

INVESTMENT IN DIGITAL CURRENCIES

An insured institution with an investment in digital currencies is considered to be in material non-compliance with DICO's By-Law No.5 – Standards of Sound Business and Financial Practices

Background

Digital currencies are electronically created and stored mediums of exchange where the unit of value is defined by software codes. Digital currencies enable users to trade among themselves. Though attracting increased attention from investors, they are not considered legal tender in Canada¹. Examples of digital currency include Peer Coin, LiteCoin, Ripple and Bitcoin, which is currently the most widely traded.

The Government of Canada's 2014 Budget document includes plans to change anti-money laundering and anti-terrorist financing regulations for virtual currencies such as Bitcoin.

Risks to the Credit Union

Digital currencies do not offer any consumer protection as they are not regulated. They cannot be deposited in a bank and are not protected by any deposit insurance scheme or backstopped by a reserve.

The value of digital currencies is highly volatile as it is determined by demand and, as such, an investment is considered to be highly speculative.

Increased incidents of theft and fraud are being reported as Bitcoin has appreciated in value. As a result of user anonymity, accidental deletion of digital wallets (used to house digital currencies online) results in permanent loss and, once completed, a transaction is irreversible.

Credit unions should also be cautious of members operating brokerages, trading, or accepting payments in digital currencies as they currently operate in a legal and regulatory grey zone. Owing to anonymity of digital currency transactions among users and in the exchanges, digital currencies can result in circumventing regulations intended to prevent money laundering and tax avoidance.

¹ Section 8 of the Currency Act defines "legal tender" as the coins and notes issued by the Bank of Canada pursuant to the Bank of Canada Act intended for circulation in Canada.

Major financial institutions have refused to provide banking services to digital currency brokerages and to individuals dealing in digital currencies due to the associated potential risks. For this reason any credit union that has chosen to provide services to members dealing in digital currencies must have a comprehensive and robust anti-money laundering and compliance regime in place.

An institution that has made an investment in a digital currency is considered to be in material non-compliance with DICO By-law No. 5 – Standards of Sound Business and Financial Practices with respect to Market and Operational Risk Management practices. In addition, as digital currencies are similar to a commodity, the credit union may be in breach of subsections 60(3) and 61(3) of Ontario Regulation 237/09.

DICO's Expectations

Investments in Digital Currencies

Any credit union currently holding an investment in digital currencies must notify its DICO Regional Manager. The credit union will be expected to develop a plan and timeline for divesting itself of the investment.

Providing Banking Services to Individuals & Businesses Dealing in Digital Currencies

DICO has the following expectations of credit unions or caisses populaires that provide banking services to members operating digital currency brokerages, trading in digital currencies, or accepting payments in digital currencies:

- A comprehensive risk assessment process should be in place to identify and monitor high risk clients.
- Increased scrutiny of the activity of these accounts is required as they are considered extremely high risk.

At a minimum, for an individual or business that trades or accepts payments in digital currencies, credit unions are expected to:

- Conduct background checks of account principals (financial and criminal/terrorist);
- Obtain business and financial references;
- Determine the scope and size of operations, including client base and nature of material transactions;
- Provide appropriate reporting to the Board.

Should you have any questions regarding this matter, please contact your Regional Manager.

Please note: The Royal Canadian Mint is currently testing its own digital currency “MintChip” for use in small everyday transactions. This advisory would not apply to MintChip should it ultimately be introduced.

Legislative Reference

Ontario Regulation 237/09

Investment in commodities

60. (3) A class 1 credit union shall not make a direct investment in, or purchase of, any commodity, including metals, food and grain, that trades on a commodity exchange.

61. (3) A class 2 credit union shall not make a direct investment in, or purchase of, any commodity, including metals, food and grain, that trades on a commodity exchange.