

CSA Issues Securities Law Implications for Token Offerings

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On June 11, 2018, the Canadian Securities Administrators (the CSA) issued CSA Staff Notice 46-308 – *Securities Law Implications for Offerings of Tokens*. This Staff Notice supplements the previously released CSA Staff Notice 46-307 – *Cryptocurrency Offerings* by providing additional guidance on the applicability of securities laws to coin and token offerings, including those concerned with “utility tokens”¹.

Key Takeaways

- **Determining whether securities laws apply to an offering of tokens is dependent on the economic realities of the offering as a whole.** Emphasis should be placed on substance over form when making the determination.
- **Multiple step token offerings can be subject to securities laws.** If a token delivered at a second or later step maintains security-like attributes, the CSA may consider it to be a security.

Summary and Background

The Staff Notice provides additional guidance on the Canadian regulatory approach to cryptocurrency offerings and funds and offerings and follows Staff ongoing engagement with numerous industry participants. Cryptocurrency offerings are often similar to initial public offerings of shares or equity. This resemblance is because the offering can involve the distribution of an investment contract, and/or the offering and/or the tokens issued under the offering are otherwise securities. Cryptocurrency offerings that involve the sale of securities will be subject to securities laws.

When an Offering of Tokens May or May Not Involve an Offering of Securities

In this Staff Notice, the CSA expanded on the applicability of securities laws, specifically with regards to the determination of whether or not an investment contract exists in the context of token offerings. The CSA emphasized the focus on substance over form in the analysis, stating that an assessment should be made on both the technical characteristics of the token itself *and* the economic realities of the offering as a whole. Further, when interpreting the term “investment contract,” consideration should be given as to whether the offering involves an investment of money, in a common enterprise, with the expectation of profit to come significantly from the efforts of others.

On the topic of “utility tokens,” the Staff Notice provides that the fact that a token has a utility is not, in and of itself, determinative as to whether an offering involves the distribution of a security. In fact, the CSA

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highlighted that the majority of “utility token” offerings that it had reviewed have involved the distribution of a security, usually an investment contract.

The Staff Notice also discusses tokens that are reasonably expected or marketed to trade on one or more crypto-asset trading platforms. Such instances can give rise to implications on the presence of elements of an investment contract, due to the fact that purchasers may purchase tokens with an expectation to resell for profit. When determining whether tokens are reasonably expected to trade in the secondary market, formal and informal representations made by the issuer will need to be considered, along with third party representations that have been endorsed by the issuer or management.

Offerings of Tokens That Are Structured in Multiple Steps

The CSA further addresses token offerings structured in multiple steps. These offerings generally proceed as follows:

- The purchaser agrees to contribute money in exchange for a right to receive tokens at a future date. While no token is delivered at the time of purchase, there is generally a distribution of a security in the form of the right to a future token, which is usually made under a prospectus exemption.
- The issuer then delivers the token after having represented that the online platform is built or the goods or services are available, and the token is functional.

Securities laws are applicable in these multiple step offerings. The Staff Notice specifically notes that a “utility token” delivered at a second or later step may still be considered a security if it continues to have a number of security-like attributes. Additionally, since the distribution of a security is subject to the prospectus requirement, issuers must ensure their compliance with the relevant National Instrument requirements. If the distribution of the security at the first step is made without complying with the requirements, the issuer will remain in default of the requirements, even if subsequent steps may have occurred.

The Upshot

In issuing the Staff Notice, the CSA provides greater clarity into the current securities law implications for token offerings. The CSA intends to continue taking regulatory action to prevent securities law violations in the context of coin and token offerings. Businesses should, therefore, consider and seek advice regarding the applicability of securities laws when dealing with the evolving cryptocurrency industry.

For further information regarding the applicability of securities laws to coin and token offerings, please contact Brigeeta Richdale, Jessica Lewis, or any other member of our Securities Litigation Group.

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¹ "Utility token" refers to a token that has one or more specific functions, such as allowing its holder to access or purchase services or assets based on blockchain technology.

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