Gems, coins, bells and bottle caps: Canadian AML regime amendments affect some video game and social media virtual currencies

Blockchain and Digital Assets News and Trends

25 February 2021
By: Ryan J. Black | Eric Belli-Bivar | Tyson Gratton

Providers of interactive entertainment services and platforms are taking a careful look at key definitions under new amendments to Canada’s Proceeds of Crime (Money Laundering) and Terrorist Financing Suspicious Transaction Reporting Regulations. These new amendments (the New Regulations) will come into force on June 1, 2021.

The purpose of these New Regulations is to close loopholes found in the existing regime and to adapt to commercial realities in an era of e-commerce, FinTech, and digital technology. In order to understand whether a particular provider of an interactive entertainment service or platform is operating a “money service business,” it is critical to understand what types of virtual currencies will subject a provider to the New Regulations.

Under the New Regulations, the definition of a “money services business” has been expanded to include persons and entities who “are engaged in the business of ... dealing in virtual currency.” The definition has also been clarified as it relates to foreign businesses: under the New Regulations, businesses based outside Canada have fundamentally the same obligations as domestic Canadian businesses when providing “money service business” services directed at customers in Canada. Money services businesses are highly regulated in Canada and must be registered with FINTRAC, Canada’s anti-money laundering regulator. In addition to registration, money services businesses must comply with
know-your-client, recording-keeping and other compliance and reporting requirements.

In today’s interactive entertainment environment – ranging from free-to-play mobile games through massively multiplayer online games and AAA releases – virtual currency is often used as a way for players to enhance their gameplay experience, with virtual currency (either earned in game or purchased for real money) serving as a reward for gameplay, or a medium of exchange for virtual goods and benefits, as well as a repository of in-game value or prestige. The same is true of social media and online social engagement platforms, where users can often buy virtual tokens or currencies to unlock certain features, recognize or promote content, or reward, encourage, and interact with content creators.

While many games and platforms operate what is known as a closed virtual currency system (meaning that real-world money can only go into the platform as virtual currency and not come back out through some transfer of value back to the user or other participant on the platform), some games and platforms feature ways for users to receive and/or “transmit” or send real-world value for the virtual currencies they hold, either indirectly or through direct cash or cash-like payments, in what is known as an open or convertible virtual currency system. As users increasingly generate perceived or actual “value” inside of a closed virtual currency system, and particularly as virtual economies move to an open or convertible virtual currency system, the risk of falling within Canada’s Act increases.

An interactive entertainment service or platform must evaluate which types of virtual currencies will subject the service or platform provider to the Act’s regime as a money service business. This requires a deep dive into three key definitions under the New Regulations that will come into force on June 1, 2021.

First, “virtual currency” is defined as (a) a digital representation of value that can be used for payment or investment purposes that is not a fiat currency and that can be readily exchanged for funds or [readily exchanged] for another virtual currency that can be readily exchanged for funds or (b) a private key of a cryptographic system that enables a person or entity to have access to a digital representation of value referred to in paragraph (a).

Second, “fiat currency” means “a currency that is issued by a country and is designated as legal tender in that country”.

And third, “funds” means “(a) cash and other fiat currencies, and securities, negotiable instruments or other financial instruments that indicate a title or right to or interest in them; or (b) a private key of a cryptographic system that enables a person or entity to have access to a fiat currency other than cash.”

As a result, the key elements of a virtual currency under the New Regulations (a Regulated VC) are that (1) it must be able to be used for payment or investment purposes (eg, making in-platform purchases); (2) it is not a fiat currency (eg, cash); and (3) it is capable of being readily exchanged for fiat currencies or stores of fiat currency value (eg, US dollars, Canadian dollars, stocks). This also includes private keys in cryptographic systems (eg, a user’s cryptocurrency wallet) that would enable a person to access what would otherwise be a Regulated VC.

For practical purposes, dealing in a Regulated VC is not prohibited; however, it does subject the provider to several obligations, including registration, reporting and record-keeping obligations, in order to prevent and detect money-laundering. As of June 1, 2021, these will also include submitting Large Virtual Currency Transaction reports to FINTRAC for purchases or receipt of funds for virtual currencies valued at more than C$10,000. However, for understandable reasons, not the least of which is significant regulatory compliance overhead, providers of interactive services should carefully discuss their individual situations with experienced advisors before subjecting themselves to the argument that they are money service businesses caught by the Act.

An obvious example of an interactive entertainment or online platform dealing in Regulated VC would be one that allows users to directly convert some form of in-platform virtual currency or ledger into cash (eg, in US dollars or Canadian dollars), or one that pays holders of certain amounts of virtual currency using some mechanism that is convertible into funds or fiat-like currency (for example, gift cards or other stores of fiat-like currency). In these contexts, because the virtual currency digitally represents value convertible into fiat currency, it would likely be Regulated VC.

But there may be other, less obvious examples. It is important to note that the definition of a Regulated VC does not require that the provider itself provide the means to exchange the virtual currency for funds; rather, it is a factual question about whether the virtual currency “can be readily exchanged” for fiat-like funds and whether the virtual currency “can be used for payment or investment purposes” that will determine whether it is capable of being as Regulated VC or not. This means that even if the provider or virtual economy does not change its own offerings, changes in secondary markets or factual conditions about how users actually use the virtual currencies could result in a virtual currency being a Regulated VC.
Consider the example of an interactive game with a closed virtual economy and an Aztec setting, where players can optionally purchase virtual cocoa beans for their characters in the game using real-world money. The game itself is a work of fiction, with a narrative pursued by the player via purchase or access to the game and its content. When players direct their character to “spend” the virtual cocoa beans in the game, are they making a “purchase” or simply furthering the game or enhancing the playing experience or narrative? If a secondary market exists (like a third-party website) where players can buy or sell accounts holding a certain number of virtual cocoa beans or directly buy and sell virtual cocoa beans themselves via in-game or outside-of-game mechanisms, is the publisher dealing in a virtual currency that “can be readily exchanged for funds” and would that depend on the ease of access to, or popularity of, the secondary market? What if the game features an in-game trading or auction house functionality where players' characters could buy or sell virtual items using these virtual cocoa beans or transfer virtual cocoa beans to each other, as opposed to earning them through in-game play? These are all factual circumstances that must be carefully considered in order to evaluate whether the in-game currency mechanics meet the definition of a Regulated VC.

Given the novelty of the New Regulations, none of this is settled by official guidance or case law. Certainly, virtual currency ecosystems (particularly those that further an in-game narrative) presented by modern video games may not be as clear when it comes to AML regulations as, say, a cryptocurrency exchange or online trading platform; and regulators and courts will have some tricky boundaries to navigate. Nevertheless, as interactive media and online social platform platforms look for ways to engage and monetize users, it merits a close examination as the New Regulations come into force and as guidance and best practices emerge.

You can read more on this topic in these DLA Piper articles: In the crosshairs — New reporting entities caught by changes to Canada’s anti-money laundering regime and New record keeping obligations under Canada’s changing anti-money laundering regime.

AUTHORS

Ryan J. Black  
Partner  
Vancouver | T: +1 604 687 9444  
ryan.black@dlapiper.com

Eric Belli-Bivar  
Partner  
Toronto | T: +1 416 365 3500  
eric.belli-bivar@dlapiper.com

Tyson Gratton  
Associate  
Vancouver | T: +1 604 687 9444  
tyson.gratton@dlapiper.com