

INVESTOR ADVISORY PANEL

April 17, 2024

To: 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

Re: Proposed Amendments to National Instrument 81-102 Investment Funds Pertaining to Crypto Assets

On behalf of the Investor Advisory Panel (the “Panel”), I wish to thank you for this opportunity to comment on the Canadian Securities Administrators’ (“CSA”) proposed amendments pertaining to reporting issuer investment funds that seek to invest in crypto assets (“the proposed amendments”).

The Panel’s mandate

The Panel is an initiative of the Ontario Securities Commission (“OSC”) to ensure investor concerns and voices are represented in the OSC’s policy development and rulemaking process. Our mandate is to solicit and articulate the views of investors on regulatory initiatives that have investor protection implications.

The Panel’s comments

The Panel is highly supportive of the CSA reviewing existing requirements for public crypto asset investments and implementing regulations and guidance that ensure adequate investor protection.

The Panel has previously expressed concern regarding the average retail investors’ ability to invest in crypto assets given the potential volatility and significant risks associated with these investments. In the Panel’s [comment letter](#) on the OSC’s Statement of Priorities for the fiscal year ending March 31, 2024, we encouraged the OSC to seek to better understand how and why investors are engaging with crypto assets. The prior year, in the Panel’s [comment letter](#) on

the OSC's Statement of Priorities for the fiscal year ending March 31, 2023, we urged the OSC to ensure investors can make informed decisions about the nature of speculative investments such as crypto. We noted that investors must be equipped to understand factors such as the nature of the underlying investments, their cost and the management styles of these products. We view the proposed amendments as an important step in this direction.

In this letter, the Panel's comments relate specifically to public crypto asset funds, as that term is described in [CSA Staff Notice 81-336 Guidance on Crypto Asset Investment Funds That Are Reporting Issuers](#). As stated in that notice, Canada's public crypto asset funds currently invest only in bitcoin and/or ether and achieve this primarily through direct holdings of those crypto assets, including through fund-of-fund structures.

Regarding the specific questions raised in the CSA's consultation document, we wish to offer comments on questions two through five.

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

The Panel is supportive of publicly distributed investment funds being restricted to only holding fungible crypto assets. The potential benefits to investors of holding non-fungible crypto assets are limited, while the risk of investor harm is high.

- 3. 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. 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.*

The Panel is supportive of the proposed amendments 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". The Panel is of the view that such a restriction provides necessary protection to retail investors, similar to how restrictions on investments in non-exchange traded securities serve to protect investors in traditional equity mutual funds.

The Panel notes as well that there are currently crypto-related assets that trade on regulated exchanges in Canada, such as bitcoin and ether ETFs. Funds will therefore be able to gain exposure to crypto-related assets by investing in securities listed on recognized exchanges.

Of course, not all crypto assets are available on recognized exchanges. However, the Panel views investments in non-exchange traded crypto assets to present too much risk to make such investments suitable for broad availability to retail investors.

4. *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. 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.*

The Panel's paramount concern is with the integrity of the custodians and sub-custodians that hold crypto assets on behalf of investment funds. Crypto assets must be properly safeguarded and capable of being valued.

The Panel would urge the CSA to ensure that any reporting requirements it adopts enable investment funds and their investors to meaningfully assess the integrity of crypto custodians. For this to be achieved, reporting and compliance measures must be more than *pro forma* exercises. Rather, they must enable funds and investors to meaningfully evaluate custodians' internal controls and policies to ensure they are sound and effective.

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.*

The Panel is concerned about the potential concentration in crypto assets within a traditional fund-of-funds structure, particularly those that employ a tactical asset allocation approach and are made available to retail investors. According to data from Morningstar, there are 77 of these structures spread across 420 share classes.

The proposed amendments point to subsection 2.5(2) of NI 81-102 in reference to fund-of-fund structures. However, this section does not address the potential for a traditional mutual fund (using a fund-of-funds structure) to invest across multiple asset management funds, each of which have significant exposure to crypto assets.

Given the CSA's cautionary yet progressive approach to crypto assets, the Panel would encourage it to provide enhanced clarity and guidance around what would constitute an acceptable exposure to crypto assets within the traditional mutual fund (and fund-of-funds) space, particularly pertaining to tactical asset allocation funds.

We thank you again for the opportunity to comment on the proposed amendments. We would be happy to clarify or elaborate on our comments should the need arise.

Sincerely,

A handwritten signature in black ink, appearing to read "Ilana Singer". The signature is fluid and cursive, with the first letter "I" being particularly large and stylized.

Ilana Singer
Chair, OSC Investor Advisory Panel