Canadian Web3 Council

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Delivered via Email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

British Columbia Securities Commission
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
Office of the Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Dear Sirs/Mesdames,

RE: Canadian Securities Administrators "CSA" Request for Comments
Amendments to National Instrument 81-102 *Investment Funds* ("NI 81-102") and 81-102CP (the "Proposed Amendments")

The Canadian Web3 Council (CW3) appreciates the opportunity to provide the CSA with comments to the Proposed Amendments. As stated in prior communications with the CSA, we believe public consultations are an important part of the rule-making process.

The CW3 is a non-profit trade association founded by industry leaders to work constructively with policymakers and establish Canada as a leader in Web3 technology. The CW3 represents organizations that have made a critical impact on the development of Web3 technologies across the globe, and who are committed to responsibly building and innovating in Canada. Our members have operations in Canada and abroad, and this diverse group includes providers of centralised and decentralised financial products and crypto trading platforms to crypto asset custodians, investors, and open-source blockchain projects. Our members operate in over 100 countries and are committed to the responsible development of the Web3 digital asset ecosystem.

This consultation addresses specific questions relevant only to Public Crypto Asset Funds[1]. We make a few general comments that will provide context to our answers to your specific questions.

[1]See Introduction to The Proposed Amendments and CP Changes pertain to reporting issuer investment funds that seek to invest directly or indirectly in crypto assets (Public Crypto Asset Funds).

General Comments

We commend the CSA for taking an important first step in a much larger effort in rule-making for crypto assets. As a general rule-making comment, definitions are essential in NI 81-102 and then subsequently carried through to NI 14-101 *Definitions and Interpretations* once all rule-making regarding crypto assets is completed. This would ensure consistency in the interpretation and application of defined terms across the investment fund and broader securities regulatory framework. In our view, the Proposed Amendments to NI 81-102 are not inconsequential. **We ask the CSA to provide a blacklined version of NI 81-102 so that market participants can review the Proposed Amendments in its entirety and in the proper context.**

Crypto assets can serve multiple purposes and can take many forms; they are used to power, access, and secure blockchain networks. Some are used for payments or for investment purposes, and some are also network assets that will power the future of Web 3.0 development. The regulatory landscape continues to evolve and there is both institutional and retail demand for regulated crypto asset products and services. To fully protect investors who seek these assets for investment purposes, securities regulations must also work in concert with other legal, prudential and regulatory frameworks (e.g. property laws, corporate law, retail payments, and investment protection/deposit insurance). **To avoid overlapping jurisdictional issues, the securities regulatory framework must evolve in tandem with other regulatory frameworks in Canada, such as retail payments and prudential regulations. Moreover, the evolution of Canadian securities regulations also needs to consider global developments. Adopting positions that are consistent with other major nations will not only benefit the coordination of regulatory supervision and oversight both domestically and globally, but it will also enable Canadian operators and end-users to transact seamlessly in global payments, financial and capital markets.**

The CSA acknowledges that investment funds operate within a larger securities regulatory framework[2] in Canada that includes marketplaces and registrants, each with its own set of rules. We acknowledge that these other matters are not within the scope of this consultation. However, in order to achieve the CSA's investor protection goals, a coordinated approach is needed to ensure the consistent and timely application of concepts and terms across these frameworks. For example, regulatory authorities in other countries have made the regulation of fiat-backed stablecoins a priority. They have engaged in public consultations and they have published strategic plans and/or legislative/implementation timelines for regulating fiat-backed stablecoin arrangements (see attached Appendix A). **Canadian stakeholders would also benefit from understanding the CSA's intentions for the entire framework for regulating crypto assets and their service providers within Canadian securities law. For these reasons, it's essential for the**

[2] Other frameworks in securities regulation include definitions and interpretation, marketplace regulations, registrant and compliance, Investment Fund etc

CSA to dedicate sufficient resources, including training, to develop other rules to accommodate crypto assets, and to do so in a cohesive and timely manner.

The Proposed Amendments are a good first step to begin codifying some of the existing practices that are already in use by Public Crypto Asset Funds. However, the Proposed Amendments lack the necessary clarity to achieve your stated goals of investor protection and supporting new product innovation[3]. **Most notably, the absence of a definition of crypto assets that provides the foundation for the rules in NI 81-102 presents challenges, particularly in areas where securities legislation intersects with other legislation, e.g., Retail Payments[4].** Moreover, clarity is essential to accommodate the tokenization of real world assets such as stocks and bonds. In our view, these types of crypto assets represent underlying assets that are already permitted investments for mutual funds under NI 81-102. A proper definition of crypto assets within NI 81-102 (and later in NI 14-101) will provide the necessary clarity to achieve consistency in application and outcome across these intersections. Other countries have either enacted or proposed legislation treating certain crypto assets as payment instruments/digital settlement assets, or as a distinct asset class[5]. To date, however, the CSA have only made assertions by way of Staff Notices that crypto assets (including fiat-backed stablecoins) are securities and/or derivatives. **For rule-making, the CSA's assertions that crypto assets are securities and/or derivatives must be supported by clear legal analysis and go through the proper rule-making process, which involves public consultation as required under each province or territory's Securities Act, e.g., section 143.2 of the *Securities Act (Ontario)*.**

We encourage the CSA to be open to creating a taxonomy that distinguishes amongst different classes of crypto assets that can be used to set regulatory boundaries. We believe that regulators should not ignore the asset's primary function within the crypto ecosystem, and the fundamental nature of the underlying assets associated with a token, and/or the rights associated with a crypto asset when ascertaining regulatory jurisdiction. The CSA's approach appears to treat crypto assets as all one class. Another approach could involve creating a taxonomy that distinguishes amongst the following classes:

- Crypto assets that are utilized for investment purposes and that are digital representations of underlying asset types that are already captured under the existing

[3] The CSA articulates its goals under "Substance and Purpose" of the Proposed Amendments and changes to NI 81-102 and 81-102CP is "provide investment fund managers greater regulatory clarity concerning investments in crypto assets" and to "facilitate new product development in the space while also ensuring that appropriate risk mitigation measures are built directly into the investment fund regulatory framework"

[4] Para 2 of the RPAA grants an exemption for Securities-related transactions: "A transaction in relation to securities is a prescribed transaction for the purpose of paragraph 6(b) of the Act if it is performed by an individual or entity that is regulated, or exempted from regulation, under Canadian securities legislation as defined in National Instrument 14-101 *Definitions*, as amended from time to time, of the Canadian Securities Administrators."

[5] For example, the EU countries have adopted the Markets in Crypto Assets Regulation, the U.K. has amended its Financial Services Markets Act and will introduce secondary legislation to regulate fiat-backed stablecoin arrangements, the U.S. has introduced the Stablecoin Transparency Act (2022), Singapore's Payment Services Act (2019) regulates Digital Payment Tokens

securities regulatory framework. Types of crypto assets in this subclass include tokenized stocks, bonds, cash equivalents, money market instruments/funds;

- Crypto assets that function as payment instruments or as a digital settlement asset, and where the store of value is essential (e.g. fiat-backed stablecoins), and that are captured under, or prescribed by, other regulatory frameworks (e.g. retail payments, prudential); and

- Crypto assets that are network assets or non-fungible tokens. They represent underlying interests and/or participation rights in a network, and that are not presently captured under existing securities regulatory frameworks. Types of crypto assets under the network asset subclass include cryptocurrencies, DeFi tokens, utility tokens etc. For these types of crypto assets, we ask the CSA to openly share their legal analysis to support their position that such assets are securities and/or derivatives as part of the rule-making process. We believe that an asset or token's primary function is an important factor for determining regulatory jurisdiction, as is the nature of the underlying interest (e.g. an asset or a liability), and/or participation rights, and the legal form of the issuer.

To achieve the CSA's investor protection goals and to reduce regulatory burden, a coordinated approach by the CSA to prioritize further changes within the entire securities regulatory framework is needed (see response to Custody and Section 5 of this response). We encourage the CSA to move in a more timely manner to publish their proposed regulatory framework that will align the regulation of crypto assets and crypto asset service providers with the aim of creating proposed amendments to other key rules. We favour principles-based rules that allow market participants to tailor the applicable aspects of rules in order to adjust to rapid technological change and new use cases. Furthermore, **to achieve improved compliance outcomes for both market participants and regulators, implementation should be a key consideration for rule-making, and we encourage the CSA to engage with the industry participants and adopt rules that can be operationalised.**

Our comments to the specific questions (in italics below) posed by the CSA in this consultation are set out below.

Guidance on "crypto asset"

1. *We [The CSA] are seeking feedback as to whether the guidance in the CP Changes provides sufficient clarity in understanding the type of assets that will be considered crypto assets for the purpose of NI 81-102.*

   The CSA has fallen short of its goal to provide market participants with the necessary clarity. The 81-102CP contains a description of what the CSA will generally consider to be crypto assets, this is not a definition. We call on the CSA to provide a clear definition for

crypto assets in NI 81-102 (and later added to NI 14-101) and to specify those classes that are permitted investments for investment funds. The terminology can then be applied consistently across the entire securities regulatory framework. Investment funds operate within a larger regulated ecosystem consisting of marketplaces, registrants, issuers and market participants. Other stakeholders, including those responsible for other regulatory frameworks (e.g. *Retail Payment Activities Act and Regulations*) also reference NI 14-101 when prescribing activities that are in scope or out of scope. A proper definition of crypto assets is a necessary starting point to achieve consistency across those intersections. **We recommend the CSA include a definition of "crypto assets" as part of this rule-making exercise so that all stakeholders can determine how the definition will impact these intersections.**

The CSA states, "the proposed guidance is consistent with terminology used in prior CSA publications and with the general understanding of what constitutes a crypto asset by market participants". The CSA initially published CSA SN 46-307 *Cryptocurrency Offerings* issued in August 2017. Yet, the general understanding of crypto assets **and their use cases** have evolved and will continue to evolve. Further, the CSA does not explain why the proposed description is different from more recent definitions used by global standard setters such as IOSCO, or the Financial Stability Board ("FSB") (OSFI[6] has adopted the FSB's definition). As such, the inconsistent language leads to confusion over regulatory jurisdiction for certain types of crypto assets in Canada. **We encourage the CSA to use an "adopt" or "explain" approach[7] in situations where the CSA uses a modified definition from that used by international standard setters such as IOSCO[8].**

We believe it would be helpful to regulate crypto assets according to a taxonomy that distinguishes between classes of crypto assets. Assets that function as investment instruments can be further distinguished between those crypto assets that represent the tokenization of asset types that are already covered by existing securities regulations (e.g. stocks, bonds, money market funds, etc.) and other crypto assets that are permitted investments for the purposes of NI 81-102. This action would promote greater consistency in applying the regulations under the current investment fund framework and outcomes. Market participants can then evaluate whether a crypto asset meets the criteria to qualify as a permitted investment under NI 81-102 (e.g. see Question 3) without imposing undue regulatory burden.

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[6] OSFI uses the FSB's definition of crypto asset: A type of private digital asset that depends primarily on cryptography and distributed ledger or similar technology. Digital asset: A digital representation of value which can be used for payment for investment purposes. This does not include digital representations of fiat currencies.

[7] See para 1.4 (page 7) the HM Treasury *Update on Plans for Regulation of Fiat-backed Stablecoins* (Oct 2023) Link Here

[8] IOSCO's glossary gives the following "definition for crypto assets": An asset, sometimes called a "digital asset," that is issued and/or transferred using distributed ledger or blockchain technology. Crypto-assets include, but are not limited to, so-called "virtual currencies", "coins," and "tokens." To the extent digital assets rely on cryptographic protocols, these types of assets are commonly referred to as "crypto-assets."

The proposed description of crypto assets used in 81-102CP leads to inconsistent outcomes for mutual funds. The Proposed Amendments will preclude mutual funds from investing/holding crypto assets that are digital representations of asset types that are already subject to existing securities regulations (e.g. stocks, bonds, cash equivalents).

We are seeing more and more examples of tokenization of stocks[9], bonds and cash equivalents[10], and these fall within the CSA's proposed description of "crypto asset" in 81-102CP based on our interpretation. Mutual funds can invest in stocks and bonds and hold cash equivalents. It follows that mutual funds should be allowed to invest in tokenized stocks and bonds and hold tokenized cash equivalents. For example, the CSA's proposed description for crypto assets in the 81-102CP[11] can be a digital representation of value like stock or other forms of digital cash equivalents such as fiat-backed stablecoins, etc. Under the CSA's Proposed Amendments, only "Alternative Mutual Fund[12]" (AMF) could hold tokenized stocks and bonds. **We ask the CSA to clarify whether this is the intended outcome of the Proposed Amendments.**

Restrictions on Investing in Crypto Assets

The Proposed Amendments contemplate restricting publicly distributed investment funds to only holding fungible crypto assets.

2. *We [the CSA] are seeking feedback on whether this is a reasonable restriction in light of the risks that are generally associated with holding non-fungible crypto assets in an investment context. If not, please be specific as to why you think the scope of permitted crypto assets should be expanded to include non-fungible crypto assets and what investor protection measures are appropriate for Public Crypto Asset Funds to hold these types of assets.*

   If the CSA intends to place a restriction on publicly distributed investment funds, as noted above, then we recommend the CSA provide a proper definition of a "fungible crypto asset." We note that fiat-backed stablecoins "FBSCs" are a type of fungible crypto asset and should be a permitted type of holding for tokenized investment fund products. FBSCs are digital settlement assets that provide a more efficient means of settlement for tokenized assets than fiat currency.

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[9] A tokenized stock is a digital representation of the value of a stock that is recorded, traded, and settled on blockchain infrastructure, and where the stocks are held by a depository.

[10] A tokenized deposit is a digital representation of cash on deposit at a bank that moves on blockchain rails.

[11] Sn 2.01 of 81-102CP, The term "crypto asset" is not defined in the Instrument, but for the purposes of the Instrument, the Canadian securities regulatory authorities will ***generally*** consider a crypto asset to include any digital representation of value that uses cryptography and distributed ledger technology, ***or a combination of similar technology***, to create, verify and secure transactions.

[12] The CSA's proposed definition of an Alternative Mutual Fund is: "a mutual fund,..., with fundamental investment objectives that permit it to invest in physical commodities, crypto assets or specified derivatives..."

We believe it would be short-sighted of the CSA to implement such a restrictive rule. We encourage the CSA to be open to specifying the principles/criteria that would allow market participants to assess whether certain non-fungible crypto assets would also be permissible for the purposes of NI 81-102. This approach will provide flexibility for other types of crypto assets to become permitted investments for the purposes of NI 81-102, section 2.3(1.3) and 81-102 CP (2.04) without undergoing a lengthy rule-making process; and it allows regulators to support innovation without sacrificing investor protection.

We believe that the absence of open price discovery is not in itself a sufficient reason to preclude an investment in crypto assets. Bonds are permitted investments; however, some bonds trade on open markets while others trade over the counter. Moreover, investment funds, subject to concentration restrictions, are permitted to invest in private securities where there is also no open price discovery. The absence of open price discovery is a valid accounting and valuation consideration, particularly for AMFs directed at retail investors. **Rather than an outright restriction, we believe liquidity and valuation risks can be addressed through fund structure (e.g. non-redeemable investment fund) using appropriate pricing indices based on auditable parameters or by applying fund concentration limits to fund holdings rather than requiring an outright restriction, where appropriate for the fund type.**

Recognized Exchange

The Proposed Amendments also contemplate restricting publicly distributed investment funds to holding crypto assets that trade on, or are reference assets for specified derivatives that trade on, a "recognized exchange." This reflects market integrity concerns with certain crypto asset markets and is intended to limit funds to holding those crypto assets for which spot prices can be derived through regulated sources that reflect institutional support and promote price discovery, which is not dissimilar to how more traditional fund portfolio assets trade.

3. *We are seeking feedback as to whether this is a reasonable qualifying criterion. If not, please provide feedback on what criteria may be more appropriate for determining when a crypto asset should be deemed an appropriate investment for an investment fund directed at retail investors.*

   Liquidity and price discovery represent legitimate investor protection aspirations, especially for investment products directed at retail investors. While we welcome the clarification in s 3.3.01 of the *81-102CP* that alternative investment funds are not precluded from trading crypto assets on regulated CTPs, one way to improve liquidity and price discovery is to allow for a spot market for crypto assets to further develop on regulated CTPs (see second bullet below). However, for reasons set out below, we find the limitations contained in the Proposed Amendments to be overly restrictive, particularly from a product development perspective:

- In Canada, currently, only BTC futures are listed for trading on an "exchange recognized by a securities regulatory authority in a jurisdiction in Canada,"[13] which currently limits Canadian product offerings to BTC only. Under the Proposed Amendments, it follows that no Canadian crypto asset ETF (which is a public crypto asset fund subject to NI 81-102) would be allowed to invest in crypto assets other than BTC.

- In Canada, the CSA permits crypto assets to be offered by regulated CTPs for trading, subject to registration orders or pre-registration undertakings for CTPs. The CSA have been leaders in allowing "spot" trading for crypto assets by providing a path for CTPs to be registered as Investment Dealers and to become members of the Canadian Investment Regulatory Organization ("CIRO"). However, these CTPs are not recognized exchanges in Canada. We believe it's time to recognize that CTPs are regulated platforms for "spot" trading of crypto assets, given that they will be overseen by CIRO and subject to trade surveillance monitoring. It follows that crypto assets that are listed on such platforms should also be permissible under NI 81-102, given that these are regulated "spot" trading activities. However, more work is needed for the CSA/CIRO to begin developing the regulatory framework that might lead to developments such as the lifting of the trading limits currently placed on regulated Canadian CTPs. We acknowledge that the regulatory framework for CTPs is beyond the scope of this consultation.

- With tokenization, we expect new markets to develop quickly. This development leads to two important conditions for investor protection: improved liquidity and more open price discovery. These conditions allow for the potential to permit new types of crypto assets to be appropriate investments for investment funds and not just AMFs.

- The Proposed Amendments preclude Canadian AMFs from investing in assets that are offered globally but not offered in Canada, and on venues that provide 24 x 7 trading, improved liquidity and price discovery for a global asset class. We encourage the CSA to allow AMFs to invest in crypto assets that trade on regulated exchanges recognized by securities regulators in comparable foreign jurisdictions.

We find the proposed wording in sub paragraph 2.3(1.3)(b) to be overly restrictive, given the uncertainty that all crypto assets are securities or derivatives. We believe that CTPs, which are Investment Dealers and members of CIRO, already meet the necessary requirements for investor protection and market integrity. **As such, we recommend the following amendment to the proposed wording: "The crypto asset, or related financial**

[13] https://app.tmx.com/bitcoin-price-index-futures/

instrument, trades on a regulated platform, ~~an exchange~~ recognized by a securities regulatory authority in a jurisdiction of Canada or in a comparable foreign jurisdiction.

Custody

The Proposed Amendments include a requirement that custodians or sub-custodians that hold crypto assets on behalf of an investment fund obtain an annual assurance report prepared by a public accountant that assesses the design and effectiveness of various internal controls and policies concerning their obligations to custody crypto assets. The CP Changes clarify that obtaining a SOC-2 Type 2 will be considered to comply with the requirement without prescribing that specific report.

4. *We are seeking feedback regarding other assurance reports that may be comparable to a SOC-2 Type 2 that we should also consider sufficient for complying with this requirement. We are also seeking feedback regarding the appropriate scope of any reporting to be provided under this requirement.*

   In answering this question, we believe that it's important for the rules to make a distinction between requirements for digital assets using distributed ledgers more generally and the use of blockchain technology to support crypto assets. The list of risks cited in the Proposed Amendments should also make this distinction. For example, of the risks cited in 8.1(2)(b), only the use of wallets in storing cryptographic keys are unique to crypto assets. **The remaining risks cited are technology risks that apply across all custodians including those using distributed ledger technology (permissioned and permissionless).**

   1. Crypto Assets

      We agree that the holding of crypto assets gives rise to specialized areas of risk, and the investment fund managers must ensure that unique risks are covered by the scope of the SOC 2 Type 2 Report or equivalent provided by the (sub) Custodian. To be consistent with other standards within the Canadian securities regulatory framework, **we believe the Proposed Amendments should require the Canadian standards to apply to the SOC 2 Type 2 reports and permit other internationally recognized audit and assurance standards as equivalent.** This allows the custodian or sub-custodian to apply the standards in the country they are located, and that is acceptable to the investment fund manager.

      In addition to an assurance report for the controls of a custodian, we advocate for the continued elevation of standards for custodians operating in Canada to advance the trust and stability in the digital assets space. As such, we suggest there should be a requirement for custodians to obtain and provide further

assurance reports to an investment fund. One such report that should be required is a proof of reserves audit completed periodically, which would demonstrate the accuracy of custodial record keeping for assets under custody at a specific point in time. Another report that should be required is a penetration test, which would provide comfort that there are no major vulnerabilities in the custodian systems. As the industry evolves and new risks are identified, we believe it is essential that the custodial requirements for safeguarding assets and the audits a custodian undertakes evolve accordingly.

2. For digital assets that are held on distributed ledger (including blockchain) networks (permissioned and permissionless) more broadly

   As the use of distributed ledger technology expands to different aspects of the banking and settlement systems, including traditional custodianship functions, it will be important to incorporate technology risks more broadly. The Proposed Amendments only apply the requirements to digital custodians holding crypto assets specifically. It is time to update the existing custodial requirements to address the technology risks including those accompanying asset tokenization.

We draw your attention to the limited scope of a SOC 2 Type 2 Report. It does not address all of the risks concerning the safeguarding of assets that use distributed ledger/blockchain technology described in section 8.1(2) of the Proposed Amendments to 81-102CP, e.g. cybersecurity and blockchain technology[14]. However, **we believe that other internationally recognized technical reports[15] do address these specialized areas, and the Proposed Amendments should accommodate these other types of reports.** While we acknowledge that the CSA has provided some flexibility with the statement "other comparable reports may be considered from time to time", these words seem to imply pre-approval or consent is required for any comparable report. The clarification can be provided by adding the following wording: "CSA consent is not required when the reports are prepared under International Auditing and Assurance Standards or other internationally recognized technical standards".

Other best practices that could be considered in the 81-102CP include the above mentioned custodian "proof of reserve" report, which both helps demonstrate that a centralized custodian has sufficient assets to cover customer assets at a specific point in time and further attests to its controls, such as its record keeping. Additionally, the aforementioned penetration tests should be required to be provided by the custodian annually to assess the security of its systems.

[14] Given the unique features of blockchain and the full scope of risks, other standards have been created to assess the features of the blockchain, such as the International Organization for Standardization (ISO) standard for blockchain and Distributed Ledger Technology, ISO/TR 23244:2020

[15] https://www.cpacanada.ca/business-and-accounting-resources/audit-and-assurance/internal-control/publications/soc-2-guide

Qualified Custodian and Standard of Care

Finally, as we transition to a digital financial system, we must review the definition of a "Qualified Custodian" more broadly. The current definition takes into consideration financial resilience but not expertise and operational resilience in providing digital asset custodial services[16] other than the requirement for such entities to be regulated financial institutions.

Qualified domestic custodians - while growing - are currently providing custodial services to a relatively small amount of Public Crypto Asset Funds. This is largely the result of a legacy landscape from before regulated domestic digital asset custodians were operational. There are now high quality, viable, and regulated domestic digital asset custody providers with established track records, and the expertise and technology to provide digital asset custody services. Given the requirements under section 6.1(2) of NI 81-102 in respect of custodianship of portfolio assets of the investment fund, this development bodes well for investment fund managers who are looking to offer crypto asset funds, or to transition from traditional fund products to offering fund products in tokenized forms, e.g., tokenization of stocks, bonds and investment funds. We encourage the CSA to implement an "adopt or explain '' approach to compliance with section 6.1(2), i.e., to require investment funds to disclose information that would allow stakeholders to assess, monitor and manage concentration and other related risks regarding the safekeeping of fund assets, set priorities, and to make risk-informed policies. With respect to section 6.1(2), we ask the CSA to consider a requirement for investments funds holding digital assets (e.g., tokenized stocks, bonds, crypto funds etc) to disclose[17] the following:

- The % of digital assets held in the portfolio by domestic and/or foreign (sub) custodians
- The % of digital assets held in hot/warm/cold wallets
- The reason(s) why it is appropriate to use a foreign (sub) custodians (as per section 6.1(2)(b))

Furthermore, to meet the standard of care required by section 6.6 of NI 81-102, a digital asset custodian should have the necessary expertise (and technology) to provide digital asset custodial services. It's time to consider what minimum operating standards are required to provide digital asset custody services. For example, the minimum standard of care for custodianship of portfolio assets under Sn 8.1 of 81-102CP currently requires investment funds to take additional steps to address the legal risks when portfolio assets are held outside of Canada. Given that these are minimum standards, we ask the CSA to

[16] Digital asset custodial services include securing of the private keys, asset segregation, acting on instructions and also offering a variety of services such as processing entitlements, proxy voting etc.

[17] For example, continuous disclosure documents under NI 81-106, and offering documents under NI 81-101, 41-101

update the 81-102CP to require crypto asset funds to address the unique legal risks associated with digital assets held outside of Canada[18].

Competition in this space is increasing including from foreign custodians. While we believe the domestic ecosystem will evolve over time, attention is required to monitor and address concentration risk of portfolio assets held by a single custodian and to elevate the requirements for digital asset custodial services. **Enabling Canadian regulators to directly manage systemic and concentration risks in the event of a crisis are important policy considerations for investor protection and domestic financial stability.**

Broader Consultation

5. *We are seeking comments on other issues or considerations relating to investment funds that invest in crypto assets that the CSA should also be considering. This feedback will help inform the broader consultations for the third phase of the Project.*

   We ask the CSA to begin the rule-making process for those other rules that intersect within the securities regulatory framework to ensure consistency of application within securities regulations. (See General Comments, Custody, NI 31-103, etc).

   We strongly encourage the CSA to begin with public consultation prior to the rule-making process for the wide range of activities addressed in CSA Staff Notice 81-336 and current exemption orders. We ask the CSA to pay particular attention to those areas that may present operational challenges or that serve a particular purpose in the crypto asset ecosystem, e.g. the closing of a crypto wallet, staking, securities lending, etc.

   Finally, it's important to create the taxonomy that will ultimately underlie NI 14-101. It will inform rule-making for permissible and/or non-permissible activities for Crypto Asset Investment Funds. The taxonomy framework can support the reasoning behind some of the rules regarding (non) permissible activities for Crypto Asset Investment Funds and help to ensure consistency in reasoning and application. For example, the activity of staking for Crypto Asset Investment Funds is described in CSA SN 81-336 as being akin to securities lending economically, and the CSA reminds Investment Fund Managers that NI 81-102 prohibits the lending of portfolio assets that are not securities. However, it's important first to acknowledge that one of the key objectives of staking is to secure the underlying network and to incentivize network participants for this activity. This difference can inform rule-making as it concerns staking by crypto asset investment funds.

[18] The unique legal risks associated with digital assets include property and corporate laws that require updating to accommodate digital assets.

Conclusion

We thank the CSA for taking an important first step towards rule-making for crypto asset investment funds. The CSA has provided leadership in developing a regulated crypto asset ecosystem in Canada. At this critical juncture, it's essential to ensure alignment within Canada and globally to address the important intersections between securities regulation and other external regulatory frameworks. Areas of rule-making that are of **strategic importance** include:

- Working collaboratively to establish the rules for creating and operating a liquid market for "spot" trading of crypto assets in Canada on centralized and decentralized trading platforms, and to elevate the standards for qualified digital asset custodians. **This would enable Canada to remain at the forefront of developing product and service offerings for institutional and retail investors, and the crypto asset ecosystem.**

- Creating a taxonomy for Crypto Assets that provides a strong foundation to begin rule-making activities for Crypto Assets in Canada.

- **Addressing those rules that intersect with external regulatory frameworks (e.g. payments, prudential regulation, PCMLTFA) resulting in a cohesive, well-functioning (and non-overlapping) regulatory frameworks for crypto assets in Canada that prioritize Canada's national interest.**

We hope you find these comments constructive. We are committed to working with you, and we encourage the CSA to dedicate sufficient resources that will further the responsible development of the crypto asset ecosystem in Canada in a cohesive and timely manner.

Thank you for your consideration. We would be pleased to answer any questions you may have.

Yours truly,

Canadian Web3 Council (CW3)

Appendix A

The countries below have prioritized the regulation of fiat-backed stablecoins and related activities, and have comprehensive plans and timelines for bringing such activities into the regulatory perimeter.

Jurisdictions	Regulatory Authorities	Publication	Link
Australia	Australian Government Minister for Financial Services	A Strategic Plan for Australia's Payments System Building a Modern and Resilient Payments System (June 2023)	Link Here
Australia	Australian Government The Treasury	Regulation of Payment Service Providers (FACTSHEET) Overview of Australia's reforms	Link Here
Australia	Australian Government The Treasury	Payments System Modernisation (Licensing: Defining Payment Functions) Consultation paper (June 2023)	Link Here
European Union	European Securities & Market Authorities "ESMA"	ESMA Website (MiCA Implementing Measures) including transition period Supervisory Convergence in the MiCA Transitional Phase	Link Here
European Union	ESMA	Statement on MiCA Supervisory Convergence ESMA clarifies timeline for MiCA and encourages market participants and National Competent Authorities to start preparing for the transition	Link Here
Hong Kong	Hong Kong Monetary Authority	Conclusion of Discussion Paper on Crypto Assets and Stablecoins (Jan 2023) What will be regulated and target implementation dates (Pgs 4-5)	Link Here
Hong Kong	Financial Services and the Treasury Bureau Hong Kong Monetary Authority	Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong (Dec 2023)	Link Here
United Kingdom	HM Treasury	Update on Plans for the Regulation of Fiat-backed Stablecoins (Oct 2023)	Link Here
United Kingdom	Financial Conduct Authority	Discussion Paper 23/4 (and consultation), (Nov 2023) Regulating Crypto Assets, Phase 1: Stablecoins	Link Here