

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

APPLICATION
(FOR HEARING AND REVIEW OF A DECISION UNDER
SECTION 8 OF THE SECURITIES ACT, RSO 1990, C S.5)

A. ORDER SOUGHT

The Applicants, 3iQ Corp. (**3iQ** or the **Manager**) and The Bitcoin Fund (the **Fund**), request a hearing so that the Ontario Securities Commission (**OSC** or the **Commission**) may make the following orders (the **Orders**):

1. An order setting aside the decision (the **Decision**) of the Director, Investment Funds & Structured Products (the **Director**) dated February 15, 2019 refusing to issue a receipt for the final non-offering prospectus of the Fund under subsections 61(1) and 61(2)(a)(i) of the *Securities Act*, RSO 1990, c. S.5 (the **Act**).

2. An order directing the Director to issue a receipt for the final non-offering prospectus of the Fund under section 61 of the Act.

3. Such further and other relief as counsel may advise and as may seem just.

B. GROUNDS

The grounds for the request and the reasons for seeking a hearing and review are:

The Fund

4. The Fund is a non-redeemable investment fund (**NRIF**) to be established as a trust under the laws of the Province of Ontario.

5. The Fund's investment objectives are to seek to provide its investors with: (a) exposure to the digital currency bitcoin and the daily price movements of the U.S. dollar price of bitcoin; and (b) the opportunity for long-term capital appreciation.
6. To achieve its investment objectives, the Fund will invest in long-term holdings of bitcoin.
7. 3iQ is the investment fund manager and portfolio manager of the Fund. 3iQ is registered as an investment fund manager, portfolio manager, exempt market dealer and commodity trading manager in Ontario.
8. 3iQ's management team has significant experience in managing investment funds and portfolios focused on novel and uncorrelated asset classes, derivative investment strategies and innovative investment structures.
9. Cidel Trust Company (**Cidel** or the **Custodian**) will be appointed as the custodian of the assets of the Fund. The Custodian is a federally regulated trust company and is a qualified custodian for the purposes of National Instrument 81-102 *Investment Funds* (**NI 81-102**).
10. Gemini Trust Company, LLC (**Gemini** or the **Sub-Custodian**) will be appointed as the sub-custodian of the Fund. The Sub-Custodian is a trust company licensed by the New York State Department of Financial Services and is qualified to act as a sub-custodian of the Fund for assets held outside of Canada in accordance with NI 81-102.
11. The Manager will purchase bitcoin for the Fund from Gemini and other reputable bitcoin exchanges and over-the-counter (**OTC**) counterparties (each, a **Bitcoin Source**) that are regulated for virtual currency business activities under the New York State Department of Financial Services BitLicense or another regulatory regime which mandates know your client (**KYC**) and anti-money laundering/anti-terrorist financing (**AML**) procedures in compliance with applicable law in the

Bitcoin Source's home jurisdiction. Initially, the Fund's Bitcoin Sources are expected to be Gemini, Genesis Global Trading, Inc., Xapo Limited and Circle Internet Financial Limited.

12. The Fund's bitcoin will be valued based on the MVIS CryptoCompare Bitcoin Index (MVBTC) maintained by MV Index Solutions GmbH (MVIS). MVIS is an index provider based in Frankfurt, Germany and regulated as an index administrator by the German Federal Financial Supervisory Authority (BaFin).

13. Raymond Chabot Grant Thornton LLP (RCGT) will be appointed as the auditor of the Fund. RCGT is a participating firm as required under Part 2 of National Instrument 52-108 *Auditor Oversight* and participates in the Canadian Public Accountability Board (CPAB) oversight program, which is required for accounting firms that audit reporting issuers.

14. The Manager intends to apply to list the units of the Fund (Units) for trading on a regulated stock exchange in Canada and has had discussions with a leading stock exchange in Canada regarding the listing of Units.

15. In addition to the liquidity provided by a stock exchange listing, holders of Units will have the right to redeem their Units annually for a redemption price equal to the net asset value (NAV) per Unit, or on a monthly basis at a discount to the market price, consistent with the redemption rights normally offered by public and listed NRIFs in Canada.

16. The Manager expects that the initial public offering (IPO) of the Fund will be conducted by a syndicate of agents which are registered as investment dealers under applicable securities laws and are members of the Investment Industry Regulatory Organization of Canada (IIROC), and the Manager has had discussions with several IIROC members regarding their leadership and/or participation in the IPO of the Fund.

17. The Sub-Custodian and the auditor of the Fund have changed since the preliminary non-offering prospectus of the Fund was filed on October 30, 2018 (the **October 2018 Prospectus**) and since the Decision was published by the Director. The Manager has provided Staff of the IFSP (**Staff**) with an updated version of the preliminary non-offering prospectus of the Fund (the **March 2019 Prospectus**) together with a blackline to the October 2018 Prospectus.

The Prospectus and Events Leading up to the Decision

18. In November 2016, the Manager had an initial meeting with the Director of the Investment Funds and Structured Products Branch of the OSC (**IFSP**) to discuss its idea for the Fund.

19. On April 7, 2017, after a series of discussions with the Director of IFSP, the Manager confidentially pre-filed an initial draft preliminary prospectus of the Fund (the **Confidential Preliminary Prospectus**) with Staff.

20. During the period from mid-May 2017 to late June 2018, Staff delivered four comment letters on the Confidential Preliminary Prospectus and 3iQ filed four responses to Staff's comments.

21. On July 17, 2018, Staff delivered a letter to 3iQ stating that it would not be prepared to recommend to the Director to issue a receipt for the prospectus of the Fund, should it be publicly filed (the **Pre-File Refusal Letter**).

22. At the recommendation of Staff, 3iQ responded to the Pre-File Refusal Letter by submitting a request under OSC Notice 15-701 *Meetings with a Commissioner Regarding a Prospectus or Application for Exemption or Registration* to discuss a "serious difference of opinion with Staff" with an OSC Commissioner.

23. On August 1, 2018, 3iQ attended a meeting with an OSC Commissioner, as requested.
24. Shortly after the meeting, 3iQ was advised by Staff that its next step toward obtaining a receipt for the prospectus of the Fund would be to publicly file a prospectus, be refused a receipt and seek an opportunity to be heard before a panel of OSC Commissioners, at which the OSC's public interest jurisdiction to refuse a receipt for the prospectus would be debated. At that time, 3iQ and Staff agreed that it would be appropriate to file a non-offering prospectus for the purpose of establishing a public filing record for the Fund which would be necessary to trigger the Director's refusal of the receipt and the opportunity to be heard.
25. On October 9, 2018, 3iQ attended the meeting with the Director and Staff and engaged in a productive discussion regarding the issues raised by the Director upon his review of the Confidential Preliminary Prospectus and the Pre-File Refusal Letter (the **October 2018 Meeting**).
26. On October 30, 2018, Staff delivered a letter to 3iQ affirming its position set out in the Pre-File Refusal Letter that it would not be prepared to recommend to the Director to issue a receipt for the prospectus of the Fund, should it be publicly filed, and requesting additional information regarding the Fund.
27. On October 30, 2018, 3iQ publicly filed the October 2018 Prospectus.
28. On October 31, 2018, the OSC issued a preliminary receipt for the October 2018 Prospectus.
29. During the period from early November 2018 to the end of January 2019, Staff provided verbal and written comments on the October 2018 Prospectus and 3iQ filed three written responses to Staff's comments.

30. On January 25, 2019, Staff delivered a letter to 3iQ recommending against issuing a receipt for the final prospectus of the Fund (the **Negative Recommendation Letter**).

31. On January 31, 2019, 3iQ filed a response to the Negative Recommendation Letter which: (i) requested written reasons of the Director for the decision regarding his refusal to issue a receipt for the final prospectus of the Fund; and (ii) waived its opportunity to be heard under Section 61(3) of the Act on the basis that it will seek a hearing and review of the decision of the Director under Section 8(2) of the Act.

32. On February 15, 2019, the Director issued the Decision.

The Decision and 3iQ's Response to the Decision

33. The Director's reasons for refusing to grant a receipt for the prospectus of the Fund fall into two categories:

- (a) First, the Director was of the view that it is not in the public interest to issue a receipt for the prospectus because a perceived lack of established regulation of the bitcoin market prevents the Fund from addressing certain operational risks sufficiently to provide the high level of investor protection expected from public investment funds (the "**Alleged Public Interest Reasons**").
- (b) Second, the Director was of the view that bitcoin is an illiquid asset and, therefore, the prospectus is non-compliant with applicable securities laws because the Fund would not comply with investment restrictions against holding illiquid assets applicable to public investment funds in Canada (the "**Bitcoin Illiquidity Reason**").

(a) Alleged Public Interest Reasons

34. The Director determined that: “in deciding whether it is not contrary to the public interest to issue a receipt for a prospectus of an investment fund, [the Director is] required to consider whether fund operational risks are adequately managed by measures other than providing disclosure of such risks to investors.”

35. The Director identified three operational risks which are not, in his view, adequately managed by the Fund: (i) valuation; (ii) safeguarding of assets; and (iii) auditability of financial statements.

36. As described below, 3iQ has adopted robust operational processes and engaged globally leading service providers to address the operational risks identified in the Alleged Public Interest Reasons, with the objective of providing Canadian retail investors with the opportunity to invest in bitcoin through a safer alternative to the unregulated exchanges and platforms through which most Canadian retail investors purchase bitcoin today.

37. In reaching his conclusion that the Fund does not adequately manage operational risk, the Director erred in his consideration of the evidence regarding the operational risks and in law by applying standards which are not prescribed in the securities regulatory regime applicable to public investment funds in Canada.

(i) Valuation

38. In the Decision, the Director acknowledged that the bitcoin of the Fund will be valued based on the MVBTC.

39. The MVBTC is an index of the U.S. dollar price of one bitcoin maintained by MVIS, an index administrator regulated by BaFIN.

40. MVIS has adopted indexing practices which comply with EU benchmark regulations with pricing benchmarks that comply with International Organization of Securities Commissions (IOSCO) regulations.

41. Nonetheless, the Director erred in his consideration of the evidence by agreeing with Staff's "concerns regarding the impact on the Fund's ability to accurately value its assets due to the fragmented and unregulated environment in which bitcoin generally trades" and by accepting Staff's submission that "trading activities on other less reputable platforms can impact pricing of bitcoin on more reputable platforms".

42. Many assets held by public investment funds, most notably cash and precious metals, trade on both regulated and unregulated markets. The existence of unregulated markets for assets does not impugn the ability of a fund manager to value those assets accurately.

43. Staff did not provide any evidence in support of their submissions that the existence of bitcoin trading on "less reputable platforms" will negatively impact the Manager's ability to value the bitcoin of the Fund based on the MVBTC and, if appropriate, other public pricing sources.

44. Further, Staff and the Director failed to consider that the calculation methodology for MVBTC (the **MVBTC Methodology**) is transparent, auditable and replicable, addressing concerns regarding pricing manipulation in accordance with industry best practices that comply with European and IOSCO standards.

45. In addition, Staff and the Director failed to consider that the Manager can confirm the ongoing accuracy of the MVBTC by referring to other widely used and reputable pricing sources for bitcoin, including:

- (a) the market price quoted on Bloomberg under ticker XBT, which consolidates bitcoin prices from eight exchanges vetted by Bloomberg;
- (b) the CME CF Bitcoin Real-Time Index, which sets the price for bitcoin futures listed on the Chicago Mercantile Exchange under ticker BTC, which had average daily trading volumes of USD\$119 million in 2018;
- (c) the auction price of bitcoin on the Gemini exchange, which sets the price for bitcoin futures listed on the Chicago Board Options Exchange under ticker XBT, which had average daily trading volumes of USD\$34 million in 2018;
- (d) the trading price of the Grayscale Bitcoin Investment Trust (GBTC), which has been trading since May 2015 and had average daily trading volumes of USD\$25.7 million in 2018; and
- (e) readily available prices from the Fund's Bitcoin Sources.

46. Even the U.S. Federal Reserve Bank of St. Louis has begun to post the U.S. exchange rate to bitcoin based on pricing provided by Coinbase.

47. Accordingly, the Manager will be able to determine the market value of the bitcoin of the Fund based on reported prices and quotations in an active market in accordance with the fair value pricing requirements set out in Part 14 of National Instrument 81-106 *Investment Fund Continuous Disclosure* (NI 81-106).

48. Further, the MVBTC Methodology provides for the calculation of a price for bitcoin which reflects the criteria for an active market described in Section 9.4 of the Companion Policy to NI 81-106.

49. Accordingly, the Director erred in his consideration of the evidence regarding the Manager's ability to determine the market value of the bitcoin of the Fund. In addition, the Director erred in law by applying standards to the Fund's valuation processes which are more onerous and conservative than the requirements of the securities regulatory regime for public investment funds.

(ii) Safeguarding of Assets

50. NI 81-102 sets out regulatory requirements for public investment funds to provide protection for investors against the risks associated with operating an investment fund.

51. The custodial requirements set out in Part 6 of NI 81-102 – Custodianship of Portfolio Assets prescribe a custodial regime for public investment funds for the purpose of managing the risks associated with the safekeeping of assets of a public investment fund, including, without limitation:

- (a) the registration or licensing regimes to which qualified custodians must be subject, and minimum capital requirements for certain categories of custodian;
- (b) certain provisions which must be included in custody agreements;
- (c) the standard of care to which custodians must adhere; and
- (d) an annual compliance certification for process for custodians.

52. Both the Custodian and the Sub-Custodian of the Fund are "qualified custodians" for the purpose of NI 81-102 and intend to comply with the requirements of Part 6 of NI 81-102 when providing custody services to the Fund.

53. Neither Part 6 of NI 81-102, nor any other provision of applicable securities law in Canada, require the custodian of a public investment fund to complete Service Organization Controls

(SOC) audits and provide the reports of such SOC audits (SOC Reports) to the manager of the Fund.

54. However, Staff has taken the position that because it is customary for custodians of traditional asset classes to provide SOC Reports to their clients, the Sub-Custodian should be required to produce SOC Reports in order to satisfy the OSC that the operational risks associated with the safeguarding of bitcoin have been adequately addressed by the Fund.

55. The Director erred both in his consideration of the evidence and in law by accepting the submission of Staff that an investment in the Fund presents a novel risk regarding the safeguarding of bitcoin to the extent that the Sub-Custodian is not able to provide SOC Reports.

56. The Manager and the Custodian selected Gemini as the Sub-Custodian because it is subject to a robust regulatory regime and offers leading edge, segregated cold storage technology for the secure, offline safekeeping of the Fund's bitcoin.

57. The Manager understands that to date, Gemini has never experienced a loss due to unauthorized access from its hot wallet or the cold storage vaults where the Fund's bitcoin would be custodied.

58. As a fiduciary under Section 100 of the New York Banking Law, Gemini is held to specific capital reserve requirements and banking compliance standards.

59. Gemini is also subject to the laws, regulations and rules of applicable governmental or regulatory authorities, including:

- (a) money service business regulations under the Financial Crimes Enforcement Network (FinCEN);

- (b) U.S. state money transmission laws;
- (c) laws, regulations, and rules of relevant tax authorities;
- (d) applicable regulations and guidance set forth by FinCEN;
- (e) the Bank Secrecy Act of 1970;
- (f) the USA PATRIOT Act of 2001;
- (g) AML regulations as mandated by U.S. federal law and any other rules and regulations regarding anti-money laundering/counter-terrorist financing;
- (h) issuances from the Office of Foreign Assets Control;
- (i) the New York Banking Law;
- (j) regulations promulgated by the New York Department of Financial Services from time to time; the National Futures Association;
- (k) the Financial Industry Regulatory Authority; and
- (l) the Commodity Exchange Act.

60. Gemini will use segregated cold storage bitcoin addresses for the Fund which are separate from the bitcoin addresses that Gemini uses for its other customers and which are directly verifiable via the bitcoin blockchain by the Manager, the Custodian and the auditor of the Fund.

61. Gemini will at all times record and identify in its books and records that such bitcoins constitute the property of the Fund.

62. Gemini will not loan, hypothecate, pledge or otherwise encumber the Fund's bitcoins without the Fund's instruction.

63. Gemini, in carrying out its duties concerning the safekeeping of, and dealing with, the Fund's bitcoins, would be required to take reasonable care and use commercially reasonable efforts in executing its responsibilities and has agreed to adhere to the standard of care required by law, including NI 81-102.

64. The Prospectus sets out detailed disclosure regarding Gemini's industry-leading security policies and practices, program for compliance with the U.S. Bank Secrecy Act and applicable AML requirements, website security, internal controls and commercial crime insurance.

65. Staff's view that bitcoin presents novel risks regarding safeguarding of fund assets is based primarily on risks associated with unregulated bitcoin trading platforms.

66. As the bitcoin market has matured over the past ten years, custodians such as Gemini, Xapo Limited and Coinbase Inc. have emerged as industry leaders and have become regulated as financial institutions in order to provide investors with reliable, secure cold storage bitcoin custody.

67. The Manager and the Custodian completed rigorous due diligence of Gemini prior to selecting it as the Sub-Custodian and will continue to supervise Gemini in accordance with the standards of care which govern their roles with the Fund, and in accordance with the custodian requirements of NI 81-102.

68. The Manager has taken further safekeeping measures for the bitcoin of the Fund by restricting the parties with which it will trade in bitcoin to acceptable Bitcoin Sources.

69. The Manager will conduct due diligence on each proposed Bitcoin Source prior to transacting with such Bitcoin Source in order to confirm its reputation and stability, including by conducting research on the executive officers and significant shareholders of the Bitcoin Source and the regulatory regime, if any, applicable to the Bitcoin Source. In addition to confirming the robustness of each Bitcoin Source's KYC and AML processes, the Manager will refuse to transact with any person or entity that is on a list of designated persons or entities established and maintained under applicable AML regulation in the jurisdiction of the Bitcoin Source.

70. The Manager will also ensure that each Bitcoin Source has its head office in a jurisdiction which is a member of the International Financial Action Task Force (FATF) or its global network of FATF-Style Regional Bodies.

71. The Manager's Bitcoin Sources offer trading limits which will seek to ensure that no bitcoin sold to the Fund comes from a wallet associated with illicit activity or from dark web sites or money laundering sites (known as "mixing" sites).

72. In addition, both the Manager and Gemini will use forensic software to analyze counterparty wallet history to avoid transacting with sources known to be linked to illicit or illegal activity.

73. The fact that the Manager has been able to identify a significant number of regulated service providers to act as the Custodian, Sub-Custodian and Bitcoin Sources of the Fund illustrates that the bitcoin market has matured sufficiently to enable the Manager to manage the operational risks associated with the safeguarding of assets in accordance with NI 81-102 and in accordance with its standard of care as the investment fund manager of the Fund.

74. It is not correct for the Director to apply an additional standard to Gemini or any other proposed custodian of bitcoin – namely, that the custodian produce SOC Reports – when the custodian is already subject to a regulatory regime which satisfies the “qualified custodian” requirements of NI 81-102.

75. The Director erred in his consideration of the evidence regarding the Manager’s ability to manage the operational risks associated with the safeguarding of assets. In addition, The Director erred in law by applying standards to the Sub-Custodian which are more onerous and conservative than the requirements of the securities regulatory regime for public investment funds.

(iii) Audited Annual Financial Statements

76. RCGT has provided the Manager an indication of interest letter to become the auditor of the financial statements of the Fund.

77. The Manager expects to engage RCGT as the auditor of the Fund in accordance with terms set out in RCGT’s indication of interest letter.

78. RCGT and Catallaxy, a subsidiary of RCGT specialized in blockchain, have developed a methodology and tools to assist audit teams in gathering audit evidence for certain types of digital assets, including bitcoin, and have built up expertise conducting such audits in accordance with Canadian generally accepted auditing standards.

79. The Director accepted the position of Staff that “it is unclear how the Fund’s auditor will be able to provide an unqualified opinion on the Fund’s annual financial statements in accordance with NI 81-106 without receiving the Customary SOC Reports from the sub-custodian”.

80. The Director assumed that the Fund will not be able to obtain an unqualified audit opinion unless the Sub-Custodian delivers SOC Reports to the auditor.

81. This assumption is not based on the audit requirements applicable to public investment funds under Part 2 of NI 81-106 and Part 3 of National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*. Rather, this assumption reflects Staff's expectations based on the practices of the auditors of funds which hold traditional asset classes. By making this assumption, Staff and the Director effectively imposed a requirement on fund managers and their auditors to review SOC Reports as part of their operational risk management and audit processes for all funds that hold bitcoin or other cryptoassets.

82. Generally, it takes a service organization approximately two years to complete a SOC Type 1 engagement and a SOC Type 2 engagement.

83. By imposing a requirement for the custodians of cryptoassets to complete SOC Type 1 and SOC Type 2 engagements prior to the audit of financial statements of a public investment fund proposes to use such custodian, Staff and the Director have effectively disqualified all leading global bitcoin custodians from being capable of providing services to the Fund.

84. RCGT has confirmed that under Canadian generally accepted auditing standards, the auditability of the financial statements of a fund that holds bitcoin is not necessarily contingent on having or receiving a report of a SOC 2 – Type 2 audit engagement of the custodian of the bitcoin of such fund.

85. There is no requirement for a public investment fund to confirm with Staff that its auditor will be able to deliver an unqualified audit opinion on the fund's annual financial statements in order to obtain a receipt for its prospectus. It is impossible for an auditor to provide this level of assurance to an investment fund or to Staff until the fund has commenced operations and the auditor has completed the audit of the fund's investment portfolio, including consideration of internal controls.

86. Accordingly, by accepting the positions of Staff that in order to issue a receipt for the final prospectus of the Fund, the auditor of the Fund should be required to: (i) review SOC Reports; and (ii) confirm that it will be in a position to issue an unqualified audit opinion on the Fund's annual financial statements, the Director erred in both fact and law by applying standards to the audit of the Fund which are more onerous and conservative than the requirements of the securities regulatory regime for public investment funds.

(b) Bitcoin Illiquidity Reason

87. The Director erred in both fact and law by accepting Staff's position that bitcoin is an "illiquid asset" as defined in Part 1 of NI 81-102 and that, therefore, the prospectus of the Fund does not comply with the requirements of the Act or the regulations.

88. Staff's position, accepted by the Director, ignores voluminous trading data from the Fund's reputable Bitcoin Sources which illustrate that bitcoin is a liquid asset. The Director therefore erred in his interpretation of the evidence regarding the liquidity in bitcoin markets.

89. Bitcoin has existed for over a decade and has a total market capitalization of over USD\$65 billion today. Its source code has been scrutinized by thousands of developers, computer scientists and cryptographers and found to be sound. Bitcoin and its blockchain support over 200,000 transactions per day with an estimated aggregate transaction value in excess of USD\$200 million per day. As of December 31, 2018, there were an estimated 32 million bitcoin wallets with over seven million active bitcoin users globally.

90. Based on trading data gathered by the Manager from its Bitcoin Sources and other reputable sources, the Manager conservatively estimates that average daily trading volumes of bitcoin across multiple venues exceeds USD\$800 million.

91. In 2018, average daily trading volume of the most liquid equities listed on the Toronto Stock Exchange (TSX) were The Toronto-Dominion Bank (TSX:TD) at CAD\$392 million and Royal Bank of Canada (TSX:RY) at CAD\$376 million. Average daily trading volume of the largest Canadian exchange-traded fund (ETF), iShares S&P TSX 60 Index ETF (TSX:XIU) was CAD\$229 million. Based on the Manager's conservative estimates, average daily trading volumes of bitcoin are more than double that of the most liquid issuers and ETFs on the TSX.

92. An "illiquid asset" is defined in Section 1.1 of NI 81-102 as 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 fund. There is no definition of "market facilities" in NI 81-102.

93. The MVBTC aggregates transaction data from over 70 bitcoin exchanges and trading platforms which satisfy the criteria of the MVBTC Methodology, and Bloomberg aggregates transaction data from eight exchanges which satisfy its liquidity criteria. Holders of bitcoin can readily dispose of their bitcoin through such market facilities.

94. The Director erred in law by accepting Staff's submission that, absent a definition of "market facilities" in NI 81-102, the term "implies some form of established and mature trading facility or network in order to promote a robust valuation of a fund's assets."

95. Staff's position, accepted by the Director, that "market facilities" would not apply to the Fund's Bitcoin Sources or the bitcoin markets which form the basis for MVBTC, Bloomberg's XBT and the CME CF Bitcoin Real-Time Index is not prescribed in NI 81-102, NI 81-106 or any other securities regulatory requirement.

96. The Director erred in this interpretation of “market facilities”, which is unduly narrow, reflects expectations based on the market facilities on which traditional asset classes trade and has the result of excluding new types of market facilities.

97. The Director’s interpretation incorrectly applies standards to determining the liquidity of bitcoin which are more onerous and conservative than the requirements of the securities regulatory regime for public investment funds.

98. Alternatively, most of the Fund’s Bitcoin Sources and other market facilities which are incorporated into the MVBTC Index and/or Bloomberg’s XBT *are* “established, mature trading facilities...[which] promote a robust valuation of the fund’s assets” in accordance with the Director’s interpretation.

The Director’s Approach to the Public Interest

99. In addition to erring in fact and law by applying operational requirements to the Fund which are not generally applicable to public investment funds, the Director erred in fact in his description of the universe of public investment funds available in Canada.

100. In the Decision, the Director erroneously assumed that “[c]urrently, the types of assets that public investment funds invest in are more mature traditional assets (such as equities and bonds) for which established regulation already exists.”

101. In doing so, the Director ignored the existence of public investment funds, including conventional mutual funds and ETFs that: (i) hold precious metals and other commodities; (ii) engage in non-traditional investment strategies such as leverage, directional short selling and complex derivative strategies; and (iii) provide exposure and inverse exposure to specified securities, assets or markets.

102. For example, as of March 9, 2019, there were at least: (i) 17 public investment funds in Canada that hold or track the performance of precious metals and other commodities, with at least \$1.419 billion in aggregate net assets; (ii) 10 ETFs in Canada that engaged in passive inverse/leveraged strategies, with at least \$966 million in aggregate net assets; (iii) 21 ETFs in Canada that provide exposure to emerging markets equities, with at least \$3.481 billion in aggregate net assets; and (iv) 18 alternative mutual funds in Canada which engage in leveraged investment strategies, with at least \$807 million in aggregate net assets.

103. Generally, when the first of each of these types of investment funds was proposed, the fund did not fit perfectly within the Canadian regulatory framework and presented unique operational risks for consideration by the fund manager.

104. In each of these circumstances, the OSC acknowledged that it was in the public interest for retail investors to have access to the proposed new asset class or investment strategy for the purpose of diversification, investment in an uncorrelated asset class or more generally to keep pace with financial innovation.

105. Consequently, the OSC has been willing to work with fund managers, often by providing exemptive relief from certain investment fund regulations, in order to facilitate the launch of novel types of public investment funds while at the same time preserving core investor protections.

106. Over time, as new types of funds have gained acceptance in the market, investment fund regulation has evolved to permit such funds to operate without exemptive relief.

107. Bitcoin is a new asset class, and consequently, the Manager has appropriately developed new approaches toward operational risk management for the Fund.

108. Ultimately, the Manager has achieved a risk management system for the Fund which complies with the requirements of NI 81-102 and NI 81-106, but also leverages the technology and expertise of global leaders in bitcoin valuation (MVIS and the MVBTC), custody (Gemini), trading (the Bitcoin Sources) and audit (RCGT) to provide services to the Fund.

109. In contrast with the Fund's innovative approach to managing risk associated with a new asset class, the Director applied an antiquated conception of investment funds as holding "traditional stocks and bonds".

110. From this erroneous starting place, the Director concluded that the only acceptable way for an investment fund to manage operational risk is the same way equity and bond funds have always done it.

The Director's Incorrect Approach to the Purposes of the Act

111. The Director erred in his consideration of the evidence, as well as in law and principle, by failing to adequately consider the purposes of the Act in the Decision.

112. The three purposes of the Act are to:

- (a) provide protection to investors from unfair, improper or fraudulent practices
(Investor Protection);
- (b) foster fair and efficient capital markets and confidence in capital markets (**Fair and Efficient Capital Markets**); and
- (c) contribute to the stability of the financial system and the reduction of systemic risk
(Systemic Risk Reduction).

113. The Director's reasons for refusing to issue a final receipt for the prospectus of the Fund are based entirely on Investor Protection, and do not give appropriate weight to Fair and Efficient Capital Markets.

114. The Director's decision is *unfair* because it imposes standards for valuation, custody, audit and liquidity to the Fund which are not prescribed in the regulatory regime for public investment funds.

115. The Decision *fails to promote efficient capital markets and confidence in capital markets* because it prevents retail investors from accessing bitcoin through a regulated, professionally managed fund structure. The Fund's service providers and operational systems will allow the Fund to obtain best execution when purchasing bitcoin and to manage the risks associated with investments in bitcoin in accordance with prudent business practice.

116. Currently, Canadian retail investors seeking exposure to bitcoin have no alternative but to obtain their exposure to bitcoin through one of the following channels:

- (a) purchase bitcoin directly from an unregulated exchange and hold such bitcoin in a "hot wallet" online, where it is susceptible to hackers and fraudsters;
- (b) purchase bitcoin from an automatic teller machine (ATMs) located in various retail locations and urban centres in Canada; or
- (c) invest in a publicly-traded issuer listed in on the TSX Venture Exchange or the Canadian Securities Exchange which has bitcoin as its primary asset (each, an **RTO Crypto Issuer**).

117. Unregulated exchanges and ATMs which sell bitcoin are not subject to best execution obligations and have been known to charge commissions of 5-10% for bitcoin transactions, well in excess of the commissions and spreads which are expected to be charged by the Fund's Bitcoin Sources.

118. Most, if not all, of the RTO Crypto Issuers achieved their public listings by completing reverse-take overs and have not been subject to the due diligence of a public offering underwriting syndicate which typically precedes an IPO.

119. It is in the public interest to permit retail investors, and their investment advisors, to obtain a suitable amount of exposure to bitcoin in their investment portfolios. The Fund is not intended to be a complete investment program for any investor, but rather a small allocation within an investment portfolio to provide diversification to an uncorrelated asset class.

120. The IPO of the Fund is expected to be completed by a syndicate of IIROC dealers, as agents on a best efforts basis, and investors would have the benefit of investment advice from regulated investment professionals when considering the risk profile associated with an investment in bitcoin, and whether the asset is suitable for their portfolio.

121. The prospectus of the Fund discloses all known risks associated with an investment in the Fund, and more generally with investments in bitcoin, to assist prospective investors and their advisors to determine whether an investment in bitcoin is suitable.

122. The current channels through which Canadian retail investors may purchase bitcoin are far less efficient, and provide far less Investor Protection, than would an investment in the Fund.

123. Once qualified by prospectus and listed on a stock exchange, the Fund would be subject to the public disclosure regime applicable to investment fund issuers, and investors would benefit

from daily liquidity for their Fund holdings at the market price, as well as the right to redeem units of the Fund at their net asset value on an annual basis.

124. In addition, the NRIF structure will enable 3iQ to control the amount of capital raised and the size and timing of follow-on offerings in accordance with its standard of care as the Manager of the Fund.

125. In 2017, at least 5% of Canadians owned bitcoin. Canadian retail investors who currently invest in bitcoin frequently do so through unregulated cryptoasset trading platforms operating both inside and outside of Canada. As a result, they are exposed to the risks of halts in trading, inability to withdraw money, and hacks and frauds against their systems.

126. Canadian retail investors investing through unregulated cryptoasset trading platforms are also exposed to the risk of platform insolvency, as exemplified by the collapse of QuadrigaCX.

127. These risks illustrate that it is in the public interest for the Director to issue a receipt for the prospectus of the Fund so that retail investors can have access to a regulated, professionally managed vehicle through which to gain exposure to bitcoin.

128. Further, it is in the public interest for the OSC to balance Fair and Efficient Capital Markets with Investor Protection when considering whether to permit a public investment fund to hold a novel asset class, such as bitcoin.

129. Accordingly, the Director erred in fact, law and principle in his reasons for refusing to issue a receipt for the prospectus of the Fund by:

- (a) failing to consider Fair and Efficient Capital Markets; and

- (b) adopting an approach to Investor Protection which creates and applies new operational risk management standards to the Fund that are not prescribed in the securities regulatory regime applicable to public investment funds.

Other Grounds

130. The hearing and review is a hearing *de novo*, and no deference is owed by the Commission to the decision of the Director.

131. Although the Applicants contend that the Director made numerous errors of principle, law and fact, the Applicants do not need to establish any such errors to be successful on the hearing and review.

132. Sections 8 and 61 of the Act.

133. Such further and other grounds as the lawyers may advise.

C. DOCUMENTS AND EVIDENCE

The Applicants intend to rely on the following documents and evidence at the hearing:

134. The Affidavit of Shaun Cumby, to be sworn.

135. The March 2019 Prospectus.

136. The record of the proceedings before the Director, including:

- (a) the October 2018 Prospectus;
- (b) comment letters of Staff on the Confidential Preliminary Prospectus and the October 2018 Prospectus, and 3iQ's responses to such comment letters;
- (c) materials presented by 3iQ at its meeting with a Commissioner on August 1, 2018;

- (d) the Pre-File Refusal Letter;
- (e) materials presented by 3iQ to the Director and Staff at the October 2018 Meeting;
- (f) the Negative Recommendation Letter; and
- (g) the Decision.

137. Such further and other evidence as the lawyers may advise and the Commission may permit.

DATED this 15th day of March, 2019

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ONTARIO SECURITIES COMMISSION

APPLICATION
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