

# ASK NOT FOR WHOM THE BELL TOLLS....THE CLOCK IS TICKING FOR UNREGISTERED CRYPTO TRADING PLATFORMS OPERATING IN CANADA AS CSA ANNOUNCE ENHANCED PRE-REGISTRATION UNDERTAKINGS

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In the wake of the collapse of FTX and as part of their continued efforts to regulate unregistered Crypto Asset Trading Platforms operating in Canada (“**Unregistered CTPs**”), the Canadian Securities Administrators (“**CSA**”) have recently published CSA Staff Notice 21-332 *Crypto Asset Trading Platforms: Pre-Registration Undertakings - Changes to Enhance Canadian Investor Protection* (the “**Staff Notice**”).<sup>[1]</sup> The Staff Notice: (i) states that Unregistered CTPs are required to agree to and file by March 24, 2023, an enhanced form of pre-registration undertakings (“**PRU**”) that includes increased standards of compliance for Unregistered CTPs while they seek registration and related exemptive relief; and (ii) provides additional guidance on how the CSA views the application of Canadian securities legislation to crypto assets and CTPs.

The Staff Notice will impose significant operational and administrative challenges for Unregistered CTPs to agree to a new form of PRU in a very short period of time in order to avoid possible enforcement actions by CSA members.

## Background

On August 15, 2022, the CSA announced that Unregistered CTPs are expected to file a PRU with their principal regulator to continue operating in Canada while they seek registration and related exemptive relief. By signing the PRU, an Unregistered CTP agrees to operate under certain terms and conditions that the CSA believes are necessary to address investor protection and level-playing-field concerns during this interim registration period.

On December 12, 2022, the CSA announced that, following recent Crypto Trading Platform insolvencies (most notably, the insolvency and collapse of FTX), they were strengthening their approach on the oversight of Unregistered CTPs by expanding existing requirements for platforms operating in Canada and would be publishing further details on this updated approach.

## Expanded Terms and Conditions on Operation

The Staff Notice states that Unregistered CTPs are required to agree to and file a new form of PRU that includes several new provisions including:

- **Enhanced custodial requirements:** An Unregistered CTP will be required to hold client assets including cash, securities and crypto assets that are not securities (a) separate and apart from its own property, (b) in trust for the benefit of the client, (c) in the case of cash, in a designated trust account or in an account designated for the benefit of clients with a Canadian custodian or Canadian financial institution, and (d) in the case of crypto assets, in a designated trust account or in an account designated for the benefit of clients with a custodian that qualifies as an “Acceptable Third-Party Custodian”. An “Acceptable Third-Party Custodian” is defined in the Staff Notice to include, among others:
  - a Canadian custodian or Canadian financial institution;
  - a qualified custodian or sub-custodian pursuant to section 6.2 of National Instrument 81-102 - *Investment Funds*;
  - a custodian that meets the definition of an “acceptable securities location” in accordance with the Investment Dealer and Partially Consolidated Rules and Form 1 of New Self-Regulatory Organization of Canada;
  - a foreign custodian for which the Unregistered CTP has obtained the prior written consent from the applicable regulators; and
  - an entity that does not meet the criteria for a qualified custodian but the Unregistered CTP has obtained prior written consent from the applicable regulators.

Unregistered CTPs are also required to commit to providing an authorization and direction that allows the CSA to obtain information on the status of Canadian client accounts directly from the custodian without going through the Unregistered CTP.

- **Continued restrictions on ability to pledge or otherwise use crypto assets:** The PRU will require evidence of compliance systems and controls designed to provide reasonable assurance that the Unregistered CTP complies with the restriction on the ability of Unregistered CTPs to pledge, re-hypothecate or otherwise use crypto assets held on behalf of Canadian clients.
- **Further restrictions on offering leverage:** Unregistered CTPs will be required under the terms of the PRU to agree not to offer or provide margin, credit or other forms of leverage to any client. Under the existing form of the PRU, Unregistered CTPs were able to offer these services to “permitted clients” (as defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“**NI 31-103**”)).

- **Commitments from controlling mind(s) and global affiliates:** The PRU will require an Unregistered CTP's global affiliates, its parent entities and/or their controlling minds to execute a PRU and undertake not to undermine the independence of the Unregistered CTP. To the extent possible, the PRU will include a provision that the Unregistered CTP's board of directors is independent from such affiliates, entities and controlling minds.
- **Exclusion of crypto assets from working capital:** To calculate the minimum excess working capital requirement applicable to registered firms, Unregistered CTPs will not be permitted to include the value of any crypto assets held which are not offset by a corresponding current liability (such as crypto assets held for clients as collateral to guarantee obligations under crypto contracts).
- **Increased financial reporting:** Consistent with the requirement for registered securities dealers, the CSA will require Unregistered CTPs to file financial statements pursuant to Section 12.12 of NI 31-103.
- **Chief Compliance Officer:** Unregistered CTPs will be required to designate an individual to act as a Chief Compliance Officer ("**CCO**") to maintain compliance procedures and to monitor and assess compliance of the Unregistered CTP with applicable Canadian securities laws. The CCO must have direct access to the board of directors of the Unregistered CTP and must generally meet the proficiency requirements of the CCO for a registered exempt market dealer in Canada.

### **Prohibition on Stablecoin Crypto Contracts without Consent**

The Staff Notice reiterates the CSA view that stablecoins or stablecoin arrangements may constitute securities and/or derivatives in certain circumstances. The CSA refer to stablecoins as "Value-Referenced Crypto Assets" or "VRCAs" which are defined as "crypto assets that are designed to maintain a stable value over time by referencing the value of a fiat currency or any other value or right, or combination thereof". The CSA may generally consider certain VRCAs that are pegged to or backed by a reserve of assets denominated in fiat currency (a "**Fiat-Backed Crypto Asset**") or assets other than fiat currency to be securities under Canadian securities legislation (and therefore, registered crypto trading platforms or that have entered into an existing PRU may not facilitate the trading of these assets in Canada).<sup>[2]</sup> This is in stark contrast to the position taken in relation to other crypto assets where the CSA have explicitly placed the obligation on each crypto trading platform to make a determination as to whether the crypto asset is, or is not, a security or a derivative.

The CSA have identified concerns regarding the transparency of reserve assets, the stabilization mechanisms for maintaining their value, and governance factors are key risk factors of VRCAs. In recognition that compliance with the new form of PRU may mitigate the risks associated with VRCAs and that VRCAs may not always be considered to be securities and/or derivatives, the new form of PRU does not impose an outright prohibition on the facilitation of trading of all VRCAs.

The new PRU requires Unregistered CTPs to obtain the prior written consent from the CSA in order to facilitate the trading of specific VRCAs, such consent being premised on the Unregistered CTP conducting sufficient due diligence to ensure that applicable VRCA risks are addressed, including (as applicable) that:

- the VRCA is a Fiat-Backed Crypto Asset;
- a distribution of a VRCA is made in compliance with applicable Canadian securities legislation;
- the issuer maintains a reserve of assets with a market value at least equal to the value of the outstanding units of the Fiat-Backed Crypto Asset at the end of each day and that such reserve is (i) comprised of highly liquid assets, (ii) held by a qualified custodian in favour of the holders of the Fiat-Backed Crypto Asset; (iii) segregated from the assets of the issuer and other classes of crypto assets issued by the issuer; and (iv) subject to a monthly attestation and audit by an independent auditor;
- the redemption rights of the VRCA holder are clearly articulated in policies and procedures that have been publicly disclosed;
- the issuer maintains (i) a plan for recovery to support an orderly wind-down in case of a crisis or failure, and (ii) effective governance practices;
- pertinent and accurate information about the Fiat-Backed Crypto Asset is made publicly accessible in plain-language; and
- the Unregistered CTP is not otherwise prohibited from entering into crypto contracts in respect of the Fiat-Backed Crypto Asset.

### **Compliance Deadline and Enforcement**

The Staff Notice states that all Unregistered CTPs are expected to:

- agree to and file the new PRU in a form acceptable to CSA staff by March 24, 2023;
- implement any necessary operating changes to comply with the provisions of the new PRU within the timeline set out therein; and
- make a bona fide attempt to progress through the registration process as quickly as possible.

The CSA advised it will consider compliance and/or enforcement action against an Unregistered CTP and its principals if the Unregistered CTP does not meet these requirements, or if the Unregistered CTP's operations raise other investor protection or public interest concerns. Enforcement action by CSA members may include the Unregistered CTP being named on an investor alert or warning list, the CTP being directed to stop providing services to Canadian users and impose access restrictions to Canadian users, an order that the CTP and its principals cease trading activities with residents of Canada, and other penalties or sanctions against the Unregistered CTP and its principals.

[1] See [CSA Staff Notice 21-332 Crypto Asset Trading Platforms: Pre-Registration Undertakings - Changes to Enhance Canadian Investor Protection](#).

[2] To date, Tether (USDT), a Fiat-Backed Crypto Asset, is the only crypto asset that the CSA have explicitly prohibited a CTP from offering trading services in respect thereto. See the exemptive relief decision of [Coinberry Limited](#) and [Wealthsimple Digital Assets Inc.](#)

by [Michael Burns](#), [Jason Chertin](#), [Grant Y. Wong](#), [Matthew DeAmorim](#) and [Adam Jones](#)

### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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