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RE: Consultation Paper 21-402 Proposed Framework for Crypto-Asset Trading Platforms (the “Consultation Paper”)

National Digital Asset Exchange Inc. (“NDAX”) would like to thank the Canadian Securities Administrators and the Investment Industry Regulatory Organization of Canada (collectively the “Regulators”) for the opportunity to participate and provide feedback to the Consultation Paper. We look forward to collaborating with the Regulators to bring forward this new paradigm in the financial industry. For simplicity and clarity, we seek to include all crypto assets under the scope of our comments to the Consultation Paper. From day one, NDAX’s mission has been to bring more traditional financial frameworks to the crypto asset industry for the benefit and security of investors. NDAX has led the way in being the first Platform to establish a strong Canadian banking relationship; offering a frictionless experience for getting clients’ money in and out of crypto assets. Advanced trading tools, institutional-grade custody, and 24/7 live customer service are key

factors that set NDAX apart from its competitors. We take pride in our exceptional client service, data protection and security of assets.

Please find to follow our comments to the Consultation Paper.

1. Are there factors in addition to those noted above we should consider?

- a. Whether investors' fiat currencies are pooled together with those of other investors and with the assets of the Platform.
- b. How cold storage is protected? Who has access to cold storage? How many signatures are required to access it? Can one individual access it in the case of an emergency?
- c. If the Platform has insurance on its hot wallet.
- d. The resiliency of Business Continuity Plan, how often it is updated, and how extensively possible are issues covered.
- e. How is the hiring, selection and screening of new employees done? Do they all go through a police check and other available verification processes, to prevent the possibility of internal fraud?
- f. At this point, the majority of crypto asset trading is speculative. We encourage the Regulators to enforce rules across the board to keep a level playing field.
- g. Rule enforcement and prosecution in accordance with applicable law, to deter bad players from entering the market and violating the rules.

2. What best practices exist for Platforms to mitigate these risks? Are there any other substantial risks which we have not identified?

- a. There should be no abusive trading of any kind on Platforms. Such practices (i.e. "wash trading") have been used by many crypto asset trading platforms to enhance their Platform's popularity by creating artificial volumes.
- b. Registered exchanges should be held to a higher standard of diligence, including insurance and audits.
- c. Custody of crypto assets on Platforms has been a major issue of concern. With new developments in the space, it is now one of the major topics up for discussion. Protection and segregation of investors' crypto assets can be addressed through custodial services. NDAX was able to resolve this issue with the implementation of a secure storage system provided by world-renowned third-party service provider Ledger Vault. Ledger Vault provides multi-signature access and is deemed one of the most reliable solutions for crypto asset storage and safekeeping. Strong internal controls for custody need to be into place and clearly outlined in a Platform's Policies and Procedures manual (the "P&P").
- d. Processes, policies and procedures – strong internal controls need to be established with clear segregation of duties between departments. All processes must be clearly outlined in the P&P and regularly updated to reflect any changes in regulations or internal business structure.
- e. A Business Continuity Plan must be established, covering all issues that may arise and providing a clear and precise action plan in the case of an emergency. Unforeseen circumstances such as natural disasters should be outlined in detail, including an indication of an alternative workplace, call tree established, with roles and responsibilities assigned.
- f. All employees of the firm need to go through extensive background checks through a reliable third-party service provider.

- g. Investors' assets may be at risk in the event of a Platform's bankruptcy or insolvency – an issue that can be mitigated through full segregation of the Platform's operating capital and investors' assets. This can be addressed through the proper custody of crypto assets as well as a segregation of the Platform's and investors' fiat accounts.
- h. Investors may not have important information about the crypto assets that are available for trading on the Platform – Platforms should be responsible for providing “full, true and plain disclosure” about the assets that are trading on the platform, as well as trading volume and historical data.
- i. Investors may not have important information about the Platform's operations – all of the functions should be clearly outlined on the Platform's website. All fees should be disclosed to investors prior to the use of the Platform and should be fully disclosed when placing a trade.
- j. Investors may purchase products based on their independent research as no additional recommendations are provided by the trading platform – full risk disclosure should be provided to clients prior to executing a trade on the Platform. Risk disclosures should be published on the website, and the client should read and acknowledge it at the account opening stage. Service provided to the clients through crypto asset trading platforms is equivalent to the service currently provided by discount brokerages, where no assurance of suitability of the assets purchased is provided.
- k. Conflicts of interest may not be appropriately managed – strong internal policies and procedures to manage conflict of interest should be established. If the Platform acts as a principal to the trade fulfilling their market-making responsibility, such information should be disclosed at the account opening stage.
- l. Manipulative and deceptive trading may occur – proper internal controls should be put into place for monitoring trading activities regardless of the source. Automated brakers should be put in place to prevent manipulative and deceptive trading. All such functions must be regularly tested and monitored to ensure the adequacy and efficiency of the systems.
- m. There may not be transparency of order and trade information – the Platform should show the most up to date order book for every trading pair available for purchase and sale. An order book must show the current price and the quantity offered at that price. Additional statistics should be shown on the trading platform, such as the last price, 24H change, 24H volume, 24H high, 24H low and buy and sell volume.
- n. System resiliency, integrity and security controls may be inadequate - resiliency of the trading platform must be frequently tested. A dedicated technical team should be testing the trading platform regularly for the adequacy of security controls and vulnerabilities. Cybersecurity risks must be taken very seriously and fully understood by the technical team behind the platform. Strong safeguards against risks are of utmost importance.
- o. To prevent unauthorized access and protect participants' confidential information, access to such information should be limited internally and given only to employees required to have such access to adequately perform their duties. Two-factor identification (2FA) should also be enabled in all programs, used in day to day operations where that program permits. Additionally, it is important to select third-party service providers with careful due diligence, ensuring their cybersecurity policies and procedures are in line with that company's standards.
- p. Above all, any Platform dealing in crypto assets, cryptocurrencies or crypto tokens of any kind should be subject to the same or similar requirements as existing regulated securities dealers and marketplaces. This allows for certainty to both investors and businesses.

3. *Are there any global approaches to regulating Platforms that would be appropriate to be considered in Canada?*

The proposed regulations in the United States and guidance that were issued by the US Securities and Exchange Commission are most relevant to the way the Canadian market operates and could be used as guidance for new regulations in Canada.

In the new and rapidly changing environment of crypto assets, crypto asset trading Platforms are becoming a very popular and easy way for investors to buy and sell crypto assets. Investors prefer to utilize Platforms over crypto ATMs as they provide greater transparency, convenience, and lower fees. Regardless of one's location, a participant can visit multiple marketplaces, compare trading options, pricing and volumes available to make decisions suitable for them. With no regulatory guidance in place, however, Canadians can easily be taken advantage of. Several fraudulent exchanges operate in the space and, with hundreds of millions of dollars lost in the last few years, it's time for crypto asset regulation that will not stifle innovation.

With people around the world utilizing crypto assets for buying and selling goods online, transferring money to relatives overseas, or simply for general investing purposes, it is evident cryptocurrency is here to stay. As numerous companies have begun to choose Initial Coin Offerings (ICOs) over more traditional ways of fundraising, there is a burgeoning market for crypto assets, and new regulations are needed.

Crypto asset trading platforms provide a marketplace for listing, buying and selling crypto assets. This may lead to listing ICOs and helping new companies enter the market. Crypto asset trading platforms register their clients and perform their due diligence through the client onboarding process, fulfilling the role of a dealer. Platforms normally do not perform suitability assessments, as they operate in the same way as a discount brokerage and not a full-service brokerage. Also, the majority of Platforms provide crypto asset storage solutions to their clients, acting as a custodian for crypto assets. Based on the hybrid functions that crypto asset trading platforms perform, they likely fall into more than one category such as Alternative Trading System (ATS), Exchange, Discount Brokerage, and in some cases, Custodian.

You can also refer to the sandbox implemented in Switzerland referenced in the following links

<https://www.news.admin.ch/news/message/attachments/55153.pdf>

<https://www.finma.ch/en/authorisation/fintech/>

<https://switzerlandblog.ey.com/2019/03/15/updates-on-the-swiss-fintech-license-and-sandbox/>

4. *What standards should a Platform adopt to mitigate the risks related to safeguarding investors' assets? Please explain and provide examples both for Platforms that have their custody systems and for Platforms that use third-party custodians to safeguard their participants' assets.*

All clients trading on a crypto asset trading platform should have Direct Electronic Access to such Platform. Before receiving such access, all clients should read and acknowledge the terms of the Platform's User Agreement, Privacy Policy, Risk Disclosure and provide essential information to satisfy KYC requirements.

It is critical that Platforms have strict internal controls and automated braker systems, as the trading is done on a twenty-four hours a day, seven days a week basis; requiring robust automated system monitoring.

The industry is still evolving, and major industry players are collaborating to determine the most secure practices to safeguard investors' assets. The digital nature of assets makes them susceptible to cybersecurity threats. NDAX recommends at least 95% to 98% of crypto assets stored in cold wallets that are air-gapped and have multi-signature authority. Best practices for managing hot wallets governed by agreed-upon policies and procedures should be uniquely tailored to crypto assets under a broker-dealer license.

5. *Other than the issuance of Type I and Type II SOC 2 Reports, are there alternative ways in which auditors or other parties can assure regulators that a Platform has controls in place to ensure that investors' crypto-assets exist and are appropriately segregated and protected and that transactions with to those assets are verifiable?*

Independent third-party audits could be sufficient to ensure that investors' crypto assets exist and are appropriately segregated and protected. Another approach would be to provide periodic proof-of-reserve.

6. *Are there challenges associated with a Platform being structured to make actual delivery of crypto assets to a participant's wallet? What are the benefits to participants, if any, of the Platforms, holding or storing crypto assets on their behalf?*

There are no direct challenges associated with a Platform making actual delivery of crypto assets to a participant's wallet. Centralized platforms need to act as a custodian to participants' funds briefly to ensure the execution of the trade. Another reason for a Platform to temporarily hold customer funds is to comply with FINTRAC's regulatory framework and monitor for money laundering, terrorist activity financing and fraud prevention. Once these conditions are met, a Platform can deliver assets quickly to participants' wallets. Benefits to participants keeping assets on a Platform include easily accessible crypto assets for trading, no requirement to pay withdrawal or mining fees upon delivery to a private wallet, the convenience of not having to worry about custody of their assets, and the challenges associated with misplacing private wallet keys, theft, etc.

7. *What factors should be considered in determining a fair price for crypto assets?*

Generally, the free market will determine fair pricing for crypto assets. However, the market cannot be hindered by manipulation to do so. Some Platforms have invested in security and systems, creating appropriate liquidity to mimic current regulatory standards as near possible and, therefore, should be looked upon with more favourable regulatory standards.

8. *Are there reliable pricing sources that could be used by Platforms to determine a fair price, and for regulators to assess whether Platforms have complied with fair pricing requirements? What factors should be used to determine whether a pricing source is reliable?*

Major financial data feeds such as Bloomberg, NASDAQ and others have been utilizing the services of financial services providers to disseminate information on crypto assets. These indices may be a good place to start. As the industry evolves and liquidity increases, we expect the markets and its participants will dictate fair pricing.

9. *Is it appropriate for Platforms to set rules and monitor trading activities on their marketplace? If so, under which circumstances should this be permitted?*

Until such time that appropriate marketplace surveillance is available, Platforms will need to be trusted to monitor their activities and should employ well-trained and highly qualified compliance and operations personnel to assist in doing so.

10. *Which market integrity requirements should apply to trade on Platforms? Please provide specific examples.*

Platforms should abide by integrity requirements set similar to traditional markets. Platforms should have policies and procedures towards abusive trading, short selling, best execution, trading in the marketplace, and others based on each Platform's offering.

11. *Are there best practices or effective surveillance tools for conducting crypto asset market surveillance? Specifically, are there any skills, tools or special regulatory powers needed to effectively conduct surveillance of crypto asset trading?*

We believe that there are no crypto asset market surveillance tools currently developed that can adequately perform market surveillance, supervision and oversight. The industry is changing rapidly, and several widely used equity marketplace surveillance providers may expand their offerings to the crypto space.

12. *Are there other risks specific to trading of crypto assets that require different forms of surveillance than those used for marketplaces trading traditional securities?*

Most surveillance tools currently used for traditional marketplaces are tailored to securities trading and contain the core functionalities that should be sufficient to monitor the crypto assets industry. Additionally, Platforms should be mandated to adopt blockchain forensic tools to monitor for money laundering, terrorist financing, and other criminal activities.

13. *Under which circumstances should an exemption from the requirement to provide an ISR by the Platform be appropriate? What services should be included/excluded from the scope of the ISR? Please explain.*

All platforms should be subject to an ISR, with some exemptions. The crypto market is relatively new, and so are the Platforms. The Platforms will require a transitional period to work with regulators, auditors, and their technology to meet the ISR standards.

14. *Is there disclosure specific to trades between a Platform and its participants that Platforms should make to their participants?*

Disclosure specific to trades between a platform and its participants should be made during the account opening process and not on a trade by trade basis. The Canadian market has extremely low liquidity, and platform acting partially as a counterparty to the trade is almost always granted. The combination of being a market dealer registrant, complying with the fair pricing model, and providing full disclosure during the account opening stage should be considered satisfactory.

15. *Are there particular conflicts of interest that Platforms may not be able to manage appropriately given current business models? If so, how can business models be changed to manage such conflicts appropriately?*

Yes, promoting certain coins above others and being both a broker-dealer and a marketplace would be viewed as a conflict of interest as measured by traditional standards. Such conflicts can be easily managed by full segregation of departments and responsibilities, effectively creating a “Chinese Wall” where required.

16. *What type of insurance coverage (e.g. theft, hot-wallet, cold-wallet) should a Platform be required to obtain? Please explain.*

Insurance coverage for loss of crypto assets through theft, fraud, and hot wallets threats should be governed by the business limited insurance policy. Having strong internal governance will dictate the Platform’s ability to manage risk and determine the level of insurance coverage. Mandating cold storage solutions to have a minimum of 95% of the total assets, third-party audit reports and strict access policy should allow for lower insurance requirements.

17. *Are there specific difficulties with obtaining insurance coverage? Please explain.*

Yes, there are a lot of challenges surrounding insurance coverage for crypto assets. The crypto marketplace is still evolving and there is a limited number of insurance providers who are willing to provide insurance coverage to crypto asset trading platforms. These insurance providers can dictate

higher premiums, which prevent most of the Platforms to obtain coverage. We urge regulators to work with platforms to create a framework that reduces risks and protects the client's and Platforms' assets.

18. *Are there alternative measures that address investor protection that could be considered that are equivalent to insurance coverage?*

The Canadian Investor Protection Fund (CIPF) would apply if a Platform became registered with IIROC. As an alternative, the platform could adopt the Binance platform model by using a percentage of trading fees towards a self-insurance policy, which proved to be successful in their latest cyber attack.

19. *Are there other models of clearing and settling crypto assets that are traded on Platforms? What risks are introduced as a result of these models?*

There are currently no models of clearing and settling crypto assets traded on Platforms. Crypto asset platforms are unique in such a way that Platforms generally act as both the facilitator between counterparties and the custodian for their funds. Platforms typically maintain an internal ledger that audits and maintains a record of all transactions that occur between parties, while the Blockchain acts as an open distributed ledger that can be used to audit transactions in & out of the Platform. NDAX understands the risks associated with Platforms maintaining internal ledgers and therefore propose that Platforms be required to register as a broker-dealer with designated securities regulators where they are obligated to produce audited policies and procedures to accurately handle clearing and settlement of the Platform's internal ledger. The Blockchain will then act as the public validator by providing the records of deposits and withdrawals.

20. *What, if any, significant differences in risks exist between the traditional model of clearing and settlement and the decentralized model? Please explain how these different risks could be mitigated.*

Having a hybrid model where the Blockchain, along with the Platform's policies and procedures maintain their internal ledger, should be sufficient to address the risk associated with not having third-party clearing and settlement house. Additionally, please see the response to Q19.

21. *What other risks could be associated with clearing and settlement models that are not identified here?*

Ultimately, there are no designated regulatory body monitoring transactions. Please see responses to Q19 and Q20.

22. *What regulatory requirements (summarized at Appendices B, C, and D), both at the CSA and IIROC level, should apply to Platforms or should be modified for Platforms? Please provide specific examples and the rationale.*

1. Exemption for clearing and settlement house as justified in the response above – Q19 and Q20
2. Exemption from third-party custody
3. Broker-dealer license with exemption to the listing and issuance of securities requirements

We appreciate the opportunity to provide feedback to the Canadian Regulators and look forward to hearing recommendations from the industry. Investor protection, security and certainty are of utmost importance to the NDAX team. Should you have any questions or require further feedback, please do not hesitate to contact us for additional information.