

PUBLICATION

Public Cryptocurrency Companies and the Disclosure Expectations of Canadian Securities Regulators (CSA Staff Notice 51-363)

March 22, 2021

On March 11, 2021, the Canadian Securities Administrators released “[CSA Staff Notice 51-363: Observations on Disclosure by Crypto Assets Reporting Issuers](#)” (the “Notice”). The following is a summary of the Notice and recommended disclosure best practices for issuers dealing in digital assets, such as cryptocurrencies, tokens, stablecoins, and similar digital assets relying on blockchain technology (“crypto assets”).

The Canadian Securities Administrators (“CSA”) is a collective organization composed of Canada’s provincial securities regulators. This Notice marks the first time CSA guidance has specifically targeted reporting issuers and public companies. This new focus may reflect a reaction by regulators to the recent growth of public institutions’ investment in bitcoin and other cryptocurrencies, and a response to an uptick in the industry overall.

Crypto asset issuers who are considering filing a prospectus or conducting a reverse take-over or similar restructuring transaction must carefully consider the following disclosure obligations in order to meet minimum regulatory requirements. However, it should be noted that these disclosure expectations are entirely relevant for private issuers, and those crypto asset companies relying on offering memorandums or other exemptions from the prospectus registration requirements.

Disclosure Best Practices

Custody

- Ensure appropriate measures are taken to guard against theft and/or loss. This is key to material risk disclosure and particularly relevant for crypto asset companies.
- Disclosure of custodial practices will be a focus of provincial securities regulators going forward in their audits.
- Failure to adopt adequate protections may give rise to public interest concerns about the issuer.
For issuers that self custody crypto assets:
- Issuers must disclose whether assets are insured and any exclusions in insurance policies. If uninsured, issuers should include detailed discussion of resulting risk factors in a prospectus or other offering document.
- Disclosure should include a description of measures taken to guard against cybersecurity risks, as these risks are particularly heightened in the crypto asset industry.

- Controls may include multi-signature wallets, safeguarding of private keys, the use of “cold wallets” and frequent monetization of cryptocurrency assets into fiat currency.
- The appropriateness of controls may vary based on issuer size and the frequency with which assets move to and from “hot wallets”.
- Not all issuers will retain third-party custodians. For those that do not, the reasons why not are considered material information for investors. There should be full, true and plain disclosure in this regard as to why a third-party custodian is not being used.

For issuers that retain third-party custodians, material disclosure will include:

- The identity and location of the third-party custodian;
- If the custodian has appointed a sub-custodian to hold certain crypto assets, the identity and location of the sub-custodian(s);
- A general discussion of the services provided to the issuer by the custodian (e.g., is the custodian a payment processor or just responsible for holding and/or safeguarding the crypto assets?);
- Whether the custodian is a Canadian financial institution (as defined in National Instrument 45-106 *Prospectus Exemptions*) or a foreign equivalent, and if so by whom the custodian is regulated;
- Whether assets held by the custodian are insured and any limitation on custodian liability in the event of loss or theft;
- The quantity and/or percentage of an issuer’s assets held by a custodian in any given reporting period;
- Whether the custodian is a related party of issuer; and
- Treatment of assets in the event of bankruptcy or insolvency of the custodian.

Trading Platforms

- Using crypto platforms to hold or trade assets is considered a material risk because the issuer does not hold a private key to or have control over the assets held by the platform. Extensive risk disclosure is always recommended (via the use of risk factor disclosure) where there is a material risk.
- Issuers holding assets on a platform are expected to disclose the same information about the platform that is applicable to a third-party custodian, i.e., there must be disclosure on insurance, cybersecurity measures taken by the platform, treatment of assets in the event of bankruptcy by the platform, etc.

Business Description and Risk Factors

- Issuers should include information about how the business intends to generate revenue, disclose the specialized skill and knowledge possessed by issuer, and outline competitive conditions facing the issuer.
- Risk factors may include:
 - Availability and cost of electricity;
 - Declines and volatility in price of cryptocurrency assets; and
 - Decreased rewards for mining certain assets.
- Risks differ between more established currencies (like bitcoin) and novel digital assets, i.e., more risk disclosure for anything other than bitcoin!

Material Change

Scenarios considered likely to require a material change report and/or news release:

- Entering into a new custodial arrangement;
- Loss or theft of cryptocurrency;
- Changes to mining equipment, pool operations or electricity supply for miners;

The CSA notes that some issuers have failed to report material changes within the stipulated 10-day timeframe.

To date, there has been some leniency in this regard but expect that to change and expect more enforcement in response to noncompliance

Investment Funds

- It is very important to remember that issuers with a material business of investing in cryptocurrency assets who do not have other substantial operations may be considered investment funds under securities laws. Investment funds are very heavily regulated in Canada.
- Such issuers could be required to take mitigation efforts to comply with the investment funds regime prior to obtaining a receipt for a prospectus, including concentration restrictions, investment portfolio disclosure and the use of a qualified custodian.

Accounting and Audit

(note, we are not accounting and audit specialists. Please consult your accounting/taxation experts for more information)

- The CSA acknowledges that novel accounting issues are raised by cryptocurrency holdings and issuers should monitor/consider guidance published by accounting standard setters and regulatory bodies.
- International Financial Reporting Standards (IFRS) provide that IAS 2 applies to cryptocurrencies (NOT all crypto assets) when they are held for sale in the ordinary course of business.
- IAS 38 applies to cryptocurrencies (NOT all crypto assets) otherwise.
- If cryptocurrencies are reported at fair value, financial statements must include disclosure regarding:
 - The valuation techniques used (especially with decentralized currencies and defi assets); and
 - Whether fair value measurement is categorized as Level 1, 2 or 3 of the Fair Value hierarchy;
 - Depending on the Level, an issuer may need to consult and adhere to IFRS 13 requirements.
 - Where fair value re-measurement of an issuer's crypto assets has a significant impact on its financial results in a reporting period, the realized and unrealized components of this gain or loss should be separately disclosed in the financial statements, including any reversal of previously unrealized fair value gains or losses.
- Accounting policies may differ for issuers that mine cryptocurrency, as mining introduces additional complexities.

Statistics

The CSA notes that there are approximately 49 public companies in Canada with some crypto asset or cryptocurrency mining exposure.

- Most of these issuers went public via reverse takeovers or other transactions that do not involve a prospectus.
- Most entered public markets in 2017/2018 as a result of the initial coin offering boom and did their first annual filings at end of 2018.
- British Columbia is the home province of the most cryptocurrency reporting issuers at 31, with Ontario coming in second place with 18.
- As to where these public cryptocurrency companies are traded on, the following is a breakdown per traditional securities exchange in Canada:
 - 27 are listed on the Canadian Securities Exchange;
 - 18 are listed on the Toronto Stock Exchange Venture (TSX-V);
 - 2 are listed on the Toronto Stock Exchange (TSX);
 - 1 is listed on the NEO exchange.

Conclusion

Public companies in the crypto asset industry are subject to the same disclosure obligations as public companies in other industries. However, the CSA acknowledges that the unique features of crypto assets can raise novel compliance issues. The CSA reminds crypto asset issuers to avoid inaccurate or misleading disclosure and to provide investors with the information necessary to make an informed investment decision.

We believe that in the years to come there will be increased activity in crypto asset companies being listed and traded in the Canadian public markets. However, as with other industries, far more action takes place in the private markets where issuers access private capital. The best practices outlined in this summary should also be considered by private companies involved in selling securities or crypto assets directly to accredited investors, family, friends and close business associates, eligible investors and others.

If you have any questions, please do not hesitate to contact any of our Cryptocurrency & Blockchain lawyers.