Canada & U.S.: Progress on cryptocurrency securities regulation

March 27, 2019

In the cryptocurrency space, the magic word is nuance. This March, both Canadian and the United States' securities regulators have displayed increasingly nuanced positions on digital tokens and the platforms on which they are transacted.

Canada

On March 14, 2019, the Canadian Securities Administrators and the Investment Industry Regulatory Organization of Canada (IIROC and together, Regulators) jointly published Consultation Paper 21-402 —*Proposed Framework for Crypto-Asset Trading Platforms*(Consultation Paper). The purpose of the Consultation Paper is to solicit "feedback from the financial technology community, market participants, investors and other stakeholders on how requirements may be tailored for" platforms that facilitate the buying and selling or transferring of crypto assets (Platforms) operating in Canada or having Canadian participants.

The Consultation Paper: (i) contains general discussion on the nature of crypto assets, application of securities legislation, risks and international regulatory approaches; and (ii) sets out the Regulators' proposed framework for Platforms (Proposed Framework).

The application of the Proposed Framework, though context-dependent, broadly includes:

- the application of marketplace requirements
- the application of dealer requirements
- investment dealer registration and IIROC membership
- recognition as an exchange
- certain derivatives requirements.

In connection with the Proposed Framework, the Consultation Paper seeks written comments on the following:

- custody and verification of assets
- price determination
- surveillance of trading activities

- systems and business continuity planning
- conflicts of interest
- insurance
- clearing and settlement.

Written submissions on the consultation questions identified throughout the Consultation Paper are due by May 15, 2019 (Consultation Deadline).

United States

On March 7, 2019, the Securities and Exchange Commission (the SEC) published a letter (the Clayton Letter)from its Chairman, the Honorable Jay Clayton (the SEC Chair). In the Clayton Letter, the SEC Chair, writing in response to a letter from Congressman Ted Budd dated September 28, 2018, reinforced previous public statements by the SEC regarding its nuanced approach to determining whether digital tokens constitute securities. In his writing, the SEC Chair touched on the following key points:

- to determine if a digital token is an investment contract, the SEC will:
    - consider the facts and circumstances, including the economic realities of the transaction
    - look for "the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others" (the Howey Framework)1and
- the determination of whether a digital token as a security is not fixed — to the extent that a digital token meets, or ceases to meet, the Howey Framework, its status as a security may change.

The Clayton Letter's nuanced perspective stands in stark contrast to the SEC Chair's prior statement in February of 2018 that "every ICO [he has] seen is a security". Taken at its face value, the Clayton Letter suggests that the SEC intends to continue a two-pronged approach to developing its regulation of digital tokens:

- Engaging with innovators and the public through initiatives, such as the Strategic Hub for Innovation and Financial Technology and
- Vigorously enforcing federal securities laws against those who offer digital tokens in violation of such laws, particularly where the misconduct has targeted Main Street investors.

Next Steps

Canada

Market participants should carefully review the Consultation Paper to determine if, under the Proposed Framework, their organization could be regulated as a Platform. Performing a preliminary triage will allow firms to engage proactively with legal counsel to ensure that the nuances of their business are put forward during the Regulators' consultation process.

Leading up to the Consultation Deadline, BLG will prepare a submission for the Regulators. If you or your firm wish to comment, we would be pleased to discuss the Consultation Paper further with you.

United States

We continue to monitor regulatory developments in the United States. Market participants should be encouraged by the SEC's embrace of nuance with respect to digital tokens, as set out in the Clayton Letter. Additionally, because the Howey Framework continues to be the SEC's regulatory "touchstone", market participants should continue to discuss the creative structuring opportunities that are available with their legal counsel.

Contact Us

If you have any questions about the Consultation Paper or the Clayton Letter, please contact one of the authors of this bulletin or any other member of BLG's Cryptocurrency and Blockchain Group. Our Cryptocurrency and Blockchain Group leverages BLG's expertise in legal areas, such as investment management, corporate finance, derivatives and fintech, to provide advisory and transactional support right from the start.

1 The Howey Framework is derived from *SEC v. Howey* and its progeny, including *United Housing Found., Inc. v. Forman*.

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