

February 2019

Failure to Launch – OSC Director Determines That Bitcoin Fund is Not Ready for the Retail Spotlight

On February 15, 2019, the Director of the Investment Funds & Structured Products Branch (the “**Director**”) of the Ontario Securities Commission (the “**OSC**”) [refused to issue a receipt](#) for a non-offering prospectus of a non-redeemable investment fund (the “**Fund**”) that would invest substantially all of its assets in Bitcoin (the “**Decision**”).

Background

3iQ Corp. (the “**Manager**”) filed a preliminary non-offering long-form prospectus to qualify the Fund as a reporting issuer on October 30, 2018. The Fund’s investment objectives were to provide its investors with: (i) exposure to Bitcoin and the daily price movements of the U.S. dollar price of Bitcoin; and (ii) the opportunity for long-term capital appreciation. To achieve its investment objectives, the Fund would invest in Bitcoin “directly” – i.e. not through any specified derivatives.

The Decision

The Director refused to receipt the prospectus pursuant to the powers granted under subsections 61(1) and 61(2) of the *Securities Act* (Ontario) because: (1) the issuance of the receipt appeared to be contrary to the public interest; and (2) the prospectus (and the Fund) did not comply with substantial aspects of securities law.

The key findings of the Director can be summarized as follows:

1. *Operational risks must be adequately managed by measures other than disclosure* – Bitcoin represents a unique operational risk for investment funds that the Manager must address by means other than disclosure.
2. *Valuation risks* – the fragmented and unregulated Bitcoin trading environment creates significant risks concerning the valuation of the assets of the Fund since the price of Bitcoin from reputable sources can be manipulated based on trading activities on less reputable platforms.
3. *Inadequate custody* – given the risks associated with Bitcoin (and by extension, other cryptoassets), although not an explicit requirement for investment funds, the custodian (or sub-custodian) that is holding the Fund's Bitcoin must: (1) produce Customary SOC Reports (Type 1 and Type 2); and/or (2) maintain insurance against loss of Bitcoin.
4. *Financial statements* – it is unclear how the Fund's auditor will be able to obtain the required level of comfort to issue an unqualified audit opinion for the Fund's annual financial statements.
5. *Bitcoin is an "illiquid asset"* – in order to not be classified as an "illiquid asset" under National Instrument 81-102 – *Investment Funds*, Bitcoin must trade on "market facilities", interpreted by the Director to require a form of "established and mature trading facility or network in order to promote a robust valuation of a fund's assets" – the Bitcoin market failed to pass this threshold.

It remains to be seen if the Manager will request a hearing before the OSC to review the Decision of the Director, but in the meantime, the Decision provides key insights about the hurdles investment fund managers must overcome to launch retail investment funds that hold cryptoassets in Canada.

Please contact a member of McMillan's Investment Funds and Asset Management Group if you have any questions with respect to any of the above information.

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[a cautionary note](#)

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