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OSC Invites TokenFunder to Play in the CSA Sandbox

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Earlier this month, the Ontario Securities Commission (OSC) released its decision to grant exemptive relief from applicable Canadian registration requirements to Token Funder Inc. (TokenFunder) for the launch of its initial offering of FNDR tokens. By blessing the upcoming offering by TokenFunder – a platform being developed to facilitate the launch of securities law-compliant token offerings – the OSC has provided a road map for companies seeking to use this novel form of fundraising which provides terms more favourable to entrepreneurs than are typically obtained through early stage investment by venture capital funds and angel investors.

A Step in the Right Direction?

In February 2017, several members of the Canadian Securities Administrators (CSA) launched a regulatory sandbox to support Fintech businesses seeking to offer innovative products, services and applications in Canada. So far, only two blockchain companies have agreed to play in the CSA sandbox: Impak Finance Inc. (Impak) and TokenFunder.

Both Impak and TokenFunder were successful in obtaining exemptive relief from CSA members to proceed with their initial coin offerings – a step in the right direction. These decisions may bring early stage companies and blockchain businesses looking to raise funds through a coin or token offering one step closer to accessing Canadian capital markets, provided that the coins or tokens offered are treated as securities and are offered in compliance with applicable Canadian securities laws.

However the Fintech community is still waiting for more meaningful guidance on whether cryptocurrency tools and distributed ledger technologies where value is not premised on speculation (known as utility tokens) can be designed, built and used in Canada without the risk of enforcement action by the CSA.

Initial FNDR Token Offering

TokenFunder was established for the purposes of creating a platform to be known as the smart token asset management platform or STAMP, which is intended to, among other things, (i) facilitate third-party issuers raising capital through the offering of blockchain-based securities, including tokens and coins; (ii) provide token and coin management and governance services for issuers; and (iii) provide for certain transferability of tokens and coins, subject to receiving appropriate exemptive relief and regulatory approvals.

TokenFunder will begin offering FNDR tokens on November 1, 2017, in reliance on the offering memorandum exemption set out in National Instrument 45-106, *Prospectus Exemptions*. Once issued, the FNDR tokens will not be freely tradable under Canadian securities laws.

A total of one billion FNDR tokens will be created through a smart contract on the Ethereum Blockchain, of which up to 200 million tokens will be offered under the initial offering. Of the remaining FNDR tokens, up to 100 million will be reserved for payment currency for advisers, and the balance will be reserved for further offerings.

The initial offering will result in total gross proceeds of up to approximately C\$10 million (depending on the exchange rate of Ether to the Canadian dollar). Each investor is limited to purchasing C\$2,500 of FNDR tokens (paid through the Ether equivalent or through fiat currency), unless TokenFunder can verify an investor's status as an "accredited investor" or "eligible purchaser." Proceeds from the offering will be returned to investors if a minimum of C\$500,000 is not raised in the initial offering.

Holders of FNDR tokens will be entitled to share in distributions declared by TokenFunder arising from the operation of STAMP and will have limited voting rights – namely, in respect of the entities entitled to use STAMP. In this regard, the FNDR tokens are significantly different from tokens sold in most other offerings.

The TokenFunder offering is consistent with best practices that have emerged regarding token offerings, including (i) a minimum placement condition with funds held in escrow until the closing of the offering, a condition that provides some limited certainty to investors that the issuer will have sufficient financing to develop its platform; and (ii) updates regarding milestones for development.

The OSC Exemptive Relief

The relief granted to TokenFunder by the OSC in respect of the FNDR token offering is similar to the relief obtained by Impak, with certain notable exceptions:

- Given the nature of STAMP as a capital-raising or crowdfunding platform, TokenFunder is required to become a registrant immediately after its initial token offering and is prohibited from facilitating any capital-raising efforts by issuers through STAMP in the absence of such registration.
- TokenFunder must file an initial report with the OSC containing regional and average investor purchase amounts on the earliest of (i) raising C\$10 million, (ii) closing the offering, and (iii) January 17, 2018. Subsequent reports are to be filed with the OSC quarterly.
- TokenFunder is required to deliver to the OSC details of any investor complaints.
- The relief granted by the OSC is time-limited and will expire on October 17, 2018.

The OSC decision also creatively addresses investor protection concerns by requiring prospective investors to complete surveys confirming their detailed understanding of blockchain technology and token offerings, thereby ensuring participants have the necessary knowledge to make informed investment decisions.

As was the case with Impak, the OSC clearly states in the TokenFunder decision that the exemptive relief granted should not be viewed as a precedent for other issuers. This is consistent with earlier statements of the OSC that initial coin and token offerings will be considered on a case-by-case basis and any relief granted will be specific to the facts of each offering.

Impact on Utility Token Offerings

Utility tokens derive value from a functional purpose, such as allowing the holder to provide services or store information, rather than a return on investment or an appreciation in value. Issuers of utility tokens often take the view that their tokens are not securities and that any offering of such tokens should not be subject to Canadian securities laws. Treating utility tokens as securities is inconsistent with the function of these decentralized platforms and expectations of developers creating these platforms. The OSC has taken the view that “many” cryptocurrencies are “securities” (see [Cooling the Blockchain Boom](#)). The TokenFunder and Impak decisions do not temper that view for utility tokens.

Free transferability is indispensable for most tokens, in particular utility tokens. The technology that achieves distributed consensus often depends on a decentralized network infrastructure for token transfers and mining activities. As TokenFunder did not seek relief from the prospectus requirement and Impak’s relief was limited to transfers between holders and merchants, these decisions do not provide guidance on when or whether a utility token would *not* be considered a security.

Although it is encouraging to see that the OSC and other members of the CSA are prepared to work with issuers in allowing initial coin or token offerings to proceed, the decisions to date leave the Fintech community wanting more.

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