

# Cassels

## Controlling the Crypto Craze: The OSC's Response to the Growing Crypto Market

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Since the creation of Bitcoin in 2008, there has been a growing interest in crypto assets, with significant acceleration in the last few months. In particular, between January and April 2021, the global crypto asset market capitalization doubled from \$1 trillion to \$2 trillion (USD).<sup>1</sup> In turn, there has been a proliferation of crypto asset trading platforms (CTPs or platforms) that allow investors to trade these crypto assets.

Platforms that neglect or otherwise fail to register with securities regulators present significant risks to investors because assets may not be adequately safeguarded, and internal controls intended to mitigate risks may be lacking or non-existent. As a result, the Ontario Securities Commission (OSC) has recently announced that it will be cracking down on CTPs that are not compliant with Ontario securities law.<sup>2</sup> The OSC has followed through by commencing three proceedings (to date) against non-compliant platforms.<sup>3</sup> Given the incredible growth of the crypto market, we believe that this is only the beginning of enforcement efforts in this burgeoning industry.

### Key Takeaways

- **Securities regulators and administrators are looking to regulate the crypto market.** As the crypto industry grows at an exponential pace, a lack of regulations may put investors at risk. Accordingly, securities regulators and administrators including the CSA and IIROC are moving quickly to require crypto issuers to swiftly comply with regulations and guidelines and to commence enforcement proceedings against those who do not heed these measures.
- **The global nature of crypto assets does not decrease the possibility of regulation.** Registration and disclosure are cornerstones of Ontario securities law. CTPs that are operating in Ontario, regardless of place of incorporation, are required to comply with these tenets.
- **The OSC is committed to taking action against non-compliant platforms.** Since issuing a strong statement that CTPs operating in Ontario must take steps to comply with Ontario securities laws, the OSC has brought proceedings against three platforms that failed to contact the OSC to discuss steps they would take to ensure compliance. This is a clear signal to all issuers and CTPs that the OSC has made regulating this industry a priority.

### Summary and Background

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On March 29, 2021, the Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) published a notice outlining the securities law requirements that apply to CTPs and steps required for compliance with securities legislation.<sup>4</sup> On the same day, the OSC also published notice of their expectations of CTPs that currently offer trading in derivatives or securities to persons or companies located in Ontario.<sup>5</sup> These platforms were required to contact the OSC by April 19, 2021 to discuss the steps they would take to bring their operations into compliance with Ontario securities law. Platforms that failed to contact the OSC by this date would be subject to enforcement measures.

On May 25, 2021, the OSC published a Statement of Allegations against Polo Digital Assets, Ltd. (Poloniex) for failing to comply with Ontario securities law. Poloniex, an unregistered CTP incorporated in the Republic of Seychelles, had encouraged Canadians to use the platform and had allowed Ontario residents to trade crypto asset products that are securities and derivatives. On June 7, 2021, the OSC took action against Mek Global Limited, incorporated in the Republic of Seychelles, and PhoenixFin Pte. Ltd., incorporated in Singapore, (collectively, KuCoin), with similar allegations. On June 21, 2021, the OSC commenced similar proceedings against Bybit Fintech Limited, a CTP incorporated in the British Virgin Islands.

The OSC alleges that these CTPs engaged in, or held themselves out as engaging in, the business of trading in securities without the necessary registration or applicable exemptions. In particular, the OSC alleges that investors access the relevant platforms by creating an account, into which they can subsequently deposit their crypto assets (e.g., Bitcoin or Ether) and can also use fiat currency (including CAD) to purchase crypto assets, which are then credited to their account. This account or “wallet” is controlled by the CTP. In order to take possession of the crypto assets reflected in their account balance, an investor must request a withdrawal from the CTP. As a result, the investor is dependent on the CTP to satisfy their withdrawal request by delivering crypto assets to an investor-controlled wallet.

The OSC alleges that since the CTPs provide investors with instruments or contracts involving crypto assets, these instruments or contracts constitute securities and derivatives. The OSC seeks orders ceasing the CTPs from trading in any securities or derivatives and prohibiting the further acquisition of any securities.

## The Upshot

The OSC has demonstrated that the regulation of CTPs is a priority and that it is willing to devote enforcement resources to following through against those platforms that have failed to contact the OSC to discuss how they will bring their operations into compliance with Ontario securities law. The enforcement proceedings that have been brought to date also show that the OSC is willing to expand its reach to target global non-compliant CTPs and that it will continue to work with international securities regulators to take action against global non-compliant CTPs.

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As of June 2021, over 70 platforms had initiated compliance discussions with Canadian securities regulators, with almost one quarter of them based outside of Canada.<sup>6</sup> It is anticipated that the recent enforcement proceedings may lead to further compliance efforts by remaining platforms.

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<sup>1</sup> [https://www.osc.ca/sites/default/files/2021-05/20210519\\_grant-vingoe-spring-keynote-canadian-club\\_0.pdf](https://www.osc.ca/sites/default/files/2021-05/20210519_grant-vingoe-spring-keynote-canadian-club_0.pdf)

<sup>2</sup> <https://www.osc.ca/en/news-events/news/osc-working-ensure-crypto-asset-trading-platforms-comply-securities-law>

<sup>3</sup> <https://www.osc.ca/en/news-events/news/osc-takes-action-against-non-compliant-international-crypto-asset-trading-platform-bybit>

<sup>4</sup> <https://www.osc.ca/en/news-events/news/canadian-securities-regulators-outline-regulatory-framework-compliance-crypto-asset-trading>

<sup>5</sup> <https://www.osc.ca/en/news-events/news/osc-working-ensure-crypto-asset-trading-platforms-comply-securities-law>

<sup>6</sup> <https://www.osc.ca/en/news-events/news/osc-takes-action-against-non-compliant-international-crypto-asset-trading-platform>

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