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OSC Gives Relief to First Initial Token Offering

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On October 17, 2017, the Ontario Securities Commission ("OSC") granted relief to an initial token offering ("ITO"), its first decision of this kind. The OSC granted exemptive relief to Token Funder ("Funder") in connection with its ITO of FNDR tokens (as defined below) through a private placement offering (the "Offering"). The exemptive relief was sought through the Canadian Securities Administrators' regulatory sandbox (the "CSA Sandbox"), which is an initiative of the CSA to support fintech businesses seeking to provide innovative products, services and applications by offering a faster and more flexible process to register and/or obtain exemptive relief from securities laws requirements.

Token Funder and the FNDR Offering

Funder is a Toronto-based blockchain business established for the purposes of creating a smart token asset management platform ("STAMP"), which is intended to (subject to regulatory approvals and exemptive relief) facilitate (i) third-party issuers raising capital through the offering of tokens and coins, (ii) token and coin management and governance services for issuers and (iii) the raising of capital in accordance with National Instrument 45-106 – *Prospectus Exemption* ("NI 45-106") or as a crowdfunding portal pursuant to Multilateral Instrument 45-108. To fund the establishment of STAMP, Funder will create 1,000,000,000 digital tokens through a smart contract on the Ethereum blockchain (the "FNDR tokens").

Funder applied for relief from the dealer registration requirement in connection with a private placement to be completed pursuant to the offering memorandum prospectus exemption set out in Section 2.9 of NI 45-106. The Offering will involve an initial distribution of up to 200,000,000 of the 1,000,000,000 FNDR tokens created by Funder for total gross proceeds of up to approximately CAD$10,000,000. The FNDR tokens will be offered to potential investors through Funder's website, subject to a maximum investment equivalent to CAD$2,500 unless such investor can demonstrate its status as an "eligible investor" or "accredited investor" under NI 45-106. The subscriptions may be made through payment of Ether or Canadian dollars. In cases where an investor chooses to subscribe for the FNDR tokens with Ether, the value of the subscription will be determined at the time the investor completes the suitability review and is approved for participation in the ITO.

In its application for exemptive relief, Funder emphasized its commitment to investor protection. For instance, Funder will ensure that each potential investor undergoes a comprehensive review process, including the collection of information such as investment needs and objectives, financial circumstances and risk tolerance, and each investor will complete a survey to ensure that they have a detailed understanding of cryptocurrency and digital token offerings. Further, Funder represented that each investor will be provided with updates regarding the milestones for development of STAMP and any other material events concerning

the business of Funder, including all required regulatory disclosures required by as a result of reliance on the offering memorandum prospectus exemption.

OSC's Exemptive Relief

The OSC granted the requested exemptive relief for a period of 12 months on the condition that the following conditions are satisfied:

- the FNDR Tokens issued in the Offering will not be listed and traded on any exchange, cryptocurrency exchange or organized market unless such listing and trading is approved in advance by the OSC and compliant with applicable securities legislation;
- following the consummation of the Offering, Funder will seek to become a registrant and will not facilitate any capital raising efforts by issuers through STAMP in the absence of such registration;
- Funder will establish, maintain and apply policies and procedures to sufficiently manage the risks associated with its business, including in the case of the Ethereum blockchain certain cybersecurity and conflicts of interest checks;
- neither Funder nor any of its representative shall provide investment recommendations or advice to any investor;
- know-your-client and suitability reviews will be conducted by Funder; and
- Funder will deal fairly, honestly and in good faith with its investors.

Further, Funder must ensure that full and complete disclosure will be provided to all potential investors in the FNDR tokens through the offering memorandum, including audited financial statements required by applicable securities laws indicating all expenses incurred and paid or accrued by Funder.

Impact of Decision

The decision demonstrates CSA Sandbox's commitment to supporting businesses looking to innovate in the Canadian markets by helping these businesses raise capital through non-traditional financing models, such as ITOs. However, this decision still leaves companies looking to raise funds through ITOs with more questions than answers.

CSA Staff Notice 46-307 – Cryptocurrency Offerings dated August 24, 2017 (the "Notice") noted that "in many instances" coins and tokens fall within the definition of "security" for the purposes of securities laws. The Notice drew a distinction between utility tokens (such as a token that allows a purchaser to play video games on the platform) and value-based tokens (such as a token tied to the future profits of a business), and noted that value-based tokens "will likely be considered securities" while "it is possible that securities may not be involved" in utility tokens. As the decision was related to the dealer activities of Funder in marketing and selling the FNDR tokens, the OSC's decision did not include an analysis of whether the FNDR tokens would be considered utility or value-based tokens or provide any framework to conduct such

an analysis. Funder was amenable to having the FNDR tokens treated as traditional restricted securities issued by a private company. Based on the guidance provided in the Notice, however, the FNDR tokens would likely be considered value-based as they provide a right to share in distributions arising from the operating of STAMP. A framework to classify tokens under Canadian law remains to be developed and real guidance remains to be provided. Companies looking to raise money through cryptocurrency offerings continue to operate under much uncertainty where the tokens may have utility and should tread carefully. Issuers must ensure that they understand the potential registration related consequences of issuing, selling and trading cryptocurrencies.

To read full text of the OSC's decision, click here.

We Can Help

For more information about how Cassels can assist with your business, please contact Amanda Metallo or another member of our firm's cross-disciplinary Emerging Companies Group.

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