To:
Consultations and Public Affairs Branch
Department of Finance Canada
14th floor
90 Elgin Street
Ottawa, Ontario K1A 0G5

November 30, 2024

Re: Targeted Engagements on the Regulatory Approach for Stablecoins

Coinbase Canada, Inc., a wholly-owned subsidiary of Coinbase Global, Inc. (together with its affiliates, Coinbase) appreciates the opportunity to respond to the Targeted Engagements on the Regulatory Approach for Stablecoins (the **Consultation Paper**) Department of Finance Canada (the **Department**).

Coinbase started in 2012 with the idea that anyone, anywhere, should be able to send and receive Bitcoin easily and securely. Today, we are publicly listed in the United States and provide a trusted and easy-to-use platform that millions of verified users in over 100 countries rely on to access the crypto economy.

Stablecoins are central to our digital asset ecosystem and, as with all participants in this ecosystem, essential to our business operation. Stablecoins serve at the digitally native fiat settlement leg of every tokenized transaction. The Consultation Paper is, therefore, an important step in ensuring the success of the digital asset economy in Canada.

Coinbase appreciates the Department's thoughtful attention to this important topic, including the focus on developing a strong regulatory framework. We look forward to continuing to work with you to advance the regulatory treatment of digital assets, including stablecoins.

Yours sincerely,

Tom Duff Gordon, Vice President,
International Policy, Coinbase

Lucas Matheson, Country Director Canada, Coinbase

Introduction

Stablecoins are already widely used in Canada. An appropriate regulatory framework for issuers of stablecoins (**Issuers**) is essential to minimizing the financial risk to consumers participating in the digital asset ecosystem, as demonstrated by other jurisdictions that are in the process of implementing regulatory frameworks for Issuers. To maintain Canada's competitiveness and ensure that our users can continue to access stablecoins, we must avoid applying disclosure-based securities laws that are inappropriate for fully collateralized stablecoins.

We applaud the Department for proposing a framework that addresses stablecoins at the Federal level in Canada. This the right approach to regulating stablecoins, as it would avoid fragmenting the treatment of these assets across Provinces and create synergies within Canada across traditional finance and its increasing digitization. In particular, if stablecoins were treated as a means of payment in one Province but (inappropriately) as a security in another, Canada's crypto asset ecosystem would be unnecessarily fragmented and undermine Canadian competitiveness in the emerging technology.

In our view, stablecoins should be regulated under the federal Retail Payment Activities Act (**RPAA**), which correctly recognizes the need for Canada to have a uniform payments ecosystem. Stablecoins should not be regulated in accordance with Canada's securities laws, as the risks posed by a stablecoin that is fully collateralized with high quality liquid assets (**HQLA**) are entirely different from those posed by a traditional debt or equity security.

We also commend the Department looking to the regulatory frameworks already established or in process in other jurisdictions and further encourage the Department to work towards global harmonization of stablecoin regulation. In particular, we would flag for the Department's consideration the following:

- The EU's Markets in Crypto-Assets Regulation, which provides a comprehensive prudential regulatory framework for stablecoins.
- The U.S. President's Working Group on Financial Markets Report, which recommends against treating stablecoins as securities.
- The U.K. FCA's Consultation on Stablecoins, which proposes a regulatory framework that would treat stablecoins as a payment method.

It is important that Canada adopts a regulatory framework that appropriately balances consumer protection and the encouragement of innovation and in doing so maintains global economic competitiveness. Accommodating the cross-border nature of digital assets through regulatory harmonization with other leading jurisdictions will make Canada an attractive place for future investment in the digital asset economy. Stablecoins are central to efficient operation of the digital asset ecosystem, and we depend on the

efficiencies and functionality that properly structured stablecoins as the settlement instrument for trading pairs. As such, our comments are informed by our experience in digital asset markets and a conviction that appropriately regulated stablecoins will help to bring digital assets and the promise of economic freedom to the mainstream. We have sought to provide specific responses to the questions posed by the Department.

Targeted responses

Question 1 – *How do you see stablecoins being used in Canada today? Are there any trends you are observing in terms of stablecoin use in Canada? Based on your observation, how do you see the usage of stablecoins evolving in the immediate future?*

Stablecoins are essential to the crypto asset ecosystem, serving as the digitally-native fiat currency. The atomistic settlement of tokenized purchases – a key feature of the digital asset ecosystem – would not be possible without them. Just like with other forms of paper and electronic money, stablecoins remove any variations in the price paid for a good or service that is unrelated to that good or service; they allow consumers in the digital asset ecosystem to engage for consumptive purposes without concern for potential volatility in a payment instrument.

Initially, stablecoins served as the key payment mechanism for crypto native assets, like Bitcoin (BTC) and Ether (ETH). We have also seen, however, consumers begin to use stablecoins for more mainstream transactions, capitalizing on the secure, peer-to-peer nature of a blockchain recorded transaction, that settles in real time. Of the $10.3 trillion in transactions facilitated by stablecoins in 2023, $2.3 trillion was related to "organic" activities including payments and cross-border remittances, among others.[1]

Question 2 – *What benefits, if any, could stablecoins bring to Canada?*

Compared to traditional payment methods that travel through a daisy chain of bank debits and credits, stablecoins are faster, cheaper, and operate 24/7. Stablecoins allow any person with access to a phone and internet to exchange value to send money to anyone, anywhere in the world as easily as sending a text message. Moreover, the programmability of payments using stablecoins creates scope to automate not only regulatory requirements (e.g., compliance checks) but also how and when transactions are made and settled (e.g., micropayments, salaries, subscriptions, trading, insurance, lending etc).

This functionality provides stablecoin users with alternatives to incumbent payment systems that can be slow and more costly, particularly for cross border transfers. Current

---

[1] Coinbase, *Stablecoins and the New Payments Landscape*, (Aug. 5, 2024) [Stablecoins and the New Payments Landscape - Coinbase Institutional Trading Insights]

payment and remittance platforms require multiple intermediaries to execute a transaction, often resulting in longer transaction and settlement times and additional fees, such as foreign transaction fees. In Canada, 1 in 5 people remit money to people abroad paying 6-12% in fees. In addition, Interac scores poorly on fees, failure rate, speed, settlement and user experience. By comparison, today, on Base, a Coinbase created layer 2 blockchain, users can transfer stablecoins that settle for less than one cent and in minutes or seconds. Allowing a stablecoin payment ecosystem to develop in Canada will benefit consumers and businesses by increasing competitive pressure on incumbent systems.

Question 3 – *What risks, if any, could stablecoins pose to Canada?*

We do not believe that the adoption of well-structured and appropriately-regulated stablecoins poses a risk to Canada. In fact, we believe that movement towards a mixed payments ecosystem that includes a flourishing stablecoin market will deliver many benefits to Canadian consumers, as we discuss in response to Question 2. We believe that many of the possible risks (financial and operational risks) can be addressed through an appropriately tailored regulatory framework – just as it is currently the case for other well regulated financial entities and infrastructure.

As we have discussed in other regulatory consultations, [2] Coinbase has done an extensive analysis of the capital requirements for stablecoins, which supports (1) the adoption of a minimum rather than variable capital requirement and (2) the conclusion that a well-structured stablecoin minimizes financial risk and is instead primarily a matter of mitigating operational risk.

> "The initial results of this analysis indicated that, if the stablecoin's reserves are composed entirely of highly safe, liquid assets – such as highly rated sovereign debt securities maturing in less than 90 days, and deposits at regulated financial institutions – then the stablecoin's exposure to financial risks can be minimal. Our initial estimates depended significantly on assumptions regarding the accounting treatment of reserve assets – i.e., approximately 20 basis points under held to maturity (HTM) assumptions, and 36 basis points under available for sale (AFS) assumptions. Given this composition of assets, a minimal capital buffer would be sufficient to fully protect stablecoin holders against all categories of financial risk, including credit risk and market risk.
>
> The stablecoin's remaining risk exposures are operational in nature... [O]ur initial findings indicate that a capital buffer of a well-structured and properly regulated stablecoin on the order of one percent of the total amount of stablecoins

[2] See Coinbase Response on 2/6/24 to the UK FCA paper titled "DP23/4: Regulating Crypto Assets Phase 1: Stablecoins":
https://assets.ctfassets.net/c5bd0wqjc7v0/6BCKUrXEHMxlhGZkJy55j3/78c6e6134879862f94ac92f5afa2b91f/Coinbase_-_Feb_2024_Response_to_FCA_Stablecoin_Consultation.pdf

> outstanding should be sufficient to protect against financial and operational risks for an issuer that maintains a reasonably effective risk management program."

Question 4 – *Is a regulatory framework needed in Canada beyond what is currently in place?*

We believe that Canada should adopt a stablecoin regulatory framework under the RPAA rather than as an extension of Canadian securities laws.

In our view, the use of stablecoins can generally be regulated under the RPAA with appropriately tailored rules to accommodate for any unique risks and practices. Notably, today, a gap exists in that there is currently no framework for regulating non-bank issuers of stablecoins, which the regulatory framework proposed by this Consultation would establish. The RPAA's governance and operational framework is already well suited for 'holding funds' and initiating payments on behalf of users. The key change that would be required to regulate stablecoin issuers would be establishing requirements for the HQLA reserve. And absent risks associated with securities, it would be inappropriate to establish a framework designed for, or subject to, existing securities laws. Importantly, the value of the stablecoin should never depend on the financial performance or creditworthiness of its issuer, but instead on the portfolio of HQLA for which it is redeemable. Securities laws are designed to deal with issuer risk primarily through disclosure requirements, but a well-structured stablecoin's primary risk is operational – how redemptions are facilitated – and the securities laws are not designed to mitigate that risk. Moreover, securities regulators do not have the appropriate regulatory tools to monitor Issuer activities and step in, e.g. with respect to resolution, when needed to protect users. To this end, a prudential framework is much better suited to addressing the consumer protection risks associated with stablecoins.

Question 5 – *What types of stablecoins could be captured under a regulatory framework (e.g., based on use cases such as investment or payment, or based on a stabilization mechanism such as single-fiat referenced or algorithmic)?*

We believe that many types of stablecoins - ranging from algorithmic to fiat backed to commodity backed - can flourish. All types of stablecoins issued in Canada or available to Canadians should fall within the regulatory perimeter. It is also important to note that regulated stablecoins should be able to pay rewards to customers. In particular, we urge the Department to permit the sharing of rewards associated with reserve assets.

Question 6 – Should a regulatory framework capture issuers or extend beyond issuers to capture other parts of the stablecoin arrangement, such as wallets and custodians?

We encourage the Department to follow an incremental approach to extending the scope of stablecoin regulation. Many requirements that could be applied to stablecoin

custodians should be considered more holistically, alongside a full array of crypto assets beyond just stablecoins, to help ensure a broadly workable regulatory framework for the entire ecosystem.

There is potential for significant unintended and adverse outcomes if rules designed for payment use cases are broadly adopted for other crypto use cases, which are not currently being considered. We believe it is important that any non-stablecoin issuer related rules be considered and ultimately applied to stablecoins in conjunction with rules that apply to crypto assets more broadly, otherwise the differences in timing will introduce significant operational and compliance challenges.

Our view is that custody requirements for stablecoins should only apply when the broader regulatory framework for crypto assets comes into effect, which should consider stablecoins as one part of the broader framework. As such, initial rules should apply to stablecoin issuers only. Doing so will avoid an outcome where crypto asset custodians implement one-size-fits-all requirements to digital assets that are inherently different from stablecoins. For this reason we urge the Department to ensure that the implementation timelines are aligned for custody rules for both stablecoins and crypto assets generally.

This view applies equally to the regulation of crypto asset wallets. Until rules are adopted that apply to crypto asset wallets generally, extending the scope of a stablecoin regulatory framework to wallets when used for stablecoins is likely to have unintended consequences that can stifle innovation. This is particularly true for wallets because users are likely to have individual preferences with respect to the manner in which they hold their crypto assets – including stablecoins. Some may prefer the convenience of assets maintained in an omnibus wallet by a crypto asset service provider, whereas others may prefer to self-custody their crypto assets. Extending the perimeter prematurely may unnecessarily impede consumer choice.

Question 7 – *Should a regulatory framework capture all stablecoin issuers or only ‘significant’ issuers (e.g., issuers of global stablecoins)?*

We think it is appropriate for a regulatory framework to apply to all stablecoin issuers – perhaps with an exemption for truly de minimis issuers. We recognize that regulators are concerned that the amount outstanding in a particular stablecoin could increase quickly, and if it can take time for an issuer to develop the internal controls and procedures to comply with a new regulatory framework, this may pose a risk if the framework only applies to the largest stablecoin issuers.

However, it remains important to appropriately tailor the regime for smaller issuers, and not necessarily apply the same regulatory requirements to all issuers within the framework. The RPAA applies to all PSPs that perform a "payment function". There are exemptions when the function is incidental to other activities and is not the core business,

or is provided only internally to affiliates within a corporate group. In our view, a similar approach would work for stablecoin Issuers.

Question 8 – *Do you agree with the list of requirements proposed in Table 1 and, in your view, would it be appropriate in the Canadian context? Are there suggested alternative approaches or other key requirements for stablecoin issuers to mitigate financial stability risks of stablecoins?*

We agree with the Department's proposed set of topics, though because the description of the requirements are at a high level, it is possible to say whether the final rules implementing these requirements would be appropriate.

Of all the requirements, we believe particular focus should be on permitted stablecoin reserves. As we have noted in other regulatory consultations,[3] we believe that the makeup of a stablecoin issuer's reserve assets can be determinative of the additional requirements imposed to mitigate that issuer's risk. To the extent that an issuer plans to include reserve assets that are riskier than HQLA or bank deposits, which is the standard that many jurisdictions are seeking to impose, the Department should make clear that additional measures including appropriate capital requirements should be considered.

Conversely, where reserve assets are limited to cash and cash equivalents, the need for financial risk management guardrails, stress testing, recovery and resolution planning, and detailed disclosure requirements decreases significantly. For example, if an issuer plans to limit backing assets to HQLA, where financial risk is minimal, our analysis supports lower capital requirements, focused almost exclusively on operational risks, and winding down an issuer that is backed with such assets should be purely an operational exercise with sufficient capital to complete that operation while ensuring 1:1 redemptions for stablecoin holders.

We additionally urge the Department to proceed thoughtfully in determining the minimum amounts of commercial bank deposits it will approve, and any associated diversification requirements. Bank deposits are primarily used by stablecoin issuers to manage liquidity – through the mint and burn process that bridges the stablecoin to underlying fiat – but need not form a greater percentage of the reserves structure than what is required to manage the redemption process, particularly because,unlike HQLA, deposits introduce bank credit risk to the reserves. We saw with Silicon Valley Bank failure in the US how this can introduce spillover risk from the banking sector into crypto. It is also important to recognize that banks have discretion over whether to serve potential issuers, and in some jurisdictions, given the early stage of development of the digital asset ecosystem, some

[3] See Coinbase Response on 7/16/24 to the Bermuda Monetary Authority Guidance on Digital Asset Business Single Currency Pegged Stablecoins: https://assets.ctfassets.net/o10es7wu5gm1/56AN66eXV3WMHe5JBicGUe/c9c45ed97d7776df6648aa2f1b74d638/2024.07.16.Digital_Asset_Business_Single_Currency_Pegged_Stablecoins.pdf

issuers may face challenges in securing those relationships, particularly if banks view issuers as a potential competitor.

In addition to issuer requirements, the Department should clearly lay out what it will *permit* stablecoin issuers and resellers to do. In particular, we urge the Department to permit the sharing of rewards associated with reserve assets. As banks move towards tokenizing deposits, allowing issuers to earn and pay rewards on backing assets is critical to ensuring a level playing field across like instruments. As banks move towards tokenizing deposits, allowing issuers to earn and pay rewards on backing assets is critical to ensuring a level playing field across like instruments.

Question 9 – What steps could Canada take in developing a framework to ensure effective international coordination in regulating stablecoins, while mitigating cross-border risks and fostering global financial innovation?

We encourage the Department to continue to engage with industry as it is doing in this Consultation Paper. While we also believe that the Department should work with global regulators to move towards regulatory harmonization, we also believe that regulatory engagement and soliciting feedback is an important way to hear what is *not* working in other jurisdictions from innovators and companies that run into obstacles.

Question 10 – How can a regulatory framework for stablecoins be designed to promote financial stability and maintain the integrity of the financial system?

In our view, stablecoin regulation can most effectively promote financial stability by ensuring 1:1 reserve backing. Stablecoins do not involve leverage (i.e., credit risk) or opacity (total amounts outstanding are fully observable on chain), which were the two biggest contributing factors to past financial crises, including the 2008 financial crisis. The absence of these factors means that traditional financial stability risks are less present in stablecoins than other financial instruments. In particular, there is no run risk if stablecoins holders have confidence that the stablecoin is redeemable at par at all times. We believe, therefore, that 1:1 reserve backing is of primary importance and that approaches contemplated by other jurisdictions (e.g., holding limits) are both not necessary and in some way counterproductive to the possibility that stablecoins can serve as a financial stability backstop.[4]

[4] See Coinbase Response on 2/12/24 to the UK Bank of England paper titled "Regulatory regime for systemic payment systems using stablecoins and related service providers": https://assets.ctfassets.net/c5bd0wqjc7v0/79eAgHAAjvCd8hSZ5WsoO9/dacc395835e1c25235f145d393cad21f/Coinbase_-_Feb_2024_Response_to_BoE_Systemic_Stablecoin_Discussion_Paper.pdf

Question 11 – Given concerns around illicit use of stablecoins, are there other measures that should be considered to help address this risk?

We believe it would be appropriate for the Department to apply existing financial crime measures to stablecoin issuers, as is contemplated by Table 1 of the Consultation Paper. We would encourage the Department, however, to consider that in certain circumstances, for example the redemption of regulated stablecoins, it should be justifiable to use simplified due diligence where risk is low - regulated stablecoins will, by their nature of being heavily regulated, be low risk assets. In short, there should be a payments-focused approach to KYC, rather than a crypto asset approach, to ensure a “same risk, same regulatory outcome” with payments.