Fintechs Canada

Department of Finance Canada **December 6, 2024**
90 Elgin Street
Ottawa, Ontario K1A 0G5
Canada

RE: Targeted Engagements on the Regulatory Approach for Stablecoins

Dear Sir/Madams:

On behalf of Fintechs Canada, I would like to thank you for the opportunity to comment on the government's consultation on possible federal approaches for regulating stablecoin arrangements in Canada.

Fintechs Canada is the unified voice for the most innovative financial technology companies. Serving millions of Canadians daily, our members are market-leading Canadian fintechs, fintech-friendly financial institutions, the technology companies that power the credit union space, and global fintech companies, among others. Our mission is to make Canada's financial sector more competitive and innovative, while also strengthening the sector's stability and security.

Stablecoins have emerged as a novel technology and their full potential is still unknown. In recent years, fiat-backed stablecoins have gained popularity worldwide due to their ability to maintain a stable value and facilitate fast, cost-effective transactions. Despite being built on new technologies, these stablecoins share many of the same features and characteristics as existing financial services. Therefore, existing laws and regulations should be amended to capture the use of stablecoins in the distribution of financial services.

In this submission, we provide our perspective on how the government should regulate fiat-backed stablecoins in Canada. We recommend applying the principle of "same activity, same risks, same regulation." This means that if the issuance of a stablecoin is akin to the provision of an existing financial service, it should be regulated as such, rather than as a brand new thing.

Stablecoin use cases

Not all stablecoins are designed the same or present the same use cases. There are generally three categories of stablecoins:

- **Fiat-backed stablecoins:** stablecoins backed by fiat-denominated assets, such as cash, treasury bills, or commercial paper.
- **Crypto-backed stablecoins:** stablecoins backed by crypto assets, where the collateral may fluctuate significantly in value.
- **Algorithmic stablecoins:** stablecoins that maintain price stability through preprogrammed algorithms that adjust in response to market conditions.

Fiat-backed stablecoins in particular have emerged as a popular payment option globally. Unlike other cryptocurrencies or crypto-backed and algorithmic stablecoins, which are often used for investment or speculative purposes due to their volatility, fiat-backed stablecoins are designed to maintain a stable value. This stability, combined with their ability to facilitate fast and cost effective payments, makes them suitable for Canadians looking for reliable payment methods.

In 2023, stablecoins processed $10.8 trillion in transactions globally, with $2.3 trillion specifically related to payments, such as peer-to-peer (P2P) transfers and cross-border remittances. A study by Georgetown University found that the proportion of stablecoins used for speculative trading has decreased by 90% over the past five years. The report further indicates that payment stablecoins are now more commonly used for real-world applications like cross-border payments, humanitarian relief, and remittances, rather than speculative trading.

According to the Ontario Securities Commission's Crypto Asset Survey, Canadians are increasingly using stablecoins for payments. Among crypto asset owners, 22% (up from 21% in 2022) have used stablecoins to convert to cash, 18% (up from 15%) have used them to pay for goods and services, 14% (up from 11%) have used them for international payments or transfers, and 11% (up from 10%) have used them for other purposes.

Benefits and risks of stablecoins

Fiat-backed stablecoins in particular could offer faster and more efficient payment options to Canadians due to the features of the novel technology they are built on.

Stablecoins have a distinct advantage in that they operate on blockchain technology that connects a wide network of participants, creating shorter transaction paths for cross-border payments. With features like composability, interoperability, and instant settlement, stablecoins could provide continuous 24/7 access to funds and allow instant processing across borders. For Canadians, this provides them with a new avenue to securely purchase goods and services online or transfer money internationally with immediate settlement—eliminating the delays, costs, and risks often associated with traditional bank wires and transfers.

However, for a stablecoin to serve as a reliable means of payment, users must have confidence that its value will remain stable. This requires the stablecoin to be reliably and immediately redeemable at par value for another liquid asset. It also requires a level of transparency, such as a high standard of disclosure and regular reporting. Failing these things could undermine confidence in the stablecoin, which could lead to the materialization of reputational, operational, and financial risk for the issuer of the stablecoin.[1]

Proposed regulatory approach to stablecoins

Issuers of fiat-backed stablecoins and other service providers in the related ecosystem must be regulated on the basis of the activity they're performing and the risks they pose. Issuing a stablecoin, by itself, doesn't mean anything. Neither does selling a piece of plastic with a magnetic strip and a chip. It's not until this piece of plastic is turned into a debit card by card networks and financial institutions that it becomes a payment method. The plastic, magnetic strip, and chip are just technologies that make up the payment method. In the case of debit cards, it's the payment method that's regulated, not the underlying technologies in and of themselves—which is why when the same underlying technologies are used to issue a credit card the activity is regulated differently.

In the case of certain fiat-backed stablecoins, the service being provided to consumers and businesses is more akin to payment facilitation than banking or the provision of securities. Therefore, the federal government should regulate these fiat-backed stablecoins with federal payments legislation. In particular, the federal government should use:

[1] Recent events, such as the temporary de-peg of USDC with the US Dollar following the collapse of Silicon Valley Bank, have demonstrated how market confidence for insufficient backing assets can influence a fiat-backed stablecoins ability to achieve stability.

- The Retail Payment Activities Act (RPAA) to supervise non-prominent or non-systemically important issuers of stablecoins, as well as any custodians or digital wallets that give their customers the option to transact with stablecoins. The RPAA should be amended to include such activity in its definition of what a "payment function" is, as well as to require issuers to hold highly liquid, low risk reserves with prudentially regulated financial institutions and to immediately accept redemption requests. What's more, as it works to add market conduct provisions to Canada's retail payments supervision framework, the government should make sure that stablecoin issuers are required to transparently disclose all the necessary terms and conditions with their customers.[2]
- The Payments Clearing and Settlement Act (PCSA) to give the Bank of Canada the power to designate prominent and systematically important issuers of stablecoins (i.e., stablecoin arrangements). In so doing, the Bank of Canada would be able to require stablecoin arrangements to meet the appropriate interpretation of the Bank for International Settlements' (BIS) principles for financial market infrastructure (PFMIs), with additional guidance from the BIS. The PFMIs would have it so that stablecoin arrangements are meeting the Bank of Canada's expectations to manage a comprehensive range of risks. Given the principles-based nature of such oversight, the expectations could be tailored to the unique facts and circumstances of the stablecoin arrangement. Amendments should be made to the PCSA to allow the Bank of Canada to do this.

In cases where issuers of stablecoins act more like banks (i.e., intermediation between savers and borrowers, as well as creating money through a fractional reserve system), the government should require such companies to be licensed as banks and supervised by the Office of the Superintendent of Financial Institutions, as well as the Financial Consumer Agency of Canada. Similarly, in cases where stablecoins are backed with volatile cryptocurrency or market-driven algorithms, the stablecoins are more akin to investment products and should be regulated as if they are securities and by existing securities regulators.

Canada should take advantage of the financial sector legislative framework and regulators it already has, rather than creating brand new laws and establishing

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[2] In the event the issuer is not in a legal relationship with the end user and relies on partners such as digital wallets to give end-users the ability to make use of stablecoins, the digital wallets should also be required to register under the RPAA and comply with all the relevant requirements.

brand new regulators. Any approach taken should be technology-agnostic and aligned with the principle of "same activity, same risks, same regulation." Given the novelty of this emerging technology, policymakers must avoid narrowly defining its use and regulating it as if it has only a single use. Stablecoins, themselves, represent a technological innovation that can be used in different ways. Regulators should allow for different use cases while ensuring appropriate safeguards are in place.

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Fintechs Canada thanks you for considering our perspective on how the government should regulate stablecoins in Canada. We look forward to working with you and continue to support the government's efforts.

Sincerely,

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