

## Securities Law and Technology

September 12, 2017

### Cryptocurrencies: Further Legal Developments

On August 30, we published an Update (“*Initial Coin Offerings in Canada: The CSA Weighs In*”) summarizing guidance from the Canadian Securities Administrators (CSA) with respect to the potential application of Canadian securities laws to initial coin offerings (ICO). Given the ongoing explosive growth in cryptocurrencies, it is not surprising that in less than two weeks since our Update we have seen a number of additional noteworthy regulatory developments related to this emerging asset class.

#### ICOs: International Developments

In the Update, we observed that greater international regulation of cryptocurrency offerings seemed inevitable. That prediction was quickly validated. On September 4, China’s central bank declared ICOs illegal in China and required an immediate halt to all ongoing ICO activity as well as a refund of all money previously raised by way of ICO (although it is not clear how that will actually occur). There have also been reports that China plans to ban trading of cryptocurrencies on domestic exchanges.

On September 5, the day after China banned ICOs, Hong Kong’s Securities and Futures Commission weighed in, cautioning (much like the CSA and U.S. Securities and Exchange Commission before them) that certain tokens have characteristics that qualify them as securities and will be regulated as such.

The recent trend toward greater regulatory scrutiny of ICOs, particularly in China, has contributed to a significant decline in the value of cryptocurrencies in recent weeks; since the start of September, the value of Bitcoin has dropped by approximately 20%, including a

fall of as much as 11.4% in the immediate aftermath of the announcement of China’s ICO ban.

We expect that securities regulators worldwide will continue to closely monitor the rise of cryptocurrency offerings, leading to additional guidance and rules that will help to clarify when existing securities laws will apply and, eventually perhaps, develop a new framework designed specifically for cryptocurrencies.

#### ICOs: Canadian Developments

In the Update, we also discussed Kik Interactive’s pending US\$125 million sale of Kin tokens. These tokens will initially be used to access various features on Kik’s existing messaging app, but Kik’s broader vision is to develop an ecosystem of everyday digital services using Kin as a common digital currency. We observed that Kik’s ICO was not structured to comply with Canadian securities laws, which suggested Kik believed Kin tokens do not constitute securities in Canada.

On September 7, Kik’s CEO announced Kik decided to exclude Canadians from the Kin ICO due to “weak guidance” from the Ontario Securities Commission (OSC) as to whether Canadian securities law will apply to the offering. While few details regarding Kik’s interactions with the OSC are publicly known, Bloomberg reported an OSC representative had confirmed to it that the OSC views the Kik ICO as an offering of securities and had been discussing options with Kik for allowing the ICO to proceed in Canada with appropriate investor protections.<sup>1</sup> Kik was apparently not interested in these options and decided to simply exclude Canadian investors from the offering altogether.

This outcome was no doubt disappointing to Kik, which had taken great pains to characterize Kin as a common currency and its offering not as an ICO but

<sup>1</sup> For example, in August 2017, the OSC granted various exemptions from Canadian securities laws to Impak Finance Inc. in connection with a proposed ICO. The exemptions were subject to a number of conditions including (i) delivery of an offering memorandum and certain ongoing information to investors, (ii) implementation of various know-your-client, suitability, anti-money laundering and anti-terrorist financing procedures, (iii) a maximum investment limit of \$2,500 for non-accredited investors and (iv) limits on secondary trading of the cryptocurrency.

# Goodman's Update

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as a “TDE” (token distribution event). While it is now abundantly clear there are no “magic words” that can be used (or avoided) to describe a cryptocurrency that will determine whether it will be characterized as a security, Kik’s experience also confirms our earlier observation that the guidance regulators have provided to date (other than China’s absolute ban on ICOs) is somewhat vague and offers limited practical assistance in determining whether any particular token offering will be subject to securities law. It also appears that, at least for now, Canadian regulators are inclined to take a conservative approach to coin or token offerings and in most cases companies should assume ICOs will be regulated as securities offerings in Canada and, if interested in pursuing such offerings, should consider engaging with the regulators early to see if relief can be obtained.

## Canada’s First Registered Cryptocurrency Fund

On September 6, the British Columbia Securities Commission announced that First Block Capital Inc. has been approved as an investment fund manager and exempt market dealer in order to operate a bitcoin investment fund. This represents the first registration in Canada of an investment fund manager dedicated solely to cryptocurrency investments.

The conditions of First Block Capital’s registration include a number of terms aimed specifically at the unique risks posed by investing in cryptocurrencies (such as custodial, trading and valuation arrangements) and will presumably serve as a template for registration of other Canadian cryptocurrency funds. The regulatory flexibility evident in this area, which seems to have been at least partly driven by a desire to give Canadian investors access to cryptocurrency investments via a regulated entity, is an interesting contrast to the more restrictive approach to ICOs evidenced by CSA Staff Notice 46-307 – *Cryptocurrency Offerings* and the OSC’s response to Kik’s ICO.

## Conclusion

Blockchain technology and cryptocurrency offerings continue to create a number of challenging legal questions. The way existing law applies to these new technologies and asset classes is often unclear, and the

rapid pace of their evolution and adoption have left regulators scrambling to keep up. For now, we expect that regulatory reactions and pronouncements will continue to err on the side of caution and focus on investor protection.

For further information relating to this bulletin, please contact any member of our Securities Law Group or Technology Group.

## Goodmans Tech Group

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