

# Briefing on Cryptocurrency: Risks, Opportunities, and Intervention

**Department of Finance  
Government of Canada**

Policy Analysts: Afraz Bakhtiar, Napas Thein, Wanyi Wang, & James Yeretsian

Team Lead: Mary Mikhail

# Issue Statement

What **risks** and **opportunities** does the introduction of cryptocurrency pose to Canada's financial system? How can the Federal Government address these risks and take advantage of potential opportunities?

# Background

Cryptocurrencies are independent virtual assets used as currency and/or investment vehicles.

## Overview

- Operates and is verified on blockchains, which record transactions.
- Decentralized: no central authority - processing transactions is split across miners/stakers.
- Used for buying goods, paying bills, or investing.
- Examples: Bitcoin & Ether

## Traction

- Global market capitalization of around \$1.14 Trillion.
- As of Feb 2023, nearly 9,000 currencies exist globally.
- 13% of Canadians own crypto assets/funds - predominantly men aged 24 to 44.
- Investment is the most cited reasons for owning Bitcoin.

## Regulation

- No global unified approach to regulations - even inconsistencies within CAN.
- Requires interagency collaboration & coordination.
- In 2021, El Salvador adopted crypto as legal tender.
- Bans on crypto: Algeria, Bangladesh, China, Egypt, Iraq, Morocco, Nepal, Qatar, & Tunisia.

# Current Status

*Given the recent FTX collapse and numerous cases of fraud with crypto, Gov. action is needed.*

## Exchange Collapses & Fraud

- 2022: Bankruptcy of FTX - the third largest crypto-exchange in the world at the time
  - Had over 30,000 users in Canada
  - Ontario Teachers' Pension Plan lost \$95 M USD
  - Regulators (CSA & OSC) have put new regulations in place for crypto trading platforms, such as:
    - Ban on stablecoin offerings - unless specifically permitted by regulators.
    - Client cryptocurrency segregated from firm's own funds.
    - Ban on offering margin trading or forms of debt.
- 2022: Troy Hogg's fraudulent token offering
- 2019: Collapse of Quadriga CX
  - 76,000 mostly Canadian investors; losses of \$100+ M

## Canada's Regulatory Landscape

- Canadian Securities Administration (CSA)
  - Works to improve & harmonize securities regulation across the 13 provincial & territorial regulators (Ex. OSC)
- Investment Industry Regulatory Organization of Canada (IIROC)
  - Regulates all investment dealers & trading activity in debt & equity markets
- Financial Transactions and Reports Analysis Centre of Canada (FINTRAC)
  - Regulates Anti-Money Laundering (AML) & Counter-Terrorist Financing (CTF) compliance for crypto exchanges
- Bank of Canada (BoC)
  - Considering crypto in the future of the monetary system

# Key Considerations: Overview



## Vehicle for Illegal Activity

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Crypto's features of anonymity & decentralization has allowed it to be used for illegal activity.



## Crypto markets are volatile & risky

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Crypto markets present investment opportunities, but are extremely volatile and risky.



## Remittances present an opportunity

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Remittances are a positive use case of crypto, promoting trade and reducing transaction costs.

# Key Consideration #1

*Crypto as a Vehicle for Illegal Activity*

## Cases of Illegal Activities

1. “Silk Road” (2011-2013)
  - Online black market which operated with Bitcoin
2. “Freedom Convoy” (2021)
  - Over \$1 million was collected by protestors in the trucker convoy through Bitcoin

## Regulatory Developments

### **FINTRAC’s Regulatory Developments:**

1. Anti Money Laundering regulations (AML)
  - Laws now require crypto exchanges to know the identity of the person giving and receiving cryptocurrency
  - However, an issue here is that there are hundreds of crypto exchanges which may choose to not follow these regulations

# Key Consideration #2

## Cryptocurrency Markets are volatile and have economic risks

- Cryptocurrencies can serve to introduce stability and instability.
- Stability can be introduced as it can **help diversify portfolios beyond traditional financial instruments.**
- Instability can be introduced through the introduction of unregulated “Ponzi-scheme” style **Initial Coin Offerings** and flawed **Stablecoin** mechanisms (eg. UST and Lunacoin).
- The lack of regulation in cryptocurrency exchanges has lead to the **collapse of the multi-billion dollar FTX exchange**, which has economy-wide consequences.

# Key Consideration #3

## Remittances present an opportunity

- Reduction in transaction cost and Promotes international trade

### Cryptocurrency vs Electronic currency

	Electronic currency	Cryptocurrency
<b>Ownership form</b>	Proof of trust/record of ownership	Direct Ownership of digital money
<b>Parties involved</b>	Require third party	Just the buyer and seller
<b>Transaction settlement</b>	Promise of money Time delay	Direct settlement Real time



# Options and Recommendations

## #1. Develop a Regulatory framework for Cryptocurrency and exchanges.

- **Exchange-based regulations:** Develop a clear and coherent set of rules, in collaboration with the Provinces, on Cryptocurrencies regulations that licenced exchanges must follow.
- Prevent adoption and protect investors from “Ponzi-scheme”-style cryptocurrencies by keeping licensed exchanges responsible for verifying and communicating risks and flaws to investors.
- Promote responsible adoption and stability by regulating the introduction of Stablecoins into the Canadian financial system.
- **Prevent Illegal Activity:** Equip RCMP and related institutions with authority to monitor and prevent money laundering and financing of illegal activity.

# Options and Recommendations

## #2. Work with and fund studies of new Cryptocurrencies and Blockchain innovations

- Provide **grants** to organizations to study and make audits of new incoming Cryptocurrencies and Blockchain innovations.
- Keep these studies/reviews public and informative to keep investors and exchanges informed and to support governments with the development of ongoing regulations.
- **Quantstamp** is an example Blockchain technology auditor organization.
- Consider “open source” methods for studying new technology and criminal activity monitoring as Crypto transactions and Blockchain activity is public.

# Options and Recommendations

## #3. Develop a Central Bank Digital Currency

- Why do we need it?
  - Stable price and guarantee of value
  - Faster payments
  - Less expensive international transfers
  - 24/7 access
  - Support for the unbanked and underbanked
  - More efficient government payments
- Who can we look at?
  - Countries piloting CBDC: Australia, Thailand, Brazil, India, South Korea, Russia, Sweden and Japan
  - Countries already rollout CBDC: China, India, Nigeria and the Bahamas
- What are the potential Challenges?
  - Too many currencies to navigate at the moment.
  - Developing a CBDC will take time and tax dollars

# Overview of Recommendations

## Implementation Timeline

**Short Term:** Fund studies and promote open-sourced research on Blockchain and Cryptocurrency

**Medium Term:** Develop the regulatory framework for Cryptocurrency for all Provinces

**Long Term:** Develop a Government-backed CBDC Stablecoin

**Overall:** Promotes market growth, stability, and security in the Cryptocurrency space.

