

# CANADIAN REGULATORY DIRECTION AND PRESSURE FOR CRYPTOCURRENCY PLATFORMS

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On March 29, 2021, the Canadian Securities Administrators (the “**CSA**”) and the Investment Industry Regulatory Organization of Canada (“**IIROC**” and together with the CSA, the “**Regulators**”) issued Staff Notice 21-329 (the “**Notice**”). The Notice provides a firm statement of the Regulator’s intent to apply Canadian securities laws to ‘crypto asset trading platforms’ (“**CTPs**”), and the regulatory hurdles they will be required to jump if they are to operate in Canada. This Notice also reinforces that the regulation of CTPs has become a regulatory priority of Canadian securities regulation given the recent popularity of these assets amongst investors.

The Notice comes during a period of extended growth in the crypto space. The direct listing of the largest cryptocurrency exchange in the U.S. (by trading volume), Coinbase, was one of the most highly anticipated public offerings of 2021, and the cryptocurrency market cap recently surpassed \$2 trillion USD after doubling this year.<sup>[1]</sup>

Since issuing the Notice, the Regulators’ enforcement response has involved a combination of public warnings and commencement of proceedings against CTPs who have not sought registration. The parent entities behind the Kucoin crypto exchange,<sup>[2]</sup> and Poloniex,<sup>[3]</sup> another crypto exchange, have been the latest subjects of the Ontario Securities Commission’s (the “**OSC**”) enforcement initiative. Similar regulatory responses have been initiated in other jurisdictions, including by the SEC in the United States and the Financial Conduct Authority in the United Kingdom.

Prior to issuing the Notice, the OSC enforced regulations over CTPs on a more ad-hoc basis. McMillan LLP (“**McMillan**”) was a first-mover in providing legal advice on such issues. McMillan lawyers negotiated the first regulatory settlements involving CTPs in Canada.<sup>[4]</sup> In addition, our team have had discussions with the OSC LaunchPad on behalf of some of our fintech clients who are exploring innovative business models dealing with crypto assets.

For discussion on previous developments in the Canadian securities regulatory space in respect of CTPs, please see [Cryptocurrency Securities law Update – Platform Framework and Service Providers](#).

## CTPs, Dealer Platforms and Marketplace Platforms

The purpose of the Notice is an attempt to reach regulatory consensus and consistency with respect to the treatment of CTPs. In past cases, the legal question at issue was whether cryptocurrency, itself, is a security or not. Without landing on a reliable position on that issue, much of the regulatory resolution of issues related to CTPs concerned whether the Crypto Contracts exchanged on CTPs fell within the definition of derivative contracts under Canadian law. This issue avoided the more complicated question of whether any particular cryptocurrency constituted a “security” under Canadian law. The treatment of crypto contracts as derivatives found more easy approval by the decision-making branches of the Regulators, such as the OSC’s tribunal.

The Notice defines a CTP as a platform that facilitates the trading of: (a) crypto assets that are securities (“**Security Tokens**”); or (b) instruments or contracts involving crypto assets (“**Crypto Contracts**”).<sup>[5]</sup>

The Notice illustrates that the regulatory requirements applicable to a CTP will depend on whether the CTP operates as a ‘Dealer Platform’ or a ‘Marketplace Platform’.

### Key Activities of Dealers:

The two most common activities undertaken by a CTP operating as a Dealer Platform are:

- exclusively facilitating the primary distribution of Security Tokens; and
- acting as the counterparty to each trade of Security Tokens and/or Crypto Contracts, and users do not trade with one another on the CTP.

### Key Features of Marketplaces

In contrast to a Dealer Platform, the Regulators’ position is that a CTP operates as a Marketplace Platform if it:

- constitutes, maintains or provides a market or facility for bringing together buyers and sellers or parties to trade in Security Tokens and/or Crypto Contracts;
- brings together orders of Security Tokens and/or Crypto Contracts of buyers and sellers or parties of the contracts; and
- uses established, non-discretionary methods under which orders for Security Tokens and/or Crypto Contracts interact with each other and the buyers and sellers or parties entering the orders agree to the terms of a trade.

### Regulatory Requirements

According to the nature of the CTP’s activities, Dealer Platforms are required to register under the appropriate category of dealer registration. A Dealer Platform, that does not offer margin or leverage, and solely facilitates

the distribution of Security Tokens pursuant to prospectus exemptions, will generally be required to register as an exempt market dealer, or a restricted market dealer, as appropriate. A Dealer Platform offering margin or leverage for Security Tokens must register as an investment dealer and obtain IIROC membership. The Notice also outlines that Dealer Platforms trading Crypto Contracts are required to register under an appropriate dealer category. Furthermore, where these platforms trade or solicit trades for retail investors that are individuals, they will generally be required to be registered as an investment dealer and obtain IIROC membership.

Existing registered firms introducing crypto asset products and/or services are required to report a change in their business activities.

In respect to Marketplace Platforms, the Notice states that the provisions relevant to marketplaces under the existing instrument framework will apply. Trading activity on Marketplace Platforms will likely be subject to market integrity requirements, and Marketplace Platforms will operate under the oversight of the CSA and IIROC. Additionally, the regulations applicable to exchanges may also apply to Marketplace Platforms. If a Marketplace Platform trades Security Tokens and regulates issuers of those Security Tokens, or if it regulates and disciplines its trading participants, other than by denying them access to the platform, the Marketplace Platform will likely be viewed as carrying on business as an exchange. Marketplace Platforms carrying on exchange activities are required to seek recognition as an exchange, or an exemption from such recognition.

The Notice additionally makes it clear that Marketplace Platforms and Dealer Platforms are not mutually exclusive categories. Marketplace platforms conducting activities similar to those of Dealer Platforms are subject to the applicable dealer requirements, and visa-versa.

Importantly, the Notice reminds CTPs operating from jurisdictions outside Canada that have Canadian clients that they are required to comply with Canadian securities legislation.

### **Regulatory Tailoring and Interim Approach**

Although the Notice serves as a firm statement that the Regulators expect CTPs to comply with Canadian securities legislation, in order to foster innovation and provide flexibility, the Regulators have provided for an interim period in recognition of: (a) the time it takes to prepare for, and obtain, required registrations and IIROC membership; and (b) those CTPs looking to test a novel business idea in a rapidly developing industry. Accordingly, a CTP that does not offer leverage, margin trading or operate as an exchange, will likely be required to register as a restricted dealer, or exempt market dealer, and consider future registration as an investment dealer. This interim period will allow the CTP to operate under terms and conditions tailored to the CTP's business model. For those Marketplace Platforms operating an exchange function, the Regulator's appear open to considering if recognition as an exchange or an exemption is required during the interim

period in order to tailor the regulatory requirements to the specific business model of businesses impacted by this Notice.

### **Enforcement and Effect**

In past and current enforcement matters involving CTPs, the OSC has requested a plethora of corrective and punitive actions for allegedly failing to comply with securities legislation. In the matter involving Poloniex, the order the OSC is seeking includes that Poloniex:

- cease trading in any securities or derivatives permanently or temporarily;
- be prohibited from acquiring any securities permanently or temporarily;
- be reprimanded;
- be permanently prohibited from acting as a registrant, investment fund manager or promoter under securities regulations;
- disgorge to the OSC any amounts obtained from Ontario based users; and
- pay costs and additional penalties.<sup>[6]</sup>

In the future, CTPs are likely to simply discontinue such offerings to avoid regulatory risk in Canada, given the relative size of the Canadian market. The nuance, cost, and inconvenience arising from seeking registration in Canada (assuming it is even available to them) is leading CTPs to simply not offer products to Canadians. It is impractical to think that CTPs that offer services around the world, in dozens or hundreds of countries, will make significant changes to their businesses to satisfy the Regulators when those other countries do not have similar requirements. It is not a coincidence that on June 25, 2021, Binance, the world's largest crypto exchange (by trading volume), announced it would no longer provide service to Ontario-based users.<sup>[7]</sup> However, it is welcome that the Regulators, in issuing the Notice and making the interim period available for seeking registration, have sought to use tools other than those arising from enforcement.

There are good questions surrounding whether the Notice adequately takes into consideration the impact of technology with respect to CTPs. Does the process set out in the Notice, and related enforcement actions which have followed, truly benefit Canadians who, if they wish to trade Crypto Contracts or Security Tokens, are likely to find off-shore ways to do so? As these technologies serve to decentralize currency itself, are efforts to fit cryptocurrency into existing securities regulatory regimes an appropriate or adequate methodology – even if there can be no doubt that is the approach currently applied in Canada? What we do know is that CTPs will have to continue to navigate matters with the Regulators until a different approach is available.

[1][ps2id id='1' target=''] See [Crypto Market Cap Surpasses \\$2 Trillion After Doubling This Year](#)

[2][ps2id id='2' target=''] See [Statement of Allegations: In the Matter of Mek Global Limited and PhoenixFin](#)

[Pte. Ltd.](#)

[3][ps2id id='3' target=''] See [Statement of Allegations: In the Matter of Polo Digital Assets, Ltd.](#)

[4][ps2id id='4' target=''] See e.g. *eToro (Europe) Limited*, 2018 ONSEC 49 (eToro), and *International Capital Markets Pty. Ltd. (Re)*, 2019 ONSEC 28.

[5][ps2id id='5' target=''] CTPs that facilitate the trading of Crypto Contracts includes those platforms that allow users to buy and sell crypto assets, but only grant the user a contractual right or claim to the underlying crypto asset and the platform provider is not required to immediately deliver the crypto asset to the user. See CSA Staff Notice 21-327.

[6][ps2id id='6' target=''] *Supra*, note 3.

[7][ps2id id='7' target=''] See [Binance Terms of Use Review \(2021-06-25\)](#)

by [Matthew DeAmorim](#), [Adam Chisholm](#) and [Raj Dewan](#)

### **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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