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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
Office of the Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

submitted via email to comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca to

The Secretary
Ontario Securities Commission
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Me Philippe Lebel
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April 17, 2024

Dear Sir/Madam,

AIMA response to the Canadian Securities Administrators (“CSA”) proposals for investment funds seeking to invest in crypto assets

The Alternative Investment Management Association (“AIMA”)¹ welcomes the opportunity to respond to the CSA notice and request for comment on the proposed amendments to National Instrument 81-102 (“NI 81-102”) and

¹ The Alternative Investment Management Association (AIMA) is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA’s fund manager members collectively manage more than US\$3 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry

proposed changes to 81-102 Companion Policy (“81-102CP”) concerning reporting issuer investment funds that invest in crypto assets (“Public Crypto Asset Funds”).²

AIMA generally welcomes the efforts of the CSA in seeking to foster greater clarity regarding the regulation and oversight of crypto and broader digital asset markets. However, we would also like to highlight the prevailing trend that we have seen in other global jurisdictions in terms of recognizing the impact of distributed ledger technology (DLT) on financial markets. Notably, this is demonstrated by the growing number of nascent asset tokenization initiatives gaining traction among traditional regulated financial entities. We therefore welcome well-designed and appropriate regulation of crypto and broader digital asset markets that avoids creating negative unintended consequences, for example, in terms of economic growth and further innovation.

Leveraging the collective insights and expertise of our members, we have provided feedback on the CSA’s proposed amendments and changes, as outlined below.

(i) Definition of “Alternative Mutual Fund”

We support the proposed amendment to expand the definition of “alternative mutual fund” to include those investing in crypto assets. This adjustment to the definition of “alternative mutual fund” in NI 81-102 implies that any investment fund engaging directly or indirectly with crypto assets must fall under the classification of an “alternative mutual fund” (also commonly referred to as liquid alts/alternative funds). We acknowledge that this establishes the CSA’s intention to formalize the existing process for investment funds seeking exposure to crypto assets.

Furthermore, we recognize the CSA’s stance that this change aligns with the notion that “alternative mutual funds” are permitted to have increased exposure to certain alternative asset classes or investment strategies, such as commodities, compared to other mutual fund types.

(ii) Definition of Crypto Asset

We support the proposal to introduce guidance on defining “crypto assets” for investment fund regulation purposes. The suggested guidance aligns with the general understanding of crypto assets among market participants and offers clarity regarding the types of assets falling under this classification within NI 81-102.

However, we would also highlight that the statement made in 81-102CP as to what is generally considered to be a crypto asset for purposes of the proposed amendments is much broader than the definition of crypto assets used by the CSA in the context of crypto asset trading platforms (CTPs) – for example, 81-102CP includes crypto assets that are also securities and/or derivatives. Our concern is that the use of the term “crypto asset” in a matter different from what the market is accustomed to may be misleading and may cause unnecessary confusion. To the extent that 81-102CP will refer to crypto assets that are securities and/or derivatives, the guidance should make it clear that such assets are subject to the same requirements as all other securities and/or derivatives.

(iii) Investment Restrictions

We agree with the proposal to amend the investment restrictions to allow only “alternative mutual funds” and “non-redeemable investment funds” to directly buy, sell, hold or use crypto assets. We note that for mutual funds other than alternative mutual funds, investing in crypto assets would only be permissible by investing in underlying

initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage over US\$1 trillion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For more information, visit www.aima.org.

² See, www.bcsc.bc.ca/securities-law/law-and-policy/instruments-and-policies/8--investment-funds/current/81-102/81102-csa-notice-and-request-for-comment-january-18-2024.

alternative mutual funds or non-redeemable investment funds that engage in such investments, subject to the fund of fund rules in NI 81-102.

While we welcome the development and institutionalization of new investable assets, including crypto assets, which offer investment opportunities to access new return drivers and risk premia, we seek clarity on the proposal's restriction limiting Public Crypto Asset Funds to crypto assets traded on, or referenced by derivatives trading on, a "recognized exchange" in Canada. Consequently, for a spot or underlying derivative-based product investing in a crypto asset other than bitcoin or ether, must an option be available? Clarification is needed on whether the actual spot crypto asset must be listed on a "recognized exchange."

We are concerned the proposed limits restrict a Public Crypto Asset Fund's investment to only those crypto assets for which futures are offered on an exchange that is recognized in Canada. Currently, that is only bitcoin and ether. This restriction stands in contrast with the much larger number of crypto assets that may be purchased by retail investors through CTPs in Canada.

We are concerned that these stringent provisions may stifle market and product development and potentially drive investors toward less-regulated markets and products with inadequate investor protections. Our recommendation would be for the CSA to allow Public Crypto Asset Funds to invest in any of the crypto assets that are offered by one or more of the CTPs.

(iv) Non-fungible Tokens (NFTs)

We do not agree with the proposal to entirely prohibit Public Crypto Asset Funds from purchasing or holding non-fungible crypto assets (NFTs). Despite encountering challenges, the potential of NFTs as an emerging technology remains significant. Future advancements may unveil new opportunities as technological innovation expands, application scenarios evolve, and market participants reassess risks and values.

We contend that under certain circumstances, it could be appropriate to permit investment funds to invest in NFTs, akin to other liquid alternatives. We recognize the necessity for specific regulatory parameters, such as thresholds, which could be delineated within the regulatory framework for investment funds to facilitate such investments. We therefore advocate for the expansion of the scope of permitted crypto assets to encompass NFTs, while concurrently introducing investor protection measures for funds seeking to hold these asset types.

(v) Use of Crypto Assets in Securities Lending, Repos and Reverse Repos

We disagree with the proposal to entirely ban the utilization of crypto assets in securities lending, repurchase transactions, or reverse transactions as loaned securities, transferred securities, or collateral. While challenges may exist currently, it is conceivable that safeguards could be implemented over time, rendering the use of crypto assets for securities lending, for instance, a viable option. However, the proposals would have the effect of preventing Public Crypto Asset Funds from using crypto assets for securities lending, repurchase and reverse repurchase transactions, even if it were possible to do so in a manner that complies with the existing NI 81-102 framework for these types of transactions. We therefore seek clarification at least on whether this stance will be subject to review as capabilities mature and market structures progress further.

(vi) Crypto Custodian Requirements

We support the proposal to mandate custodians and sub-custodians holding crypto assets for investment funds ("Crypto Custodians") to maintain those assets in offline storage or cold wallets, except as required to facilitate purchases and sales or other portfolio transactions in the fund.

We agree with the proposal mandating Crypto Custodians to obtain an annual report from a public accountant evaluating their internal management and controls related to security, availability, processing integrity, confidentiality, and privacy. However, we believe that prescribing a specific type of report, such as a Service Organization Control (SOC) report, is unnecessary. Similarly, we do not support prescribing the type of report Crypto



Custodians should obtain regarding their security measures, as such prescriptiveness is not applied to other asset types. SOC-2 Type 2 Reports (“SOC-2”) are typically issued by organizations that do not process financial transactions on behalf of clients (data hosting providers, for example) but require some independent assurance by an audit firm. The SOC-2 largely overlaps with the scope of a SOC-1 Type 2 Reports (“SOC-1”) examination but covers some additional controls that may be of interest to client organizations for purposes other than financial reporting. When working with a traditional bank custodian that is subject to rigorous regulatory oversight as well as the existing control coverage that is available via the SOC-1, ISO27001 certification, penetration testing attestations and other client-ready materials and are generally able to address any outstanding concerns clients have regarding the bank’s control environment as it relates to the Trust Services Principles included in the SOC-2. Additionally, to provide coverage over a larger set of controls that may be of interest to client organizations, bank custodians generally are able to share additional information related to Personnel Security, including controls related to background checks for new employees. We recommend that that proposed amendments take a principles-based approach to allow for a broad base of digital asset custodians to demonstrate their commitment and controls with respect to security, availability, confidentiality, processing integrity, and privacy.

While we generally support expanding guidance on meeting the standard of care requirement for Crypto Custodians outlined in NI 81-102, we caution against prescribing specific technologies. The term “multi-signature technology”, included in sub-bullet three of the proposed new subsection 8.1(2), may be interpreted as prescriptive in the type of wallet infrastructure technology digital asset custodians must employ. It is our recommendation that the proposed subsection 8.1(2) refrain from using terms that are also used to describe one type of wallet infrastructure technology, which may imply a requirement that is more prescriptive than intended.

In the alternative, we recommend that the proposed amendments take a principles-based approach to address the risk of single point of failure, which includes characteristics present in “multi-signature technology” as well as in “multi-party computation” technology and potentially other technologies, namely,

- (i) the security and mitigation of single point of failure risk by distributing the digital wallets’ cryptographic material across multiple geographically distributed and independent machines;
- (ii) the control of the cryptographic material, and associated with a backup and recovery process and procedure; and
- (iii) the use of independently secure and geographically remote locations, with separate and independent administrators and access points.

We advocate for allowing Crypto Custodians to make operational decisions regarding the most appropriate custodial solutions based on their unique circumstances. Therefore, we do not recommend specifying particular types of custodial solutions in the guidance.

(vii) Sale of Securities of a Mutual Fund

We support the proposal to codify exemptive relief granted to existing Public Crypto Asset Funds, allowing them to accept crypto assets as subscription proceeds.

Additionally, we agree with the proposal to clarify that a mutual fund can accept non-securities crypto assets as subscription proceeds under specific conditions. These conditions include: (i) the mutual fund being permitted to invest in the relevant crypto asset, with approval from the fund’s portfolio advisor and alignment with the fund’s investment objectives, and (ii) the value of the crypto asset accepted as subscription proceeds being at least equal to the issue price of the mutual fund’s securities for which they are payment, with the value calculated as if the crypto asset was a portfolio asset of the fund. We note the CSA’s observation that this clarification will enable future Public Crypto Asset Funds, particularly ETFs, to facilitate similar market-making functions without requiring exemptive relief.

(vii) Other Issues



With regard to additional feedback to the CSA, we would like to raise two matters that the CSA has not addressed in these proposed amendments and changes, namely:

- (i) **Staking** – Given that certain CTPs offer staking services subject to a number of terms and conditions that have been agreed to with the CSA and existing registered firms in Canada are permitted to engage in lending or staking activities as an investment strategy for private investment funds (that are not subject to NI 81-102) managed by such firms, we think that Public Crypto Asset Funds should be permitted to engage in staking through one or more CTPs that offer staking services.
- (ii) **Value-referenced crypto assets** – The proposed amendments do not permit Public Crypto Asset Funds to purchase and hold value-referenced crypto assets. However, the CSA’s working group on value-referenced crypto assets permits CTPs to offer one or more value-referenced crypto assets. Accordingly, we think that the CSA should permit Public Crypto Asset Funds to purchase, sell, use or hold any such value-reference crypto assets notwithstanding the fact that these value-referenced crypto assets will not meet the investment criteria set out in the proposed amendments.

We would be happy to elaborate further on any of the points raised in this letter. For further information please contact James Delaney, Managing Director, Asset Management Regulation at jdelaney@aima.org or Claire Van Wyk-Allan, Managing Director, Head of Canada and Investor Engagement, Americas at cvanwykallan@aima.org.

Sincerely,

Jiří Król
Deputy CEO and Global Head of Government Affairs

Annex

As the global representative of the alternative investment management industry, AIMA is actively engaged in the digital assets sector, reflecting the increasing interest among its members. We are dedicated to supporting the institutionalization of digital assets as a recognized asset class. As part of this commitment, AIMA recently developed a new series of due diligence questionnaires (DDQs) tailored for digital asset investment managers and funds.³ These DDQs serve as useful tools for investors, enabling them to assess the unique investment and operational risks associated with allocating capital to digital asset investment funds. By providing a standardized template for information sharing, the DDQs streamline the due diligence process and enhance transparency, thereby meeting investor demands more effectively. This initiative underscores our proactive approach to facilitating informed decision-making and fostering greater confidence for investors in the digital asset space.

Digital assets are carving out an increasingly important role for the financial sector as potential investment opportunities in a fast-moving technology sector as well as diversifiers within portfolios. Though it is not just “traditional” cryptocurrencies that are forging the way ahead. The distributed ledger technology (DLT) that gave rise to bitcoin has yielded distinct advantages and use cases, such as stablecoins, tokenization, central bank digital currencies (CBDCs) and non-fungible tokens (NFTs), among others.

A growing number of AIMA’s members in the alternative investment industry are either exploring or actively participating in various digital asset markets or harnessing the potential of DLT-driven products. These AIMA member firms include:

- digital asset funds employing alternative active strategies in digital asset investments;

³ See, www.aima.org/compass/ddqs/digital-assets-ddq.html.



- established alternative investment managers seeking to enhance portfolio diversification through active or passive digital asset investments; and
- various fund managers, service providers and platforms leveraging technology to deliver innovative solutions to investors and clients, capitalising on the transformative potential of DLT.

In response to the growing interest of members and operational complexities within the digital asset markets, AIMA established its own global digital assets and blockchain peer group in 2017. This initiative was driven by the need to address members' interest, engagement and operational challenges in these nascent markets. The AIMA Digital Assets Working Group (AIMA DAWG) serves as a nexus between traditional alternative investments and digital assets, specifically focusing on issues pertinent to institutional buy-side investing in this space. Comprising of a diverse array of senior industry experts, including fund managers, allocators and service providers, the AIMA DAWG is tasked with driving AIMA's thought-leadership initiatives, regulatory engagement, and education and operational guidance in the digital assets space.