

Canadian Securities Regulators Seek Feedback on Rules for Public Investment Funds Holding Crypto Assets

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The Canadian Securities Administrators (CSA) have opened a 90-day comment period for their recently proposed regulatory requirements applicable to public investment funds seeking to invest in crypto assets.¹ The CSA is aiming to provide fund managers with greater clarity on the direction of regulation while securities regulators determine whether a more comprehensive regime is required. With an increasing number of financial institutions becoming involved with crypto assets, including with the approval of several spot Bitcoin Exchange-traded Funds in the United States,² the CSA's proposed amendments are focused on protecting investors through crypto asset investment restrictions, custodial obligations, and other mechanisms.

CSA's Proposed Regulatory Requirements

The CSA has proposed amendments to National Instrument 81-102 *Investment Funds* (NI 81-102) and Companion Policy 81-102CP (81-102CP).³ These proposed amendments are a part of Phase 2 of the CSA's implementation of a regulatory framework for Public Crypto Asset Funds (the Project). The objectives of the Project are to: (i) review existing requirements, provide guidance, and ultimately implement a regulatory framework relating to Public Crypto Asset Funds aimed at protecting investors and mitigating potential risk; and (ii) provide investment fund managers greater regulatory clarity with regards to investments in crypto assets.

Phase 1 of the Project was completed on July 6, 2023, with the publication of CSA Staff Notice 81-336 *Guidance on Crypto Asset Investment Funds that are Reporting Issuers* (SN 81-336).⁴ Phase 1 outlined information to stakeholders on areas the CSA believed needed greater guidance with respect to CSA expectations and developments relating to Public Crypto Asset Funds. Looking forward, Phase 3 of the Project will involve a public consultation that is ultimately intended to inform a comprehensive regulatory framework for funds investing in crypto assets.⁵

The proposed amendments to NI 81-102 and 81-102CP are targeted amendments that reflect priority issues and seek to codify policies and practices of existing Public Crypto Asset Funds that were developed and adopted through the prospectus review process. Moreover, the proposed amendments seek to codify exemptive relief for crypto assets.

The following are summary highlights of the proposed amendments:

Proposed Amendments to NI 81-102:

- *Part 1 – Definitions:* the CSA proposes amending the definition of “alternative mutual fund” to include a mutual fund that invests in crypto assets.
- *Part 2 – Investments:*
 - 2.3 – the CSA proposes amending the investment restrictions in this section to permit only alternative mutual funds and non-redeemable investment funds to buy, sell, hold, or use crypto assets directly;
 - 2.12 – the CSA proposes prohibiting the use of crypto assets in securities lending, repurchase transactions or reverse transactions, as the loaned securities, transferred securities or collateral posted in connection with these transactions; and
 - 2.18 – the CSA proposes that a “money market fund,” as defined under this section, cannot buy or hold crypto assets.
- *Part 6 – Custodianship of Portfolio Assets:*
 - 6.5.1 – the CSA proposes that custodians and sub-custodians that hold crypto assets on behalf of an investment fund (Crypto Custodians) be required to keep crypto assets in offline storage (also known in industry as “cold storage” or storage in a “cold wallet”), except as needed for facilitating purchases, sales and other portfolio transactions;
 - 6.6(3.1) – the CSA proposes that Crypto Custodians be required to maintain insurance for the purposes of their held crypto assets against a standard of reasonable prudence; and
 - 6.7 – the CSA proposes that Crypto Custodians be required to annually obtain a report prepared by a public accountant assessing the custodian’s internal management and controls.
- *Part 9 – Sale of Securities of a Mutual Fund:*
 - 9.4(2) – the CSA is proposing to codify exemptive relief granted to Public Crypto Asset Funds that permit them to accept crypto assets as subscription proceeds under s. 9.4(2). The CSA further proposes that under s. 9.4(2)(c), a mutual fund can accept crypto assets that are not securities as subscription proceeds if:
 - The mutual fund is permitted to purchase the applicable crypto asset, the asset is acceptable to the fund’s portfolio manager, and consistent with the fund’s objectives; and
 - The value of the crypto asset accepted as subscription proceeds is at least equal to the issue price of the securities of the mutual fund for which they are payment.

Proposed Amendments to 81-102CP:

- 2.01 – the CSA is proposing to add further guidance to the companion policy to provide greater specificity as to when and how a crypto asset may be considered within the regulatory ambit of

investment funds rules.

- 3.3.01 – the CSA is proposing further guidance clarifying that funds may continue to acquire crypto assets from sources such as Crypto Asset Trading Platforms (CTPs), if the particular crypto asset(s) the fund invests in meets the necessary criteria outlined in s. 2.3(1.3) of NI 81-102.
- 8.1 – the CSA is proposing to expand on the guidance for meeting the standard of care requirement outlined in s. 6.6 of NI 81-102 in the context of Crypto Custodians. The requirements include, among others, ensuring the Crypto Custodian has the requisite expertise, and the use of multi-signature technology to limit the risk of a single point of failure.
- 8.3(2) – the CSA proposes that a Crypto Custodian be required to obtain an assurance report of its security processes. In particular, the CSA proposes that the custodian obtain a SOC-2 Type 2 report.

Conclusion

The proposed amendments to NI 81-102 and its companion policy are intended to progress rulemaking for public investment funds that seek to buy, sell, hold, custody or otherwise transact crypto assets. It remains integral that legislators and industry stakeholders alike continue the collaborative approach to promulgating “rules of the road” for the regulated crypto asset space in Canada. To that end, stakeholders are invited to provide comments in writing to the CSA on or before April 17, 2024.

If you or your organization would like to submit a comment to the CSA, we welcome you to contact our Blockchain & Digital Assets Group to assist you in formatting and submitting your comments.

¹ Canadian Securities Administrators, “Canadian securities regulators seek feedback on rules for public investment funds holding crypto assets” (18 January 2024) online: <securities-administrators.ca/news/canadian-securities-regulators-seek-feedback-on-rules-for-public-investment-funds-holding-crypto-assets/>.

² BNN Bloomberg, “SEC Authorizes Bitcoin-spot ETFs in crypto’s big breakthrough” (10 January 2024) online: <bnnbloomberg.ca/sec-approves-bitcoin-spot-etfs-in-milestone-for-digital-assets-1.2020423>.

³ Canadian Securities Administrators, “CSA Notice and Request for Comment – Proposed Amendments to National Instrument 81-102 Investment Funds Pertaining to Crypto Assets” (18 January 2024) online (pdf): <osc.ca/sites/default/files/2024-01/csa_20240118_81-102_rfc_crypto-assets.pdf>.

⁴ Canadian Securities Administrators, “CSA Staff Notice 81-336: Guidance on Crypto Asset Investment Funds That Are Reporting Issuers” (6 July 2023) online (pdf): <osc.ca/sites/default/files/2023-07/csa_20230706_81-336_guidance-on-crypto-asset-funds.pdf>.

⁵ CSA, *supra* note 2.