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**IN THE MATTER OF
3IQ CORP. and THE BITCOIN FUND**

**REASONS AND DECISION
(Section 8 of the *Securities Act*, RSO 1990, c S.5)**

Hearing: June 3, 6, 7 and July 24, 2019

Decision: October 29, 2019

Panel: Lawrence P. Haber Commissioner and Chair of the Panel

Appearances: Christopher Naudie For 3iQ Corp. and The Bitcoin Fund
Lori Stein
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REASONS AND DECISION

I. OVERVIEW

- [1] This is an application for a hearing and review under section 8 of the *Securities Act*.¹ The Applicants – The Bitcoin Fund and 3iQ Corp. – seek to set aside the decision of the Director of the Ontario Securities Commission’s (the **Commission**) Investment Funds & Structured Products branch denying a receipt for The Bitcoin Fund’s prospectus.
- [2] This application engages foundational concepts of securities legislation: the prospectus requirement, the public interest jurisdiction of the Commission, and the purposes and principles of the Act. Specifically, this application is about the prospectus clearance and review process under the Act and the scope and limits of the Director’s authority under the Act to refuse to issue a prospectus receipt.
- [3] This application is not about the merits of the units to be offered by The Bitcoin Fund. It is not the role of securities regulators to approve or disapprove of the merits of securities being offered to the public. In fact, there is clear language to this effect on the face of the fund’s prospectus and on the face page of every prospectus filed in Ontario and in Canada:
- No securities regulatory authority has expressed an opinion about these securities and it is an offence to claim otherwise.
- [4] It is also outside the scope of the authority of securities regulators to immunize investors against risk or against loss. And, it is not the job of securities regulators to ban speculation or risk-taking.
- [5] This application is not about the merits of bitcoin as an investment. As with other classes of assets or undertakings or businesses underlying an issuer, the investment potential of these underlying assets, undertakings and businesses are outside the scope of securities regulation.
- [6] Bitcoin is a novel asset in an emerging and evolving market. It is a risky asset. Markets for novel asset classes and securities evolve over time. Emerging markets for securities and asset classes look and feel very different from mature markets. As markets evolve and mature, they change, either through the efforts of the market participants or through government intervention or regulation, or both.
- [7] Some novel asset classes and securities products fail. They become tulip bulbs or dot.com’s. Others succeed and become gold or the next great technology. Securities regulators are not mandated to try to pick winners and losers.
- [8] The public interest jurisdiction under the Act is broad, but it is not infinite.
- [9] Securities regulators are required to ensure broad public interest considerations are addressed and to balance the (sometimes) competing purposes and principles of the Act. Consumer protection policy considerations, which do not otherwise engage the public interest test under the Act, are outside the scope of

¹ *Securities Act*, RSO 1990, c S.5 (the **Act**), s 8.

jurisdiction of securities regulation and must be left to federal, provincial and territorial governments to address (or not address), as they see fit.

- [10] The Director denied a receipt for The Bitcoin Fund's prospectus because of concerns about bitcoin, namely: concerns about bitcoin's liquidity and the integrity of the bitcoin markets, and concerns about The Bitcoin Fund's ability to value and safeguard its bitcoin and file audited financial statements.
- [11] The concerns about bitcoin expressed by the Director, and by Staff in this proceeding, are warranted and should be taken seriously. But, for the reasons described herein, those concerns do not warrant denying a receipt for The Bitcoin Fund's prospectus. An Order will be issued setting aside the Director's decision and directing the Director to issue a receipt for a final prospectus of The Bitcoin Fund, provided the Director is satisfied that there are no grounds under s. 61 of the Act for the Director to refuse to issue a receipt for any such prospectus, other than the grounds set out in the Director's decision or these reasons.

II. BACKGROUND

A. The Application

- [12] In the normal course, if an investment fund wants to distribute its securities to the public in Ontario, it begins by filing a preliminary prospectus with the Commission's Investment Funds & Structured Products branch (**IFSP**). Staff of the IFSP reviews, provides comments and may ask for changes to the preliminary prospectus. If the investment fund's preliminary prospectus meets the satisfaction of the IFSP, a final prospectus is submitted. If the IFSP Director (the **Director**) issues a receipt for a final prospectus, the prospectus can then be used to offer securities to the public. The investment fund becomes a reporting issuer in Ontario coincident with the issuance of the receipt for the final prospectus, and it is then subject to ongoing continuous disclosure and other public issuer obligations.
- [13] There are two applicants in this proceeding: The Bitcoin Fund (the **Fund**) and 3iQ Corp. (**3iQ**) (collectively, the **Applicants**). The Fund will be a public, non-redeemable investment fund that will invest substantially all of its assets in bitcoin. It will be established as a trust under the laws of Ontario. 3iQ will be the Fund's investment fund manager and portfolio manager. 3iQ also manages a private investment fund that invests in crypto-assets.
- [14] Beginning in late 2016, 3iQ had a series of meetings and exchanged correspondence with IFSP Staff to discuss the Fund and its proposed preliminary prospectus. IFSP Staff ultimately advised that they would not be prepared to recommend that the Director issue a receipt for the Fund's prospectus. 3iQ then publicly filed the Fund's preliminary non-offering prospectus. IFSP formally recommended against the Director issuing a receipt for that prospectus. 3iQ responded by requesting that the Director issue written reasons regarding the refusal to issue a receipt for the Fund's prospectus. 3iQ also waived its opportunity to be heard by the Director, on the basis that 3iQ would seek a hearing and review of the Director's decision. After receiving the Director's written decision, 3iQ and the Fund filed this application for a hearing and review.

- [15] In this hearing and review application, the Applicants seek an order:
- a. setting aside the Director’s decision dated February 15, 2019, denying a receipt for the Fund’s prospectus; and
 - b. directing the Director to issue a receipt for the Fund’s final non-offering prospectus.
- [16] The application was heard over four days, including two days of oral evidence. Most evidence was entered via affidavits. The Applicants relied on the affidavits and testimony of Shaun Cumby, who is an officer, director and shareholder of 3iQ. He has been 3iQ’s Chief Investment Officer since 2018 and is responsible for its investment strategies. He was cross-examined on his affidavits by Staff at the hearing.
- [17] Staff relied on the affidavits and testimony of Neeti Varma and Cosmin Cazan, both of whom were cross-examined by the Applicants. Ms. Varma is a Senior Accountant with IFSP and also a current Acting Manager within IFSP. Mr. Cazan is a Senior Investigator, Analytics and Market Specialist in the Market Abuse Team of the Commission’s Enforcement Branch. He is on secondment from the Commission’s Market Regulation Branch.

B. Bitcoin

- [18] The Director denied a receipt for the Fund’s prospectus because of concerns about Bitcoin.² Given that, I will first provide a brief general description of Bitcoin, its protocols and markets before turning to the specific issues for determination in this Application.
- [19] Bitcoin is a digital crypto-asset that is not issued by any government, bank or central organization. It is based on the decentralized, open source protocol of the peer-to-peer Bitcoin computer network, which creates the decentralized public transaction ledger known as the “blockchain”. All bitcoin transactions are recorded on the blockchain.
- [20] The blockchain is a record of every bitcoin transaction and every bitcoin address associated with a quantity of bitcoin. The Bitcoin network, and its software applications, can interpret the blockchain to determine the bitcoin balance of any public bitcoin address listed in the blockchain. A bitcoin private key controls the transfer or “spending” of bitcoin from its associated public bitcoin address.
- [21] People who use Bitcoin must establish a bitcoin wallet. A wallet provides the user with a public key that is used to derive an address for others to send them bitcoin, as well as a private key, which is used to unlock balances of the user’s bitcoin to send to others. A bitcoin wallet may be software or a hardware device. In either case, the user is in control of the private keys that control the bitcoin. Alternatively, consumers may use a hosted bitcoin wallet where a provider protects the private keys, and the consumer accesses their accounts through a web browser or mobile application.
- [22] Bitcoin private keys are stored in two different forms: “hot wallet” storage, whereby the private keys are stored on devices connected to the Internet, and “cold wallet” storage, where private keys are stored offline. Cold wallet storage

² As is common practice, these Reasons will refer to Bitcoin with a capital “B” when referring to the protocol or network, and bitcoin with a lowercase “b” when referring to the digital asset.

is regarded as more secure because Internet-connected devices can be hacked, resulting in the theft of private keys and the bitcoin that those private keys control.

- [23] There are two ways to hold bitcoin: 1) directly purchase and hold bitcoin, or 2) invest in securities of companies or other entities that hold bitcoin. If purchasing bitcoin directly, investors generally use either Bitcoin teller machines or crypto-asset trading platforms (often referred to as crypto-currency exchanges). Crypto-asset trading platforms operate websites that facilitate the purchase and sale of bitcoin and other crypto-assets.
- [24] Though some investment products can provide investors with exposure to bitcoin, most of these products are only available on a private placement basis. One example is the Grayscale Bitcoin Trust (**GBTC**), which is available in the exempt market for purchase by “accredited investors”, as defined under applicable U.S. securities laws, and may be held in registered savings accounts. GBTC is also available to Canadians in the exempt market through a small number of financial institutions.
- [25] Canadian investors can also indirectly obtain bitcoin and other crypto-assets by investing in reporting issuers that have crypto-assets as their primary asset and have obtained stock exchange listings by completing reverse take-overs on the Toronto Stock Exchange Venture Exchange (**TSXV**) or the Canadian Securities Exchange (**CSE**) (**RTO Crypto Issuers**). There are approximately ten RTO Crypto Issuers listed for trading on the TSXV. RTO Crypto Issuers are not investment funds and are not required to meet the securities law requirements for public investment funds.

III. PRELIMINARY ISSUES

- [26] I will briefly address a few preliminary issues that were raised in this proceeding: 1) the burden and standard of proof, 2) the treatment of hearsay evidence, 3) the treatment of opinion evidence, and 4) a motion to file an authority that was issued after the close of the oral hearing.
- [27] Staff concedes that it bears the burden of proof to show that a receipt should not be issued for the Fund’s prospectus. Staff bears this onus under the civil standard of proof that is applied in all hearing and review applications: proof on a balance of probabilities.³
- [28] The evidence adduced by both parties includes significant amounts of hearsay evidence. Hearsay evidence is admissible in Commission proceedings,⁴ though the panel must determine the weight to be accorded to such evidence. Care must be taken to avoid placing undue reliance on uncorroborated evidence that lacks sufficient indicia of reliability.⁵ I admitted all the tendered hearsay evidence, subject to my consideration of the weight to give it. I will address the issue of weight for specific hearsay evidence as it arises in my below analysis.
- [29] The parties also adduced opinion evidence. Although opinion evidence is generally only admissible when provided by an expert witness, other opinion

³ *FH v McDougall*, 2008 SCC 53, [2009] 3 SCR 41 at para 40.

⁴ *Statutory Powers Procedure Act*, RSO 1990, c S.22, s 15(1).

⁵ *Sunwide Finance Inc (Re)*, 2009 ONSEC 20, (2009) 32 OSCB 4671 at para 22, citing *Starson v Sway*, 2003 SCC 32, [2003] 1 SCR 722 at para 115.

evidence may be admissible when founded on a lay witness's personal knowledge, observation, or experience.⁶ The parties did not adduce any expert evidence. The parties did elicit some opinion evidence from their witnesses. The majority of the opinion evidence adduced was hearsay opinion evidence in the form of articles, research papers and other exhibits to the affidavits of the parties' witnesses. The opinion evidence was admitted subject to a determination of weight. I will address the issue of weight for specific opinion evidence as it arises in my below analysis.

- [30] After the close of the oral hearing, on October 18, 2019, Staff brought a motion seeking that the Panel consider a decision of the Division of Trading and Markets of the U.S. Securities and Exchange Commission (the **SEC**) dated October 9, 2019. That decision concerned an application by an exchange for a proposed rule change to allow the listing and trading of shares of the Bitwise Bitcoin ETF Trust. The Applicants opposed the motion. Staff seeks to file the decision as a relevant authority that was not issued at the time of the hearing. I accept it on that basis, and not as evidence of the findings of fact made by the Division of Trading and Markets of the SEC on the evidentiary record that was before it. As I will discuss below, I distinguish this decision and several similar SEC decisions from the current case.

IV. ISSUES

- [31] A hearing and review of a Director's decision is a fresh consideration of the matter. The Commission may confirm the Director's decision or substitute its own decision, making such other decision as the Commission considers proper.⁷ The Commission need not show deference to the Director's decision.⁸
- [32] Staff submits that I should confirm the Director's decision to refuse a receipt for the Fund's prospectus for the reasons given by the Director, which are:
- a. Bitcoin is an illiquid asset, as defined in National Instrument 81-102 *Investment Funds (NI 81-102)*.⁹ Therefore, by holding bitcoin, the Fund would not comply with the restriction against holding illiquid assets set out in section 2.4 of NI 81-102.
 - b. It appears that it is not in the public interest for a receipt to be issued for the Fund's prospectus given concerns about:
 - i. the Fund's ability to value its assets for investors given the significant market integrity concerns regarding the trading of bitcoin;
 - ii. the security and safekeeping of the Fund's bitcoin; and
 - iii. the Fund's ability to file audited financial statements, as required.
- [33] The Applicants submit that I should order the Director to issue a receipt for the Fund's prospectus.

⁶ *Banks (Re)*, (2003) 26 OSCB 3377 at para 17, citing A. Bryant, J. Sopinka & S. Lederman, *The Law of Evidence in Canada*, 2d ed. (Toronto: Butterworths, 1999) at 605-607.

⁷ Act, s 8(3).

⁸ *Triax Growth Fund Inc (Re)*, 2005 ONSEC 16, (2005) 28 OSCB 10139 at para 25.

⁹ (2000), 23 OSCB (Supp 59).

- [34] The Applicants submit that Staff has not shown that bitcoin is an illiquid asset as defined in NI 81-102. On the contrary, the Applicants submit that trading platforms and over-the-counter (**OTC**) desks for trading bitcoin promote reliable price discovery so that the Fund can value its bitcoin and provide sufficient liquidity for the Fund to dispose of bitcoin, as required to satisfy redemption requests.
- [35] The Applicants submit that Staff has not demonstrated that issuing a receipt for the Fund's prospectus would not be in the public interest. They submit that the concerns identified by Staff are speculative and not demonstrated by the evidence. The Applicants argue that Staff failed to prove their above concerns on a balance of probabilities.
- [36] The Applicants submit that the Fund would comply with all aspects of NI 81-102 and should not be held to a different standard just because it will hold bitcoin. Refusing a receipt for the Fund's prospectus, they say, would deter future innovators, like the Fund, which seek to bring professional management to new asset classes like bitcoin, while mitigating the associated risks.
- [37] The two main issues that arise from the parties' submissions are:
- a. Is bitcoin an illiquid asset such that the Fund will not be compliant with the NI 81-102 restrictions on illiquid assets?
 - b. Is issuing a receipt for the Fund's prospectus not in the public interest?

V. IS BITCOIN AN ILLIQUID ASSET SUCH THAT THE FUND WILL NOT BE COMPLIANT WITH THE NI 81-102 RESTRICTIONS ON ILLIQUID ASSETS?

A. Law on Liquidity

- [38] A receipt for a prospectus shall be refused where the prospectus does not comply with the Act or regulations. Specifically, s. 61(2)(a) of the Act provides that the Director shall not issue a receipt for a prospectus if it appears to the Director that the prospectus does not comply in any substantial respect with any of the requirements of the Act or the regulations.
- [39] NI 81-102 is one of the regulations with which investment fund prospectuses must comply.¹⁰ Under NI 81-102, there are restrictions on the amount of illiquid assets that a non-redeemable investment fund (such as the Fund) can hold or purchase. The rationale for these restrictions is that illiquid assets are generally more difficult to value, for the purposes of calculating an investment fund's net asset value, than liquid assets. As a result, where a non-redeemable investment fund has a large proportion of its assets invested in illiquid assets, it may raise concerns about the accuracy of the fund's net asset value and the amount of any fees calculated with reference to the net asset value.¹¹
- [40] Accordingly, the Fund would be prohibited from purchasing more than 20% of its net asset value in illiquid assets and holding more than 25% of its net asset value in illiquid assets for a period of 90 days or more.¹²

¹⁰ Subsection 1(1) of the Act defines "regulations" to include rules made under s 143 of the Act. NI 81-102 is a rule made under s 143 of the Act, and therefore a regulation for the purpose of s 61(2)(a).

¹¹ NI 81-102CP, s 3.3.1.

¹² NI 81-102, s 2.4.

[41] The definition of “illiquid asset” is set out in NI 81-102 to include:¹³

a portfolio asset that cannot be readily disposed of through market facilities on which public quotations in common use are widely available at an amount that at least approximates the amount at which the portfolio asset is valued in calculating the net asset value per security of the investment fund...

[42] If bitcoin meets this definition of illiquid assets for the purposes of NI 81-102, then the Fund would not comply with NI 81-102, and s. 61(1)(2)(a) of the Act provides that a receipt for the Fund’s prospectus shall be refused.

B. Analysis

[43] Staff submits that a receipt for the Fund’s prospectus should not be issued because bitcoin is an illiquid asset as defined in NI 81-102. Therefore, the Fund, which would hold bitcoin, would not comply with the restriction against holding illiquid assets in section 2.4 of NI 81-102.

[44] I do not agree with Staff’s submission and, for the following reasons, I find that Staff has not shown that bitcoin is an illiquid asset, as defined in NI 81-102.

[45] Staff submits that bitcoin is not currently traded on market facilities comparable to the Toronto Stock Exchange (**TSX**), where trading activities are subject to real-time monitoring. There is also no central source for trading data concerning bitcoin. Staff argues that the publicly available trading volume data for bitcoin may be inaccurate and the Fund may have difficulties acquiring or liquidating its assets. Staff also notes that the Fund’s prospectus itself acknowledges potential liquidity issues, stating that the Fund may not always be able to acquire or liquidate its assets at a desired price, because bitcoin are still maturing assets.

[46] Staff adduced evidence about inaccurate trading data (along with allegations of fake and manipulated trading discussed in greater detail in the public interest analysis below) through the affidavits and attached exhibits, and testimony of Mr. Cazan and Ms. Varma. Much of their evidence was about crypto-assets, generally, rather than specifically addressing liquidity issues for bitcoin. I give no weight to their evidence insofar as it relates to non-bitcoin crypto-asset trading, and non-registered exchange trading.

[47] I find that there is sufficient evidence of real volume and real trading in bitcoin on registered exchanges in large dollar size, both in absolute terms and compared to other markets for commodities and equities, which constitutes a liquid market.

[48] The regulation does not define the term “market facility” that is found in the definition of “illiquid asset”. Staff argues that “market facility” should be interpreted to imply some form of established and mature trading facility or network, in order to promote a robust valuation of an investment fund’s assets.

[49] I disagree and find that Staff’s interpretation of “market facility” is unduly narrow. I agree with the Applicants’ submission that “market facility” is a market that provides sufficient liquidity for disposition of a fund asset and that promotes price discovery for calculating an asset’s net asset value.

¹³ NI 81-102, s 1.1.

- [50] I also find that there is sufficient evidence that such market facilities currently exist for bitcoin. The Applicants adduced evidence about trading volume, data from the various markets and published price and volume information. That evidence included evidence about bitcoin trading platforms (including evidence about average daily volume in USD), the bitcoin OTC market, the bitcoin futures market, and the size of the bitcoin market. The evidence shows that substantial volumes of bitcoin trade daily on market facilities, many of which are regulated. These market facilities provide a liquid market for promoting price discovery for valuing the Fund's assets and for disposing of bitcoin to satisfy redemption requests.
- [51] Trading platforms for trading bitcoin promote reliable price discovery so that the Fund can value its bitcoin and provide sufficient liquidity. The top ten online trading platforms for bitcoin, which account for virtually all of the economic bitcoin trading, traded over USD \$550 million in bitcoin on a daily basis, as of April 2019. By early June 2019, daily trading volume for bitcoin on these ten platforms had increased to over USD \$900 million. The bitcoin market has narrow spreads on and between trading platforms.
- [52] In addition to the trading platforms, OTC trading desks facilitate larger bitcoin transactions. Since the precise volumes traded in the OTC market are unknown, I place little weight on this evidence. However, Mr. Cumby did state in his evidence that the trading volume may be as large as, if not larger than, the volume traded on trading platforms, and his evidence on this point was uncontroverted.
- [53] Many of the bitcoin trading platforms and OTC desks are regulated by the New York State Department of Financial Services (**New York State**) under the so-called BitLicense, a comprehensive scheme for regulating virtual currency businesses. Regardless of the OTC trading volume, trading volumes for bitcoin exceed trading volumes for some liquid Canadian equities and funds.

C. Conclusion on Liquidity

- [54] For the above reasons, I conclude that, in so far as Staff has not demonstrated that bitcoin is an illiquid asset, the Fund will be compliant with the NI 81-102 restrictions on illiquid assets.
- [55] Staff has not identified any other requirements of the Act or the regulations with which the Fund does not comply. Therefore, s. 61(2)(a) of the Act does not apply to the Fund's prospectus and does not preclude the Director's issuance of a receipt for the Fund's prospectus.
- [56] In this proceeding, there is no issue engaging s. 61(2) of the Act (*i.e.*, the 'blue sky' laws) other than the issue regarding liquidity, which is addressed above. The public interest becomes the only remaining issue, which I turn to next.

VI. IS ISSUING A RECEIPT FOR THE FUND'S PROSPECTUS NOT IN THE PUBLIC INTEREST?

A. Law on the Public Interest Test

- [57] Subsection 61(1) of the Act provides that the Director "shall issue a receipt for a prospectus filed ... unless it appears to the Director that it is not in the public interest to do so."

- [58] The Commission has a broad discretion under the Act to determine what is or is not in the public interest. However, its discretion must be exercised with some caution and restraint,¹⁴ and is not unlimited. The Commission must exercise its jurisdiction in a manner consistent with the purposes and fundamental principles set out in the Act, and must not focus on one purpose at the expense of the others.¹⁵
- [59] The Commission does not need to find a breach of Ontario securities law in order to exercise its public interest jurisdiction and refuse a receipt for the Fund's prospectus.¹⁶ It is sufficient that issuing a receipt to the Fund would be inconsistent with Ontario securities law or the animating principles underlying that law, or an abuse of shareholders or the capital markets.¹⁷
- [60] The Applicants and Staff made submissions on the scope of the Commission's public interest jurisdiction under s. 61(1), including referring me to several decisions of the Commission or a Director of the Commission in which s. 61(1) was considered.¹⁸ Having regard to those submissions, I am not persuaded that the Commission's public interest jurisdiction under s. 61(1) is broader or narrower than articulated above.
- [61] In particular, the inclusion of the phrase "it appears" in s. 61(1) does not mean that the standard of proof under s. 61(1) is lower than a balance of probabilities. In this regard, I agree with and adopt the Commission's reasons in *Dhillon*.¹⁹ Accordingly, the inclusion of the phrase "it appears" does not mean that the Commission's public interest jurisdiction under s. 61(1) is necessarily broader than under the sections of the Act that do not contain this phrase.
- [62] Staff submits that issuing a receipt for the Fund's prospectus is not in the public interest because the operational risks inherent in the Fund cannot be adequately managed at this time. The operational risks identified by Staff are concerns about:
- a. the Fund's ability to value its assets for investors given the significant market integrity concerns regarding the trading of bitcoin;
 - b. the security and safekeeping of the Fund's bitcoin; and
 - c. the Fund's ability to file audited financial statements, as required.
- [63] I will first consider each of the operational risks that Staff has identified. I will then consider whether Staff has established that issuing a receipt for the Fund's prospectus is not in the public interest.

¹⁴ See e.g., *Magna International Inc (Re)*, 2010 ONSEC 13, (2010) 34 OSCB 1290 (**Magna**) at para 186.

¹⁵ *Committee for the Equal Treatment of Asbestos Minority Shareholders v Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 SCR 132 at paras 39-41.

¹⁶ *Biovail Corporation (Re)*, 2010 ONSEC 21, (2010) 33 OSCB 8914 at paras 373-89; *Canadian Tire Corp (Re)*, (1987) 10 OSCB 857 at para 130, aff'd *Canadian Tire Corp v CTC Dealer Holdings Ltd* (1987), 59 OR (2d) 79 (Div Ct).

¹⁷ *Magna* at para 186.

¹⁸ *ONE Financial Corp (Re)*, (2012) 35 OSCB 3083; *Biocapital Biotechnology & Healthcare Fund (Re)*, (2001) 24 OSCB 2659; *Inland National Capital Ltd (Re)*, (1996) 19 OSCB 2053; *Tricor Holdings Co Inc (Re)*, (1988) 11 OSCB 4059.

¹⁹ *Dhillon (Re)*, 2018 ONSEC 14, (2018) 41 OSCB 3053 at paras 14-24.

B. Valuation and Market Manipulation

- [64] Under National Instrument 81-106 *Investment Fund Continuous Disclosure (NI 81-106)*,²⁰ the Fund will be required to calculate its net asset value using the fair value of its assets and liabilities. "Fair value" means either: 1) the market value based on reported prices and quotations in an active market or, if such market value is unreliable or unavailable, 2) a value that is fair and reasonable in all of the circumstances.²¹
- [65] The Applicants propose to value the Fund's bitcoin by reference to an index maintained by MV Index Solutions GmbH (**MVIS**). The index is called the MVIS CryptoCompare Institutional Bitcoin Index (**MVIBTC**). MVIS is regulated as an index administrator by the German Federal Financial Supervisory Authority. The MVIBTC is calculated by CryptoCoin Comparison Ltd., based on transaction data from multiple exchanges and markets (**MVIBTC Platforms**), which have entered into information sharing agreements with CryptoCoin. The MVIS pricing benchmarks comply with the European Union benchmark regulations and the International Organisation of Securities Commissions regulations.
- [66] Staff submits that the Fund will not be able to arrive at a net asset value that satisfies the requirements of NI 81-106. Staff argues that there are issues with the proposed valuation methodology and a number of concerns with several of the MVIBTC Platforms. Staff points to allegations of price distortion caused by market manipulation, such as wash trading, spoofing, pump-and-dump schemes, abusive trading and fake trading patterns. Some MVIBTC Platforms lack formal market surveillance tools and some allow for employees to trade on their own platforms, raising conflict of interest issues.
- [67] Staff argues further that the MVIBTC is not based on the required "active market" because the reported bitcoin prices do not reflect "actual and regularly occurring market transactions on an arm's length basis".²² Rather, Staff argues that the majority of the reported bitcoin trading is fake, occurring on trading platforms with limited monitoring and regulatory oversight, if any. Staff says that no "active market" or even a "fair and reasonable" value for bitcoin currently exists because of arbitrage, whereby bitcoin pricing on "bad platforms" invariably affects the bitcoin pricing on "good platforms".
- [68] Although the risk of price manipulation associated with crypto-asset markets is real and Staff's concerns in this regard are genuine, for the reasons that follow, I find that Staff has not established that the Fund will be unable to arrive at a net asset value that satisfies the requirements of NI 81-106.
- [69] I place considerable weight on the Fund's investment parameters and restrictions that are set out in the Fund's prospectus and confirmed by Mr. Cumby's evidence:
- a. the Fund will invest in bitcoin, not in all crypto-assets,
 - b. the Fund will be static and will pursue a buy and hold strategy and not an active trading strategy, and

²⁰ (2005), 28 OSCB 4911.

²¹ NI 81-106, s 14.2.

²² Companion Policy to National Instrument 81-106 - *Investment Fund Continuous Disclosure*, (2005) 28 OSCB 4949 and (Supp-1) 1, as amended, s 9.4.

- c. the Fund will only buy and sell bitcoin on regulated exchanges.
- [70] The Fund will invest in bitcoin only. While there is evidence of market manipulation and the associated risks, there is also sufficient evidence of a real market in bitcoin, with real trading. Though that real trading may be somewhat impacted by fake trading and though other crypto-asset trading and unregistered market trading may have some knock-on effect, Staff has not proven that true price discovery in the bitcoin market is prevented by insufficient 'true trading' or price manipulation, at least on the regulated exchanges.
- [71] While the Applicants acknowledge the existence of wash trading and fake volume on certain bitcoin trading platforms, there is less evidence of wash trading or fake volume in the bitcoin-to-USD markets on the top ten platforms.
- [72] Staff did not demonstrate that the purpose of such trading was to manipulate the price of bitcoin or that wash trading or fake volume has had a significant effect on bitcoin prices. On the evidence before me, the purpose of wash trading and fake volume is to attract crypto-asset traders and issuers of new crypto-assets by creating the illusion that a platform has liquidity.²³ The evidence of other types of market manipulation identified by Staff also did not establish systemic and sustained manipulation of the price of bitcoin.
- [73] I also place weight on the evidence of the steps the Applicants have taken to mitigate the existing risks of manipulation. While the risks of price manipulation in the bitcoin spot market still exist, 3iQ has mitigated the potential impact on the Fund's valuation through several steps: its selection of MVIBTC as the index, the use of a professional investment manager experienced in bitcoin markets, and the Fund's use of the non-redeemable investment fund structure.
- [74] The Fund intends to use the MVIBTC to calculate the net asset value of the Fund's bitcoin. MVIBTC is composed of bitcoin market prices drawn from 22 trading platforms and is provided by MVIS, a regulated index administrator. The methodology for MVIBTC reduces the ability of manipulation on any one platform to distort MVIBTC and therefore the valuation of the Fund's bitcoin. I give credit to the Applicants for evolving the valuation methodology that it proposes to use for the Fund. Staff characterized their past changes as "a moving target" and asked me to draw a negative inference. I view the Applicants' evolving methodology as evidence of the Applicants' willingness to adapt, and I would hope that the Fund would continue to evolve its methodology in this regard over time, if circumstances warrant it.
- [75] Mr. Cumby is a professional investment manager experienced in bitcoin markets. I rely on his evidence that he is confident he can price the bitcoin for the purposes of the Fund. The MVIBTC's calculations are based on publicly available transaction data. 3iQ will therefore be able to confirm the accuracy of the MVIBTC, including through references to other alternative bitcoin pricing sources. However, in the event the MVIBTC price is not available or is believed to be unreliable, 3iQ has discretion as the portfolio manager to apply a bitcoin value that it considers to be fair and reasonable in all the relevant circumstances. 3iQ,

²³ T. Rodgers, *95% Of Volume Could Be Wash Trading As Bitcoin Price Surges* (4 April 2019); Y. Khatri, *Executives at Korean Crypto Exchange UPbit Indicted for Fraud* (21 December 2018); O. Williams-Grut, *Crypto exchanges are charging up to \$1 million per ICO to list tokens: 'It's pure capitalism'* (12 March 2018), Exhibits 28, 29 and 30 to C. Cazan's Affidavit sworn May 16, 2019.

as manager of the Fund, will have the ability to use other pricing sources to value the Fund's bitcoin if, in the exercise of its professional judgment, it determines that MVIBTC is not fairly valuing the Fund's bitcoin. This discretion is available to all registered investment fund managers, pursuant to NI 81-106.²⁴

- [76] I also note that other bitcoin holdings have been successfully valued. For instance, 3iQ has operated a private crypto-asset fund for over a year and has not encountered an issue valuing those crypto-assets. In addition, GBTC, which has units available to retail investors in the exempt market, holds over \$1 billion USD worth of bitcoin and there was no evidence of any issues valuing its bitcoin.
- [77] The fact of the Fund's static portfolio is also a key means of mitigation. The Fund has ample time to plan for annual redemption and monthly reporting of pricing. This will help to mitigate the impact of any price manipulation at the margins of the markets. The analysis might have been somewhat different for an exchange-traded fund (**ETF**), which is distinguished by its nature. An ETF would require continuous purchases and sales to balance and rebalance the portfolio frequently and daily. An ETF is, by nature and design, a dynamic trading vehicle. In contrast, the Fund only has to report pricing monthly and provide for potential redemption yearly, so the impact of any manipulation in the market is mitigated for the Fund. Therefore, as a non-redeemable investment fund that does not create or redeem units on a daily basis, the Fund is less susceptible to price manipulation than an ETF or other type of investment vehicle that must create or redeem units daily.
- [78] In reaching a determination, I distinguish the Bitcoin decisions issued by the SEC to date.²⁵ These decisions concerned applications by exchanges for proposed rule changes to allow the listing and trading of shares of bitcoin-based ETFs. All but one of the seven submitted SEC decisions were issued by the Division of Trading and Markets of the SEC under delegated authority, and not issued by the SEC Commissioners themselves. The SEC decisions applied a different legal test to different evidence, with a different burden of proof, which burden was not placed on agency staff. In the most recent SEC decision filed by Staff on October 18, 2019, the Division of Trading and Markets of the SEC summarizes its considerations as follows:²⁶

Although the Commission is disapproving this proposed rule change, the Commission emphasizes that its disapproval does not rest on an evaluation of whether bitcoin, or blockchain technology more generally, has utility or value as an innovation or an investment. Rather, the Commission is disapproving this proposed rule change because, as discussed below, NYSE Arca has not met its burden under the Exchange Act and the Commission's Rules of Practice to

²⁴ NI 81-106, s 14.2(1.2)(b).

²⁵ *Winkelvoss Bitcoin Trust* (Division of Trading and Markets, March 10, 2017), *SolidX Bitcoin Trust* (Division of Trading and Markets, March 28, 2017), *Winkelvoss Bitcoin Trust* (SEC Panel, July 26, 2018), *ProShares Trust II* (Division of Trading and Markets, August 22, 2018), *Direxion Shares ETF Trust II* (Division of Trading and Markets, August 22, 2018), *GraniteShares ETP Trust* (Division of Trading and Markets, August 22, 2018), and *Bitwise Bitcoin ETF Trust* (Division of Trading and Markets, October 9, 2019) (collectively, the **SEC decisions**).

²⁶ *Bitwise Bitcoin ETF Trust* (Division of Trading and Markets, October 9, 2019), p 3.

demonstrate that its proposal is consistent with the requirements of Exchange Act Section 6(b)(5), and, in particular, the requirement that the rules of a national securities exchange be “designed to prevent fraudulent and manipulative acts and practices.”

(footnotes omitted)

- [79] The SEC decisions related to different products, with different structures. There are key material differences between ETFs and the Fund, including the amount of exposure to bitcoin and the frequency at which bitcoin is required to be purchased, sold and valued. Accordingly, I give little if any weight to the SEC’s consideration of proposed rule changes to allow the listing and trading of shares of bitcoin-based ETFs.
- [80] Although this doesn’t impact my conclusion about price manipulation and valuation, it is worth noting that bitcoin is a commodity, not an equity or other security. As such, the bitcoin market should be examined like other commodity markets and not held to the standards applicable to securities markets. The risk of market manipulation exists in all commodity markets. Many of Staff’s stated concerns could apply equally to other commodities, such as precious metals or foreign currencies. Staff did not persuade me that bitcoin is more susceptible to manipulation than other commodity products.

C. Safeguarding of the Fund’s Assets

- [81] To safeguard its assets, the Fund will use a regulated Canadian trust company as its custodian and a New York State trust company as a sub-custodian. The custodian, Cidel Trust Company (**Cidel**), is regulated by the federal Office of the Superintendent of Financial Institutions. It has experience as a custodian and with managing relationships with sub-custodians. The sub-custodian, Gemini Trust Company, LLC (**Gemini**), is regulated by New York State and is a qualified custodian under NI 81-102.
- [82] Staff raises two concerns with the safeguarding of the Fund’s assets: 1) risk of loss, and 2) lack of insurance.
- [83] Regarding the risk of bitcoin losses, Staff points to the risks of unauthorized access to the private keys that are used to send bitcoin. Once a private key is taken or lost, it is difficult or impossible to recover a crypto-asset. Staff also submits that it is commonplace for crypto-asset trading platforms to have substantial losses due to hackings, insider thefts, phishing scams and other security breaches. Though Staff acknowledges that Gemini has security controls in place, they argue that the specific implementation of the security controls is important. Gemini does not yet have a System and Organization Controls for Service Organizations (**SOC 2**) type 2 report, which would provide assurance and comfort that Gemini’s security controls are working effectively. Staff says that, in the absence of a SOC 2 type 2 report, there is no available information on the effectiveness of Gemini’s internal controls.
- [84] On the issue of the lack of insurance, Staff submits that neither the Fund nor Cidel will maintain insurance against the loss of bitcoin because such insurance is not available in Canada on economically reasonable terms. Gemini will have insurance for the Fund’s bitcoin when it is held in hot wallets, which will only be for brief periods when it is sold to satisfy redemption requests. Otherwise, the

Fund's bitcoin will be held offline, in "cold storage", which is less vulnerable to hacking, and will be uninsured.²⁷ Though Gemini will maintain commercial crime insurance for the digital assets in its hot wallets, Gemini will have no insurance for the bitcoin held in cold storage. Therefore, since the Applicants will hold the vast majority of its bitcoin in cold storage, there will be no government or private insurance in place for most of the Fund's bitcoin assets.

- [85] Like any valuable commodity, I accept that bitcoin can be stolen or lost. The Applicants also concede that point. But Staff did not establish that Cidel or Gemini, specifically, do not follow sufficient practices for safeguarding bitcoin. Rather, Staff relies on evidence of examples of losses incurred by crypto-asset trading platforms, all but one of which were unregulated and most of which involved hacks of hot wallets. I am not persuaded that there was sufficient evidence that professional, regulated crypto-asset custodians, like Gemini, have suffered losses of customer assets.
- [86] I recognize the operational risks presented by the Applicants' proposed safeguarding arrangements. However, in evaluating Staff's concerns in the circumstances of this Application, I also weigh the risks of the Applicants' proposed arrangements against the safekeeping risks that face investors who hold bitcoin directly, whether on crypto-asset trading platforms or otherwise. Staff has not shown that the bitcoin held by the Fund will be inadequately safeguarded despite the Fund's use of qualified custodians and other protective measures.
- [87] The general safeguarding of assets is an "operational risk" that is highlighted in the Fund's prospectus. Staff's concerns on this issue were sufficiently addressed by the Applicants for the purposes of this Application. In particular, I note that:
- a. Cidel is a regulated Canadian trust company;
 - b. Cidel is an experienced custodian;
 - c. Gemini is regulated by New York State and is subject to a regulatory regime specific to crypto-assets. Every two years, New York State conducts an examination to determine the safety of the conduct of Gemini's business;
 - d. Gemini has a legal obligation under New York law to establish and maintain an effective cybersecurity program and a written business continuity and disaster recovery plan;
 - e. Gemini is a qualified custodian under NI 81-102;
 - f. Gemini has over \$100 million in assets (which could be used to satisfy any settlement or judgment in favor of the Fund, even without insurance); and
 - g. Gemini will have insurance for the Fund's bitcoin to the extent it is held in hot wallets, for the brief periods when the bitcoin is sold to satisfy redemption requests. Otherwise, the Fund's bitcoin will be held offline in cold storage. This approach to insurance appears to be the standard industry practice.

²⁷ A "cold storage" wallet is created and stored on a computer with no access to a network, *i.e.*, an "air-gapped" computer with no ability to access the Internet.

[88] Gemini obtained a SOC 2 type 1 report from a reputable accounting firm and expects to obtain a SOC 2 type 2 report by the end of 2019. I accept the Applicants' submission that the absence of a SOC 2 type 2 report does not necessarily mean that Gemini's controls are inadequate. Rather, Gemini has not yet satisfied an auditor applying a particular assurance that Gemini's controls are effective. On the other hand, there is some evidence that Gemini has effective internal controls, including Gemini's operation for over three years without a loss from its hot or cold wallets.

D. Auditability of the Fund's Financial Statements

- [89] Investment funds that are reporting issuers are required to file financial statements that have been audited and contain an auditor's report.²⁸ When an investment fund relies on a service organization,²⁹ the controls at the service organization are relevant to the investment fund's audit. Service organizations may rely on subservice organizations, such as Cidel relies on Gemini as the sub-custodian for the Fund. Pursuant to Canadian Auditing Standards, an investment fund's auditor must obtain information about the operating effectiveness of controls at an investment fund's subservice organization.
- [90] The Fund's proposed auditor is Raymond Chabot Grant Thornton LLP (**Raymond Chabot**), which is a participating firm under National Instrument 52-108 – *Auditor Oversight*. Raymond Chabot is a qualified and reputable auditor, with experience in the auditing of companies holding crypto-assets.
- [91] When auditing the Fund to meet the objectives of the Canadian Auditing Standards, Raymond Chabot will need to obtain audit evidence about the operating effectiveness of Gemini's controls. To do so, Raymond Chabot could: 1) obtain a SOC 2 type 2 report from Gemini's auditor, or 2) perform appropriate testing of Gemini's controls (either directly or by using another auditor to perform such testing). As already noted, Gemini does not currently have a SOC 2 type 2 report, but anticipates having one by the end of 2019.
- [92] Staff submits that it is not in the public interest to issue a receipt for the Fund's prospectus because of concerns over the Fund's ability to file audited annual financial statements in the future.
- [93] Staff points to the current lack of Gemini's SOC 2 type 2 report and the fact that Gemini may deny Raymond Chabot access to test the operating effectiveness of Gemini's controls. Gemini's agreement with 3iQ does not oblige Gemini to provide access to their systems, books or records. Though Gemini provided a letter to the Commission in support of the Application, Gemini's letter did not address the issue of access for Raymond Chabot if a SOC 2 type 2 report is not available.
- [94] More generally, Staff also notes significant deficiencies in previous audits of other reporting issuers holding crypto-assets. There is no comparable audit of a public investment fund holding crypto-assets because no such investment fund currently exists. But Staff notes that the Canadian Public Accountability Board (**CPAB**), which is Canada's audit regulator, issued an inspection report of audits

²⁸ NI 81-106, s 2.1.

²⁹ The Canadian Auditing Standard 402, s 8(e) defines a "service organization" as a third-party organization that provides services to user entities where those services are part of the entity's information systems relevant to financial reporting.

of three other crypto-miners and/or reporting issuers holding crypto-assets. That report found significant deficiencies in all three reviewed files.

- [95] I note that the CPAB report confirmed that the identified deficiencies were in the course of being remediated. The CPAB report did not identify the nature of the deficiencies found for the audits of other issuers, including whether the deficiencies pertained to crypto-asset mining activities (which the Fund would not do) or crypto-assets other than bitcoin (which the Fund would not hold). The CPAB report does not provide a reasonable basis for me to conclude that Raymond Chabot will be unable to audit the Fund.
- [96] Overall, I find that Staff has not shown that the Fund will be unable to obtain the required audit opinion. While I accept Staff's concerns about the availability of the SOC 2 type 2 report, I rely on the Applicants' evidence that a qualified and reputable auditor says it can conduct the audit, even without the report, and still comply with generally accepted auditing standards (**GAAS**).
- [97] In coming to that determination, I consider the consequences of all three potential outcomes for the Fund's efforts to obtain audited financial statements, which are:
- a. Gemini's auditor provides Raymond Chabot with a SOC 2 type 2 report,
 - b. in the absence of a report, Raymond Chabot performs appropriate testing of Gemini's controls (either directly or by using another auditor to perform such testing), or
 - c. the Fund is ultimately unable to obtain the required audit opinion.
- [98] First, it remains possible that Gemini's auditor could provide Raymond Chabot with a SOC 2 type 2 report. There is evidence that work on Gemini's SOC 2 type 2 report is underway and a timely SOC 2 type 2 report remains possible. Staff's witness conceded on cross-examination that it remains possible for the report to be complete by the end of 2019.
- [99] However, even if Gemini does not obtain a timely and satisfactory SOC 2 type 2 report, Raymond Chabot could still express the required unmodified audit opinion on the Fund's financial statements. SOC 2 type 2 reports are not required for audits of public investment funds. There is no dispute that it is possible for an auditor to give an unmodified audit opinion on a reporting issuer, despite the absence of a SOC 2 type 2 report for its sub-custodian. If no report is available, there are other acceptable methods for Raymond Chabot to evaluate Gemini's controls and render a clean audit report. Raymond Chabot would be required to obtain access to, or information from, Gemini and Staff has not shown that Gemini would refuse to provide it.
- [100] The Applicants' evidence is that Raymond Chabot is prepared to conduct the audit. As a qualified auditor for public issuers, Raymond Chabot must conduct the audit in compliance with GAAS. In its letter dated March 14, 2019, Raymond Chabot indicates an understanding that NI 81-106 requires an external auditor to express an unmodified opinion on the annual financial statements and states that, for an unmodified opinion to be expressed, the auditor needs to obtain sufficient appropriate audit evidence, including as it relates to the Fund's digital assets. According to Raymond Chabot, such audit evidence may include evidence related to the existence, accuracy, valuation, allocation, and ownership

of the Fund's digital assets. Such audit evidence may also include the evidence obtained from third parties, including from SOC reports, if deemed necessary.³⁰ It is notable that Raymond Chabot is the auditor of 3iQ's private fund and gave an unmodified opinion regarding the private fund's 2018 financial statements. In addition, other reporting issuers holding crypto-assets have obtained unmodified audit opinions on their financial statements.

[101] Finally, there is the possibility that the Fund will ultimately fail to deliver the required audit report. That operational risk is highlighted in the Fund's prospectus. If those circumstances arise in the future, Staff will have access to the normal course measures to address that deficiency, including a potential request for a cease trade order. For a Panel to intervene at this time, based only on the speculation that the Fund might not be able to obtain the required audit report, in pre-emptive circumstances of this sort, would be extraordinary. I reject Staff's submission that, *ex ante*, I should essentially decide now that the Fund is inauditable on the evidence before me.

E. Application of the Public Interest Test

[102] Having considered each of the operational risks identified by Staff, I now consider whether Staff has established that issuing a receipt for the Fund's prospectus is not in the public interest. As discussed above, the Commission's public interest jurisdiction is grounded in the purposes and fundamental principles set out in the Act. The purposes of the Act are as follows, and those that are relevant to my analysis are bolded:

- (a) **provide protection to investors from unfair, improper or fraudulent practices;**
- (b) **foster fair and efficient capital markets and confidence in capital markets; and**
- (c) contribute to the stability of the financial system and the reduction of systemic risk.³¹

[103] I agree with the Applicants and Staff that the third purpose is not applicable in this proceeding.

[104] The fundamental principles set out in the Act are listed below, and those that I find most relevant to my analysis are bolded:³²

- 1. Balancing the importance to be given to each of the purposes of this Act may be required in specific cases.**
- 2. The primary means for achieving the purposes of this Act are,**
 - i. requirements for timely, accurate and efficient disclosure of information,**
 - ii. restrictions on fraudulent and unfair market practices and procedures, and**

³⁰ Letter from L. Roy, Raymond Chabot, to 3iQ Corp (14 March 2019), Exhibit Z to S. Cumby's Affidavit sworn April 12, 2019.

³¹ Act, s 1(1).

³² Act, s 2.1.

iii. requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.

- 3. Effective and responsive securities regulation requires timely, open and efficient administration and enforcement of this Act by the Commission.**
4. The Commission should, subject to an appropriate system of supervision, use the enforcement capability and regulatory expertise of recognized self-regulatory organizations.
5. The integration of capital markets is supported and promoted by the sound and responsible harmonization and co-ordination of securities regulation regimes.
- 6. Business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized.**
- 7. Innovation in Ontario's capital markets should be facilitated.**

[105] With respect to the first fundamental principle above, I have balanced the importance given to both purposes that are relevant to my analysis, and I do not attach greater weight to either.

[106] Staff submits that investor protection in the context of s. 61(1) includes a consideration of the assets that the Fund proposes to hold. Staff emphasizes the need to protect investors from the operational risks Staff has identified, which result from the Fund proposing to hold bitcoin.

[107] Staff submits that the market for bitcoin is in its infancy and is too new to have been fully addressed by Ontario securities law. Staff refers to the consultation paper jointly published earlier this year by the Canadian Securities Administrators (**CSA**) and the Investment Industry Regulatory Organization of Canada (**IIROC**),³³ as evidence of the early stage of regulation of bitcoin and other crypto-assets, and of the market integrity and investor protection concerns regulators have with crypto-assets. Staff makes a similar submission about the status of regulation of crypto-assets in the United States. In particular, Staff relies on the SEC decisions in which the SEC rejected proposed rule amendments to list and trade shares of ETFs that would primarily invest in bitcoin or bitcoin futures. Given that the bitcoin market and regulation of that market is in its infancy, Staff submits that the Fund's compliance with NI 81-102's requirements is not enough to exhaust the policy concerns that led to NI 81-102 in the first place or the policy concerns underlying s. 61(1) of the Act.

³³ Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada Consultation Paper 21-402, *Proposed Framework for Crypto-Asset Trading Platforms* (14 March 2019).

- [108] Each of the operational risks identified by Staff arises from the assets that the Fund proposes to hold – bitcoin – and not from the structure or management of the Fund.
- [109] I do not agree with Staff’s submission that investor protection under s. 61(1) necessarily extends to a consideration of the assets a fund proposes to hold or the markets in which those assets trade. If that analysis were applied to deny a receipt to the Fund, as Staff submits it should, it would amount to a ban on any funds holding bitcoin, regardless of their structure or management. Further, the length of Staff’s proposed ban would be uncertain. Staff is effectively proposing a ban on funds holding bitcoin that would remain in place until Staff deems the market for bitcoin to have matured enough that Staff’s concerns about the operational risks have diminished. Staff has not provided any authority for imposing such an indeterminate ban.
- [110] Given that investors have other means of acquiring bitcoin, I question whether the ban proposed by Staff would protect investors from “unfair, improper or fraudulent practices”,³⁴ as provided for under the Act’s purposes. Instead of ensuring that investors could not invest in bitcoin, denial of the receipt would only ensure that investors could not invest in bitcoin through a public fund.
- [111] Denying investors the opportunity to invest in bitcoin through a public fund would not promote fair and efficient capital markets and confidence in capital markets. Instead, it would suggest that investors should acquire bitcoin through unregulated vehicles, and capital market participants should be encouraged to create those vehicles.
- [112] Imposing a ban of uncertain length on investment funds that propose to hold particular assets would not be timely, open or efficient, and would not provide certainty for capital market participants.
- [113] In the Panel’s view, investor protection under s. 61(1) of the Act is most often concerned with the issuer and matters that are within the issuer’s control or power, like the structure of the fund and the operations of the issuer by the issuer’s management and employees. For example, the Commission has refused a receipt where the issuer did not have a true business,³⁵ and where the issuer could not prove that an unacceptable person with prior securities related criminal convictions for fraud was not in charge of the fund.³⁶ Subsection 61(1) is less concerned with extraneous or external forces beyond the Fund’s control or power, like the issues Staff has identified with the assets the Fund intends to hold and the markets in which those assets are traded.
- [114] There are no allegations in this matter that the Applicants would engage in unfair, improper or fraudulent practices in their operations and management of the Fund and, in fact, the evidence is to the contrary; the Applicants intend to operate and manage the Fund in a prudent and professional manner. Furthermore, insofar as the operational risks identified by Staff relate to potential unfair, improper or fraudulent practices in the bitcoin markets, these practices are not within the Applicants’ control or power. Rather, the evidence is

³⁴ Act, s 1(1)(a).

³⁵ *Inland National Capital Ltd (Re)*, (1996) 19 OSCB 2053.

³⁶ *Tricor Holdings Co Inc (Re)*, (1988) 11 OSCB 4059.

that the Applicants are well aware of these operational risks and intend to take reasonable steps to mitigate them.

- [115] The issue before me is not whether and how bitcoin or crypto-assets in general should be regulated. That issue is the subject of the joint consultation paper published by the CSA and IIROC and may also be a broader issue for governments of competent jurisdiction to consider within the scope of their legislative authority.
- [116] The issuance of a receipt for the final prospectus of the Fund would promote efficient capital markets by creating an alternative to GBTC (which is available to Canadian retail investors in the secondary exempt market, but trades at a significant premium to its net asset value) and to RTO Crypto Issuers. The issuance of a receipt would also promote efficient capital markets by giving retail investors a means of diversifying their investment portfolios through access to an additional uncorrelated asset class.
- [117] A refusal to issue a receipt would be contrary to the principle that business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized.
- [118] The issue before me is whether a receipt should be issued for the Fund. The issue is fund-specific. In that regard, the SEC decisions referred to by Staff are distinguishable. The SEC was applying a different legal test to a different type of fund. It was considering whether to amend the rules to permit the listing of bitcoin ETFs. The SEC was also dealing with matters where the burden of proof was on the exchanges proposing rule changes, not on the agency staff.
- [119] An ETF needs to create and redeem units on a frequent and ongoing basis. In contrast, the Fund need only redeem units at specific times. The Fund is a static buy and hold fund. It does not propose to be an active trader and does not need to trade actively to meet redemption requests. An ETF is, by nature and design, a dynamic trading vehicle and materially different than a static buy and hold fund. If the Fund were an ETF, that might have impacted my analysis of the risks identified by Staff, in particular, with regard to price manipulation risk.
- [120] In addition to structuring the Fund so that it does not need to trade actively, the Applicants have sought to mitigate the risks posed by bitcoin and the bitcoin markets, by putting in place professional management, advisers and third-party service providers. 3iQ is also a registrant and as such, it must satisfy the proficiency, integrity and ongoing compliance requirements applicable to all registrants, which adds an additional measure of protection for investors.
- [121] The notion of professionalizing investing in risky assets to mitigate risks should be encouraged, not discouraged. Ontario capital market participants should be encouraged to engage with the Commission, and not incentivized to avoid doing so.
- [122] Pooling of investor funds under a professional management structure to address and mitigate risks in an underlying asset market is innovative and should be encouraged, especially when it provides an alternative to investors acquiring bitcoin through unregulated vehicles.

- [123] Much has been said in the hearing of this matter about doors and gates; the front door and back door into Ontario's capital markets, and the gates that control access of retail investors to investment products in the public securities markets. While the parties' submissions in this regard did not impact my decision that Staff did not show, on a balance of probabilities, that issuing a receipt for the final prospectus would be contrary to the public interest, it is nevertheless worth addressing these issues relating to doors and gates, to provide some context.
- [124] I disagree with Staff's submission that approving the Fund's final prospectus will open the floodgates to other public offerings of crypto-asset issuers.
- [125] While I note the role of securities regulators as a front door gatekeeper of the capital markets through its function of approving prospectuses, it certainly isn't the only front door gatekeeper. Investment dealers and their salespersons are also gatekeepers for retail investors through their know your client, suitability and other obligations and duties to their retail clients. In addition, investment dealers must approve products for their shelves before their salespersons are permitted to sell the products, and it is yet to be seen whether and to what extent such approval will be forthcoming regarding these types of investment products. This investment dealer/salesperson gatekeeper role should not be disregarded or discounted.
- [126] In addition, and as noted above, the Applicants have come through the front door for prospectus review and approval, and this behaviour should be encouraged.
- [127] While this doesn't mean that every issuer coming in the front door for prospectus approval is entitled to approval (it does not), the front door prospectus approval process also needs to be viewed in the context of the back door to the Ontario capital markets that is still available.
- [128] In Ontario and other Canadian jurisdictions, back door access to the public securities markets is available through one or more types of reverse take over corporate structures, whereby a private issuer with a business or assets combines with an existing public issuer (*i.e.*, reporting issuer) whose business is dormant or defunct, effectively becoming a public issuer without ever coming in the front door for prospectus review and approval. This backdoor access has resulted in some of the largest and most prominent issuer failures in the Canadian capital markets (*e.g.*, Sino-Forest Corporation and YBM Magnex International Inc., to name a few), with catastrophic financial consequences for investors in these issuers.
- [129] It is outside the scope of this proceeding to address whether and to what extent the back door should be regulated or closed. Nevertheless, the fact of its existence, and the fact that, according to the evidence in this case, there are now approximately ten reporting issuers operating in Ontario that are RTO Crypto Issuers, which have accessed Ontario's capital markets in this back door fashion, is a factor that the Panel considers in addressing both the investor protection test in the purposes of the Act and the broader public interest test, as outlined above.
- [130] Finally, and as noted above, while the public interest jurisdiction under the Act is broad, it is not unlimited. In the context of the purposes of the Act, investor

protection means protection from “unfair, improper and fraudulent practices” and not risk. If there are consumer protection issues or investor protection issues or concerns in relation to the issues raised in the preceding sections that are beyond the scope of the jurisdiction of the Commission under the Act, it is incumbent upon governments of competent jurisdiction to address those concerns, within the scope of their powers.

[131] Having considered all of the operational risks identified by Staff, viewed through the lens of the public interest test in s. 61(1) of the Act, and as informed by the purposes and principles in ss. 1.1 and 2.1 of the Act, I find that the issuance of a receipt for the final prospectus of the Fund is not contrary to the public interest.

VII. CONCLUSION AND TERMS AND CONDITIONS

A. Conclusion

[132] Staff has not demonstrated that:

- a. bitcoin is an illiquid asset such that the Fund will not be compliant with the restrictions on illiquid assets in NI 81-102, or
- b. it is not in the public interest to issue a receipt for the Fund’s prospectus, because of Staff’s concerns regarding the integrity of the bitcoin markets, and the Fund’s ability to value and safeguard the bitcoin it holds and file audited financial statements.

[133] Accordingly, I will order that the Director’s decision be set aside and the Director issue a receipt for the Fund’s prospectus.

B. Terms and Conditions

[134] Before closing arguments, I invited both Staff and the Applicants to provide submissions on the terms and conditions that may apply to an order that the Director issue a receipt for the Fund’s prospectus, should I decide to make that order.

[135] Staff submits that, in the event the Director is ordered to issue a receipt, the order: 1) should recognize that there are remaining steps for completion before a final offering prospectus can be receipted, and 2) should be subject to several specific terms.

[136] Regarding outstanding steps, Staff submits that if the Applicants wish to proceed with an offering of the Fund, they must file a final prospectus that contains the information required by Form 41-101F2 - *Information Required in an Investment Fund*. The final prospectus would include additional information regarding the offering, such as pricing information and details regarding underwriters. Also, if the Fund anticipates offering units in Canadian jurisdictions outside of Ontario, Staff submits that the Applicants will likely still need to consult with other CSA jurisdictions and file a prospectus in those jurisdictions.

[137] In response, the Applicants delivered a draft preliminary prospectus for the Fund (the **July 2019 Preliminary Prospectus**) to the Panel and Staff in advance of the oral closing arguments in this Application. They also delivered a blackline tracking the changes to the non-offering prospectus that was filed in March 2019 to inform the record for this proceeding. 3iQ also confirmed that it does intend to offer units of the Fund to Canadian retail investors in all provinces and territories of Canada. The filing of a preliminary prospectus of the Fund across

Canada would require at least one IIROC dealer to certify the prospectus as agent of the Fund and would customarily include a syndicate of several IIROC dealers as agents. 3iQ expects that, if an Order is granted directing the Director to issue a receipt, the preliminary prospectus of the Fund that will ultimately be filed will be substantially in the form of the July 2019 Preliminary Prospectus, subject to input from the agents' syndicate.

- [138] Staff's proposed conditions for the Order address several issues:
- a. insurance requirements for the Fund's bitcoin held in both hot wallets and cold wallets;
 - b. restrictions on the entities from whom the Fund may purchase bitcoin and to whom the Fund may sell bitcoin;
 - c. modified requirements for the quantity and quality of the pricing information that the Fund would use to value its bitcoin; and
 - d. disclosure of the matters referred to above in any prospectus for which the Applicants seek a receipt.
- [139] The Applicants submit that the Order should not prescribe any terms and conditions on the Fund, since all terms and conditions that must be satisfied prior to the issuance of a receipt are already prescribed in NI 81-102 and other applicable securities regulation.
- [140] In the alternative, the Applicants propose a revised version of Staff's conditions. The Applicants accept the proposed conditions about insurance for bitcoin held in hot wallets and about disclosure of the matters referred to in the conditions. But the Applicants maintain that cold wallet insurance is not a necessary condition because Gemini is a qualified custodian under NI 81-102 and Gemini's cold storage has not suffered any previous losses. The Applicants also submit that there should be an expansion of Staff's proposed restrictions on the entities from whom the Fund may purchase bitcoin: in addition to entities subject to the BitLicense regulations administered by New York State, or other comparable regulatory requirements, the permitted sources should be expanded to include entities registered or licensed as dealers in securities or commodity futures contracts in Group of Seven (G7) countries. The Applicants submit that such an expanded list of counterparties would facilitate the best execution for the Fund.
- [141] Finally, the Applicants submit that they are prepared to consider Staff's views regarding the composition and methodology for a modified valuation index. Although the Applicants maintain that MVIBTC is an appropriate index, they are amenable to using a different index. But the Applicants argue that Staff's proposed condition is not practical if it requires valuation to use pricing information from at least five entities that hold BitLicenses. The Applicants point to restrictions on information-sharing maintained by certain bitcoin sources and the limited number of BitLicensed trading platforms. Instead, 3iQ proposes a condition to value its bitcoin using pricing information primarily from at least three entities that hold a BitLicense, and verified with reference to the price of Chicago Mercantile Exchange bitcoin futures and the market price for bitcoin quoted on Bloomberg under ticker XBTUSD BGN.
- [142] I find that the Applicants have taken reasonable steps to mitigate the risks associated with the Fund and the bitcoin markets through the structure of the

Fund and the use of professional and qualified third-party service providers. The Applicants submit that the Order should not prescribe any terms and conditions on the Fund as described in paragraph [139] but, in the alternative, proposed modifications to Staff's proposed terms and conditions if the Panel were to decide to impose terms and conditions.

- [143] Specifically, the Applicants submit that they are prepared if necessary to accept the condition requested by Staff about insurance for bitcoin held in hot wallets. The Panel's view is that it is not necessary to impose this condition on the Applicants. While such hot wallet insurance may be currently available and available on a reasonable cost basis, there is no assurance that such insurance will always be available to the Applicants or, if available, that it will be so on a reasonable cost basis. The Panel does not wish to impose a condition that may either be unable to be met in the future or that may only be met on a basis that is very expensive to the Fund. If 3iQ determines in its professional discretion that obtaining such insurance is prudent for the Fund then it should do so, but will not be required to do so by this Panel.
- [144] The Applicants addressed Staff's proposed restrictions on the entities from whom the Fund may purchase bitcoin and also Staff's views regarding proposed restrictions on the composition and methodology for the Fund's valuation index. The Panel does not wish to impose conditions that may unduly restrict or constrain 3iQ's ability to exercise its professional judgement regarding these two matters. In both of these cases, as the bitcoin market evolves, it may in fact be prudent for 3iQ to adapt and evolve its practices and methodology. As such, the Panel does not accept Staff's submissions that any constraints should be imposed in this regard by way of terms of conditions in the Order.

C. Order

- [145] For the above reasons, I will order that:
- a. the Director's decision is set aside; and
 - b. the Director shall issue a receipt for a final prospectus of The Bitcoin Fund, provided the Director is satisfied that there are no grounds under subsection 61 of the Act for the Director to refuse to issue a receipt for any such prospectus, other than the grounds set out in the Director's decision dated February 15, 2019 or in these reasons.

Dated at Toronto this 29th day of October, 2019.

"Lawrence P. Haber"

Lawrence P. Haber