

# Goodmans<sup>LLP</sup> Update

## CSA Provides Guidance on Crypto-Asset Trading Platforms

On March 29, 2021, the Canadian Securities Administrators (CSA) and the Investment Industry Regulatory Organization of Canada (IIROC) released much anticipated comprehensive guidance for crypto-asset trading platforms (CTPs) facilitating or proposing to facilitate trades in security tokens or crypto contracts. Joint CSA/IIROC Staff Notice 21-329 *Guidance for Crypto-Asset Trading Platforms: Compliance with Regulatory Requirements* (“**Staff Notice 21-329**”), sets out how existing rules will apply to CTPs, depending on their functions. It does not introduce new rules, but rather clarifies how existing requirements under securities legislation will apply and offers insights into how the CSA and IIROC expect CTPs to act in accordance with applicable legislation.

At the same time, the Ontario Securities Commission (OSC) announced that CTPs must contact OSC staff by April 19, 2021 to discuss how to bring their operations into compliance with Ontario securities law. This applies to all CTPs operating in Ontario as well as those located outside of Ontario that allow Ontarians access to their platform. The OSC noted that CTPs who fail to contact OSC staff by the April 19th deadline will face potential enforcement actions.

### Background

With ever growing investor interest in crypto assets, and questions about whether or not they meet the definition of securities (see our August 27, 2019 Update, *What Makes a “Utility Token”? – SEC Delivers Rare No-Action Letter to Token Issuer*), regulatory bodies have faced significant challenges in determining how existing securities legislation should apply to these types of assets and to CTPs. Based on extensive consultation with industry stakeholders, Staff Notice 21-329 confirms that CTPs – both domestic and foreign – that service Canadian-based clients must comply with Canadian securities legislation, sets out the CSA’s expectations as to what that will entail, and generally provides a two-year interim period to allow CTPs to transition into full compliance.

### Crypto-Asset Trading Platforms

Staff Notice 21-329 applies to CTPs that facilitate the trading of:

- crypto assets that are securities (Security Tokens), or
- certain instruments or contracts for the purchase, sale or delivery of crypto assets, as indicated in *CSA Staff Notice 21-327 Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto-Assets*

### Distinguishing Between Dealer and Marketplace Platforms

The requirements applicable to a CTP under securities legislation depend on how it operates and the types of activities it undertakes. Staff Notice 21-329 distinguishes between two types of platforms – Dealer Platforms and Marketplace Platforms.

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The two most common characteristics of a Dealer Platform are:

- it only facilitates the primary distribution of Security Tokens; and
- it is the counterparty to each trade in Security Tokens and/or Crypto Contracts, and client orders do not otherwise interact with one another on the CTP.

Dealer Platforms may also engage in other activities and functions such as onboarding of retail clients onto the CTP, acting as agent for clients trades, and offering custody of assets (either directly or through a third party provider).

In contrast, a CTP is a Marketplace Platform if it:

- constitutes, maintains or provides a market or facility for bringing together multiple 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 multiple 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.

Staff Notice 21-329 suggests that no centralized marketplace is involved when a digital ledger (such as blockchain) is used to record “trades” agreed between parties. However, the staff notice is clear that if multiple buyers and sellers or parties are brought together on a third-party facility, and the interaction of orders results in a trade, that facility constitutes a marketplace.

## **Dealer Platforms - Registration**

Staff Notice 21-329 indicates the registration requirements for Dealer Platforms will depend on the nature of its activities. For those that only facilitate distributions or the trading of Security Tokens in reliance on prospectus exemptions and do not offer margin or leverage, registration as an exempt market dealer, or in some cases, as a restricted dealer, may be appropriate. Dealer Platforms may not offer margin or leverage for Security Tokens unless they are registered as full investment dealers and are IIROC members.

Dealer Platforms that trade Crypto Contracts are expected to be registered in an appropriate dealer category, and where they trade or solicit trades for individual retail investors, they will generally be expected to be registered as investment dealers and be IIROC members.

## **Marketplace Platforms - Registration**

Similar to the regulation of alternative trading systems, a Marketplace Platform must operate under the oversight of the CSA and IIROC. The concepts outlined in National Instrument 21-101 *Marketplace Operation* (NI 21-101), National Instrument 23-101 *Trading Rules* (NI 23-101) and National Instrument 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces* (NI 23-103) will generally apply to Marketplace Platforms. In addition, trading on Marketplace Platforms will be subject to market integrity requirements, such as IIROC’s Universal Market Integrity Rules, with certain modifications as appropriate to accommodate the novel aspects of CTPs.

Marketplace Platforms that also undertake activities similar to those of Dealer Platforms will be subject to appropriate dealer requirements, as outlined above. The CSA and IIROC noted, however, there would be “flexibility regarding how the requirements will apply” and that the potential exists for customization or tailoring depending upon the specific functions or operational model of the Marketplace Platform in question. A Marketplace Platform that operates as a trading venue only and does not perform any dealer activities would likely not be subject to NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and many of the IIROC Dealer Member Rules.

There may be cases where a Marketplace Platform is more appropriately regulated as an exchange. Examples include a Marketplace Platform that trades Security Tokens and regulates issuers of those securities, or regulates and disciplines trading participants other than by merely denying them access to the platform. In this case, the platform may be carrying on the business of an exchange and is expected to seek recognition as an exchange or seek an exemption from the requirements.

## **Interim Period**

The CSA and IIROC recognize that CTPs will require time to prepare for and obtain the necessary registrations and IIROC memberships contemplated by Staff Notice 21-329. Accordingly, the CSA and IIROC indicated they will provide an interim period – generally two years – for CTPs to seek the necessary registrations and IIROC memberships. In the meantime, it appears CTPs will be permitted to continue to operate subject to becoming registered as an exempt market dealer or restricted dealer, as appropriate, and obtaining any other exemptions that may be required.

## **Additional Considerations Regarding Clearing and Settlement**

Staff Notice 21-329 also reminds CTPs that if they perform clearing functions they may be captured as clearing agencies or clearing houses in some CSA jurisdictions. CTPs should be mindful of the relevant regulatory requirements and those that offer clearing services should discuss these functions with the appropriate securities regulatory authority.

## **IIROC Membership for Entities with Novel Business Models**

The CSA and IIROC note it is likely appropriate that some CTPs become IIROC members, and aim to facilitate this process even where entities operate with novel business models (including Dealer or Marketplace Platforms). The process would involve consideration of the elements of a Dealer or Marketplace Platform's business, on how best to apply current requirements, and whether any exemptions and/or time-limited terms and conditions are appropriate.

## **Implications**

Staff Notice 21-329 makes it quite clear the CSA and IIROC believe CTPs that operate in Canada are subject to Canadian securities law and are expected to transition into full compliance within two years – including, where applicable, by becoming registered as a dealer and becoming a member of IIROC. While the CSA and IIROC indicated that they will be flexible in how CTPs are expected to comply with their obligations as registrants and IIROC members, this will still involve a significant change from the effectively unregulated environment in which most CTPs have been operating in Canada to date. Canadian-based CTPs will effectively have no choice but to comply with the process set out in Staff Notice 21-329 and begin preparing applications for the registrations and memberships called for. Foreign CTPs will need to consider whether the economic benefits of continuing to service Canadian-based customers merit the time and expense that will be involved in complying with their obligations under Canadian securities law as outlined in the staff notice. We would not be surprised if some foreign CTPs decide to withdraw from Canada as a result.

It is also clear Canadian securities regulators are no longer willing to tolerate the continued operation in Canada of CTPs that do not comply with Canadian securities law. CTPs have been given a short window (until April 19, 2021) to contact the OSC to begin transitioning into compliance in accordance with the framework in Staff Notice 21-329. Those who fail to do so will face the prospect of an enforcement proceeding.

To the extent you require assistance analyzing the application of Staff Notice 21-329 to your business, or if you would like assistance approaching the OSC regarding your business, please contact any member of the [Goodmans Technology Group](#).

## Goodmans Technology Group

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