

# Stability and security: the CSA's characterization of stablecoins

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On February 22, 2023, the Canadian Securities Administrators (CSA) published Staff Notice 21-332, *Crypto Asset Trading Platforms: Pre-Registration Undertakings—Changes to Enhance Canadian Investor Protection*, in which the CSA shared its views on the characterization of stablecoins and outlined its requirements for crypto asset trading platforms trading in crypto contracts for stablecoins.

## What you need to know

- CSA staff are of the view that asset backed stablecoins generally meet the definition of “security” and/or would meet the definition of “derivative” in several Canadian jurisdictions.
- Crypto asset trading platforms are not permitted to trade crypto contracts for stablecoins without the prior written consent of the CSA and are required to conduct sufficient due diligence to address the applicable risks of such stablecoins.
- The CSA does not expect to consent to platforms trading crypto contracts for algorithmic stablecoins—stablecoins that are not fully backed by an appropriate asset reserve but rather maintain their peg through an algorithm.

## Background: the illusion of stability

A stablecoin is a crypto asset that is designed to function the way its name suggests—by maintaining a stable value relative to an underlying asset. However, the crash in 2022 of terraUSD (an algorithmic stablecoin issued by the Terra Network, which was supposed to maintain a peg to US\$1) showed the crypto community and regulators worldwide that, in certain situations, stablecoins are neither as stable nor as risk-free as the fiat currencies to which they are purportedly pegged.

## The CSA's characterization of stablecoins

The CSA in SN 21-332 acknowledges, that stablecoins, which it refers to as “value-referenced crypto assets”, experience volatility and notes that there have been several instances where stablecoins did not maintain their peg on trading platforms. Whether a particular stablecoin is a security and/or derivative will depend on the specific facts and circumstances of the stablecoin. In SN 21-332, CSA staff note that they are of the view that fiat-backed

stablecoins generally meet the definition of security and/or derivative. Moreover, CSA staff indicate that they would consider stablecoins backed by assets other than fiat currency (such as gold or other crypto assets) to also be a security and/or derivative.

## Platforms supporting crypto contracts for stablecoins

The CSA in SN 21-332 requires platforms trading crypto contracts for a particular stablecoin to seek prior written consent from the CSA and conduct sufficient due diligence to address the applicable risks of that stablecoin, including ensuring that:

- the stablecoin is a fiat-backed crypto asset;
- Canadian distributions of the stablecoin are in compliance with Canadian securities laws;
- the stablecoin is fully backed by the underlying asset reserves with a market value at least equal to the value of the outstanding stablecoins at the end of each day;
- the underlying asset reserves are highly liquid assets such as cash or cash equivalents;
- the underlying asset reserves are held by a qualified custodian in favour of the stablecoin holders;
- the underlying asset reserves are segregated from assets of the issuer of the stablecoin and each class of crypto asset issued by the issuer of the stablecoin;
- the underlying asset reserves are subject to publicly accessible monthly attestations and an annual audit from an independent auditor;
- the redemption rights of the stablecoin holder against the issuer of the stablecoin are clearly articulated and publicly disclosed;
- the issuer of the stablecoin has a plan of recovery and/or orderly wind-down in case of a crisis or failure;
- the issuer of the stablecoin maintains effective governance practices;
- key accurate information about the stablecoin is publicly available in plain and non-technical language; and
- the platform is permitted by the CSA to trade crypto contracts in respect of the particular stablecoin.

## What's next?

SN 21-332 clarifies the CSA's view that most stablecoins fall within the purview of Canadian securities regulators. It will be interesting to see how the CSA further develops the regulatory approach to the issuance and distribution of stablecoins and regulates platforms that trade crypto contracts for such instruments.

*To discuss these issues, please contact the author(s).*

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