

Response to CSA Request for
Comment:

Proposed Amendments to
NI 81-102 and Companion Policy
Pertaining to Crypto Assets

Submitted by:

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I N V E S T M E N T S

This submission on behalf of Purpose Investments Inc. is made to the Canadian Securities Administrators, c/o:

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

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Executive Summary

We would like to extend our sincere appreciation to the Canadian Securities Administrators (the “CSA”) for providing the opportunity to respond to the public consultation on proposed amendments to National Instrument 81-102 Investment Funds (“NI 81-102”) and the Companion Policy 81-102CP pertaining to crypto assets (the “Proposed Amendments”).

This valuable initiative demonstrates the CSA’s commitment to engaging stakeholders and seeking input on important regulatory matters that directly impact investors, industry and Canadian capital markets.

We support the CSA’s efforts to increase regulatory clarity with respect to governance of public crypto asset funds (“PCAF”). Our response to the consultation is based on a careful analysis of the Proposed Amendments and considers the perspectives and interests of investors, industry, experts, and regulatory bodies.

We have identified key areas of consideration and have provided recommendations that aim to ensure investor protection, align with the pace of innovation, and encourage strong and stable capital markets.

Accordingly, we recommend that the CSA consider the following:

- *Securities lending using crypto assets as collateral:* Avoid implementing an outright ban on securities lending transactions by a PCAFs of crypto assets owned by the fund. We believe this should continue to be assessed on a case-by-case basis to account for nuances and differing circumstances.
- *Tokenization:* Consider introducing provisions that address and allow for digital tokenization of money market funds, which offers benefits including greater liquidity and shorter trade settlement windows.
- *Multiple crypto custodians:* Incorporate provisions that require the use of multiple qualified crypto custodians for diversification resulting in increased protection.
- *Staking:* Consider including provisions that clarify requirements concerning cryptocurrency staking, including those concerning fund concentrations and liquidity.
- *Security Requirements for Investment Fund Managers (“Managers”) of PCAFs:* Consider enhancing security requirements, or related criteria, for Managers of PCAFs and their partners recognizing the particularities of crypto assets.

We thank the CSA for seeking industry input on these issues.

If you wish to follow up, or require any supporting documentation, please feel free to reach out (c/o Vlad Tasevski, vladt@purposeinvest.com).

Respectfully,
Vlad Tasevski
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Purpose Investments Inc.

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History and Background

Purpose Investments Inc. (“Purpose”) is a modern investment firm with unique insight into the crypto and digital assets industry. In February 2021, Purpose made history by launching in Canada the world’s first spot Bitcoin ETF backed by physically settled Bitcoin (the Purpose Bitcoin ETF, “BTCC”). In its first month, the BTCC surpassed \$1 billion in assets under management (“AUM”).

Today, BTCC is one of the largest spot Bitcoin ETFs in the world with over \$2 billion in AUM.¹ In April 2021, Purpose again made history by launching the world’s first ETF backed by physically settled Ether tokens.

In launching these funds, Purpose worked in close coordination with the Ontario Securities Commission. We welcome the opportunity to continue to work closely with the regulators to establish safe and secure ways for investors to gain exposure to crypto assets.

PCAFs are permitted to invest in bitcoin and/or ether crypto assets primarily through direct holdings of those assets, in accordance with requirements set out in NI 81-102. These funds are generally subject to the same regulatory framework as other publicly distributed investment funds in Canada. PCAFs that are structured as ETFs or mutual funds are classified as “alternative mutual funds” under NI 81-102. Custodians and sub-custodians hold the portfolio crypto assets of PCAFs in accordance with qualification criteria set out in NI 81-102.

We note that the CSA has recognized that PCAFs have not experienced material difficulties in meeting redemption requests. Additionally, ETFs with investments in crypto assets have been able to meet redemption requests as part of normal operating procedures with redeemed securities paid in cash at the net asset value (“NAV”) based on respective valuation indices, with next day settlement.²

We view crypto assets as a growing part of mainstream adoption in Canada, fueled in part by appropriate controls that ensure investor protection. As of April 30, 2023, there were 22 PCAFs in Canada, with approximately \$2.86 billion in collective net assets.³

By the same token, we recognize the rapid pace of advancement in the industry and the need to offer investors suitable and secure options that keep up with innovation. Our input below strikes a balance that recognizes these objectives. By considering these recommendations, we hope the CSA will continue in its mission to strengthen the resilience of Canada’s capital markets and continue to adapt to emerging changes in the financial sector.

¹ See: <https://www.purposeinvest.com/thoughtful/purpose-investments-marks-three-year-anniversary-of-the-worlds-first-bitcoin-etf>; Note that the first PCAF was approved in Canada by prospectus receipt issued in April 2020, see CSA [Staff Notice 81-336](#) *Guidance on Crypto Asset Investment Funds That Are Reporting Issuers* (“SN 81-336”) dated July 6, 2023.

² SN 81-336.

³ SN 81-336.

Response to CSA Proposed Amendments

Definition of “Alternative Mutual Fund” and Restrictions on Investing in Crypto Assets

The Proposed Amendments seek to alter the definition of “alternative mutual fund” to include a mutual fund that invests in crypto assets. In addition, the Proposed Amendments will amend section 2.3 of NI 81-102 to provide that only alternative mutual funds and non-redeemable investment funds may buy, sell, hold or use crypto assets directly.

Conventional non-mutual investment funds that are not alternative mutual funds or non-redeemable investment funds would not be permitted to acquire crypto assets directly and therefore, would only obtain exposure indirectly through an investment fund that is permitted to directly invest in and hold crypto assets.

Additionally, investment funds would be restricted to investing only in crypto assets listed for trading on, or are the underlying interest for, a specified derivative where that specified derivative trades on an exchange that has been recognized by a securities regulatory authority in Canada. PCAFs would also be prohibited from buying or holding non-fungible crypto assets, such as collectibles.

We generally support these Proposed Amendments, which we view as a positive development that will enhance clarity and avoid the need to obtain exemptive relief, as appropriate, in respect of these requirements.

We recommend that the Proposed Amendments also incorporate a definition of non-fungible crypto assets that describes these assets with sufficient clarity. We note that non-fungible tokens (“NFT”), which are unique cryptographic tokens that cannot be replicated, are an example of the type of non-fungible crypto asset that generally, under current market circumstances, would be incompatible with investment fund products offered to retail investors based on liquidity and risk.

We caution that the long-term uses of NFTs is not yet known and encourage the regulators to continue to monitor developments in this area and remain flexible in the event of innovation and related market developments.

Securities Loans, Repurchase Transactions, & Reverse Repurchase Transactions

The Proposed Amendments will explicitly prohibit the use of crypto assets in securities lending, repurchase transactions or reverse transactions (collectively, “Securities Lending Transactions”), as the loaned securities, transferred securities or collateral posted in connection with these transactions.

Currently, NI 81-102 permits Securities Lending Transactions, with certain restrictions. We suggest that crypto assets should be permitted to be used by an investment fund as collateral

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but not loaned in Securities Lending Transactions, in line with current requirements under NI 81-102, where a market to borrow such assets exists.

An outright ban restricts innovation and minimizes investor purchasing power. A ban may reduce investor protection by encouraging Canadian investors to seek opportunities outside of the Canadian regulatory landscape.

We recommend that the use of crypto assets as collateral in Securities Lending Transactions continue to be assessed on a case-by-case basis which allows for the nuances of particular circumstances to be considered. In appropriate circumstances, a fund may be able to earn revenues from these activities in a prudent manner which would provide additional income and encourage a safe, reliable market in which these transactions can develop.

Additionally, we recommend that the CSA consider whether the proposed ban would apply to indirect crypto asset holdings.

Money Market Funds

The Proposed Amendments would clarify that a "money market fund", as defined in section 2.18, cannot buy or hold crypto assets.

While we support this, we recommend that the CSA consider implementing regulatory changes that would clarify that a money market fund may be tokenized. Tokenization allows for an asset to be digitally represented on a blockchain. When an asset is represented by a token, it can more easily, quickly and cost-effectively be transferred, traded or used as collateral. Secure smart contracts are used to execute transactions based on pre-agreed codified terms that can ensure settlement automatically.

In our view, tokenized money market funds can readily adhere to current regulatory requirements, in particular, know-your-client requirements, as well as anti-money laundering provisions.

A number of benefits flow from tokenizing money market funds including increased liquidity through expanded reach, reduced fund distribution costs, and as noted, shorter trade settlement windows.

Notably, in October 2023, in the United States, BlackRock Inc. used the Tokenized Collateral Network of JP Morgan Chase to tokenize shares in one of its money market funds. The tokenized interests were sent to Barclays as collateral for an over-the-counter derivatives trade which took one second to post.

We expect that through tokenization most investors will have access to various investment strategies at a lower cost, with lower friction and improved transparency.

Crypto Custodians

The Proposed Amendments would introduce provisions specifically applicable to custodians and sub-custodians that hold crypto assets on behalf of an investment fund. We support the addition of crypto custodian requirements to NI 81-102 and agree with the proposed changes.

In addition, we encourage the CSA to include provisions that encourage or require PCAFs to use more than one qualified crypto custodian and more than one qualified crypto sub-custodian.

Engaging multiple crypto custodians and sub-custodians further distributes risk thereby enhancing security. In practice, qualified crypto custodians would each be responsible for a portion of a fund's crypto holdings, increasing investor protection and the safety of crypto asset investment. In our view, the use of only one crypto sub-custodian increases risk, including liquidity risk.

Sale of Securities of a Mutual Fund

The Proposed Amendments provide that PCAFs that are alternative mutual funds would be permitted to accept crypto assets that do not constitute securities as subscription proceeds, with certain restrictions. This clarification would codify exemptive relief that has been granted to existing funds, primarily to allow dealers registered in Canada and other market makers to exchange crypto assets they hold for "creation units" of crypto funds that are ETFs.

We agree that PCAFs that are mutual funds, including ETFs, should be permitted to accept crypto assets as subscription proceeds without the requirement for exemptive relief. This is a significant and welcome step that may lower transaction costs and offer greater resistance to market manipulation.

Additionally, allowing crypto assets to satisfy in-kind subscriptions is expected to enable the trading price of the listed securities to be more closely aligned to the NAV per security of an ETF.

Additional Recommendations

In addition to the Proposed Amendments, we recommend the introduction of provisions related to crypto asset staking.

Staking has been considered by the CSA, specifically in the July 2023 Staff Notice 81-336 *Guidance on Crypto Asset Investment Funds That Are Reporting Issuers* ("SN 81-336"). Staking refers to the act of committing crypto assets in smart contracts to permit the owner or the

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owner's agent to act as a validator for a particular proof-of-stake consensus algorithm which allows the crypto asset to generate rewards.⁴

While SN 81-336 provides high level guidance with respect to staking, provisions related to staking have not been included among the Proposed Amendments. We encourage the CSA to consider introducing regulatory provisions concerning staking to reduce ambiguity.

In our view, regulatory amendments should address the following:

- Types of Funds: Provisions outlining the types of funds that may engage in staking, which we expect would include alternative mutual funds and non-redeemable investment funds;
- Thresholds: Guidance concerning the maximum amount of portfolio assets that may be staked;
- Liquidity: Guidance on whether illiquidity thresholds as set out in section 2.4 of NI 81-102 apply or will be varied with respect of staking;
- Validators: Clarification on requirements related to validators, along with related obligations and constraints, and confirmation that the use of validators external to a custodian is permitted; and,
- Borrowing: Provisions that clarify whether bridge financing, and other borrowing arrangements, are permissible to alleviate liquidity concerns with respect to the “unstaking” of assets.⁵

Finally, we recommend enhancing the requirements that Managers of PCAFs must meet to ensure the protection and security of crypto assets. Given the unique attributes of crypto assets, we suggest including provisions that further clarify the knowledge, proficiency, governance and security requirements of Managers of PCAFs. As set out above, we agree with the proposed measures concerning the obligations of Crypto Custodians. In addition to this, and in consideration of Managers' fiduciary obligations, our view is that the regulations should include criteria or thresholds for Managers of PCAFs to meet ensuring that they are equipped to properly execute their duties and obligations in relation to crypto assets.

The CSA should consider including minimum security standards that Managers must institute, for example, those concerning platform access and transactional activities, security of application programming interfaces, and technical knowledge and proficiency standards that their partners or counterparties in respect of a PCAF must meet.

Conclusion

Purpose would like to thank the CSA for their receptiveness to feedback on these issues. We believe that it is helpful to continue a constructive dialogue given the pace of change and innovation around crypto assets.

We repeat our request that you consider the recommendations that we have outlined above and welcome the opportunity for further discussion if you so require.

⁴ SN 81-336.

⁵ This refers to the period before assets are available to transfer or sell following a request to unstake.