

April 17, 2024

SENT BY ELECTRONIC MAIL

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 Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
E-mail: comments@osc.gov.on.ca

Me Philippe Lebel
Corporate Secretary and Executive Director, Legal Affairs
Autorité des marchés financiers
Place de la Cité, tour Cominar
2640, boulevard Laurier, bureau 400
Québec (Québec) G1V 5C1
E-mail: consultation-en-cours@lautorite.qc.ca

Dear Mesdames/Sirs:

RE: CSA Notice and Request for Comment – Proposed Amendments to National Instrument 81-102 Investment Funds Pertaining to Crypto Assets

We at CIBC Mellon Global Securities Services Company Inc. and CIBC Mellon Trust Company (collectively, **CIBC Mellon**)¹ appreciate the opportunity to provide comments on the CSA proposed amendments (the **Proposed Amendments**) to National Instrument 81-102 *Investment Funds (NI 81-102)* and proposed changes (the **CP Changes**) to Companion Policy 81-102CP *Investment Funds (81-102CP)* (collectively referred to as the **Proposed Amendments and CP Changes**).

¹CIBC Mellon is one of Canada's largest asset servicing organizations, providing asset servicing and custodial services to more than \$2.7 trillion in assets, including upwards of 40% of Investment Funds in Canada. CIBC Mellon is also the provider for the majority of Public Crypto Assets Funds in Canada, providing administration services to 15 of the Crypto Asset Investment Fund Market (13 ETFs and 2 open-ended mutual funds).

While CIBC Mellon is generally in support of the CSA's proposed amendments, we believe there may be more pressing matters we believe ought to take priority over digital assets with respect to amendments to NI 81-102 and 81-102CP. We are also concerned that the Proposed Amendments and CP Changes perhaps do not sufficiently contemplate future trends and emerging activities in the evolution of digital assets space, such as tokenization. Finally, we also believe the proposed amendments are perhaps overly prescriptive, which runs contrary to the historical prudential principles-based approach by which Canadian regulators have sought to foster a level playing field and sound industry practice while supporting innovation.

(i) Definition of "Alternative Mutual Fund"

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

Furthermore, we recognize the CSA's stance that this change aligns with the notion that "alternative mutual funds" are permitted to have increased exposure to certain alternative asset classes or investment strategies, such as commodities, compared to other mutual fund types. This approach mirrors the structure of publicly offered crypto asset funds in Canada, which are currently structured as mutual funds.

We seek clarification on whether this amendment automatically reclassifies existing crypto asset ETFs as "alternative mutual funds".

(ii) Definition of Crypto Asset

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

We note an important gap in the current absence of an internationally agreed-upon taxonomy or classification system for crypto assets at present. Looking ahead, we believe that establishing a common global taxonomy will become essential for supporting regulatory certainty as well as consistency for market participants engaging in crypto asset activities over the long term.

A universally-accepted taxonomy would mitigate regulatory fragmentation and foster innovation within the crypto asset sector as well as support clarity for investors and providers. Such a taxonomy should be designed to remain flexible and adaptable, evolving alongside technological advancements and the dynamic nature of the crypto asset landscape, and we encourage the CSA to engage with market participants as well as with regulatory bodies in other jurisdictions in support of the development of such an international taxonomy.

(iii) Investment Restrictions

We agree with the proposal to amend the investment restrictions to allow only “alternative mutual funds” and “non-redeemable investment funds” to directly buy, sell, hold or use crypto assets. This restriction would also extend to indirect investment in crypto assets through specified derivatives. For mutual funds other than alternative mutual funds, investing in crypto assets would only be permissible by investing in underlying alternative mutual funds or non-redeemable funds that engage in such investments, subject to the fund of fund restrictions outlined in NI 81-102.

While we appreciate the development and institutionalization of new investable assets, including crypto assets, which offer investment opportunities to access new return drivers and risk premia, we seek clarity on the proposal’s restriction limiting publicly distributed investment funds to crypto assets traded on or referenced by derivatives trading on a “recognized exchange” in Canada. Notably, neither Bitcoin nor Ether are currently traded on recognized exchanges. Consequently, for a spot or underlying derivative-based product investing in a crypto asset other than Bitcoin or Ether, must an option be available? Clarification is needed on whether the actual spot crypto asset must be listed on a “recognized exchange.” We are concerned that these stringent provisions may stifle market and product development and potentially drive investors toward less-regulated markets and products with inadequate investor protections.

(iv) Non-fungible Tokens (NFTs)

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

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

(v) Use of Crypto Assets in Securities Lending, Repurchases Agreements and Reverse Repurchase Agreements

We disagree with the proposal to entirely ban the utilization of crypto assets in securities lending, repurchase transactions, or reverse transactions as loaned securities, transferred securities, or collateral. While challenges exist currently, it is conceivable that safeguards could be implemented over time, rendering securities lending, for instance, a viable solution. We also contend that securities lending plays an important role in supporting liquidity and price discovery, and as such is part of the healthy functioning of markets. We also note that investor

appetite for lending services related to crypto assets may cause investors to pursue these opportunities through less regulated channels.

If the prohibition of these lending activities remains in force in the final amendments, we seek clarification on whether and under what circumstances this stance will be subject to review as capabilities mature and the market progresses further.

(vi) Use of Crypto Assets in Money Market Funds

We agree with the proposal to prohibit money market funds from engaging in activities or holding assets that are associated with alternative mutual funds and specifically buying or holding of crypto assets.

(vii) Crypto Custodian Requirements

We support the proposal to mandate custodians and sub-custodians holding crypto assets for investment funds (“Crypto Custodians”) to maintain those assets in offline storage or cold wallets, except as required to facilitate purchases and sales or other portfolio transactions in the fund. We disagree with allowing omnibus wallets to be used for either online or offline storage and believe this requirement does not align with established best practices for crypto asset custody (when not actively needed for transactions).

Regarding the requirement for Crypto Custodians to maintain insurance for custodied crypto assets, we acknowledge that commercial practices may vary, necessitating flexibility. We disagree with the proposal to clarify that the CSA’s expectations regarding this insurance requirement do not prescribe a minimum amount but establish a “reasonably prudent” standard, considering various factors.

We agree with the proposal mandating Crypto Custodians to obtain an annual report from a public accountant evaluating their internal management and controls related to security, availability, processing integrity, confidentiality, and privacy. However, we believe that prescribing a specific type of report, such as a Service Organization Control (SOC) report, is unnecessary. Similarly, we do not support prescribing the type of report Crypto Custodians should obtain regarding their security measures, as such prescriptiveness is not applied to other asset types. SOC-2 Type 2 Reports (“SOC-2”) are typically issued by organizations that do not process financial transactions on behalf of clients (data hosting providers, for example) but require some independent assurance by an audit firm. The SOC-2 largely overlaps with the scope of a SOC-1 Type 2 Report (“SOC-1”) examination but covers some additional controls that may be of interest to client organizations for purposes other than financial reporting. Bank-backed custodians and trust companies are subject to rigorous regulatory oversight, have existing control coverage available via the SOC-1, have ISO27001/ISO 27001 certification, penetration testing attestations as well as other client-ready materials. This generally allows them to address any outstanding concerns clients have regarding the control environment as it relates to the Trust Services Principles included in the SOC-2. Additionally, to provide coverage over a larger set of controls that may be of interest to client organizations, bank-backed custodians and trust companies generally are able to share additional information related to

Personnel Security, including controls related to background checks for new employees. We recommend that the Proposed Amendments take a principles-based approach. This will allow for a broad base of digital asset custodians to demonstrate their commitment and controls with respect to security, availability, confidentiality, processing integrity, and privacy.

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

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

- The security and mitigation of single point of failure risk by distributing the digital wallets’ cryptographic material across multiple geographically distributed and independent machines;
- The control of the cryptographic material, and associated with backup and recovery processes and procedures; and
- The use of independently secure and geographically remote locations, with separate and independent administrators and access points.

Instead, we advocate for allowing Crypto Custodians to make operational decisions regarding the most appropriate custodial solutions based on their specific circumstances within an overall prudential standard or expectation. Therefore, we do not recommend specifying particular types of custodial solutions in the guidance but rather the inclusion of broader language designed to communicate an expected outcome.

(vii) Sale of Securities of a Mutual Fund

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

Additionally, we agree with the proposal to clarify that a mutual fund can accept non-securities crypto assets as subscription proceeds under specific conditions. These conditions include: (i) the mutual fund being permitted to invest in the relevant crypto asset, with approval from the fund’s portfolio advisor and alignment with the fund’s investment objectives, and (ii) the value of the crypto asset accepted as subscription proceeds being at least equal to the issue price of the mutual fund’s securities for which they are payment, with the value calculated as if the crypto asset was a portfolio asset of the fund. We note the CSA’s observation that this clarification will

enable future Public Crypto Asset Funds, particularly ETFs, to facilitate similar market-making functions without requiring exemptive relief.

As presently drafted, the Proposed Amendments appear to only contemplate fintech companies as custodians serving the digital asset market and its customers. This is indicative from the language used throughout the Proposed Amendments, and most overtly in the requirement of a SOC-2 Type 2 Report, which is not customary for traditional financial institutions to have as a part its myriad of third-party reviews, audits, or other regulatory oversight. The SOC 1 Type 2 Report along with additional reporting or disclosures to clients are the ways in which custodians that process financial transactions address the principles detailed in components of a SOC 2 Type 2 Report.

As banks, custodians, trust companies and other traditional market players ramp up their digital asset custody products and services, they bring with them their legacy of risk and control protection. For custodians and trust companies in particular, client asset safety being a top priority. Custodians' extensive focus on safekeeping, optimizing processing precision in addition to their robust risk governance, and technology, are reflective of their fundamental commitment to asset safety and security. Should the Proposed Amendments require a financial institution to obtain a SOC-2 Type 2 Report, the prohibitive cost to do so may prevent banks and traditional custodians from entering into this business, which would ultimately be detrimental from a consumer protection perspective.

We thank you for allowing us the opportunity to comment on the Consultation Paper. Please feel free to contact the undersigned if you would like further elaboration of our comments.

Sincerely,

Richard Anton, Chief Client Officer, CIBC Mellon

Tedford Mason, Chief Legal Officer, CIBC Mellon

Ronald C. Landry, Vice President, Head of Asset Manager and ETF Solutions, CIBC Mellon

Brent Merriman, Head of Marketing, CIBC Mellon