



INVESTMENT INDUSTRY ASSOCIATION OF CANADA  
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

[www.iiac.ca](http://www.iiac.ca)

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**Delivered Via Email:**

[comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca); [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca); [vpinnington@iiroc.ca](mailto:vpinnington@iiroc.ca)

Investment Industry Regulatory Organization of Canada  
British Columbia Securities Commission  
Alberta Securities Commission  
Financial and Consumer Affairs Authority of Saskatchewan  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des Marchés Financiers  
Financial and Consumer Services Commission of New Brunswick  
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island  
Nova Scotia Securities Commission  
Securities Commission of Newfoundland and Labrador  
Superintendent of Securities, Northwest Territories  
Superintendent of Securities, Yukon  
Superintendent of Securities, Nunavut

The Secretary  
Ontario Securities Commission  
20 Queen Street West  
22nd Floor, Box 55  
Toronto, Ontario M5H 3S8  
Fax: 416-593-2318  
[comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

Me Anne-Marie Beaudoin  
Corporate Secretary  
Autorité des marchés financiers  
800, Square Victoria, 22e étage  
C.P. 246, Tour de la Bourse  
Montréal (Québec) H4Z 1G3  
Fax : 514-864-6381  
[Consultation-en-cours@lautorite.qc.ca](mailto:Consultation-en-cours@lautorite.qc.ca)

Victoria Pinnington  
Senior Vice President, Market Regulation  
Investment Industry Regulatory Organization of Canada  
Suite 2000, 121 King Street West  
Toronto, Ontario M5H 3T9  
[vpinnington@iiroc.ca](mailto:vpinnington@iiroc.ca)

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

The Investment Industry Association of Canada (“IIAC”) would like to submit its comments regarding the proposed framework for crypto-asset trading platforms. You will find below general comments from the IIAC and its industry members, followed by answers to the consultation questions listed in the joint proposal. We remain available for further discussions.

The IIAC and its mandate

The IIAC is the national association representing the position of 118 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues. We work to foster a vibrant, prosperous investment industry driven by strong and efficient capital markets.

Therefore, the IIAC believes that, to maintain a prosperous investment industry, a crypto-asset regulatory regime should be merged with the current regulatory framework in Canada through the Investment Industry Regulatory Organization of Canada (“IIROC”). Crypto-asset trading platforms must be held to the same standards as IIROC-regulated entities. We believe that a different or non-existent regulatory regime would create regulatory arbitrage and would be detrimental to Canadian investors.

The IIAC represents IIROC-regulated broker dealers. Our members' clients know they are dealing with entities that comply with a stringent CSA/IIROC regulatory framework. Clients understand that this stringent regulatory framework protects them. A similar framework should be implemented for crypto-assets.

#### Main objective of the regulatory framework: Investor protection

The regulatory framework for crypto-assets should have the main objective of protecting investors. We believe that a stringent regulatory regime and regulatory oversight will not only protect investors but may also bring more credibility to crypto-assets - which Canadians seem to want. We believe that no Canadian investor should have to worry about being in the next QuadrigaCX saga.

#### Do "investors" understand crypto-assets and related risks?

In this submission letter, the IIAC will refer to Canadians transacting in crypto-assets as "investors" even if we would not necessarily categorize crypto-assets as "investment products". The investment firms we represent exist to help investors reach their investment goals. By contrast, crypto-assets are often seen as being purely speculative products with few investment properties.

Our members believe that, for many Canadians, crypto-assets are just "another investment product". Clients do not seem to properly understand the crypto products, the trading platforms, the risks and the current lack of regulation. For example, we do not believe that Canadians know:

- that no platform is recognized as an exchange or is authorized to operate as a marketplace or broker dealer in Canada;
- that most platforms currently operate without insurance coverage for investors' assets;
- that there are no regulated clearing agencies for crypto-assets (securities or derivatives).

The fact that over 200 platforms offer over 2000 crypto-assets without any regulatory oversight proves that global customers are interested in these innovative products but may not fully understand the risk associated with these crypto-assets. We doubt that investors, if clearly told that they will send money to an unregulated platform, would choose to do so. Investors must better understand the risk of crypto-assets before they decide whether or not to trade them. In any case, a stringent regulatory framework is required.

The IIAC believes that the current consultation is therefore an important step in the right direction with respect to protecting the Canadian public. Having our Canadian regulators collaborate with foreign regulators is also the only way crypto-assets will be properly regulated since innovation has no physical boundaries.

### IIROC-regulated investment firms: True benefits to investors

The IIROC-regulated firms we represent must meet numerous stringent rules and regulations to ensure clients are properly protected. Our members are used to implementing internal controls, monitoring such controls, maintaining documentation and being inspected by regulatory agencies. Our members' clients feel safe investing their savings with our members and we believe clients should also be protected when dealing in crypto-assets - if and when they chose to do so. We believe IIROC is well positioned to regulate crypto-assets if amendments are made to the way it currently regulates broker dealer activities. Furthermore, we are supportive of marketplaces and dealers registering with IIROC to prevent crypto-asset regulatory arbitrage.

### Proper framework: Theory and practice

As the consultation paper clearly states, the crypto platforms can be a mix of marketplace, broker dealer, clearer and custodian. Our members believe that using the existing rules and regulations as a basis for the framework is proper and accurate.

We also believe that amendments will need to be done to certain rules to apply to crypto-asset platforms and to the way they are to be implemented by these platforms. We also believe that regulators will need to change the way in which they perform their regulatory role. Regulators may need a different type of resource, such as employees with extensive technology and regulatory knowledge. However, the main objective for the rules, regulations and their regulatory surveillance should remain unchanged: The protection of the Canadian public.

In theory, all stakeholders could possibly agree on a theoretical framework that would provide customer protection through privacy, data protection, fair value, and safeguard against fraud. Platform executives (such as the Chief Compliance Officer and Ultimate Designated Person in the current IIROC-regulated environment) should be required to successfully pass certain amended regulatory exams and should possibly certify that the platform is, to the best of their knowledge, in compliance with rules and regulations.

In practice, the innovative technology being used by these crypto-asset platforms and the innovative processes they use (such as hot or cold wallets) complicate our recommendation-making process. Unfortunately, we may not have the extensive technology knowledge and experience required to properly recommend detailed regulatory/surveillance actions for such an innovative technology environment.

#### Proper framework: Implementation by trading platforms

We believe that trading platforms should come up with proper ways of mitigating the risk identified by the regulators. This can be done if collaboration between the parties (platforms and regulators) truly exists. We believe the Canadian regulatory sandboxes may be the best places to discuss risks (identified by regulators) and controls.

#### Proper framework: Surveillance by regulators

The IIAC believes that trading platforms should comply with market integrity rules, when applicable to crypto-assets. We also believe that the monitoring and surveillance performed by regulators must follow the same general guidelines that currently exist for marketplaces, broker dealers, clearing agencies. We believe the regulator should perform regular inspections of the platforms, investigations when needed, should have access to complete data to perform proper surveillance and identify possible market manipulation and fraud. The regulator should also monitor the risk adjusted capital (or similar calculation) and review monthly early warning signals to assess the platform's financial health. Furthermore, the regulator should not be in a conflict of interest with the trading platform in order to provide fair and just surveillance.

#### Insurance coverage for asset protection

We believe that crypto-assets, in hot and cold wallets or any other method of custody, should be protected through insurance coverage. Furthermore, we believe that a fund similar to the Canadian Investor Protection Fund ("CIPF") should provide protection for crypto-assets held by clients if the crypto-asset trading platform becomes insolvent.

#### Harmonization on a global level

A main issue is the discrepancy between the global reach of these platforms (the internet is everywhere) and the limited jurisdictional powers of our Canadian regulators. The IIAC has previously mentioned a similar issue regarding foreign (and fraudulent) binary option trading platforms that were targeting Canadian investors. Since our Canadian regulators do not have a global reach, collaboration and harmonization between international regulators is required to protect investors. Furthermore, if Canadian clients cannot be properly protected when trading on a foreign platform, should we accept foreign platforms in Canada?

## Consultation questions

### **1. Are there factors in addition to those noted above that we should consider?**

No comments.

### **2. What best practices exist for Platforms to mitigate these risks? Are there any other substantial risks which we have not identified?**

No comments.

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

No comments.

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

The standards related to safeguarding crypto-assets are the same whether the platform custodies directly or indirectly. Crypto-assets must be properly safeguarded. We believe that technology experts would be better positioned to recommend controls for these platforms.

### **5. Other than the issuance of Type I and Type II SOC 2 Reports, are there alternative ways in which auditors or other parties can provide assurance to regulators that a Platform has controls in place to ensure that investors' crypto-assets exist and are appropriately segregated and protected, and that transactions with respect to those assets are verifiable?**

We believe that SOC 2, Type I and Type II Reports should be required – but may need to be amended to apply to crypto-assets.

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

No comments.

### **7. What factors should be considered in determining a fair price for crypto assets?**

Based on our understanding of crypto-assets, determining a fair price may be tricky for a multitude of products. We believe that the bid and ask (offer and demand) should be the basis of fair value for a lot of crypto-assets that do not derive their value from “standard” products.

**8. Are there reliable pricing sources that could be used by Platforms to determine a fair price, and for regulators to assess whether Platforms have complied with fair pricing requirements? What factors should be used to determine whether a pricing source is reliable?**

No comments.

**9. Is it appropriate for Platforms to set rules and monitor trading activities on their own marketplace? If so, under which circumstances should this be permitted?**

The IIAC has submitted previous comment letters regarding conflicts of interest between a marketplace and its regulator. Such regulator monitors trading activities on a marketplace while regulatory staff is possibly being remunerated based on the volumes traded on the marketplace. Industry members have stated, on more than one occasion, their serious concerns with a proposed governance structure where regulator and marketplace would ultimately report to the same board members.

We once again wish to state that a marketplace can set its own commercial rules (for example, on new products they wish to list) but should not, under any circumstances, have its trading activities monitored by a related party. The reputation and integrity of the Canadian market, of its industry participants, as well as the protection of investors are at stake.

**10. Which market integrity requirements should apply to trading on Platforms? Please provide specific examples.**

We believe that market integrity requirements should apply to crypto-asset platforms. These platforms should provide fair and orderly markets and should not tolerate market manipulation or market fraud. They should also maintain risk management processes, supervisory controls, policies and procedures manuals, disaster recovery plans/business continuity plans and should document these processes and controls.

We also believe that, at least initially, these platforms should not permit dark trading or short selling activities, and should not extend margin to their clients.

**11. Are there best practices or effective surveillance tools for conducting crypto asset market surveillance? Specifically, are there any skills, tools or special regulatory powers needed to effectively conduct surveillance of crypto asset trading?**

Platform regulators will need to have a new set of skills. Regulators will need to hire technology experts who fully understand the technology used by the crypto-asset trading platforms. As for surveillance tools, they should be able to analyze data from different products in order to identify suspicious patterns.

**12. Are there other risks specific to trading of crypto assets that require different forms of surveillance than those used for marketplaces trading traditional securities?**

No comments.

**13. Under which circumstances should an exemption from the requirement to provide an ISR by the Platform be considered? What services should be included/excluded from the scope of an ISR? Please explain.**

No comments.

**14. Is there disclosure specific to trades between a Platform and its participants that Platforms should make to their participants?**

Platforms must be transparent and provide clear trade and fee information to its clients, similar to other marketplaces. Clients should be made aware whether they traded against the inventory of the platform or against another client. We believe that strong disclosure requirements for dealers that trade against their clients should be implemented. Platforms should also disclose conflicts of interest.

We recommend strong risk disclosure language be included at account opening for crypto-assets since their volatility and risk can be in excess of volatility currently experienced with other products.

Firms should also consider implementing a specific Know-Your-Client (KYC) section and an appropriateness test for crypto-assets, given volatility and possible low liquidity.

**15. Are there particular conflicts of interest that Platforms may not be able to manage appropriately given current business models? If so, how can business models be changed to manage such conflicts appropriately?**

Platforms should not be allowed to monitor their own trading activities (see answer to question #9 above) as we would consider this a significant conflict of interest.

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

Since insurance companies hire professional risk assessors, they may be better positioned to identify specific risks in the crypto-asset space.

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

There are probably difficulties for platforms to obtain insurance coverage. We believe that if insurance coverage for platforms becomes a regulatory requirement, insurance companies will quickly expand their offering to protecting crypto-assets. Insurance companies should be involved in the discussions.

**18. Are there alternative measures that address investor protection that could be considered equivalent to insurance coverage?**

We are unaware of such measures. However, we believe that the CIPF should be involved in the current discussions. We believe that the CIPF or a similar type of fund should cover crypto-assets in the case of bankruptcy/insolvency if the platforms are to be regulated by IIROC.



**19. Are there other models of clearing and settling crypto assets that are traded on Platforms? What risks are introduced as a result of these models?**

We are unaware of other clearing and settling models. That being said, we believe that platforms should comply with the existing regulatory framework. They need to have updated policies and procedures manuals and controls to mitigate the different types of risk (operational, custody, liquidity, investment and credit).

**20. What, if any, significant differences in risks exist between the traditional model of clearing and settlement and the decentralized model? Please explain how these different risks may be mitigated.**

No comments.

**21. What other risks are associated with clearing and settlement models that are not identified here?**

No comments.

**22. What regulatory requirements, both at the CSA and IIROC level, should apply to Platforms or should be modified for Platforms? Please provide specific examples and the rationale.**

The IIAC and its members believe that the existing regulatory framework should generally apply. We believe some modifications will be needed to properly assess and monitor risk for crypto-asset trading platforms. We also believe that these platforms should regularly (monthly) inform their regulators of their financial health. A monthly financial report (“MFR”) as well as an annual audited report, similar to that of IIROC-regulated dealers, should be implemented. Platforms should be required to provide a calculation similar to the risk adjusted capital (“RAC”) calculation of IIROC-regulated dealers, including margin amounts and non-allowable assets, in order to help the regulator assess the platforms’ financial health. Early warning tests should also be put in place for these platforms.

**Conclusion:**

The IIAC and its members would like to thank the CSA and IIROC for drafting this consultation paper.

The Canadian public seems to have adopted crypto-assets, and therefore must be protected. Canadians should be able, if they wish to do so, to trade crypto-assets on regulated platforms that will properly safeguard their assets.

Canadians should be made aware, by clear and simple disclosure, that crypto-assets can be risky and speculative in nature and may not be a proper investment vehicle.

In order to properly protect investors, the IIAC and its members believe crypto-assets should be regulated by IIROC.

IIROC is well-positioned to become the regulator of crypto-asset platforms in Canada since it already regulates listed equities and fixed income products, and is not, as a regulator, in a conflict of interest with a marketplace.

Furthermore, we believe that the Canadian marketplace will be better protected by a regulator that has access to trading data for all products (versus regulators that try to maintain market integrity by performing surveillance solely on crypto-assets).

We believe that further consultations will be needed between the different stakeholders to keep pace with innovation and, as such, please note that the IIAC and its members, as always, remain available for further consultations.

Yours sincerely,



Annie Sinigagliese  
Managing Director  
Investment Industry Association of Canada  
asinigagliese@iiac.ca