

Crypto-Compliance: The OSC's New Pre-Registration Requirements

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Introduction

On the heels of escalated efforts by the Ontario Securities Commission (OSC) to commence enforcement proceedings against crypto trading platforms (CTPs or platforms) that operate in Ontario without having engaged with the OSC regarding registration,¹ the Canadian Securities Administrators (CSA) issued a news release dated August 15, 2022, announcing CTPs are now expected to provide a pre-registration undertaking to the OSC if they intend to continue operations while their application for registration is being reviewed. Failure to do so may lead to disciplinary action from the CSA.

In addition to the CSA's announcement, the OSC published the first pre-registration undertakings, filed by Coinsquare Capital Markets Ltd. (Coinsquare) and Foris Dax, Inc. c.o.b. Crypto.com (Crypto.com and, together, the Filers), which provides valuable insight into the types of undertakings that may be required of other CTPs going forward.

Key Takeaways

- The exponential growth in the global crypto market, along with its inherent susceptibility to fraudulent transactions and violations of the *Securities Act*, has forced securities regulators and administrators to adopt new measures and escalate enforcement mechanisms to provide better investor protections.
- Crypto trading platforms that fail to comply with pre-registration undertaking requirements may be subject to enforcement action from the CSA.
- While extensive, the undertaking requirements may differ between CTPs and will be tailored to the issuer itself and the level of protection warranted in the circumstances.

Summary

Last year, the CSA and IIROC published a notice outlining securities law requirements for CTPs and the steps required for compliance.² Platforms that failed to comply would be subject to enforcement measures.

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The new undertaking requirements add an additional layer – CTPs that are not yet registered must comply with the terms and conditions in their undertaking in order to operate.

While the terms in each individual platform's undertaking may differ, they are generally designed to ensure investors' crypto assets are securely held and remain accessible to them. They also ensure that the platform is complying with securities regulations and that investors are adequately apprised of the risks.

In the Filers' case, until a decision is made by the OSC with respect to applications for registration and related applications for exemptive relief, the Filers are required to comply with the terms and conditions in their undertaking, including:

- Informing the OSC of any material change affecting the Filer or of a material breach of the Filer's system of controls or supervision – loss of any amount of Crypto Assets³ impacting the Filer's customers will be considered a material breach.
- Informing the OSC if any jurisdiction initiates a proceeding or renders a judgement related to a compliance or enforcement action involving the Filer that is material to the client.
- Informing the OSC if the Filer becomes subject to bankruptcy or a proceeding under the CCAA.
- The Filer faces restrictions on the products and services they can trade or offer. These restrictions include:
 - Only trading Crypto Contracts⁴ based on Crypto Assets that the Filer has reasonably determined are not securities or derivatives.
 - Refraining from offering Crypto Asset lending products or services or Staking Services⁵ to clients without prior consent of the OSC (or other jurisdictionally appropriate regulatory authority).
 - Without prior consent, the Filer cannot trade Crypto Assets issued by or on behalf of a person or company that is or has in the last five years, been sanctioned or fined.
- The Filer is restricted from offering margin, credit, or other forms of leverage to clients (barring certain exceptions).
- The Filer must evaluate whether entering into Crypto Contracts with the Filer is appropriate for a prospective client before the opening of a client account. In doing so, the Filer must consider the:
 - client's experience and knowledge in investing in Crypto Assets;
 - client's financial assets and income;
 - client's risk tolerance; and
 - Crypto Assets approved to be made available to a client on the Filer's platform.
- Before a prospective client opens an account with the Filer, the Filer will deliver to the client a statement of risks and will require the client to provide electronic acknowledgement of having received, read and understood the statement.
- The Filer must also be proficient and experienced in holding Crypto Assets and must conduct due diligence on third-party custodians – the Filer has and will retain the services of third-party custodians to hold not less than 80% of the total value of Crypto Assets owned by clients.

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- The Filer must also, within 30 days of the end of each March, June, September and December, report certain information including:
 - aggregate reporting of activity (e.g., the number of client accounts opened and closed, the number of trades conducted, and the average value of trades);
 - details of any material client complaints, fraudulent activity, or cybersecurity; and
 - the amount of Crypto Assets held in hot wallets at the end of the quarter.

While the above requirements are contained in both the Filers' undertakings, there are noticeable differences between them. For example, Crypto.com's undertaking delineates that the maximum amount of Crypto Assets that a client, other than (i) clients resident in Alberta, British Columbia, Manitoba and Quebec and (ii) other permitted clients, may purchase and sell on its platform in the preceding 12 months cannot exceed a net acquisition cost of \$30,000. On the other hand, Coinsquare must ensure that the maximum amount of Crypto Assets that a client, except those clients resident in Alberta, British Columbia, Manitoba, and Québec, purchases and sells does not exceed:

- a net acquisition cost of \$30,000 in the case of a client that is not an Eligible Crypto Investor;⁶
- a net acquisition cost of \$100,000 in the case of a client that is an Eligible Crypto Investor, but is not an Accredited Crypto Investor;⁷ and
- in the case of an Accredited Crypto Investor, there is no limit.

This increased flexibility afforded to Coinsquare may be due to the expectation that it will be regulated as an order-execution-only platform under the IIROC rules.

The Upshot

The undertaking requirement is another example of the methodical approach taken by Canadian securities regulators to bring the crypto industry into compliance with the broader securities regime and to protect crypto investors from breaches of the *Securities Act* without being unduly heavy-handed. Investors can now more confidently engage with platforms that are in the liminal stage between seeking registration and registration approval.

While this requirement demonstrates a firmer approach to regulation, the OSC appears to have left some room for issuers to negotiate the particular undertakings to which they will be subjected based on their unique characteristics and risk profile. For example, while there are substantial similarities between the Filers' undertakings, the differences in restrictions on investment limits signals that undertakings may be tailored to the issuer itself.

Recent enforcement measures show the OSC's demonstrated willingness to bring enforcement proceedings against non-compliant platforms. With the new undertaking requirements, we can likely expect

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this increased scrutiny to persist.

Any CTPs that are considering engaging with the OSC in respect of pre-registration undertakings should contact Cassels for assistance with navigating the process.

Links to the news release, Crypto.com's undertaking and Coinsquare's undertaking can be found [here](#).

¹ Crypt-Oh-No: The OSC Continues to Crack Down on Unregistered Crypto Asset Trading Platforms

² Controlling the Crypto Craze: The OSC's Response to the Growing Crypto Market

³ A "Crypto Asset" means Bitcoin, Ether, and anything commonly considered a crypto asset, digital or virtual currency, or digital or virtual token, that are not themselves securities or derivatives.

⁴ A "Crypto Contract" means an investor's contractual rights relating to a Crypto Asset and related rights under the investor's agreement with the Filer.

⁵ "Staking Services" means any and all services conducted by the Filer and third parties in order to enable the Staking of clients' Crypto Assets that are held on the Filer's Platform.

⁶ An "Eligible Crypto Investor" generally means a person whose: (i) net assets, alone or with a spouse exceed \$400K; (ii) net income exceeds \$75K; or (iii) net income alone or with a spouse exceed \$125K.

⁷ An "Accredited Crypto Investor" generally means an individual who: (i) owns financial assets that exceed \$1M; (ii) has a net income of \$200K or more; (iii) with a spouse, has a net income \$300K or more; or (iv) owns net assets of at least \$5M.

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