Securities Exchange Act of 1934].

⁷⁵ Securities Act of 1933.

⁷⁶ Securities Exchange Act of 1934.

⁷⁷ Adam Hayes, *Satoshi Nakamoto*, INVESTOPEDIA (last updated Dec. 8, 2021), <https://www.investopedia.com/terms/s/satoshi-nakamoto.asp>.

⁷⁸ Nakamoto, *supra* note 4.

⁷⁹ Silk Road 1 is now defunct.

⁸⁰ Annie Lowrey, *Bitcoin Is Falling Out of Favor on the Dark Web*, THE ATLANTIC (Mar. 1, 2018), <https://www.theatlantic.com/business/archive/2018/03/bitcoin-crash-dark-web/553190/>.

However, just as it would in real life, the use of bitcoin for payment of low-value items was ineffective due to the volatility, complicated by an “escrow” step included in the payment procedure that required holding the money between buyer and seller until the buyer is in receipt of the goods.⁸¹ Given that cryptocurrencies have not found success in a traditional vendor transaction, it logically follows that the ability to digitally store value has been repurposed in other ways, including as a cross-border payment system, a speculative investment, a hedging instrument, and an innovative technology.

1. Cryptocurrency as a Currency

Exchanges such as Coinbase⁸² and Binance⁸³ allow the user to buy and sell a variety of cryptocurrencies, such as bitcoin, Litecoin, ether, Dogecoin, and Ripple’s XRP, on each currency’s respective blockchain and send cryptocurrency payments to other wallet holders. Interpreted literally, these exchanges allow users to achieve the goal function of bitcoin—to be a peer-to-peer digital money exchange system.⁸⁴ Operating a peer-to-peer network eliminates the need for a third party to intercept and modify the transaction, through verification or other means. A number of companies are also working to bridge the gap between cryptocurrency and retail. The goal of crypto-centric payment companies such as Bakkt,⁸⁵ Winklevoss-twin-owned Gemini,⁸⁶ and traditional fiat payment companies such as Visa⁸⁷ and PayPal⁸⁸ is developing technology to connect a buyer’s digital asset wallet and a typical fiat-based merchant. Bakkt and Gemini are babies of the crypto boom, both operating as exchanges and wallets with additional functional features, while Visa and PayPal are among the first “old-school” payment companies to embrace cryptocurrency. For instance, a stablecoin tethered to the U.S. Dollar has been utilized by Visa to settle merchant transactions on the Ethereum blockchain.⁸⁹ Visa requires the buyer to pay in cryptocurrency and the merchant to settle in fiat, appealing to traditional merchants, but complicating payment systems for businesses built on crypto acceptance.⁹⁰

I. Risks in an Unregulated Market: Examples from the United States and Canada

1. Fraud

The invention of the internet, email, and online banking spurred a new generation of “royalty.” A royal, usually a prince, would seek help from wealthy

⁸¹ *Id.*

⁸² *The Future of Money Is Here*, COINBASE, <https://www.coinbase.com/>.

⁸³ *Buy and Sell Crypto in Minutes*, BINANCE, <https://www.binance.com/en>.

⁸⁴ Nakamoto, *supra* note 4.

⁸⁵ Our Vision Is to Connect the Digital Economy, <https://www.bakkt.com/about-us>.

⁸⁶ Paying with Crypto Is Simple, Secure, and Free, GEMINI, <https://www.gemini.com/pay>.

⁸⁷ *Visa Becomes First*, *supra* note 35.

⁸⁸ Anne Sraders, *Corporate Crypto 101: How Companies Are Using Bitcoin and Other Digital Currency*, FORTUNE (July 29, 2021), <https://archive.ph/QnK9K>.

⁸⁹ *Visa Becomes First*, *supra* note 35.

⁹⁰ *Id.*

internet users, asking by email for access to a bank account or money transfer, to safely store a large sum of money while he escapes from his country. In return, once the royal was safe, he would split the sum and reward his savior handsomely.⁹¹ Owing, at least in part, to the innate altruism of humans described earlier in this article, unsuspecting individuals have sent these royals millions of dollars in an attempt to help them escape their treachery. In fact, in 2019 alone, Americans sent over \$700,000 to help these poor princes.⁹² However, helping the princes in their time of need usually invoked the opposite result of what was promised, leaving generous people as victims of fraud.

2. Fraud and Cryptocurrency

Fraud and scams have evolved over time and are now much more devious than tricking unsuspecting victims into providing their exact bank information. Clicking on an unsecure link on a website or in your email can compromise your computer, sharing your saved information and passwords with hackers. For cryptocurrency, if your wallet password is saved in your computer, a hacker that has access to your information can fraudulently send themselves cryptocurrency on your behalf. Or, in a similar vein to the online prince scam, a blockchain developer can ask for an investment, promise big returns, and run away with your money.

a. Breaches

Fraud in the crypto industry wears different masks including fraudulent ICOs and ITOs as well as wallet hacks and blockchain breaches (like the DAO Token event).⁹³ Blockchain breaches, where a vulnerability in the blockchain code is exploited by hackers to acquire funds, on average seize significantly less cryptocurrency than other types of fraud.⁹⁴ The number and value of fraudulent instances in cryptocurrency generally trend upward from year to year, closing out 2020 with nearly \$1.8 billion in crypto fraud in that year. As of October 2021, the industry is sitting just \$14 million shy of \$3 billion in fraud for 2021, almost doubling last year's amount in just ten months.

b. Celebrity Impersonations, Banking Regulations, Cult Persuasion, and a Ponzi Scheme

Discussed later in this article will be the Canadian case of QuadrigaCX and its owner, Gerald Cotten, who knowingly misled investors on the storage and safety of their funds until the platform collapsed alongside Cotten's untimely death, taking over \$200 million dollars with it. Part of Quadriga's tremendous

⁹¹ How That "Nigerian Email Scam" Got Started, NPR (May 22, 2013) <https://www.npr.org/2013/05/22/186048342/how-that-nigerian-email-scam-got-started>.

⁹² Megan Leonhardt, "Nigerian Prince" Email Scams Still Rake in Over \$700,000 a Year—Here's How to Protect Yourself, MAKEIT (Apr. 18, 2019), <https://www.cnbc.com/2019/04/18/nigerian-prince-scams-still-rake-in-over-700000-dollars-a-year.html>.

⁹³ See Part II.K.

⁹⁴ James Page, *Crypto Breaches & Fraud*, CRYPTO HEAD (last updated Jan. 2022), <https://cryptohead.io/research/crypto-breaches-and-fraud/>.

downfall was the refusal of Canadian banks to hold so much volatile, untrusted financial product.⁹⁵ South of the border, while the SEC has addressed fraud in other ways such as making a faux-scam website to inform potential investors,⁹⁶ rising to the goal of investor protection,⁹⁷ their efforts have not been fool-proof. Crypto fraudsters have tried a variety of currency collection methods including impersonating crypto-god Elon Musk,⁹⁸ selling crypto sans blockchain to users in a cult-like haze despite media exposés on the fraud,⁹⁹ and operating a crypto-centric Ponzi scheme.¹⁰⁰ Bitclub Network, operating from 2014 until 2019, offered users an incentive for investing in an allegedly über-functional mining scheme, offering them a portion of the “mining earnings” in return for large investments into the company.¹⁰¹ At the time of arrest, \$722 million was recovered from investments into a surprisingly mining-free Ponzi scheme.¹⁰² While Informing investors aids in protection and encourages active participation in the market, crypto is a complicated beast attracting fraudsters who capitalize on its ultra-modern nature. To *tabula rasa* investors, the promise of high returns on their investments is incredibly appealing; however, because the investment occurs through nascent and misunderstood technology, informational programs greater than *Howeycoins.com*¹⁰³ may be necessary.

2. Liability for Fraud

Liability for fraud is assigned to an actor or a group of actors. In a decentralized setting, with no clear ownership, who is the liability assigned to? In the previous examples, such as QuadrigaCX, the answer is clear—the person who made the misrepresentation. However, in blockchain breaches, the answer is not as clear, and funds are still at stake. Assigning liability for fraud was a driving factor in the DAO Event investigation by the SEC, the tipping-off point for cryptocurrency securities regulation in the United States. Explained in detail below, the DAO Event occurred when a group of hackers took advantage of a

⁹⁵ QuadrigaCX: A Review by Staff of the Ontario Securities Commission, ONTARIO SECURITIES COMMISSION (Apr. 14, 2020), <https://www.osc.ca/sites/default/files/2020-10/QuadrigaCX-A-Review-by-Staff-of-the-Ontario-Securities-Commission.pdf>.

⁹⁶ HOWEYCOINS, <https://www.howeycoins.com/index.html>.

⁹⁷ Kate Rooney, *SEC Chief Says Agency Won't Change Securities Laws to Cater to Cryptocurrencies*, CNBC (last updated June 11, 2018), <https://www.cnbc.com/amp/2018/06/06/sec-chairman-clayton-says-agency-wont-change-definition-of-a-security.html?>

⁹⁸ Neil Vigdor, *Elon Musk Impostors Scammed \$2 Million in Cryptocurrency, U.S. Says*, N.Y. TIMES (May 18, 2020), <https://archive.ph/YhARu>.

⁹⁹ Antonio Madeira, *OneCoin: A Deep Dive into Crypto's Most Notorious Ponzi Scheme*, COINTELEGRAPH (SEPT. 1, 2020), <https://cointelegraph.com/news/onecoin-a-deep-dive-into-crypto-s-most-notorious-ponzi-scheme>.

¹⁰⁰ BITCLUB, U.S. ATTORNEY'S OFFICE (Aug. 16, 2021), <https://www.justice.gov/usao-nj/bitclub>.

¹⁰¹ Jordan Atkins, *BitClub Network Co-Conspirator Admits Offering Unregistered Securities*, COINGEEK (Sept. 7, 2020), <https://coingeek.com/bitclub-network-co-conspirator-admits-offering-unregistered-securities/>.

¹⁰² *Id.*

¹⁰³ HOWEYCOINS, *supra* note 96.



liability in blockchain code, misappropriating funds to their private wallets.¹⁰⁴ To solve the problem in a controversial manner, the Ethereum blockchain's history was rolled back by its creator¹⁰⁵ and was permanently divided into Ethereum 2.0, the predominantly-used version without the attack, and Ethereum Classic, the less-used original with the attack in its history.¹⁰⁶ Investors' stolen funds were returned, the SEC exemplified the situation through an investigative report, and the DAO hackers were never held accountable.

While bitcoin and ether were not created with the intention of being an investment tool, it is one of the major functions that they have amassed in their short lifespans. As a reaction to the societal role of cryptocurrencies, securities commissions stepped up to create and enforce regulations. The threat of the volatility, popularity, and insecurity of the industry makes it high-risk for investors. Flashbacks to major market crashes like the Great Depression and 2008 Financial Crisis spur securities commissions forward to protect investors, no matter where they are focusing their money. Commonly, securities commissions regulate in substance, not form. If investors are risking their money on a product that does not truly walk and talk like a duck, but could be a distant cousin, there may be an opportunity to provide regulatory guidance.

By taking a substantive approach, rather than a formal one, the securities commissions are reassuring investors that they are fulfilling the general mandate principles of investor protection from fraud and other failures. However, the securities commissions walk a thin line by taking this approach. Balancing investor protection while still encouraging innovation is difficult once the factors of time and cost for registration are considered. As well, by analyzing in substance, securities commissions can gain access to a field otherwise entirely unrelated to securities! As discussed in this article, cryptocurrencies are released as their own entities, often being used to replicate existing and complicated payment systems or as a unit of storage. The dual treatment of the cryptocurrencies as an investment product alongside their intended uses and crooked actions by those who manipulate a budding and profitable industry have demonstrated the call for regulation by securities commissions.

The following two sections explain the approaches of the American and Canadian securities administrators to cryptocurrencies. The two countries have taken different approaches to regulation, have encountered different difficulties and fraudulent schemes, and have their own advantages and disadvantages. Yet, both have been able to foster an innovative cryptocurrency hub that navigates within the current regulatory landscape.

¹⁰⁴ Cryptopedia Staff, *What Was the DAO?, The DAO Hack Remedy Forks Ethereum*, GEMINI (Apr. 27, 2021), <https://www.gemini.com/cryptopedia/the-dao-hack-makerdao#section-the-dao-hack-remedy-forks-ethereum>.

¹⁰⁵ Having a single actor act in an authoritative role on a decentralized platform muddies pure decentralization.

¹⁰⁶ Cryptopedia Staff, *supra* note 104.

II. SECURITIES REGULATIONS FOR CRYPTO IN THE UNITED STATES

A. Two Pathways for Regulations

For hundreds of years, humans have struggled with a fundamental problem: which came first, the chicken or the egg? It is difficult to deduce by logic alone. A chicken can lay an egg, but the chicken must first hatch from an egg. Realistically, the answer is much less straightforward; there are a number of interacting biological factors that have allowed a chicken and an egg to evolve into the hatching process we are familiar with. One does not come directly after the other; the two products are a result of interplay. In common law countries, the law has developed in a similar way. Both statutes and jurisprudence interact with each other to produce a wide range of rules for every legal area. Just like the chicken and egg, there is no distinct “first A, then B.” Instead, statutes are interpreted through judicial opinions, and common law doctrines are codified in new regulations. The challenge arises when a new legal area is hatching. The interactions between the judicial and political systems take time to develop, and there is no clear formula for initial regulation. So the question becomes, where does the law start? The common law or the statutes? The chicken or the egg?

For regulating cryptocurrency, Canada and the United States have opted for different starting points. The American approach will be examined in this Part before comparison with the Canadian approach.

B. Categorization of Cryptocurrency

While it is called *cryptocurrency*, the name is misleading as the digital asset is not recognized in the United States as legal tender.¹⁰⁷ Instead, crypto is often compared to a commodity, like gold or oil, where the price is driven by the supply and demand of the market and preference of liquid assets.¹⁰⁸ The United States has long since regulated the federal commodities market through a primary regulatory body, the Commodity Futures Trading Commission (CFTC).¹⁰⁹ The CFTC was established under the Commodity Futures Trading Commission Act of 1974 to “promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation.”¹¹⁰ Commodities in the United States, such as grains, have been regulated since 1859¹¹¹ and have been

¹⁰⁷ APPLICATION OF FINCEN’S REGULATIONS TO VIRTUAL CURRENCY MINING OPERATIONS, FIN. CRIMES ENFORCEMENT NETWORK (Jan. 30, 2014), <https://www.fincen.gov/resources/statutes-regulations/administrative-rulings/application-fincens-regulations-virtual-0>.

¹⁰⁸ Tom Wilson, *Is It a Currency? A Commodity? Bitcoin Has an Identity Crisis*, REUTERS (Mar. 3, 2020), <https://www.reuters.com/article/us-crypto-currencies-idUSKBN20Q0LK>.

¹⁰⁹ COMMODITY EXCHANGE ACT & REGULATIONS, COMMODITY FUTURES TRADING COMM’N, <https://www.cftc.gov/LawRegulation/CommodityExchangeAct/index.htm>.

¹¹⁰ HISTORY OF THE CFTC, COMMODITY FUTURES TRADING COMM’N, https://www.cftc.gov/About/HistoryoftheCFTC/history_1970s.html [hereinafter HISTORY OF THE CFTC]; THE COMMISSION, COMMODITY FUTURES TRADING COMM’N, <https://www.cftc.gov/About/AboutTheCommission> [hereinafter COMMODITY FUTURES TRADING COMMISSION].

¹¹¹ *Id.*

under federal regulation since the 1920s.¹¹² In 1868, the first regulations to ban manipulation of contract fulfillment came into effect.¹¹³ Specifically, the CFTC and its predecessors regulate derivatives, a type of security. Extrapolated and examined at a high-level, this was the first instance of anti-fraud regulations for capital markets.

C. *Securities Regulation History in the United States*

Regulation has since expanded beyond contracts to purchase grain and has become the backbone of the American financial markets. Specifically, securities regulation grew out of the need for transparency. Just prior to the Great Depression in 1929, the American stock market was hyperinflated.¹¹⁴ There was great encouragement to buy stocks and invest in corporations with little disclosure about the actual financial capacity and value of those corporations.¹¹⁵ Eventually, with disproportionate returns on high speculation, investors sold their stock quickly and in large quantities, causing the market to crash and a decade of financial ruin.¹¹⁶ To prevent future large-scale, fraud-driven catastrophes, Congress quickly passed two bills that have since drastically changed the face of American financial law: the 1933 Act¹¹⁷ and the 1934 Act.¹¹⁸

D. *Goals of the 1933 Act and 1934 Act*

The primary goal of the 1933 Act and 1934 Act is to mandate disclosure so that investors may have access to accurate and complete financial information about a corporation and its issued securities. The SEC, its jurisdiction, and its role in the investor economy were created within the 1934 Act. The current role of the SEC is to inform and protect investors, enforce federal securities laws, and regulate securities markets.¹¹⁹ Briefly, a security is a financial instrument that is issued by individuals, companies, and governments, and traded on a capital market.¹²⁰ Given the subject matter of this article, the definition of security will be broken down into all of the parts mentioned. For specific and exhaustive list of securities, please refer to the 1933 Act and 1934 Act.

¹¹² COMMODITY FUTURES TRADING COMMISSION, *supra* note 110.

¹¹³ HISTORY OF THE CFTC, *supra* note 110.

¹¹⁴ *Securities Law History*, LEGAL INFORMATION INST., https://www.law.cornell.edu/wex/securities_law_history [hereinafter *Securities Law History*].

¹¹⁵ HISTORY OF THE CFTC, *supra* note 110.

¹¹⁶ *Id.*

¹¹⁷ Securities Act of 1933.

¹¹⁸ Securities Exchange Act of 1934.

¹¹⁹ *Supporting Small Business*, U.S. SECURITIES & EXCHANGE COMM'N, <https://www.sec.gov/>.

¹²⁰ *What Is a Security?*, *supra* note 22; see also <https://www.fdic.gov/regulations/laws/rules/8000-6200>.

1. Expanded Definition of a Security

a. Financial Instrument

A financial instrument is a legal agreement that holds value.¹²¹ There are two types of financial instruments: cash instruments, the value of which is derived from the supply and demand fluctuations in capital markets, and derivative instruments, the value of which is derived from changes in an underlying asset.¹²² Financial instruments can also be classified as either debt-based, where the initial investment is returned plus interest after a period of time, or equity-based, where there is payment to the instrument issuer upfront with no guarantee of returns.¹²³ Specifically for securities, examples of debt-based financial instruments include bonds, and equity-based financial instruments include stocks.

b. Issued

Securities are offered by individuals, companies, and governments. The act of offering a security is its issuance. While a loan repaid to a friend plus interest is an issued security, the SEC primarily focuses on securities traded on capital markets.

c. Traded

Trading is the act of buying or selling a security to or from a corporation or other individual.

d. Capital Market

Capital markets provide the arena for trades to occur. Capital markets is a broad term, encompassing stock markets, where corporate stocks are exclusively traded; primary markets, where investors buy directly from the issuer; and secondary markets, where investors trade with each other through a brokerage system.¹²⁴

Now that a security has been defined, does the description of cryptocurrency fit within the definition?

E. Risks Associated with Lack of Registration

In the United States, the Financial Crimes Enforcement Network¹²⁵ (“FinCEN”) does not consider cryptocurrency to be legal tender, but it is concerned with its ability to foster money laundering. FinCEN largely addresses

¹²¹ Will Kenton, *Financial Instrument*, INVESTOPEDIA (Aug. 29, 2021), <https://www.investopedia.com/terms/f/financialinstrument.asp> (financial instrument).

¹²² *Id.*

¹²³ *Id.*

¹²⁴ The Investigative Team, *Capital Market vs. Stock Market: What’s the Difference?*, INVESTOPEDIA (last updated Sept. 30, 2021), <https://www.investopedia.com/ask/answers/021615/whats-difference-between-capital-market-and-stock-market.asp>.

¹²⁵ Financial Crimes Enforcement Network, <https://www.fincen.gov/>.

concerns of money laundering and related crimes such as terrorism.¹²⁶ Due to the popularity and tendency of cryptocurrency to be held in large chunks worth thousands of dollars, cryptocurrency exchanges have become prime vehicles for money laundering.¹²⁷ While all transactions are recorded on a blockchain for transparency, the blockchain also provides anonymity through encrypting the transactions.¹²⁸ The encryption makes it much easier to launder money as all parties and destinations are anonymous and cannot be traced past the one transaction recorded on the blockchain. As well, compared to traditional money laundering schemes, which are cash-focused, using a cryptocurrency exchange to launder takes mere minutes.¹²⁹ When combined with the anonymity of the blockchain, the speed adds to an environment that encourages criminal activity.

F. Tax Treatment of Cryptocurrencies

The United States Internal Revenue Service (IRS) takes a different approach to cryptocurrency, mandating that it is considered property and taxing it as such.¹³⁰ Additionally, the IRS does not consider cryptocurrency to be a foreign currency, and any transactions that occur in cryptocurrency must be reported in U.S. dollars.¹³¹ Cryptocurrency that is mined by a private taxpayer, either for personal or commercial use, must be reported and the fair market value of the mined coins on the date of mining is taxed as gross income.¹³²

If the IRS considers cryptocurrency to be property, and FinCEN considers cryptocurrency to primarily act as a money-laundering vehicle without legal tender status, why is the SEC attempting to regulate cryptocurrency as a security?

G. ICOs and ITOs, Fraud, and Securities Registration

The SEC has determined that ICOs and ITOs are subject to security regulations under the 1933 Act.¹³³ The implications of this decision classify crypto holders participating in an ICO or ITO as “investors” who require protection from the SEC.¹³⁴ Returning to the alliterative allusion of IPOs with ICOs, another layer is added: initial payment of a large sum of money to the issuer, subjecting investors to potential fraudulent schemes. Money laundering is a form of fraud in which funds derived from illegal activities are channeled

¹²⁶ Mission, Financial Crimes Enforcement Network, <https://www.fincen.gov/about/mission>.

¹²⁷ *Money Laundering Through Crypto Exchanges*, COMPLY ADVANTAGE (Apr. 22, 2021), <https://complyadvantage.com/knowledgebase/money-laundering-crypto-exchanges/> (Crypto Laundering).

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *IRS Virtual Currency Guidance*, Notice 2014021, IRS, https://www.irs.gov/irb/2014-16_IRB#NOT-2014-21.

¹³¹ *Id.*

¹³² *Id.*

¹³³ Rosenthal, *supra* note 43.

¹³⁴ *Id.*

through a legal, legitimate institution to cloak their source.¹³⁵ Using cryptocurrency to launder money is one of many forms of crypto fraud. Simply trying to release a fraudulent coin or token and then leaving with the profits is another standard scheme.¹³⁶ Because there is no official set of regulations for issuer reporting and disclosure, it is recommended that investors act responsibly and utilize the resources provided by the issuing company, such as a whitepaper.¹³⁷ A whitepaper is a document released by the issuing company that explains the goals, financing, timelines, and feasibility for the project, including the project goals following an ICO or ITO, and the rights associated with owning tokens.¹³⁸ If the whitepaper does not show a solid plan, then the recommendation is to avoid investment in the project. When regulation does not insist on transparency, it is in the investors' best interests to be cautious with their own assets and take preventative action.¹³⁹ Fraudsters can use the appeal of crypto's volatility to entice unsuspecting investors into a "get rich quick" speculative investment with the release of a new coin or token. Then, just as quickly as the investments are made, the fraudsters run off, taking all the profits with them.

H. *Why Securities Regulation and Disclosure Are Important*

Reflecting on the events that caused the initial call for securities regulation, parallels can be drawn between them and the issue at hand. Historically, companies encouraged investors and brokers to make speculative investments with little documentation to confirm information or funds availability.¹⁴⁰ The result of such non-disclosure was the biggest stock market crash in the United States. If the pattern is extrapolated, a repeat could occur with cryptocurrency ICOs; unsuspecting investors could suffer if regulated disclosure is lacking. To combat this issue, the United States has been building jurisprudence to address whether cryptocurrency is a security and, therefore, subject to regulation under the 1933 Act and 1934 Act.

I. *Howey Test and Jurisprudence*

In 1946, the Supreme Court decided *SEC v. W. J. Howey Co.*¹⁴¹ The question before the Court was whether a simultaneous purchase of units of a citrus grove along with a contract that returns net proceeds to the investor would qualify as an "investment contract," and, therefore, a security under the 1933 Act, subjected to

¹³⁵ Fraud and Money Laundering, Topic Gateway Series No. 31, THE CHARTERED INST. OF MANAGEMENT ACCOUNTANTS, https://www.cimaglobal.com/Documents/ImportedDocuments/31_Fraud_and_Money_Laundering.pdf.

¹³⁶ Nathan Reiff, *How to Identify Cryptocurrency and ICO Scams*, INVESTOPEDIA (last updated July 21, 2021), <https://www.investopedia.com/tech/how-identify-cryptocurrency-and-ico-scams/> [hereinafter Reiff, *How to Identify*].

¹³⁷ *Id.*

¹³⁸ *Id.*; Rosenthal, *supra* note 43.

¹³⁹ Reiff, *How to Identify*, *supra* note 140.

¹⁴⁰ Securities Law History, *supra* note 114.

¹⁴¹ *SEC v. Howey Co.*, 328 U.S. 293 (1946).

registration requirements.¹⁴² To determine if a transaction qualifies as an investment contract, it must pass a four-part test (the “*Howey* test”):

1. if there is an investment of money in;
2. a common enterprise with;
3. a reasonable expectation of profits;
4. to be derived from the efforts of others.¹⁴³

If all four questions are answered in the affirmative, the transaction is a security and must comply with registration requirements under the 1933 Act or be subject to judicial enforcement actions from the SEC. The current policies on cryptocurrencies have been developed through court opinions using the *Howey* test.

1. Application of *Howey* to ICOs and ITOs

To date, the SEC has developed consistency with its treatment of ICOs and ITOs that satisfies the *Howey* test. As discussed previously, the main intention of ICOs and ITOs is to act as a capital-raising vehicle for novel cryptocurrencies based on crowdfunding. Members of the public pre-pay for a coin or token that is part of a single, new cryptocurrency being released. In return for the investment, the developers can expand their product and software, creating more opportunities for the cryptocurrency to reach a larger customer base, increase the volume of its transactions, and realize a higher value. Subsequently, the actions of the issuer cause the initial investors to (hopefully) reap a return on their profits. Following the steps of the *Howey* test, the crowdfunding and prepayment immediately qualify as an investment of money. A common enterprise is a phenomenon where the investor’s profit depends upon the effort put towards, and the successful completion of, the offering corporation’s goals by the corporation or third parties.¹⁴⁴ For cryptocurrencies, a common enterprise is achieved through the continued development and expansion of software, using funds raised during the initial offering. The investors provide fiat or other cryptocurrencies to the development team who put in effort to expand the software, drawing in a larger collection of users, and providing the opportunity to rise in value. Taken a step further, investors are also reliant on third-party payment companies, both crypto-centric and fiat-centric, to innovate and connect their elusive, uber-modern currency with their superannuated, physical world. Taken as a whole, ICOs and ITOs clearly pass the *Howey* test and qualify as securities to be regulated through registration. However, there are also exemptions within the 1933 Act that will nullify the requirement for registration.

J. Mandatory Disclosure and Exemptions under 1933 and 1934 Act

Securities regulation in the United States is primarily controlled by two regulatory statutes, the 1933 Act and the 1934 Act. The 1933 Act focuses on

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ Common Enterprise Law and Legal Definition, U.S. LEGAL, <https://definitions.uslegal.com/c/common-enterprise/>.

primary market transactions and sets the disclosure requirements for securities issuers making public offerings, such as a description of the offered security, the type of security, accountant-verified financial statements, and information about the companies' corporate governance.¹⁴⁵ Primary market transactions are when investors purchase securities directly from the issuer, such as during an IPO. The 1934 Act focuses on regulating secondary market transactions, which occur when investors buy and sell securities to and from other investors, commonly on a stock market, and the actors and institutions who participate in them, such as broker-dealers and their brokerage companies. The 1934 Act also requires publicly traded companies to file quarterly and annual reports containing information important for investor decision making, such as past financial statements. Further, companies must also disclose certain major events such as changes to corporate governance, bankruptcy, and material modifications to rights of security holders.¹⁴⁶ However, while there are also exemptions for disclosure under the 1933 Act, all securities transactions are the subject of anti-fraud federal securities law.¹⁴⁷

Exemptions for security registration under the 1933 Act and 1934 Act exist for "safe" securities.¹⁴⁸ Keeping in mind the original reason for passing the Acts and enforcing their disclosure requirements was to eliminate fraud, it is important to appreciate why the privilege of disclosure exemption is awarded. By not requiring disclosure, the SEC is demonstrating that certain securities are less likely to be fraudulent. For instance, if a security is only being offered to "accredited investors," such as financial institutions, charitable organizations, or individuals each having a net worth greater than \$1 million (not including their primary residence), then it is exempt from registration.¹⁴⁹ It is assumed that accredited investors are more sophisticated and experienced with securities markets. Through possessing a deeper understanding of the securities markets, accredited investors are less likely to be victimized by a fraudulent securities scheme. Additionally, if a security is only being offered intrastate, or if it is issued by a government authority (such as a U.S. Treasury Bond), it is exempt from registration.¹⁵⁵ While a targeted demographic is one type of exemption, there are others which can be applied if the company itself meets certain requirements.

¹⁴⁵ *What Is an Exempt Transaction?*, COR. FIN. INST., <https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/exempt-transaction/> [hereinafter *What Is an Exempt Transaction?*].

¹⁴⁶ Form 8-K, U.S. SECURITIES & EXCHANGE COMM'N, <https://www.sec.gov/fast-answers/answersform8khtm.html>.

¹⁴⁷ Frequently Asked Questions About Exempt Offerings, U.S. SECURITIES & EXCHANGE COMM'N, <https://www.sec.gov/smallbusiness/exemptofferings/faq>.

¹⁴⁸ Securities Exempt from Registration under the Securities Act of 1933, <https://thismatter.com/money/stocks/exempt-securities.htm>.

¹⁴⁹ *Id.*; see also Commodity Exchange Act, 17 C.F.R. § 230.501 (2017).

¹⁵⁵ Securities Act of 1933 § 3(a)(11) (1986).

1. Applying Exemptions to Cryptocurrency

There are five main categories of exemptions for registration under the 1933 Act, including Private Placement offerings and Regulation Crowdfunding.¹⁵⁰ Of the existing exemptions, the Private Placement exemption may be the only one under which cryptocurrencies fall. Largely, the different regulations place monetary limits on the amount of capital raised in the offering, as well as restrictions on advertisement. Private Placement offerings under 1933 Act Section 4(a)(2) allows for unlimited capital raising, so long as the investors are sophisticated and can sufficiently evaluate the risks associated with investment.¹⁵¹ However, some disclosure, a private placement memorandum, is still required for the functionality of this exemption.¹⁵² Exemptions such as Intrastate Offerings, which require 80% of all of the issuer's business to occur within the state of incorporation and the buyers to be residents of that state, would not be feasible for applicability given the inherent disagreement with crypto's global goals. Regulation Crowdfunding allows companies to offer securities through crowdfunding with a limit of \$5 million raised in a twelve-month period, and the company must do so through a SEC-registered broker-dealer or crowdfunding portal.¹⁵³ As well, companies that qualify for this exemption from registration must limit the amount that non-accredited investors can contribute and the company must file with the SEC, making required disclosures to investors and the facilitating intermediary.¹⁵⁴ The catch to consider is that for an exemption to apply, the developer must first admit its cryptocurrency and its ICO are a security and its subsequent offering. With that registration under the SEC as a security, the company sets its digital coins up for a lifetime of regulation—even if the coins do not retain security status through the remainder of their life.

K. Case Study: The DAO

The first instance of deeming an ICO an unregistered security under the 1933 Act was in 2017 with the release of Decentralized Autonomous Organization (DAO) tokens. Slock.it, an unincorporated German fintech company, wanted to create a peer-to-peer payment system based off of smart contracts operating on the Ethereum blockchain.¹⁵⁵ Users could buy a DAO token to participate on the platform through a payment to the developers of

¹⁵⁰ Securities Act of 1933; *see also* Jeff Benson, *SEC Makes It Easier for Crypto Startups to Raise Funds*, DECRYPT (Nov. 2, 2020), <https://decrypt.co/46994/sec-makes-it-easier-crypto-startups-raise-funds>; *What Is an Exempt Transaction?*, *supra* note 145.

¹⁵¹ SEC v. Ralston Purina Co., 346 U.S. 119 (1953).

¹⁵² *Id.*

¹⁵³ *Regulation Crowdfunding*, U.S. SEC. & EXCHANGE COMM'N, <https://www.sec.gov/small-business/exemptofferings/regcrowdfunding>.

¹⁵⁴ *Id.*

¹⁵⁵ Slock.it—Decentralizing the Emerging Sharing Economy, SLOCK.IT BLOG (Dec. 2, 2015), <https://blog.slock.it/slock-it-decentralizing-the-emerging-sharing-economy-cf19ce09b957>.

Ethereum, another cryptocurrency.¹⁵⁶ The purchased DAO Token held limited voting rights and could be used to vote on project proposals from “Contractors,” which, when approved, would be implemented by the developers to improve and expand the company and its payment network.¹⁵⁷ Before opening to votes, “Curators” who were selected by Slock.it would review the proposals and if approved, would publish them to the Ethereum blockchain.¹⁵⁸ In return for buying DAO and using the token to vote, DAO holders would receive “rewards,” similar to the way stockholders receive dividends in proportion to the amount of stocks owned, ultimately giving them profits on their investment in the proposal.¹⁵⁹ If a proposal received a majority vote (proportional to the amount of DAO Tokens held by the voting investors), it would be approved and implemented.¹⁶⁰ The capital raised in the proposal is supplied to the Contractor in exchange for performance of its duties.¹⁶¹ The DAO ITO raised \$150 million USD.¹⁶² Unfortunately, the code on the Ethereum blockchain for the DAO Tokens was unsecured and a hacker gained access, diverting one-third of the ether raised in the DAO ITO to his personal holding address.¹⁶³ However, the Ethereum blockchain developers were able to redirect all of the DAO Tokens released, including those diverted by the hacker, to a safe, separate holding account, and the investors did not lose their invested funds.¹⁶⁴ After the attack, the DAO team hired a security expert to maintain an adequately secured code.¹⁶⁵ The financial detriment brought by the attack attracted the attention of regulators at the SEC to the pitfalls of cryptocurrency as an investment product.¹⁶⁶ The SEC investigation found that the process of selling DAO Tokens in exchange for Ethereum, the voting rights associated with the tokens, and dependency of the investors upon the Curators and Contractors, satisfied the requirements of the *Howey* test and constituted an investment contract, and, therefore, a security that requires regulation.

The DAO Token case study raises several concerns for securities regulation, including vulnerabilities in software. Two details where cryptocurrency and blockchain companies differ from a typical security-issuing organization is the lack of directors and their required fiduciary duty towards the corporation, as well as the system of issuing securities through an ITO and their subsequent

¹⁵⁶ REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934, SEC. & EXCHANGE COMM’N (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf> [hereinafter DAO REPORT].

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ James J. Park, *When Are Tokens Securities? Some Questions from the Perplexed*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 20, 2018), <https://corpgov.law.harvard.edu/2018/12/20/when-are-tokens-securities-some-questions-from-the-perplexed/>.



storage by investors. A primary concern in the DAO Token report is that the Curators did not operate under standardized rules and had tremendous power that they used subjectively.¹⁶⁷ Because Curators had ultimate discretion in the DAO ecosystem over proposals, and therefore power over the future viability of the cryptocurrency, fiduciary duty to the DAO may have been present. Without regulation of their role, Curators subjectively determined criteria for publishing a proposal,¹⁶⁸ leading to inconsistencies and providing a platform for a potential misuse of power. Regulation would introduce standardization and limit potential misuse of power in settings lacking pure decentralization, but regulating the industry as it is currently, with no set rules and great variations in form, poses great difficulties.

While different cryptocurrencies and blockchains have different goals and operations to achieve their goals, the process of raising money through an ICO or ITO for project funding is relatively similar between issuers. The SEC has utilized this similarity in its approach to cryptocurrencies, using its ultimate conclusion of the DAO ITO, an unregistered security offering, as a strong argument when applied to other cryptocurrency operations. However, the lack of standardization in the cryptocurrency industry poses a problem for implementation of a standardized test and raises the question of regulating form or regulating substance.

Typically, the SEC has opted to regulate substance over form.¹⁶⁹ To determine if an offering is an investment contract under the *Howey* test, the substance of the transaction is examined—what are the expectations of the investors and is their investment going towards a common enterprise? The form, the actual exchange of money or if the corporation is issuing common or preferred shares, is not the focus. However, each cryptocurrency release and development is vastly different. Between any two currencies, the only similarities may be that the investor has a “coin” that represents some amount of value, and it is tied to a blockchain. If a cryptocurrency, such as a stablecoin, is only aimed at replacing a currency dollar-for-dollar, in substance, profits may not be expected. Further, the current securities regulations have been in active use since the 1930s and have had time to automate and standardize the form, leaving the majority of focus on substance. Cryptocurrencies greatly vary from each other, spurring the question of whether their regulation should continue in substance only (with ultra-modern technology following antiquated securities law), or if a new cryptocurrency regulation statute or collection of policies should be instilled to regulate both form and substance.

Through regulating securities issuers, intermediaries (such as broker-dealers), securities markets (such as stock exchanges), and security market

¹⁶⁷ DAO REPORT, *supra* note 156.

¹⁶⁸ *Id.*

¹⁶⁹ Ben Strack, *SEC Reportedly Could Look to Regulate DeFi Projects*, BLOCKWORKS (Aug. 19, 2021), <https://blockworks.co/sec-reportedly-could-look-to-regulate-defi-projects/>.

utilities (such as clearinghouses),¹⁷⁰ the SEC regulates the securities themselves. By judicially deploying the *Howey* test to determine if an ICO constitutes an investment contract, and therefore a security, the SEC can determine if the issuer, markets, and market utilities related to that cryptocurrency require regulation. In the case of cryptocurrencies, the intermediaries are the cryptocurrency investors themselves, and the SEC’s job is not to regulate them, but protect them.¹⁷¹ To continue the comparison, the issuers are the developers, the coin exchanges are the markets, and the blockchains are the market utilities. From such a perspective, it seems like a straight-forward, one-to-one trade-off between the current regulation system and the incoming cryptocurrency system. However, the snag does not lie in whether the cryptocurrency holds value in the same way a security does—it lies in the intended use and the distribution methods.

L. Regulating Substance Over Form

In the previous section, bitcoin was exemplified as a typical cryptocurrency intended for use as a payment system. However, investors have taken advantage of the limited supply and high demand, turning bitcoin and cryptocurrencies in general, into investments alongside their application as a currency. Former SEC Chair Jay Clayton clarified that currencies are not regulated as a security, and the SEC views bitcoin as a replacement for currency.¹⁷² The SEC’s interpretation of the intended and actual use of bitcoins aligns with the developer’s intended use of the coin as a peer-to-peer cash payment system,¹⁷³ rather than the actual treatment of the cryptocurrency by investors. Instead, the SEC has used the approach of regulating the auxiliary components of a cryptocurrency, rather than the actual product, to protect investors and prevent fraud. One of the ways the SEC has implemented this strategy has been discussed—classifying ICOs and ITOs as securities offerings that require disclosure.¹⁷⁴ Specifically, Clayton classified ICOs and ITOs as an “IPO with a token,”¹⁷⁵ which qualifies the offerings for mandatory disclosure. Clayton’s statements indicate the SEC has taken the position that the form of an ICO or ITO, whereby a token that may include voting rights is provided in exchange for participation in initial crowdfunding, is adequately equivalent in form to the existing system of providing a stock certificate in exchange for investment, that the substance and other components of cryptocurrency distribution must be analyzed. Through focusing on the substance of cryptocurrencies, the SEC can pinpoint the distinctions of the different auxiliary components discussed previously, examine how they interact with the cryptocurrency, and how the components affect

¹⁷⁰ *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, CONG. RES. SERV. (Mar. 10, 2020) <https://sgp.fas.org/crs/misc/R44918.pdf>.

¹⁷¹ U.S. SECURITIES AND EXCHANGE COMMISSION, <https://www.sec.gov/>.

¹⁷² Rooney, *supra* note 97; Rakesh Sharma, *SEC Chair Says Bitcoin Is Not a Security*, INVESTOPEDIA (updated June 25, 2019), <https://www.investopedia.com/news/sec-chair-says-bitcoin-not-security/>.

¹⁷³ Nakamoto, *supra* note 4.

¹⁷⁴ Rooney, *supra* note 97.

¹⁷⁵ *Id.*

cryptocurrency's status as a security. To exemplify how form can affect a cryptocurrency's status as a security, the distinction between bitcoin and Ripple's XRP is reviewed.

1. Case Study: Ripple's XRP

Part of the appeal and notoriety of bitcoin is that the bitcoin blockchain is entirely decentralized and totally reliant on the public to create nodes and maintain blockchain efficiency. In its truest sense, bitcoin is public and decentralized. Because bitcoin is the most popular and oldest publicly used cryptocurrency,¹⁷⁶ bitcoin and its mechanisms are often exemplified to explain how cryptocurrency operates. However, the release of bitcoin and its blockchain merely provided the base layer for the cryptocurrency world to grow and innovate, with other major coins, such as Ethereum, citing Satoshi Nakamoto's creation as ultimate inspiration.¹⁷⁷ From the standpoint of securities regulation, a highly controversial innovation is propagated by fintech company Ripple Labs ("Ripple")—a decentralized currency exchange operating on a distributed consensus ledger.¹⁷⁸ Now, we will explore why the SEC wants to regulate a currency exchange and how a distributed consensus ledger is different from blockchain.

To begin, we start with a short refresher. Bitcoin is presented as a peer-to-peer electronic cash payment system that operates on a version of a distributed ledger, the blockchain, which is hosted by thousands of servers.¹⁷⁹ Blocks are added to the blockchain each time a miner verifies a transaction. Each miner is a separate node and supports the blockchain from their server.¹⁸⁰ The chain is intended to be so long and so widely distributed that it is simply not possible for hackers to match the speed of growth, let alone attack the system.¹⁸¹ Often, "blockchain" and "distributed ledger" are used as interchangeable terms, but they are two different concepts.¹⁸² A distributed ledger is a decentralized, living record that is accessible by many parties and is customizable. A blockchain is a type of distributed ledger that automatically creates a tamper-proof seal on the last block of information (a bitcoin mined or transaction verified) when a new block is added.¹⁸³ Ripple uses a distributed consensus ledger, which verifies transactions through synchronizing multiple nodes partaking in the verification.

¹⁷⁶ John Hyatt, *Decoding Crypto: The 10 Most Popular Cryptocurrencies*, NASDAQ (Aug. 5, 2021), <https://www.nasdaq.com/articles/decoding-crypto%3A-the-10-most-popular-cryptocurrencies-2021-08-05>.

¹⁷⁷ *Ethereum Whitepaper*, ETHEREUM (last updated Jan. 26, 2022), <https://ethereum.org/en/whitepaper/>.

¹⁷⁸ Bernard Marr, *What Is the Difference Between Bitcoin and Ripple?*, FORBES (Feb. 28, 2018), <https://archive.ph/JZweq>.

¹⁷⁹ Nakamoto, *supra* note 4.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Difference Blockchain and DLT*, MARCO POLO NETWORK (Jan. 30, 2018), <https://www.marco.polonetwork.com/articles/distributed-ledger-technology/>.

¹⁸³ *Id.*



Using crowd input as a verification method allows trust to be built within the community when transparency is only at the hands of the developers.¹⁸⁴

Further, while Ripple has also released its own cryptocurrency, XRP, the coins are not intended to offer the same service as bitcoin. Instead, Ripple purports to offer a faster, less-expensive alternative to traditional settlement systems, such as SWIFT, which is used for wire transfers.¹⁸⁵ In a traditional, centralized wire transfer using different currencies, the U.S. dollar may be used to settle, converting the debtor's currency to U.S. dollars before converting it to the creditor's currency. For example, if this Canadian author decides to live out her Parisian dreams in a cute, little apartment in the 1st Arrondissement and is paying her (extravagant) rent deposit by wire transfer, her Canadian dollars may be routed through an intermediary in the United States and converted to U.S. dollars, before being converted again and sent to France in Euros. While these conversions are occurring between the debtor and creditor bank, and sometimes an intermediary bank, it can take up to four business days for the centralized SWIFT system to analyze the funds for legality and provide availability of the funds to the creditor.¹⁸⁶ Payment, conversion, and settlement are handled by different parties, increasing costs, inefficiency, and time needed to complete the transaction. Synchronizing many different actors requires expensive infrastructure—the general SWIFT network—which is costly to operate.¹⁸⁷ Payment is obtained by charging SWIFT transfer fees as well as maintaining an inflated exchange rate.¹⁸⁸

Comparatively, the Ripple settlement system works by exchanging other cryptocurrencies or fiat for XRP, the cryptocurrency associated with Ripple's blockchain. XRP can then be sent to another user, who can keep the payment as XRP or convert it to another cryptocurrency or choice of fiat. Procedurally, it is a similar process to a traditional wire transfer—start with one currency, convert it, send it to another party—but using distributed consensus ledger technology allows the process to evade a centralized authority by distributing the responsibility of verifying the transaction across thousands of parties.¹⁸⁹ The division of responsibility between multiple parties also allows verification to occur at a faster pace, exponentially increasing the amount of transactions verified and completed within twenty-four hours.¹⁹⁰ While there are still costs associated with settling a payment through Ripple, they are much lower and subject to community consensus regarding their amount.¹⁹¹ At the time of writing

¹⁸⁴ Anthony Stevens, *Distributed Ledger Consensus Explained*, HACKERNOON (Apr. 30, 2018), <https://hackernoon.com/distributed-ledger-consensus-explained-b0968d1ba087>.

¹⁸⁵ Marr, *supra* note 178.

¹⁸⁶ Mike Smith, *SWIFT Transfers Explained (How They Work, How Long They Take & What They Cost)*, KEY CURRENCY, <https://www.keycurrency.co.uk/swift-transfer/>.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ Reiff, *Bitcoin v. Ripple*, *supra* note 24.

¹⁹⁰ *Id.*

¹⁹¹ Thomas Silkjaer, *14 Common Misunderstandings about Ripple and XRP*, FORBES (Mar. 7, 2019), <https://www.forbes.com/sites/thomassilkjaer/2019/03/07/14-common-misunder>

this article, the current transaction cost is 0.00001 XRP,¹⁹² also called 10 “drops” and equivalent to approximately \$0.0000109 USD.¹⁹³ Compared to £25 in fees at some UK banks,¹⁹⁴ the Ripple costs are *de minimis*. However, the SWIFT system is not regulated by the SEC, so why is the commission concerned with a digital product that is intended to replicate it?

William Hinman, a former SEC director, suggested in a speech in 2018 that Ethereum, its network, and the transactions that take place thereon, should not be considered securities to be regulated by the SEC, joining bitcoin in an exempted space.¹⁹⁵ Hinman stated that adding disclosure requirements to current ether or bitcoin transactions would not be a value-add for investors.¹⁹⁶ Ether’s exemption from federal securities regulation rests on the use of the coin as a utility on the Ethereum network, rather than the treatment of the coin as a speculative investment by investors.¹⁹⁷ Similar to Ripple, the Ethereum Blockchain is not meant solely to provide a system for digital currencies. Instead, its purpose is to be a programmable, public blockchain that can also be utilized for digital currency transactions.¹⁹⁸ Developers can build smart contracts and apps on the decentralized infrastructure, provide public amenities such as games,¹⁹⁹ or use the blockchain network to support other cryptocurrencies, such as the DAO token mentioned previously. As the SEC is a commission that tends to regulate substance over form,²⁰⁰ the decision to allow bitcoin and ether to function without regulation, valuing their intended use over their subsequent treatment by investors, is surprising.

Uniquely, Ripple’s SWIFT-emulating network is only semi-decentralized.²⁰¹ Ripple Labs owns the software to operate its network, as well as a public-access open source code.²⁰² Comparatively, ownership for both the Ethereum and bitcoin blockchains are truly public and fully decentralized.²⁰³ Due to the ownership of the network, part of the value of XRP may be driven by the ability

standings-about-ripple-and-xrp/?sh=567100c071d0; *Transaction Cost*, XRP LEDGER, <https://xrpl.org/transaction-cost.html> [hereinafter *Transaction Cost*].

¹⁹² *Transaction Cost*, *supra* note 191.

¹⁹³ COINDESK, <https://www.coindesk.com/price/xrp/> (accessed on Sept. 11, 2021, XRP:USD 1:1.09).

¹⁹⁴ Smith, *supra* note 186.

¹⁹⁵ Sam Cooling, *Ripple Latest: SEC Fails in Bid to Prevent Hinman Questioning*, COINRIVET (July 16, 2021), <https://coinrivet.com/ripple-latest-sec-fails-in-bid-to-prevent-hin-man-questioning/>.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ Jake Frankenfield, *Ethereum*, INVESTOPEDIA (last updated Jan. 12, 2022), <https://www.investopedia.com/terms/e/ethereum.asp>.

¹⁹⁹ Ryan Browne, *The World’s Second-Biggest Cryptocurrency Is Getting a Major Upgrade—Here’s What You Need to Know*, CNBC (Dec. 1, 2020), <https://www.cnbc.com/2020/12/01/ethereum-2point0-eth-cryptocurrencys-network-starts-a-major-upgrade.html>.

²⁰⁰ Strack, *supra* note 169.

²⁰¹ David H. Freedman, *Why Ripple’s SEC Lawsuit Could Have a Lasting Impact on Crypto*, FORTUNE (July 29, 2021), <https://archive.ph/V6a1T>.

²⁰² *Id.*

²⁰³ *Id.*



of Ripple Labs to enhance, upgrade, and cheapen its network.²⁰⁴ As opposed to the pure, supply-and-demand-plus-labor, totally-market-driven, it-has-value-because-we-as-a-species-decided-it-does,²⁰⁵ value of a commodity, crypto investors now have to rely in part on the company that owns the currency and the software to do good work.²⁰⁶

2. SEC v. Ripple Labs

In December 2020, the SEC filed a complaint against Ripple Labs, Inc., and its co-founders and CEO, Bradley Garlinghouse and Christian Larsen, claiming that the exchange, with the help of its officers, had participated in unregistered securities offerings worth more than \$1.3 billion USD, violating Sections 5(a) and 5(c) of the 1933 Act.²⁰⁷ Starting with their distribution in 2013, Ripple has sold²⁰⁸ over 14.6 billion units of XRP to date.²⁰⁹ At the time of the initial offering, Ripple had not provided disclosure statements nor specific financial and managerial information regarding the company and its cryptocurrency. Instead, it had provided only very select information to currently existing investors. The information provided is largely in the form of quarterly market reports that discuss the sales, price, and volume of the cryptocurrency, volatility, and other general insights from the fintech industry at large.²¹⁰ Through the lens of securities regulation, less transparency creates a riskier environment for investors. Ripple makes it clear that it intends to keep a strong hand on their privacy—providing grand severance packages to exiting executives in exchange for an all-consuming non-disclosure agreement.²¹¹ While XRP was designed and promoted as a low-cost and efficient conversion medium for cross-border payments and uses crowd-input for transaction verification, the control of Ripple Labs over the disclosure of information and distribution of coins, as well as the treatment of the cryptocurrency as an investment, are the driving forces behind the SEC’s complaint and Ripple’s potential unregistered security offering of XRP.

²⁰⁴ *Id.*

²⁰⁵ Wilks, *supra* note 5.

²⁰⁶ Freedman, *supra* note 201.

²⁰⁷ Complaint, Securities and Exchange Commission v. Ripple Labs, Inc., Bradley Garlinghouse, and Christian A. Larsen, Complaint, 20 Civ. 10832 (SDNY 2020), <https://www.sec.gov/litigation/complaints/2020/comp-pr2020-338.pdf>.

²⁰⁸ Yes, *sold*, not mined. Uniquely, Ripple minted pre-mined coins and transfers ownership of the cryptocurrency to the purchaser through the XRP ledger.

²⁰⁹ First Amended Complaint, Securities and Exchange Commission v. Ripple Labs, Inc., Bradley Garlinghouse, and Christian A. Larsen, Complaint, 20 Civ. 10832 (SDNY 2021), <https://storage.courtlistener.com/recap/gov.uscourts.nysd.551082/gov.uscourts.nysd.551082.46.0.2.pdf>, at page 16.

²¹⁰ *Q2 2020 XRP Markets Report*, RIPLE (Aug. 3, 2020), <https://ripple.com/insights/q2-2020-xrp-markets-report/>.

²¹¹ Jeff John Roberts, *SEC v. Ripple: Inside the Case That Could Make or Break the Crypto Industry*, DECRYPT (Aug. 11, 2021), <https://decrypt.co/78153/ripple-inside-the-sec-case-that-could-make-or-break-the-crypto-industry>.



3. Preventive Measures by Issuers Against Investment

Despite measures taken by issuers to advertise the intended use of the cryptocurrency and discourage investing, if a cryptocurrency is treated like a security in form, it falls within the purview of securities regulation. For instance, even with a warning to investors not to use the issued utility token as a speculative investment and prohibiting resale after the twelve-month initial offering closed, the SEC still brought suit against Block.one and its \$4 billion ITO of EOS tokens, eventually settling for \$24 million.²¹² In form, Block.one released utility tokens that allowed token holders to develop, host, and run other business applications on the EOS blockchain, similar to the hosting goals of the Ethereum blockchain.²¹³ The utility of the token is storage and development ability on the blockchain, as well as voting rights for the cost of new tokens, allowing the voters to control the rate of inflation.²¹⁴ Block.one discouraged American investors from buying the coins through nullification of a required Token Purchase Agreement if the purchase agreement was signed by an American investor.²¹⁵ To increase preventative measures, the company blocked IP addresses located in the United States.²¹⁶ In substance, investors still treated EOS tokens as a speculative investment, buying large amounts and subsequently trading them on a number of other exchanges within the coin's first year.²¹⁷ Additionally, a number of American investors were not deterred by geo-blocking software or a breached contract, obtaining EOS tokens regardless of the preventative measures.²¹⁸ As well, new tokens are not mined in a traditional bitcoin manner, but produced and released by centralized block producers who

²¹² Freedman, *supra* note 201; *see also* In the Matter of Block.one, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order [before the Securities and Exchange Commission, Administrative Proceeding File No. 3-195568, Sept. 30, 2019], <https://www.sec.gov/litigation/admin/2019/33-10714.pdf>.

²¹³ Shobhit Seth, *EOS*, INVESTOPEDIA (Aug. 7, 2021), <https://www.investopedia.com/tech/what-is-eos/>.

²¹⁴ *Id.*

²¹⁵ In the Matter of Block.one, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order [before the Securities and Exchange Commission, Administrative Proceeding File No. 3-195568, Sept. 30, 2019], <https://www.sec.gov/litigation/admin/2019/33-10714.pdf>.

²¹⁶ In the Matter of Block.one, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order [before the Securities and Exchange Commission, Administrative Proceeding File No. 3-195568, Sept. 30, 2019], <https://www.sec.gov/litigation/admin/2019/33-10714.pdf>.

²¹⁷ In the Matter of Block.one, Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order [before the Securities and Exchange Commission, Administrative Proceeding File No. 3-195568, Sept. 30, 2019], <https://www.sec.gov/litigation/admin/2019/33-10714.pdf>. *See also* Stephen Palley, *What the Block.one SEC Settlement in the EOS ICO Sale Means (and Doesn't)*, THE BLOCK (Oct. 1, 2019), <https://www.theblockcrypto.com/post/41632/what-the-block-one-sec-settlement-in-the-eos-ico-sale-means-and-doesn't>.

²¹⁸ Palley, *supra* note 228.

are in control of their sale price (subject to votes from token holders).²¹⁹ Following its traditions, the SEC settlement with Block.one indicates that the substance, rather than the form, is a strong focus for SEC regulation. In form, Block.one did not sell to Americans; in substance, Americans treated a semi-centralized cryptocurrency system as a security, and, therefore, the SEC took regulatory enforcement action. However, it is important to note that a settlement does not set a jurisprudence precedent. Rather, the settlement indicates the attitude and potential actions that may be taken against future cryptocurrency schemes.

Largely, the SEC has focused on cryptocurrency companies issuing a security through an ICO without registration in violation of the 1933 Act. Doing so helps to protect investors making a large initial investment in a potentially fraudulent scheme. To demonstrate how easy it is to create, market, and release a cryptocurrency, a *New York Times* journalist, with the help of YouTube, Reddit, and an investment of \$1000, released a cryptocurrency (aptly named Idiot Coins) with explicit instructions not to purchase it under any circumstances.²²⁰ Despite all precautions, seventy-three Idiot Coins were still sold.²²¹ The author created his cryptocurrency for demonstrative and journalistic purposes, but a fraudster could use the system to his advantage just as easily, taking advantage of the desire and demand of investors who override direct instructions not to buy (as demonstrated through Idiot Coins and Block.one). However, crypto exchange fraud is certainly a reality and will be exemplified in the next Part.

III. SECURITIES REGULATION FOR CRYPTO IN CANADA

A. Canada's Approach

Overall, Canada has taken a more proactive, involved, and organized approach to regulating cryptocurrencies (and other crypto assets, as discussed further in this Part) as securities than the United States and the SEC. Canada has utilized the piecemeal approach of the country's securities administration regime to achieve efficiency in regulation as well as enforcement. As a result, Canada has seen success when mixing regulation into the cryptocurrency industry. While several similarities are shared with the United States, such as the threshold test for whether a crypto asset is a security and the overall positive attitude towards regulation, the two regimes are not as agreeable in other aspects. The following section sets out to explore how Canada, as a whole and as its parts, has approached regulating cryptocurrencies as a security.

B. CSA

In the United States, the SEC is the main regulatory body for the country and was created under a federal statute, the 1934 Act. Comparatively, the provincial

²¹⁹ Seth, *supra* note 224.

²²⁰ *Going for Broke in Cryptoland*, N.Y. TIMES, <https://www.nytimes.com/2021/08/05/business/hype-coins-cryptocurrency.html>.

²²¹ *Id.*

regulators in Canada are independent Crown corporations with a similar statutory mandate and overall function in the financial system: to protect investors, maintain fair and efficient capital markets, and contribute to the stability of the financial system while reducing systemic risk.²²² There are ten provincial and three territorial regulators who are harmonized by the Canada Securities Administrators (CSA).²²³ The CSA is not a securities regulator itself, but rather an informal body which provides the framework for the participation and cooperation of the thirteen Canadian securities regulators. The purpose of the CSA is to unite what has the potential to be a drastically different system across each border.

C. IIROC

Other national level regulatory bodies exist to harmonize the piecemeal set-up of the Canadian securities administration. Alongside the CSA, the Investment Industry Regulatory Organization of Canada (IIROC) works to oversee all investment and trading activity in Canada's marketplaces as part of a larger scheme of financial regulation.²²⁴ The IIROC is a self-regulatory organization with a similar mandate to other securities commissions: protect investors and maintain trust and integrity in the marketplace.²²⁵ The IIROC sets and enforces rules for investment firms and individuals who act in a dealer capacity.²²⁶ Two sets of rules comprise IIROC's regulatory framework: the Universal Market Integrity Rules (UMIR) and the IIROC Rules, which set out requirements for securities related trading on IIROC regulated marketplaces and rules that govern the activities of investment firms, respectively.²²⁷ The IIROC publishes a variety of notices, providing guidance on compliance with rules set out by it, in areas such as Anti-Money Laundering ("AML")²²⁸ and price disclosure.²²⁹

²²² *About Us*, ONTARIO SEC. COMM'N, <https://www.osc.ca/en/about-us>; *Our Mission*, CANADIAN SEC. ADMINISTRATORS, <https://www.securities-administrators.ca/about/who-we-are/our-mission/>.

²²³ *About Us*, CANADIAN SEC. ADMINISTRATORS, <https://www.securities-administrators.ca/about/who-we-are/>.

²²⁴ *Welcome to IIROC*, INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA, <https://www.iiroc.ca/>.

²²⁵ *About IIROC*, INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA, <https://www.iiroc.ca/about-iiroc>.

²²⁶ *What We Do*, INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA, <https://www.iiroc.ca/about-iiroc/what-we-do>.

²²⁷ *UMIR Rules*, INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA, <https://www.iiroc.ca/rules-and-enforcement/umir-rules>.

²²⁸ *Anti-Money Laundering Compliance Guidance*, INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA (Oct. 14, 2021), <https://www.iiroc.ca/news-and-publications/notices-and-guidance/anti-money-laundering-compliance-guidance-0>.

²²⁹ *Guidance on Marketplace and Average Price Disclosure for Trade Confirmations*, INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA (Oct. 14, 2021), <https://www.iiroc.ca/news-and-publications/notices-and-guidance/guidance-marketplace-and-average-price-disclosure-trade-confirmations-1>.

1. Other Harmonizing Authorities

The CSA and IIROC work with other national-level financial regulators who also have the intent to harmonize regulation. Another body that regularly interacts with Canadian securities regulators is the Joint Forum of Financial Markets Regulators (“Joint Forum”). The CSA, along with other financial regulators, including the Canadian Council of Insurance Regulators (CCIR), and Canadian Association of Pension Supervisory Authorities (CAPSA), has representatives composing the Joint Forum,²³⁰ which, as its name suggests, provides a forum for three federally focused regulatory bodies to devise guidelines, but not regulations, for the Canadian financial sector at large.²³¹

D. Provincial Regulators and Passport System

Because each province and territory has its own regulator, securities laws have developed independently in each region. While there are similarities within each regulator’s legislation and rules, there are also critical differences. If a corporation was required to make a disclosure in multiple provinces, each jurisdiction may require an entirely unique disclosure document. Doing so is inefficient, costly, and leaves room for errors and inconsistencies. The CSA works to harmonize the thirteen regulators and encourage market participation in Canada through the institution of a “Passport” regulatory system.²³² The Passport system requires the market participant to gain approval from its home regulator and then also meet a set of harmonized laws.²³³ Once the market participant has met the harmonized requirements, it is allowed to access the other provincial capital markets, creating a more streamlined Canadian securities landscape.²³⁴ The single exception to the CSA Passport system is Ontario, in which the OSC makes its own decision about outsider access to the largest capital markets in Canada, but looks to the principal regulator for guidance on its decision.²³⁵

E. Role of CSA and IOSCO

The CSA often acts as Canada’s securities representative in international organizations such as the North American Securities Administrators Association (NASAA), the Council of Securities Regulators of the Americas (COSRA) and the International Organization of Securities Commissions (IOSCO).²³⁶ COSRA and IOSCO both exist for the benefit of the investors—to protect investors, maintain market integrity, and encourage regulatory cooperation and the sharing

²³⁰ About Us, CANADIAN SEC. ADMINISTRATORS, <https://www.securities-administrators.ca/about/regulatory-cooperation/>.

²³¹ Initiatives and Projects, JOINT FORUM OF FINANCIAL MARKET REGULATORS, <https://www.jointforum.ca/en/init/>.

²³² About Us, CANADIAN SEC. ADMINISTRATORS, <https://www.securities-administrators.ca/about/regulatory-cooperation/>.

²³³ *Id.*

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ Initiatives and Projects, JOINT FORUM OF FINANCIAL MARKET REGULATORS, <https://www.jointforum.ca/en/init/>.

of information between multiple countries.²³⁷ IOSCO aims to act as the global standard setter for securities markets regulation²³⁸ and does so by publishing a variety of documents including annual reports,²³⁹ public reports,²⁴⁰ and comment letters,²⁴¹ as well as compiling guidelines from IOSCO members on specific topics such as ICOs.²⁴² IOSCO has a compliance division—the Assessment Committee—which develops and delivers programs to different IOSCO regulators, and performs Country and Thematic Reviews to analyze any shortcomings in a country’s regulatory landscape for securities.²⁴³ Regulatory conglomerates, such as IOSCO and COSRA, show the benefits of uniting international securities commissions and how a wide demographic of investors may be protected in an effective and efficient manner.

F. OSC and Ontario

In Canada, while the regulatory landscape may have goals of harmonization, a factor weighing heavily on the development of a fair and efficient, nationally organized system is the focus on Ontario. Ontario is home to Toronto, the financial capital of Canada, and the TSX, the largest capital market in Canada. As a result, the OSC has a higher volume of requests to process and must monitor substantially more activity than the other provincial regulators. In Canada, the provincial regulators have similar divisions to the SEC and carry out very similar roles. For instance, the OSC has a compliance and enforcement division, investigation division, and litigation and tribunal opportunities.²⁴⁴ However, a key difference is the heavy use of instruments, rules, and policies by the OSC, rather than relying strictly on legislation (such as the SEC relying heavily on the pre-made 1933 Act and 1934 Act). The rules made by the OSC have the force of law and are easier and faster to publish or rescind than the SEC regulations, which are codified in a statute.²⁴⁵ Adopting the use of instruments and policies over a reliance on legislation allows the OSC, and CSA, to

²³⁷ *Id.*

²³⁸ The Global Standard Setter for Securities Market Regulation, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, <https://www.iosco.org/>.

²³⁹ Annual Reports, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, https://www.iosco.org/publications/?subsection=annual_reports.

²⁴⁰ Public Reports, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, https://www.iosco.org/publications/?subsection=public_reports.

²⁴¹ Comment Letters by IOSCO, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, https://www.iosco.org/publications/?subsection=iosco_comment_letters&subSection1=iasb.

²⁴² Regulators’ Statements on Initial Coin Offerings, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, <https://www.iosco.org/publications/?subsection=ico-statements>.

²⁴³ Assessment Committee: What Is AC and What Does It Do?, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, https://www.iosco.org/about/?subsection=display_committee&cmtid=19.

²⁴⁴ Welcome to the Ontario Securities Commission, ONTARIO SECURITIES COMMISSION, <https://www.osc.ca/en>.

²⁴⁵ Rules, Regulations and Schedules, U.S. SECURITIES & EXCHANGE COMM’N, <https://www.sec.gov/divisions/corpfin/ecfrlinks.shtml>.

maneuver novel landscapes with more fluidity and react to changing investor activities. Instruments can be applicable to one, some, or all of the provinces and territories and are categorized accordingly: a National Instrument has been adopted by all thirteen commissions while a Multilateral Instrument has been adopted by more than one commission, but less than all.²⁴⁶ As well, the regulators are able to take a proactive approach and set rules in place pre-emptively when the first signs of high volatility or exceptional risk are present.

G. *Beginning of Canadian Regulatory Framework—Investment Contract Test*

The instruments, rules, policies, and notices published by the OSC and CSA play a major role in responding to trends in capital markets. While Canada is considered to have passed the world's first federal law on cryptocurrencies with the royal assent of Bill C-31 (*An Act to Implement Certain Provisions of the Budget Tabled in Parliament on February 11, 2014, and Other Measures*),²⁴⁷ the CSA has since updated and refined the treatment of cryptocurrencies as a security.²⁴⁸ Bill C-31 received royal assent on June 19, 2014, categorizing “virtual currencies” (for the purposes of this paper, cryptocurrencies) as a money service business to be regulated under anti-money laundering laws. For regulatory purposes, companies that work with cryptocurrencies are required to register with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) and subsequently keep appropriate records of their dealings, while reporting any suspicious activity.²⁴⁹ The regulatory requirements proscribed through FINTRAC are aligned with the intended use of the cryptocurrencies—as a payment system. It is the treatment of the cryptocurrencies as a speculative investment that has urged securities commissions to step in and create stability in a highly volatile environment.

H. *Six Key Documents in Canada's Crypto Securities Framework*

1. CSA Staff Notice 46-307 Cryptocurrency Offerings

The first major step in creating national securities regulations for cryptocurrencies in Canada occurred on August 24, 2017, when CSA Staff Notice 46-307 *Cryptocurrency Offerings* (“46-307”) was published, offering guidelines and requirements relating to ICOs, ITOs, exchanges, and cryptocurrency investment funds.²⁵⁰ Notice 46-307 generally describes what the

²⁴⁶ Resources, CANADIAN SECURITIES ADMINISTRATION, <https://www.securities-administrators.ca/resources/access-rules-policies/>.

²⁴⁷ Bill C-31, *An Act to Implement Certain Provisions of the Budget Tabled in Parliament on February 11, 2014, and Other Measures*, Second Session, Forty-first Parliament, 62-63 Elizabeth II, 2013-2014, Statutes of Canada 2014 Ch. 20, <http://www.parl.ca/DocumentViewer/en/41-2/bill/C-31/royal-assent>, archived at <https://perma.cc/2N7QE68C>. See also Regulation of Cryptocurrency in Selected Jurisdictions, LAW LIBRARY: LIBRARY OF CONGRESS, <https://tile.loc.gov/storage-services/service/l1/lglrd/2018298388/2018298388.pdf>.

²⁴⁸ Regulation of Cryptocurrency in Selected Jurisdictions, LAW LIBRARY: LIBRARY OF CONGRESS, <https://tile.loc.gov/storage-services/service/l1/lglrd/2018298388/2018298388.pdf>.

²⁴⁹ *Id.*

²⁵⁰ *Id.*

auxiliary components of cryptocurrencies are, such as exchanges, and how they may tie into the securities landscape in Canada.²⁵¹ The CSA announced its approach to determining whether ICOs and ITOs constitute investment contracts, and set out a four-step Investment Contract test, taken from the relevant case law that reads markedly similar to the American *Howey* test:²⁵²

An ICO or ITO is an investment contract if it involves: An investment of money;

In a common enterprise;

With the expectation of profit;

To come significantly from the efforts of others.²⁵³

Notice 46-307 clarifies which securities laws apply if an offering is deemed an investment contract under the test and which prospectus exemptions may apply.²⁵⁴ It highlights two categories of prospectus exemption: accredited investors which are exempt under the accredited investor prospectus exemption, or retail investors which may be exempt under the offering memorandum prospectus exemption.²⁵⁵ Then, 46-307 analyzes the use of whitepapers as disclosures documents. Whitepapers may provide vital information for investors, such as the capital fundraising goal, the goal of the project, and the management of the business, but they do not hold the same rights for investors as a prospectus does in the face of misrepresentation by the issuer.²⁵⁶ Notice 46-307 warns that the information appearing in prospectuses is specific and standardized, offering protections for investors, including civil remedies, and subjecting the issuer to ongoing disclosure requirements, rather than the informal singularity of the whitepaper and disclosure at the discretion of the developers.²⁵⁷ Subsequently, 46-307 lists the conditions to be met to qualify for an offering memorandum exemption, and provides examples of the material to be disclosed in the offering memorandum itself.²⁵⁸ Such conditions include, but are not limited to: obtaining a signed risk acknowledgement form from each investor, providing audited annual financial statements and ongoing disclosure to investors, and filing reports of exempt distribution with the securities regulatory authorities.²⁵⁹ Some material information to be disclosed is: features of the coins, including potential returns on investment, exit strategies, and liquidity; the number of coins that will be held by management and the number of coins that will be offered for sale to

²⁵¹ CSA Staff Notice 46-307 Cryptocurrency Offerings (Aug. 24, 2017), http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20170824_cryptocurrency-offerings.htm, archived at <https://perma.cc/7XF6-3T3E>.

²⁵² *Id.*

²⁵³ *Id.*

²⁵⁴ A prospectus is a formal document provided by the issuer disclosing material information about the offered security.

²⁵⁵ CSA Staff Notice 46-307 Cryptocurrency Offerings (Aug. 24, 2017), http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20170824_cryptocurrency-offerings.htm, archived at <https://perma.cc/7XF6-3T3E>.

²⁵⁶ *Id.*

²⁵⁷ *Id.*

²⁵⁸ *Id.*

²⁵⁹ *Id.*

the public; and management members' identities and backgrounds, including any regulatory or legal proceedings against them.²⁶⁰ The section concludes with a reminder that the disclosure must be truthful, written in plain language, and focused on the material facts.²⁶¹

Notice 46-307 moves on to addressing dealer registration or exemption for the developers trading in securities for a business purpose.²⁶² Four key factors are recognized in the determination of whether a person is trading for a business purpose: (1) soliciting a broad base of investors, including retail investors; (2) using the internet to disseminate information and advertise the ICO; (3) advertising in person at public events such as conferences and meetups; and (4) raising a significant amount of capital from a large number of investors.²⁶³ If a crypto company performing an initial offering meets the business purpose criteria, it must register as a dealer or apply for an exemption.²⁶⁴ The section concludes with a discussion of two additional areas of risk: fundamental obligations to investors, specifically know-your-client ("KYC") and suitability, and cybersecurity.²⁶⁵ Notice 46-307 advises that merely collecting names, email addresses, and/or IP addresses would not satisfy the KYC obligation, instead it guides developers to collect sufficient information, potentially through an online, automated process, to verify investor's identities and ensure that purchases of coins or tokens are suitable for the investor.²⁶⁶ Finally, a guideline is set for cybersecurity requiring developers hosting ICOs or ITOs to have strong compliance systems, strong cybersecurity measures, and policies and procedures that address potential cybersecurity risks.²⁶⁷ It concludes with an advertisement for the CSA Regulatory Sandbox, an experimental arena, exempt from securities regulation, which is discussed in greater detail below.

2. CSA Staff Notice 46-308 Securities Law Implications for Offerings of Tokens

On June 11, 2018, the CSA released a follow-up to 46-307: CSA Staff Notice 46-308 *Securities Law Implications for Offerings of Tokens* ("46-308"). This Notice offers an in-depth discussion of existing securities laws, adapted guidelines, and reader-friendly examples of guideline application.²⁶⁸ Publishing 46-308 created a consulting resource for blossoming Canadian crypto projects and a national, standardized approach to application of securities legislation to cryptocurrency offerings.²⁶⁹ Specifically, 46-308 provides guidance on two key

²⁶⁰ *Id.*

²⁶¹ *Id.*

²⁶² *Id.*

²⁶³ *Id.*

²⁶⁴ *Id.*

²⁶⁵ *Id.*

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ CSA Staff Notice 46-308 *Securities Law Implications for Offerings of Tokens*, CANADIAN SECURITIES ADMINISTRATORS, https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/2018juin11-46-308-avis-acvm-en.pdf.

²⁶⁹ *Id.*

issues: when a token offering may or may not involve an offering of securities; and token offerings structured in multiple steps.²⁷⁰ Further, 46-308 ensures the guidelines will remain consistent with the latest market and business trends and will be modified as required.²⁷¹

Notice 46-308 begins by addressing when a token offering involves a securities offering. Securities offerings are evaluated on a case-by-case basis and are triggered by two factors, which can occur simultaneously or independently: when the ICO or ITO involves the distribution of an investment contract, and when the offered assets are securities by definition.²⁷² Following a brief review of the Investment Contract test, 46-308 asserts that the totality of the context should be analyzed for each case with a concentration on substance over form.²⁷³ Likely correlated to the wholesome outlook the CSA has on context, the section concludes with a statement that many tokens that are marketed as “utility tokens” are actually securities, and having a utility, such as representing storage space on a blockchain, does not disqualify the token from truly being a security.²⁷⁴ Then, to illustrate the Investment Contract test and how it may apply in various situations, the CSA staff took a smattering of real-life examples and explained the possible implications on the Investment Contract test.²⁷⁵ For instance, the second example points to an ICO where the tokens are not immediately delivered to investors. This delivery delay could indicate an expectation of profit when the technology in question is still being developed, as well as indicate the existence of a common enterprise due to the user’s reliance on the developers to finish the project and deliver usable tokens.²⁷⁶

Notice 46-308 goes on to address the issue of tokens that are reasonably expected or marketed to trade.²⁷⁷ If purchasers reasonably expect the asset to trade in a secondary market (on a crypto exchange), such expectation is a factor that plays into expecting a profit. If representations about establishing a secondary market through resale after initial purchase is made in a whitepaper, through social media, or by a third party that is specifically endorsed by the developer, they are strong indicators of seeking a profit.²⁷⁸ As well, the absence of control over the creation of a secondary market by other parties is not relevant in determining whether the purchasers expect a profit.²⁷⁹ Again, all standards set by the CSA show its intention to regulate substance over form, asking what actually happens to the cryptocurrencies rather than what the developers plan or announce.²⁸⁰

²⁷⁰ *Id.*

²⁷¹ *Id.*

²⁷² *Id.*

²⁷³ *Id.*

²⁷⁴ *Id.*

²⁷⁵ *Id.*

²⁷⁶ *Id.*

²⁷⁷ *Id.*

²⁷⁸ *Id.*

²⁷⁹ *Id.*

²⁸⁰ *Id.*

The second major section of 46-308 addresses token offerings that are structured in multiple steps.²⁸¹ Generally, the user will invest money and sign a “simple agreement for future tokens” in exchange for a right to receive a set amount of tokens when release occurs.²⁸² Following this structure, the first step usually involves the distribution of a security, subject to a prospectus exemption if the ICO has been offered to accredited investors.²⁸³ The second step, when the token is delivered and the platform is functional, brings a divide between developers and the CSA.²⁸⁴ Developers argue that the token itself is not a security, and while 46-308 acknowledges such a possibility, the delivered token can also be a security.²⁸⁵ According to 46-308, a token may still qualify under the Investment Contract test or possess other security-like attributes, including profit-sharing interest, even if it is a utility token.²⁸⁶ Erring on the side of caution and pro-regulation, readers are reminded that distribution of a security requires a prospectus to be filed, and 46-308 subtly recommends that developers should file for an exemption. If the developers intend to open resale indefinitely, a second prospectus exemption is required to do so.²⁸⁷ As well, to reiterate 46-307, a reminder that any person in the business of trading securities is required to register as a dealer and “trade” is defined broadly to include acts, advertisements, or other conduct performed directly or indirectly in furtherance of a trade.²⁸⁸ The section concludes with a guideline to professional advisers and developers indicating the substance of the crypto platform should be valued over the form, and step-structured offerings should not be used in an attempt to avoid securities legislation; any defaults in securities registration requirements will be carried over into the offerings’ subsequent steps.²⁸⁹

Finally, 46-308 ends with a statement confirming active surveillance of offerings by the CSA and pending regulatory and enforcement action, if necessary. It recommends consultation with legal counsel to determine how to comply with securities legislation when the targeted demographic of investors lies within and outside of Canada.²⁹⁰ As usual, 46-308 concludes with information about, and encouragement to use, the CSA Regulatory Sandbox. Both 46-307 and 46-308 are built upon in 2019 and 2020 with CSA Staff Notice 21-327 *Guidance on the Application of Securities Legislation to Entities Facilitating the Trade of Crypto Assets*, discussed later in this section, which clarifies the CSA’s stance on whether cryptocurrencies are securities,²⁹¹ and the

²⁸¹ *Id.*

²⁸² *Id.*

²⁸³ *Id.*

²⁸⁴ *Id.*

²⁸⁵ *Id.*

²⁸⁶ *Id.*

²⁸⁷ *Id.*

²⁸⁸ *Id.*

²⁸⁹ *Id.*

²⁹⁰ *Id.*

²⁹¹ CSA Staff Notice 21-327 *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets*, CANADIAN SECURITIES ADMINISTRATORS,

Joint CSA/ IIROC Consultation Paper 21-402 *Proposed Framework for Crypto-Asset Trading Platforms*, which subjects cryptocurrency exchange platforms to security regulation if cryptocurrencies qualifying as a security are traded on the platform.²⁹²

I. CSA Regulatory Sandbox

Suddenly, with all the new regulations, Canada does not have the nicest playground for budding crypto creators to put their product on the market. In response, the CSA created its Regulatory Sandbox.²⁹³ The Regulatory Sandbox allows cryptocurrency and other fintech creators to offer their innovation without registration or with exemptive relief from securities laws registration requirements.²⁹⁴ The Regulatory Sandbox does not discriminate based on innovator status as a start-up or as an established company, encouraging widespread participation in the fintech and cryptocurrency world.²⁹⁵ Innovators who apply to the CSA and are approved for the Regulatory Sandbox are given a time-limited period to test drive their business model under the supervision of CSA staff, and may be required to provide reports on the data collected during their duration.²⁹⁶ Companies dealing in cryptocurrencies that have grown a large customer-base, like Wealthsimple, have had a successful start in the CSA Regulatory Sandbox.²⁹⁷

J. OSC Regulations

While the CSA and IIROC have published instruments, rules, and policies regarding cryptocurrencies, so has the OSC. As mentioned, due to its unique standing in the Canadian securities regulatory system and the volume of requests it processes, the OSC has a more aggressive approach than other provincial regulators.²⁹⁸ In March 2021, the OSC posted a bulletin warning investors that there has been a significant increase in the number of crypto exchange platforms,

https://www.osc.ca/sites/default/files/pdfs/irps/csa_20200116_21-327_trading-crypto-assets.pdf.

²⁹² Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada Consultation Paper 21-402 *Proposed Framework for Crypto-Asset Trading Platforms*, ONTARIO SECURITIES COMMISSION (MAR. 14, 2019), <https://www.osc.ca/en/securities-law/instruments-rules-policies/2/21-402/joint-canadian-securities-administrators-investment-industry-regulatory-organization-canada>.

²⁹³ CSA Staff Notice 46-307 *Cryptocurrency Offerings* (Aug. 24, 2017), http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20170824_cryptocurrency-offerings.htm, archived at <https://perma.cc/7XF6-3T3E>.

²⁹⁴ Resources, CANADIAN SECURITIES ADMINISTRATION, <https://www.securities-administrators.ca/resources/regulatory-sandbox/>.

²⁹⁵ *Id.*

²⁹⁶ *Id.*

²⁹⁷ Resources: Decisions, CANADIAN SECURITIES ADMINISTRATION, <https://www.securities-administrators.ca/resources/regulatory-sandbox/decisions/>.

²⁹⁸ Vanmala Subramaniam, *OSC to Start Enforcing New Rules for Unregistered Crypto Trading Platforms*, THE GLOBE & MAIL (Apr. 22, 2021, last updated Jan. 27, 2022), <https://archive.ph/pohFg>.

and, as a result, with the intention to protect investors, the OSC required all crypto asset trading platforms that offer a custodial holding function for investors (i.e. hot wallet) in Ontario to become registered as a security dealer by April 19, 2021.²⁹⁹ Despite confirming appropriate repercussions and enforcement under securities law for those who choose not to register, the OSC saw a low turnout for registration.³⁰⁰ Considering hundreds of cryptocurrency companies that offer digital asset storage have registered with FINTRAC as a money service business, the reluctant attitude toward a secondary registration as a securities dealer is understandable. By introducing the requirement for all crypto trading platforms to register with their provincial regulator, Canada is taking a multifaceted approach to the definition of a cryptocurrency as a financial product, as well as approaching fraud elimination from a variety of angles. Registering with a securities commission means cryptocurrency creators are admitting that their products are securities, a global bone of contention in the industry.

Canadian regulation of cryptocurrencies is complicated and layered. The CSA, IIROC, OSC, and FINTRAC all have their own ideas about when cryptocurrency companies should be registered, which products of theirs should be registered, and as what they should be registered. Former SEC Chairman Jay Clayton and William Hinman share this sentiment, noting that cryptocurrencies may not be securities throughout their entire lifespan, and should have the ability to change their designation.³⁰¹

K. Case Study: QuadrigaCX

Unfortunately, even though Canadian regulators acted quickly, creating regulations for cryptocurrencies under a securities law framework, fraud still reared its ugly head in the case of QuadrigaCX (“Quadriga”).

Quadriga, now defunct, was an early Canadian cryptocurrency exchange founded by Gerald Cotten in December 2013.³⁰² At the time, bitcoin was just reaching its first peak in popularity, but the ability to buy bitcoin in Canada was lacking.³⁰³ Quadriga filled a hole in the market, acting as a standard cryptocurrency exchange operating on decentralized ledger technology.³⁰⁴ Quadriga customers were able to purchase bitcoin and other emerging cryptocurrencies with fiat or bitcoin and paid a small fee to do so, 0.2% to 0.5% of the value of each trade.³⁰⁵ While other employees joined and exited the company, Cotten remained, eventually becoming the sole controller of

²⁹⁹ *Id.*

³⁰⁰ *Id.*

³⁰¹ Aaron Hankin, *SEC’s Jay Clayton Says Ether Isn’t a Security, Reiterating the Regulator’s Stance*, MARKET WATCH (Mar. 12, 2019), <https://www.marketwatch.com/story/secs-jay-clayton-says-ether-isnt-a-security-reiterating-the-regulators-stance-2019-03-12>.

³⁰² Quadriga’s Launch and Platform Operations, ONTARIO SECURITIES COMMISSION, <https://www.osc.gov.on.ca/quadrigacxreport/quadriga-launch.html>.

³⁰³ *Id.*

³⁰⁴ *Id.*

³⁰⁵ *Id.*

Quadriga's multi-million dollar operation.³⁰⁶ Quadriga customers believed that the platform was somehow connected to a financial regulator and that their funds were protected from fraud.³⁰⁷ However, the blockchain on which Quadriga was centered was not put to good use.

As explained earlier in this article, transactions are recorded on a blockchain. When a transaction is verified and the next transaction occurs, the first transaction becomes a secure block on the public chain, viewable by anyone. Unfortunately, Quadriga (along with a number of other cryptocurrency exchanges) did not fully follow this model of building the blockchain. Purchases and sales of cryptocurrency to and from Quadriga were recorded on the public blockchain; however, customer-to-customer exchanges were only recorded on Quadriga's private records, viewable by specific personnel only.³⁰⁸ Further, Quadriga held all of its customers' assets in custody in a general asset pool, rather than allowing the customers to actually keep their funds in their wallets.³⁰⁹ The amount reflected as "held" by the customer, was actually just a claim against Quadriga for that specific amount, accessible through approval of a withdrawal request submitted by the customer.³¹⁰ Due to Quadriga offering a service whereby customers' cryptocurrency assets are in the custody, control, and possession of Quadriga, rather than a business that involves securities, Quadriga decided not to register with the OSC in violation of Staff Notice 31-327.³¹¹

Cotten fraudulently claimed in both emails and Reddit posts that the cryptocurrencies were stored in cold wallets requiring multi-signatures to access.³¹² In reality, customers' cryptocurrencies were being stored in a mix of hot wallets and other cryptocurrency exchanges, with the central actor being Cotten himself, not a communal Quadriga wallet.³¹³ The anonymity of blockchain transactions may have worked too well, with any trades being performed by Cotten on the other exchanges masking his identity through encryption.³¹⁴ Another major problem encountered by Quadriga was the exchange of fiat for cryptocurrencies. Cotten found that Canadian financial institutions were unwilling to accept cash that had originated from cryptocurrency dealings.³¹⁵ Any fiat-crypto exchanges were eventually performed by Cotten himself, sending envelopes of cash by mail to selling customers, or accepting suitcases of cash from buying customers.³¹⁶

³⁰⁶ *Id.*

³⁰⁷ *Id.*

³⁰⁸ Quadriga's Launch and Platform Operations (Continued), ONTARIO SECURITIES COMMISSION, <https://www.osc.gov.on.ca/quadrigacxreport/quadriga-launch-continued.html>.

³⁰⁹ *Id.*

³¹⁰ *Id.*

³¹¹ *Id.*

³¹² *Id.*

³¹³ *Id.*

³¹⁴ *Id.*

³¹⁵ *Id.*

³¹⁶ *Id.*

To complicate things further, Cotten operated several alias accounts that were manually credited with assets that did not exist.³¹⁷ Using his proximity to the Quadriga records, and independence in the control of Quadriga, Cotten manually adjusted Quadriga ledgers to fund his alias accounts. Clients only believed that Quadriga was holding their funds; they were unaware that their funds were being used to develop on the platform or to pay for Cotten's personal trading adventures.³¹⁸ Further, Quadriga's clientele relied heavily on the touted volume of trading that occurred on the platform, citing it as one of the most important features indicating safety in the company.³¹⁹ Quadriga's overall lack of books and records, coupled with numerous falsified claims from Cotten regarding the functionality of the exchange platform and his misuse of client funds, contributed to the ultimate downfall of Quadriga from a regulatory perspective.³²⁰

Quadriga came to a halt alongside Cotten's untimely death, part-way through his honeymoon in India.³²¹ After new directors assumed the vacant position, they halted activity on the platform.³²² At the time of Cotten's death, Quadriga owed \$215 million to affected clients, with Cotten's trading losses due to his fraudulent actions comprising \$115 million of that total. The OSC's investigation of the Quadriga scandal occurred retrospectively, with Quadriga flying under the radar while the platform was still afloat. The OSC exemplified this case as an extreme example of what fraud could possibly occur in the cryptocurrency world,³²³ but also to demonstrate the reasoning for the Joint CSA/IIROC Consultation Paper 21-402 (*Proposed Framework for Crypto-Asset Trading Platforms*)³²⁴ and provide resources such as the CSA Staff-Notice 21-327 (*Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets*).³²⁵

³¹⁷ *Id.*

³¹⁸ *Id.*

³¹⁹ *Id.*

³²⁰ *Id.*

³²¹ Quadriga's Launch and Platform Operations, ONTARIO SECURITIES COMMISSION, <https://www.osc.ca/quadrigacxreport/downfall-of-quadriga.html>

³²² *Id.*

³²³ Quadriga's Launch and Platform Operations: Conclusion, ONTARIO SECURITIES COMMISSION, <https://www.osc.ca/quadrigacxreport/conclusion.html>.

³²⁴ Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada, Consultation Paper 21-402 Proposed Framework for Crypto-Asset Trading Platforms, CANADIAN SECURITIES ADMINISTRATORS (Mar. 14, 2019), https://www.osc.ca/sites/default/files/pdfs/irps/csa_20190314_21-402_crypto-asset-trading-platforms.pdf.

³²⁵ CSA Staff Notice 21-327, Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets, CANADIAN SECURITIES ADMINISTRATORS (Jan. 16, 2020), https://www.osc.ca/sites/default/files/pdfs/irps/csa_20200116_21-327_trading-crypto-assets.pdf.

L. Six Key Documents, Continued

1. Joint CSA/IROC Consultation Paper 21-402 Proposed Framework for Crypto-Asset Trading Platforms

CSA/IROC Consultation Paper 21-402 *Proposed Framework for Crypto-Asset Trading Platforms*³²⁶ (“Consultation Paper”) clarifies the CSA’s position on the matter of crypto asset trading and lays out the differences in requirements for cryptocurrencies and exchange platforms that have varying functions.³²⁷ The Consultation Paper begins with a short definition of “crypto assets,” distributed ledger technology, exchange platforms, a brief advertisement of the CSA’s Regulatory Sandbox, and an explanation of the overall goals of the Consultation Paper.³²⁸ A major initiative in the Consultation Paper is the expanded definition of “crypto assets,” rather than a sole focus on “cryptocurrencies.” Crypto assets take on three main forms: a utility token (which often also qualifies as a security), a tokenized version of a traditional security, and a form of payment or means of exchange with features analogous to commodities (bitcoin is exemplified).³²⁹ It is clarified, as of publication, March 14, 2019, that there were no exchange platforms in Canada authorized to operate as a crypto asset marketplace or dealer in Canada.³³⁰ The Consultation Paper highlights factors used in determining whether securities are involved in the cryptocurrency exchange, subjecting it to regulation, such as: crypto asset custody and holding, individual or pooled storage of the assets, and trading abilities of investors.³³¹ As well, the Consultation Paper clarifies that the CSA and IROC recognize different forms of crypto assets, particularly those that resemble a commodity, are not always securities.³³²

Prior to the Proposed Framework, the Consultation Paper outlines numerous risks related to platforms, many of which arose in the Quadriga case.³³³ All of the risks discussed center around investor protection, which embraces transparency in financial reports, operations, products, and security measures taken, as well as safeguarding the actual assets.³³⁴ As well, the Consultation Paper points to the securities regulations of other international jurisdictions, including the United States.³³⁵ In particular, the SEC’s statement³³⁶ that a platform offering the

³²⁶ Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada, Consultation Paper 21-402 Proposed Framework for Crypto-Asset Trading Platforms, CANADIAN SECURITIES ADMINISTRATORS (Mar. 14, 2019), https://www.osc.ca/sites/default/files/pdfs/irps/csa_20190314_21-402_crypto-asset-trading-platforms.pdf.

³²⁷ *Id.*

³²⁸ *Id.*

³²⁹ *Id.*

³³⁰ *Id.*

³³¹ *Id.*

³³² *Id.*

³³³ *Id.*

³³⁴ *Id.*

³³⁵ *Id.*

³³⁶ Statement on Potentially Unlawful Online Platforms for Trading Dital Assets: Divisions of Enforcement and Trading and Markets, U.S. SECURITIES AND EXCHANGE COMMISSION (Mar.

marketplace experience of trading securities must register with the SEC as a securities exchange, with FINRA as a broker-dealer operating an alternative trading system (“ATS”), or have a registration exemption,³³⁷ as well as the CFTC’s indication that bitcoin is a commodity.³³⁸

Following the acknowledgement of the multi-faceted nature of crypto assets, the Consultation Paper denotes the different types of market participants that are addressed in the regulations, including: marketplaces (ATSS, exchanges), dealers, custodians, and clearing agencies.³³⁹ Using specific functions of existing market participants, the Consultation Paper highlights the most important factor or factors to compare in furtherance of the conclusion of whether the crypto service in question qualifies for securities regulation. For example, if, “like an exchange, [the platform] may facilitate the creation or ‘listing’ of a crypto asset,” marketplace requirements apply.³⁴⁰ As well, for qualifying platforms, the CSA and IIROC propose the platform registers with both the CSA as an investment dealer, and the IIROC as a dealer and marketplace member, as the IIROC comes equipped with specialized knowledge and rules garnered from its oversight on all investment dealers and marketplaces in Canada.³⁴¹ Through its position as a national regulatory organization, the IIROC has experience in developing tailored compliance programs and rules for marketplaces in every province while maintaining national cohesion through the Universal Market Integrity Rules.³⁴² The section concludes with the extrapolation of the typical notion of a crypto asset exchange (buy and sell cryptocurrencies for fiat or other cryptocurrencies) to an exchange that trades derivatives based on cryptocurrencies, and asserts that such derivative-focused exchanges may or may not be subject to the same proposed framework, but anticipated requirements will be tailored and released specifically for derivative-focused exchanges.

The final major section of the Consultation Paper begins by noting the CSA’s recognition and appreciation of innovation in relation to investor protection and fair and efficient capital markets.³⁴³ As a result, the Consultation Paper announces consideration of a new set of regulations tailored specifically to crypto platforms.³⁴⁴ Then, feedback is requested on eight key areas that will aid

7, 2018), <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading>.

³³⁷ *Id.*

³³⁸ Retail Commodity Transactions Involving Virtual Currency, COMMODITY FUTURES TRADING COMMISSION, 17 CFR Part 1, Federal Register, Vol. 82, No. 243 (Dec. 30, 2017), <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2017-27421a.pdf>.

³³⁹ Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada, Consultation Paper 21-402 Proposed Framework for Crypto-Asset Trading Platforms, CANADIAN SECURITIES ADMINISTRATORS (Mar. 14, 2019), https://www.osc.ca/sites/default/files/pdfs/irps/csa_20190314_21-402_crypto-asset-trading-platforms.pdf.

³⁴⁰ *Id.*

³⁴¹ *Id.*

³⁴² *Id.*

³⁴³ *Id.*

³⁴⁴ *Id.*

in designing the regulatory framework for the platforms: custody and verification of assets, price determination, surveillance of trading activities, systems and business continuity planning, conflicts of interest, insurance, clearing and settlement, and applicable regulatory requirements.³⁴⁵ In each of the key areas, the Consultation Paper outlines the regulatory steps that will be taken to ensure that the standards for each area are met. For instance, in the Insurance section, the Consultation Paper cites National Instrument 31-103, requiring dealers to maintain bonding or insurance for specific risks and amounts.³⁴⁶ Then, the current difficulty and minimal commonality of insurance in the crypto industry is acknowledged, noting that it may be difficult to obtain due to the prevalence of cyber-security attacks.³⁴⁷ All eight sections end with Consultation Questions, intended to gather information from the reader to shape the burgeoning guidelines for crypto platforms. For instance, the Insurance section asks the reader's opinion on the type of insurance coverage that should be required for a platform, what the difficulties are with obtaining insurance, and if there is an equivalent to insurance that should be considered in the regulation.³⁴⁸

After another promotion of the CSA Regulatory Sandbox, the Consultation Paper concludes with four appendices, one listing the consultation questions, and three containing summaries of regulatory requirements applicable to marketplaces, dealers, and clearing agencies.³⁴⁹ The summaries of regulatory requirements point to specific applicable national instruments and existing categories of regulation by which crypto asset products must abide.³⁵⁰ Focus on factors such as transparency and record-keeping arise multiple times throughout each summary of regulatory requirements.³⁵¹ Requiring disclosure and other formal records and documents proscribes ownership over the information, and liability in cases of fraud. The Consultation Paper's discussion of decentralized platforms is tucked away in a single paragraph and single consultation question, warning that decentralized centralized platforms, which only facilitate transfers on a blockchain will require the installation of certain controls to manage appropriate risks.³⁵² The lack of discussion regarding a primary feature of cryptocurrencies is indicative of the CSA's attitude towards crypto assets—it is much easier to qualify under the framework as a regulated product.

³⁴⁵ *Id.*

³⁴⁶ *Id.*; 26 s. 12.3 of NI 31-103.

³⁴⁷ Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada, Consultation Paper 21-402 Proposed Framework for Crypto-Asset Trading Platforms, CANADIAN SECURITIES ADMINISTRATORS (Mar. 14, 2019), https://www.osc.ca/sites/default/files/pdfs/irps/csa_20190314_21-402_crypto-asset-trading-platforms.pdf

³⁴⁸ *Id.*

³⁴⁹ *Id.*

³⁵⁰ *Id.*

³⁵¹ *Id.*

³⁵² *Id.*

2. CSA Staff Notice 21-327 Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets

Building on the Consultation Paper, CSA Staff Notice 21-327 *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets* (Staff Notice) was released on January 16, 2020.³⁵³ The Staff Notice clarifies what the Consultation Paper merely acknowledged — cryptocurrency can be categorized in a number of different ways by a number of different regulators, so when is a cryptocurrency a security under Canadian security regulations?

The Staff Notice begins by highlighting a key difference in the operation of cryptocurrency platforms—the immediate delivery of a crypto asset.³⁵⁴ Platforms that merely provide a contractual right to a crypto asset will be subject to securities regulation.³⁵⁵ Applying this rule retrospectively, Quadriga would have been subject to securities regulation; Quadriga’s operation consisted of holding all the clients’ assets in one pool and fulfilling orders for withdrawal and deposit based on the “held” amount reflected in the customers’ wallets, rather than allowing the customers to store the funds privately in their own wallets and conduct exchanges at will.³⁵⁶ Then, the Staff Notice clearly states the two requirements for exemption from securities regulation:

1. The underlying crypto asset itself is not a security or derivative; and
2. The contract or instrument for the purchase, sale, or delivery of a crypto asset

Results in an obligation to make immediate delivery of the crypto assets, and Is settled by the immediate delivery of the crypto asset to the Platform’s user account to the Platform’s typical commercial practice.³⁵⁷

The two other distinct examples given for when a crypto asset qualifies as a security are: when a token or coin mimics a typical share and carries voting rights and rights to dividends, and when the token or coin operates as a derivative, for example, an option to buy or sell asset in the future, potentially at a set price.³⁵⁸ The Staff Notice notes that there will be a number of factors included in each case-by-case analysis of crypto assets and platforms, including the above test, which is substantially open to interpretation.³⁵⁹

Specifically, the Staff Notice mentions analyzing the intention of both the platform and the user to make and take immediate delivery of a crypto asset.³⁶⁰ The critical distinction is whether the delivery is *immediate* or if it creates a

³⁵³ CSA Staff Notice 21-327 https://www.osc.ca/sites/default/files/pdfs/irps/csa_20200116_21-327_trading-crypto-assets.pdf.

³⁵⁴ *Id.*

³⁵⁵ *Id.*

³⁵⁶ *Id.*

³⁵⁷ *Id.*

³⁵⁸ *Id.*

³⁵⁹ *Id.*

³⁶⁰ *Id.*

contractual right or claim to take delivery in the future.³⁶¹ Making such a distinction can be understood as a push by the CSA for more disclosure from the platform. For a user or customer to intend to take immediate delivery, he must be informed enough about the operations of the platform to understand it is not merely a contractual right they are being provided with, but the coin itself. When determining if a delivery is immediate, the CSA will analyze the obligation and intention of the parties by using standing contract interpretation principles, such as considering all the written and unwritten terms, the surrounding contextual facts and circumstances, as well as typical commercial practice. The investors understanding of the delivery timing may have a crucial role making determinations based on totality of the circumstances. The section concludes with a reiteration of regulating substance over form; if the standard commercial practice is to refrain from making delivery of the asset, even when the contract for purchase obligates such delivery, then the contract will be considered a security and, therefore, be subject to regulation.³⁶²

Because a critical factor in the CSA's analysis of a crypto asset is immediate delivery, a Staff Notice section was dedicated to defining the term and how it will be considered in context with the greater operational scheme of the platform.³⁶³ For immediate delivery to occur, two conditions must be met:

1. The platform must immediately transfer ownership, possession and control of the crypto asset to the platform's user, and, as a result, the user is free to use, or otherwise deal with, the crypto asset without

a. further involvement with, or reliance on, the platform or its affiliate, and
b. the platform or any affiliate retaining any security interest or any other legal right to the crypto asset; and

2. Following the immediate delivery of the crypto asset, the platform's user is not exposed to insolvency risk (credit risk), fraud risk, performance risk or proficiency risk on the part of the platform.³⁶⁴

In essence, the "immediate delivery of a crypto asset" can be thought of as the platform operating as a pure currency exchange. For instance, for paper fiat and international travels, when preparing for a trip from the United States to Japan, the traveler would visit his bank or a currency exchange kiosk and provide his U.S. Dollars in exchange for the equivalent amount of Japanese Yen. The exchange would occur on the spot, and the space in his wallet occupied by U.S. bills would be replaced one-for-one with paper Yen. The asset, Yen, was immediately delivered, and the traveler has full ownership of the bills. To demonstrate a contractual obligation for the asset using the same analogy, imagine if, when depositing his bills at the U.S. bank, the traveler received a draft to cash in at the Japanese bank for a set amount of paper Yen derived from that day's exchange rate. In this scenario, the traveler still has title to the same amount of money; however, he is not in actual, physical possession of it. Rather,

³⁶¹ *Id.*

³⁶² *Id.*

³⁶³ *Id.*

³⁶⁴ *Id.*

the bank has undertaken an obligation to provide the correct amount of physical bills to the traveler when he arrives in Japan.

The subsequent section of the Staff Notice provides two examples: one of when securities legislation does apply and one of when securities legislation does not apply. The example provided for an exempt exchange highlights the mechanism for a pure exchange of fiat for crypto assets, exemplifying bitcoin, and including such features as no capital market trading services available, records made and kept on an internal ledger or book, and immediate delivery of the crypto assets.³⁶⁵ The example provided for a qualifying exchange highlights an operational mechanism structurally similar to Quadriga's. The platform retains custody of the assets and merely records the transaction on the ledger to log the purchase, thereby creating a contractual obligation to fill upon request of the user.³⁶⁶ The Staff Notice provides two specific reasons explaining why this structure is not exempt: no obligation was created to make immediate delivery of the crypto assets to the user, and the typical commercial practice of the platform is to deliver upon request, denying the user true ownership, possession, and control over his crypto assets.³⁶⁷ Relying on an unregulated exchange to be the custodian of their own funds exposes users to a variety of risks, including credit or insolvency risk, fraud risk, performance risk, and proficiency risk³⁶⁸—basically, many ways for investors to lose their money.

The Staff Notice concludes with an encouragement to seek legal guidance on the application of securities regulations to any crypto exchanges, as well as remind foreign crypto exchange offerors with Canadian users to review Canadian cryptocurrency guidelines and ensure compliance.³⁶⁹ As well, the CSA encourages fintech businesses that want to test new products to apply to the CSA Regulatory Sandbox, discussed earlier in this section, which allows the business to obtain exemptive relief on a time-limited basis to test its products. Overall, the CSA indicates that opportunities in Canada exist for both qualifying and exempt exchanges and other crypto services that encourage innovation.

Together, the four documents comprise a set of guidelines that provide guidance for both provincial regulators, such as the OSC, and crypto developers themselves. The guidelines have been formulated based on public feedback and real-life events involving crypto assets and platform developers in Canada. The documents provide expansive guidelines for complying with existing securities regulations, while tailoring the required tests and disclosure to fit both the need of investor protection and the need of developer freedom for innovation. The CSA Regulatory Sandbox is heavily advertised and has fostered successful and regulated cryptocurrency platforms, such as Wealthsimple. Canada began regulating the cryptocurrency industry early on but is not glued to the current regulations. Instead, Canada is opting to respond to developer needs and market

³⁶⁵ *Id.*

³⁶⁶ *Id.*

³⁶⁷ *Id.*

³⁶⁸ *Id.*

³⁶⁹ *Id.*

trends as they evolve. The guidelines are published by a federal representative of all provincial and territorial securities commissions, and they apply to each crypto asset project developed in Canada for a domestic or foreign demographic. Canada's openness to new technology and involvement in the industry allowed the CSA to publish CSA Staff Notice 51-363 *Observations on Disclosure by Crypto Assets Reporting Issuers* ("51-363") on March 11, 2021, in which guidelines for nine elements of crypto asset companies are provided for crypto companies whose business is investment equity, mining, blockchain technology, or trading platforms.³⁷⁰ Just under three weeks later, the CSA and IROC released another joint document, Staff Notice 21-329 *Guidance for Crypto Asset Trading Platforms: Compliance with Regulatory Requirements* ("21-329").³⁷¹

3. CSA Staff Notice 51-363 Observations on Disclosure by Crypto Assets Reporting Issuers

Staff Notice 51-363 begins by clarifying the full extent of the regulated "crypto asset" industry.³⁷² These categories include: "cryptocurrencies, tokens, stablecoins, and similar digital assets relying on blockchain technology."³⁷³ The Notice goes on to analyze trends in crypto asset reporting issuer disclosures and offer regulatory guidance and disclosure requirement clarity.³⁷⁴ The subject and intended audience of the Notice are investment equity, mining, blockchain technology, trading platform and other types of crypto companies throughout Canada.³⁷⁵ Nine different elements of disclosure are discussed that address the storage of user's assets, disclosure of risk factors, and disclosure of financial statements, among other topics.

Notice 51-363 begins with a discussion about risk and safeguarding crypto assets, highlighting investor protection through necessary disclosure of material risks impacting a security issuer's business.³⁷⁶ Material risks can come from the storer of the crypto assets, whether they are held in self-custody or through a third-party custodian.³⁷⁷ Because using a third-party custodian introduces additional risk into the company, more stringent disclosure requirements regarding its technology, amount of holdings for the company, and overall credibility are required.³⁷⁸ Conversely, the disclosure for self-custody is primarily focused on the technology as well as an inquiry into the steps taken to mitigate

³⁷⁰ CSA Staff Notice 51-363 Observations on Disclosure by Crypto Assets Reporting Issuers, CANADIAN SECURITIES ADMINISTRATORS (Mar. 11, 2021), https://www.osc.ca/sites/default/files/2021-03/csa_20210311_51-363_observations-disclosure-crypto-asset.pdf.

³⁷¹ Notice 21-329, [https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/JointCSAIROCNotice21-329\(March29_2021\).pdf](https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/JointCSAIROCNotice21-329(March29_2021).pdf)

³⁷² CSA Staff Notice 51-363 Observations on Disclosure by Crypto Assets Reporting Issuers, CANADIAN SECURITIES ADMINISTRATORS (Mar. 11, 2021),

³⁷³ *Id.*

³⁷⁴ *Id.*

³⁷⁵ *Id.*

³⁷⁶ *Id.*

³⁷⁷ *Id.*

³⁷⁸ *Id.*

cyber security risks.³⁷⁹ Further, crypto companies that hold their crypto assets through a trading platform are required to disclose, at a minimum, the same information as those that use a third-party custodian.³⁸⁰ Third-party risks of insolvency, integrity, and proficiency, as well as a contractual claim against the crypto company are introduced by the existence of a trading platform holding account.³⁸¹ Notice 51-363 goes on to provide clarity for disclosure about the description of business, risk factors affecting crypto companies, promotional activities, and material changes to the company.³⁸² When a company's business is investing in crypto assets, 51-363 subjects it to disclosure requirements similar to those required under an investment fund regime and encourages disclosure of the investment portfolio.³⁸³ The introduction of financial investment acts as a segue into the final major part of 51-363, financial statements.

A crucial part of traditional disclosures are the financial statements. Financial statements are audited documents reporting the financial health of the company that are released at regular intervals.³⁸⁴ An example of a financial statement is a balance sheet that summarizes the total assets, liabilities, and equity of a company.³⁸⁵ Financial statements allow investors to view, at a glance, the financial stability and health of a company. The investors are able to use such information to make informed investment decisions.³⁸⁶ Publishing an audited financial statement adds a layer of assurance to the investor that the figures can be relied upon when making investment decisions. However, because the crypto industry is unique and nascent, finding an auditor and going through an audit can present substantial difficulty when the accounting bodies are also adjusting.³⁸⁷ In light of that fact, the CSA states that the guidelines that are laid out are what the CSA staff believes are considerations relevant to crypto accounting and disclosure issues, but to carefully consider accounting standards as well.³⁸⁸ The discussion under the financial statements section of 51-363 considers accounting policies and disclosure expectations: disclosure if cryptocurrencies are recorded at fair value, accounting for mining of cryptocurrency, cryptocurrency mining equipment and the sustainability of the mining, and non-monetary transactions settled in cryptocurrencies (such as using the coin as a utility token on its blockchain).³⁸⁹ Notice 51-363 concludes with both a reminder that proper, truthful, and full disclosure is a necessary tool for investors to make informed

³⁷⁹ *Id.*

³⁸⁰ *Id.*

³⁸¹ *Id.*

³⁸² *Id.*

³⁸³ *Id.*

³⁸⁴ Chris B. Murphy, *Financial Statements: What Are Financial Statements*, INVESTOPEDIA (last updated Sept. 9, 2020), <https://www.investopedia.com/terms/f/financial-statements.asp>.

³⁸⁵ *Id.*

³⁸⁶ *Id.*

³⁸⁷ *Id.*

³⁸⁸ *Id.*

³⁸⁹ *Id.*

investment decisions, especially in the novel industry of crypto assets, and a disclaimer that complying with the above regulations can raise novel issues.³⁹⁰

4. Joint CSA/IIROC Staff Notice 21-329 Guidance for Crypto Asset Trading Platforms: Compliance with Regulatory Requirements

To date, the conclusory chapter on securities regulations for cryptocurrencies in Canada is the fifty-sixth page of 21-329, published on March 29, 2021.³⁹¹ The length of this document is notable.³⁹² Of the six predominant documents guiding the Canadian securities landscape for cryptocurrencies, four are CSA Staff Notices and two are joint IIROC/CSA documents, the Consultation Paper, and this Staff Notice 21-329.³⁹³ Apart from the Consultation Paper, each of the documents offers regulatory clarity on a distinct singular topic in the nexus of Canadian securities regulation, cryptocurrencies, and other crypto assets.³⁹⁴ All of the CSA Staff Notices are between five and nine pages in length, and the Consultation Paper consists of twenty-eight pages.³⁹⁵ Of 21-329's fifty-six pages, the first twelve are filled with content, divided into four main parts: Introduction, Background, Application of Securities Legislation to Crypto Asset Trading Platforms ("CTPs"), and Complying with Securities Legislation.³⁹⁶ Application of Securities Legislation to CTPs is the focal point of the document, providing clarity on securities regulation for dealer and marketplace platforms, clearing and settlement, and IIROC membership.³⁹⁷ The remaining pages are comprised of Appendices A, B, and C. Appendix A discusses CTP risks and applicable regulatory requirements; Appendix B provides a summary of IIROC requirements for CTPs; Appendix C is thirty-four pages long and provides both a summary of the comments and responses to the questions posed in Consultation Paper.³⁹⁸

The introduction of 31-329 informs the reader that CTPs will be the main subject of the staff notice. A CTP is a platform that proposes to or facilitates the trading of (both as defined in 31-327): 1) crypto assets that are securities; or 2) instruments or contracts involving crypto assets. It is noted that the content of the Notice does not provide any new rules specifically applicable to CTPs, rather it describes how the existing rules have been tailored to CTPs and explains that exemption does exist at the discretion of the CSA.³⁹⁹ Notice 31-329 is mandating that all CTPs in Canada must either 1) adhere to disclosure requirements as articulated in the Notice, or 2) apply for and attain exemptive relief from

³⁹⁰ *Id.*

³⁹¹ Notice 21-329, https://www.osc.ca/sites/default/files/2021-03/csa_20210329_21-329_compliance-regulatory-requirements.pdf.

³⁹² *Id.*

³⁹³ *Id.*

³⁹⁴ *Id.*

³⁹⁵ *Id.*

³⁹⁶ *Id.*

³⁹⁷ *Id.*

³⁹⁸ *Id.*

³⁹⁹ *Id.*

disclosure requirements.⁴⁰⁰ As well, it is clarified that applications that provide traditional capital market trading in addition to crypto “trading” are subject to both sets of disclosure requirements.⁴⁰¹ The section concludes with a distinct nod to the future and how the regulations discussed in the Notice intend to evolve alongside innovation.⁴⁰² The Background section follows, providing a brief history of CTP regulatory framework (the Consultation Paper), how cryptocurrencies started, and what the rest of the Notice will entail.

The meat of 31-329 is in the Application of Securities Legislations to CTPs.⁴⁰³ The section begins with a blanket statement that each CTP is different and, as a result, the applicable requirements will be evaluated on a case-by-case basis. However, there are two main categories of CTPs: Dealer Platforms and Marketplace Platforms, each one providing a starting point for the correct applicable requirements.⁴⁰⁴ Dealer Platforms are solely issuers of crypto tokens, and Marketplace Platforms bring together multiple parties to trade crypto tokens or participate as an actor in a trade on the secondary market.⁴⁰⁵ For both types of platforms, the Notice provides guidance on adhering to the registration categories and their disclosure requirements, a time-limited, interim approach to public engagement for the platform while preparing to file the registration documents, and the application process for becoming registered as an exempt market dealer or investment dealer with the IIROC.⁴⁰⁶ Additionally, for Marketplace Platforms, the Notice provides clarity for platforms that conduct dealer and marketplace activities, as well as Marketplace Platforms that operate as an exchange.⁴⁰⁷ The next subsection addresses CTPs that engage in clearing and settlement functions, providing clarity on which National Instrument has the correct policies and procedures for disclosure.⁴⁰⁸ The last subsection discusses IIROC registration if the novel crypto business model does not fit the Dealer or Marketplace platform categories, clarifying that the IIROC will assess every application to determine how best to apply the existing requirements and determine whether any exemptions apply.⁴⁰⁹ The main content concludes with an invitation from the CSA, encouraging consultation with its staff and the IIROC, as well as continued dialogue from the public.⁴¹⁰ Overall, the CSA makes its position clear—crypto platforms of any kind dealing with crypto assets as a security must be registered in Canada and adhere to some discretionary version of the reporting requirements.

400 *Id.*

401 *Id.*

402 *Id.*

403 *Id.*

404 *Id.*

405 *Id.*

406 *Id.*

407 *Id.*

408 *Id.*

409 *Id.*

410 *Id.*

The Appendices hold a lot of information. When discussing CTP risks and the applicable regulatory requirements in Appendix A, the topic is divided into six subcategories and the ways in which the disclosure requirements manage risks for each. The specific concerns addressed are: safeguarding investor assets where a dealer platform or marketplace platform has custody; access to marketplace platforms; system resiliency, integrity, and security controls; transparency about the CTP's operations and the crypto assets traded on the CTP; market integrity and price discovery; direct access by retail investors; and conflicts of interest.⁴¹¹ Largely, the specific concerns address safety from a variety of perspectives. For instance, the unpredictable nature of investors is addressed under "Direct Access by Retail Investors"—a CTP may be provided exemptive relief from the risk of investors purchasing or trading crypto assets that are not suitable for them.⁴¹² If the CTP does not provide any recommendations or advice to the investors, just purely provides a service to buy and sell crypto assets, the CTP may still operate in a similar manner to an execution-only dealer.⁴¹³ In addition, the risk of the CTP being used for money-laundering and counter-terrorist financing is addressed through requiring know-your-client and suitability requirements.⁴¹⁴ Appendix B is a list of IIROC requirements that would apply, being sourced from UMIR and the DMR, categorized by topic, such as Registration, Conflicts of Interest, and Know Your Client.⁴¹⁵ Lastly, Appendix C addresses the comments made on the Consultation Paper. Following a list of the names of the commenters, the summarized comments and their corresponding CSA/IIROC responses are listed. The responses to the comments explain decisions that CSA/IIROC have made with respect to the points raised, whether the CSA/IIROC have faced any difficulties in that area, or whether something tailored addressing the specific concern is forthcoming.⁴¹⁶

Through the release of lengthy, detailed framework, and transparent communications with the public, the CSA and IIROC make it clear that Canada's securities administrators are invested in the crypto community. Once it was clear that the investors were treating cryptocurrencies for something other than their intended purposes, the CSA and IIROC reacted quickly. Their approach has been to find the closest-fitting disclosure requirements, apply them broadly, and make considerations on a case-by-case basis. Navigating within the securities regulation environment for cryptocurrencies and other crypto assets is relatively clear if the developer's product is similar to those already on the market and, therefore, has been considered in the guidance offered. Further dialogue with the public is encouraged and provincial regulators are expected to be the enforcers of the current rules, under their general mandated intention of investor protection.

⁴¹¹ *Id.*

⁴¹² *Id.* at 17.

⁴¹³ *Id.*

⁴¹⁴ *Id.*

⁴¹⁵ *Id.* at 20.

⁴¹⁶ *Id.*

Securities regulators entered the crypto world because they regulate in substance. Cryptocurrencies and other crypto assets are generally not created with the intent of becoming a security to be traded, but the same investors who participate in traditional capital markets are the actors treating the digital assets like they have a ticker on the NYSE. As a result, certain cryptocurrencies that were never intended to be traded like a security have come under regulatory scrutiny of securities commissions. In doing so, the regulatory commission must be able to strike the right balance between regulating the substantial treatment of cryptocurrencies (and other crypto assets) and respecting their intended form. As demonstrated above, the Canadian and American securities regulators have both felt the need to step in and regulate the crypto world but have opted to go about it in different ways.

Canada's current regulatory framework for cryptocurrencies as securities provides much more content for commentary than its American counterpart. The amount of detail contained in the regulations is a testament to the participation of the public. The rate of participation and innovation by investors is driving the CSA to consider the substance of crypto assets and cryptocurrencies. The participation also shows the commitment by investors to fostering a fraud-free crypto industry in Canada. Conversely, the United States quietly defines the rules through SEC settlements and enforcement actions. Beliefs about cryptocurrencies, such as bitcoin and ether, and whether they qualify as securities are not published in official statements, but rather in opinions expressed during a press conference. Compared to the CSA, the SEC has a significant lack of involvement with the public, even though the same goal of investor protection applies. The next section of this article examines a variety of differences between the American and Canadian approaches to securities regulation and where each falter and succeed.

IV. A COMPARISON OF CANADIAN AND AMERICAN SECURITIES REGULATIONS FOR CRYPTOCURRENCIES AND A REGULATORY PROPOSAL

A. Structure of the Regulator

The Canadian securities administration bodies and the American securities administration bodies are structured quite differently. In the United States, there is one regulatory body, the SEC, which governs securities administration at a national level. The SEC is responsible for all the working parts of the securities industry, including enforcement, compliance, risk analysis, maintaining fair and efficient capital markets, and investor protection across the United States. In Canada, each province or territory has its own securities regulator, and representatives of each of the thirteen regulators are a part of the larger CSA, which publishes instruments that may be applicable to any or all of the provincial or territorial regulators. Each of the thirteen regulators is responsible for monitoring, investigating, enforcing, and legislating in their regions. In addition, the CSA works with other harmonizing authorities, such as the IIROC, to specifically approach the crypto industry from several perspectives, release

guidelines, and delineate how the disclosure requirements are different for each type of crypto product.

1. Approach to Creating Regulations

The difference in structure between the American and Canadian sections of this article reflects the real-world difference between the SEC and the CSA. The SEC has chosen to develop its position on cryptocurrencies as securities through a series of court actions and a few statements by chairpeople. The landscape is murky and companies, such as Ripple, can operate with ease for years and be taken by surprise when the SEC files a Wells notice. To determine if a crypto company or its product is subject to regulation in America, the company must sift through case law that applies a single historical test, make a determination about its product, and take action to register with the SEC if necessary. At the other end of the spectrum, the CSA and IROC have made it perfectly clear what qualifies for registration under the Canadian securities administration regime, and, to no one's surprise, basically everything that smells like holding or trading cryptocurrency qualifies. To date, the CSA and IROC have published their guidelines in six dense, but relatively short, documents, creating a clear starting point for crypto companies to navigate the industry when starting up. The CSA and IROC also make it clear both that public dialogue is encouraged and considered, and that the guidelines are not permanent—they are subject to evolution alongside the crypto world.

2. Crypto Culture by Country

The United States is an exceptional country for starting technology companies; Amazon, Facebook, Twitter, Instagram, and countless other companies coming from the mecca of Silicon Valley have redefined our daily lives and are the result of pure American creativity. The enthusiasm for innovation has carried over into the crypto world with highly innovative crypto companies providing many different fintech services. The popularity of the United States for ICOs is shown in its ranking as the fourth most popular country to have an ICO in 2019 (the United States hosted 75 ICOs in 2019).⁴¹⁷ Conversely, Canada did not crack the top ten in the year after the CSA published its staff notices on cryptocurrency offerings.⁴¹⁸ For reference, Germany, the tenth most popular country for hosting ICOs in 2019, had twenty-two ICOs that year.⁴¹⁹ However, Canada does not have the same track history with technology company success as the United States does and does not attract the same volume. The crypto companies that have started in Canada, such as Ethereum⁴²⁰ and

⁴¹⁷ Haffke & Fromberger, *supra* note 67.

⁴¹⁸ *Id.*

⁴¹⁹ *Id.*

⁴²⁰ Taylor Locke, *Ethereum Co-Founder on Why He Got Into Crypto: Empower the Little Guy, "Screw" the Big Guy—They Already Have Enough Money*, MAKEIT (May 18, 2021), <https://www.cnbc.com/2021/05/18/why-ethereum-founder-vitalik-buterin-got-into-crypto-bitcoin.html>.

WealthSimple, have also seen widespread success—granted, at a much slower rate overall than U.S.-based companies.

B. Evaluation of Each System

Each system has legitimate pros and cons despite inequality within the comparison when the United States' status as a powerhouse for technology companies is recognized. Overall, the United States has a vibrant community for innovative crypto creation, but the SEC is disorganized and unclear with the regulatory regime. There is an impending anxiety of litigation unless the developers willingly register with the SEC. However, the SEC has limited funds and power, unable to match its rate of enforcement with the rate of crypto company growth. Opening a crypto company in the United States is a gamble unto itself, let alone the treatment of any issued cryptocurrency by investors. Programs that sound promising, such as Coinbase's crypto lending program, which provides returns on stablecoins lent back to Coinbase, are threatened without explanation by the SEC,⁴²¹ and later announce that they are cancelled alongside the request for greater regulatory clarity for the crypto industry.⁴²² The crypto innovation in the United States is fantastic; however, it is at the absolute discretion of a sole regulatory body with the utmost power in the securities industry. The irony is the lack transparency in the Wells notices⁴²³ and pettiness to subtweet about it.⁴²⁴ Coinbase nailed it when it asked for more regulatory clarity. The SEC is just starting to clarify its beliefs on securities regulations for cryptocurrencies, with its largest statement to date being an information sheet aimed to equip investors with more knowledge about investing in cryptocurrencies and ICOs.⁴²⁵ Two years and one chairman after its public statement, the SEC continues to take the position that investors are responsible for their own protection and to be ultra-aware of fraud⁴²⁶—but don't worry, the SEC is working on the guidelines!

⁴²¹ Paul Grewal, *The SEC Has Told Us It Wants to Sue Us Over Lend. We Don't Know Why*, THE COINBASE BLOG (Sept. 7, 2021), <https://blog.coinbase.com/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why-a3a1b6507009>.

⁴²² *Update as of 5pm ET, Friday, September 17th: We Are Not Launching the USDC APY Program Announced Below*, THE COINBASE BLOG, <https://blog.coinbase.com/sign-up-to-earn-4-apy-on-usd-coin-with-coinbase-cdad79e5f5eb>.

⁴²³ Paul Grewal, *The SEC Has Told us It Wants to Sue Us Over Lend. We Don't Know Why*, THE COINBASE BLOG (Sept. 7, 2021), <https://blog.coinbase.com/the-sec-has-told-us-it-wants-to-sue-us-over-lend-we-have-no-idea-why-a3a1b6507009>.

⁴²⁴ Mitchell Clark, *Coinbase Says SEC Threatened Lawsuit Over Lend Feature*, THE VERGE (Sept. 8, 2021), <https://www.theverge.com/2021/9/8/22662826/coinbase-sec-lend-regulation-crypto-lawsuit-exchange>.

⁴²⁵ Statement on Cryptocurrencies and Initial Coin Offerings, U.S. SECURITIES AND EXCHANGE COMMISSION (Dec. 11, 2017), <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>.

⁴²⁶ Maggie Fitzgerald, *Watch SEC Chair Gensler Discuss the Agency's Oversight, Including Crypto, before the Senate*, CNBC (Sept. 14, 2021), <https://www.cnbc.com/2021/09/14/watch-sec-chair-gensler-discuss-the-agencys-oversight-including-crypto-before-the-senate.html>.

North of the border, Canada was leading the pack when Bill C-31 was published, and the CSA and IROC have kept up the pace since then. The guidelines are outlined in six short documents and Canada has made it clear that innovation is encouraged and business is encouraged, but the CSA and IROC must monitor everything. While Canada also uses a version of the American *Howey* test to determine if a crypto asset is a security, other sub-categorizations (such as ICOs and CTPs) exist to provide regulatory clarity. Interaction and engagement with the public has been promised and delivered, but so has enforcement along with those rules.⁴²⁷ By providing regulatory guidance at a federal level, but enforcing at provincial and territorial levels, the Canadian securities administration system is efficiently maximizing the potential of bringing a nascent and chaotic industry into alignment. However, Canada's crypto world is not as booming as that of the United States. While innovation is encouraged, the time and money required for preparing registration and other disclosure statements, and adhering to external factors such as obtaining insurance, is a burden. An ICO may not raise enough money to even get off the ground prior to adding registration fees on top of that burden. Investors want their money to be kept safely, and regulation can ensure such, but crypto creators must decide if the time and money spent consulting counsel is worth the expense for their budding companies.

While it has produced reputable, trustworthy, and popular crypto companies, the CSA Regulatory Sandbox still requires crypto companies to file for exemptive relief to participate. Again, money up front, and potentially suited to already developed companies with a user-base that is likely to adapt to the new product. Wealthsimple has been exemplified in this article as a successful crypto company that has effectively utilized the CSA Regulatory Sandbox, but it is worth noting that there was already a strong user base of investors through its other lines of products.⁴²⁸ A company that had the means, the experience, and the demographic took on a new infrastructure and industry with successful results, utilizing a regulatory relationship it had already developed through other securities products. While companies can be successful through the CSA Regulatory Sandbox, Wealthsimple's narrative is an awfully narrow category to fit into. However, not all companies have the same story, with some start-ups, like Token Funder Inc.,⁴²⁹ finding long-term success and some young companies, like ZED Network Inc.,⁴³⁰ using crypto to speed their growth early in their lifespan and seeing current international success.⁴³¹ Clearly, Canada's system is

⁴²⁷ Chris Barker, Alex Moore & Christopher Jones, *OSC Flashes Further Warnings to Non-Compliant Crypto Asset Trading Platforms and Initiates First Enforcement Actions*, BLAKES (June 16, 2021), <https://www.blakes.com/insights/bulletins/2021/osc-flashes-further-warnings-to-non-compliant-cryp>.

⁴²⁸ Wealthsimple, <https://www.wealthsimple.com/en-ca/about/who-we-are>.

⁴²⁹ TokenFunder, <https://about.tokenfunder.com/>.

⁴³⁰ Zed Network, Inc., LINKED-IN, <https://www.linkedin.com/company/zednetwork/about/>.

⁴³¹ CSA Regulatory Sandbox: Decisions, CANADIAN SECURITIES ADMINISTRATORS, <https://www.securities-administrators.ca/resources/regulatory-sandbox/decisions/>.

relatively efficient and does foster successful crypto companies, albeit at a slower and more expensive rate than the United States.

C. *Bitcoin and ether—The Decentralized Difference*

The SEC has taken a position on both bitcoin and ether, claiming both to be non-securities under the *Howey* test. One feature found in both is explicit: true decentralization. Bitcoin and ether are both cryptocurrencies that are not owned and operated by any private source; they are built on an open-sourced blockchain, an entirely public design. Such publicity allows for pure transparency. The open-sourced code is monitored by a user force greater in number and speed than the SEC and CSA combined. Should another attack happen, like the DAO Token event, the blockchain can be mended by coders posthaste. While the Ethereum blockchain was not initially decentralized, ether is given a green light to proceed without regulation as the developing company does not own ether nor the Ethereum blockchains and has decentralized every aspect of its system.⁴³² Bitcoin has always been entirely decentralized and public, maintained by its users. Thirteen years in the making, bitcoin's blockchain has never been hacked and no fraudulent "bitcoins" have ever been produced on the blockchain.⁴³³ Everything that happens on the blockchain is public and can be monitored by every single other node on that blockchain. It is truly the central goal of all actors to keep the blockchain functioning as efficiently as possible and maintain a fast transaction rate. If, from a securities regulation standpoint, bitcoin is the gold standard for exemption from regulation, the critical aspects of bitcoin must be considered, with true decentralization being the focus.

What sets XRP apart from its contemporaries is not its use, but its ownership by Ripple Labs. For instance, XRP, like bitcoin, is also supposed to be used as a payment system, the XRP ledger is open-sourced,⁴³⁴ and investors also treat the coin like a traditional security. However, the investors are at the mercy of Ripple Labs' discretionary choices of disclosure regarding XRP coins, and small batch releases of one billion minted coins per month.⁴³⁵ Conversely, a set number of bitcoins initially programmed onto the decentralized bitcoin protocol are fair game to the first miner. Because investors will treat nearly any crypto gamble like an investment (remember the Idiot Coins?), it is critical to ensure the highest level of investor protection is available. One way is through pure decentralization, such as the case in ether or bitcoin; the other is through regulated securities disclosure. As mentioned earlier, Hinman stated that adding disclosure requirements to current ether or bitcoin transactions would not be a

⁴³² Ethereum Whitepaper, <https://ethereum.org/en/whitepaper/>.

⁴³³ *Can Bitcoin Be Hacked*, RIVER FINANCIAL, <https://river.com/learn/can-bitcoin-be-hacked/>.

⁴³⁴ About RippleX, RIPPLE, <https://ripple.com/ripplex/>.

⁴³⁵ Nathan Reiff, *Bitcoin vs. Ripple: What's the Difference?*, INVESTOPEDIA (July 27, 2021), <https://www.investopedia.com/tech/whats-difference-between-bitcoin-and-ripple/>.

value-add for investors.⁴³⁶ If adding disclosure does not add value, then it must be the true publicity and decentralization, access for any and all actors, that makes part of the difference.

D. *Role of International Crypto Asset Requirements*

While Canada and the United States have both opted to regulate crypto assets, including cryptocurrencies, as securities, their systems may not agree with each other. For instance, an American crypto company is subject to Canadian crypto asset securities regulations, which may make the Canadian market unappealing for expansion due to the increased costs and bureaucratic tape around proper disclosure. This situation can happen between any two countries that host audiences and developers for crypto companies. Organizations like IOSCO should work to unite cryptocurrency regulations so that innovation can be maximized around the world. To save time and increase efficiency when expanding across borders, adopting a passport system similar to the one implemented by Canadian provincial and territorial regulators would be highly beneficial. The system maintains efficiency by delegating enforcement to smaller regulatory bodies, all of which follow and enforce the same guidelines. In Canada, all crypto companies must follow the CSA and IIROC guidelines, while being monitored by their home regulatory body. Because Canada has demonstrated that it is possible to create a system that achieves success, public engagement, innovation, and efficiency for crypto asset company development, it is an entirely achievable objective for such a system to be refined and extrapolated on a global level.

If companies that offered crypto assets were regulated on an international scale, it would be a step forward to achieving the overarching goal of eliminating borders. Meeting one set of criteria that provides eligibility to operate in a variety of countries begets true crypto globalization. Many crypto companies already target a cross-border transaction of some sort, with ZED Network, Inc. and Ripple, both offering globalized settlement systems, being perfect examples. If a company geared toward reaching a global demographic cannot move beyond its own borders due to conflicting regulatory regimes, then it cannot fulfill its purpose. Operating under consistent regulatory guidelines allows a highly volatile and unpredictable product to maintain some regularity in the eyes of cautious investors, encouraging market participation. While they may not be intended to be securities, investors will treat a cryptocurrency as such, regardless of its intended use. Rather than taking a fundamentalist approach to cryptocurrencies and insisting on treatment according to the content within the four edges of the associated whitepaper, or insisting on strict categorization and regulation as a security, a solution that encourages borderless transactions and investor protection must be created.

⁴³⁶ Sam Cooling, *Ripple Latest: SEC Fails in Bid to Prevent Hinman Questioning*, COIN RIVET (July 16, 2021), <https://coinrivet.com/ripple-latest-sec-fails-in-bid-to-prevent-hinman-questioning/>.

E. Jurisdiction of Securities Regulators

An important distinction and clarification is that cryptocurrencies do not actually trade on a traditional capital market. Instead, the price is driven by the supply and demand of the cryptocurrency holders, and such an equilibrium gives it value, much like a commodity such as gold (bitcoin also has a large, but finite, amount, takes work to mine, and holds value). As well, gold itself is not traded on a capital market. The price of gold is set independently, while ETFs and gold futures can be traded on capital markets and are regulated by commissions including the CFTC. Bitcoin and other cryptocurrency prices operate apart from traditional markets like the NYSE. The value of the coin is driven by the supply, demand, and social climate surrounding it. Generally, securities commissions state in their mandates that their goal is to foster and maintain fair and efficient capital markets. Crypto products are not capital markets, nor are they traded on them. CTPs and platforms that offer buying and selling, allowing the user to view prices and complete transactions, are the closest equivalent to the functions of a traditional secondary market. Because cryptocurrencies carry duality in their qualities, and securities commissions are quite keen in claiming jurisdiction regardless, what other considerations should be made when trying to apply the traditional regulatory scheme of a security?

F. Considerations for International Regulations

1. Decentralization

The original purpose of bitcoin, cryptocurrency, and Decentralized Finance (DeFi) was to spread responsibility and access over infinite users using a completely transparent blockchain system. The gamble DeFi companies take is that there will be more good actors than bad actors, and spreading a wide net is advantageous for gaining more good actors. The same reasons drive the functionality of the Prisoner's Dilemma. A prisoner deciding on guilt admission has something invested for himself and the other person. If both people cooperate, thinking in the best interest of themselves and the best interests of the other person, both people attain the best result. However, people who only think in the interest of themselves exist and hack the blockchain when there is a vulnerability. Switching over from a long-developed, tried-and-true banking system to a new-fangled chain of letters and numbers that has no associated physical object but apparently has value is difficult! Actors who take advantage of a fledgling blockchain to manipulate it for their own good do not sway the tide from the steady and centralized banking system that is currently used. DeFi's central focuses are transparency, efficiency, and actor participation. The qualities reflect what securities commissions require and strive to maintain. Additionally, because DeFi and blockchains depend on a high volume of users, the systems are self-maintained, and enforcement is fast and unavoidable when the focus is on system health and efficiency. If every part of the program is viewable and accessible, such as in bitcoin or ether, and disclosure is not a value-add, then no disclosure should be required for truly decentralized systems. After an initial

disclosure, such as a whitepaper, ongoing disclosure is not required as transparency is constant.

2. Environmental and Political Considerations

With the polarizing reaction to cryptocurrencies around the world, any international guidelines must be cautious in their treatment of crypto companies and their products. Mining uses tremendous amounts of energy, so much so that China banned it entirely.⁴³⁷ China relies heavily on the use of coal for energy, creating pollutive gases when burned to power energy-inefficient crypto mining farms. When a single bitcoin transaction matches the monthly energy consumed by an average American family kilowatt for kilowatt, precautions must be taken.⁴³⁸ Renewable energy sources have been utilized for mining, but the rate at which energy is consumed is unparalleled, potentially causing availability problems for the area at large as well as blockchain inefficiency from the lack of available energy.⁴³⁹ The pursuit of blockchain efficiency should not come at the cost of environmental health. Information regarding the amount of energy required for mining, as well as long-range plans to reduce environmental impact, should be considered in the disclosure documents, providing investors with material information about the actual sustainability of an already volatile product—if the system burns through its gas, becoming inefficient or stagnant, the coin will go down with the blockchain. Guidelines may consider restrictions on the forms of energy available to use for mining, or a cap on the amount of energy needed to facilitate a transfer, limiting the production of greenhouse gases and other energy-consumption waste. A solution to the energy consumption conundrum posed by mining is to release coins in a similar fashion to Ripple. However, release at the discretion of the issuer brings forth the issue of transparency and fraud. Guidelines for disclosure addressing the different possibilities arising from the decision to mine or release coins may be required.

While China has banned mining entirely, countries such as Iran and Siberia are significant supporters of crypto mining farms, signaling a variety of attitudes toward supporting each aspect of the cryptocurrency industry.⁴⁴⁰ Some countries embrace the technology wholeheartedly, such as El Salvador, which was the first country to declare bitcoin legal tender (it ended up being a total disaster—remember the discussion about volatility and vendors?),⁴⁴¹ while others, such as

⁴³⁷ *China Declares All Crypto-Currency Transactions Illegal*, BBC NEWS (Sept. 24, 2021), <https://www.bbc.com/news/technology-58678907#:~:text=Trading%20crypto%2Dcurrency%20has%20officially,continued%20online%20through%20foreign%20exchanges.&text=In%20June%2C%20it%20told%20banks,computers%20to%20make%20new%20coins>.

⁴³⁸ Elizabeth Kolbert, *Why Bitcoin Is Bad for the Environment*, THE NEW YORKER (Apr. 22, 2021), <https://archive.ph/kRnBW>.

⁴³⁹ *Id.*

⁴⁴⁰ *Id.*

⁴⁴¹ David Gerard, *El Salvador's Bitcoin Law Is a Farce*, FOREIGN POLICY (Sept. 17, 2021), <https://foreignpolicy.com/2021/09/17/el-salvador-bitcoin-law-farce/>.

Bolivia and Indonesia, have placed bans on cryptocurrency.⁴⁴² The polarizing reactions from various countries indicate there is a fine line to walk when drafting global securities regulations guidelines for cryptocurrencies. Other laws, such as environmental, insurance, and tax, should be considered. Being too restrictive may stifle both innovation and willingness to operate under a proposed set of international guidelines, while being too open may frighten countries that have already taken a stance against the technology.

3. Enforcement Considerations

Under the Canadian securities regulatory framework, the CSA publishes national guidelines that are enforced by provincial and territorial regulators. Such piecemeal enforcement increases efficiency and allows each regulator to maintain control over its region. Comparatively, the SEC is both the federal regulatory and enforcement agency, staying busy constantly. In a global setting, aligning enforcement activities and encouraging cooperation between regulators is a primary goal. The SEC, which is already overwhelmed by domestic crypto companies, cannot possibly begin to start efficiently and effectively regulating foreign crypto companies with an American audience as well. Mutual legal assistance is a necessary complement for the effective enforcement of globalized guidelines. Cooperation between enforcement agencies allows the appropriate regulatory body to take action on its own company, even if the violation did not occur on its soil. Additionally, standardized cooperation between regulatory bodies encourages consistency in the regulatory regime. A fraudster cannot simply take his scheme to another country with less stringent guidelines in hopes of avoiding domestic enforcement. Unfortunately, decentralization poses a problem for enforcement. If the crypto company does not have an actor representing it (such as Cotten for Quadriga), then the determination of who to pursue for liability is a mystery. Such a predicament raises the question—should each decentralized crypto company have at least one actor or registered corporation to whom liability is assigned in the case of fraud or insolvency?

4. Other Considerations

Both Canada and the United States preliminarily use the *Howey* test to determine if a crypto asset is a security, but the test may not be the same in other international jurisdictions. If international guidelines are developed, a meta-analysis of existing crypto securities regulations should be completed to determine the most effective guidelines for producing regulated but innovative crypto companies. Countries such as Japan are open-minded to crypto products and regularly try to adopt them, while still maintaining a workable regulatory

⁴⁴² Chloe Orji, *Bitcoin Ban: These Are the Countries Where Crypto Is Restricted or Illegal*, EURO NEWS (updated Nov. 1, 2021), <https://www.euronews.com/next/2021/09/24/bitcoin-ban-these-are-the-countries-where-crypto-is-restricted-or-illegal2>.

regime.⁴⁴³ Bermuda has also taken a very progressive approach, reflected with the adoption of a policy to accept USDC (stablecoins whose value is pegged to the U.S. dollar) as payment for taxes.⁴⁴⁴ Explained below, the Bermudian system takes a different approach than both Canada and the United States to securities regulation of crypto companies and has seen successful results.

In 2018, Bermuda Parliament passed the Digital Assets Business Act (DABA), implementing a two-tier licensing system for all types of crypto companies, including token issuers, wallet providers, exchanges, payment services, and those operating as a “digital asset services vendor” to encapsulate categories still emerging or not specifically listed.⁴⁴⁵ The Bermuda Monetary Authority (BMA) was given authority to provide enforcement and guidance under DABA, though its role includes oversight responsibilities outside of just capital markets.⁴⁴⁶ All crypto companies must register with the BMA, apply for a first-tier license and are given what is equivalent to a limited duration in the CSA Regulatory Sandbox.⁴⁴⁷ Once its time in the sandbox with modified disclosure requirements expires, the company may apply for a second-tier license or have to cease carrying on business.⁴⁴⁸ DABA, alongside separate ICO legislation, contains the full regulatory requirements for the crypto landscape in Bermuda, and have awarded Bermuda the fame of having the world’s most progressive crypto legislation, which honors whitepapers accordingly.⁴⁴⁹

G. Stifled Innovation

Regulations, through the time, money, and energy spent maneuvering them, stifle innovation. If a company has a really great, future-altering idea, but no funds to hire counsel to navigate, for example, Canada’s regulatory landscape, then the idea may never see the light. A simplification of regulated disclosure is required, a checklist of sorts, that would be user-friendly, and able to be applied to whitepapers and filed independently to assign potential liability to the issuer. Whitepapers are published with most, if not all, crypto projects and are a fantastic source for all crypto users and enthusiasts to learn about the project. However, because they are not regulated, a crypto company can release any

⁴⁴³ Timothy Smith, *Cryptocurrency Regulations Around the World*, INVESTOPEDIA (Sept. 21, 2021), <https://www.investopedia.com/cryptocurrency-regulations-around-the-world-5202122>.

⁴⁴⁴ Sandali Handagama, *Bermuda to Pilot Digital Dollar for Rum Sales*, COINDESK (Feb. 18, 2021), <https://www.coindesk.com/markets/2021/02/18/bermuda-to-pilot-digital-dollar-for-rum-sales/>.

⁴⁴⁵ CAREY OLSEN, *BERMUDA BLOCKCHAIN AND CRYPTOCURRENCY REGULATION 2020* (2d ed. 2020), https://www.careyolsen.com/sites/default/files/CO_BER_Blockchain-and-Cryptocurrency-Regulation-2020-2nd-Edition.pdf.

⁴⁴⁶ The BMA’s Role, BERMUDA MONETARY AUTHORITY, <https://www.bma.bm/the-bma-role>.

⁴⁴⁷ OLSEN, *supra* note 445.

⁴⁴⁸ *Id.*

⁴⁴⁹ Stephanie Sanderson, *Bermuda: Guide to ICOs in Bermuda—September 2019*, MONDAQ (NOV. 2019), <https://www.mondaq.com/fin-tech/861182/guide-to-icos-in-bermuda-september-2019>.

information it wishes, and it is harder to hold the company accountable for any falsified information. Regulating the content made available in whitepapers may be an agreeable way for crypto companies to provide proper disclosure. The statements made may not have to rise to the level of disclosure that a securities registration does, but rather highlight absolute key information needed for investors to make an informed, safe, and responsible decision. The whitepapers can address the duality that exists and may contain a warning not to use an issued cryptocurrency as a security, while also providing enough information on risk factors, mining limits, cybersecurity measures, and other pre-existing disclosure categories. A crypto asset company that refuses to take on liability in a category of reasonable disclosure that is likely already addressed in its whitepaper is inherently suspicious.

H. A Borderless System

Ideally, a global passport system exists for crypto assets. However, bringing the world together in one set of documents is a steep mission considering the current individual regulatory approaches and disagreement between regimes. To begin, an approach similar to the SEC and CSA's current Multijurisdictional Disclosure System (MJDS) should be considered, at least between the United States and Canada. The MJDS encourages cross-border registration of Canadian securities in the American market by allowing Canadian issuers to list on an American stock exchange if the issuer meets a set of basic requirements and files forms largely based on Canadian disclosure requirements with some American tailoring.⁴⁵⁰ As well, Canadian issuers can continue to meet American continuous disclosure requirements in a similar manner—file Canadian documents with the SEC including minor changes to meet American requirements.⁴⁵¹ There is enough similarity and agreement between the guidelines of the two countries that any key differences may be highlighted and accounted for in the transfer documents, but overall, there is a level of trust that indicates what is safe for listing in one country is safe for listing in another. Concretely, having a full G license in Ontario allows the holder to drive legally in any American state. Even though road rules may be different, there are enough key similarities between American and Canadian driving requirements that such minor differences do not have a substantial impact on overall competency. Determining the key factors that should be regulated to ensure investor protection while encouraging innovation without monetary roadblocks is of absolute importance when fostering a borderless crypto industry.

I. Striking the Balance

Each securities administration system has a valid approach to crypto asset regulation, no matter what its approach is. However, some are much more efficient than others and breed a healthier crypto industry. Through court actions,

⁴⁵⁰ Will Kenton, *Multijurisdictional Disclosure System (MJDS)*, INVESTOPEDIA (Jan. 31, 2021), <https://www.investopedia.com/terms/m/multijurisdictional-disclosure-system-mjds.asp>.

⁴⁵¹ *Id.*

the SEC is responding to cues from the marketplace itself and, in the case of Coinbase, takes preventative measures against potentially infringing products. The end result leads to an environment where the surface seems safe, but the regulatory watchdog is lurking in the dark, waiting to quietly set the tone through a settlement. The companies that have full faith in their ideas, a strong demographic, and a willingness to risk SEC enforcement have produced remarkable and innovative products. Oppositely, Canada's speedy approach has laid out the terrain to navigate and produce successful crypto companies, but the volume of output is not the same. Canada demonstrated that public engagement in a fast-moving industry is possible and has shown efficiency through division of guidance and enforcement. Both systems have had major instances of fraudulent behavior occur (the DAO Token event and Quadriga) and have taken regulatory action as a result. Both countries have faced difficulties in the budding industry, and both countries have seen success.

Summarily, after analyzing the crypto asset security regulation regimes in the United States and Canada, this article proposes the following considerations to strike the balance of regulating an unprecedented financial technological advancement as a security:

1) A single regulatory body, similar to IOSCO, made up of at least one representative from every participating country. The representative will be from the regulatory body dealing with securities. For instance, the SEC in the United States, and the CSA and IIROC in Canada.

2) The regulatory body will publish regulations and guidance (the "International Guidelines") on all currently recognized types of crypto businesses, including, but not limited to, token issuers, exchange platforms, investment funds, and payment services. Public consultation will occur when drafting these regulations, as well as an analysis of the effectiveness of existing securities regulations for crypto assets.

3) Implementation of a Passport System, such as the one currently used in Canada, or similar to the MJDS. Create a set of basic regulatory disclosure requirements that qualify a crypto company to operate in any of the participating countries, as long as the requirements are met. Participating countries may request reasonable additional information for disclosure if the International Guideline disclosure requirements do not satisfy existing material information disclosures.

4) Enforcement of the International Guidelines will be carried out by each country's own regulator. For example, the SEC would enforce the International Guidelines in the United States.

5) The International Guidelines provide a user-friendly, readable, checklist-type document for adhering to the disclosure requirements. The disclosure requirements may not rise to the level of currently existing securities disclosures but will provide ample information for investors to make informed decisions. The disclosures will be tailored and modernized to crypto assets.

6) The regulatory body will require registration (at low or no cost) for every crypto company that intends to release a product. Registration is for KYC-type

and statistical purposes only and to ensure individual regulators can properly pursue enforcement in their jurisdiction if necessary.

7) Each individual regulator will offer a time-limited “Sandbox” pursuant to the International Guidelines for product testing.

8) If a crypto company is entirely decentralized and fully transparent, like bitcoin or ether, and adheres to whitepaper disclosure requirements, continuous disclosure is not required because it is not a value-add for investors.

J. Why Regulate the Whole Industry?

Merriam-Webster defines entropy as a trend to disorder.⁴⁵² In terms of cryptocurrencies and crypto assets, the definition is correct. Before bitcoin, there was no disorder. After bitcoin, the industry grew and trended to disorder faster than it could be understood and regulated. As a result of clever but selfish humans, the need for regulation and order grew as the value of the industry increased. Unfortunately, the nexus of collision for cryptocurrencies and regulatory bodies, de/centralization, is a hard switch to flip. When one body is in charge, it carries absolute control over risk; when every actor is in charge, the need for “control” is lost, and risk all but disappears due to transparency and communal surveillance. During the process of evolution, the crypto landscape is messy and hard to navigate, but once order returns, it can flourish. A global industry requires global regulation. Crypto has always been meant to cross borders, so why are individual borders trying to contain it?

⁴⁵² Merriam Webster Dictionary, definition of entropy, <https://www.merriam-webster.com/dictionary/entropy>.

