



Canadian  
Web3  
Council

# Written Submission for the Consultation on Proposals to Strengthen Canada's Financial Sector

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## **Introduction**

The Canadian Web3 Council welcomes the opportunity to share insight on upholding world-class regulation in the financial sector. As the voice of Canada's Web3 industry, we believe it is critical that regulatory frameworks evolve to keep pace with rapid technological change while fostering innovation and protecting consumers and expanding consumer choice.

The digitalization of finance offers significant opportunities but also introduces new challenges for policymakers and regulators. Web3 technologies like blockchain and cryptocurrencies are fundamentally reshaping how value is transferred and stored. Meanwhile, innovations such as decentralized finance (DeFi) protocols are creating new financial products and services that often do not fit neatly into existing regulatory categories.

We believe Canada has an opportunity to become a global leader in Web3 innovation, but only if we create the right regulatory environment. Other jurisdictions, such as the European Union ("EU"), Singapore, Switzerland, and the United Kingdom have taken proactive steps to introduce (or amend) legislation to accommodate digital assets. Canada must keep pace to remain competitive and attract investment in this fast-growing sector.

## **General Comments**

As Finance Canada considers refinements to the legislative framework, we urge policymakers to take a balanced approach that protects consumers while allowing room for innovation. Overly prescriptive rules risk stifling the development of promising new technologies. Instead, we advocate for principles-based regulation that focuses on outcomes rather than specific technological approaches.

For Web3 technologies, this approach could be guided by core principles such as consumer protection, financial stability, market integrity, and the promotion of innovation. It is equally important that existing legislation accommodates the digital economy. For example, the Bank Act envisions banking activities taking place in physical branches, and the Bank of Canada Act addresses money issued in physical, but not digital, form. Updating these and other statutes is essential for Canada to transition to a financial system underpinned by emerging technologies.

Additionally, new regulations should remain technology-neutral whenever possible. The Web3 space is evolving rapidly, with new protocols and use cases constantly emerging. Regulations that are too narrowly focused on current technologies risk becoming outdated quickly. A flexible framework that adapts to future innovations will better serve both industry and consumers in the long term.



As traditional financial institutions increasingly explore blockchain applications and crypto offerings, regulatory frameworks must also evolve. We support a level playing field that allows both established players and new entrants to innovate responsibly. Regulations should be based on the nature of activities, not the type of entity conducting them. For example, the European Union's Markets in Crypto-Assets (MiCA) regulation applies a consistent approach to all crypto asset service providers, whether they are traditional banks or fintech startups. This framework establishes clear rules for stablecoins, licensing requirements, and consumer protections across the EU, creating a more level playing field for both traditional financial institutions and emerging crypto companies. However, when it comes to DeFi, traditional regulatory frameworks may not be fit for purpose. Jurisdictions like the EU recognized the complexities of regulating the spectrum of DeFi activities and have opted for a consultative approach to developing a regulatory framework. We encourage Canada to take this approach.

Ultimately, it is imperative that federal and provincial regulators collaborate to develop a cohesive, principles-based approach to regulating digital assets and Web3 technologies. The current patchwork of securities regulations across provinces (for example, imposing a \$30,000 limit on certain crypto assets in some regions) introduces operational challenges for innovators and puts Canada at risk of falling behind other countries in fostering Web3 innovation.

### **On Collaboration and Regulatory Predictability**

We commend Finance Canada for recognizing the need for greater coordination between federal, provincial and territorial regulators. The Web3 industry would benefit tremendously from a more harmonized regulatory environment that eliminates interjurisdictional friction, and we encourage the creation of formal mechanisms for ongoing dialogue between regulators and industry including all levels of government as they consider the future of emerging technologies.

Indeed, regulatory predictability will be essential in helping the Web3 sector evolve. Though it has certainly matured, the industry is still in an early stage, with many startups and projects operating on limited capital. Sudden regulatory changes can have an outsized impact on these companies' ability to operate and innovate. Fit-for-purpose regulations that reflect the unique dynamics of the Web3 space are crucial for fostering sustainable growth. Therefore, we strongly support the proposal for a consultative and coordinated approach, with periodic announcements on likely forthcoming regulatory actions. This would enable Web3 companies to better prepare for new requirements, ensuring that regulations are both effective and supportive of innovation.

We also believe conducting and publishing impact statements for new regulations would provide startups the guidance they need to continue innovating. This would foster greater understanding of regulatory rationales and allow industry to provide more informed feedback. Given the complex and technical nature of many Web3 innovations, it is essential that regulators fully



assess potential impacts before implementing new rules.

Further, the proposal to develop a forum for coordinating on international issues is especially pertinent for the Web3 industry. Cryptocurrencies and blockchain networks are inherently global in nature, transcending traditional jurisdictional boundaries. As such, there is a pressing need for greater regulatory harmonization at the international level. Canada should seek to align its approach with other leading jurisdictions to create a consistent global framework for digital assets.

We are also encouraged by the suggestion to enhance information sharing about integrity and security risks in the financial sector. The Web3 industry takes these issues seriously and is constantly working to improve security practices. Indeed, Web3 companies are continuously working to enhance their security practices through various means. These include implementing advanced encryption protocols, conducting regular security audits, developing multi-factor authentication systems, and employing blockchain analytics tools to detect and prevent fraudulent activities.

The intersection of data privacy regulations and blockchain technology also merits careful consideration. The immutable nature of most blockchain networks can create challenges in complying with data protection rules. We recommend convening a multi-stakeholder working group to explore these issues and develop workable solutions.

As DeFi protocols continue to grow in popularity and complexity, developing an appropriate regulatory framework will be crucial. We caution against simply applying traditional financial regulations to these novel systems. Instead, a nuanced approach that considers the unique characteristics and risks of DeFi is needed.

Cybersecurity will continue to be a critical concern as more financial activity moves onto blockchain networks. We recommend increased collaboration between regulators, law enforcement, and industry on threat intelligence sharing and best practices for securing digital assets. Consideration should also be given to updating legal frameworks to better address crypto-related cybercrimes.

Additionally, we see more fulsome dialogue between regulators and industry as the best way to identify and mitigate risks. For regulators, this collaboration would provide access to real-time insights on emerging threats, a better understanding of complex technological landscapes, and the ability to develop more effective and targeted regulatory approaches. Concurrently, the industry would benefit from clearer regulatory expectations and compliance guidelines, improved risk management strategies, and enhanced credibility and trust among users and investors. Consumers, in turn, would enjoy increased protection against fraud and cyber threats, greater confidence in using Web3 and DeFi services, and the potential for more stable and secure financial products.



We also note that consumer education must be a critical component of any regulatory strategy for Web3 technologies. Many Canadians still lack a basic understanding of cryptocurrencies and blockchain. We recommend increased funding for neutral, fact-based educational initiatives to help consumers make informed decisions about engaging with digital assets.

As new financial products and services emerge in the Web3 space, ensuring adequate investor protections will be paramount. We support efforts to combat fraud and market manipulation in crypto markets. However, care must be taken to avoid overly burdensome requirements that could drive innovation offshore.

As the Web3 industry matures, self-regulatory organizations (SROs) may play an important role in setting standards and best practices. We encourage regulators to explore ways to formally recognize and empower industry-led initiatives that promote responsible innovation. This could help alleviate some of the burden on government regulators while leveraging industry expertise.

### **On Access to Financial Services**

One of the most significant challenges facing our industry is the persistent difficulty in accessing basic financial services. The core of the problem lies in the reluctance of traditional financial institutions to provide services to crypto-related businesses. Many banks in Canada have adopted a risk-averse stance, often implementing blanket policies that exclude crypto companies from accessing even the most fundamental banking services, including the closing of bank accounts. This approach stems from several factors, including regulatory uncertainty, reputational concerns, and a lack of understanding of blockchain technology and cryptocurrencies.

Regrettably, there remains a degree of ambiguity that makes banks hesitant. The evolving nature of crypto regulations and the potential for future changes create an environment where financial institutions are wary of potential compliance issues. Additionally, high-profile incidents of fraud and money laundering in the global crypto space have led to a perception that the entire industry is high-risk, causing banks to worry about reputational damage. Furthermore, many traditional financial institutions still lack a comprehensive understanding of blockchain technology and cryptocurrencies, contributing to an overestimation of risks and an underappreciation of the potential benefits of serving the crypto sector.

The inability to secure reliable banking partnerships and services has far-reaching consequences for Canadian crypto companies. Without access to basic banking services, crypto businesses struggle with day-to-day operations. Simple tasks like paying employees, managing cash flow, and processing customer transactions become unnecessarily complex and costly. This lack of financial services also hampers the ability of crypto companies to scale their operations, making it challenging to raise capital, manage funds efficiently, and expand into new markets.



Consequently, Canadian crypto businesses find themselves at a disadvantage compared to their counterparts in jurisdictions with more accommodating banking environments, risking the loss of innovative companies and talent from Canada.

Addressing the banking challenges faced by the Canadian crypto industry requires a multi-faceted approach. There needs to be increased communication and collaboration between crypto businesses, financial institutions, and regulators. This dialogue can help bridge the knowledge gap and foster a better understanding of the crypto industry's needs and risks. Banks should develop more nuanced risk assessment models for crypto businesses, allowing them to differentiate between high-risk and well-managed crypto operations.

Additionally, efforts to educate banking professionals about blockchain technology and cryptocurrencies could help dispel misconceptions and reduce unfounded fears. The development of crypto-friendly financial services and institutions could also provide alternatives for businesses struggling with traditional banking, although these solutions would need to operate within the existing regulatory framework.

The Canadian crypto industry has shown remarkable resilience in the face of these banking challenges. Many companies have found creative workarounds, such as partnering with international financial institutions or utilizing crypto-native financial services. However, these solutions are often suboptimal and can introduce additional complexities and costs.

As we move forward, it's crucial that we continue to advocate for fair access to banking services, promote education and understanding of blockchain technology, and work towards a regulatory framework that encourages innovation while protecting consumers. Only then can we fully unlock the potential of the crypto industry and solidify Canada's position as a leader in this transformative technology. The path ahead may be challenging, but with perseverance and collaboration, the Canadian crypto industry can overcome these barriers and contribute significantly to the country's economic growth and technological advancement.

### **Adapting to Geopolitical Risks**

In the face of emerging geopolitical risks and evolving threats to national security, the Canadian government is right to consider significant changes to its oversight of the financial sector, with particular implications for the cryptocurrency industry.

The cryptocurrency industry in Canada finds itself at a critical juncture as these regulatory changes are considered. While acknowledging the importance of strong safeguards against threats like money laundering, fraud, and foreign interference, it's important to recognize that [cryptocurrency accounts for only a small fraction—just 0.34%—of global transaction volumes associated with illicit activities](#). Blockchain technology actually offers an advantage in this area, as



its transparent and immutable nature makes it easier to trace transactions and combat fraud more effectively than in traditional financial systems.

The challenge for policymakers is to craft a regulatory framework that addresses legitimate security concerns while leveraging the benefits of blockchain's inherent transparency and traceability. This technology can not only enhance security but also streamline compliance efforts. At the same time, it's crucial that regulations remain flexible enough to support innovation and protect Canada's competitive edge in the global digital finance landscape.

As the consultation process unfolds, it will be crucial for both government and industry stakeholders to engage in constructive dialogue. We reiterate the need for reasonable oversight that does not impede innovation, clear and predictable regulatory guidelines, and recognition of the industry's potential economic contributions. There's a strong desire within the industry for representation in the regulatory process as their expertise is essential for crafting effective and balanced regulations.

The outcome of this regulatory process has implications that extend beyond the cryptocurrency sector. It could significantly influence Canada's position in the global financial ecosystem and its ability to attract and retain innovative financial technology companies. The government's approach to regulating cryptocurrencies may set a precedent for how it handles future technological innovations in the financial sector.

The government's task is to enhance national security while capitalizing on the strengths of blockchain technology—ensuring that new regulations protect the public and the economy without curbing the innovative potential of the crypto sector. The industry, for its part, must be prepared to adapt to new regulatory realities while continuing to advocate for policies that support growth and innovation. How Canada strikes this balance will likely have far-reaching consequences for the sector's future development and the country's role in the evolving world of digital finance.

### **Stablecoins: A Critical Component of the Web3 Ecosystem**

Turning to a specific regulatory issue, we believe providing leadership around the treatment of fiat-backed stablecoins should be a priority. As digital money equivalent, these digital assets, which are typically pegged to fiat currencies, are becoming increasingly important in the crypto ecosystem. As the financial system transitions more towards a digital economy, we believe stablecoins will play a crucial role in this evolution. Clear rules on issuance, backing, and oversight of stablecoins would provide much-needed certainty for both industry and to establish trust for consumers.



The importance of stablecoins cannot be overstated. They serve multiple functions within the crypto ecosystem, including:

- Facilitating payments and remittances
- Providing a stable store of value
- Enabling efficient trading and liquidity in cryptocurrency markets
- Supporting the growth of DeFi applications

Currently, stablecoins have a collective market capitalization of around US \$171 billion, representing about 8.5 percent of the total cryptocurrency market.<sup>1</sup> This significant market presence underscores their growing importance and adoption. Further, absent a real-time payment system, stablecoins are the only mechanism providing a secure, near-instant way to transfer value in Canada.

However, the regulatory landscape for stablecoins in Canada remains uncertain and potentially restrictive. The Canadian Securities Administrators (CSA) views all privately issued stablecoins to be securities and/or derivatives. We believe this approach is misguided and could severely limit innovation in the Canadian Web3 sector.

Fiat-backed stablecoins are primarily designed and used for payments and settlements, not for investment or speculation. Canadian businesses can use stablecoins for a variety of purposes, including receiving payments from customers, paying suppliers and contractors, processing payments for online merchants, and providing remittance services. Treating these payment instruments as securities fails to recognize their true nature and use cases.

We strongly recommend that the federal government take a leading role in prescribing the criteria for fiat-backed stablecoins to be digital money equivalent and to distinguish such tokens from securities and/or derivatives. This suggested approach would better align with international efforts such as those taken by the EU, UK, Singapore etc. Such a framework would:

- Recognize fiat-backed stablecoins as payment instruments rather than securities or derivatives;
- Focus on ensuring proper custody of reserve assets, proper asset backing and transparency of reserve assets; and
- Prioritize consumer protection, operational and financial resilience of fiat-backed stablecoin issuers, and financial stability without stifling innovation.

We believe the Retail Payment Activities Act (RPAA) provides an appropriate regulatory framework for overseeing the use of fiat-backed stablecoins in Canada. This would allow for effective regulation while avoiding the pitfalls of applying securities laws to payment instruments.

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<sup>1</sup> CoinMarketCap: <https://coinmarketcap.com/cryptocurrency-category/>





Accordingly, we also recommend developing a comprehensive and tailored framework that explicitly includes non-bank issuers of fiat-backed stablecoins within its scope. This framework should detail specific requirements for stablecoin issuers, including mandatory registration with FINTRAC, capital and liquidity requirements for assessing the financial resilience of fiat-backed stablecoin issuers, regular audits of reserve assets, and clear disclosure of backing mechanisms etc. Capital requirements and risk management protocols should be tailored to the unique characteristics of stablecoins. For instance, issuers should be required to maintain high quality and liquid reserve assets of at least equal to 100% of the outstanding value of the stablecoin supply.

The RPAA's existing provisions on operational risk management could be adapted for stablecoin issuers by requiring robust cybersecurity measures, regular penetration testing, and comprehensive disaster recovery plans. Consumer protection measures could include mandatory disclosures about redemption processes, fees, and other aspects associated with stablecoin usage.

Further, we urge policymakers to distinguish between centralized and decentralized stablecoins in their regulatory approach. The primary focus should be on centralized stablecoins intended for commercial use, as these have reached a scale that warrants regulatory attention. By developing a clear, consistent, and innovation-friendly regulatory framework for stablecoins, Canada can position itself as a leader in the global Web3 ecosystem while ensuring adequate protections for consumers and the financial system.

## **Conclusion**

The Canadian Web3 Council appreciates Finance Canada's proactive approach to evolving the regulatory framework for our rapidly changing financial sector. We believe Canada has an opportunity to position itself as a global leader in responsible Web3 innovation. By encouraging closer collaboration between regulators and industry and taking a principles-based approach, Canada can create an environment that protects consumers while allowing transformative new technologies to flourish.

We stand ready to work constructively with policymakers to develop smart, effective regulations that unlock the full potential of Web3 technologies to benefit all Canadians. Through ongoing dialogue and a shared commitment to responsible innovation, we are confident that Canada can build a world-class regulatory framework fit for the digital age.