Mastering Money Podcast

Season 9 – Dark side of money

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S9 E02: Cryptocurrency Scams – The Digital Deception

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DORETTA THOMPSON

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Hi. You're listening to Mastering Money where we explore the many aspects of good financial decision making. I'm Doretta Thompson, Financial Literacy Leader for Chartered Professional Accountants of Canada. We provide no-cost programs and free online resources that help Canadians own their finances and learn the language of money.

This season, we're looking at the dark side of money. We'll be diving into hot-button topics like how romance scams target vulnerable people, how we can protect ourselves and deal with the aftermath of robbery with the sharp increase in street crimes, to the fraudulent property sales that jeopardize our homes.

In our episode today, we'll be discussing an increasingly prevalent issue, the cryptocurrency scams. With the growing popularity of cryptocurrencies, the risk of falling victim to scams in this digital realm is higher than ever, so we're going to shed some light on how we can navigate the digital landscape securely and explore the financial consequences for unsuspecting actions.

And my guests today are from the Ontario Securities Commission. So who better to help us explore the cryptocurrency landscape? We've got Charlie Pettypiece, Senior Investigation Counsel, and Dena Staikos, who's the Manager in the Compliance and Registrant Regulation Branch of OSC. Charlie and Dena, welcome to Mastering Money.

CHARLIE PETTYPIECE

00:01:38.12

Thank you.

DENA STAIKOS

00:01:38.76

Thanks for having us.

DORETTA THOMPSON

00:01:40.23

So Dena, let's start with you. Would you like to take just a minute and tell us a little bit about you and what you do at OSC and why this is important to you?

DENA STAIKOS

00:01:50.32

Well, I've been with the Ontario Securities Commission for almost 17 years. And as you noted, I'm a Manager in the Compliance and Registrant Regulation Branch, which we call CRR for short. Our branch is responsible for the registration as well as oversight of firms that are in the business of advising and trading in securities here in Ontario. So in short, what that means is anyone that wants to participate in capital markets, we bring them in, we register them, and then we conduct compliance reviews to oversee them as they engage with retail investors.

And so recently, our CRR developed a new team, which is called the Specialized Dealer Team. I'm the manager of that team. And we focus on cryptoasset trading platforms. It's a new space. It's evolving. Definitely keeping us on our toes, and we're finding it very interesting.

DORETTA THOMPSON

00:02:44.90

Oh, wonderful. So you are absolutely the kind of expertise we need here to help us understand this landscape. And Charlie, tell us what your role is.

CHARLIE PETTYPIECE

00:02:54.23

Yeah, thanks. I'm Charlie Pettypiece. I'm Senior Investigation Counsel in the Enforcement Branch of the Ontario Securities Commission. Relatively new addition to the Commission. I've been here for about five years, most of that in the Enforcement Branch and in a couple different roles.

I started as a litigation counsel, which is more of the OSC equivalent of a prosecutor except we appear before a tribunal instead of the courts. And subsequent to that, I've moved more into the investigation space, which means I focus more naturally on the investigation stage of matters. And what the Enforcement Branch does more broadly is investigate and prosecute breaches or violations of the Ontario Securities Act.

DORETTA THOMPSON

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Well, it sounds like we've got a lot of expertise to draw on because I am going to start you right back at the very basics to help our listeners understand what exactly is crypto. Because we hear these words thrown around all the time, exchanges and wallets and all that stuff. Charlie, do you want to give us a crypto 101? What exactly is it?

DENA STAIKOS

00:04:03.69

Sure. Yeah, I'll do my best. And I'll do the usual lawyer thing and qualify everything I say by telling you I'm not an expert in crypto, but it is — become more and more a part of my role here at the OSC. And I don't have a computer science background, although I lean pretty heavily on the people here that do.

So just with that qualifier out of the way, I think crypto more broadly, at least in how we describe it at the OSC, we refer to, I guess, what we would call cryptoassets, which is an extremely broad term that we define as all digital assets that use cryptography. And of course, that's not the most helpful definition to anyone because I've just defined something with two other words that you don't know or that need defining themselves.

So digital assets is an even broader category. It's basically anything that's digital that has some sort of value. And cryptography is just a way of securing data using encryption. So you match those two things together, and you get digital things that are secured with encryption. And that's what we consider to be cryptoassets.

So really, what we do is we focus on how these things are used. So how they're bought, traded, why people are purchasing them, what representations are being made about these crypto things. And we go from there and decide whether we classify them as being something that falls within our jurisdiction.

DORETTA THOMPSON

00:05:32.56

So Dena, I wonder if you would help us get a little deeper into what that means. As I understand it and from what Charlie said, cryptocurrency is not money the way that we think of money. It's digital assets that there is a kind of record that's kept, and the idea is that it exchanges hands directly without the intermediary of banks, et cetera.

The idea is that you have sort of person-to-person transactions, and what you own is not money, per se, but sort of a key to certain assets that are kept in a wallet. And that then you have the ability to release so much of that with your key, and that's how the transaction takes place. Is that kind of how it works?

CHARLIE PETTYPIECE

00:06:18.27

Yeah. No, no, that's exactly it. And there's definitely intermediaries involved. And that's where we step in, and that's where we get involved to register these CTPs, Cryptoasset Trading Platforms. I'll refer to them as CTPs for short.

And so one thing is a lot of people say is not your key, not your crypto. So essentially, what that means is if I don't have it in my wallet, as you said earlier, it doesn't necessarily mean that it's in my possession. So you could have the cryptoasset trading platform, holding it on your behalf.

DORETTA THOMPSON

00:06:54.71

And then the most famous cryptocurrency is Bitcoin. Is that right? That's the name that people kind of know?

DENA STAIKOS

00:07:01.25

Yeah, I think that's the most prominent Bitcoin out there. I don't have the stats in front of me. I don't know, Charlie, if you have the information on that, but that's definitely the more leading crypto out there.

CHARLIE PETTYPIECE

00:07:11.30

Yeah. I just happened before this podcast today to look up the market, or what we would call the market cap of Bitcoin, and it's somewhere north of $880 billion. LAUGHS And so US dollar equivalent of about $880 billion. So it's a very prominent asset in the crypto community.

And maybe I can also expand a little bit on my very broad definition of what a cryptoasset is, just kind of following on your questions. And Dena touched on the importance of keys in respect of crypto.

And one analogy I've always liked to use is just looking at these digital wallets and keys as a bank account, you know? So crypto is held in digital wallets, which is essentially like a bank account that's encoded through a computer network. So kind of like a bank account in traditional banks. Your account's not really at a physical location or at a particular branch. It can be accessed from almost anywhere in the world and through a bunch of networks that connect banks and ATMs.

And the way you access your digital wallet that holds your crypto is through keys. So there's a concept of a public key and a private key. And your public key is sort of like your bank account number where there's some sensitivity to bank account number, of course. You don't just publish it everywhere and let everyone know what your bank account number is.

But you know, your bank account number alone doesn't give people access to your funds, but it does allow people to send you money. So you might give your employer your account number so that they can give you your employment income.

The other side of that is your private key. So your private key is kind of like your PIN code or your password to your bank account or to your crypto wallet, in this case, which you obviously keep secret as you would your PIN code, and you might only give it to people you trust. And that's what allows movement of funds out of your account or out of your crypto wallet. So that's usually an analogy I like to keep in mind when I'm thinking about how to make sense of these keys and what they hold and as it applies to the digital wallet.

DORETTA THOMPSON

00:09:25.94

That's helpful, actually, because we understand how bank accounts work. But what I'd like to know, why are people excited about these? Like, Dena, what is it about crypto that attracts people? Why is it an exciting thing? Does the monetary system not work? What is it that is magical about crypto?

DENA STAIKOS

00:09:44.63

It's a great question. This past weekend I was with friends, and it just — you know, started to ask some questions. What is it that excites you about crypto? Just to get a sense.

And we have some information as well just through our reviews, and so forth. And there's many reasons why people get excited about it, one of which is financial incentives. This includes — there's contests out there that give away tokens. They give away crypto, give away NFTs, and having access to free content and more. So it makes it much more attractive.

And a large part of the excitement is the community hype. So being part of a community that's dedicated to the buying, selling, and trading of cryptoassets, tokens, and NFTs.

There's also the kind of get rich quick schemes which may lead people to buying crypto without conducting due diligence. So someone might feel pressured into investing in speculative and high-volatile assets, especially when they're not feeling financially secure. They're getting close to retirement and they feel they don't have enough money saved up. So there's potential for high returns when it comes to crypto, and so they're looking to get more saved up for their retirement.

But you see it on the other end where there has been a lot of returns for some early investors in, let's say, Bitcoin. But we've also seen it on the other side where because it's volatile, there have been a lot of losses as well.

So recently, actually, our Investor Office published a 2023 cryptoasset survey. And in there, it talked a little bit about, why do people get involved with crypto? And according to the survey, the most common reason people gave for buying crypto continues to be a speculative investment or gambling, which is about 28% is what the respondents had said. So for 2022 as well as '23.

DORETTA THOMPSON

00:11:40.50

So fear of missing out's the big component of why people do this.

DENA STAIKOS

00:11:43.89

Absolutely, yes. Yeah.

DORETTA THOMPSON

00:11:46.29

And don't want to sound totally cynical or anything, but is there a use for crypto beyond creating something that then gets bought and sold and the money is just on that speculation? Like, is it actually useful?

DENA STAIKOS

00:12:01.33

I think there's definitely cases out there where people do use it to purchase and use it as a commodity versus speculative reasons. But I think the vast majority are using it for that gambling, speculative-type nature.

DORETTA THOMPSON

00:12:16.72

And Charlie, from your perspective, does that make sense?

CHARLIE PETTYPIECE

00:12:19.96

Yeah. I mean, there's a lot of different type of cryptoassets, so it's hard to talk about them all in a single way. Some crypto is created for the purpose of specific uses. So Dena touched on this a little bit. Some are used as a currency. So they're exchanged for goods or services and that's how they're perceived, and that might have been the purpose for which they were created.

There's other cryptoassets or tokens that some call utility tokens. So holding this particular asset actually gives you the ability to do something on a particular platform, whether you can vote on a particular thing, or get access to a website, or get certain discounts on services. So there's kind of a use component to holding that. And some companies will do that for promotional purposes or other purposes.

So there's lots of different cryptoassets out there. Some are commonly known as stablecoins. They're intended to be backed by assets, and they peg or try and reference their value to traditional currencies. And in that way, they try and replicate how Canadian dollars function as a currency. So there's lots of different types of assets out there, and so your explanation or your justification for why they exist other than speculation can take many different forms.

DORETTA THOMPSON

00:13:49.37

So what are some of the other kinds of cryptoassets are there?

CHARLIE PETTYPIECE

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Well, I mentioned a few of them. And again, none of these terms — these terms are kind of thrown around loosely. They're not technical definitions. So you might hear people use the word cryptocurrency or utility token or stock token or stablecoin, and there's no agreed upon necessarily definitions to what these things are.

And they're not mutually exclusive, so something could be both, right? Something could function like a currency, but also be speculative. And I think we talked about Bitcoin a little bit earlier. We saw a lot of that with Bitcoin where some people will buy it because they think it's going to go up in value and incorporate it into their portfolio, whereas some businesses will actually accept Bitcoin as a form of payment. So in that sense, it functions more as a currency. So there's different types.

One thing I haven't mentioned yet is NFTs, which are their own world of crypto. And the defining feature or what's sort of touted as being the defining feature of NFTs is that they're not fungible. So things like Bitcoin or just like a US dollar, one US dollar is no different from any other US dollar, and one Bitcoin's no different from another Bitcoin. They're fungible.

These NFTs or Non-Fungible Tokens are exactly that. They're supposed to be not fungible, unique, and have been used to kind of represent ownership of pieces of artwork or digital, other real-world assets. It's a large kind of gray area of crypto, at least in my opinion.

DORETTA THOMPSON

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I think that those kinds of insights maybe will help us sort of anchor our conversation. My kind of key takeaway is it's complex. It is actually something that is changing constantly. So it's kind of slippery in a way to understand what it is and why it is and how it works.

CHARLIE PETTYPIECE

00:15:51.76

Yeah, I would agree with that. And there is — when you're talking about crypto scams — and we might get into more about that later — there's almost a benefit to the confusion around crypto and the opacity of how these things actually work, what the value proposition is. And you can kind of, in a sense, pull the wool over an investor's eyes by just bombarding them with confusing technical explanations as to what's going on, what's underlying these tokens, and what the promises of future value are. So the confusing nature of these assets is to some a feature, not a bug.

DORETTA THOMPSON

00:16:31.73

I was listening to a podcast recently that was doing an analysis of the trial of Sam Bankman-Fried. And one of his sort of key things was he managed to convince people that he was just the smartest person you have ever met. And if he says this is a good thing, you have that whole sort of fear of missing out, and that maybe you're just not smart enough to understand what's going on. And so you don't want anybody to know that, so you go along. It's kind of a crazy thing, right?

So Dena, as I understood it originally, the idea of cryptocurrency was supposed to be to get rid of all these intermediaries and stuff, and that it was supposed to be secret and private and all of that. And here you are at the Ontario Securities Commission, regulating cryptocurrency. So can you give us a little bit of insight into, what does it mean to regulate crypto? And what are we trying to do? And why are we trying to do it?

DENA STAIKOS

00:17:30.80

As a CSA — so in Canada, we have the provincial regulators which we refer to as the CSA — we regulate firms that trade in cryptoassets. And in some cases, cryptoassets themselves. So regulating these CTPs is crucial, given the important role that they play, as you said, as intermediaries. And they're the ones that are involved with retail investors on a daily basis.

So back in — it's been almost three years — March 29, 2021, the CSA along with the IIROC jointly published a staff notice, and it provided guidance for CTPs which outlined compliance with regulatory requirements. And so really, what this guidance did was provide a roadmap, essentially, for how securities legislation applies to firms trading in cryptoassets. There was no new rules in this. It was just really tailoring the existing requirements to address the risks that are being raised by the firm's activities.

So what does this all mean? Well, once the firm is regulated and once we have registered them, there are certain rules that they need to follow, which includes many investor protection components to help protect investors. And although it's not guaranteed to prevent everything, the protections do provide those guardrails or safeguards.

So as part of the registration process, what we do — and you kind of touched on it a little bit about the podcast — we do our best to verify whether the individuals have the right proficiency. Do they have the right work experience? Are they individuals that are involved with this firm? Do they have integrity, or are they known criminals?

We also look at the solvency of the firm. Once investors are putting money into this firm, we want to make sure that they're not going to close up shop the next day because they don't have the financial means or that there's no motivation to steal other people's money.

So we really do look under the hood as part of our registration process to understand the firm's business, their firm's systems, their policies and procedures. And once they're registered, as I mentioned earlier, we do have investor protections in place.

And one thing that we do do within our branch is we go out and conduct compliance reviews. So after a certain period of time, we will go to the firm, look at their books and records, and see whether or not they're complying with securities laws.

DORETTA THOMPSON

00:19:53.79

And of course, we have our own crypto disaster story here in Canada with Quadriga, which is a scary kind of thing. If those controls had been in place, would you have caught that?

DENA STAIKOS

00:20:05.43

It's hard to say, but I think knowing what we do know about Quadriga, there are certain elements that were not in place that we have put in place, requirements for our CTPs and even post-FTX. We took our learnings from FTX and applied that for our CTPs going forward.

And you know, I'm sure I'll touch on it shortly, but it's having a segregation of the firm's assets. So making sure they're not co-mingling their assets with investor assets. Having a third-party custodian in place to ensure that there's protections of client assets, and so forth.

So I mean, we could get into the whole details of it, but I think there's certain protections that we would have had in place that would have hopefully helped prevent Quadriga. But as I said earlier, nothing is guaranteed. But we can try and at least put those measures in place to minimize any wrongdoing.

DORETTA THOMPSON

00:21:03.24

We've talked about what it is and how we're trying to protect investors in these assets. Charlie, how do people go about investing in crypto? What does that look like?

CHARLIE PETTYPIECE

00:21:16.35

Yeah, I mean, there's a few different avenues, and one we've touched on already. Well, actually, we've touched on two a little bit already. I talked a little bit about digital wallets. And digital wallets are one way you can just hold a cryptoasset directly. So you could transfer it from an exchange and hold it in your own wallet with your own private key, and that's holding a piece of crypto, self-custodying in a way.

And that's one way to invest in these assets, but I think it's a very, very rare occurrence that anyone would do this. The most prominent way that people invest in cryptoassets, I would guess, is through the cryptoasset trading platforms that we've been discussing, and which are the subject of a big push for registration under Ontario securities laws and Canadian securities laws.

So the difference — and we've touched on this, and we'll keep coming back to this issue of custody. But the difference in these platforms is that you as a user of the platform or an investor, you don't actually have custody of the crypto that you're buying. The platform often does.

And if it's an unregistered platform, the platform has control of those assets, and there might not be a lot of transparency as to what the platform is doing on the back end. It's a bit of a black box as to how user deposits and user assets are being used, which, again, has led to some of the issues that we've already discussed with Quadriga and FTX. So those are two ways to get into the crypto space, so to speak, is buy cryptoassets and get them in your own wallets. You can go on a CTP or crypto trading platform and buy them on there.

There are other ways to get exposure to the crypto markets, though. There are funds that have been registered and approved in Canada, which trade on traditional stock exchanges. And their assets hold things like Bitcoin or Ethereum. And holding those traditional financial instruments is another way to get access to the crypto space.

And of course, there's companies that operate in the world of crypto and blockchain technology. And investing in those companies, again, through traditional exchanges and securities, is another way to get involved in crypto without dipping your toe into the cryptoasset platform world.

DORETTA THOMPSON

00:23:41.88

So is this just kind of a way of packaging different kinds of crypto to sell? Is that what they do?

CHARLIE PETTYPIECE

00:23:50.45

Yeah, I guess there's a lot of different ways to take cryptoassets and package them. And you might be asking a slightly different question, but it leads me to another area, which is, you can take something like Bitcoin, which we've talked about, and which is treated for all intents and purposes as more of a commodity that doesn't have a particular function. It's just something that people will buy and sell in the markets.

But there are different ways to package Bitcoin that can turn it into a security in the view of regulators. There are futures contracts that can be executed around Bitcoin where you're essentially betting on the future price, whether it's a rise or fall. And you can introduce leverage into that scenario where you're essentially borrowing money from a crypto platform in order to make a bet on the future price of Bitcoin.

And when you start to sort of package cryptoassets in this way, they very obviously fall under the jurisdiction of securities regulators, and not only resemble securities, but also more traditional derivatives. And regulators understandably get more concerned in those scenarios too because it really elevates the risk because when you start borrowing money from an unregistered platform to make a speculative bet on the future price of a cryptoasset, you're really amplifying your chances of losing your money.

So yeah, there's a lot of different ways to package these assets. And the analysis from a legal perspective — and obviously, we're not providing legal advice here. But the analysis from a legal perspective really changes depending on how they're sold.

DORETTA THOMPSON

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So I think I understand how people can go about investing. And I guess, Dena, that's really where the regulatory role comes in because even if you can't touch whatever these assets are themselves, you can regulate the process through which they are bought and sold. Is that the idea?

DENA STAIKOS

00:25:52.26

That's exactly right. So the Commission gets involved with CTPs that facilitate the trading of the contracts involved in cryptoassets. And I think Charlie alluded to this earlier. And essentially, you have a contract. So it's not that you have the underlying asset. It's a contract with the CTP. And at a high level, it's really about, who has control over the cryptoassets? And I think the best way to explain it is through an example.

So if I were to buy a Bitcoin, and if the CTP holds onto that Bitcoin on my behalf — so they have it in their custody, and it's not in my personal digital wallet. I do not have sole control over the Bitcoin. The platform still holds and controls my Bitcoin, and I'm reliant on their solvency that I talked about earlier, the integrity of the individuals and the proficiency of the individuals at the CTP. All I have, as I said earlier, is a contractual right or claim to the underlying cryptoasset.

So this is a crypto contract that's been created. And in this case, securities legislation does apply to that crypto contract, and that's where the Commission gets involved. But if I were to buy a Bitcoin and take it into my possession and put it directly into my wallet, then securities legislation does not apply, as I will be retaining sole control of that cryptoasset.

DORETTA THOMPSON

00:27:19.21

So Charlie, you said that that's not done very often, that it's mostly through the exchanges, et cetera. Why not? I mean, if I'm going to buy something imaginary, at least, don't I want to control my imaginary thing that I bought? I mean, doesn't it seem to be adding another whole level of risk to say, I'm going to buy this, but really, I'm just going to buy the right to it, and somebody else can do stuff with it? What value am I getting from having the exchange control it rather than me control it personally?

CHARLIE PETTYPIECE

00:27:51.40

I think it comes down to — it's the business model of these exchanges to attract users. They have promotional campaigns. You've probably seen ads for these exchanges. They make it very simple, at least on the face of how they operate, to acquire things.

They're operated very much like any website. You create a user account on a website. It's very easy to fund that account with money transfer, credit card, or other crypto. And there's a very pretty user interface that you click and you can buy things. So I think the short answer to your question is these cryptoasset platforms make it easy and attractive to buy these things through them, whereas I think you need to have a little bit more of an in-depth understanding of how wallets are created and different ways of acquiring assets in order to self-custody it.

And as well, things like Bitcoin are one thing where you can go to a convenience store on a street corner in Toronto and go to a Bitcoin ATM and buy Bitcoin through that, and it goes directly into a wallet. There are thousands of other cryptoassets out there that don't have street corner ATMs that you can purchase things. And often, the only place that you can go to acquire those assets is to these platforms. So they're selling something you can't otherwise find, and they make it easy and attractive to buy it, so I think that's what brings people to the platform.

DORETTA THOMPSON

00:29:24.16

So Dena, can you give us some sort of hard examples of how investor protection works in the crypto space?

DENA STAIKOS

00:29:33.25

Yeah, sure. So I'll talk about it from two elements, first prior to the CTP getting registered or the registration process, as well as once they're registered. So one of the key investor protection measures we have in place is the registration of the CTPs. And Charlie's alluded to it. There's a lot of unregistered platforms out there. But we also have a number that are registered here in Canada. And if you go onto the CSA or the OSC website, you can see who is registered.

DORETTA THOMPSON

00:30:03.65

So if I can just clarify.

DENA STAIKOS

00:30:05.11

Sure.

DORETTA THOMPSON

00:30:05.35

So if I want to buy, I should stick to one that is regulated, and I can find out if they're regulated by going to the OSC website. Is that —

DENA STAIKOS

00:30:13.12

That's right. That's right. So you can go on there. There's a link where it says, Check Registration. And that's not just for CTPs. It's for all investment fund managers, portfolio managers, and so forth. But if you're interested in crypto, you want to go to a CTP that is registered. So you can see on the website who is registered.

So registration — the registration requirement serves as an important gatekeeping function by ensuring that only properly qualified and suitable persons and organizations are permitted to engage in the business of trading securities with the public. And so I touched on it earlier. We look at the proficiency. We look at solvency. We look at integrity.

So our team does extensive due diligence with regards to the individuals and firms that are applying for registration. So we do internal checks. We look for registration history. We look for prior concerns. We do background checks, and so forth.

So once they do get registered and they're in the door, what we have done — and as I mentioned before, there was no real new requirements. We just tailored the existing requirements or rules to tailor to these CTPs.

So the one thing that we do — one measure that we put in place is account appropriateness assessment. Well, what does that mean? And it's exactly what the name suggests. And it's, is this account appropriate for the individual to open on the platform?

And so what the CTP does is they look at all sorts of information. So if you were to go on, they would look at your financial circumstances. They would look at your experience with regards to crypto, your knowledge in investing in crypto, as well as, what is your risk tolerance? That's one criteria we've put in place.

We've also implemented investment limits. So there's a limit on how much you can invest with regards to crypto on each of these platforms. However, we do have for crypto, which we refer to as specified cryptoassets. That's Bitcoin, Ether, Bitcoin Cash, and Litecoin. However, the remaining cryptoassets, all individuals have a limit of $30,000 of net purchases. So really, that's just kind of limiting the amount that you can invest in the year, and it's a protection.

And I guess the third piece would be establishing a client limit for each investor. So although you have an investment limit, within that you also have a client limit. And this is really, what can the client incur or withstand with regards to losses? And it's tailored by individual. And so there are certain triggers that are put into place as you're approaching these limits.

And then there's other protections in place as I mentioned earlier. And Charlie mentioned having a third-party custodian, so that's separating the client assets from the firm's assets. We require all CTPs to have insurance in place to cover losses of client crypto, as well as disclosure.

And Charlie touched on sometimes they make it a bit confusing for investors, and so forth. So we just want to make sure that CTPs are providing clear risk disclosure to all investors on the risks of trading cryptoassets. And so those are just some of the protections that we've put in place, along with many others.

DORETTA THOMPSON

00:33:36.14

And Charlie, what kind of issues have you discovered? What kind of stuff have you come up against in the crypto world?

CHARLIE PETTYPIECE

00:33:43.49

I'd say it's a mix of different things. So there was an effort that was parallel with the registration efforts that Dena's described to bring enforcement proceedings against unregistered crypto trading platforms who failed to contact the OSC and failed to get into the registration stream. So there are those cases that focus more on registration and the need and failure to get registered, and we've brought some proceedings successfully against very large global platforms in that space.

On the other side, we start to get into scams and fraud. And often, these types of arrangements take on a similar form to the other investment scam, but there's a crypto element to the scam. So there's either a promise that particular crypto tokens are being created or will increase in value, or that a business has a technological development.

And so it's the more classic frauds where there are big, flowery promises being made about something being a great investment and a great retirement option. And in the background, it's a very different picture. And crypto's just another way to kind of obfuscate the nature of the scam with a bunch of confusing crypto language and technical description. So you know, crypto, it kind of makes its way into our enforcement cases in a lot of different levels from the more technical registration perspective to the more overt fraudulent investment scams.

DORETTA THOMPSON

00:35:31.28

So that's kind of like if we think about the Quadriga case, that was, as I understand it, just a basic Ponzi scheme except it was wrapped in the bells and whistles of crypto.

CHARLIE PETTYPIECE

00:35:44.17

Yeah. And the Quadriga case kind of brings together both aspects, right? Like, it was a cryptoasset trading platform that was unregistered. And because of the lack of transparency, there was no controls over — or limited controls over how client assets were being used. And that kind of creates a fertile environment for a bad actor to misuse those funds. And in that case, because of the lack of oversight, lack of transparency, the platform was able to be operated as what was essentially a Ponzi scheme.

And in addition to being a Ponzi scheme, there are findings — and there was a lengthy OSC investigation in relation to Quadriga and a report that was published online, which I'd recommend anyone who's interested to read. But the owner of that platform not only operated a Ponzi scheme where one user's withdrawals were being paid with another user's investments, but the operator was also just misappropriating the client assets and engaging in their own high-risk trading, funding their own lifestyle.

The more classic kind of misappropriation of funds you'd see in any investment scheme that really had nothing to do with crypto. It's just the fact that it was able to be operated in this kind of under-the-radar manner.

DORETTA THOMPSON

00:37:09.61

The other big one in the news — FTX, of course. What was going on there? Was that more of a, there were no controls around mingling investors' funds in FTX with Sam Bankman-Fried's other company? Is that kind of how that went?

CHARLIE PETTYPIECE

00:37:24.66

Yeah. So what I can offer on FTX is no more than I'm sure anyone else has read in the media and in the books that have been published on the sort of collapse, I'll call it, of FTX. But I think you hit the nail on the head there.

You know, FTX was a crypto trading platform operated by FTX companies. But there was also a sister company called Alameda Research, which was a trading company, notionally separate from the exchange. But again, this comes down to custody and protection of user assets on the platform. Instead of protecting those user assets and maintaining custody of them, they were essentially transferred over from the FTX platform to this trading company and used in a manner that users likely wouldn't have expected them to be used.

And the whole thing crumbled when there was a leak that the trading firm called Alameda — that a large portion of its balance sheet was actually made up of its own tokens, which was the FTT token. And when that leaked, there was a rush to sell off that token, which devalued it. And because the money that was transferred from FTX to Alameda was owed back to FTX, once that token is devalued, Alameda's not able to repay that.

And when you have users of the FTX platform making massive withdrawal requests, FTX is left not having the actual assets in custody to repay those. And it can't go to Alameda and ask for those assets because most of Alameda's balance sheet was just devalued.

And so you asked about controls. And I think there's a now widely published quote from the CEO that took control over FTX, John Ray, where he said, "Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here." So just exemplifying how that lack of control, lack of transparency and oversight through a regulator can lead to all sorts of misconduct.

DORETTA THOMPSON

00:39:40.45

So we've talked about a couple of the very high-profile frauds that have happened in crypto. Is there a high level of fraud in the crypto world? Is this typical? What's your sense about the prevalence of fraud?

CHARLIE PETTYPIECE

00:39:53.46

I think that's a difficult question to answer. It's not as if we're comparing levels of fraud in one industry to another. I think there's just a higher prevalence of crypto fraud because that's a focus of a lot of people's interest in the last few years.

I think we talked about this early on, that to some people it's an exciting new area. They've heard stories of people getting rich quick. A lot of attention, a lot of opportunity. And there are bad actors who have been around for a while who latch on to this new industry and reframe a business idea as a crypto idea and pour a bunch of crypto sauce onto their scheme and pitch it anew, and they get interest.

So going back to your original question, it's hard to say what level of fraud there is. We certainly see different types, all different types coming — you know, ranging from the ones that we've discussed, the Quadrigas, the FTXs where large platforms are misusing investor funds down to the very small-scale investment schemes that are perpetrated by a small group of people who are pitching an idea that really doesn't have any basis in reality.

DORETTA THOMPSON

00:41:06.01

Let's talk for a few minutes about how people who might be interested in investing in crypto, how can they avoid the frauds? What tips would you offer for people thinking about investing in crypto to do it in a kind of informed and lower risk manner? Dena, let's start with you.

DENA STAIKOS

00:41:28.02

Yeah, so I think one of the first things to do, and a bit of a plug here for the OSC's Investor Office, is to be educated about crypto and crypto-related scams. So the OSC's Investor Office has a dedicated website to crypto, which is getsmarteraboutcrypto.ca where you can learn more about crypto itself and the risks of investing in crypto, including types of common scams. So getting educated is really the best tool to help identify these scams on your own.

We talked about this earlier is check registration. So as I mentioned earlier, the CSA has a website and you can go on there to check registration as well as the OSC's website. And then just doing your own research through Google search, other review sites, social media posts, and really understand some of these entities or crypto that you're interested in.

DORETTA THOMPSON

00:42:23.28

And anything you'd like to add to that, Charlie?

CHARLIE PETTYPIECE

00:42:25.80

I think that was a great summary. Yeah, educating yourself and doing your own diligence are, I think, the key things. I'd add to that a healthy sense of skepticism over any representations or claims that are made about a particular crypto investment. You know, treat it like you would any other investment and kick the tires and really think about it in that respect and not as something that if you don't act now, you're going to miss out on some great opportunity. Take the time and educate yourself and look into it.

DORETTA THOMPSON

00:42:57.23

And for our listeners, we'll include the link to Get Smarter About Crypto and the other OSC resources in the notes to the podcast. And I will say, I refer people to the OSC information a lot. I think it's just superbly well done. Thank you all for that. Anything you'd like to add? Red flags, any thoughts?

DENA STAIKOS

00:43:18.46

I think kind of going back to what Charlie said, it's just looking out for high-pressure sales tactics, you know? You can get multiple calls from a company telling you to act now or you'll miss out. The fear of missing out. Or you might hear from a new friend on social media. So being aware of that.

And again, Charlie's point about healthy skepticism, unrealistic returns, or returns that are too good to be true. You really need to look into that a bit more, so having that healthy amount of skepticism.

DORETTA THOMPSON

00:43:49.34

Charlie?

CHARLIE PETTYPIECE

00:43:50.15

I don’t think there’s anything to add to that. I think we’ve covered it all. And if you’re looking to invest in crypto, again, plugging the registration. Look for registered platforms. Look for ones where there is some degree of oversight and safeguards in place to mitigate the risk of loss.

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00:44:08.03

DORETTA THOMPSON

00:44:08.90

Well, thank you both for this. It has been fascinating.

DENA STAIKOS

00:44:12.36

Thank you for having us.

CHARLIE PETTYPIECE

00:44:13.77

Thank you for having us.

DORETTA THOMPSON

00:44:14.96

Yeah, it was great.

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00:45:06.66