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IN FOCUS

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SEC Approves Bitcoin Exchange-Traded Products (ETPs)

On January 10, 2024, the Securities and Exchange Commission (SEC) approved 11 spot Bitcoin exchange-traded product (ETP) Rule 19b-4 applications. U.S. Bitcoin ETP proposals first appeared more than a decade ago, but these were the first *spot* Bitcoin ETPs (as opposed to Bitcoin *futures* ETPs, explained in more detail below) to be approved. **Table 1** lists the relevant ETPs, their listing exchanges, and fees. This In Focus examines ETPs and their regulation and recent Bitcoin ETP developments and implications.

Table 1. SEC-Approved Spot Bitcoin ETPs (1/10/2024)

Issuer	Ticker	Exchange	Fees
Grayscale Bitcoin Trust	GBTC	NYSE	1.50%
ARK 21Shares Bitcoin ETF	ARKB	CBOE	0.21%
BlackRock's iShares Bitcoin Trust	IBIT	Nasdaq	0.25%
Bitwise Bitcoin ETF	BITB	NYSE	0.20%
VanEck Bitcoin Trust	HODL	CBOE	0.25%
Wisdomtree Bitcoin Fund	BTCW	CBOE	0.30%
Invesco Galaxy Bitcoin ETF	BTCO	CBOE	0.39%
Fidelity Wise Origin Bitcoin Trust	FBTC	CBOE	0.25%
Valkyrie Bitcoin Fund	BRRR	Nasdaq	0.49%
Hashdex Bitcoin ETF	DEFI	NYSE	0.90%
Franklin Bitcoin ETF	EZBC	CBOE	0.29%

Source: CRS using information from the SEC.

Notes: Some funds offer fee waivers for initial investment periods. Although some funds self-label as ETFs, they are technically ETPs per SEC standards. For more fund-level details, click here for an Excel file from the *Financial Times*. CBOE = Chicago Board Options Exchange BZX Exchange. NYSE = New York Stock Exchange Arca Exchange. Nasdaq = Nasdaq Stock Market, LLC.

Regulatory Frameworks

ETPs are pooled investment vehicles that gather and invest money from a variety of investors. Unlike mutual fund shares, which trade once per day at market close, ETPs trade throughout the day on national securities exchanges. ETPs include a diverse range of products that invest in a variety of financial assets. Exchange-traded funds (ETFs) are the largest and most well-known category of ETPs. ETFs must invest primarily in securities and register as investment companies under the Investment Company Act of 1940. The SEC has adopted "generic listing standards" that allow national securities exchanges to list and trade ETFs without obtaining individualized approval from the SEC. ETPs that are not ETFs include trust or partnership vehicles that invest primarily in physical commodities or derivatives contracts. Because they do not invest primarily in securities, ETPs in this category do not register under the Investment Company Act. Instead, they register their securities under the Securities Act of 1933. These ETPs are not registered investment companies. Thus, the SEC's generic listing standards are not available to them, and they are subject to individual approval from the SEC.

Rule 19b-4 Evaluations

National securities exchanges must obtain SEC approval of a proposed rule change under Rule 19b-4 before listing and trading the ETPs mentioned above. The Securities Exchange Act of 1934 requires the SEC to ensure that the rules of national securities exchanges meet certain standards. Section 6(b)(5) of the act prescribes that an exchange's rules must be "designed to prevent fraudulent and manipulative acts and practices." The SEC has not adopted a rule interpreting this language and instead evaluates exchange rule changes—including rule changes involving new ETPs—on a case-by-case basis.

Disclosure Requirements

Bitcoin ETP issuers must file Form S-1, the initial registration statement under the Securities Act for any new securities to be listed on national securities exchanges. Form S-1 includes information on the issuer's risk factors, a description of the securities and the issuer's management, use of proceeds, determination of offer price, and audited financial statements, among other disclosures. Part I of Form S-1 serves as the prospectus, the explanation document that investors involved in securities offering and sales must receive. After the effective initial filing, issuers must also comply with ongoing reporting requirements.

National Securities Exchanges Listing Standards

Bitcoin ETPs that list on national securities exchanges must comply with the respective exchange's listing rules governing practices such as financial and distribution standards and corporate governance requirements.

Regulation of Investment Advisory Intermediaries

Intermediaries involved in Bitcoin ETP asset management and investment advisory services, such as broker-dealers and SEC-registered investment advisors, could be subject to SEC fiduciary and Regulation Best Interest standards. These standards govern the intermediaries' professional conduct and disclosures, including mitigating conflict-of-interest concerns and appropriately prioritizing clients' interests relative to their own.

Spot Bitcoin ETP v. Bitcoin Futures ETP

An ETP can offer Bitcoin exposure by purchasing either Bitcoin itself ("spot" Bitcoin) or Bitcoin futures contracts. In 2021, the SEC did not object to the registration and listing of three ETFs providing exposure to Bitcoin futures. These ETFs were structured in a way that allowed them to be registered as investment companies under the Investment Company Act: The funds hold 75% of their assets in fixed-income securities and 25% of their assets in the form of shares of a wholly owned subsidiary, which in turn invests in Bitcoin futures traded on the Chicago Mercantile Exchange. While the ETFs are thus likely to derive the bulk of their total return from Bitcoin futures, their investment in securities makes them eligible for Investment Company Act registration. Because the ETFs were eligible for the SEC's generic listing standards given their status as registered investment companies, national securities exchanges were not required to submit rule change applications to the SEC before allowing the ETFs to trade.

In April 2022, the SEC approved the New York Stock Exchange's (NYSE's) application to list the Teucrium Bitcoin Futures Fund—an ETP registered under the Securities Act but not the Investment Company Act. In doing so, the SEC concluded that the ETP complied with Section 6(b)(5)'s requirement regarding fraud and manipulation by virtue of the NYSE's surveillance-sharing agreement with the Chicago Mercantile Exchange . (This argument later created ramifications for the D.C. Circuit's *Grayscale* decision that paved the way for the SEC's approval of spot Bitcoin ETPs.)

While Bitcoin futures ETPs offer investors exposure to Bitcoin, commentators have identified several potential disadvantages that such products face relative to a spot Bitcoin ETP. Perhaps most significantly, because futures contracts expire upon a certain date, futures ETPs must regularly "roll" contracts from one period to another, incurring costs that can diminish returns.

The ETP structure may offer investors certain advantages over holding Bitcoin directly due to operational considerations. For example, a Bitcoin ETP would allow investors to gain exposure to Bitcoin via a traditional brokerage account, which would avoid the challenges that accompany self-custody of Bitcoin. While spot Bitcoin ETPs are new to the United States, multiple Ethereum and Bitcoin ETFs have received regulatory approval and popular market reception in Canada since 2021. Global spot Bitcoin ETFs trading in Canada, Europe, Brazil, and Australia, among others, reportedly totaled more than $4 billion as of November 2023.

The spot Bitcoin ETP structure also offers advantages to the largest publicly traded Bitcoin fund—the Grayscale Bitcoin Trust (GBTC). As of December 2023, GBTC owned more than 3% of Bitcoin in circulation, representing more than $26 billion. GBTC shares traded at a discount from the net asset value of GBTC's Bitcoin holdings. This discount was the result of GBTC's previous structure that did not allow investors to redeem shares for the trust's underlying assets, precluding the type of arbitrage that would cause the price of GBTC shares to converge with the price of those assets. The ETP structure—which relies on continuous creation and redemption of shares by authorized participants to keep an ETP's market price in line with its net asset value—erased the gap between GBTC share price and the value of its Bitcoin holdings right after the SEC approval.

Policy Debates

Bitcoin ETP proponents argue that the funds provide a familiar and convenient way for investors to invest in digital assets, enabling them to partake in potential financial gains. Additionally, one SEC commissioner has argued that the merits of Bitcoin as an investment are not appropriate considerations for the SEC, which is tasked with ensuring adequate disclosure and protecting investors from fraud—not evaluating the value of particular products. In a separate statement, two SEC commissioners stated that spot Bitcoin ETPs could be a pathway to allow the Bitcoin market to mature and provide investors with a safer means of accessing Bitcoin. Some Members of Congress sent a letter to the SEC in September 2023 and supported the spot Bitcoin ETPs as a safer and more transparent pathway for investors to access Bitcoin.

Opponents of spot Bitcoin ETPs point to risks associated with the funds. Concerns about fraud and manipulation remain at the center of the debates. Skeptics have argued that spot Bitcoin markets are rife with abuses and that SEC approval of a spot Bitcoin product would give cryptocurrencies an undeserved veneer of legitimacy. These concerns are related to separate arguments about the merits of Bitcoin as an investment. Some have questioned the economic or social value of cryptocurrencies, contending that Bitcoin has proven useful only as a vehicle for speculation and facilitator of illicit activity. In addition, Bitcoin ETP challenges as articulated in a 2018 SEC staff letter include valuation and pricing, custody, and liquidity.

The S-1 filings for spot Bitcoin ETPs summarize a variety of risk factors, including risks associated with Bitcoin and the Bitcoin network as innovative technology with limited operating history; the fact that Bitcoin spot markets are relatively new and largely unregulated; risks related to fraud, manipulation, and security breaches; cybersecurity risks; illicit activity concerns; valuation and trading risks; and regulatory uncertainty.

Market Implications

Bitcoin prices have increased in the months leading up to the SEC's spot Bitcoin ETP approval. The price increases may reflect anticipation that spot ETPs could generate greater demand in Bitcoin from retail as well as institutional investors, such as pension funds and registered investment adviser-based funds. Whether these higher price levels are sustainable remains to be seen. In the meantime, major traditional and new ETF vendors—such as BlackRock, Fidelity, and 21Shares—have staged a fee competition in connection with spot Bitcoin ETPs to attract capital inflow to their funds.

U.S. Bitcoin ETPs saw $4.6 billion in trading on their first day. BlackRock's IBIT became one of the best performing brand-new ETPs. This initial success of spot Bitcoin ETPs have prompted debates about the potential approval of more ETPs backed by other forms of digital assets, such as Ether. Skeptics remain wary over the longer-term benefits of the funds.

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