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Obey or Pay: OSC Warns Off-Shore, Unregistered Trading Platforms Offering Securities to Ontario Investors

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The Ontario Securities Commission (OSC) recently approved a settlement agreement with eToro (Europe) Limited (eToro), a Cyprus-based brokerage firm that operates an online cryptocurrency and stock trading platform, imposing over C\$2.8 million in penalties on eToro for violating registration and prospectus requirements under Ontario securities laws. eToro admitted to operating trading accounts for Ontario residents in which contracts for difference (CFDs), which the OSC previously confirmed constitute “investment contracts” and “securities” for the purposes of Ontario securities laws,¹ were traded and distributed without registration and without a prospectus or an exemption from the prospectus requirement. CFDs are derivative products that allow investors to obtain exposure to price movements in an asset, such as a share or other publicly traded security, an index, a currency or a commodity, without acquiring ownership of the asset.

Between 2008 and 2017, nearly 2,500 accounts for Ontario residents were operated on eToro’s platform, allowing Ontario investors to trade CFDs based on exposure to underlying assets, including cryptocurrencies and stocks. Since 2010, the OSC has repeatedly raised concerns regarding the Ontario accounts, and received assurances from eToro that its staff members were aware they were not to accept trades of CFDs from investors in Ontario. However, eToro failed to address the OSC’s concerns through written policies or meaningful controls to prevent Ontario residents from opening accounts on the firm’s platform, and a total of US\$1,791,163 in revenues were earned from the Ontario accounts between 2008 and 2017.

As part of its settlement with the OSC, eToro agreed to disgorge the total amount of revenues generated from the accounts of Ontario residents, to pay a C\$550,000 administrative penalty and to pay C\$25,000 to cover the costs of the OSC’s investigation. In its reasons for approval of the settlement, the OSC placed particular emphasis on eToro’s repeated violations and its misleading assurances to OSC staff that verification measures were being taken, which were an aggravating factor that likely influenced the penalty imposed on eToro.

The settlement signals that the OSC will be taking tougher enforcement action on off-shore exchanges and trading platforms that offer securities to Ontario residents without complying with Ontario registration and prospectus requirements. This includes platforms offering blockchain and cryptocurrency tokens that constitute “investment contracts” and “securities” for the purposes of Ontario securities laws. The OSC underscored this message in its oral reasons for approval of the settlement agreement. Such off-shore platforms and cryptocurrency exchanges that fail to comply with Ontario securities laws and appropriately exclude Ontario investors “should be considered to be on notice and can reasonably expect to face more stringent consequences” for such conduct in the future.²

The settlement agreement also requires that eToro implement several enhanced procedures and controls designed to prevent Ontario residents from opening accounts on the eToro platform. These procedures exemplify some of the measures that the OSC expects off-shore, unregistered platforms to take to show meaningful controls have been put in place to exclude Ontario residents. In addition to closing all accounts of Ontario residents, eToro agreed to do the following:

- Block its website to Canadian IP addresses.
- Revise its online account application process.
- Inform its “KYC Verification Department” that Canadian residents are not permitted to open accounts.
- Adopt a written policy against accepting clients from Canada.
- Automatically reject applicants with Canadian phone numbers or who use “.ca” email domains.

- Make further inquiries where a deposit is made using a Canadian-based credit card or wire transfer from a Canadian financial institution to ensure that the account holder resides outside Canada.

We understand a number of off-shore cryptocurrency exchanges and platforms have started opening accounts created by Canadian investors, provided that account holders fund their accounts using cryptocurrency rather than a Canadian-based credit card or wire transfer from a Canadian financial institution. Although the OSC's oral reasons for approval of the settlement don't address whether these platforms violate securities laws, it is unlikely that requiring Canadian residents to fund their accounts using cryptocurrency rather than Canadian-based sources would be sufficient to exclude such platforms from the application of Canadian securities laws.

The OSC emphasized that brokerage firms operating in multiple jurisdictions are expected to have robust compliance systems to ensure authorized dealings with customers. The decision serves as a strong reminder that off-shore trading platforms and exchanges must at the outset register with the OSC or seek an applicable exemption from Ontario securities laws in order to offer securities to Ontario investors. Should such platforms seek to register in Ontario in the future, prior conduct and contravention of Ontario securities laws will be considered by the OSC in evaluating whether such platforms should be registered and what conditions should be imposed.

¹ OSC Staff Notice 91-702 – *Offerings of Contracts for Difference and Foreign Exchange Contracts to Investors in Ontario*

² *eToro (Europe) Limited*, 2018 ONSC 49 at para 24.

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