OSLER

Crypto bankruptcies and how Canada's regulatory regime can help protect Canadian investors

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The collapse of the crypto market between May and July of this year created a crisis of confidence following heavy investment losses and the high profile bankruptcy of some crypto lenders. For institutional investors, it is important to thoroughly understand the crypto market and to fully assess all risks before investing in this space.

Osler partner Laure Fouin outlines the due diligence steps investors can take to mitigate their risks and to provide some protection when considering crypto assets in the video below:

Transcript

LAURE: Hello, I'm Laure Fouin, Co-Chair of the Digital Assets and Blockchain Group at Osler based in Montreal.

What happened in the crypto market from May to July is a story you have all heard before: a perfect storm of debt, high leverage, collateral valuation issues and a bear market… except this time, it is in the crypto market and not traditional financial markets.

In May of this year, the collapse of a popular so-called stablecoin cost investors tens of billions of dollars and caused a shockwave on global crypto markets wiping out $1T. TerraUSD and its sister token luna saw a high-profile run-up before it collapsed.

The market wasn't reacting the way the algorithm assumed the market would react. TerraUSD "depegged" and Luna went to zero, provoking a crisis in confidence in cryptos which saw bitcoin's valuation fall nearly 50% between April and July 2022. This confidence crisis was exacerbated by high profile bankruptcies of crypto lenders and hedge funds (i.e. centralized players), which all suffered great losses from their exposures to LUNA, and to each other.

In Canada we have regulated platforms

There is a regulatory regime for crypto platforms in Canada and there is a way of dealing with digital assets and blockchain assets in a safe way. While crypto lending is not yet subject to a specific regulatory regime in Canada, Canadian platforms that are registered with the Canadian Securities Administrators or actively working on obtaining such status are subject to investor protection requirements.

For institutional investors and players, we are here to help you better understand the risks with cryptoassets and when you should or should not invest in this area.

Some examples of the current terms and conditions applicable to crypto platforms include:

- Mandatory insurance covering losses of client's assets
- Custody of client's assets with a qualified custodian and cold storage requirements
- Prescribed risk disclosure to clients
- KYC, account appropriateness and recommended loss limits
- Specified cryptoassets and purchase limits
- Two-year transition to IIROC registration

When investing in the crypto space, whether in a product (a coin) or in an enterprise.

It's important to do your due diligence as one would do for any investments, but we would also highlight a few things:

- Understand the business model and the "thesis", as well as the drivers behind it
- Is it code-reliant? The code should be audited
- Compliance with laws and appropriate compliance structure
- Intellectual property
- Integration and APIs: it is important to assess the level of dependence on other players

If you are interested in learning more about how institutional investors can be protected when dealing with crypto companies, reach out to me and the Digital Assets and Blockchain team at Osler, and we can help you determine if a crypto project is viable or risky from a legal perspective.