

# **OSC GRANTS EXEMPTIVE RELIEF TO TOKEN FUNDER INC.**

Posted on November 1, 2017

## Categories: Insights, Publications

Not long after Quebec-based Impak Finance Inc. completed Canada's first legally sanctioned initial coin offering ("ICO"), the Ontario Securities Commission (the "OSC") has granted exemptive relief to Toronto-based Token Funder Inc. ("Funder") to conduct Ontario's first regulated ICO or initial token offering (an "ITO"). In particular, the OSC has granted regulatory relief to Funder which will exempt Funder from the dealer registration requirements, and allow Funder to carry out an ICO/ITO under existing prospectus exemptions. The impact of this decision is that it provides early stage companies and other high growth companies with the ability to raise capital through an ICO/ITO, which has emerged as a novel fundraising mechanism in the last year, on the basis that such an offering of coins or tokens are treated as securities. The decision also confirms the sentiments of the CSA Staff Notice 46-307 – *Cryptocurrency Offerings* where the CSA stated that "many" of the digital coins or tokens investigated by regulators in Canada fall under the definition of a security; thereby triggering a range of requirements under applicable securities laws.

## Background

The Canadian Securities Administrators recently launched a regulatory sandbox (the "**CSA Sandbox**") to support financial technology businesses seeking to offer innovative products, services and applications in Canada. The CSA Sandbox allows businesses to register and/or obtain exemptive relief from securities requirements, under a faster and more streamlined process than through a standard application.

In the context of the CSA Sandbox, Funder applied for and obtained exemptive relief from the OSC pursuant to National Policy 11-203 – *Process for Exemptive Relief Applications in Multiple Jurisdictions* from the dealer registration requirement (the "Registration Relief"). In reliance on Multilateral Instrument 11-102 – Passport System, the OSC's decision is intended to be relied upon in all of the provinces and territories of Canada.

## Token Funder Inc.

Funder is a blockchain business that was established for the purpose of creating a platform (the "Platform") to, amongst other things, (i) provide token and coin management and governance services for issuers, (ii) provide for certain transferability of tokens and coins (subject to regulatory approvals) and (iii) to operate as a capital raising platform for third-party issuers through the offering of blockchain-based securities in accordance with



National Instrument 45-106 – Prospectus Exemptions ("**NI 45-106**") or as a crowdfunding portal pursuant to Multilateral Instrument 45-108 – Crowdfunding.

## The Offering

To fund the creation of the Platform and its ongoing working capital needs, Funder proposed to complete a private placement by way of an ITO (the "**Private Placement**") pursuant to the offering memorandum prospectus exemption set out in section 2.9 of NI 45-106. Funder will create 1,000,000,000 digital tokens through a smart contract on the Ethereum Blockchain (each a "**FNDR Token**"). Pursuant to the Private Placement, Funder will distribute up to 200,000,000 of the 1,000,000 FNDR Tokens for total gross proceeds of up to CAD \$10,000,000.

Each subscriber under the Private Placement will subscribe for FNDR Tokens through a smart contract using the Ethereum Blockchain. Subscribers may provide consideration for the FNDR Tokens in the form of Ether or Canadian dollars. Funder will conduct know-your-client and suitability reviews for each subscriber, and will also conduct a survey to ensure that subscribers have sufficient understanding of cryptocurrencies and ICOs/ITOs. The suitability analysis conducted by Funder will result in a limit assigned to the investment amount in the smart contract. Unless the subscriber proves otherwise, Funder will assume that the subscriber is not an "eligible investor" or an "accredited investor" and a maximum investment amount of CAD \$2,500 will be imposed.

Following the Private Placement, holders of FNDR Tokens will share in distributions from Funder arising from operations of the Platform. Further, the holder of FNDR Tokens will receive all disclosure required pursuant to NI 45-106 and other applicable securities laws.

## The OSC Decision

The OSC granted the Registration Relief on the basis that:

- 1. Funder will seek to become a registrant promptly after the completion of the Private Placement pursuant to National Instrument 31-103 Registration Requirements, Exemptions and
- 2. Ongoing Registrant Obligations;
- 3. Funder will not facilitate any further capital raising efforts through the Platform before becoming a registrant;
- 4. the Registration Relief is only sought for a limited period of time;
- 5. Funder will provide full and complete disclosure to investors through its offering memorandum; and
- 6. Funder will conduct know-your-client and suitability reviews.

The Registration Relief was granted for a twelve month period from the date of the OSC's decision provided



that the following conditions are met:

- 1. Funder will comply with the terms and conditions of the OSC's decision;
- 2. Funder will conduct know-your-client and suitability reviews for each subscriber and verify subscribers that represent themselves as "eligible investors" or "accredited investors";
- 3. FNDR Tokens will not be listed and traded on any exchange unless the listing and trading complies with applicable securities laws and is approved by the OSC in advance;
- 4. Funder will deal fairly, honestly and in good faith with its investors;
- 5. Funder will establish and apply policies to manage the risks associated with its business;
- 6. Funder will not provide investment advice to investors; and
- 7. Funder will report to the OSC quarterly and provide the OSC with details of any investor complaints in a timely manner.

## Conclusion

Although the securities regulators have encouraged innovative business and capital-raising models through the creation of the CSA Sandbox, there remain significant hurdles to achieve regulatory approval for ICOs/ITOs in Canada. Although the OSC's decision indicates a growing level of acceptance of platforms for raising capital through the use of digital currencies, it was largely based on the specific facts and circumstances of Funder's application and its conclusion that the ITO was subject to applicable securities law. In addition, the OSC's decision does leave open the question as to how the OSC will treat the offering of coins or tokens which are multidimensional, and which are appropriately structured to provide investors with rights which should not meet the definition of a security, often referred to as "utility tokens".

by Raj Dewan, Kosta Kostic, Valenteena Suvaminathan and Brent Thomas, Articling Student

## **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.

© McMillan LLP 2017