



“Buyer Aware: applying essential protections to the crypto world”

Keynote Address by Grant Vingoe

Chief Executive Officer, Ontario Securities Commission

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Thank you to the Economic Club for the opportunity to speak here today about the regulation of digital assets and their intermediaries, an area with important implications for our capital markets and the broader financial system.

It has also become a hotly debated topic in the public discourse, and the OSC has received our fair share of attention in that regard. We certainly don't want the OSC to be the story, but if our actions draw public attention to the risks and opportunities of the crypto sector, the attention serves an important purpose.

Unfortunately, the debate about appropriate regulation of the crypto industry is rife with misinformation, both intentional and unintentional. Much of it is put forward by those self-interested players who benefit from the absence of regulation and the confusion that results.

I believe that one of the most important responsibilities we have at the OSC is to be fully transparent about our work and to communicate with clarity. In the face of misinformation, we have a responsibility to set the record straight. That is what I will aim to do in my remarks today by dispelling some of the misconceptions about crypto regulation being pitched in the public sphere.

I will outline the approach we are taking to regulate key players in the crypto industry, and why these actions are necessary to protect both investors and the integrity of our capital markets.

There is a lot at stake. Globally, the market capitalization for crypto assets remains close to a trillion dollars¹ despite a nearly 70% collapse in the last several months. Meanwhile, this asset class is becoming more interconnected with the wider financial system and has a growing potential to pose a systemic risk.

We know from our own research (being published later this month) that more than 30 per cent of Canadians plan to buy crypto assets in the next year.

There is clearly great potential in blockchain technology on which crypto assets are based. It has broad applications for businesses, institutions, and governments that would benefit from transaction records that cannot be altered. There are opportunities to modernize our capital markets with the possibility of dramatically lower transaction costs and improved efficiency, and perhaps even the overlay of regulation by smart contract. There is great work being done in these areas.

The crypto market as a whole, however, is extremely volatile and most of the investment remains largely speculative. The prominent losses, platform failures and instances of fraud we've all heard about have a devastating cost to people's financial lives.

Equally concerning is that our economy also pays a price for this outsized focus on speculative crypto investments. Promoting speculation takes away much-needed capital from businesses that are looking to grow and employ people outside of the crypto universe.

¹ \$0.9 trillion USD as at Sept 28 (<https://coinmarketcap.com/charts/>)

There is only a limited amount of high-risk capital that a retail portfolio can appropriately withstand. When it is being diverted to an unknown avatar somewhere in the virtual world, it is not supporting our local businesses and communities.

There are real reasons behind this trend of speculation. People are feeling stuck. Coming out of the 2008 financial crisis, many felt as though the markets were stacked against them. Trust in our institutions is low², while the cost of living continues to rise.

People feel that they need to get in on the ground floor of the Next Big Thing just to get ahead, or to save up for a down payment on a home. They see the crypto market as that opportunity, but unfortunately, many overestimate the potential or do not understand how the entities involved operate.

Misconception #1: Crypto should be regulated differently

This brings me to the first misconception I'd like to address, which is the idea that the crypto industry should have different regulatory treatment from other similar entities. In my view, this is completely misguided.

This thinking likely stems from the origin story of crypto assets, which are designed to operate independently of a centralized authority and offer individuals a store of value that is not subject to a country's political forces or monetary policy. It has in its roots an anti-regulatory bias.

Indeed, there are compelling use cases for crypto assets, for example, to provide people with access to the financial system in parts of the world where many do not have a relationship with a regulated bank. And as a response to the financial environment in countries struggling with political instability and hyperinflation.

Digital assets can also be a mechanism for building businesses that can compete, grow the economy and provide jobs. Unfortunately, not enough of these businesses have yet materialized except for the intermediaries themselves, and too much money is being diverted into pure speculation.

As securities regulators, none of the characteristics of crypto assets or their underlying technology, either positive or negative, drives our regulatory approach. We are not here to pick winners and losers among investments. We take a careful and technology-neutral approach to all new products that come into our market, and we apply the same reasoning in assessing them.

The fundamentals of regulation are equally applicable to stocks, bonds and crypto contracts.

They include disclosure, conduct regulation for intermediaries, reasonable investment limits to avoid the worst risk of loss to retail investors (from concentration or outsized investments),

² Edelman Trust Barometer <https://www.edelman.ca/sites/g/files/aatuss376/files/trust-barometer/2022%20Canadian%20Edelman%20Trust%20Barometer.pdf>

prudential regulation of intermediaries and investment infrastructure, regulatory scrutiny and examinations, proficiency and ethics, enforcement, and redress.

There is no reason why crypto assets and their intermediaries should be free from these critical elements of regulation.

The OSC's activities are governed by our multi-pronged mandate, which requires us to act when something falls within our jurisdiction – and the vast majority of crypto-based entities clearly do.

Bitcoin and Ether, for example, are generally considered commodities, given their scale and lack of centralized management.

The arrangements that trading platforms have with investors constitute securities. This is because what investors have purchased using the platform is a contractual right to the asset, which is essentially an IOU, and they are therefore highly dependent on the platform operators.

Some of these contracts are considered derivatives when their value is dependent on the value of underlying interests, similar to a swap, which we have regulatory authority over as well.

Platforms facilitating the trading of crypto assets, then, are subject to registration as investment dealers and for some, regulation as exchanges or at least alternative trading systems.

Applying the same definitions in the past has helped us successfully regulate other online trading platforms offering a variety of option-like or asset-based products.

Crypto asset trading platforms need to be subject to scrutiny and ongoing examination like any other intermediary. History has shown that without this, there will be fraud, cheating, and potential harm to investor confidence.

We saw this with the failure of QuadrigaCX in 2019, which was essentially an old-fashioned Ponzi scheme wrapped in the jargon of innovation. It resulted in well over \$100 million in losses, predominantly to Canadians – of whom 40 percent were in Ontario³.

In Canada, we have pivoted from other prominent failures to bring in key reforms, notably following the frauds in the 1990s and 2000s in the mining and emerging markets sectors, which similarly were devastating for many Canadian investors.

Today Canada is widely recognized as having the best mining disclosure standards in the world. This is one of the reasons that the TSX and TSXV together are the world's leading listing and public capital raising venue for mining companies⁴. Building investor confidence in our crypto sector has the potential to produce similar benefits and support its international growth.

³QuadrigaCX Staff Review <https://www.osc.ca/quadrigacxreport/web/files/QuadrigaCX-A-Review-by-Staff-of-the-Ontario-Securities-Commission.pdf>

⁴ TMX Group (<https://www.tsx.com/news?id=905>)

Canada has a strong track record of openness to facilitating alternative ways of trading. We have pivoted quickly to address issues of investor protection and market confidence to allow innovation and competition to flourish.

Canada had the first exchange-operated computerized trading system and licensed it around the world. We were the first to introduce an index-based exchange-traded fund. Decimalization, as well as our eventual introduction of Bitcoin and Ether ETFs, are other examples.

We have worked with marketplaces that came to us with their ideas for new and innovative ways of trading listed securities at a time when most trades in Canada went through TMX marketplaces. Today, we have 12 non-TMX-owned marketplaces that process almost half of all trades in listed securities⁵.

Canada has been a leader in novel financing techniques, including the willingness of our dealers, in true entrepreneurial fashion, to commit capital to bought deals. Another example is our successful establishment of the Multi-jurisdictional Disclosure system with the U.S. to aid Canadian companies effect cross-border public offerings.

Misconception #2: Regulators were slow to react

This brings me to the second misconception I'd like to address, which is the notion that Canadian securities regulators have been slow to react to regulate the crypto industry.

In fact, I'd argue the opposite is true.

Innovation happens quickly and regulation by its very nature is reactive. You can't regulate something that doesn't exist yet or grant permission when no one is asking.

Many firms in this space were established very quickly, often in places with few rules or with regulatory ambiguity. They set up websites and began conducting business without permission from either their home jurisdictions or those of their targeted customers. This was a concern for us.

In Canada, we have been at the forefront of bringing crypto assets into the regulatory perimeter to give genuine innovators room to develop their ideas while still protecting investors. We have taken many concrete measures while others continue to struggle with definitions and fight jurisdictional battles.

Back in early 2019, the CSA and IIROC proposed a regulatory framework for crypto asset trading platforms, and we engaged closely with the industry on what that should look like. By August of 2020, we had approved the first platform to offer services in Ontario.

In March of last year, the CSA published guidance to improve the quality of disclosures provided by crypto asset reporting issuers, such as the controls in place to protect against loss or theft of

⁵ IIROC <https://www.iiroc.ca/media/19011/download?inline>

the assets they hold themselves, basic information about the third-party custodians they use, their accounting practices and promotional activities.

Working jointly with IIROC, the CSA then outlined the securities law requirements that apply to crypto asset trading platforms wanting to do business in our market. It was not one-size-fits-all; our guidance outlined areas where requirements may be tailored to their specific business models, provided key risks are addressed such as ensuring fair access, being transparent about their fees, and managing conflicts of interest.

CSA members share the view that platforms offering these crypto assets to Canadians need to be subject to conduct and prudential regulation, adapted to how they conduct business but with a central commitment to investor protection.

We have been flexible in tailoring requirements through our restricted dealer category so that we can be responsive to differences without compromising our standards. We are systematically registering all platforms in the queue for registration – we are up to nine now – and engaging with them while providing a pathway to get registered with IIROC.

It is our view at the OSC that IIROC registration is the right destination for most of these firms because they are ultimately investment dealers offering services to retail investors. IIROC has the expertise in governing these entities, as will the new SRO launching at the end of this year.

In our view, it is not sound public policy to exclude platforms that deal in the most speculative assets from IIROC oversight while requiring it for dealers that are involved in traditional capital markets. That is the very definition of an uneven playing field.

At the OSC, we took the additional step of setting a deadline for platforms to embark on the road to registration. We didn't want to give anyone the incentive to drag their feet. If they missed the deadline or said they didn't want to do business in Ontario, they had to wind down their services to Ontarians, or face enforcement.

This has been effective because many international platforms don't want the stigma of being censured in Canada, which could hinder their credibility and global ambitions.

Obviously, it is a challenge to bar non-compliant firms from offering services in Canada. With a limited budget and finite Enforcement staff to cover our entire capital markets, there is only so much we can do. But we are making progress. We have already had successful enforcement actions against international players with the assistance of our counterparts in their home jurisdictions.

In August, we began accepting pre-registration undertakings from firms awaiting registration. These critical undertakings hold them to the same investor protection standards as registered firms. We now expect all unregistered firms to do this, which helps level the playing field.

Some of the largest platforms in the world were among the first to agree to or close to proceeding with these undertakings. They see the reputational value of being within the regulatory perimeter

and competing on a level playing field. Well-run firms tend to be receptive to a reasonable approach that includes open conversations, manageable deadlines, and an efficient onboarding process.

Misconception #3: “Buyer beware” is an appropriate regulatory philosophy

The final misconception that I will address before I finish today is that a so-called “free market” hands-off approach is best, and that “buyer beware” is an appropriate regulatory philosophy. I assure you, it is not, and it is obviously much better when buyers are aware.

As with any highly divisive issue, one needs to consider the motivations of those advocating their position; in this case, for the lightest regulation possible. The freedom for bad actors to rip off their fellow citizens is not the kind of freedom that benefits any market.

If any dealer does not have the capacity to make good to its clients, we should all question whether they should be in business. The over-arching public interest requires that they serve their clients, and are appropriately compensated for it, and not the other way around.

The 76,000 investors who were wiped out in the collapse of QuadrigaCX had placed their trust in the platform. As one investor who lost over half a million dollars remarked, “How could I know?”⁶

Regulatory oversight can help shine a light into dark corners and provide a greater degree of transparency and confidence than can be achieved by the blockchain alone.

As I’ve mentioned, our regulatory concerns go well beyond protecting the end users of these platforms. There are prudential concerns of the entities themselves, including poor risk management, the status of the counterparties they are trading with, and what happens in the event of insolvency.

In recognition of these risks, our colleagues at OSFI recently released guidance which aims to ensure that federally regulated financial institutions set prudent limits in relation to their crypto asset exposures.

We are also working toward greater international cooperation in the regulation of this sector through IOSCO and bilateral efforts.

I believe our approach to crypto regulation at the OSC has been pragmatic and proportionate to the risks involved. Our work is directed by the various elements of our mandate, which must be balanced, including our obligation to foster competitive markets.

⁶ Wealth Professional <https://www.wealthprofessional.ca/investments/alternative-investments/quadriga-crypto-exchange-collapse-costs-man-his-life-savings/365371>

For a market to be competitive it must offer a level playing field to attract capital and be supported by appropriate disclosures and fundamental investor protections. These foundations provide investors, innovators, and entrepreneurs with the confidence to participate.

It is important that efforts to protect the public interest are not dragged into non-regulatory debates, the likes of which we are seeing more often in relation to crypto assets, ESG, and other areas. We must always be grounded in our mandates and urge others to evaluate our work in that light.

There are many in the crypto world who share our view that regulation is a critical key to trust and adoption.

We have worked closely with home-grown firms to understand their unique business models and provide them with tailored exemptive relief so they can operate in our market. In turn, they have helped us streamline our regulatory framework in a manner that works for crypto platforms. These have been positive interactions.

When approaching innovation, we need to be responsive to feedback and flexible to different business models, but the fundamental policies of securities regulation, including investor protection, are not negotiable.

It is my hope that firms, investors, and members of the public will understand that it is the presence of sound regulation, not its absence, that gives our capital markets their strength and resilience.

We will be amplifying this message in the public sphere and in our conversations with stakeholders, and I ask for your support in doing the same.