

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.

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.

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.

	Examples of situations	Possible implications
1.	<p>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.</p>	<p>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.</p> <p>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.</p> <p>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.</p>
2.	<p>The tokens are not immediately delivered to purchasers.</p>	<p>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</p>

	Examples of situations	Possible implications
		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 expanding the team of developers, developing relevant applications and products, expanding the network of participants on the platform, installing necessary infrastructure and marketing efforts.	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 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	This may reduce the purchaser’s expectation of profit if tokens are

	Examples of situations	Possible implications
	increase over time, or change based on non-commercial factors.	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.	<p>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.</p> <p>In contrast, a continuous or unlimited supply of tokens may reduce the probability that purchasers buy with an expectation of profit.</p>
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 or companies 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.	<p>This could indicate that the offering is being marketed and sold as an investment, thus creating an expectation of profit.</p> <p>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,</p>

	Examples of situations	Possible implications
		the implication that purchasers have an expectation of profit may be reduced.
13.	Tokens are distributed to users for free.	<p>The distribution of tokens for free will likely not involve an investment of money.</p> <p>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.</p>
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 based on market forces and not on continued development of a business by the issuer.	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.

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 National Instrument 45-106 *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 National Instrument 45-102 *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 or company that is in the business of trading in securities is subject to the dealer registration requirement under securities laws². 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.

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

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

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.

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
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