WILDEBOER DELLELCE LLP

April 17, 2024

DELIVERED BY EMAIL: comments@osc.gov.on.ca

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Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumers Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities Service Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
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Dear Sirs/Mesdames:

RE: Comments Concerning Proposed Amendments to National Instrument 81-102 *Investment Funds* ("NI 81-102") and Proposed Changes to Companion Policy 81-102CP *Investment Funds* ("81-102CP") Pertaining to Crypto Assets (the "Proposed Amendments")

We are writing in response to the request for comments on the Proposed Amendments. The Proposed Amendments were developed following the publication of CSA Staff Notice 81-336 *Guidance on Crypto Asset Investment Funds that are Reporting Issuers* ("**SN 81-336**") on July 6, 2023.

We thank you for the opportunity to provide comments on the Proposed Amendments. Please note that this letter reflects the collective views of certain members of our securities and investment funds practices, rather than the firm as a whole or any of its clients. These comments are provided without prejudice to any stance our firm has taken or may adopt in the future, either independently or on behalf of any client.

Wildeboer Dellelce is one of Canada's premier corporate, securities and business transaction law firms. We are recognized in the Chambers Canada 2024 Guide as Highly Regarded for Corporate/Commercial in Ontario, one of Canada's Best Law Firms for 2024 by The Globe and Mail, and one of the 'Top 10 Corporate Law Boutiques in Canada' by Canadian Lawyer Magazine. In addition, the Canadian legal LEXPERT Directory and Best Lawyers Canada recognize Wildeboer Dellelce lawyers in several areas, including mergers and acquisitions, investment funds and asset management, corporate finance, securities and technology.

Wildeboer Dellelce is proud to serve a broad and diverse client base within the digital economy, including domestic and foreign crypto-trading platforms ("**CTPs**"), asset managers, public and private investment funds, custodians, financial intermediaries, venture capital and private equity sponsors, early stage and emerging growth companies, as well as publicly listed issuers.

We acknowledge the efforts of the Canadian Securities Administrators ("**CSA**") in their attempt to refine the regulatory framework pertaining to reporting issuer investment funds that seek to invest directly or indirectly in crypto assets ("**Public Crypto Asset Funds**") through the Proposed Amendments as well as the work conducted by CSA staff generally across a number of related crypto initiatives. While several of the Proposed Amendments significantly advance the public interest concerns of the CSA most recently set forth in SN 81-336, we believe there are substantial issues associated with other aspects of the Proposed Amendments. In the subsequent sections, we outline our perspectives on the limitations of the Proposed Amendments and offer suggestions for other methods by which the CSA's legitimate public interest concerns can best be achieved.

Specific Issues for which the CSA Seek Comments

In the CSA Notice and Request for Comment dated January 18, 2024 (the "**CSA Notice**"), the CSA have identified specific issues for which they seek comments. We do not intend to comment on all of the proposals, as many are in line with existing guidance and related industry practices. Our comments and suggestions regarding specific issues referenced in the CSA Notice are set out below.

Item #1 in the CSA Notice: Guidance on "crypto asset"[1]

We agree that the alternative funds framework remains appropriate for the purposes of seeking exposure to crypto assets and that the definition be expanded to include reference to this asset class.

The definition of "crypto asset" as currently proposed is broad and does not appear to link the asset to a taxonomy that can be relied upon by market participants to determine the application of securities laws. The IOSCO Final Report from February 2020 defines crypto assets as "a type of private asset that depends primarily on cryptography and DLT or similar technology as part of its perceived or inherent value, and can represent an asset such as a currency, commodity or security, or be a derivative on a commodity."[2] Inclusion in 81-102CP of indicia as to what elements would facilitate the review and analysis of the application of securities laws to these assets would further enhance the application of the proposed framework and ensure consistency with other jurisdictions in which these assets may circulate.

[1] CSA Notice at page 5.
[2] IOSCO Final Report, "Issues, Risks and Regulatory Considerations Relating to Crypto-Asset Trading Platforms", February 2020 at page 1.

Item #3 in the CSA Notice: Restrictions on investing in crypto assets[3]

If the Proposed Amendments are adopted in their current form, Public Crypto Asset Funds would only be permitted to invest in crypto assets that are listed for trading on, or are the underlying interest for a specified derivative that trades on, an exchange that has been recognized by a securities regulatory authority in Canada (the "**Recognized Exchange Requirement**"). Thus, the Recognized Exchange Requirement would appear to restrict the investible crypto assets of Public Crypto Asset Funds to bitcoin ("**BTC**") (futures contracts listed on the TMX Montreal Exchange) and ether ("**ETH**") (futures contracts listed on the Chicago Mercantile Exchange).

For the reasons outlined below, we believe that the Recognized Exchange Requirement is unnecessarily restrictive and is therefore not an appropriate qualifying criterion. Furthermore, we believe that there are other criteria which are more appropriate for determining when a crypto asset should be deemed an appropriate investment for Public Crypto Asset Funds.

Why the Recognized Exchange Requirement is Not a Reasonable Qualifying Criterion

(i) New Product Development

Canada has consistently been at the forefront of market breakthroughs relating to innovative financial products.[4] This innovation has also been evident in Canada's regulation of crypto assets, as Canada has been a global leader in the regulation of Public Crypto Asset Funds.[5] The launch of the initial BTC and ETH closed end funds in Canada in 2020 and the subsequent listing of their exchange-traded fund counterparts has been a successful example of Canadian asset managers and their financial sponsors providing investors with exposure to emerging asset classes in a regulated and responsible manner.[6] The recent introduction of staking as an investment strategy is a further step in the right direction as this ecosystem continues to develop and evolve.

We believe that the Recognized Exchange Requirement will hinder Canada's ability to remain a global leader in the continued development and issuance of Public Crypto Asset Funds.

In the CSA Notice, the CSA state their belief that the Proposed Amendments will serve to "facilitate new product development in the [Public Crypto Asset Fund] space while also ensuring that appropriate risk mitigation measures are built directly into the investment fund regulatory framework."[7] We believe that the Recognized Exchange Requirement runs counter to this belief, as it will unnecessarily suppress new product development in the Public Crypto Asset Fund space. As outlined below, there are alternative qualifying

[3] CSA Notice at page 5.
[4] For example, Canada is often recognized as having created the first modern-day exchange-traded fund (ETF), which was launched by the Toronto Stock Exchange (TSX) in March 1990 (Exchange-Traded Funds: Evolution of Benefits, Vulnerabilities and Risks, by Ian Foucher and Kyle Gray).
[5] For example: (i) in 2020, Canada's 3iQ launched North America's first major exchange-listed BTC and ETH Funds (https://3iq.io/us/our-story); (ii) in 2021, Canada's Purpose Investments obtained approval from the CSA for the world's first actively managed crypto-based ETF (https://www.purposeinvest.com/thoughtful/purpose-investments-launches-worlds-first-bitcoin-etf-invested-directly-in-the-digital-asset); and (iii) in 2023, Canada's 3iQ launched the world's first ETH staking ETF (https://3iq.io/us/our-story).
[6] There are also a number of Canadian non-redeemable and open-ended mutual funds and alternative investment funds providing a wide range of targeted exposure to asset classes comprised of emerging and/or innovative technologies and related industries such as carbon capture, exponential technologies, AI and robotics, biotech, genomics, as well exposure to track market trends including social sentiment, market momentum and other thematic investment ideas.
[7] CSA Notice at page 1.

criteria that can be employed which will serve to protect investors and mitigate risks, while still allowing for new and innovative product development within the Public Crypto Asset Fund framework.

(ii) Recognized Exchange Requirement Not Necessary to Mitigate Risks

Pursuant to SN 81-336 and the CSA Notice, the Recognized Exchange Requirement is intended to address the CSA's concerns relating to liquidity, market integrity and price discovery of crypto assets. We agree that each of these concerns are valid and must be addressed to protect Canadian investors. However, as outlined below, it is possible to address these concerns while still facilitating new product development within the Public Crypto Asset Fund framework.

Addressing Liquidity Concerns

Under section 2.4 of NI 81-102, investment funds are subject to restrictions on the proportion of "illiquid assets" that can be held in their portfolios. Pursuant to section 1.1 of NI 81-102, an "illiquid asset" includes "a portfolio asset that cannot be readily disposed of through market facilities on which public quotations in common use are widely available at an amount that at least approximates the amount at which the portfolio asset is valued in calculating the net asset value per security of the investment fund." In a panel decision of the Ontario Securities Commission in 2019 (the "**BTC Decision**"), it was determined that BTC is not an illiquid asset under NI 81-102.[8] This finding was largely based on the fact that substantial volumes of BTC trade daily on CTPs which "promote reliable price discovery so that the Fund can value its bitcoin and provide sufficient liquidity."[9] For the same reason, we believe that many crypto assets that do not meet the Recognized Exchange Requirement are liquid assets (i.e., are not caught under the definition of "illiquid assets" in NI 81-102).

One example is the digital currency Solana ("**SOL**"), the native digital currency of the Solana Network. SOL can be traded on regulated CTPs in Canada and internationally and is currently the fifth largest crypto asset in the world with a market capitalization of over USD$90 billion (as of March 31, 2024).[10] From January 17, 2024 to March 17, 2024, SOL had an average daily trading volume of approximately USD$3.5 billion.[11] This is far greater than the average daily trading volume of the most liquid equities and ETFs listed on the Toronto Stock Exchange. Despite all of this, if the Proposed Amendments are adopted in their current form, Public Crypto Asset Funds would not be able to invest in and hold SOL because SOL does not meet the Recognized Exchange Requirement. As such, the Recognized Exchange Requirement is not an accurate indicator of market liquidity.

Addressing Market Integrity and Price Discovery Concerns

As per SN 81-336, the CSA are of the view that "the presence of a regulated futures market for a crypto asset provides support for the proper valuation of a Public Crypto Asset Fund that invests in that crypto asset, along with other operational benefits."[12]

There is evidence that Public Crypto Asset Funds can accurately and consistently value their crypto assets, even if the particular crypto asset does not meet the Recognized Exchange Requirement. As noted in SN 81-336, when it comes to valuation, the primary approach taken by existing Public Crypto Asset Funds that

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[8] *3iQ Corp (Re)*, 2019 ONSEC 37 at paras 54-56.
[9] *Ibid* at para 51.
[10] As per CoinMarketCap (https://coinmarketcap.com/).
[11] *Ibid*.
[12] SN 81-336 at page 4.

directly hold BTC or ETH is to base their valuations on spot pricing from available crypto asset indices.[13] There are many publicly available indices that aggregate pricing from a variety of sources to determine a spot price, and that are administered by regulated index providers using transparent, auditable and replicable calculation methodologies that comply with industry best practices as well as European and IOSCO standards. By using these reputable indices, Public Crypto Asset Funds are able to mitigate price discovery concerns while not necessarily meeting the Recognized Exchange Requirement.

It is also unclear how reliance on these platforms will strengthen price discovery as the underlying inputs used in the broader futures markets are generally derived from the same sources currently in use by asset managers and CTPs.

For example, Cboe Digital Exchange, LLC ("**Cboe Digital**") has established futures contracts for both BTC and ETH. In doing so, Cboe Digital uses the Cboe Kaiko Bitcoin Rate to reflect economic exposure related to the price of BTC. Kaiko is a cryptocurrency market data provider who has established criteria for the purposes of vetting eligible exchanges who provide Kaiko with their spot pricing for BTC, and which currently include the following exchanges: LMAX Digital, Bitstamp, itBit and Cboe Digital.[14]

Each underlying exchange must meet the following criteria as part of the vetting process for inclusion in the Cboe Kaiko Bitcoin Rate: it is absent from any sanction list; has been operating for the past five years; is located in a stable and open country; is regulated by an independent government body; has KYC/AML controls in place; has trading policies in place; offers reliable API and data feeds; offers reliable live and historical trade data; and provides cold storage for customers funds. Additionally, the liquidity of each exchange is assessed to only consider meaningful contributors, defined as at least 0.5% of the total observed liquidity over the past three months.[15]

Moreover, in a recent regulatory submission, Cboe Digital included the results of its analysis of the Cboe Kaiko Rates prices compared to other BTC index providers over the last year to determine whether the Cboe Kaiko Rates are representative of the broader BTC and ETH markets (the "**CME CF Reference Rates**"). These reference rates included data published by Coinbase, Gemini and Kraken. Cboe Digital identified a 0.998-0.999 correlation between the Cboe Kaiko Bitcoin Rate and the CME CF Reference Rates, suggesting almost perfect alignment.[16]

Cboe Digital also reviewed the differences between the Cboe Kaiko Rates and the daily CME CF Reference Rates, the weekly CoinDesk Index Rates and the hourly Kaiko Reference Rates over a year look-back for BTC (the ETH results were almost identical). The study identified average hourly, daily and weekly differences between the Kaiko rate and the reference rates to be 0.01%, 0.06% and 0.13%, respectively.[17] Cboe Digital's analysis demonstrates that the Cboe Kaiko Rates adequately and consistently represent the price of the BTC and ETH spot markets due to high price correlation and marginal price divergence as compared to other digital asset spot market indexes which are generally representative of the wider spot market.

(iii) The Launch of an ETH-Focused Fund in 2020

When the CSA approved the first ETH-focused Public Crypto Asset Fund in 2020 (the "**3iQ ETH Fund**"), ETH did not meet the Recognized Exchange Requirement. Despite this, the 3iQ ETH Fund did not

[13] *Ibid*.
[14] Letter from CBOE Digital to the Commodity Futures Trading Commission dated November 1, 2023 at page 6.
[15] *Ibid* at page 5.
[16] *Ibid* at page 7.
[17] *Ibid*.

experience any significant liquidity or valuation issues, and this fund has continued to flourish since its inception while paving the way for other ETH-focused Public Crypto Asset Funds to enter the market. The market capitalization, trading volumes and on-chain activity of ETH in 2020 are comparable to other crypto assets at present (e.g., SOL). As was the case in 2020, Public Crypto Asset Funds should not be prevented from investing in crypto assets solely because these assets do not meet the Recognized Exchange Requirement.

(iv) Demand for Crypto Assets That Do Not Meet the Recognized Exchange Requirement

In SN 81-336 and the CSA Notice, the CSA suggest that the presence of a regulated futures market for a given crypto asset generally correlates with institutional support for that particular crypto asset.[18] We believe that this suggestion does not accurately reflect the current market conditions in Canada.

An example of the demand for non-BTC/ETH Public Crypto Asset Funds is the demand for the Grayscale Solana Trust ("**GSOL**"). GSOL trades over-the-counter and is invested in and derives its value from the price of SOL. GSOL has been a popular product despite the fact that it has historically traded at significant premiums to the actual price of SOL (550% as of April 15, 2024). We believe that this indicates that there is institutional and retail demand for Public Crypto Asset Funds that focus on crypto assets other than BTC and ETH.

There is also anecdotal evidence that, until U.S. centric taxonomy issues associated with the regulation of certain crypto assets as securities or commodities are resolved, the ability for licensed futures exchanges to develop a futures market is limited due to these uncertainties.

Enabling access for investors to acquire the underlying investment asset via regulated investment vehicles should serve to enhance the ability for these exchanges to offer additional financial instruments such as specified derivatives. Until then, the futures markets are often thinly traded and are not themselves a significant indicator of the underlying trading volumes or liquidity in the reference asset.

As such, it is essential to ensure the development of financial products, including collective investment vehicles, within the spot market whilst ensuring reliable pricing discovery.

<u>Proposed Changes to the Recognized Exchange Requirement</u>

As a result of the foregoing, it would appear to us that to promote price discovery and mitigate market manipulation, the CSA should consider implementing the following:

1. Providing a clear taxonomy and regulatory classification of crypto assets.
2. Facilitating the regulated development of additional spot market activity via collective investment vehicles in crypto assets.
3. Ensuring that investment fund managers have policies and procedures designed to confirm the reliability of the pricing of the crypto assets in which their Public Crypto Asset Funds and private investment funds invest.
4. At a minimum, expanding the Recognized Exchange Requirement to include crypto assets that trade on any CTP licensed in Canada (or by a foreign securities regulator), or which has executed a pre-registration undertaking (each, a "**Regulated CTP**"). Registration as a Regulated CTP requires platforms to meet substantially similar criteria as those adopted by the data providers and licensed exchanges who support any associated futures market in determining the reliability of the

[18] SN 81-336 at page 4 and the CSA Notice at page 5.

pricing for the reference asset. Regulated CTPs already meet the necessary requirements for market integrity, reporting and investor protection, and Public Crypto Asset Funds should not be further restricted by the Recognized Exchange Requirement.

While there is no doubt that the presence of a futures market enables two-way directional trading activity and the ability to hedge exposure, it does not support the basis upon which to restrict access to the reference asset by investors seeking exposure through Public Crypto Asset Funds.

We believe that the CSA should adopt a more measured approach, rather than denying investments in any crypto assets that do not meet the Recognized Exchange Requirement.

Alternatively, we would suggest that the Proposed Amendments be changed in order to allow Public Crypto Asset Funds to invest in any crypto asset that is traded on a Regulated CTP, subject to the approval of their principal regulatory authority. This discretionary approach would ensure that crypto assets other than BTC and ETH are not automatically precluded, while still providing the CSA with the ability to reject investments in any particular crypto asset. If this approach is adopted, 81-102CP should be amended to provide guidance on the characteristics required for a particular crypto asset to be approved (i.e., thresholds relating to market capitalization, trading volumes and on-chain activity and the availability of acceptable valuation methods).

Item #4 in the CSA Notice: Custody[19]

With regards to the proposed recommendations relating to the custodianship of crypto assets, we are advised that the focus on the SOC 2 Type 2 requirement may be overly prescriptive. Given the somewhat unique and limited technological underpinnings associated with the custodianship of these assets, suggested alternatives could include a requirement for a SOC 2 Type 1 report focussed on security (versus the need to conduct further review of the "trust service principles" including availability, privacy, confidentiality and processing integrity that are contemplated in a SOC 2 Type 2 report) and that alternatives such as an ISO 27001 certification or an independent systems review by an external audit firm may also be sufficient for the purposes of obtaining assurances regarding the platform. A number of industry participants have advised that the language in the definitions of "acceptable third-party custodian" set forth in CSA Staff Notice 21-332 *Crypto Asset Trading Platforms: Pre-Registration Undertakings Changes to Enhance Canadian Investor Protection* could be sufficient for this purpose.

We also note that references in the guidance regarding best practices of crypto custodians to the use of strong passwords, multi-factor authentication and encryption of client information to limit the risk of hacking are all appropriate, however the reliance on the use of multi-signature technology to mitigate points of failure can be applied at either the blockchain protocol layer or at the business logic layer (which is likely more effective). Although inclusion of such a distinction in the guidance may not be warranted, the guidance should also generally ensure it is not overly prescriptive. For example, multi-signature technology is sometimes deployed via an Ethereum based smart contract which should not be deemed sufficient for safe-keeping purposes (while arguably meeting the standard of care).

Although outside the scope of the proposals, the CSA should consider whether the definition of "qualified custodian" should be amended to incorporate a larger grouping of platforms, such as those who would otherwise be "acceptable third-party custodians" to Regulated CTPs and CIRO registrants, and whether or not the corresponding definition under CIRO Rules as to what constitutes an "acceptable securities location" should be reviewed in tandem. Reliance on qualified custodian status precludes the ability of a number of sophisticated platforms from delivering their services to Public Crypto Asset Funds in the

[19] CSA Notice at page 5.

absence of exemptive relief (if such relief were to be available), resulting in a concentration of assets on a very limited number of large (and primarily non-domestic) digital custodian platforms.

We thank you for the opportunity to comment upon the Proposed Amendments and would welcome the opportunity to expand on any of our comments contained in this letter.

Wildeboer Dellelce LLP