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Recent Guidance by the Regulators on Marketing and Advertising Activities by CTPs

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On September 23, 2021, the Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) issued a joint staff notice 21-330 (Notice) to platforms trading in crypto assets (CTPs) outlining how requirements under securities legislation and IIROC rules may apply to their advertising, marketing, and use of social media. The Notice was issued after CSA and IIROC become aware of advertising and marketing activities by CTPs, including "gambling style" promotions, bonuses, time-limited offers, and potentially false or misleading statements that could breach these requirements. The Notice is intended to provide guidance to CTPs on their marketing and advertising activities. A brief summary of the Notice follows.

When Does Securities Legislation Apply to CTPs?

The application of securities legislation to a CTP is complex but has been outlined by the CSA and IIROC in previous staff notices:

- CSA Staff Notice 21-237 Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets
- CSA-IIROC Staff Notice 21-329 Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements

In brief, CSA Staff Notice 21-237 states that a CTP is subject to securities legislation if the crypto assets that are traded on the CTP are securities or derivatives thereby making the CTP a "dealer" and/or a "marketplace," as those terms are defined by securities legislation.

The Notice states that securities legislation *may* also apply to a CTP that facilitates the buying and selling of crypto assets, including commodities, because users possess contractual rights to those crypto assets, which rights may fall within the definitions of securities and/or derivatives.

To Whom Does the Notice Apply?

The Notice applies to:

- CTPs registered as dealers under securities legislation, defined in the Notice as “registered CTPs”;
- CTPs that have or will be applying for registration as dealers, defined in the Notice as “prospective CTP registrants”; and
- Other registrants that may be considering establishing a CTP.

The Notice highlights that compliance with securities legislation and IIROC rules is critical for these parties. For registered CTPs, CSA staff can review advertising and marketing as part of their post registration compliance review; and for prospective CTP registrants, non-compliant advertising and marketing activities may raise concerns “relating to the fitness of the firm and its principals” thereby potentially compromising any application for registration. For those CTPs found not complying with securities legislation, CSA can take enforcement action, including against foreign CTPs with Canadian investors, which may ultimately result in conduct bands and/or monetary sanctions, among other remedies.

The Prohibition on False or Misleading Advertising in Securities Legislation and IIROC Rules

Securities legislation and IIROC rules contain a number of provisions prohibiting the making of false or misleading statements including, for example, statements that suggest a CTP is registered under securities legislation, when it is not, and statements that a securities regulator has endorsed or approved the CTP or any of its products.

Beyond these prohibitions, securities legislation and, if applicable, IIROC rules, place overarching obligations on registered CTPs that can impact their advertising and marketing. These include their obligations arising from their role as “gatekeepers of the integrity of the capital markets,” their obligation to treat their clients fairly, honestly and in good faith, and their “suitability obligations” under Part 13 of National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations.

In short, “suitability obligations” place upon registered dealers an obligation to assess the suitability of their products for clients and to identify and respond to any conflict of interest in the best interests of their clients. Suitability obligations apply not only to recommendations relating to trading strategies generally, but also to individual trades.

Some CTPs have obtained (or will seek) exemption from suitability obligations on the condition that they are not providing any recommendations or advice. However, the exempt status can be revoked if CTPs act contrary to the conditions of their exemption, as discussed further below.

Even if a CTP has been granted an exemption from the obligation to determine suitability on an individual trade-by-trade basis, a CTP still has other obligations at the account opening stage to, for example, assess

products based on factors such as clients' experience in investing in crypto assets and using online brokerages, their financial assets, income, risk tolerance, and the obligation to set appropriate limits on clients' losses. See IIROC Guidance on Order Execution Only Services and Activities dated April 9, 2018.

"Gambling Style" Promotions and Schemes

The Notice makes specific mention of examples of recent promotions and schemes by CTPs that are designed to encourage investors, not only to trade, but to trade quickly for fear of missing out. These include time-limited offers, such as the offer of a bonus interest in crypto assets for the first x-number of investors who respond to an offer within a short time frame. CSA and IIROC are concerned that such activities encourage investors to engage in excessively risky trading and may violate registered CTPs' obligation to treat clients fairly, honestly and in good faith. Moreover, CSA and IIROC warn that activities, such as the active solicitation of trading through advertising, may be contrary to the conditions of CTPs' exemption from suitability obligations and may trigger them.

(As an aside, in addition to securities laws and IIROC rules, promotional contests are governed by other laws including the *Criminal Code*, the *Competition Act*, private sector privacy legislation, and for Quebec, *An Acting Respecting Lotteries, Publicity Contests and Amusement Machines*, each of which imposes their own obligations on contest mechanics; disclosures about the contest; the collection, use and disclosure of personal information; and the registration of publicity contests with the Quebec government; among other things. Recent amendments to the Quebec law mean that, in some cases, contests open to residents outside Canada no longer need to be registered.)

Registered CTPs on Social Media

Registered CTPs must maintain records of their business activities, financial affairs, and client transactions. The Notice raises the concern that the use of social media websites and platforms to communicate with clients and the general public increases the risk that registered CTPs may not be retaining adequate records. CTPs are required to design systems that allow for record retention and retrieval from these sites, and to supervise statements made on these sites, not just by the CTP but also by its directors, officers, employees, shareholders and third parties acting on the CTP's behalf.

CTPs are required to adopt policies and procedures governing the use of social media for marketing. In addition to retention, retrieval, and supervision of advertising and marketing materials, the Notice states that CTPs must designate an appropriate individual to be responsible for the approval of all marketing materials (not just those made on social media sites), and implement a system to monitor compliance with those policies and procedures.

Non-Exhaustive List of Examples of Potentially False or Misleading Statements

Appendix A to the Notice provides examples of marketing statements followed by an explanation of why they could be potentially false or misleading. Some of the examples and explanations are listed below. (The statements and names used in the examples are fictitious and are provided by CSA and IIRCO in Appendix A for illustration only.)

"Your crypto assets are safe with us because we meet all regulatory requirements as fully licensed Money Services Business Services under Canadian legislation."

The statement suggests that registration as Money Business Services is sufficient to protect clients' interest or provides regulation comparable to securities regulatory requirements, which is not the case.

"The BuyEasy Crypto Exchange is the leading global exchange for trading 16 of the most commonly traded crypto assets."

The statement raises twofold concerns. First, under securities legislation, "exchange" refers to a particular type of regulated entity. A CTP that facilitates trades in securities and derivatives must not refer to itself as an "exchange" unless it is recognized as an "exchange" under securities legislation. Similar concerns arise with CTPs referring to themselves as a "marketplace," which is also a particular type of regulated entity.

Second, superiority claims such as "the leading global exchange" require adequate substantiation.

"Our platform is consistently rated the safest and most trusted platform by leading rating agencies, including Digital Bitcoin Rating Services and Triple A Crypto All Stars."

The superiority claims require adequate substantiation, which in this case, includes due diligence on the third-party sources referenced in the claim. Care must be taken to ensure that statements do not create the misimpression that third parties are regulated or have expertise they do not possess.

As well, statements by CTPs must be fair and balanced by including a discussion of the risks associated with the advertised product. It is unacceptable to rely on disclaimers or any key assumptions contained within a client agreement or offering document to correct any misimpression made by the main marketing message.

"'When I want to buy Bitcoin, I always use the BuyEasy Crypto Platform – it's so easy to buy!' said noted action movie star…."

The use of an individual to promote the CTP's securities or derivatives may be considered a form of recommendation or advice triggering obligations under securities legislation for both the CTP and the individual, and may, depending on the circumstances, contravene securities legislation. There are general exemptions in securities legislation (described as "general advice" and the "newsletter exemption" in the Notice) but there are conditions for these exemptions to apply, including the concurrent disclosure by the individual promoter of any "financial or other interest" with the issuer.

"On our platform, you keep more of your money because we never charge any commissions."

The statement could be false or misleading if only certain types of products are offered on a commission-free basis while others are subject to commissions, or, apart from commissions, the CTP charges fees in other ways, such as through a mark-up on the best price or takes a spread on trades. Under securities regulations, registrants must, among other things, provide clear and complete disclosure of fees charged to investors.

"We do not have suitability obligations. We make it clear to investors that trading crypto is risky but we are not required to tell clients whether crypto trading is suitable for them or not."

As discussed above, even if a registered CTP is exempt from suitability obligations, it still has other client assessment obligations at the account-opening stage that must factor in the client's risk tolerance, among other things. The statement suggests that the CTP is devoid of any such obligations.

"Important Update! BTC skyrockets! Don't get left behind!"

The statement may be considered a form or recommendation or advice. As a condition of being granted exemption for trade-by-trade suitability obligations, CTPs are generally not permitted to make recommendations or provide advice regarding the trading of a crypto asset.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.