



CSA Guidance For Crypto Asset Investment Funds

Key Takeaways For Digital Asset ETF Providers From CSA Staff Notice 81-336

Tetra Trust Company
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The logo features the letters "CSA" in a bold, blue, sans-serif font, followed by "ACVM" in a bold, yellow/gold, sans-serif font. The text is set against a dark blue rectangular background.The background of the bottom section of the page is a photograph of several modern skyscrapers with glass facades, viewed from a low angle looking up. The image is slightly faded and serves as a backdrop for the CSA ACVM logo.

Introduction

The Canadian Securities Administrators (CSA) recently released *CSA Staff Notice 81-336 Guidance on Crypto Asset Investment Funds That Are Reporting Issuers*. Though a CSA staff notice does not create new regulation, it provides insights on and clarifications on existing regulation surrounding a topic of interest.

The Staff Notice follows a series of CSA reviews that were conducted of the current public crypto asset funds (PCAFs) holding digital assets that covered their ETF structure, liquidity, and custody. In these reviews there were no material findings, suggesting the industry is in a satisfactory state under the current regulations. At the same time, however, the CSA is further raising its expectations for the participants in the space, in addition to limiting short term opportunities for assets beyond bitcoin and ether. Finally, the custodial aspects of crypto ETFs were clearly defined for PCAFs, noting that specific crypto expertise is an expected custodian trait.

The notice is well researched and articulated in a manner that proves the CSA considers the cryptocurrency sector to be a serious industry worth regulating with thought. Additionally, there is evidence of increasing harmonization across crypto-related regulation with Canada, as aspects of this notice further aligns the expectations of PCAFs to those of crypto trading platforms (CTPs).

Key Takeaways

- 1** The CSA conducted a series of reviews of the public crypto asset funds holding digital assets with positive results. Crypto ETFs are meeting the current regulatory expectations.
- 2** The CSA has indicated they will watch this space through an increasingly stringent lens, with bitcoin and ether likely to remain the only eligible cryptocurrencies for ETFs in the near future.
- 3** The minimum expectations for custodians were stipulated. Amongst other standards, these expectations call specifically for custodians to possess crypto expertise.



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Looking at the existing PCAFs in Canada, the CSA conducted reviews of their liquidity, ETF structure, and custody. Beginning in 2021 with liquidity, it was noted that since their inceptions, the examined PCAFs experienced no material difficulties for redemption requests on their ETFs. When examining the ETF structures, it was found that "most of the ETFs traded very closely to their NAV." Additionally, any large redemption requests required no extraordinary measures to process, allowing for settlement on the next business day. Finally, several key expectations for crypto asset custodians were confirmed to be employed by the custodians of the funds, as noted below. In short, no material concerns were noted from these reviews.

These positive results demonstrate that the investment funds participating in the Canadian cryptocurrency industry are adhering to the regulations and taking them seriously. Conversely, it is apparent that Canadian regulators are too taking the industry seriously, and giving robust consideration to their view of risks and mitigations.

Confirmed Custody Expectations

The CSA confirmed in November 2022 that the custodians of the PCAFs:

- segregated PCAF funds from other clients and from the custodian's funds;
- used offline, cold storage technology for the assets;
- had the PCAF recorded as the beneficial owner of the assets held;
- ensured security, segregation, and ownership of the crypto assets through controls;
- made visible the segregation on the blockchain itself and not just their books; and
- maintained insurance on the assets.



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Citing specifically the collapses of FTX, Genesis, and LUNA as recent events which highlighted the importance of liquidity, the CSA continues to emphasize liquidity risk management programs for PCAFs. The CSA's stance is that many digital assets do not have the same liquidity that bitcoin and ether have, thereby exposing any potential ETFs with illiquid assets to the same risks of collapse.

The CSA also expects any additional crypto assets to demonstrate that they can be priced fairly and that the markets are efficient before approval can be granted for PCAF offerings. This may include considering whether there is a regulated futures market or regulated and public indices for the asset.

This section of the Staff Notice reads as though the CSA will have heightened expectations going forward. An example is the CSA has suggested that when determining if crypto assets have adequate market depth and liquidity, that firms should consider their trading volumes "both in absolute terms and when compared to other markets for commodities and equities." The end result seems sure to be that additional crypto assets may be slow to market in the fund segment.

"[...] CSA staff are of the view that the markets for bitcoin and ether best support the operations of Public Crypto Asset Funds at this time without compromising investor protection. In the future, greater institutional support and mainstream adoption of other crypto assets may result in those crypto assets becoming suitable investments for publicly distributed investment funds."

— Excerpt from the CSA Staff Notice 81-336



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The CSA made asset custody a priority in both their reviews and staff notice alike. The CSA reiterated that PCAFs must use custodians that abide by the NI 81-201 requirements, meaning the custodian must meet the "qualified custodian" criteria. In addition, the CSA recognized there are "unique custodial considerations" with digital assets, and as such, a minimum expectation outlined by the CSA is that a custodian for digital assets is equipped with the appropriate specializations to provide appropriate custody. Additionally, the CSA noted these expectations are "substantially similar" to those for CTP's, which is another step—albeit small—in increased regulatory harmonization.

"The investment fund manager (IFM), consistent with its fiduciary obligations to the Public Crypto Asset Fund, should satisfy itself that a proposed Crypto Custodian has the necessary expertise and experience to safely custody the crypto assets to be held on behalf of the Public Crypto Asset Fund."

— Excerpt from the CSA Staff Notice 81-336

Minimum Expectations for Digital Asset Custodians

- ✓ **Crypto expertise**
- ✓ **Storing assets in cold storage**
- ✓ **Asset segregation visible on the blockchain**
- ✓ **Website security**
- ✓ **Insurance for crime or theft**
- ✓ **SOC 2 Type 2 reports**

Staking Specific Guidance

The CSA touched on the topical subject matter of staking. With respect to custody, staked assets should be held under the crypto custodian's possession and control in cold storage. These assets should be staked through engaging a third party service provider. Neither a fund, nor its managers, should act as validators. Monitoring the validators, however, is recommended.

Furthermore, PCAFs should be aware that "depending on how it is conducted, staking may involve the issuance of a security or derivative." As well, due to the potential illiquid nature of staked assets, PCAFs should remain mindful of liquidity.



Trusted Digital Asset Custody

Tetra Trust Company is Canada's first and only trust company licensed to custody digital assets with a vision of enabling the institutional adoption of digital assets.

Registered as a Canadian trust company under the Loan and Trust Corporations Act (Alberta), Tetra is fiducially responsible to act in the best interests of its clients. Its operations are overseen by a Canadian regulator.

Tetra invites you to contact us to understand how we adhere to the CSA guidelines and set the standard for Canadian digital asset custody.

Contact



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Steve has 20+ years experience in financial markets and has held previous senior risk management and compliance roles at BP based out of Calgary, London, and Singapore. He is a CFA charterholder and is also a sessional instructor at the University of Calgary where he teaches a fourth year course on Corporate Governance.