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 than immediately delivering the

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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.

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

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[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 transactions 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.

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
  o further involvement with, or reliance on the Platform or its affiliates, and
  o 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;

- 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;

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[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.

- 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