



Comment Letter regarding a proposed rule change to list and trade shares of the iShares Ethereum Trust under Nasdaq Rule 5711(d), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder

March 2024

*This comment letter is provided by CF Benchmarks, the UK Financial Conduct Authority regulated Administrator of both the CME CF Ether Dollar Reference Rate – New York Variant (ETHUSD\_NY) the “Benchmark Index” cited as the means for calculating the NAV of the iShares Ethereum Trust, and the CME CF Ether Dollar Reference Rate (ETHUSD\_RR) that is used to settle the Ether-USD futures contract listed for trading by CME Group.*

## Introduction

The proposed rule change (the “Proposal”) would allow for the listing of the iShares Ethereum Trust (“the Trust”) on the Nasdaq Stock Market (“Nasdaq”), making it the first exchange traded product (ETP) holding Ether (ETH) to be listed for trading on a National Securities Exchange (NSE). To best understand whether the proposed listing of the Trust would be consistent with the obligations of Nasdaq under the Securities and Exchange Act 1934 (the “Act”) CF Benchmarks believes that the recent order approving spot Bitcoin ETPs would serve as the best guide to understand what standard is required to be met for an Ether ETP to be approved under the Act, because:

- Bitcoin and Ether are both crypto assets:
  - both being the native economic unit, the means of payment to facilitate transactions, of their respective blockchains;
  - both are traded on spot trading platforms that are not yet subject to capital markets regulations such as the Securities and Exchange Act 1934 (“unregulated”);
  - both having futures and options contracts listed on Designated Contract Markets (“DCM”), cleared by Designated Clearing Organisations (“DCO”) as commodity futures and options contracts and thus solely under the regulatory oversight of the Commodities and Futures Trading Commission (“CFTC”)

In the order approving the listing of spot Bitcoin ETPs<sup>1</sup> the Commission cited a number of reasons why the proposed spot Bitcoin ETPs met the regulatory standard required of ETPs under the Securities and Exchange Act 1934 (Exchange Act) and thus the proposed 19b(4) rule changes were approved. These reasons were:

- That Bitcoin was correctly classified as a commodity by NSE’s, hence the proposals to list the Bitcoin ETPs under Commodity Trust rules were correct.
- That the NSE’s had in place surveillance sharing agreements with a significant market – the CME Bitcoin-USD Futures market, “*to assist in detecting and deterring manipulation of the ETP, because a person attempting to manipulate the ETP is reasonably likely to also engage in trading activity on that “significant market.”*”
  - The CME Bitcoin -USD Futures market was deemed a “significant market” able to due to the returns exhibited from that market over specified intervals was highly correlated with that of major spot Bitcoin trading platforms.

In the course of this letter CF Benchmarks will demonstrate that both the above conditions also hold true for Ether.

## Listing the iShares Ethereum Trust as Commodity Trust Shares under Nasdaq Rule 5711(d) - Ether as a Commodity

The proposed listings of Bitcoin ETPs were as commodity trust shares, and Bitcoin was treated as such in the Commission’s determination that the listing of the ETPs under the Exchange rules was appropriate. To understand whether this proposal by Nasdaq should be approved by the Commission we must therefore examine whether Ether is a commodity and hence that the designation of the proposed ETP shares as commodity trust shares is appropriate. Whilst many experts have opined on what attributes determine whether something is a commodity, for the purposes of determining whether the proposed Nasdaq rule change is appropriate we believe that this determination should be grounded in **regulatory precedent** and all known regulatory actions regarding the designation of Ether.

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<sup>1</sup> <https://www.sec.gov/files/rules/sro/nysearca/2024/34-99306.pdf>

### The CME Ether Futures and Options Markets

The CME Group first listed Ether-USD futures for trading on February 8<sup>th</sup> 2021, subsequent to that on September 12<sup>th</sup> 2021 options on Ether-USD futures were also listed for trading. Since these initial launches, futures and options contracts for Micro Ether - USD (sized at 0.1 of an Ether as opposed for 50 Ether for the existing Ether futures) were also launched. CF Benchmarks is the settlement index provider for all the aforementioned Ether-USD contracts.

Whilst DCMs and DCOs fall solely under the regulatory purview of the CFTC, futures contracts themselves are regulated in a variety of ways depending on the underlying assets that the contracts reference. Specifically, CFTC regulated futures **contracts** are designated as **commodity futures contracts** or **security futures contracts**. Commodity futures contracts as their name implies reference underlying commodity assets with solely the CFTC providing regulatory oversight. Security futures contracts, where the futures contract references a single security or a narrow index of securities as the underlying asset(s), come under the joint regulatory jurisdiction of the CFTC and the Commission<sup>2</sup>

Since the CME Ether-USD futures contracts were first listed and through the subsequent listing of options on these contracts, micro Ether-USD futures contracts and options on such contracts they have all been designated commodity futures contracts, regulated solely by the CFTC. In fact there have since December 2022 been ETPs listed on NSE's under the Commissions direct regulatory purview that solely hold these Ether-USD futures contracts regulated by the CFTC, as commodity futures contracts.

### The Commissions Legal Complaints Against Spot Crypto Asset Trading Platforms

The Commission's enforcement division has filed complaints against a number of spot crypto asset trading platforms (including Kraken, the ultimate owner of CF Benchmarks) that offer trading in the Ether crypto asset. In these complaints the Commission alleges that the spot trading platforms are operating as unregistered; securities exchanges, transfer agents, broker-dealers and clearing agency, the allegations stem from the Commission's belief that a number of crypto assets are in fact crypto asset securities, and hence the various services that the spot trading platforms provide are in fact regulated activities as they are delivered in service of crypto asset securities. Specifically, the Commission cited the below crypto assets as in fact, being crypto asset securities:

- Solana (SOL)
- Cardano (ADA)
- Polygon (MATIC)
- Filecoin (FIL)
- The Sandbox (SAND)
- Axie Infinity (AXS)
- Chiliz (CHZ)
- Flow (FLOW)
- Internet Computer Protocol (ICP)
- NEAR (NEAR)
- Voyager (VGX)
- Dash (DASH)
- Nexo (NEXO)

Historically when the Commission has determined that unregistered securities transactions have taken place it has filed a complaint against the issuer of the unregistered security. Whilst the Commission's approach in filing complaints against the service providers is novel, the most important point for the purposes of contemplating the

<sup>2</sup> <https://www.cftc.gov/IndustryOversight/ContractsProducts/SecurityFuturesProduct/sfpregulationsrequirements.html>

Commented [JZ1]: Added apostrophe to 'Commission's'

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Commented [JZ3]: Added apostrophe to 'Commission's'

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Proposal is that the above list does not include Ether, even though all the spot trading platforms offer markets for the trading of Ether.

Given the regulatory record and the previous actions of the Commissions it would be difficult to conceive of Ether as anything other than a commodity and hence the Proposal to list the shares of the Trust as commodity trust shares would be consistent with the Commission's prevailing definitions of such instruments.

### Meeting the Standard of the Securities & Exchange Act 1934 Section 6(b)(5)

*Securities and Exchange Act 1934 Section 6(b)(5), that the rules of a national securities exchange be "designed to prevent fraudulent and manipulative acts and practices" and "to protect investors and the public interest."*

#### The Commission's interpretation of how the standard can be met with reference to crypto assets

The Commission has maintained a consistent approach to how the standards of Section 6(b)(5) can be met by NSE's seeking to make a crypto asset ETP available for trading. This is first elucidated in the order disapproving a proposed rule change by the BATS BZX Exchange Inc. to list the shares of the Winklevoss Bitcoin Trust<sup>3</sup> ("the Winklevoss Order"):

*"First, the exchange must have surveillance-sharing agreements with significant markets for trading the underlying commodity or derivatives on that commodity. And second, those markets must be regulated."*<sup>4</sup>

In subsequent orders disapproving proposals from other NSEs to list spot Bitcoin ETPs the standard was further expanded upon, defining the significant market requirement.

*"Thus, a surveillance-sharing agreement must be entered into with a "significant market" to assist in detecting and deterring manipulation of the ETP, because a person attempting to manipulate the ETP is reasonably likely to also engage in trading activity on that "significant market."*<sup>5</sup>

In the subsequent order approving the listing of several spot Bitcoin ETPs<sup>6</sup> on multiple NSEs the standard was deemed to have been met due to **both** the below, being true<sup>7</sup>.<sup>7</sup>

1. Each of the NSE's being members of the Inter-market Surveillance Group (ISG) and hence having surveillance agreements in place with the CME Group
2. That the Bitcoin-USD Futures listed by CME Group was empirically evidenced to show very high correlation with major spot Bitcoin markets

The Commission drew the conclusion that the CME BTC-USD futures market being one of "significant size" because the high degree of correlation of returns of spot and futures markets meaning that "a person attempting to manipulate the ETP is reasonably likely to also engage in trading activity on that "significant market" [CME Group]

<sup>3</sup> Order Disapproving a Proposed Rule Change, as Modified by Amendments No. 1 and 2, to BZX Rule 14.11(e)(4), Commodity-Based Trust Shares, to List and Trade Shares Issued by the Winklevoss Bitcoin Trust <https://www.sec.gov/files/rules/sro/batsbzx/207/34-80206.pdf>

<sup>4</sup> Ibid (p2)

<sup>5</sup> Order Disapproving a Proposed Rule Change, as Modified by Amendment No. 1, Relating to the Listing and Trading of Shares of the Bitwise Bitcoin ETF Trust Under NYSE Arca Rule 8.201-E

<sup>6</sup> Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendments Thereto, to List and Trade Bitcoin-Based Commodity-Based Trust Shares and Trust Units: (<https://www.sec.gov/files/rules/sro/nysearca/2024/34-99306.pdf>)

<sup>7</sup> Ibid,p10

**Does the Proposal meet part one of the standard?**

As far as CF Benchmarks is aware the Nasdaq Stock Market is a member of the ISG alongside CME Group and therefore a comprehensive surveillance sharing agreement is in place. Thus, the first condition for approval based on the Commissions standard has been met.

**Correlation of returns between major spot ETH-USD markets and the CME Ether-USD futures market**

To ascertain conformance to the second condition and whether the CME Ether-US Dollar futures market can be considered a market of “*significant size*” a comparison to the data published by the Commission in its Approval Order for spot Bitcoin ETFs is required.

CF Benchmarks undertook a comprehensive an analysis of returns observed in the CME ETH-USD Futures market and those observed on major Ether-USD spot market.

Period	Trading Volume Share of ETH-USD markets of spot Ether trading platforms						
	Coinbase	Bitstamp	itBit	Kraken	Gemini	LMAX Digital	Others*
2023 Q1	59.11%	3.32%	0.48%	8.98%	1.13%	8.42%	18.56%
2023 Q2	56.47%	4.28%	0.53%	13.05%	1.56%	14.32%	9.79%
2023 Q3	56.08%	4.11%	0.62%	9.90%	1.38%	10.80%	17.10%
2023 Q4	44.88%	2.29%	0.52%	10.97%	1.44%	8.70%	31.20%

Source: CF Benchmarks- data collected in real time from public API of spot Ether trading platforms

\*Bitfinex, Gate.io, Crypto.com Exchange, CEX.io

The spot platforms chosen, constitute on average, 75% of Ether-USD trading volume over the past four quarters and have contributed on average 87% of the trading volume observed in the determination of the CME CF Ether-Dollar Reference Rate – New York Variant, the benchmark index provided by CF Benchmarks that the Trust will use to calculate the Net Asset Value for the Trust.

**Analysis Method**

- All transactions conducted on the following markets between February 2<sup>nd</sup> 2022 and February 2<sup>nd</sup> 2024 were observed (all spot Ether trading platform data was collected in real time from the respective platform public API, all CME ETH-USD Futures Contract data was collected from CME DataMine):
  - Kraken:** Ether-US Dollar
  - Coinbase:** Ether-US Dollar
  - LMAX Digital:** Ether-US Dollar
  - CME: ETH-USD Futures Contract** (closest to expiry)
- Price returns for each of the above were calculated at hourly, five-minute and one-minute intervals,
- Pearson correlation analysis was conducted for the price returns of each of Kraken, Coinbase and LMAX Digital against those of CME Ether-USD Futures, in the same manner as the Commission conducted in its spot Bitcoin approval order<sup>8</sup>.
- The results of this analysis are shown in the table below:

<sup>8</sup> Ibid, p.9

Pearson Analysis		Coinbase			Kraken			LMAX Digital		
		1h	5m	1m	1h	5m	1m	1h	5m	1m
Full Sample (Feb 2nd '22 to Feb 2nd '24)		0.980	0.915	0.849	0.982	0.920	0.849	0.981	0.918	0.857
Rolling 3M	Maximum	0.990	0.929	0.868	0.990	0.934	0.869	0.994	0.947	0.881
	Minimum	0.963	0.813	0.820	0.963	0.823	0.812	0.961	0.853	0.810

In the interests of transparency and to allow the Commission Staff and any members of the public to recreate and verify our calculations the full raw data set and the calculation steps that the CF Benchmarks team undertook has been made publicly available at:

[www.cfbenchmarks.com/blog/ETHEF-SEC-Comment-Letter-Data](http://www.cfbenchmarks.com/blog/ETHEF-SEC-Comment-Letter-Data)

The results of the analysis confirm that the CME Ether-USD futures market has been consistently highly correlated with this subset of the spot Ether market throughout the past 2 years. The correlation between the CME Ether futures market and this subset of spot Ether platforms for the full sample period is no less than 98.0 percent using data at an hourly interval, 91.5 percent using data at a five-minute interval, and 84.9 percent using data at a one-minute interval. The rolling three-month correlation results are similar: ranging between 96.1 and 99.4 percent using data at an hourly interval, 81.3 and 94.7 percent using data at a five-minute interval, and 81.0 and 88.1 percent using data at a one-minute interval.

When we compare these results to the correlation analysis that the Commission undertook to confirm that the CME Bitcoin-USD futures market was highly correlated with spot Bitcoin trading platforms we see that the difference between those results and these spot Ether trading platforms and CME Ether-USD futures markets are negligible:

		Coinbase			Kraken		
		1h	5m	1m	1h	5m	1m
Full Sample (Feb 2nd '22 to Feb 2nd '24)		0.984	0.946	0.771	0.984	0.942	0.769
Rolling 3M	Maximum	0.992	0.943	0.832	0.991	0.945	0.824
	Minimum	0.950	0.876	0.695	0.950	0.840	0.679

SEC Correlation Analysis, reproduced from Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendments Thereto, to List and Trade Bitcoin-Based Commodity-Based Trust Shares and Trust Units: (<https://www.sec.gov/files/rules/sro/nyssearca/2024/34-99306.pdf>) p.9

In fact the data shows that the *minimum* correlations exhibited by spot Ether trading platforms to the CME Ether-USD futures market are on the whole stronger than those exhibited by the spot Bitcoin platforms to the CME Bitcoin-USD futures market that the Commission cited in support of its conclusion that the CME Bitcoin-USD futures market met the standard of being a “*significant market*” in the context of upholding the provisions of *Securities and Exchange Act 1934 Section 6(b)(5)*.

## Conclusion

Given the regulatory precedents set by the actions or inactions of the Commission; through its lack of involvement in the oversight of the CME Ether-USD futures contract, the approval of ETPs holding the CME Ether-USD futures contract and the complaints it has made against spot crypto asset platforms one can only conclude that Ether is a commodity and hence the Proposal for the listing of the Trusts shares as commodity trust shares is correct.

The Exchange has comprehensive surveillance sharing agreements in place with the CME Group. The CME Group can be considered a “*significant market*” for Ether-USD trading when applying the quantitative standard that the Commission applied in its approval of the spot Bitcoin ETPs. Therefore, it can be concluded that the Proposal does indeed conform to the requirements of the Securities & Exchange Act 1934 Section 6(b)(5)

Given the that the Proposal is correctly classified as the listing of commodity trust shares and that the Exchange has in place what is necessary to uphold the requirements of the **Securities & Exchange Act 1934 Section 6(b)(5)** the conclusion is that the Proposal should be approved.