

Click to print or Select 'Print' in your browser menu to print this document.

Page printed from: <https://www.law.com/newyorklawjournal/2021/04/20/the-state-of-play-of-bitcoin-etfs-in-the-united-states/>

The State of Play of Bitcoin ETFs in the United States

Although the SEC has, so far, rejected more than a dozen requests to list a Bitcoin exchange-traded fund, there is hope that the first approvals are finally on the horizon.

By **David Zaslowsky** | April 20, 2021



Photo: by Wit Olszewski/Shutterstock

Bitcoin broke into the consciousness of the general public in 2017. In March of that year, the price surpassed its then-all-time-high of \$1,342. By Dec. 17, 2017, the price was \$19,783, up 1,824% from Jan. 1, 2017. About a year later, on Dec. 7, 2018, the price had dropped to below \$3,300, a 76% drop from the prior December. But by then, many investors (especially younger ones) were seemingly hooked. And, over the past year, the upside volatility has returned. On July 27, 2020, the price for Bitcoin had recovered the value lost in the COVID-19-related crash and was selling at \$10,944. It hit a new all-time high above \$64,000 on April 14, 2021.

But purchasing Bitcoin directly is not as easy as purchasing stocks. It requires establishing an account with an exchange, many of which charge relatively high commissions on cryptocurrency purchases. It is also necessary for a person to decide what kind of wallet to use to store their Bitcoin. And, there is that pesky problem of passwords. There is no "forgot password" option for cryptocurrency wallets. If one forgets their password, the Bitcoin is lost. By some estimates, about 20% of Bitcoin—valued at hundreds of billions of dollars—has been lost due to lost wallets or forgotten passwords. Thus, the idea of using a Bitcoin exchange-traded fund (ETF), which will greatly simplify the process of investing in Bitcoin.

An ETF is an investment fund that tracks the price of an underlying asset or index. Today, ETFs are available for several assets (ranging from commodities to currencies) as well as for different industries. ETFs allow investors to diversify their investments without actually owning the assets themselves. A Bitcoin ETF would work the same way; the price of one share of the ETF would fluctuate with the price of Bitcoin. If Bitcoin increases in value, so does the ETF, and vice versa. But the investor would not have to involve herself in the complicated process of buying Bitcoin and will not be bothered with exchanges or wallets.

There are other advantages to a Bitcoin ETF as well. The vehicle is well-established and well-known to millions of investors and is much better understood by the average investor than are cryptocurrencies. With an ETF, an investor looking to add cryptocurrency to his portfolio can do so using a trading vehicle he already understands, rather than having to learn the ins and outs of something new and, to some, seemingly complicated. Furthermore, many institutional investors might not have the option of purchasing cryptocurrencies and maintaining wallets, but will have no constraints on purchasing ETFs. And, there remains the possibility that a Bitcoin ETF could purchase stock in companies related in an ancillary manner to Bitcoin, thus giving investors the opportunity to diversify their portfolio.

There are some disadvantages as well of a Bitcoin ETF. The Bitcoin true believers pray at the altar of Bitcoin's being decentralized, unregulated and untethered to central banks (or any other government agency). Regulation of any kind, such as by the Securities and Exchange Commission (SEC), will be anathema to them. ETFs also come with annual management fees, which could make the investment more expensive. And, the flip side of the diversified portfolio mentioned above is that an investor might not benefit from the full upside of an increase in Bitcoin prices.

In any event, to date, the numerous efforts to obtain approval for a Bitcoin ETF from the SEC have all met with failure. The first attempt was by Cameron and Tyler Winklevoss. In 2017, the SEC rejected their application. The reason for the denial was because, according to the SEC, Bitcoin was traded on largely unregulated exchanges, leaving it susceptible to fraud and manipulation. SEC, "Order Disapproving a Proposed Rule Change ... To List and Trade Shares Issued by the Winklevoss Bitcoin Trust (<https://www.sec.gov/rules/sro/batsbx/2017/34-80206.pdf>)," pages 1-2. The group made some changes and resubmitted their application in June 2018. But in July 2018, the SEC rejected the revised request as well. SEC, "Self-Regulatory Organizations; Bats BX Exchange, Inc.; Order Setting Aside Action by Delegated Authority and Disapproving a Proposed Rule Change, as Modified by Amendments No. 1 and 2, to List and Trade Shares of the Winklevoss Bitcoin Trust (https://www.sec.gov/rules/other/2018/34-83723.pdf?mod=article_inline)."

The exchange that sought to list the Winklevoss's ETF had argued that Bitcoin trading was too decentralized across the globe for fraudsters to manipulate the price. But the SEC found that the record did not support that conclusion. The Commission also noted that "recent academic papers suggest that the price of bitcoin can be, and has been, manipulated through activity on bitcoin trading venues."

Republican Commissioner Hester Peirce dissented and said that the statutory standard had been met and that the SEC should therefore permit the Petitioner to list and trade its Bitcoin-based exchange-traded product. She wrote:

More institutional participation would ameliorate many of the Commission's concerns with the bitcoin market that underlie its disapproval order. More generally, the Commission's interpretation and application of the statutory standard sends a strong signal that innovation is unwelcome in our markets, a signal that may have effects far beyond the fate of bitcoin ETFs.

Despite the SEC's rejection, optimists saw a ray of hope. The SEC included the following qualifier: "[D]isapproval does not rest on an evaluation of whether bitcoin, or blockchain technology more generally, has utility or value as an innovation or an investment." Some read this to mean that the SEC might be receptive to a future Bitcoin ETF if the right conditions were met and its host exchange could provide proof of sufficient market protections.

Other applications were working its way through the process at the same time. In January 2018, Direxion Asset Management sought approval for five new funds. Proshares sought approval for two Bitcoin ETFs and GraniteShares made one application. On Aug. 22, 2018, the SEC issued three separate orders rejecting all of these applications. In all three orders, the SEC said:

[T]he Commission is disapproving this proposed rule change because, as discussed below, the Exchange has not met its burden under the Exchange Act and the Commission's Rules of Practice to demonstrate that its proposal is consistent with the requirements of the Exchange Act Section 6(b)(5), in particular the requirement that a national securities exchange's rules be designed to prevent fraudulent and manipulative acts and practices.

Overall, the SEC's concerns were broad, encompassing both the lack of controls and oversight by the exchanges, as well as a failure to demonstrate that Bitcoin futures markets are significant enough to resist price manipulation.

Once again, the SEC made sure to signal that it was not passing judgment on cryptocurrency or blockchain technology. There was one other positive indication for those hoping for eventual approval in that the SEC conceded that investors would gain an extra layer of protection by trading exchange-based products for Bitcoin. The Commission said that while it “acknowledges that, compared to trading in unregulated bitcoin spot markets, trading a bitcoin-based ETP on a national securities exchange may provide some additional protection to investors, [] the Commission must consider this potential benefit in the broader context of whether the proposal meets each of the applicable requirements of the Exchange Act.”

Others continued to try. Bitwise Asset Management, a crypto-focused asset manager and index provider, sought approval for its ETF in 2019. The SEC rejected it in October 2019. Bitwise then withdrew its application in January 2020.

On Feb. 26, 2020, the SEC issued an Order that rejected the request by Wilshire Phoenix for a Bitcoin-based ETF. The SEC’s reasoning was similar to what it had said in 2019 with respect to Bitwise and in 2018 with respect to proposed listing for the Winklevoss Bitcoin Trust—namely, Wilshire Phoenix was unable to persuade the Commission that the Bitcoin market was sufficiently resistant to market manipulation.

There was another common element to the Winklevoss situation in the form of a dissent from Commissioner Hester Pierce, affectionately known as “Crypto Mom,” and who, pretty much alone among the Commissioners, has shown a real understanding of the cryptocurrency market. Apparently questioning whether the SEC will ever change its thinking about cryptocurrency, she wrote as follows:

This order is the latest in a long string of disapproval orders that the Commission has issued regarding bitcoin-related products. This line of disapprovals leads me to conclude that this Commission is unwilling to approve the listing of any product that would provide access to the market for bitcoin and that no filing will meet the ever-shifting standards that this Commission insists on applying to bitcoin-related products—and only to bitcoin-related products.

SEC, “Dissenting Statement of Hester M. Peirce in Response to Release No. 34-88284; File No. SR-NYSEArca-2019-39 (<https://www.sec.gov/news/public-statement/peirce-dissenting-statement-34-88284>).”

Most in the industry believe it is a question of when, and not whether, the SEC will finally approve a Bitcoin ETF (or ETFs). And, from recent application activity, it looks like some in the industry think that the time might be sooner than later. In December 2020, the ETF and mutual fund manager, VanEck, refiled its ETF application, after having an earlier one rejected. The SEC acknowledged that application on March 15, 2021, triggering a 45-day period to make an initial decision on the proposal, although the SEC has the right to extend that deadline. On April 9, 2021, the SEC published a notice acknowledging the ETF application that was filed for Wisdom Tree’s proposed Bitcoin ETF, thus starting the clock running on that one as well.

Six other applications are pending at the time of this writing. In January 2021, Valkyrie, the operator of the Valkyrie Bitcoin Trust (BTCV), filed its application with the SEC to list a Bitcoin ETF on the New York Stock Exchange. In February 2021, NYDIG, the Bitcoin subsidiary of Stone Ridge Asset Management, also filed for a Bitcoin ETF. In March 2021, FD Funds Management, a subsidiary of Fidelity Investments, submitted a filing for Wise Origin Bitcoin Trust, a Bitcoin ETF. Also in March, SkyBridge Capital, the hedge fund run by Anthony Scaramucci (of Trump White House fame) filed an S-1 with the SEC to offer the First Trust SkyBridge Bitcoin ETF Trust. In April, Kryptoin Investment Advisors filed its S-1 registration form for its Bitcoin ETF. Most recently, on April 12, 2021, Galaxy Digital (associated with one of the Canadian ETFs mentioned below) submitted its application.

Unquestionably, one of the factors that has persuaded the market that the SEC will finally relent is that the United States will not be the first to approve a Bitcoin ETF. It can now look to the experience in Canada. On Feb. 12, 2021, Purpose Investments announced that the Canadian securities regulators (the Ontario Securities Commission) approved the launch of the Purpose Bitcoin ETF, making it the first Bitcoin ETF in the world to gain regulatory approval. Purpose Investments said: “The ETF will be the first in the world to invest directly in physically settled Bitcoin, not derivatives, allowing investors easy and efficient access to the emerging asset class of cryptocurrency.” A few days later the OSC approved a second Bitcoin ETF, from Evolve Funds. Both trade on the Toronto Stock Exchange.

There was immediately competition between the two. Purpose launched with a 1% management fee, and Evolve then entered the market with a fee of 0.75%. Within a week of launching, the Purpose Bitcoin ETF had more than \$590 million in assets under management. In March 2021, the CI Galaxy Bitcoin ETF became the third Bitcoin ETF to be launched on the Toronto Stock Exchange. The hope is that Ontario’s approval and the experience in Canada will help push the SEC to approve a Bitcoin ETF in the United States.

Furthermore, if approval is granted, the United States will not even be the second country to approve a Bitcoin ETF. In late March, Brazilian-based digital asset manager QR Capital announced that the Brazilian Securities and Exchange Commission (CVM) approved its application to list an ETF composed solely of Bitcoin. It will be listed on the São Paulo-based B3 Stock Exchange. The QR Capital ETF is scheduled to begin trading in June 2021.

One other reason for optimism by the ETF applicants is Gary Gensler, who was recently confirmed as President Biden’s choice to head the SEC. Gensler teaches at MIT on topics such as blockchain technology, digital currencies, financial technology and public policy. He is therefore much more tech savvy than his predecessor. It is hoped that he will bring a much more nuanced view to the cryptocurrency issues before the SEC and, along with Commissioner Pierce, once and for all change the position of the SEC with respect to Bitcoin ETFs.

David Zaslowsky is a partner in the New York office of Baker McKenzie, where he is the editor of the firm’s blockchain blog. His practice focuses on international arbitration and litigation, with many cases involving technology. He can be reached at david.zaslowsky@bakermckenzie.com (<mailto:david.zaslowsky@bakermckenzie.com>).

Copyright 2021. ALM Media Properties, LLC. All rights reserved.