

# CAPITAL MARKETS PODCAST: THE CLASH BETWEEN SECURITIES LAW AND CRYPTO

Posted on November 24, 2022

**Categories:** [Insights](#), [Podcasts](#)

This podcast episode dives into the future of crypto law. [Ouvedi Rama Naiken](#) and [Anthony Labib](#), from our [Capital Markets & Securities Group](#), speak with securities litigation partner, [Adam Chisholm](#) on the current state of crypto regulations in Canada.

Please note that the following provides only an overview and doesn't constitute legal advice. Listeners are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

## Transcript

**Ouvedi Rama Naiken:** Hello and welcome to our Capital Markets podcast, a series of episodes where we discuss current issues and topics in capital markets and securities law. My name is Ouvedi Rama Naiken.

**Anthony Labib:** And I'm Anthony Labib. We are both associates at McMillan LLP with an interest in crypto regulation. We will be your co-host for today's episode.

**Ouvedi Rama Naiken:** We are so excited to welcome our special guest, Adam Chisholm, who is an experienced securities litigator and a McMillan Chambers-ranked partner in the field, who is also the co-head of our Complex Dispute and Regulatory Regime Group. Hey, Adam, thank you for joining us.

**Adam Chisholm:** Hi. Thanks so much for having me.

**Anthony Labib:** Adam, I'm curious to know, how did you and the Firm become involved in the cryptocurrency and blockchain space?

**Adam Chisholm:** Well, I, like many other people, took a personal interest in cryptocurrency in the early to mid 2010s. Some of the first people from our Firm to do work in the space were our colleagues who participated in the first initial coin offering to be granted exemptive relief in Canada in 2017. And after they did that work, they put out a bulletin which, looking back at it, it's somewhat amusing because it starts with describing what cryptocurrency is and what an ICO or initial coin offering is.

And I think that shows you just how much exposure this industry has five years later. That's obvious from the fact that McMillan LLP has an entire specialty practice group focused on cryptocurrency. My legal work in the area began around the same time as my colleagues. I was known for my work involving disputes with the Ontario Securities Commission, and we were contacted by a cryptocurrency platform that was responding to their inquiries, that matter ended up being the first settlement involving a cryptocurrency platform in Canadian history.

So, we've been doing legal work in the space for more than five years, and we've been involved with many of the firsts in Canadian law. And today, fast forward, we're doing some really interesting work. My colleagues have been working on an exciting case about code as law. I've dealt with disputes about NFTs. We do securities registration work. We do fraud work. We advise C-Suites on how to incorporate these new technologies into their business planning to help evaluate and mitigate risk, and we advise on new blockchain technologies and we do IP stuff. So there's a lot there. Some of that obviously is more focused on cryptocurrency. Some of it is more blockchain generally.

**Ouvedi Rama Naiken:** Very interesting. As you both have probably seen over the last few weeks, the news of the FTX bankruptcy and its massive impact on investments have made headlines everywhere. I think when something like this happens in the crypto space, it raises all sorts of questions around crypto regulations, investor protections, and I think more generally the future of crypto. Adam, I know you've recently written an article in the Globe and Mail on the FTX implosion. Can you share some of your views on the situation?

**Adam Chisholm:** Well, first of all, I think there's a lot left to learn as of the time that we're recording this podcast. So just yesterday, FTX filed its first bankruptcy filing, and there are some pretty damning allegations about the operations of the company. Those filings allege things like related party transactions, poor record keeping and an absence of management oversight. A lot of these sorts of problems are hallmarks of traditional frauds, like poor corporate management, concentrated responsibilities, an absence of internal controls, related party dealings and those sorts of issues.

They're really not issues that are unique to cryptocurrency or blockchain related businesses, and I'm sure we'll

find out more about those issues and facts as the matter unfolds. But, you asked about crypto regulations and investor protection, and I think that is where the questions become more challenging. FTX was not based in Canada, it wasn't based in the U.S. and clearly whatever enforcement efforts the SEC or Canadian Securities Administrators have taken did not deter the conduct here.

So, existing regulations did not prevent people from losing money in relation to FTX. It's also hard to argue that investors were not warned about being cautious in keeping assets and platform accounts. The Canadian public have already been warned about cryptocurrency platform issues because of the events in Quadriga, which is a platform that failed in 2019 and just yesterday, the superintendent, Adrienne Harris, of the New York State Department of Financial Services said that in her view, virtual assets are the first type of assets that are shapeshifting.

What she was referring to there is that the definition of a token cryptocurrency in some cases can change based on its use case, and her suggestion was that regulators need to have a more 21st century framework for dealing with these issues and all the way. I wasn't there and I haven't spoken to her about what that means. I'm inclined to agree because I think to have investor protection and crypto regulation properly, there are some things that need to be done differently.

**Anthony Labib:** Speaking of the complexity of crypto regulation, can you provide us with a brief overview of the current state of cryptocurrency regulations in Canada?

**Adam Chisholm:** Sure. So, the primary regulation of cryptocurrency related matters has been performed by Canada's Securities Administrators. These are provincial and territorial regulators across Canada. For any listeners outside of Canada, there's no single national securities regulator, despite some past attempts to create one in Canada. The Canadian Securities Administrators have published guidance on their views on crypto offerings general, but their focus has really been on cryptocurrency platforms.

And as I alluded to earlier, there have been some enforcement matters related to cryptocurrency platforms and we did the first couple of those in Canada, but for the most part, cryptocurrency platforms are picking one of two paths. The first path is to obtain relief from Canadian regulators seeking exemptive relief from securities regulations that may apply. And as of today, I think there are about ten of those entities.

There are about ten platforms and some of those entities might not be crypto platforms, but there's roughly ten that have gotten some kind of exemption from securities laws in Canada. The challenge with that path is to obtain that kind of relief, companies are being asked to make a number of concessions that they aren't necessarily making anywhere else than in Ontario or in Canada, and when you think about Canada's position globally and the size of Canada globally, you can understand why some entities may not be all that interested in making those kind of concessions or investments. So, that's led to a number of entities to make the decision

to not pursue registration here. They're either operating here without approval of our regulators or they withdraw from offering services to Canadians, and that class of entities is actually much larger in size. There are hundreds. So that's the primary way that cryptocurrency activities have been regulated. There are also other sorts of laws that can apply ranging from anti-money laundering laws to tax laws.

**Ouvedi Rama Naiken:** Very interesting. I want to shift gears for one second and focus on retail investment. So in your perspective, what are some of the risks or dangers that crypto investors face, particularly in comparison to participants, for example, who are investing in shares of a company listed on a recognized stock exchange?

**Adam Chisholm:** Well, I would start by saying that shares of a company in cryptocurrency are not really similar in any way other than the fact that they can both be bought and sold and can both involve speculation to different degrees. Shares of a company, as you know, represent an ownership interest in a corporation, and with those shares you have certain rights prescribed by law.

Shares tend to have value that is derived from multiples of earnings or the value of their assets on books or in some cases, speculation about the future success of the company. Shares are new, originally issued by the issuer itself, although secondary market transactions are obviously common. That's the way that a lot of retail investors acquired their shares.

Cryptocurrency, on the other hand, is a token recorded on a ledger and for most cryptocurrencies that doesn't necessarily attract an ownership right to anything beyond their right to own the token itself. The token has the value that it has because others are willing to transact at that price. And while some cryptocurrencies purport to be backed by hard assets, those claims have not so far been borne out in any circumstance where it really matters.

It's also true that virtually all commercially oriented jurisdictions have more reliable and long standing laws with respect to share ownership. Keep in mind that corporate statutes have existed for more than 100 years in Canada and the law originating those goes back. So when you compare that to cryptocurrency, Bitcoin was invented in 2009. We don't have cryptocurrency specific laws or a century of common law to define rights and obligations and investors really do have to understand this difference.

If they're going to treat cryptocurrency as an asset class and they're going to put money into it for the prospect of future gains, they'd be well advised to understand what they're buying first. That's, I think, the primary difference. And some of the laws that I spoke about earlier with respect to shares of a public issuer, for example, aren't available to people who own cryptocurrency.

If a company isn't being managed in a certain way, it's possible that there will be some forms of legal claims that shareholders can take in relation to that conduct. You don't have the same thing with blockchain, which is

made, for a large extent, to be automated. And even if there's a high concentration of blockchain or cryptocurrency ownership as there often is, and a lot of the tokens that we see, you don't necessarily have a prescribed law against those crypto currency holders. So that's the main distinction, and again, I think that people who acquire cryptocurrency as an asset for investment really need to understand what it is they're buying.

**Anthony Labib:** It interesting to hear the legal differences between the two and considering the entirety of our discussions today, how do you see the legal treatment of cryptocurrency evolving in Canada in the future?

**Adam Chisholm:** So domestically, and I've been public in my views on this, I think our laws are somewhat ill suited to tackle some of the challenges that cryptocurrency provides. What we've seen so far, as I alluded to earlier, is really an enforcement heavy approach by securities regulators and a path to registration that is not always taken up by entities in this space.

I think there has been some evolution just last month in our domestic approach to these issues. The Chief Executive Officer of the Ontario Securities Commission flagged that, in his view, these kind of jurisdictional issues that some parties argue about are not significant and that, for example, the Ontario Securities Commission has jurisdiction, whether cryptocurrency as a security or commodity or something else.

At the same time, the commission brought an enforcement case against entities company in a principle related to coin offering, and that's really the first enforcement case directly regarding tokens here in Canada. We'll see what kind of jurisdictional arguments are made about that. My hope is that we'll see clear direction from the legislature or regulator before enforcement action is taken.

It would be nice to see position papers if nothing else, on things like token staking before we find out afterwards what the commission believes is within its jurisdiction, contrary to the Securities Act or the Public Interest, and certainly Canadian securities administrators have been willing to focus on their views on cryptocurrency platforms to date, but what about activities like tokens staking. What is our regulator's position on that?

Let's have clarity on those kind of issues domestically to avoid unnecessary expense and potentially investor harm where there's a lack of clarity in what the laws should be. Beyond that, domestically, I think at some point you're likely to see legislative changes. Pierre Poilievre and Justin Trudeau have already extreme barbs over Bitcoin, and if what Canadians really want is stricter regulations, their politicians can affect those changes.

I think that part of the issue here, though, and I think this is what I was hinting at earlier with the piece from the New York official is that without international cooperation on things like enforcement or rulemaking, it's going to remain very challenging to regulate this space because there is not necessarily a central authority in a

lot of cases.

That's what makes crypto platforms in a way easier to target because there might be a mind of management as we're seeing at FTX. Everyone's heard the name of that, you know, top level guy who's in charge of everything. It's a little harder to deal with where you're dealing with a bunch of transactions as between individuals who may not be in this country at all.

That's why without, you know, an international kind of framework, it becomes very difficult to regulate these activities. How well can Canadians be protected, too, if Canada is an outlier? How can the usual balance of innovation and investment versus compliance be struck in this country if we hold ourselves out as enforcement-focused, or if we continue to ask of parties to do things that are they're not being asked to elsewhere?

So at some point, I think you're going to have to see a greater international consensus leading to a more stable environment for all involved. I think the other piece is that maybe you'll see evolution is, you know, first, a lot of countries are becoming involved in cryptocurrencies. So you're seeing national bank cryptocurrencies that will become something that is part of the future in this space.

Canada has been public about its intention to develop or explore at least a national bank cryptocurrency Canadian crypto currency. There have been others that have already existed with varying degrees of success around the world. I think proponents of that see the value in a kind of nationally focused cryptocurrency. I think skeptics of those cryptocurrencies are concerned about how they might be used against the people who hold them, and it's not clear to me yet whether those concerns are just focused on keeping out evil doers or bad actors or whether some states may actually use them for purposes that are unhelpful or improper. So I think you're going to see that and I also think you're going to continue to see blockchain activities that are not cryptocurrency related.

You're going to continue to see concepts like fractionalized, perhaps real estate or fractionalized commodities being a focus of future innovation. And, you know, I think, again, what is important is we have some direction and clarity about those activities as they come up. And that's a challenge for regulators, right? Like there is limited resources to deal with these vast marketplaces.

And it does pose a challenge for me to say, let's get some perspective guidance on everything that happens before it happens so we can all, you know, advise our clients, and so the people listening to this podcast can know, you know, what side of right they're on. But, I think that has to start to develop and my hope is and I think that my hope is that people will welcome those that kind of guidance.

I think regulators are working hard at it. So I'm not being critical when I talk about this having been an

enforcement focused process in Canada in particular, I'm not being critical when I say that. That's just factually how things have developed, but I think at some point, you know, if we're serious about preventing the kinds of situations we talked about earlier, then there has to be a little more perspective guidance domestically and internationally. That's hard work, and I think part of the problem is that countries are competing for this kind of business, for this kind of expertise. So if you're competing for that, then you don't want to necessarily be the least or most aggressive in regulation, but I would say that those are issues that are somewhat political as opposed to legal.

**Anthony Labib:** Some certainty and coordinated effort would definitely be welcomed. With that said, thank you very much, Adam, for coming today and joining us. You provide a very valuable insight. It would definitely be interesting to see how the landscape evolves going forward in the future.

**Ouvedi Rama Naiken:** So this concludes our episode for today. Tune in next time for a discussion on greenwashing in the context of ESG. This is Ouvedi and Anthony of McMillan. Thanks for listening.