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ONTARIO'S PROPOSED *CAPITAL MARKETS ACT* FAILS TO CRACK THE CODE FOR REGULATING CRYPTO

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In 2021, the Ontario government released its first draft of the proposed *Capital Markets Act* (the "**CMA**"),[1] following an extensive consultation with industry stakeholders and members of the public conducted throughout 2021. If enacted, the CMA will overhaul the Ontario capital markets regime, replacing both the *Securities Act*[2] and *Commodity Futures Act*[3] as the governing securities and commodities legislation in the province.

The CMA is the first legislative attempt in Canada to codify the role of the securities regime in regulating crypto. Under the current regulatory regime, companies developing in the crypto space in Ontario must rely on evolving staff notices and interpreting decisions by securities bodies to determine whether their products will be regulated as securities.

While the new legislation is an ideal opportunity for the Government of Ontario to create a modern regime fostering growth in the crypto space, the draft CMA seems to miss that mark. Rather than laying the groundwork for a mature crypto market, the draft CMA would build on existing regulatory uncertainty by granting discretionary powers to the Ontario Securities Commission ("**OSC**") to determine when a crypto asset can be regulated as a security.

The New Regime for Crypto

Under the current regime, the question of whether a crypto asset is a security is determined under the Supreme Court of Canada's 1977 ruling in *Pacific Coast Coin Exchange v. Ontario Securities Commission*.[4] Adapting a substantially similar test adopted by the U.S. Supreme Court,[5] the Supreme Court of Canada set out a four part test based on whether (1) there is an investment of money; (2) there is an investment in a common enterprise with others; (3) there is an intention of profit; and (4) the profit comes significantly from the efforts of others. If an asset has all four elements, it is an "investment contract" and therefore, a security. This test has been adopted into the crypto space through staff notices from the Canadian Securities Administrators ("**CSA**").[6]

If enacted as proposed, the CMA would allow the OSC to treat crypto very differently than under current law.

The CMA would bring "crypto asset[s]", which it defines as a "a digital representation of value or contractual rights, which may be transferred and stored electronically, using distributed ledger or similar technology",[7] under its regime by giving the Chief Executive Officer of the OSC broad powers to designate a crypto asset as a security or a derivative where, in their judgement, it is in the public interest to do so.[8]

The proposed definition of a "crypto asset" is broad, but generally in line with other jurisdictions. For instance, this definition is nearly identical to that of a "crypto-asset" in the European Union's proposed Markets in Crypto Assets ("**MiCA**") framework, which is expected to come into force in 2024.[9] The problematic aspect of the draft CMA is not the definition, but rather is the designation powers granted to the OSC. While the proposed regime would provide a company with a right to be heard on the question of whether its products are securities, the decision is ultimately placed in the discretion of the OSC.[10] The only express limitation on this discretionary power is its "public interest" qualifier, which arguably would do little to limit the subjectivity of determinations under this power. What is in the "public interest" can itself be a matter of perspective and so this qualifier could be used to bring considerations beyond financial protection of market participants into the decision-making process.[11]

The consequences of a crypto asset being designated a security under the new regime would be considerable. Companies that issue securities are restricted from offering their products outside of the limited prospectus exemptions available under securities law. Companies that become reporting issuers – which would normally occur by issuing securities under a prospectus, but could also occur under the broad designation powers granted to the OSC[12] – would become subject to expensive and onerous continuous disclosure requirements. On the secondary market, customers would also be prohibited from buying or selling crypto assets from other traders where a prospectus exemption is not available.[13]

On the topic of prospectus exemptions, not even the "Start-up Crowdfunding Registration and Prospectus Exemptions"[14] (the "**Crowdfunding Exemptions**") adopted by the Canadian Securities Administrators in 2021 are of any assistance to companies developing in the crypto space. The Crowdfunding Exemptions define a closed list of traditional forms of securities to be "eligible securities" that may be distributed to the public without a prospectus. Notably absent from this list is crypto assets or even a catch-all provision that could be interpreted to include crypto assets.

Observations

Ontario is on a path to become a hub for tech innovation, particularly in the crypto space. In a 2019 speech, Ontario's then Minister of Finance threw his support behind crypto, stating that "Ontario is well-positioned to lead blockchain innovation in Canada and on the world stage".[15] It is surprising then that the draft CMA does little to encourage the development of the crypto market in Ontario.

In granting this discretionary power, the regime risks perpetuating, rather than resolving, uncertainties in the crypto market. The move towards discretion stands in contrast to other more nuanced efforts for comprehensive regulation, including MiCA. For instance, instead of requiring crypto asset providers to use the securities prospectus process, MiCA proposes a "whitepaper" requirement for crypto assets that fall within its scope, which is broken down further by asset type with stricter requirements for "stablecoins", i.e., crypto assets which link their value to an underlying asset or commodity.[16] Furthermore, MiCA specifically excludes certain crypto assets from its scope when there already exists an instrument regulating that particular type.[17]

As it stands, the regime provides little practical guidance for how newcomers to the crypto marketplace should develop their products and business in order to avoid issuing securities and falling into a highly regulated industry. Indeed, the new regime could create risks for the existing marketplace as well. Existing crypto products that have been accepted as not securities, such as decentralized coins like Bitcoin and Ether, could see their status change upon later reflection and policy considerations by the OSC. These risks extend to other crypto assets not typically considered to fall within the traditional definition of a "security", such as NFTs representing a unique piece of art, which were presumed by the Canadian Securities Administrators not to represent a "common enterprise" due to their unique nature.[18] This unique nature would no longer exclude NFTs, or other similar crypto assets, from the security regime under the draft CMA. By opening the door in this way to regulating crypto assets as securities, even when they lack the traditional features of securities, the new regime not only undermines the current and future crypto marketplace, but also the evolution of the underlying technology within Ontario by making that technology itself a point of regulatory risk.

Beyond the potential uncertainty within Ontario, granting such power to the OSC means that crypto assets may receive divergent treatment between the provinces. While Canada lacks a central securities regulator, some harmonization has resulted through the CSA's issuances of National Instruments and Staff Notices that are generally treated as binding within the provinces. The draft CMA is a step back from Canada's progress toward a predictable, national model, as it grants a unique power to the OSC with no expectation that the same measures will be adopted in other provinces.

There is no question that to fulfil the OSC's mandate of protecting the public, an adaptable framework will better help it manage future risks of fraud in an evolving technological landscape. Nevertheless, the draft CMA proposal makes no attempt to meaningfully engage with the nuances and innovation potential of the crypto industry, opting instead for a simplistic approach that does not live up to more careful efforts and strategies in other jurisdictions and may come to undermine the future development of crypto and related technologies within the province. If the Government of Ontario simply wants regulators to have the option of saddling crypto asset providers with the same requirements as securities issuers, the new regime may achieve that. However, even in that case there are more meaningful approaches that could be adopted instead that

encourage developers and market participants to engage with regulators.

[1] *Capital Markets Act*, RSC 2021 Consultation Draft of 12 October 2021, [*Capital Markets Act –Consultation Draft*].
[2] Securities Act, R.S.O. 1990, c. S.5 [*Ontario Securities Act*].
[3] Commodity Futures Act, RSO 1990, c C.20.
[4] *Pacific Coast Coin Exchange of Canada v Ontario (Securities Commission)*, [1977] 2 SCR 112, 2 ACWS 1063 [*Pacific Coin*].
[5] *Securities and Exchange Commission v. W. J. Howey Co.*, [1946] 328 U.S. 293 [*Howey*].
[6] Canadian Securities Administrators, "CSA Staff Notice 46-308 *Securities Law Implications for Offerings of Tokens*" (11 June 2018), online: Ontario Securities Commission [*CSA Staff Notice 46-308*].
[7] *Capital Markets Act –Consultation Draft, supra* note 1 at s. 3.
[8] *Ibid* at s. 127(2).
[9] Werner Vermaak, "MiCA (Updated July 2022): A Guide to the EU's Proposed Markets in Crypto-Assets Regulation" (July 2022), online (blog): Synga Bridge [*MiCA*].
[10] *Supra* note 8.
[11] Paul D. Davis, "The Exercise of the Public Interest Power by the OSC – A New Standard is Needed" (4 September 2014), online (blog): McMillan LLP.
[12] *Ontario Securities Act, supra* note 2 at s. 11(1)(b).
[13] *Ibid* at s. 53(1); *Resale of Securities*, OSC NI 45-102, (2003) 26 OSCB 8230.
[14] *Start-Up Crowdfunding Registration and Prospectus Exemptions and Consequential Amendments*, OSC NI 45-110, (2021) 44 OSCB 7881.
[15] Chamber of Digital Commerce Canada, "Blockchain Has a Champion in Ontario" (1 April 2019), online (blog).
[16] *MiCA, supra* note 9.
[17] *Ibid*.
[18] *CSA Staff Notice 46-308, supra* note 6.

by Robert Piasentin, Jeffrey Gebert, Graham Bevans, and William Burke

A Cautionary Note

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