	Ontario	Commission des	22nd Floor	22e étage
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Ontario	Commission	de l'Ontario	Toronto ON M5H 3S8	Toronto ON M5H 3S8

IN THE MATTER OF
COINSQUARE LTD., COLE DIAMOND,
VIRGILE ROSTAND and FELIX MAZER

STATEMENT OF ALLEGATIONS
(Subsection 127(1) and Section 127.1
of the *Securities Act,* RSO 1990, c S.5)

A.   OVERVIEW

1.   While the Ontario Securities Commission (the **Commission** or **OSC**) seeks to foster innovation in the capital markets, innovators must operate with the same honesty and responsibility as all other market participants.

2.   Staff of the Commission (**Staff**) bring this proceeding against Coinsquare Ltd. (**Coinsquare**), Cole Diamond (**Diamond**), Virgile Rostand (**Rostand**) and Felix Mazer (**Mazer**) (collectively, the **Respondents**) to hold them accountable for their misconduct and to send a message to other market participants in the crypto asset sector that deceptive conduct will not be tolerated in Ontario's capital markets.

3.   The Respondents engaged in conduct contrary to Ontario securities laws and/or conduct contrary to the public interest, including:

   (a) Coinsquare engaged in market manipulation through the reporting of inflated trading volumes;

   (b) Coinsquare misled its clients about trading volumes and Diamond and Rostand authorized, permitted or acquiesced in this conduct; and

   (c) Coinsquare took a reprisal against an internal whistleblower and Diamond authorized, permitted or acquiesced in this conduct.

4.   Coinsquare is a crypto asset trading platform located in Toronto. Between July 2018 and December 2019, Coinsquare inflated its trading volumes by reporting fake or "wash" trades representing over 90% of its reported trading volume.

5.   Diamond, Coinsquare's CEO, directed that Coinsquare inflate its reported trading volumes. At Diamond's direction, Rostand, Coinsquare's founder and President, wrote the algorithm to inflate Coinsquare's trading volume.

6.   Despite several Coinsquare employees raising concerns about inflated trading volumes, Coinsquare stuck with the practice. This tone from the top undermined the compliance culture at Coinsquare and contributed to:

   (a) Coinsquare misleading clients and members of the public who raised suspicions that Coinsquare was reporting inflated trading volumes;

   (b) Coinsquare concealing the inflated trading volumes from Staff; and

   (c) Coinsquare taking a reprisal against an employee whistleblower for repeatedly raising concerns internally about Coinsquare inflating its reported trading volumes.

B.   FACTS

Staff of the Enforcement Branch of the Commission ("**Enforcement Staff**") make the following allegations of fact:

(1)   THE RESPONDENTS

7.   Coinsquare[1] operates a crypto asset trading platform based in Toronto (the **Coinsquare Platform**) that facilitates the buying and selling of crypto assets, including bitcoin, litecoin and ether. The Coinsquare Platform opened to the public in late 2014. As of December 14, 2019, it had approximately 235,000 client accounts.

8.   Rostand founded Coinsquare and developed the Coinsquare Platform. Rostand is Coinsquare's President and acted as Chief Technology Officer until January 2019, after which time he continued to be in charge of the technological aspects of the Coinsquare Platform.

9.   Diamond is Coinsquare's Chief Executive Officer (**CEO**) and has been its *de facto* Chief Financial Officer since approximately January 2019.

10.   Mazer held the title of Chief Compliance Officer (**CCO**) at Coinsquare from May 2018 to June 2020. In this role, Mazer reported directly to Diamond. Coinsquare is not registered

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[1] Formerly goNumerical Ltd. The company name was changed to Coinsquare Ltd. in September 2018.

with the Commission and Mazer is not registered in connection with his role as Coinsquare's CCO.

(2)   INFLATED TRADING VOLUMES

11.   Coinsquare inflated the trading volumes on the Coinsquare Platform through reporting "wash" trades representing over 90% of its reported trading volume between July 2018 and December 2019. Diamond directed that Coinsquare engage in this activity and Rostand developed and implemented the algorithm that made it happen. Coinsquare misled clients about its trading volumes including when questioned about the suspicious trading activity. This took place while the Respondents were engaging with Staff for the purpose of registering a Coinsquare subsidiary, Coinsquare Capital Markets Ltd. (**Coinsquare Capital Markets**), and the Respondents concealed these activities from Staff.

Chronology of Key Events

12.   In February 2018, Coinsquare submitted its first request for support to the OSC LaunchPad. The request for support process is an opportunity for firms to discuss their business with the OSC LaunchPad team, obtain informal guidance and discuss potential next steps for registration and/or exemptive relief, if required. LaunchPad staff commenced a dialogue regarding Coinsquare's intention to obtain registration with the Commission to permit the Coinsquare Platform to trade securities and derivatives in Ontario.

13.   Shortly after reaching out to OSC LaunchPad, in March 2018, Diamond began directing Rostand to significantly inflate Coinsquare's reported trading volumes. Diamond continued to follow up with Rostand until Rostand implemented a solution on July 17, 2018.

14.   On that day, Rostand implemented an algorithm to inflate the trading volumes reported on the Coinsquare Platform (the **Market Volume Function**). The Market Volume Function created simultaneous matching buy and sell orders from an internal Coinsquare account designated with the user identification number 100001 (**Account #100001**) and resulted in Coinsquare reporting "wash trades".[2] These wash trades had no economic substance and

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[2] The account numbers associated with the trades were never made visible on the Coinsquare Platform. As a result, Coinsquare's clients could not see that the trades originated from orders from the same account or that the orders came from an internal Coinsquare account.

involved no change in beneficial or legal ownership over any assets. No funds or financial interests were actually exchanged in these transactions.

15.   Between July 17, 2018 and December 4, 2019, the Market Volume Function resulted in approximately 840,000 wash trades on the Coinsquare Platform, with an aggregate value of approximately 590,000 bitcoins. The wash trades represented over 90% of the trading volume on the Coinsquare Platform during this period.

16.   Coinsquare reported the inflated volumes on its website and through its application programming interface (the **Coinsquare API**),[3] which was in turn used by third-party websites (e.g. CoinMarketCap.com) that aggregated information on crypto asset trading platforms (the **Data Aggregators**). The Data Aggregators report trading volumes and rank international crypto asset trading platforms based on their reported trading volumes. They were accessible by the public at large, including Coinsquare's existing and prospective shareholders and clients. As a result, the inflated trading volumes on the Coinsquare Platform were also reported to the public by the Data Aggregators.

17.   Almost immediately after Coinsquare commenced reporting the inflated trading volumes, clients and members of the public started to identify the suspicious activity and raise questions about it. In response to these questions, Coinsquare made misleading statements, including in responses to posts on Reddit.com about the significant increase in reported trading volumes on the Coinsquare Platform.

18.   One such instance arose from a July 21, 2018 post created on Reddit titled "Coinsquare Fake Volume". In the post, the author questioned the sudden increase in Coinsquare's reported trading volumes and speculated that the reported figures were false. Coinsquare responded to the post on July 23, 2018 through the "Coinsquare_Support" Reddit account and suggested that the increase in volume was the result of over-the-counter (OTC) trades and/or third-party trading bots on the Coinsquare Platform that Coinsquare was working to remove.

19.   In response to another Reddit post about potential inflated trading volumes on the Coinsquare Platform, the "Coinsquare_Support" Reddit account stated unequivocally on August 29, 2018 that "[w]e do not fake our volume".

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[3] At its most basic, an API is an intermediary that allows two applications to interact with each other.

20. Several Coinsquare clients also raised concerns regarding the unusual trading activity directly with Coinsquare, including through emails. In its responses, Coinsquare failed to disclose the wash trades and inflated volume. Instead, Coinsquare suggested that the unusual activity could be the result of "robo traders" or large orders and telling clients that Coinsquare was looking into the issue or working on solutions.

21. Coinsquare's responses were misleading. Coinsquare and its senior management knew the increase in trading volumes was the result of Coinsquare inflating those volumes.

22. During this same period, Coinsquare responded to questions from Staff regarding market integrity on the Coinsquare Platform and failed to provide complete responses to these questions. Rather than self-reporting that it was inflating trading volumes, Coinsquare asserted that it was taking steps to prevent market manipulation and highlighted controls it claimed could help detect such conduct.

23. In early 2019, Coinsquare Capital Markets submitted applications for registration as an investment dealer and to operate an Alternative Trading System with the Commission and the Investment Industry Regulatory Organization of Canada (**IIROC**).

24. Coinsquare failed to disclose that it was engaging in wash trading to Staff, including during an on-site pre-registration review at Coinsquare's offices between March 15 and March 19, 2019.

25. Beginning in March 2019, several employees raised concerns with senior management about Coinsquare reporting inflated trading volumes. These employees included professionals concerned about how Coinsquare's conduct could impact their professional designations. Nonetheless, Coinsquare continued to inflate its reported trading volumes.

26. On December 3, 2019, Enforcement Staff attended the Coinsquare office for an unannounced on-site inspection.

27. The next day, Coinsquare turned off the Market Volume Function and stopped reporting the inflated trading volumes.

Market Manipulation

28. As a result of the above, Coinsquare engaged in market manipulation contrary to the Ontario Securities *Act*.

29. While the Coinsquare Platform facilitated purchases and sales of crypto assets, in practice, clients did not take possession or control of crypto assets purchased on the Coinsquare Platform unless and until they requested a withdrawal from Coinsquare and it was only at this time that transactions were completed on the blockchain. Instead, the crypto assets purchased and sold on the Coinsquare Platform were held in crypto wallets Coinsquare controlled and transactions were recorded on Coinsquare's internal ledger. As a result, in the normal course, Coinsquare provided its clients with contractual rights or claims to these crypto assets rather than the crypto assets themselves. These contractual rights constituted securities and derivatives, whereas the crypto assets themselves constituted commodities and/or the underlying interests of derivatives.

30. By inflating the reported trading volumes on the Coinsquare Platform, Coinsquare engaged in a course of conduct that it knew or reasonably ought to have known resulted in or contributed to a misleading appearance of trading activity in a security, derivative and/or underlying interest of a derivative, contrary to paragraph 126.1(1)(a) of *Securities Act*, RSO 1990, c S.5 (the **Act**).

Misleading Investors

31. By reporting the inflated trading volumes on the Coinsquare Platform through the Coinsquare website and the Coinsquare API, Coinsquare falsely represented that this trading volume was an accurate reflection of the trading activity on the Coinsquare Platform. In doing so, Coinsquare made statements about its trading volumes that were untrue and omitted information necessary to prevent the statements from being false or misleading.

32. Furthermore, Coinsquare's false and misleading statements to existing and prospective clients of the Coinsquare Platform to conceal the inflated trading volumes misled these investors regarding the nature of the trading activities on the Coinsquare Platform.

33. The trading volume on a platform is a factor that a reasonable investor would consider relevant in deciding whether to enter into or maintain a trading relationship.

34. In light of the above, Coinsquare contravened subsection 44(2) of the Act. Diamond, and Rostand each authorized, permitted or acquiesced in Coinsquare's failure to comply with Ontario securities law, contrary to section 129.2 of the Act.

Conduct Contrary to the Public Interest

35. Coinsquare, Diamond, and Rostand engaged in conduct contrary to the public interest as a result of the conduct set out above, including concealing the fact that Coinsquare was reporting inflated trading volumes from Staff.

(3) REPRISAL AGAINST INTERNAL WHISTLEBLOWER

36. In addition to the conduct set out above, Coinsquare took a reprisal against an internal whistleblower (the **Internal Whistleblower**) for raising concerns regarding the inflated trading volumes to Coinsquare's senior management. Diamond authorized, permitted and/or acquiesced in the reprisal.

37. Coinsquare hired the Internal Whistleblower to work on its automated trading strategies team (the **Automated Trading Team**) in November 2018. This meant that the Internal Whistleblower was responsible for internal trading operations at Coinsquare and could be viewed as responsible for the wash trading.

38. The Internal Whistleblower learned about the Market Volume Function and between March 2019 and October 2019 reported his concerns with this practice to senior management, including Rostand and Diamond. Despite the Internal Whistleblower's complaints, Coinsquare continued to engage in the wash trading.

39. In March 2019, after learning that the OSC planned to conduct an on-site review as part of Coinsquare's pending application for registration, the Internal Whistleblower raised his concerns about the inflated trading volumes with Rostand, his immediate supervisor at the time, who in turn deactivated the Market Volume Function. However, within days, Rostand reversed course after Diamond learned it had been disabled and directed that Rostand turn it back on.

40. The Internal Whistleblower continued to escalate his concerns. However, the message he received back was that the issue was not open for further discussion. The Internal Whistleblower was told that Coinsquare planned to slowly decrease the volume of wash trading in the lead up to registration but that if he continued to raise these concerns it would impact his employment at Coinsquare.

41. In October 2019, two members of Coinsquare staff approached the Internal Whistleblower in an open area of the office and proceeded to ask the Internal Whistleblower questions

about wash trades appearing in records to be produced to the OSC. Following this conversation, the Internal Whistleblower again reported his concerns regarding wash trading, this time to his new supervisor.

42.   On October 21, 2019, the Internal Whistleblower sent a further email to Coinsquare senior management asking for the Automated Trading Team to be left out of any and all discussions regarding wash trading and expressing his deep discomfort with the practice. A few days later, the Internal Whistleblower notified Coinsquare that he was taking stress leave as a result of the stress he was experiencing from the "wash trading" and a recent inquiry from the OSC.

43.   Coinsquare formally terminated the Internal Whistleblower's employment on December 3, 2019.

44.   Coinsquare's response to the Internal Whistleblower providing information regarding the inflated trading volumes adversely affected the Internal Whistleblower's employment and constituted a prohibited reprisal contrary to section 121.5 of the Act.

45.   Diamond authorized, permitted, and/or acquiesced in Coinsquare's failure to comply with Ontario securities law as set out above, contrary to section 129.2 of the Act.

(4)   FAILURE TO IMPLEMENT CONTROLS

46.   In addition to the conduct described above, Coinsquare failed to implement appropriate controls to prevent other inappropriate trading practices.

Non-Economic Trading (Market Maker Function)

47.   Early in its operations, Coinsquare implemented a function to act as a market maker on the Coinsquare Platform (the **Market Maker Function**). The Market Maker Function operated to generate liquidity on the Coinsquare Platform by placing buy and sell orders from an internal Coinsquare account to match orders placed by Coinsquare's clients.

48.   However, without appropriate controls in place, the Market Maker Function also caused certain orders from Coinsquare's internal accounts to match each other.

49.   As a result, between December 2014 and December 2019, Coinsquare reported additional non-economic, internal trades valued at approximately 112,000 bitcoins. These trades had no economic substance and involved no change in beneficial or legal ownership over any assets.

Misleading Orders (Market Bot Function)

50. In January 2017, Coinsquare implemented another function that also purported to serve a market making purpose on the Coinsquare Platform (the **Market Bot Function**). The Market Bot Function placed orders from an internal Coinsquare account to buy and sell the equivalent of approximately 57 million bitcoins up to December 2019.

51. However, these automated orders were priced outside a range likely to result in executed trades and automatically cancelled after three minutes, further reducing the chance that the orders would match with client orders. Coinsquare operated the Market Bot Function despite the fact that over 99% of the orders it generated never resulted in executed trades.

52. Between January 2017 and December 2019, the Market Bot Function resulted in Coinsquare placing more than 10.5 million of these orders, representing approximately 30% of all orders on the Coinsquare Platform during this period.

Conclusion

53. Coinsquare's failure to implement adequate controls over trading activities as set out above was contrary to the public interest.

(5)   FAILURE TO FULFILL ROLE AS CHIEF COMPLIANCE OFFICER

54. The chief compliance officer of a registered firm is responsible for promoting a culture of compliance, overseeing the effectiveness of the firm's compliance system and assessing the firm's compliance with securities law. In carrying out these duties, a chief compliance officer "should be vigilant and ensure that all the employees and senior staff are aware of compliance issues within the firm and monitor compliance with regulatory requirements". The Commission has described the chief compliance officer role as "critical to securities law compliance oversight".

55. Mazer held the title of CCO at Coinsquare from May 2018 until his resignation in June 2020. Mazer was not acting in a registered capacity in connection with his role as Coinsquare's CCO but was held out as the CCO both within Coinsquare and to the general public.

56. Although Mazer was not the CCO of a registered firm, the public would reasonably expect that an employee with this title and held out as performing this role would generally fulfill the critical compliance responsibilities described above. Mazer failed to fulfill this critical

compliance role at Coinsquare. Mazer learned about the wash trading in or around March 2019 and failed to take steps that a reasonable CCO would have taken in the circumstances. Mazer's conduct was contrary to the public interest.

C.   BREACHES OF ONTARIO SECURITIES LAW AND CONDUCT CONTRARY TO THE PUBLIC INTEREST

Enforcement Staff allege the following breaches of Ontario securities law and/or conduct contrary to the public interest:

57.   Coinsquare engaged in a course of conduct that it knew or reasonably ought to have known resulted in or contributed to a misleading appearance of trading activity in a security, derivative and underlying interest of a derivative, contrary to paragraph 126.1(1)(a) of the Act.

58.   Coinsquare made statements about matters that a reasonable investor would consider relevant in deciding whether to enter into or maintain a trading relationship with Coinsquare which were untrue or omitted information necessary to prevent the statements from being false or misleading in the circumstances in which they were made, contrary to subsection 44(2) of the Act.

59.   Diamond and Rostand as officers and/or directors of Coinsquare, authorized, permitted or acquiesced in Coinsquare's failure to comply with subsection 44(2) of the Act, contrary to section 129.2 of the Act.

60.   Coinsquare took a reprisal against an employee of Coinsquare because the employee provided information to Coinsquare and its senior management about acts of Coinsquare and its senior management that have occurred, and that the employee reasonably believed were contrary to Ontario securities law, contrary to section 121.5 of the Act.

61.   Diamond, as an officer and/or director of Coinsquare, authorized, permitted or acquiesced in Coinsquare's failure to comply with paragraph 121.5 of the Act, contrary to section 129.2 of the Act.

62.   Coinsquare, Diamond, Rostand and Mazer acted in a manner contrary to the public interest.

D. ORDER SOUGHT

63. Enforcement Staff request that the Commission make an order pursuant to subsection 127(1) and section 127.1 of the Act to approve the settlement agreement dated July 16, 2020 between the Respondents and Enforcement Staff.

64. Enforcement Staff reserve the right to amend these allegations and to make such further and other allegations as Enforcement Staff may advise and the Commission may permit.

DATED this 16th day of July, 2020.

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