Cassels

CSA Provides Guidance on How Canadian Securities Law Applies to Cryptocurrencies

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On August 24, 2017, in response to the growing number of cryptocurrency offerings, the Canadian Securities Administrators (the "CSA") issued ***Staff Notice 46-307 - Cryptocurrency Offerings*** (the "Staff Notice"). Cryptocurrency offerings can appear in a number of forms, such as initial coin offerings (an "ICO") or the sale of securities of cryptocurrency investment funds. In an attempt to clarify its position on these offerings, the CSA issued the Staff Notice to provide guidance on how securities law in Canada may apply to this emerging field and to specify the required obligations that must be met under the current applicable regulations.

1. Cryptocurrency Exchanges

The Staff Notice defines cryptocurrency exchanges as "online exchanges that allow investors to buy and sell cryptocurrencies". These exchanges operate in a number of jurisdictions worldwide, and in many cases are unregulated and free from government oversight. A cryptocurrency exchange that offers cryptocurrencies that are securities must determine whether they are operating as a "marketplace". Marketplaces are required to comply with the rules governing exchanges or alternative trading systems. If an exchange qualifies as a marketplace and that exchange is operating in a jurisdiction of Canada, it must apply to that jurisdiction's securities regulatory authority for recognition as a marketplace or for an applicable exemption.

2. ICOs

ICOs are commonly used by start-up businesses to raise capital from investors on the internet and, in many cases, closely resemble an initial public offering. While the Staff Notice outlined that many businesses aim to market their coins and tokens as "software products", the CSA noted that it would consider substance over form in determining whether securities law applies.

To determine whether the ICO would be classified as a security under Canadian law, the CSA stated that it will consider the economic realities of the transaction. For guidance on this determination, the CSA outlined the four-part test from the Supreme Court of Canada decision in ***Pacific Coast Coin Exchange v Ontario Securities Commission*, [1978] 2 SCR 112**, which examines whether the coins/tokens issued in the ICO satisfies the following four criteria:

1. an investment of money
2. in a common enterprise
3. with the expectation of profit
4. to come significantly from the efforts of others.

If the coins/tokens are considered securities, the obligations under Canadian securities law will apply if there are Canadian investors or if the person or company selling the securities is conducting business in Canada. The CSA noted a number of fundamental securities law obligations that businesses considering an ICO must address:

a) Prospectus Requirement or Exemption

Securities may only be sold under Canadian law once a receipt has been issued from a regulatory authority for a disclosure document, known as a prospectus, or alternatively after an issuer has been granted a prospectus exemption.

While no business has used a prospectus to complete an ICO in Canada, the CSA stated that businesses may be able to sell coins or tokens to accredited investors under certain prospectus exemptions. These exemptions include, among others, the "accredited investor exemption" for investors who qualify as accredited investors under National Instrument 45-106 – Prospectus Exemption ("**NI 45-106**"), and the "offering memorandum exemption" for investors who do not qualify as accredited investors.

b) Registration Requirement or Exemption

In addition to the prospectus requirements, individuals or businesses completing ICOs may be trading in securities for a 'business purpose'. In those instances, the issuing party must either be registered with the applicable securities regulator, or rely on a registration exemption. The CSA offered a non-exhaustive list of important considerations when determining whether an issuer is trading in securities for a business purpose, including where the issuing party is:

• soliciting a broad base of investors, including retail investors;
• using the internet, including public websites and discussion boards, to reach a large number of potential investors;
• attending public events, including conferences and meetups, to actively advertise the sale of the coins/tokens; and
• raising a significant amount of capital from a large number of investors.

If this is the case, then these individuals or businesses must be registered and must, among other things, meet "know-your-client" and suitability of investment obligations for their clients.

3. Cryptocurrency Investment Funds

The Staff Notice also examined investment funds for cryptocurrencies, which are used to provide investors with the opportunity to gain exposure to cryptocurrencies or baskets of cryptocurrencies that would be otherwise unavailable. The CSA encouraged businesses looking to establish investment funds to consider a number of factors, including whether they may qualify for certain exemptions, how the cryptocurrencies comprising the fund's portfolio will be valued, and whether the fund has appropriate custodial measures in place to ensure the security of the tokens or coins.

As the Staff Notice outlines, these cryptocurrency offerings have provided exciting new ways for businesses to raise capital, and for investors to access a broader range of investments. However, businesses and investors that are interested in entering these areas should consult legal and investment professional to ensure that they are complying with the applicable securities laws and obligations.

We Can Help

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