Overview Report: Canadian Securities Administrators Publications on Virtual Assets

A. Scope of Overview Report

1. This overview report describes the Canadian Securities Administrators ("**CSA**") and attaches documents created/published by the CSA.

B. The Canadian Securities Administrators

2. The CSA is an umbrella organization of Canada's provincial and territorial securities regulators whose objective is to improve, coordinate and harmonize regulation of the Canadian capital markets. It focuses on consensus-building on policy decisions that affect the capital market and its participants across Canada. It does not handle complaints regarding securities violations, nor does it enforce securities regulations; both of these activities are handled by provincial securities regulators such as the BC Securities Commission.[1]

C. CSA documents relating to virtual assets

3. The CSA has released the following three Staff Notices relating to virtual assets, which are attached as appendices to this overview report:

a. **Appendix A:**
Canadian Securities Administrators, "CSA Staff Notice 46-307: *Cryptocurrency Offerings*" (24 August 2017) Canadian Securities Administrators, online: <https://www.osc.gov.on.ca/documents/en/Securities-Category4/csa_20170824_cryptocurrency-offerings.pdf>.

b. **Appendix B:**
Canadian Securities Administrators, "CSA Staff Notice 46-308: *Securities Law Implications for Offerings of Tokens*" (11 June 2018) Canadian Securities Administrators, online: <https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/2018juin11-46-308-avis-acvm-en.pdf>

[1] Canadian Securities Administrators, "About CSA: Overview," (2009) online: *Canadian Securities Administrators* https://www.securities-administrators.ca/aboutcsa.aspx?id=45 (accessed 9 November 2020)

c. **Appendix C:**

Canadian Securities Administrators, "CSA Staff Notice 21-327: *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets*" (16 January 2020) Canadian Securities Administrators, online: <https://www.bcsc.bc.ca/Securities_Law/Policies/Policy2/PDF/21-327__CSA_Staff_Notice__-_January_16__2020/>.

4. Jointly with the Investment Industry Regulatory Organization of Canada, the CSA also released a Consultation Paper relating to virtual assets, which is attached as an appendix to this overview report:

a. **Appendix D**:

Canadian Securities Administrations/Investment Industry Regulatory Organization of Canada, "Joint Canadian Securities Administrators / Investment Industry Regulatory Organization of Canada Consultation Paper 21-402: Proposed Framework for Crypto-Asset Trading Platforms" (14 March 2019) Canadian Securities Administrators, online: <https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/2019mars14-21-402-doc-cons-en.pdf>.

Appendix A:

Canadian Securities Administrators, “CSA Staff Notice 46-307: *Cryptocurrency Offerings*” (24 August 2017) Canadian Securities Administrators, online: <https://www.osc.gov.on.ca/documents/en/Securities-Category4/csa_20170824_cryptocurrency-offerings.pdf>.

CSA/ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Staff Notice 46-307

Cryptocurrency Offerings[1]

August 24, 2017

Introduction and purpose

Staff (**we** or **staff**) of the Canadian Securities Administrators (**CSA**) are aware of an increase in the number of cryptocurrency offerings, such as initial coin offerings (**ICO**), initial token offerings (**ITO**)[2] and sales of securities of cryptocurrency investment funds.

Cryptocurrency offerings can provide new opportunities for businesses to raise capital and for investors to access a broader range of investments. However, they can also raise investor protection concerns, due to issues around volatility, transparency, valuation, custody and liquidity, as well as the use of unregulated cryptocurrency exchanges[3]. Also, investors may be harmed by unethical practices or illegal schemes, and may not understand the properties of the investment products that they are purchasing.

Many of these cryptocurrency offerings involve sales of securities. Securities laws in Canada will apply if the person selling the securities is conducting business from within Canada or if there are Canadian investors. Given the significant growth in this area and requests for guidance, we are publishing this Staff Notice to help financial technology (**fintech**) businesses understand what obligations may apply under securities laws.[4]

We note that these products may also be derivatives and subject to the derivatives laws adopted by the Canadian securities regulatory authorities, including trade reporting rules.

Businesses should consider if and how prospectus, registration and/or marketplace requirements apply to their cryptocurrency offerings. Specifically and as described in more detail in this Staff Notice:

[1] This Staff Notice is being published in all of the jurisdictions of Canada except Saskatchewan. The Financial and Consumer Affairs Authority of Saskatchewan will advise of its approach in this matter after the provincial by-election in Saskatchewan on September 7, 2017.

[2] Cryptocurrency may also be referred to as virtual or digital currency, among other terms. ICOs and ITOs may also be referred to as token generation events (TGE), among other terms.

[3] The term "exchange" used in this context is not intended to be the same as the term used in *Regulation 21-101 respecting Marketplace Operation* and securities legislation of the jurisdictions of Canada, but instead reflects what these entities are commonly referred to today.

[4] Many authorities have recently cautioned that sales of digital assets may be subject to securities laws: https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-initial-coin-offerings http://www.mas.gov.sg/News-and-Publications/Media-Releases/2017/Consumer-Advisory-on-Investment-Schemes-Involving-Digital-Tokens.aspx

- Securities may only be sold after a receipt has been received from a securities regulatory authority for a comprehensive disclosure document called a "prospectus", or pursuant to a private placement in reliance on a prospectus exemption;

- Businesses and individuals in the business of trading in or advising on securities must be properly registered or rely on an exemption from registration; and

- A platform that facilitates trades in coins/tokens that are securities may be a marketplace and need to comply with marketplace requirements or obtain an exemption from such requirements.

This Staff Notice will:

- Respond to requests from fintech businesses for guidance on the applicability of securities laws to cryptocurrency offerings and what staff will consider in assessing if an ICO/ITO is a distribution of securities;

- Discuss what steps fintech businesses can take if they are raising capital through ICOs/ITOs, so that they comply with securities laws;

- Highlight issues that fintech businesses looking to establish cryptocurrency investment funds should be prepared to discuss with staff;

- Discuss how the use of cryptocurrency exchanges may impact staff's review of ICOs/ITOs and cryptocurrency investment funds; and

- Explain how the CSA Regulatory Sandbox can help fintech businesses with cryptocurrency offerings comply with securities laws through a flexible process.

This Staff Notice focuses on ICOs/ITOs and cryptocurrency investment funds, and their intersection with cryptocurrency exchanges. However, this guidance should also be considered in the context of other cryptocurrency or distributed ledger technology-based offerings that may trigger securities law requirements.

What is a cryptocurrency exchange?

Cryptocurrency exchanges are online exchanges that allow investors to buy and sell cryptocurrencies. Purchases and sales of cryptocurrencies can be made using either fiat currency (e.g., buying bitcoin using CAD or USD) or cryptocurrency (e.g., buying bitcoin using another cryptocurrency such as ether). We understand that in addition to cryptocurrencies such as bitcoin and ether, cryptocurrency exchanges may also offer coins/tokens that have been sold pursuant to ICOs/ITOs.

Cryptocurrency exchanges operate across the world, in many cases without government oversight or regulation. Prices for cryptocurrencies may differ significantly among exchanges, allowing for arbitrage opportunities. While arbitrage opportunities may not exist for extended

periods in efficient markets, they can persist in inefficient ones. Investment funds that purchase cryptocurrencies from these exchanges for their portfolios should be aware that standards among exchanges can vary significantly.

Recently, several jurisdictions have taken steps to impose requirements on cryptocurrency exchanges, including with respect to identity verification, anti-money laundering, counter-terrorist financing and recordkeeping.

A cryptocurrency exchange that offers cryptocurrencies that are securities must determine whether it is a marketplace. Marketplaces are required to comply with the rules governing exchanges or alternative trading systems. If an exchange is doing business in a jurisdiction of Canada, it must apply to that jurisdiction's securities regulatory authority for recognition or an exemption from recognition. To date, no cryptocurrency exchange has been recognized in any jurisdiction of Canada or exempted from recognition.

Allowing coins/tokens that are securities issued as part of an ICO/ITO to trade on these cryptocurrency exchanges may also place the business issuing the coins/tokens offside securities laws. For example, the resale of coins/tokens that are securities will be subject to restrictions on secondary trading.[5]

Coin and token offerings

Background

ICOs/ITOs are generally used by start-up businesses to raise capital from investors through the internet. These investors are often retail investors. An ICO/ITO is typically open for a set period, during which investors can visit a website to purchase coins/tokens in exchange for fiat currency or a cryptocurrency such as bitcoin or ether. The structures of ICOs/ITOs will vary, and they may be used to raise capital for a variety of projects, including the development of a new cryptocurrency, distributed ledger technology, service or platform. Anyone with internet access can create or invest in an ICO/ITO; in many cases, they can do so anonymously.

In many ways, an ICO/ITO can be very similar to an initial public offering (**IPO**). The coins/tokens can be similar to traditional shares of a company because their value may increase or decrease depending on how successfully the business executes its business plan using the capital raised.

Trades in securities

Staff is aware of businesses marketing their coins/tokens as software products, taking the position that the coins/tokens are not subject to securities laws. However, in many cases, when the totality of the offering or arrangement is considered, the coins/tokens should properly be considered securities. In assessing whether or not securities laws apply, we will consider substance over form.

[5] *Regulation 45-102 respecting Resale of Securities* restricts secondary trading in securities of non-reporting issuers.

Although a new technology is involved, and what is being sold is referred to as a coin/token instead of a share, stock or equity, a coin/token may still be a "security" as defined in securities legislation of the jurisdictions of Canada. Businesses should complete an analysis on whether a security is involved. Legal and/or other professional advice may be useful in making this determination.

Every ICO/ITO is unique and must be assessed on its own characteristics. For example, if an individual purchases coins/tokens that allow him/her to play video games on a platform, it is possible that securities may not be involved. However, if an individual purchases coins/tokens whose value is tied to the future profits or success of a business, these will likely be considered securities.

We have received numerous inquiries from fintech businesses and their legal counsel relating to ICOs/ITOs. With the offerings that we have reviewed to date, we have in many instances found that the coins/tokens in question constitute securities for the purposes of securities laws, including because they are investment contracts. In arriving at this conclusion, we have considered the relevant case law[6], which requires an assessment of the economic realities of a transaction and a purposive interpretation with the objective of investor protection in mind.

In determining whether or not an investment contract exists, businesses should apply the following four-prong test. Namely, does the ICO/ITO involve:

1. An investment of money
2. In a common enterprise
3. With the expectation of profit
4. To come significantly from the efforts of others

Securities law requirements that apply

Businesses issuing coins/tokens that are securities must identify and address fundamental securities law obligations, including the following:

Prospectus requirement or exemption

To date, no business has used a prospectus to complete an ICO/ITO in Canada. We anticipate that businesses looking to sell coins/tokens may do so under prospectus exemptions. Sales may be made to investors who qualify as "accredited investors" as defined under securities laws, in reliance on the accredited investor prospectus exemption[7]. For retail investors who do not qualify as accredited investors, sales will typically need to be made in reliance on the offering memorandum (**OM**) prospectus exemption.[8]

[6] The Supreme Court of Canada's decision in *Pacific Coast Coin Exchange v. Ontario (Securities Commission)*, [1978] 2 S.C.R. 112; as well as the various judicial and administrative decisions that have been issued subsequent to that case.
[7] Section 2.3 of *Regulation 45-106 respecting Prospectus Exemptions* (**Regulation 45-106**).
[8] Section 2.9 of Regulation 45-106.

We are aware that some fintech businesses publish whitepapers for their ICOs/ITOs, which may describe things such as the fundraising goal, the business, the project for which capital is being raised, how many coins/tokens management of the business will retain and how long the offering will remain open. Although whitepapers are a form of disclosure document for investors, it is important to note that they are often not structured in the same way as prospectuses or OMs. Investors must be provided with a document that complies with the requirements of securities laws. Under securities laws, prospectuses and OMs have specific disclosure requirements and trigger certain ongoing obligations and other protections for investors. For example, investors can sue for misrepresentations by management of the business in prospectuses and OMs.

It should also be noted that investors may also have civil remedies against persons that fail to comply with securities laws, including a right to withdraw from the transaction and/or damages for losses on the grounds that such transactions were conducted in breach of securities laws.

Unless relief is granted from the applicable securities regulatory authority, businesses relying on the OM prospectus exemption must meet all of the conditions of that exemption, including:

- Meeting the content requirements for the document;
- Obtaining a signed risk acknowledgement form from each investor;
- Complying with investor investment limits, as required;
- Providing audited annual financial statements and ongoing disclosure to investors, as required;
- Complying with resale restrictions, which will generally preclude coins/tokens from trading on cryptocurrency exchanges; and
- Filing reports of exempt distribution with the securities regulatory authorities.

Examples of material information to be disclosed in an OM are:

- A description of the business itself;
- The ecosystem on which the coin/token operates;
- Any minimum or maximum offering amounts;
- The intended use of proceeds;
- How long the offering will remain open;
- Features of the coins/tokens, including potential returns on investment, exit strategies and liquidity;
- How the coins/tokens will be valued on an ongoing basis;
- The number of coins/tokens that will be held by management compared to the number that will be offered for sale to the public;
- The timeline for achieving different milestones and any ongoing updates that will be provided;
- Management members' identities and backgrounds, including any regulatory or legal proceedings against them;
- Remuneration paid or payable to the management team and/or any advisors; and
- All material risks of investing.

Any disclosure provided to investors, whether an OM or otherwise, must not be false or misleading. The disclosure must focus on material facts and be relevant, clear, balanced, in plain language and not overly promotional.

Registration requirement or exemption

Businesses completing ICOs/ITOs may be trading in securities for a business purpose (referred to as the "business trigger"), therefore requiring dealer registration or an exemption from the dealer registration requirement. Whether or not an activity meets the business trigger is facts specific.[9]

With the ICOs/ITOs that we have reviewed, we have found the following factors, among others, as important considerations for whether a person is trading in securities for a business purpose:

- Soliciting a broad base of investors, including retail investors;
- Using the internet, including public websites and discussion boards, to reach a large number of potential investors;
- Attending public events, including conferences and meetups, to actively advertise the sale of the coins/tokens; and
- Raising a significant amount of capital from a large number of investors.

Individuals or businesses that meet the business trigger must meet fundamental obligations to investors, including know-your-client (**KYC**) and suitability. Collecting little to no information on investors, for example only names, email addresses and/or IP addresses would not be sufficient to meet this obligation. Businesses conducting ICOs/ITOs that meet the business trigger must verify investors' identities and collect sufficient information to ensure that purchases of coins/tokens are suitable, including on investment needs and objectives, financial circumstances and risk tolerance.

It is possible that a business that meets the business trigger could fulfil its KYC and suitability obligations through a robust, automated, online process that incorporates investor protections. These investor protections could include limits on investment amounts and concentration, as well as risk warnings.

Persons facilitating ICOs/ITOs of coins/tokens that are securities must have strong compliance systems in place, with policies and procedures that address cybersecurity risks. As cyberattacks are becoming more frequent, complex and costly, businesses in the cryptocurrency space should ensure that they have strong cybersecurity measures to safeguard the business and its investors.

Cryptocurrency investment funds

We are aware of "investment funds" as defined under securities laws being set up to invest in bitcoin and/or other cryptocurrencies. We understand from our discussions with the fintech

[9] A business should consider the factors outlined in section 1.3 of the *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* to determine if its offering meets the business trigger.

community that one of the key purposes of this type of investment fund is to provide investors with the opportunity to obtain exposure to cryptocurrencies, or baskets of cryptocurrencies, that they may not otherwise have.

We encourage a fintech business looking to establish a cryptocurrency investment fund to consider the following:

- Retail investors: In certain jurisdictions of Canada, the OM prospectus exemption cannot be used by investment funds to distribute securities to investors.[10] Therefore, if investors in the investment fund will include retail investors, businesses will need to consider prospectus requirements, applicable investment fund rules and whether the investment is suitable.

- Cryptocurrency exchanges: Due diligence must be completed on any cryptocurrency exchange that the investment fund uses to purchase or sell cryptocurrencies for its portfolio, including on whether it is regulated in any way and the cryptocurrency exchange's policies and procedures for identity verification, anti-money laundering, counter-terrorist financing and recordkeeping. Businesses should be prepared to discuss with staff how trading volumes on the cryptocurrency exchanges that the investment fund intends to use may affect the ability to buy and sell cryptocurrencies and to fund redemption requests.

- Registration: Businesses must consider appropriate registration categories in respect of the investment fund, including dealer, adviser and/or investment fund manager.

- Valuation: How will cryptocurrencies in the investment fund's portfolio be valued? How will securities of the investment fund be valued? Will one or multiple cryptocurrency exchange(s) be used; and how will such exchange(s) be selected? Will there be an independent audit of the investment fund's valuation?

- Custody: Securities legislation of the jurisdictions of Canada generally require that all portfolio assets of an investment fund be held by one custodian that meets certain prescribed requirements. We expect a custodian to have expertise that is relevant to holding cryptocurrencies. For example, it should have experience with hot and cold storage, security measures to keep cryptocurrencies protected from theft and the ability to segregate the cryptocurrencies from other holdings as needed.

The above list is not exhaustive. Fintech businesses should be prepared to engage in discussions with staff on other relevant issues that may be identified.

How can the CSA Regulatory Sandbox help?

We want to encourage financial market innovation and facilitate capital raising by fintech businesses, while at the same time ensuring fair and efficient capital markets and investor

[10] The OM prospectus exemption cannot be relied upon by investment funds in certain jurisdictions of Canada, per subsection 2.9(2.2) of Regulation 45-106.

protection. As cryptocurrencies become more popular and mainstream, balancing the demand for new investment opportunities and the need to protect investors from high-risk or fraudulent activities is extremely important.

In order to avoid costly regulatory surprises, we encourage businesses with proposed cryptocurrency offerings to contact their local securities regulatory authority to discuss possible approaches to complying with securities laws. We welcome digital innovation and we recognize that new fintech businesses may not fit neatly into the existing securities law framework.

The CSA Regulatory Sandbox is an initiative of the CSA to support fintech businesses seeking to offer innovative products, services and applications in Canada. It allows firms to register and/or obtain exemptive relief from securities law requirements, under a faster and more flexible process than through a standard application, in order to test their products, services and applications throughout the Canadian market on a time-limited basis.

A fintech business is invited to contact the securities regulatory authority in the jurisdiction where its head office is located:

Province	**Contact Information**
British Columbia	The BCSC Tech Team at TechTeam@bcsc.bc.ca
Alberta	Mark Franko at Mark.Franko@asc.ca or Denise Weeres at Denise.Weeres@asc.ca
Saskatchewan	Dean Murrison at dean.murrison@gov.sk.ca or Liz Kutarna at liz.kutarna@gov.sk.ca
Manitoba	Chris Besko at chris.besko@gov.mb.ca
Ontario	The OSC LaunchPad Team at osclaunchpad@osc.gov.on.ca
Québec	The Fintech Support Team at fintech@lautorite.qc.ca.
New Brunswick	Susan Powell at registration-inscription@fcnb.ca
Nova Scotia	Jane Anderson at Jane Anderson@novascotia.ca

Appendix B:

Canadian Securities Administrators, “CSA Staff Notice 46-308: *Securities Law Implications for Offerings of Tokens*” (11 June 2018) Canadian Securities Administrators, online: <https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/2018juin11-46-308-avis-acvm-en.pdf>

CSA/ACVM Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CSA Staff Notice 46-308

Securities Law Implications for Offerings of Tokens

June 11, 2018

Purpose and background

CSA staff (**we** or **staff**) are issuing this notice to respond to inquiries on the applicability of securities laws to offerings of coins or tokens, including ones that are commonly referred to as "utility tokens".

In CSA Staff Notice 46-307 *Cryptocurrency Offerings* (**SN 46-307**), we stated that many cryptocurrency offerings, such as initial coin offerings (**ICO**) and initial token offerings (**ITO**), involve sales of securities. This is because the offering and/or the coins or tokens issued under the offering constitute investment contracts or are otherwise securities, when the totality of the offering or arrangement is considered. We also stated that, depending on the facts and circumstances, these products may also be considered to be derivatives and subject to legislation and regulatory requirements that apply to derivatives.

Since SN 46-307 was published, staff have engaged with numerous businesses wishing to complete offerings of tokens and have found that most of these offerings have involved securities.

As part of this engagement with businesses, we have received various inquiries relating to offerings of tokens referred to as "utility tokens". "Utility token" is an industry term often used to refer to a token that has one or more specific functions, such as allowing its holder to access or purchase services or assets based on blockchain technology.

We have seen many businesses offering tokens to raise capital for the development of their software, online platform or application. In many of these cases, the offering will involve securities despite the fact that the tokens have one or more utility functions.

This notice provides guidance on the following issues relating to offerings of tokens:

- when an offering of tokens may or may not involve an offering of securities; and
- offerings of tokens that are structured in multiple steps.

The views outlined in this notice are based on the features we have seen in offerings to date and may change over time, as the market and business models continue to evolve.

When an offering of tokens may or may not involve an offering of securities

As we indicated in SN 46-307, every offering is unique and must be assessed on its own characteristics. An offering of tokens may involve the distribution of securities, including because:

- the offering involves the distribution of an investment contract; and/or

- the offering and/or the tokens issued are securities under one or more of the other enumerated branches of the definition of security or may be a security that is not covered by the non-exclusive list of enumerated categories of securities.

In determining whether or not an investment contract exists, the case law endorses a purposive interpretation that includes considering the objective of investor protection. This is especially important for businesses to consider in the context of offerings of tokens where the risk of loss to investors can be high. Businesses and their professional advisors should consider and apply the case law interpreting the term "investment contract"[1], including considering whether the offering involves:

1. An investment of money
2. In a common enterprise
3. With the expectation of profit
4. To come significantly from the efforts of others

In analyzing whether an offering of tokens involves an investment contract, businesses and their professional advisors should assess not only the technical characteristics of the token itself, but the economic realities of the offering as a whole, with a focus on substance over form.

We have received submissions from businesses and their professional advisors that a proposed offering of tokens does not involve securities because the tokens will be used in software, on an online platform or application, or to purchase goods and services. However, we have found that most of the offerings of tokens purporting to be utility tokens that we have reviewed to date have involved the distribution of a security, namely an investment contract. The fact that a token has a utility is not, on its own, determinative as to whether an offering involves the distribution of a security.

Examples of situations and their possible implication on one or more of the elements of an investment contract

We have identified in the table below situations that have an implication on the presence of one or more of the elements of an investment contract.

The examples that we have provided are intended to be illustrative and are based on situations that staff have seen to date. This list is not exhaustive and we expect that it will change over time, as the market and business models continue to evolve. Also, we emphasize that none of these examples should be interpreted as determinative on its own of whether or not a security exists. It is possible that an offering of tokens may be viewed as involving, or not involving, a security even with the existence, or absence, of one or more of the characteristics listed below. As such, businesses and their professional advisors should complete a meaningful analysis based on the unique characteristics of their offering of tokens and should not use the following table to complete a mechanical "tick the box" exercise.

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[1] See, for example: the Supreme Court of Canada's decision in *Pacific Coast Coin Exchange v. Ontario (Securities Commission)*, [1978] 2 SCR 112, the Ontario Securities Commission's decision in *Universal Settlements International Inc.* (2006), 29 OSCB 7880, and the Alberta Securities Commission's decisions in *The Land Development Company Inc. et al* (2002), ABSECCOM REA #1248840 v1 and *Kustom Design Financial Services Inc. (Re)*, 2010 ABASC 179.

	Examples of situations	Possible implications
1.	The proposed function of the token is to use software or an online platform or application, or to purchase goods and services, but the software, online platform or application or goods and services do not exist, are not yet available or are still in development.	This could indicate that the purchaser is not purchasing the tokens for their immediate utility, but because of an expectation of profit, which will depend on the issuer's ability to complete the development of the software, online platform or application or to offer the goods and services. Although some purchasers may be purchasing the token for the utility function, many purchasers may be purchasing the token in order to sell it on a cryptoasset trading platform or otherwise in the secondary market. This could also indicate the existence of a common enterprise because management's efforts are still needed to develop or deliver the software, online platform or application or goods and services. Regardless of the motivation of the purchaser, the purchaser bears the risk of loss if management's efforts are not successful. Whether or not a functional software or online platform or application has been developed is a question of fact. For example, we may consider that a platform is not fully developed in cases where the significant intended functions are not yet available or where end users are unable to participate, even where there may be developer functionality.
2.	The tokens are not immediately delivered to purchasers.	This could indicate that the software, online platform or application or goods and services are not yet available and purchasers are not purchasing the tokens for their immediate utility but because of an expectation of profit. It could also indicate a common enterprise exists because of the purchaser's reliance on management to deliver the tokens.
3.	The stated purpose of the offering is to raise capital, which will be used to perform key actions that will support the value of the token, the value of the issuer's business or the platform's usability. These key actions may include	This could indicate the existence of a common enterprise between management and purchasers. This could also indicate that the purchaser is not purchasing the tokens for their immediate utility, but to invest in a business under development

	Examples of situations	Possible implications
	expanding the team of developers, developing relevant applications and products, expanding the network of participants on the platform, installing necessary infrastructure and marketing efforts.	with an expectation of profit, which will be dependent on the issuer's ability to perform key actions.
4.	The issuer has set up a "bounty" or similar program that offers free tokens or other benefits to persons who promote the offering through various channels, including on social media, in blogs or elsewhere on the Internet.	Persons participating in this kind of program may have an incentive to make statements promoting the offering as an investment; for example, by suggesting the tokens have the potential to increase in value. Such statements create an expectation of profit.
5.	The issuer's management retains for themselves a significant number of unsold tokens from the offering or "pre-mines" a significant number of tokens before they are publicly available as a form of compensation for their efforts.	This could indicate the existence of a common enterprise, as any future increase in the value of the tokens will financially benefit both management and the investor.
6.	The issuer suggests that the tokens will be used as a currency or have a utility beyond the issuer's platform, but at the time of these suggestions, the issuer is not able to demonstrate that the tokens are widely used or accepted.	This could indicate a common enterprise because of the reliance on management to take key actions to establish uses for the token beyond the platform.
7.	The issuer's management has represented that it has specific skills or expertise that will likely increase the value of the token.	This could indicate a common enterprise because of the reliance on management and could also indicate an expectation of profit.
8.	Tokens have a fixed value on the platform that does not automatically increase over time, or change based on non-commercial factors.	This may reduce the purchaser's expectation of profit if tokens are continually available from the platform at a fixed value.
9.	The number of tokens issuable is finite or there is a reasonable expectation that access to new tokens will be limited in the future.	As there is a limited or reduced supply of tokens, initial purchasers may have an expectation of profit as increased demand with limited or reduced supply should lead to an increase in price. In contrast, a continuous or unlimited supply of tokens may reduce the probability that purchasers buy with an expectation of profit.

	Examples of situations	Possible implications
10.	The issuer permits or requires purchasers to purchase tokens for an amount that does not align with the purported utility of tokens. For example, the issuer permits a purchaser to acquire a disproportionately large purchase amount (e.g. $100,000) of tokens that can be used only for downloading music for personal use.	This could indicate that some purchasers are not purchasing the tokens for personal use, but rather with an expectation to sell them at a profit.
11.	Marketing of the offering targets persons who would not reasonably be expected to use the issuer's product, service or application. For example, an offering of a token that permits holders to use an existing application is marketed in Canada, but Canadian residents cannot use the product, service or application.	This could indicate that purchasers are primarily motivated by the potential for profit, not the ability to use the product, service or application. Performing know your client on purchasers may help issuers to establish the general profile of their purchasers, potentially enabling the issuer to demonstrate a purchaser's intended use of the token.
12.	Management makes statements suggesting that the tokens will appreciate in value, or compares them to other cryptocurrencies that have increased in value. Management encourages others to make, or acquiesces in others making, such statements.	This could indicate that the offering is being marketed and sold as an investment, thus creating an expectation of profit. In contrast, to the extent that management clearly and uniformly promotes the token in a manner that, taken as a whole, promotes only its utility and not its investment value, the implication that purchasers have an expectation of profit may be reduced.
13.	Tokens are distributed to users for free.	The distribution of tokens for free will likely not involve an investment of money. However, the distribution of free tokens as part of an overall sale of an ancillary or secondary product or service, may involve an investment of money if it is appropriate to "look through" the token distribution to the investment of money in the overall offering.
14.	Tokens are not fungible or interchangeable and each token has unique characteristics that result in the purchaser exercising their personal preferences to value it as a mode of entertainment or as a collectible item; any objective future market value of the token is primarily	The value of the token may be based on its unique characteristics, and not on the efforts of others. There may not be a common enterprise.

	Examples of situations	Possible implications
	based on market forces and not on continued development of a business by the issuer.	

Tokens reasonably expected or marketed to trade on cryptoasset trading platforms.

Another situation that may have an implication on the presence of one or more of the elements of an investment contract is the fact that tokens are reasonably expected or marketed to trade on one or more cryptoasset trading platforms (including decentralized or "peer-to-peer" trading platforms) or to otherwise be freely tradeable in the secondary market.

This fact indicates that purchasers may purchase the tokens with an expectation to resell them at a profit. This is particularly true where the existence of secondary trading is critical to the success of the offering of tokens or is featured prominently in the marketing of the offering.

To determine whether tokens are reasonably expected to trade in the secondary market, we consider representations made by the issuer either formally in a whitepaper or informally through social media channels (e.g., messaging platforms, community meetups, online videos). We also consider representations made by third parties that have been explicitly or implicitly endorsed by the issuer or management.

We have heard from some token issuers, for example those using the Ethereum ERC20 token standard, that they may have no control over the transferability of their token, or the creation of a market by other parties, including cryptoasset trading platforms. This possible absence of control over secondary trading is generally not, on its own, relevant in assessing whether purchasers expect a profit.

In general, with the offerings of tokens we have seen that have involved securities, the public transferability of the tokens has not been restricted, potentially placing persons trading the tokens offside resale restrictions in securities laws.

Offerings of tokens that are structured in multiple steps

We are aware of offerings of tokens that are structured in multiple steps.

As a general statement, nothing in this notice should be interpreted as staff supporting or endorsing the use of multiple step transactions to offer tokens.

For example, staff have seen offerings with two steps. In the first step, the purchaser agrees to contribute money in exchange for a right to receive tokens at a future date. This may be completed pursuant to an agreement referred to as a "simple agreement for future tokens" or "SAFT". At the time of purchase, no token is delivered. In the first step, there is generally a distribution of a security, specifically the right to a future token, which is often made under a prospectus exemption, such as the accredited investor exemption.

In the second step, the token is delivered. At that time, the issuer has generally represented that the software, online platform or application is built or the goods or services are available and the token is functional. In several instances, issuers have taken the position that the token itself is not a security.

Staff would like to note the following:

- We may consider that a token delivered at a second or later step is a security, despite the fact that the token may have some utility. This may be because the token that is unlocked or delivered involves an investment contract because it continues to have a number of the factors identified above or because the token has other security-like attributes, such as a profit-sharing interest.

- The distribution of the security is subject to the prospectus requirement. Issuers may contemplate relying on prospectus exemptions, such as the accredited investor exemption or the offering memorandum exemption provided in *Regulation 45-106 respecting Prospectus Exemptions*. An issuer that uses a prospectus exemption must ensure that it meets all conditions of the exemption. Securities that are distributed using capital-raising prospectus exemptions are typically subject to the resale restrictions in *Regulation 45-102 respecting Resale of Securities*, including, in the case of a non-reporting issuer, that they cannot be resold for an indefinite period except under another prospectus exemption.

- A person that is in the business of trading in securities is subject to the dealer registration requirement under securities laws[2]. The term "trade" is broad and includes acts, advertisements, solicitations, conduct or negotiation directly or indirectly in furtherance of a trade.

- If the distribution of the security at the first step is made without complying with securities law requirements, the issuer will remain in default of securities law requirements, even though subsequent steps may have occurred.

- We will have concerns where a multiple step transaction is used in an attempt to avoid securities legislation. As stated earlier in this notice, businesses and their professional advisors should assess the economic realities of the offering as a whole, with a focus on substance over form.

Enforcement Activity

Staff are conducting active surveillance of coin and token offerings activity to identify past, ongoing and potential future violations of securities laws or conduct in the capital markets that is contrary to the public interest. CSA members have taken and intend to continue taking regulatory and/or enforcement action against businesses that do not comply with securities laws.

Complying with Securities Legislation

In order to avoid costly regulatory surprises, we encourage businesses with proposed offerings of tokens to consult qualified securities legal counsel in their local jurisdiction about the potential application of, and possible approaches required to comply with, securities legislation.

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[2] Please refer to section 1.3 of *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations* for a description of the factors that we consider relevant in determining whether a person is trading securities for a business purpose.

As trends in the cryptocurrency industry are evolving quickly, we encourage businesses seeking flexible approaches to compliance with securities laws to contact their local securities regulatory authority to discuss their project at the contact information below. When contacting their local securities regulatory authority, businesses should be ready to provide a draft whitepaper, a business plan or a detailed description of their proposed offering. We may also ask for copies of promotional materials in connection with the offering, and a description of the promotional activities and marketing efforts in respect of the offering, as well as information on the corporate structure and principals involved.

We remind businesses to consider securities law requirements that may apply to their activities, regardless of where investors are located. A Canadian securities regulatory authority may have jurisdiction over trades to investors outside of that jurisdiction where there is a real and substantial connection between the transaction and that jurisdiction.[3]

CSA Regulatory Sandbox

We welcome digital innovation and we recognize that new fintech businesses may not fit neatly into the existing securities law framework. The CSA Regulatory Sandbox is an initiative of the CSA to support fintech businesses seeking to offer innovative products, services and applications in Canada. It allows firms to register and/or obtain exemptive relief from securities law requirements, under a faster and more flexible process than through a standard application, in order to test their products, services and applications throughout the Canadian market, generally on a time-limited basis.

The CSA have granted, through the CSA Regulatory Sandbox, exemptive relief from certain securities law requirements to firms in the context of offerings of tokens that involve the distribution of securities, subject to conditions to ensure adequate investor protection. A list of the firms that have been authorized in the CSA Regulatory Sandbox is available on the CSA website at https://www.securities-administrators.ca/.

Applications to the CSA Regulatory Sandbox are analyzed on a case-by-case basis.

Businesses contemplating offerings of tokens are invited to contact the securities regulatory authority in the jurisdiction where their head office is located:

Province	**Contact Information**
British Columbia	The BCSC Tech Team at TechTeam@bcsc.bc.ca
Alberta	Mark Franko at Mark.Franko@asc.ca, Denise Weeres at Denise.Weeres@asc.ca, Danielle Grover at Danielle.Grover@asc.ca or Christopher Peng at Christopher.Peng@asc.ca
Saskatchewan	Dean Murrison at dean.murrison@gov.sk.ca or Liz Kutarna at liz.kutarna@gov.sk.ca
Manitoba	Chris Besko at chris.besko@gov.mb.ca
Ontario	The OSC LaunchPad Team at osclaunchpad@osc.gov.on.ca

[3] The Supreme Court of Canada's decision in *Gregory & Co. v. Quebec (Securities Commission)*, [1961] S.C.R. 584; as well as the various decisions that have been issued subsequent to that case. See also *Reference Re Securities Act (Canada)* 2011 SCC 66, 3 SCR 837 at para. 45.

Québec	The Fintech Working Group at fintech@lautorite.qc.ca.
New Brunswick	Susan Powell at registration-inscription@fcnb.ca
Nova Scotia	Jane Anderson at Jane.Anderson@novascotia.ca

Appendix C:

Canadian Securities Administrators, "CSA Staff Notice 21-327: *Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets*" (16 January 2020) Canadian Securities Administrators, online: <https://www.bcsc.bc.ca/Securities_Law/Policies/Policy2/PDF/21-327__CSA_Staff_Notice__-_January_16__2020/>.

CSA/ACVM Canadian Securities Administrators | Autorités canadiennes en valeurs mobilières

CSA Staff Notice 21-327
Guidance on the Application of Securities Legislation to Entities Facilitating the Trading of Crypto Assets

January 16, 2020

Introduction and purpose

CSA staff (**we** or **staff**) are issuing this notice to provide guidance on certain factors we consider to determine whether securities legislation[1] applies to any entity that facilitates transactions relating to crypto assets, including buying and selling crypto assets (collectively, **Platforms**).[2]

On March 14, 2019, in Joint CSA/Investment Industry Regulatory Organization of Canada Consultation Paper 21-402 *Proposed Framework for Crypto-Asset Trading Platforms* , we stated that if crypto assets that are securities or derivatives are traded on a Platform, such Platform would be subject to securities legislation. In addition, if a Platform trades contracts or instruments that are derivatives based on crypto assets, the Platform would also be subject to securities legislation.

In some cases, the crypto asset is clearly a security, for example, a tokenized security that carries rights traditionally attached to common shares such as voting rights and rights to receive dividends. In other cases, the crypto asset is a derivative, for example a token that provides an option to acquire an asset in the future.

Securities legislation may also apply to Platforms that facilitate the buying and selling of crypto assets, including crypto assets that are commodities, because the user's contractual right to the crypto asset may itself constitute a derivative.[3] In some jurisdictions, this right may be considered a security, such as an investment contract or evidence of indebtedness or an evidence of title to or interest in the assets or property of another person.

When does securities legislation not apply?

Staff is aware that some Platform operators are of the view that the Platforms they operate are not subject to securities legislation because they only allow for transactions involving crypto assets that are not, in and of themselves, derivatives or securities. However, based on our analysis of how trading occurs on Platforms, we note that some Platforms are merely providing their users with a contractual right or claim to an underlying crypto asset, rather

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[1] "Securities legislation" is defined in National Instrument 14-101 *Definitions* and includes legislation related to both securities and derivatives.

[2] For greater clarity, Platforms may be "marketplaces" or dealers as defined in securities legislation.

[3] Further, in some jurisdictions, there are provisions in securities legislation that apply to underlying interests of derivatives, including provisions relating to fraud and market manipulation and misrepresentations or misleading statements.

than immediately delivering the crypto asset to its users. In such cases, after considering all of the facts and circumstances, we have concluded that these Platforms are generally subject to securities legislation.[4]

Platforms would not generally be subject to securities legislation if each of the following apply:

- the underlying crypto asset itself is not a security or derivative; and

- the contract or instrument for the purchase, sale or delivery of a crypto asset
    - results in an obligation to make immediate delivery of the crypto asset, and
    - is settled by the immediate delivery of the crypto asset to the Platform's user according to the Platform's typical commercial practice.[5]

Immediate delivery of a crypto asset

There is no bright-line test as to whether a contract or instrument results in an obligation, and reflects an intention, to make and take immediate delivery of a crypto asset. However, a transaction involving a crypto asset may be subject to securities legislation if the transaction does not result in an obligation to make and take delivery of the crypto asset referred to in the transaction immediately following the transaction.

Staff will consider the terms of the contractual arrangements governing the relationship between the Platform and the user, including whether the contract or instrument creates an obligation to make immediate delivery of the crypto asset. As part of this analysis, we will consider whether the Platform and the user intend, at the time the contract or instrument is entered into, to make and take delivery of the crypto asset on which the contract or instrument is based.

We generally will consider that there will be an obligation to immediately deliver if the contract or instrument creates an obligation on the Platform to immediately transfer ownership, possession and control to the Platform's user and as a result there is delivery to the user (as described below).

The obligation and intention of the parties must be determined by considering all the terms of the relevant contract or instrument, including written and unwritten terms, as well as the surrounding facts and circumstances, including whether the typical commercial practice is to make delivery under the contract or instrument. For example, a contract or instrument would be considered a derivative or a security even though the written contract referenced

[4] Platforms subject to securities legislation must determine which regulatory requirements are applicable in their situation. For example, unless a product is specifically excluded, derivatives trade reporting requirements will apply to Platforms facilitating transacting in derivatives.

[5] Generally delivery will occur in a Platform's typical commercial practice if delivery occurs in each instance under the contract or instrument, except where an event outside the reasonable control of the Platform prevents the delivery.

an obligation to make immediate delivery, if it was not the typical commercial practice to deliver in accordance with that obligation.

When has a crypto asset been immediately delivered?

Whether a crypto asset has been immediately delivered to a Platform's user is an important component in evaluating whether, and the extent to which, the transaction and the Platform are subject to securities legislation.

The determination as to whether and when delivery has occurred is fact specific and will depend on the economic realities of the relationship as a whole, including evidence relating to the intention of the parties to the contract or instrument, with a focus on substance over form.

We generally will consider immediate delivery to have occurred if:

- the Platform immediately transfers ownership, possession and control of the crypto asset to the Platform's user, and as a result the user is free to use, or otherwise deal with, the crypto asset without
    - further involvement with, or reliance on the Platform or its affiliates, and
    - the Platform or any affiliate retaining any security interest[6] or any other legal right to the crypto asset; and

- following the immediate delivery of the crypto asset, the Platform's user is not exposed to insolvency risk (credit risk), fraud risk, performance risk or proficiency risk on the part of the Platform.

Example of situation where securities legislation does not apply

As an example, we would consider that there is an obligation to deliver the crypto asset from the Platform to the user, immediate delivery occurs and therefore securities legislation does not apply if each of the following criteria apply:

- a Platform offers services for users to buy or sell bitcoin and does not offer margin or leveraged trading;

- users send money to the Platform to purchase bitcoin at a given price;

- the terms of the transaction require that the entire quantity of bitcoin purchased from the Platform or counterparty seller be immediately transferred to a wallet that is in the sole control of the user, and the transfer is immediately reflected on the Bitcoin blockchain;

[6] A security interest may arise due to a number of circumstances, including the use of margin, leverage or financing used to make the purchase.

- there is no agreement, arrangement or understanding between the parties that would allow the transaction to be settled other than by immediate transfer of bitcoin;

- the Platform's typical commercial practice is to make immediate delivery in accordance with the terms of the transaction, and for the Platform or its affiliates not to have ownership, possession or control of the user's bitcoin at any point following the transaction;

- the sale or purchase of bitcoin is not merely evidenced by an internal ledger or book entry that debits the seller's account with the Platform and credits the crypto assets to the user's account with the Platform, but rather, there is a transfer of the bitcoin to the user's wallet; and

- the Platform or counterparty seller retains no ownership, possession or control over the transferred bitcoin.

Example of situation where securities legislation does apply

We note that some Platforms purport to provide users with an opportunity to transact in crypto assets, including an opportunity to buy and sell crypto assets, but that, for several reasons, they retain ownership, control and possession of the crypto assets. They only require the users to transfer ownership, control and possession from the Platform's address to the user-controlled address upon the user's later request.

In these circumstances, there is no obligation to immediately deliver the crypto assets. Potentially, there will be ongoing reliance and dependence of the user on the Platform until the transfer to a user-controlled wallet is made. Until then, the user would not have ownership, possession and control of the crypto assets without reliance on the Platform. The user would be subject to ongoing exposure to insolvency risk (credit risk), fraud risk, performance risk and proficiency risk on the part of Platform.

For example, if the terms and conditions of a contract or instrument transacted on a Platform only require the Platform to transfer crypto assets to the user-controlled wallet on request (with the transaction simply recorded on the books of the Platform to evidence the purchase and the user's entitlement to receive the crypto asset on demand), the contract or instrument described above would be subject to securities legislation because:

- the contract or instrument does not create an obligation to make immediate delivery of the crypto assets to the user, and

- the typical commercial practice of the Platform is not to deliver, since users that do not make a request to transfer crypto assets do not receive full ownership, possession and control over the crypto assets that they transacted in.

In our view, a mere book entry does not constitute delivery, because of the ongoing reliance and dependence of the user on the Platform in order to eventually receive the crypto asset when requested.

Complying with securities legislation

We encourage Platforms to consult with their legal counsel on the application of securities legislation and to contact their local securities regulatory authority to discuss whether securities legislation applies to their activities and, if so, the appropriate steps to comply with the requirements. We also remind Platforms operating from outside Canada who have Canadian users to consider the requirements under Canadian securities legislation. CSA members intend to take enforcement action or continue existing enforcement action against Platforms that do not comply with securities legislation.

CSA Regulatory Sandbox

We welcome innovation and recognize that new fintech businesses may not fit neatly into the existing framework. The CSA Regulatory Sandbox is an initiative of the CSA to support fintech businesses seeking to offer innovative products, services and applications in Canada. It allows firms to register and/or obtain exemptive relief from securities law requirements, under a faster and more flexible process than through a standard application, in order to test their products, services and applications throughout the Canadian market, generally on a time-limited basis.

Several firms that have businesses or projects that involve crypto assets have been registered or have obtained exemptive relief from the securities law requirements. A list of firms that have been authorized in the CSA Regulatory Sandbox is available on the CSA website.

Contact information

Platforms seeking more information are invited to contact the securities regulatory authority in the jurisdiction where their head office is located:

Province	**Contact Information**
British Columbia	The BCSC Tech Team at TechTeam@bcsc.bc.ca and the Derivatives Branch at derivativesinbox@bcsc.bc.ca
Alberta	Denise Weeres or Katrina Prokopy at regtechsandbox@asc.ca
Saskatchewan	Dean Murrison at dean.murrison@gov.sk.ca or Nathanial Day at nathaniald.day@gov.sk.ca
Manitoba	Chris Besko at chris.besko@gov.mb.ca
Ontario	The OSC LaunchPad Team at osclaunchpad@osc.gov.on.ca
Québec	The Fintech Working Group at fintech@lautorite.qc.ca
New Brunswick	Wendy Morgan at registration-inscription@fcnb.ca
Nova Scotia	Jane Anderson at Jane.Anderson@novascotia.ca

Appendix D:

Canadian Securities Administrations/Investment Industry Regulatory Organization of Canada, “Joint Canadian Securities Administrators / Investment Industry Regulatory Organization of Canada Consultation Paper 21-402: Proposed Framework for Crypto-Asset Trading Platforms” (14 March 2019) Canadian Securities Administrators, online: <https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/2019mars14-21-402-doc-cons-en.pdf>.

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Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada

Consultation Paper 21-402

Proposed Framework for Crypto-Asset Trading Platforms

March 14, 2019

PART 1 – Introduction and purpose

The emergence of "digital assets" or "crypto assets" continues to be a growing area of interest for regulators globally. Innovations like distributed ledger technology (**DLT**) and crypto assets are relatively new and are transforming the landscape of the financial industry. Interest in crypto assets among investors, governments and regulators globally has increased significantly since the creation of bitcoin in 2008 and continues to grow. Early in 2018, at its peak, the total value of crypto assets was estimated, by one source, at more than US$800 billion.[1] While the value has since fallen, trading volumes remain significant. Today, there are over 2000 crypto assets[2] that may be traded for government-issued currencies or other types of crypto assets on over 200 platforms[3] that facilitate the buying and selling or transferring of crypto assets (**Platforms**). Many of these Platforms operate globally and without any regulatory oversight.

Although DLT may provide benefits, global incidents point to crypto assets having heightened risks related to loss and theft as compared to other assets. Regulators around the world are currently considering important issues surrounding the regulation of crypto assets including the appropriate regulation of Platforms. The Canadian Securities Administrators (the **CSA**) and the Investment Industry Regulatory Organization of Canada (**IIROC**, and together with the CSA, **we**), have been engaged with regulators globally, through IOSCO and other innovation initiatives, to seek input on a variety of regulatory approaches that exist in this area.

Platforms, depending on how they operate and the crypto assets they make available for trading may be subject to securities regulation. The CSA, through its Regulatory Sandbox[4], is in discussions with several Platforms that are seeking guidance on the requirements that apply to them. We have heard directly from Platform operators and their advisers that a regulatory framework is welcome, as they seek to build consumer confidence and expand their businesses across Canada and globally.

Currently there are no Platforms recognized as an exchange or otherwise authorized to operate as a marketplace or dealer in Canada. As such, the CSA has urged Canadians to be cautious when buying crypto assets.[5]

Platforms facilitate the buying and selling of crypto assets and perform functions similar to one or more of exchanges, alternative trading systems (**ATSs**), clearing agencies, custodians and dealers. Depending on their structure, they may also introduce novel features which create risks to investors and our capital markets that may not be fully addressed by the existing regulatory framework. Where securities legislation applies to Platforms we are considering a set of tailored regulatory requirements for them to address the novel features and risks (the **Proposed Platform Framework**).

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[1] https://coinmarketcap.com/charts/.
[2] Coinmarketcap.com listed 2098 different crypto assets as of March 1, 2019. See: https://coinmarketcap.com/all/views/all/.
[3] Coinmarketcap.com listed 241 Platforms as of March 1, 2019. See: https://coinmarketcap.com/rankings/exchanges/3.
[4] The CSA Regulatory Sandbox is an initiative of the CSA to support businesses seeking to offer innovative products, services and applications in Canada.
[5] The CSA has previously issued investor alerts reminding investors of the inherent risks associated with crypto asset futures contracts and the need for caution when investing with crypto asset trading platforms.

We endeavor to facilitate innovation that benefits investors and our capital markets, while ensuring that we have the appropriate tools and understanding to keep pace with evolving markets. The purpose of this joint CSA/IIROC Consultation Paper (the **Consultation Paper**) is to seek feedback from the financial technology (**fintech**) community, market participants, investors and other stakeholders on how requirements may be tailored for Platforms operating in Canada whose operations engage securities law. We intend to use this feedback to establish a framework that provides regulatory clarity to Platforms, addresses risks to investors and creates greater market integrity.

Throughout the Consultation Paper, investors participating on Platforms may be referred to as either **investors** or **participants**.

PART 2 – Nature of crypto assets and application of securities legislation[6]

Crypto assets differ in their functions, structures, governance and rights. Some crypto assets, commonly referred to as "utility tokens", are created to allow holders to access or purchase goods or services on a DLT network being developed by the creators of the token. As set out in CSA Staff Notice 46-307 *Cryptocurrency Offerings* and CSA Staff Notice 46-308 *Securities Law Implications for Offerings of Tokens*, staff of the CSA have found that most of the offerings of utility tokens have involved a distribution of securities, usually as investment contracts. Other crypto assets are tokenized forms of traditional securities or derivatives and may represent an interest in assets or have their value may be based on an underlying interest. If crypto assets that are securities and/or derivatives are traded on a Platform, the Platform would be subject to securities and/or derivatives regulatory requirements.

We note that it is widely accepted that at least some of the well established crypto assets that function as a form of payment or means of exchange on a decentralized network, such as bitcoin, are not currently in and of themselves, securities or derivatives. Instead, they have certain features that are analogous to existing commodities such as currencies and precious metals.

However, securities legislation may still apply to Platforms that offer trading of crypto assets that are commodities, because the investor's contractual right to the crypto asset may constitute a security or derivative. We are evaluating the specific facts and circumstances of how trading occurs on Platforms to assess whether or not a security or derivative may be involved. Some of the factors we are currently considering in this evaluation include:

- whether the Platform is structured so that there is intended to be and is delivery of crypto assets to investors,
- if there is delivery, when that occurs, and whether it is to an investor's wallet over which the Platform does not have control or custody,
- whether investors' crypto assets are pooled together with those of other investors and with the assets of the Platform,
- whether the Platform or a related party holds or controls the investors' assets,

[6] As defined in *Regulation 14-101 respecting Definitions.*

- if the Platform holds or stores assets for its participants, how the Platform makes use of those assets,
- whether the investor can trade, or rollover positions held by the Platform, and
- having regard to the legal arrangements between the Platform and its participants, the actual functions of the Platform and the manner in which transactions occur on it
    - who has control or custody of crypto assets,
    - who the legal owner of such crypto assets is, and
    - what rights investors will have in the event of the Platform's insolvency.

Consultation question

1. Are there factors in addition to those noted above that we should consider?

The CSA wishes to remind market participants that any person advertising, offering, selling or otherwise trading or matching trades in crypto assets that are securities or derivatives, or derivatives that are based on crypto assets to persons in Canada, or conducting such activities from a place of business in Canada is subject to securities legislation in Canada. Further, as noted above, although some crypto assets may be commodities, securities legislation may still apply to Platforms that offer trading of such crypto assets because the investor's contractual right to the crypto asset/commodity may constitute a security or derivative. Further, in most jurisdictions in Canada, the provisions of securities legislation relating to fraud, market manipulation and misleading statements apply not just to the trading of securities and derivatives but also to trading of the underlying interest of a derivative (e.g. the commodity).

The Proposed Platform Framework referred to in this Consultation Paper considers how existing regulatory requirements may be tailored for Platforms and should not be construed as acceptance by the CSA that securities and/or derivatives legislation may not apply to any particular offering involving crypto assets.

PART 3 – Risks related to Platforms

The operational models and the risks related to Platforms may vary from one platform to another; however, the risks are not entirely different than those applicable to other types of regulated entities such as marketplaces and dealers. The introduction of crypto assets and the operational models of Platforms, however, raise different and in some cases heightened, areas of risk. Key areas of risk include:

- **Investors' crypto assets may not be adequately safeguarded** – Many Platforms have control of their participants' crypto assets (e.g. they keep participants' crypto assets in a single account on the distributed ledger under the Platform's private key or the Platform holds its participants' private keys on their behalf). Platforms may not have necessary processes and controls in place to segregate participants' assets from their own and to safeguard those assets, including maintaining and safeguarding any private keys associated with wallets held by the Platform. There are also current challenges associated with auditing the internal controls surrounding custody of participants' assets.

- **Processes, policies and procedures may be inadequate** – Platforms may not have sufficient processes, policies and procedures in place to establish an internal system of controls and supervision sufficient to prudently manage the risks associated with their business, including business continuity risks, key personnel risks and regulatory compliance risks.
- **Investors' assets may be at risk in the event of a Platform's bankruptcy or insolvency** – Platforms may not segregate participants' assets from their own or may use participants' assets to fund operating costs and other expenses. As a result, Platforms may not hold sufficient assets to cover investor claims and return investors' assets in the event of bankruptcy or insolvency. In addition, Platforms may operate in jurisdictions that have limited asset protection and insolvency regimes.
- **Investors may not have important information about the crypto assets that are available for trading on the Platform** – Each crypto asset has its own functions, associated rights and risks. Platforms may not provide sufficient or clear information about the crypto assets for participants to make informed investment decisions. Examples of information may include the standards that the crypto asset had to meet before being admitted for trading on the Platform and any potential difficulties in liquidating the crypto asset.
- **Investors may not have important information about the Platform's operations** – Platforms may not provide sufficient information about the functions they perform and their fees. For example, some Platforms do not deliver crypto assets to a wallet controlled by the participant unless requested, but participants may not be aware of this or the risks associated with the Platform retaining custody of their crypto assets, including that they may not be able to access their crypto assets.
- **Investors may purchase products that are not suitable for them** – Exchanges and other regulated marketplaces do not interact directly with retail investors; instead they interact through regulated intermediaries (i.e. registered dealers). In contrast, Platforms may offer investors (including retail investors) direct access to the Platform without the use of a regulated intermediary that performs know-your-client and suitability assessments. As a result, participants may purchase crypto assets, many of which can be complex, high risk and volatile products, that are not suitable investments for them.
- **Conflicts of interest may not be appropriately managed –** There may be conflicts of interest between the Platform's operator and participants who access the Platform, including the inherent conflicts of interest where Platforms act as market makers and trade as principal.
- **Manipulative and deceptive trading may occur** – Platforms may be susceptible to manipulative and deceptive trading given the market volatility, lack of reliable pricing information for crypto assets, the fact that they trade 24 hours daily and the fact that trading on many Platforms is not currently monitored.
- **There may not be transparency of order and trade information** – Information relating to the price and volume of orders and trades may not be publicly available or sufficient to support efficient price discovery.
- **System resiliency, integrity and security controls may be inadequate** – Platforms have significant cybersecurity risks. DLT is a nascent technology and Platform operators may not have sufficient experience or possess the necessary skills to ensure that systems function properly and there is adequate protection against cyber theft of participants' crypto asset investments.

Consultation question

2. What best practices exist for Platforms to mitigate these risks? Are there any other substantial risks which we have not identified?

PART 4 – Regulatory approaches in other jurisdictions

In developing the Proposed Platform Framework, we considered the approaches taken by securities and financial regulators in other jurisdictions. We found that in many jurisdictions the existing regulatory requirements will apply to regulate Platforms within those jurisdictions. Some jurisdictions may tailor requirements or provide exemptions. This means that the regulatory requirements applicable to exchanges, ATSs (in the U.S. or Canada), multilateral trading venues (in Europe) and other regulated markets may apply to a Platform.

In the U.S., the Securities and Exchange Commission (**SEC**) issued a statement indicating that, if a platform offers trading of digital securities and operates a marketplace, it must be registered with the SEC as a national securities exchange, registered with the Financial Industry Regulatory Authority as a broker-dealer operating an ATS, or be exempt from registration.[7] The Commodity Futures Trading Commission (**CFTC**) has indicated that bitcoin and certain other crypto assets are encompassed in the definition of "commodity". In the context of retail commodity transactions in crypto assets, for example on Platforms, the CFTC has consulted with market participants on its approach to the proposed interpretation of the term "actual delivery".[8]

In European jurisdictions, the regulatory framework under the Markets in Financial Instruments Directive (**MiFID**) applies when crypto assets qualify as financial instruments. The European Securities and Markets Authority (**ESMA**) recently published a report with their advice on initial coin offerings and crypto assets where they identify the risks in the crypto asset sector.[9] In the report, ESMA indicates that where crypto assets qualify as transferable securities or other types of MiFID financial instruments, the existing regulatory framework will apply. ESMA also noted that the existing requirements may not address all the risks, and in some areas, the requirements may not be relevant in a DLT framework.

In Singapore, Platforms that trade crypto assets that are securities may be approved exchanges or be recognised market operators and, in both cases, are subject to regulation by the Monetary Authority of Singapore.[10]

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[7] SEC Statement on Potentially Unlawful Online Platforms for Trading Digital Assets (March 7, 2018): https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading.
[8] CFTC, Retail Commodity Transactions Involving Virtual Currency, Proposed Interpretation, 82 Fed. Reg. 60335 (December 20, 2017): https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2017-27421a.pdf.
[9] ESMA Advice – Initial Coin Offerings and Crypto-Assets (January 9, 2019): https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf.
[10] Monetary Authority of Singapore, A Guide to Digital Token Offerings (last updated November 30, 2018): http://www.mas.gov.sg/~/media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Securities%20Futures%20and%20Fund%20Management/Regulations%20Guidance%20and%20Licensing/Guidelines/A%20Guide%20to%20Digital%20Token%20Offerings%20last%20updated%20on%2030%20Nov%202018.pdf

In Hong Kong, Platforms that are trading products that are not within the remit of the Hong Kong Securities and Futures Commission (**HKSFC**) can apply to use HKSFC's Regulatory Sandbox, particularly if they will, in the future, seek to offer trading of products that are within the remit of the HKSFC. This will allow the HKSFC to engage in an exploratory stage where it observes the Platform's operations and considers the effectiveness of proposed regulatory requirements for Platforms and whether Platforms are appropriate to be regulated by the HKSFC. If the decision is made to license the Platform, additional restrictions may apply.[11]

In Malaysia, the *Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token)* Order 2019 came into force on January 15, 2019 and specifies that all digital currencies, tokens and crypto assets are classified as securities, placing them under the authority of the Securities Commission Malaysia.[12]

Many financial regulators are proactively conducting inquiries into the activities of Platforms to determine if they are carrying on activities that require them to comply with their requirements.

Consultation question

3. Are there any global approaches to regulating Platforms that would be appropriate to be considered in Canada?

PART 5 – The Proposed Platform Framework

5.1 Overview of the Proposed Platform Framework

The Proposed Platform Framework will apply to Platforms that are subject to securities legislation and that may not fit within the existing regulatory framework. It will apply both to Platforms that operate in Canada and to those that have Canadian participants.[13]

In developing the Proposed Platform Framework, the CSA considered that some of the Platforms are hybrid in nature and may perform functions typically performed by one or more of the following types of market participants: ATSs[14], exchanges[15] (exchanges and ATSs are both types of marketplaces[16]), dealers, custodians and clearing agencies. Specifically:

[11] HKSFC Conceptual framework for the potential regulation of virtual asset trading platform operators (November 1, 2018): https://www.sfc.hk/web/EN/files/ER/PDF/App%202_%20Conceptual%20framework%20for%20VA%20trading%20platform_eng.pdf

[12] Securities Commission Malaysia media release (January 14, 2019): https://www.sc.com.my/news/media-releases-and-announcements/sc-to-regulate-offering-and-trading-of-digital-assets

[13] The CSA may consider exemptive relief from the applicable requirements if the Platform is located outside of Canada and is regulated by a foreign regulator in a manner that is similar to domestic oversight.

[14] ATS is defined in every jurisdiction other than Ontario in s. 1.1 of *Regulation 21-101 respecting Marketplace Operation* (**Regulation 21-101**), and in Ontario in ss. 1(1) of the *Securities Act* (Ontario).

[15] An exchange is a marketplace that may, among other things, lists the securities of issuers; provides a guarantee of a two-sided market for a security on a continuous or reasonably continuous basis; sets requirements governing the conduct of marketplace participants; or disciplines marketplace participants. Securities legislation enables securities regulatory authorities to recognize exchanges or exempt an exchange from recognition.

[16] Marketplace is defined in every jurisdiction other than Ontario in s. 1.1 on Regulation 21-101, and in Ontario in ss. 1(1) of the *Securities Act* (Ontario).

- like an exchange or ATS, they may be a market or facility where orders of multiple buyers and sellers are brought together and matched;
- like an exchange, they may facilitate the creation or "listing" of a crypto asset;
- like an ATS or exchange, they may decide which crypto assets will be eligible for trading;
- like an exchange, they may offer a guarantee of a two-sided market and conduct regulatory activities;
- like a dealer, they may perform know-your-client and suitability reviews to grant access to investors (retail and institutional) and they may trade as principal;
- like a dealer or a custodian, they may self-custody investor's assets or otherwise have control over investors' assets; and
- like a clearing agency, they may enable the clearing and settlement of trades.

Application of marketplace requirements

The Proposed Platform Framework is based on the existing regulatory framework applicable to marketplaces and incorporates relevant requirements for dealers facilitating trading or dealing in securities. It is tailored to take into account the functions that may be performed by each Platform. Specifically, a Platform that brings together orders of buyers and sellers of securities and uses non-discretionary methods for these orders to interact is a marketplace.

As a marketplace, a Platform will be subject to requirements that will address many of the risks outlined in Part 3 of the Consultation Paper, such as those set out in Regulation 21-101, *Regulation 23-101 respecting Trading Rules* (**Regulation 23-101** and, together with Regulation 21-101, the **Marketplace Rules**) and *Regulation 23-103 respecting Electronic Trading and Direct Access to Marketplaces* (**Regulation 23-103**).

Application of dealer requirements

In addition to marketplace functions, the Platform may also perform dealer functions, for example, providing custody of crypto assets and permitting direct access to trading by retail investors. As a result, the Proposed Platform Framework will include requirements that address the risks relating to these additional functions. Many of these requirements already exist in regulatory frameworks applicable to dealers.

Some entities will not fall within the definition of a marketplace. For example, an entity that is trading crypto assets that are securities but always trades against its participants and does not facilitate trading between buyers and sellers may be regulated as a dealer only and therefore not be subject to the Marketplace Rules and the Proposed Platform Framework. For example, firms that are currently registered in the category of exempt market dealer and that are currently permitted under securities legislation to facilitate the sale of securities, including crypto assets, in reliance on available prospectus exemptions in *Regulationt 45-106 respecting Prospectus Exemptions* can continue to offer this service as long as they do not fall within the definition of "marketplace".

Registered firms introducing crypto asset products and/or services are required to report changes in their business activities to their principal regulator and the proposed activities may be subject to review to assess whether there is adequate investor protection.

Investment dealer registration and IIROC membership

Like the Marketplace Rules, the Proposed Platform Framework contemplates Platforms both becoming registered as investment dealers and becoming IIROC dealer and marketplace members (**IIROC Members**)[17]. IIROC currently oversees all investment dealers as well as trading activity on debt and equity marketplaces in Canada and, accordingly,

- has a comprehensive body of rules governing the business, financial and trading conduct of IIROC Members which are tailored to the different types of products and services offered by IIROC Members;
- has established programs to assess compliance with both IIROC's rules applicable to dealers (**IIROC Dealer Member Rules**) and the Universal Market Integrity Rules (**UMIR**) that govern trading on a marketplace;
- has experience with dealers and marketplaces that trade a variety of securities and has developed tailored compliance programs and applied tailored rules for marketplaces; and
- operates in a regulatory capacity in every province in Canada.

Recognition as an exchange

A Platform that intends to carry on business as an exchange should contact the relevant securities regulatory authority to discuss whether recognition as an exchange is appropriate or, if such Platforms offer direct retail access or trade as principal, the Proposed Platform Framework is more appropriate to address risks arising from these activities.

Derivatives requirements

The CSA plans to consult on the appropriate regulatory framework to apply to marketplaces that trade over-the-counter derivatives, including platforms that offer derivatives with exposure to a crypto asset (e.g. a derivatives trading facility or swap execution facility that facilitate transactions in bitcoin-based derivatives). In the interim, if a Platform is trading or dealing in crypto assets that may be classified as derivatives, to the extent that the Platform has similar functions or operations to those contemplated in this Consultation Paper, it may be appropriate to apply requirements to those Platforms that are similar to the requirements contemplated by the Proposed Platform Framework. We anticipate, however, that such requirements may need to be specifically tailored to reflect the requirements that currently apply to derivatives or are otherwise appropriate to apply to those products and marketplaces.[18]

[17] We note that IIROC membership may not be appropriate in all cases, depending on the facts and circumstances.
[18] We would also like to remind market participants of the requirements relating to commodity futures exchange contracts in securities and commodity futures legislation.

5.2 Proposed Platform Framework - Key areas for consultation

While the Proposed Platform Framework builds on an existing regulatory regime that was designed for a wide variety of market participants, we recognize that the existing regulatory requirements, and particularly the Marketplace Rules, were designed for marketplaces trading traditional securities (such as equities and debt). The CSA supports innovation in our capital markets while protecting investors and promoting fair and efficient capital markets. We are therefore considering a set of requirements tailored to Platforms' operations that appropriately addresses the new risks introduced.

Below, we seek feedback on a number of areas that will assist in determining appropriate requirements for Platforms.

5.2.1 Custody and verification of assets

It has been reported that crypto assets with a value of almost US$1 billion were stolen in 2018 from Platforms that operate globally.[19] The ownership of crypto assets is evidenced by private keys which are required to execute crypto asset transactions. As the loss or theft of a private key may result in the loss of assets, the safeguarding of private keys is especially critical.

The operational model of many Platforms involves the Platform having custody of its participants' assets including private keys or the Platform holding the crypto assets in its own wallet with the Platform's private key. As a result, appropriate custody controls are a necessary part of managing risks to investors. To the extent that the Platform holds or has control over investors' assets, a significant risk is that investors' assets are not sufficiently accounted for or protected by the Platform. As a result, the Platform might not have sufficient crypto assets or cash to satisfy demand or could be vulnerable to theft. This risk increases substantially if there is insufficient insurance to cover the full amount of the theft.

When looking at the operations of a Platform, we will assess whether a Platform's risk management policies and procedures are appropriate to manage and mitigate the custodial risks. Expectations will be guided by the operational model of the Platform. For example, if the trades on a Platform do not occur on the distributed ledger, and instead the Platform keeps track of changes in ownership on its own internal ledger, we will evaluate whether the Platform has a robust system of internal controls, including records, that ensures that a participant's crypto assets are accurately accounted for by the Platform and appropriately segregated from assets belonging to the Platform.

Traditional custodians that hold assets for clients typically engage an independent auditor to perform an audit of the custodian's internal controls and prepare an assurance report. There are different types of assurance reports; however, it is common for custodians to engage external auditors to issue system and organization controls reports such as SOC 1 Reports[20] and SOC 2 Reports[21] regarding the suitability of internal controls in financial reporting and controls

[19] https://www.reuters.com/article/us-crypto-currency-crime/cryptocurrency-theft-hits-nearly-1-billion-in-first-nine-months-report-idUSKCN1MK1J2.
[20] Report on controls at a service organization relevant to participant entities' internal control over financial reporting.
[21] Report on controls at a service organization relevant to security, availability, processing integrity, confidentiality or privacy.

surrounding the custody of investors' assets. The auditor will issue a report pertaining to the design of the controls (**Type I Report**), and a report assessing whether such controls are operating as intended over a defined period (**Type II Report**). We anticipate that these reports will play an important role in the authorization and oversight of the Platform, reporting of transactions, internal risk management and verification of the existence of investors' assets. We contemplate requiring that Platforms obtain SOC 2, Type I and II Reports for their custody system and, if they use third-party custodians, to ensure that they have SOC 2, Type I and II Reports.

We understand, however, that there have been challenges with crypto asset custodians and Platforms obtaining SOC 2, Type II Reports, in part due to the novel nature of crypto asset custody solutions and the limited period of time that Platforms have been in operation to allow for the testing of internal controls. Nevertheless, we contemplate that Platforms seeking registration as an investment dealer registration and IIROC membership that plan to provide custody of crypto assets will not only need to satisfy existing custody requirements but will also be expected to meet other yet-to-be determined standards specific to the custody of crypto assets.

Consultation questions

4. What standards should a Platform adopt to mitigate the risks related to safeguarding investors' assets? Please explain and provide examples both for Platforms that have their own custody systems and for Platforms that use third-party custodians to safeguard their participants' assets.

5. Other than the issuance of Type I and Type II SOC 2 Reports, are there alternative ways in which auditors or other parties can provide assurance to regulators that a Platform has controls in place to ensure that investors' crypto-assets exist and are appropriately segregated and protected, and that transactions with respect to those assets are verifiable?

6. Are there challenges associated with a Platform being structured so as to make actual delivery of crypto assets to a participant's wallet? What are the benefits to participants, if any, of Platforms holding or storing crypto assets on their behalf?

5.2.2 Price determination

Fair and efficient capital markets are dependent on price discovery. The wide availability of information on orders and/or trades is important to foster efficient price discovery and investor confidence. As with traditional marketplaces, Platforms will be required to foster price discovery for the crypto assets they offer for trading. It is important for regulators and for the participants on the Platform to understand how prices on a Platform are determined. In addition, where the Platform or an affiliate acts as a market maker and provides quotes, the mechanisms for determining those quotes are expected to be available to participants. When trading as a market maker against its participants, a Platform will also be required to provide participants with a fair price.

Consultation questions

7. What factors should be considered in determining a fair price for crypto assets?

8. Are there reliable pricing sources that could be used by Platforms to determine a fair price, and for regulators to assess whether Platforms have complied with fair pricing requirements? What factors should be used to determine whether a pricing source is reliable?

5.2.3 Surveillance of trading activities

The existing types of marketplaces have different regulatory responsibilities. Exchanges are responsible for conducting market surveillance of trading activities on the exchange and enforcing market integrity rules. All of the existing equity exchanges have retained IIROC to monitor trading activity and enforce market integrity rules. ATSs, by contrast, are not permitted to conduct market surveillance or enforcement activities and are required to engage a regulation services provider (**RSP**). IIROC currently acts as an RSP to all equity and fixed income marketplaces.

If IIROC were retained as an RSP by a Platform, IIROC would conduct market surveillance for that Platform. We understand that some of the types of manipulative and deceptive trading activities that may occur on Platforms that trade crypto assets are similar to those on marketplaces trading traditional securities. A unique challenge associated with market surveillance on Platforms is the fact that crypto assets trade on a global basis, on and off Platforms, outside regular trading hours, and may be illiquid and highly volatile. This, and the fact that there is currently no central source for pricing, may affect the price of a crypto asset trading on a Platform. This may also make it difficult to obtain reliable reference data that is needed to conduct effective surveillance.

To reduce the risks of potentially manipulative or deceptive activities, in the near term, we propose that Platforms not permit dark trading or short selling activities, or extend margin to their participants. We may revisit this once we have a better understanding of the risks introduced to the market by the trading of crypto assets.

Some Platforms have indicated that they intend to set rules and monitor the trading activities of their marketplace participants rather than retaining an RSP. This may raise conflicts of interest issues that will need to be addressed.

Consultation questions

9. Is it appropriate for Platforms to set rules and monitor trading activities on their own marketplace? If so, under which circumstances should this be permitted?

10. Which market integrity requirements should apply to trading on Platforms? Please provide specific examples.

11. Are there best practices or effective surveillance tools for conducting crypto asset market surveillance? Specifically, are there any skills, tools or special regulatory powers needed to effectively conduct surveillance of crypto asset trading?

12. Are there other risks specific to trading of crypto assets that require different forms of surveillance than those used for marketplaces trading traditional securities?

5.2.4 Systems and business continuity planning

System resiliency, reliability and security controls are important for investor protection. System failures may result in investors being unable to access their crypto assets and may have an impact on market efficiency and investor protection. Marketplaces are required to have adequate internal and information technology controls over their trading, surveillance and clearing systems and information security controls that relate to security threats and cyber-attacks.[22] Marketplaces are also required to maintain business continuity and disaster recovery plans to provide uninterrupted provision of key services.[23] To ensure that marketplaces have adequate internal and technology controls in place over their trading, surveillance and clearing systems and that their systems function as designed, marketplaces are required to engage an entity with relevant experience both in information technology and in the evaluation of related internal controls to conduct an independent systems review (**ISR**).[24]

Technology and cyber security are key risks for Platforms. For these reasons they will also be required to comply with the systems and business continuity planning requirements applicable to existing marketplaces in Regulation 21-101. One key difference between Platforms and traditional marketplaces is that there is a greater risk for participants when a Platform provides custody of investors' crypto assets and does not have the appropriate internal controls.

In the normal course, all marketplaces are required to have an ISR conducted for other critical systems including order entry, execution or data. These requirements are in place to manage risks associated with the use of technology and to ensure that minimum standards are maintained. In some cases, we have granted temporary exemptions from the ISR requirements, provided the marketplace did not pose a significant risk to the capital markets and certain reports and information are provided to regulators.

Consultation question

13. Under which circumstances should an exemption from the requirement to provide an ISR by the Platform be considered? What services should be included/excluded from the scope of an ISR? Please explain.

5.2.5 Conflicts of interest

Platforms may have certain conflicts of interests, similar to other marketplaces. They may also raise a number of unique conflicts. For example, they may provide advice to their participants, which raises a conflict because the Platform may be providing advice on the same crypto assets that they have made eligible for trading on the Platform.

Another conflict relates to proprietary trading. Like dealers, it is possible that some Platforms trade for their own account against their participants, including retail investors. This raises conflicts of

[22] Part 12 of Regulation 21-101.
[23] Ibid.
[24] Ibid.

interest and a number of risks, including that the Platform's participants may not know that the Platform operator also trades on the marketplace against the investor and the risk that investors may not receive a fair price when trading against the Platform operator.

To address these risks, we contemplate that Platforms will be required to identify and manage potential conflicts of interest and will be required to disclose whether they trade against their participants, including acting as a market maker, and the associated conflicts of interest. Disclosure will assist investors in assessing whether they want to participate on the Platform. To the extent Platforms are required to become IIROC Members, they will also be subject to requirements in the UMIR aimed at mitigating the risks associated with trading against their participants.[25]

Consultation questions

14. Is there disclosure specific to trades between a Platform and its participants that Platforms should make to their participants?

15. Are there particular conflicts of interest that Platforms may not be able to manage appropriately given current business models? If so, how can business models be changed to manage such conflicts appropriately?

5.2.6 Insurance

Some Platforms have custody of investors' assets. This makes them attractive targets for cyber-attacks and theft by insiders. Accordingly, insurance will also be an important safeguard. Dealers are required to maintain bonding or insurance against specific risks and in specified amounts.[26] This requirement may not address the specific operational risks of Platforms.

Many Platforms currently operate without any insurance covering investors' assets. We note that there may be significant difficulty and costs for a Platform to obtain insurance, in part due to the limited number of crypto asset insurance providers, and the high risk of cyber-attacks. Therefore, some Platforms have indicated that they are considering limited coverage that only extends to certain crypto assets, crypto assets in "hot wallets" or "cold wallets", loss as result of hacking, or loss from insider theft.

Consultation questions

16. What type of insurance coverage (e.g. theft, hot-wallet, cold-wallet) should a Platform be required to obtain? Please explain.

17. Are there specific difficulties with obtaining insurance coverage? Please explain.

18. Are there alternative measures that address investor protection that could be considered equivalent to insurance coverage?

[25] These include UMIR 5.3 *Client Priority*, UMIR 8.1 *Client Principal Trading* and UMIR 4.1 *Frontrunning*.
[26] s. 12.3 of Regulation 31-103.

5.2.7 Clearing and settlement

All trades executed on a marketplace are required to be reported and settled through a clearing agency.[27] A regulated clearing agency improves the efficiency of marketplaces and brings stability to the financial system.

Without exemptive relief, this requirement would also apply to Platforms that are marketplaces. However, currently there are no regulated clearing agencies for crypto assets that are securities or derivatives. As indicated above, we understand that on some Platforms, transaction settlement occurs on the Platform's internal ledger and is not recorded on the distributed ledger. We are considering whether an exemption from the requirement to report and settle trades through a clearing agency is appropriate. In these circumstances, Platforms will still be subject to certain requirements applicable to clearing agencies and will therefore be required to have policies, procedures and controls to address certain risks including operational, custody, liquidity, investment and credit risk.[28] We plan to revisit such exemptions in the future, as the space continues to develop and evolve.

Some Platforms may operate a non-custodial (decentralized) model where the transfer of crypto assets that are securities or derivatives occurs between the two parties of a trade on a decentralized blockchain protocol (e.g. smart contract). These types of Platforms will be required to have controls in place to address the specific technology and operational risks of the Platform.

Consultation questions

19. Are there other models of clearing and settling crypto assets that are traded on Platforms? What risks are introduced as a result of these models?

20. What, if any, significant differences in risks exist between the traditional model of clearing and settlement and the decentralized model? Please explain how these different risks may be mitigated.

21. What other risks are associated with clearing and settlement models that are not identified here?

5.2.8 Applicable regulatory requirements

Platforms that are marketplaces are subject to existing marketplace regulatory requirements, including those summarized at **Appendix B**. Some of these requirements may not be relevant for Platforms and others may need to be tailored to address specific risks.

Platforms may perform additional functions typically performed by dealers and clearing agencies. We are also considering how the requirements summarized at **Appendices C** and **D** may apply. Leveraging the existing regulatory frameworks will ensure that Platforms are treated similarly to

[27] Part 13 of Regulation 21-101.
[28] If not already addressed by rules applicable to IIROC Members, to the extent they apply.

other marketplaces, but with appropriately tailored requirements that are relevant for the functions they perform.

Please note that Appendices B, C and D provide only an overview of certain requirements and therefore they should not be relied upon as exhaustive lists of the requirements applicable to marketplaces, dealers and clearing agencies.

Consultation question

22. What regulatory requirements, both at the CSA and IIROC level, should apply to Platforms or should be modified for Platforms? Please provide specific examples and the rationale.

PART 6 – Providing Feedback

The CSA Regulatory Sandbox is an initiative of the CSA to support business seeking to offer innovative products, services and applications in Canada. The CSA Regulatory Sandbox is a part of the CSA's 2016-2019 Business Plan's objectives to gain a better understanding of how fintech innovations are impacting capital markets and assess the scope and nature of regulatory implications.[29]

We invite interested parties to make written submissions on the consultation questions identified throughout this Consultation Paper. A complete list of the consultation questions referred to throughout this paper is provided in **Appendix A**. We also welcome you to provide any other comments on the appropriate regulation of Platforms. The information provided will assist us in refining the Proposed Platform Framework and our understanding of this area of innovation.

Please submit your comments in writing by **May 15, 2019**. Please send your comments by email in Microsoft Word format. Address your submission to IIROC and all members of the CSA as follows:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

[29] CSA Business Plan, 2016-2019: https://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSA_Business_Plan_2016-2019.pdf

Please deliver your comments **only** to the addresses below. Your comments will be distributed to IIROC and the other CSA members.

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Certain CSA regulators require publication of the written comments received during the comment period. We will publish all responses received on the websites of the Autorité des marchés financiers (www.lautorite.qc.ca), the Ontario Securities Commission (www.osc.gov.on.ca), and the Alberta Securities Commission (www.albertasecurities.com). Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

PART 7 – Questions

Please refer your questions to any of the following CSA and IIROC staff:

Serge Boisvert Senior Policy Advisor Exchanges and SRO Oversight Autorité des marchés financiers serge.boisvert@lautorite.qc.ca	**Marc-Olivier St-Jacques** Senior Policy Advisor Supervision of Intermediaries Autorité des marchés financiers marco.st-jacques@lautorite.qc.ca
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Dean Murrison Director, Securities Division Financial and Consumer Affairs Authority of Saskatchewan dean.murrison@gov.sk.ca	**Zach Masum** Manager, Legal Services, Capital Markets Regulation British Columbia Securities Commission zmasum@bcsc.bc.ca
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Victoria Pinnington Senior Vice President, Market Regulation IIROC vpinnington@iiroc.ca	**Sonali GuptaBhaya** Director, Market Regulation Policy IIROC sguptabhaya@iiroc.ca

APPENDIX A
Consultation Questions

1. Are there factors in addition to those noted in Part 2 that we should consider?

2. What best practices exist for Platforms to mitigate the risks outlined in Part 3? Are there any other significant risks which we have not identified?

3. Are there any global approaches to regulating Platforms that are appropriate to be considered in Canada?

4. What standards should a Platform adopt to mitigate the risks related to safeguarding investors' assets? Please explain and provide examples both for Platforms that have their own custody systems and for Platforms that use third-party custodians to safeguard their participants' assets.

5. Other than issuance of Type I and Type II SOC 2 Reports, are there alternative ways in which auditors or other parties can provide assurance to regulators that a Platform has controls in place to ensure that investors' crypto-assets exist and are appropriately segregated and protected, and that transactions with respect to those assets are verifiable?

6. Are there challenges associated with a Platform being structured so as to make actual delivery of crypto assets to a participant's wallet? What are the benefits to participants, if any, of the Platforms holding or storing crypto assets on their behalf?

7. What factors should be considered in determining a fair price for crypto assets?

8. Are there reliable pricing sources that could be used by Platforms to determine a fair price, and for regulators to assess whether Platforms have complied with fair pricing requirements? What factors should be used to determine whether a pricing source is reliable?

9. Is it appropriate for Platforms to set rules and monitor trading activities on their own marketplace? If so, under which circumstances should this be permitted?

10. Which market integrity requirements should apply to trading on Platforms? Please provide specific examples.

11. Are there best practices or effective surveillance tools for conducting crypto asset market surveillance? Specifically, are there any skills, tools or special regulatory powers needed to effectively conduct surveillance of crypto asset trading?

12. Are there other risks specific to trading of crypto assets that require different forms of surveillance than those used for marketplaces trading traditional securities?

13. Under which circumstances should an exemption from the requirement to provide an ISR by the Platform be appropriate? What services should be included/excluded from the scope of the ISR? Please explain.

14. Is there disclosure specific to trades between a Platform and its participants that Platforms should make to their participants?

15. Are there particular conflicts of interest that Platforms may not be able to manage appropriately given current business models? If so, how can business models be changed to manage such conflicts appropriately?

16. What type of insurance coverage (e.g. theft, hot-wallet, cold-wallet) should a Platform be required to obtain? Please explain.

17. Are there specific difficulties with obtaining insurance coverage? Please explain.

18. Are there alternative measures that address investor protection that could be considered that are equivalent to insurance coverage?

19. Are there other models of clearing and settling crypto assets that are traded on Platforms? What risks are introduced as a result of these models?

20. What, if any, significant differences in risks exist between the traditional model of clearing and settlement and the decentralized model? Please explain how these different risks could be mitigated.

21. What other risks could be associated with clearing and settlement models that are not identified here?

22. What regulatory requirements (summarized at Appendices B, C, and D), both at the CSA and IIROC level, should apply to Platforms or should be modified for Platforms? Please provide specific examples and the rationale.

APPENDIX B
Summary of Regulatory Requirements Applicable to Marketplaces

Marketplaces are subject to the Marketplace Rules and Regulation 23-103. These include high-level principles relating to access to the marketplaces and trading on the marketplaces. A summary of the regulatory requirements is included below. Please note that this summary should not be relied upon as being an exhaustive list of the requirements applicable to marketplaces.

1. Market integrity

The Marketplace Rules and Regulation 23-103 have a number of requirements covering market integrity. For example, Regulation 21-101 requires a marketplace to take reasonable steps to ensure it operates in a way that does not interfere with fair and orderly markets.[30] Regulation 23-101 and securities legislation in some jurisdictions also prohibit any person from engaging in transactions that they know, or should know, result in market manipulation or are fraudulent. Regulation 23-103 also has requirements for marketplaces aimed at maintaining market integrity. For example, marketplaces are required to assess, on a regular basis, whether they require risk management and supervisory controls, policies and procedures, in addition to those of their participants. Marketplaces are also required to assess on a regular basis the continuing adequacy and effectiveness of these controls, policies and procedures.[31]

While the Marketplace Rules and Regulation 23-103 establish the high-level principles for marketplaces that trade in Canada, the specific requirements applicable to participants on a marketplace are included in the UMIR, which are administered by IIROC.

2. Transparency of operations

Marketplaces are required to make transparent, on their websites, a description of how their orders are entered, interact and are executed, the hours of operation, their fees (including fees for facilitation, routing and mark-ups, if applicable), their affiliates' fees, access requirements, conflicts of interest policies and procedures, and referral arrangements between the marketplace and service providers.[32] The purpose of these requirements is to ensure that market participants understand how the marketplace works, as well as the associated risks, its features and its fees.

3. Transparency of orders and trades

Except in certain circumstances, marketplaces must make transparent their order and trade information for securities traded on a marketplace by providing it to an information processor.[33] The information processor collects, consolidates and disseminates their data, and also sets the requirements for the order and trade information that must be provided to it by marketplaces.

4. Transparency to regulators

Marketplaces are required to provide certain information to the securities regulators, so that they

[30] s. 5.7 of Regulation 21-101.
[31] Part 4 of Regulation 23-103.
[32] s. 10.1 of Regulation 21-101.
[33] Part 7 of Regulation 21-101 and Part 8 of Regulation 21-101 for equity and fixed income securities, respectively.

understand the business of the marketplace and the risks it introduces to the market. Such information is described in the exhibits included in Forms 21-101F1 *Information Statement Exchange or Quotation and Trade Reporting System* and 21-101F2 *Information Statement Alternative Trading System*, for exchanges and ATSs respectively, and relates to: governance, marketplace operations, outsourcing arrangements, systems, custody, the types of securities traded, how access to services is provided, and fees. These forms must be filed prior to the commencement of the operations and must be kept up to date. Changes to the information included in these forms must also be reported to the securities regulators, either in advance, if the change is significant, or subsequent to its implementation if it is not.

In addition, marketplaces report their trading activities on a quarterly basis.[34] The quarterly reports are provided to the securities regulators in electronic form. The information reported is included in Form 21-101F3 *Quarterly Report of Marketplace Activities* and includes trading activity information (value, volume and number of trades) by category of security, information about orders and order types, and information about the most traded securities.

5. Listing securities

Exchanges may list securities of an issuer.[35] They are required to comply with the fair access requirements in Regulation 21-101 (and in their recognition orders), which include the requirement to establish written standards for granting access to each of their services,[36] including listings. Since exchanges have listings requirements in the form of rules, they must ensure that these rules require compliance with securities legislation[37] and that they provide appropriate sanctions for violations of the rules.[38]

6. Fair access

Marketplaces must not unreasonably prohibit or limit access by a person to services offered by the marketplace. A marketplace must establish written standards for granting access to each of its services and must keep records of each access grant or denial of access.[39] It must neither permit unreasonable discrimination among participants, issuers and marketplace participants nor impose any burden on competition that is not reasonably necessary and appropriate.[40] Lastly, a marketplace must not prohibit, condition or otherwise limit a marketplace participant from trading on any marketplace.[41]

7. Conflict of interest

A marketplace must establish, maintain and ensure compliance with policies and procedures that identify and manage any conflicts of interest arising from the operation of a marketplace or the

[34] Part 3 of Regulation 21-101.
[35] An issuer is listed when there is a formal arrangement between the exchange and the issuer to have the issuer's securities listed, and the exchange has and enforces listing requirements.
[36] para. 5.1(2)(a) of Regulation 21-101.
[37] para. 5.3(b) of Regulation 21-101.
[38] para. 5.4(b) of Regulation 21-101.
[39] s. 5.1 of Regulation 21-101.
[40] ss. 5.1(3) of Regulation 21-101.
[41] s. 5.1 of Regulation 21-101.

services it provides, and any conflicts that owners of the marketplace may have.[42] These policies must be disclosed on the marketplace's website.

8. Outsourcing

A marketplace that outsources key services or systems to a service provider must have policies and procedures relating to the selection of the service provider, must maintain access to the books and records of the service provider, must ensure that the securities regulatory authorities have access to data that is maintained at the service provider and must review, on a regular basis, the performance of the service provider.[43] The outsourcing requirements seek to ensure that the marketplace retains responsibility and control over the outsourced services or systems.[44]

9. Confidential treatment of trading information

A marketplace must not release the order or trade information of any of its participants. This requirement protects each marketplace participant's trading history and strategy. There is an exception to this requirement in limited situations, where data is used for capital markets research and provided certain conditions are met.[45]

10. Recordkeeping requirements

Marketplaces are required to keep books, records and other documents that are reasonably necessary for the proper recording of its business in electronic form.[46]

11. Systems and business continuity planning

Marketplaces are required to have adequate internal and information technology controls over their trading, surveillance and clearing systems and information security controls that relate to security threats and cyber attacks. A marketplace is also required to maintain business continuity and disaster recovery plans. A marketplace is required to develop, maintain and test a business continuity plan to ensure uninterrupted provision of key services. A marketplace is required to engage a qualified third party to conduct an independent system review to assess whether it has adequate internal and information technology controls and if they function as designed.[47]

12. Clearing and settlement

All trades executed on a marketplace must be reported and settled through a clearing agency.[48] Marketplace participants have a choice as to the clearing agency that they would like to use for the clearing and settlement of their trades, provided that the clearing agency is appropriately regulated in Canada.

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[42] s. 5.11 of Regulation 21-101.
[43] s. 5.12 of Regulation 21-101.
[44] Ibid.
[45] s. 5.10 of Regulation 21-101.
[46] Part 11 of Regulation 21-101.
[47] Part 12 of Regulation 21-101.
[48] Part 13 of Regulation 21-101.

APPENDIX C
Summary of Regulatory Requirements Applicable to Dealers

Registration is required if a person is in the business of or is holding itself out as being in the business of, trading securities. We have generally found Platforms that intermediate trades of securities between buyers and sellers to be "in the business" of trading securities and subject to the registration requirements set out in *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations,* and, where applicable, IIROC Dealer Member Rules and UMIR.

Although the details of the specific requirements applicable to different categories of dealers vary, the summary below captures the basic requirements applicable to a dealer. Please note that this summary should not be relied upon as an exhaustive list of the requirements applicable to dealers.

1. Proficiency

Dealers are in the business of buying and selling securities and derivatives on behalf of the clients and are implicitly or explicitly holding themselves out as having a certain level of knowledge or expertise. Accordingly, individuals registered as dealing representatives are expected to have the education, training and experience that a reasonable person would consider necessary to perform their activities competently, including understanding the structure, features and risks of each security the individual recommends.[49]

Similarly, firms are required to employ individuals as ultimate designated persons (**UDP**) and chief compliance officers (**CCO**) who meet certain additional educational and experience requirements and who will have responsibilities respecting promoting compliance with securities legislation and establishing and monitoring policies and procedures designed to assess compliance by the firm and its dealing representatives with securities legislation.[50]

2. Books and records

Dealers may hold the assets of and conduct transactions on behalf of a multitude of clients. Accordingly, it is important that they maintain books and records that accurately reflect their business activities, financial affairs and client transactions. These books and records requirements help dealers ensure that they are able to prepare and file financial information, determine their capital adequacy, and generally demonstrate compliance with the capital and insurance requirements, among other securities law requirements.[51] Maintaining proper books and records allows dealers to document information about their relationships with their clients and with other entities, as well as, to report to their clients the trades they have transacted on behalf of their clients.[52]

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[49] The proficiency requirements for registered individuals at investment dealers are set out in IIROC Dealer Member Rule 2900 *Proficiency and Education*. The requirements for registered individuals at dealers other than investment dealers are included in Part 3 of Regulation 31-103.
[50] s. 11.2 and 11.3 of Regulation 31-103, respectively.
[51] s. 11.5 of Regulation 31-103.
[52] s. 14.12 and 14.14 of Regulation 31-103.

3. Compliance system

Given the significant role registered dealers play vis-à-vis their clients and to the capital markets, dealers are required to establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation and to manage the risks associated with its business in accordance with prudent business practices.[53]An effective compliance system includes internal controls and day-to-day monitoring and supervision elements that are appropriately documented. These elements are intended to ensure the integrity of the practices of the dealer, as well as the appropriate segregation of key duties and functions, and includes employee proficiency and training.

As part of a compliance system, a registered firm must appoint both a CCO and an UDP. The CCO is responsible for monitoring, updating and reviewing policies and procedures a registered firm must have as part of its compliance system. The UDP promotes compliance with securities legislation and sets the tone for firm-wide compliance. Investment dealers are also required to appoint a Chief Financial Officer.

4. Financial condition and required capital

Dealers may have access to the assets of a multitude of clients and the insolvency of a dealer could have serious implications for clients and confidence in the capital markets. Accordingly, firms are subject to ongoing financial requirements.[54]

Registered firms are required to calculate regulatory capital to ensure that it is not less than zero. The minimum capital for an exempt market dealer and a restricted dealer is $50,000 (unless an alternative minimum is imposed). Investment dealers are required to maintain risk adjusted capital, calculated in accordance with IIROC requirements, that is greater than zero.[55]

5. Insurance

Similarly, because of the significance of the financial condition of registered dealers to their clients and the capital markets, registered dealers must also maintain bonding or insurance that contains certain specific clauses and coverage. The amount of insurance coverage depends on the category of dealer involved.[56]

6. Financial reporting

Securities regulators monitor the financial condition of registered firms by requiring them to prepare and deliver to regulators annual and interim financial information, and to abide by requirements in IIROC Dealer Member Rule 16 *Dealer Members' Auditors and Financial Reporting*.

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[53] s. 11.1 of Regulation 31-103.

[54] The financial requirements for investment dealers are found in IIROC Dealer Member Rule 17 *Dealer Member Minimum Capital, Conduct of Business and Insurance* and Form 1. The financial requirements for dealers other than investment dealers are in s. 12.1 of Regulation 31-103.

[55] Part 12, Division 1 of Regulation 31-103.

[56] The insurance requirements for dealers other than investment dealers are included in s. 12.3 of Regulation 31-103. The insurance requirements for investment dealers are in IIROC Rule 400 *Insurance*.

7. KYC and suitability

Know-your-client and suitability obligations require dealers to collect information to establish the identity of their clients, to understand their investment needs and objectives, overall financial circumstances, and risk tolerance and to then take reasonable steps to use that information to ensure a proposed transaction is suitable to the client. In order to make that suitability assessment, the dealer also needs to understand the features and risks of the security or derivative to be transacted (the know-your-product requirement).[57] In addition, dealers also have separate, specific obligations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and the associated regulations, including the requirement to verify the identity of clients for certain activities and transactions.

8. Conflicts of interest

Dealers are faced with many potential conflicts of interest between their and their clients' interests. Accordingly, securities legislation requires that a dealer take reasonable steps to identify conflicts of interests that exist and may exist between itself and its clients. Among other requirements, a dealer must identify conflicts of interest that should be avoided and respond appropriately to other conflicts of interest given the level of risk each conflict raises (e.g. through control and/or disclosure of the conflict of interest).[58]

9. Custody

As dealers may have access to clients' assets, there are a number of requirements and prohibitions regarding custody of client cash and securities. Investment dealers, as IIROC members, must comply with the custodial requirements of IIROC.[59] Depending on the location where such assets are held, investment dealers may have to provide additional capital to reflect increased risk.[60] Exempt market dealers must comply with the requirements regarding holding client cash and securities set out in Regulation 31-103 which prohibits them from holding client assets and acting as custodians themselves.[61] Instead, client assets of exempt market dealers are normally held by a custodian that is a separate legal entity.

10. Best execution and fair pricing

Investment dealers are required to establish, maintain and follow written policies and procedures that are reasonably designed to achieve best execution when acting for a client.[62] What constitutes "best execution" varies depending on the particular circumstances and, for transactions that are executed over the counter, such as transactions in fixed income securities, the expectation is that dealers have policies and procedures to ensure that prices to their clients for these securities are fair and reasonable, both for the pricing of principal transactions and for commissions that may be charged by the dealer.

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[57] The suitability requirements for dealers other than investment dealers are included in Part 13 of Regulation 31-103. The requirements for investment dealers are in IIROC Rule 1300 *Supervision of Accounts*.
[58] s. 13.4 of Regulation 31-103.
[59] IIROC Dealer Member Rule 2000 *Segregation Requirements*, Dealer Member Rule 17 *Dealer Member Minimum Capital, Conduct of Business and Insurance* and Dealer Member Rule 2600 *Internal Control Policy Statements*.
[60] IIROC Form 1 General Notes and Definitions, (d) "acceptable securities locations".
[61] s. 14.5.2 of Regulation 31-103.
[62] IIROC Dealer Member Rule 3300 *Best Execution of Client Orders*.

11. Handling Complaints

Dealers are required to document complaints and to effectively and fairly respond to them. These procedures should include monitoring of complaints, to allow the detection of frequent and repetitive complaints made with respect to the same matter, which may, on a cumulative basis, indicate a serious problem. Registered firms are required to be a member of the Ombudsman for Banking Services and Investments,[63] except in Québec where the dispute resolution service is administered by the Autorité des marchés financiers.

[63] Part 13, Division 5 of Regulation 31-103.

APPENDIX D
Requirements Applicable to Clearing Agencies

A clearing agency is defined in securities legislation as a person that, among other activities, provides centralized facilities for clearing and settlement of transactions in securities or, in some jurisdictions, derivatives.

Regulation 24-102 respecting Clearing Agency Requirements (**Regulation 24-102**) sets out certain requirements in connection with the application process for recognition as a clearing agency or exemption from the recognition requirement. Please note that this summary should not be relied upon as being an exhaustive list of the requirements applicable to clearing agencies.

Regulation 24-102 also sets out the ongoing requirements applicable to recognized clearing agencies. This includes the requirement to meet or exceed applicable principles as set up in the April 2012 report *Principles for financial market infrastructures* published by the Committee on Payments and Market Infrastructure and the International Organization of Securities Commissions (**PFMI**). The PFMI cover all areas associated with activities carried out by a clearing agency: systemic risk, legal risk, credit risk, liquidity risk, general business risk, custody and investment risk and operational risk. Clearing agencies are required to:

- have appropriate rules and procedures on how transactions are cleared and settled, including when settlement is final;
- minimize and control their credit and liquidity risks;
- have rules that clearly state their obligations with respect to the delivery of securities traded; and
- identify, monitor and manage the risks and costs associated with the delivery of crypto assets, including the risk of loss of these crypto assets.