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June 11, 2019

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F St, N.E.
Washington, DC 20549-1090

Re: File No. SR-NYSEArca-2019-01: Proposal to List and Trade Shares of the Bitwise Bitcoin ETF Trust Under NYSE Arca Rule 8.201-E - CFE Futures Question

Dear Mr. Fields,

In the U.S. Securities and Exchange Commission's (SEC's) Order Instituting Proceedings for File SR-NYSEArca-2019-01¹, the SEC asked a series of questions regarding Bitwise's proposal to list the Bitwise Bitcoin ETF Trust², as well as NYSE Arca's related and amended Rule 19b-4 Filing.³

One narrowly focused question had to do with the evolution of the regulated bitcoin futures market, and specifically, on the decision by the Chicago Futures Exchange (CFE) to stop listing additional bitcoin derivatives contracts. The Order asked:

To what extent, if at all, do recent developments in the bitcoin futures market—namely, the cessation of new bitcoin futures contract trading on the Chicago Futures Exchange—affect commenters' analysis of these questions?

The goal of this Comment Letter is to answer this narrow question.

Why Does The Bitcoin Futures Market Matter?

¹ "Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1, Relating to the Listing and Trading of Shares of the Bitwise Bitcoin ETF Trust," U.S. Securities and Exchange Commission, May 14, 2019. <https://www.sec.gov/rules/sro/nysearca/2019/34-85854.pdf>

² "Amendment No. 1 to Form S-1, Bitwise Bitcoin ETF Trust," Bitwise Asset Management, April 16, 2019. <https://www.sec.gov/Archives/edgar/data/1763415/000149315219005505/forms-1a.htm>

³ Form 19b-4, File SR-NYSEArca-2019-01. NYSE Arca, May 7, 2019.

<https://www.sec.gov/comments/sr-nysearca-2019-01/srnysearca201901-5461982-184967.pdf>

In the Winklevoss Order⁴, the SEC laid two pathways by which a bitcoin ETF could satisfy the requirements of Exchange Act 6(B)(5), which focuses on market manipulation. One of those pathways was for the listing exchange of the ETF to enter into a surveillance sharing agreement with a regulated market of significant size.

Bitwise has argued in multiple documents filed with the SEC, including “Economic and Non-Economic Trading in Bitcoin: Exploring the Real Spot Market for the World’s First Digital Commodity,” a white paper submitted to the SEC on May 24, 2019 (the “Bitwise White Paper”),⁵ that the regulated bitcoin futures market satisfies this requirement. Specifically, we have pointed out that the CME bitcoin futures market is large, with volume often exceeding that of the largest single spot bitcoin exchange, and that prices on that market are tightly linked with prices in the spot market. Because both the CME and the proposed listing exchange, NYSE Arca, are part of the Intermarket Surveillance Group, we believe our proposal satisfies the requirements laid out in the Winklevoss Order.

The SEC’s question regarding the cessation of the CFE’s bitcoin futures contract is important, however, in that it raises questions about the sustainability of the broader bitcoin futures market. Therefore, it’s important to consider whether the CFE’s abandonment of the market reflects an idiosyncratic business decision or a systemic problem with interest in bitcoin futures.

The History of the Regulated Bitcoin Futures Market

The CFE, part of the Chicago Board Options Exchange (Cboe), launched the first significant, regulated bitcoin futures contract in the U.S. on December 10, 2017.⁶ The CME Group launched its own bitcoin futures contract on December 18, 2017.⁷

Both contracts are cash-settled, and upon launch, the two were seen as directly competitive.

⁴ “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,” U.S. Securities and Exchange Commission, July 26, 2018. <https://www.sec.gov/rules/other/2018/34-83723.pdf>

⁵ “Economic and Non-Economic Trading in Bitcoin: Exploring the Real Spot Market for the World’s First Digital Commodity,” Matthew Hougan, Hong Kim and Micah Lerner, Bitwise Asset Management, May 24, 2019. <https://www.sec.gov/comments/sr-nysearca-2019-01/srnysearca201901-5574233-185408.pdf>

⁶ “CBOE Plans December 10 Launch of Bitcoin Futures Trading,” CBOE, press release, December 4, 2017.

<http://ir.cboe.com/~media/Files/C/CBOE-IR-V2/press-release/2017/cboe-plans-december-10-launch-of-bitcoin-futures-trading.pdf>

⁷ “CME Group Self-Certifies Bitcoin Futures to Launch Dec. 18,” CME Group, press release, December 1, 2017.

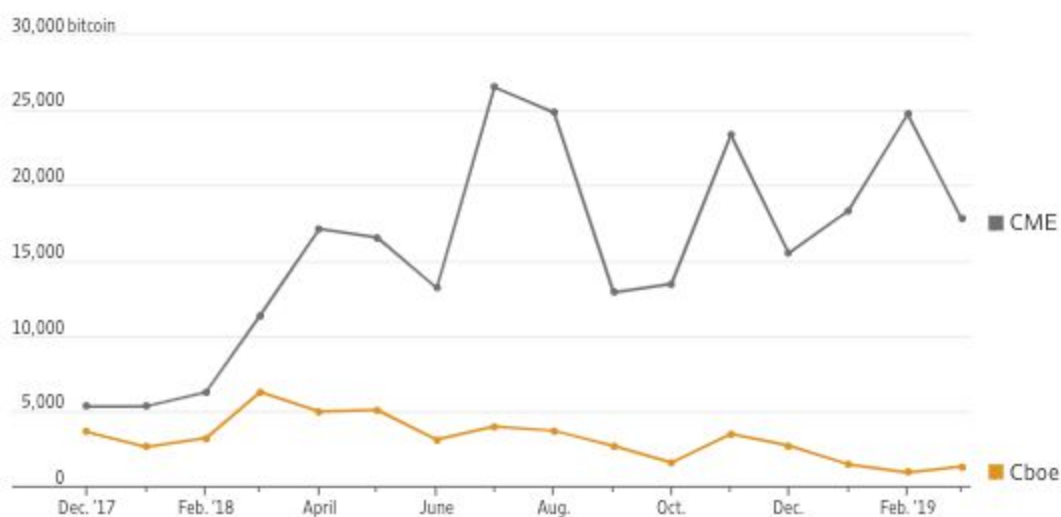
https://www.cmegroup.com/media-room/press-releases/2017/12/01/cme_group_self-certifiesbitcoinfuturestolaunchdec18.html

Almost immediately, however, the majority of volume migrated to the CME contract, as shown in this chart from The Wall Street Journal⁸:

Losing the Race

Cboe Global Markets is winding down its bitcoin futures after a rival contract from CME Group drew more trading activity.

Average daily trading volume in most active monthly contract



Note: Each Cboe contract covers one bitcoin; CME contracts are for five bitcoins each; Through Friday
Source: FactSet

It is difficult to determine precisely what caused the CME contract to win out, but the two contracts have notable differences:

- **Size:** Each CME contract accounts for 5 bitcoin, while the CFE contract represents 1 bitcoin.
- **Pricing:** The CME contract settles based on the CME CF Bitcoin Reference Rate (BRR), which draws prices from four major crypto exchanges and uses a sophisticated methodology to remove outlier prices. The CFE contract settles on the closing auction price at the Gemini exchange, which represents a relatively small fraction of global bitcoin spot volume.
- **TAS Trading:** The CME contract allows for Trading At Settlement (TAS), a popular order type that allows a trader to lock in the settlement price (or something close to it) prior to the end of the day. The CFE contract does not allow for TAS.

⁸ "Cboe Abandons Bitcoin Futures," Alexander Osipovich, The Wall Street Journal, March 18, 2019. <https://www.wsj.com/articles/cboe-abandons-bitcoin-futures-11552914001>

Whatever the reason, by early 2019, it was clear that the CME dominated the market: It had established a liquidity advantage over the CFE that would be hard for the CFE to overcome. As a result, on March 14, 2019, Cboe announced it would stop issuing new CFE bitcoin contracts, ceding the market to the CME.⁹

What Does This Mean For The Bitcoin Futures Market?

We do not believe that Cboe’s decision to cease offering new bitcoin futures contracts on the CFE suggests anything about the long-term health of the bitcoin futures market; instead, it simply suggests that Cboe lost a competitive battle to attract investors and traders to its contract.

Towards that end, since Cboe’s announcement, bitcoin futures volume on the CME has soared, setting new monthly records in each of April and May, as shown in the figure below (pulled from the Bitwise White Paper).

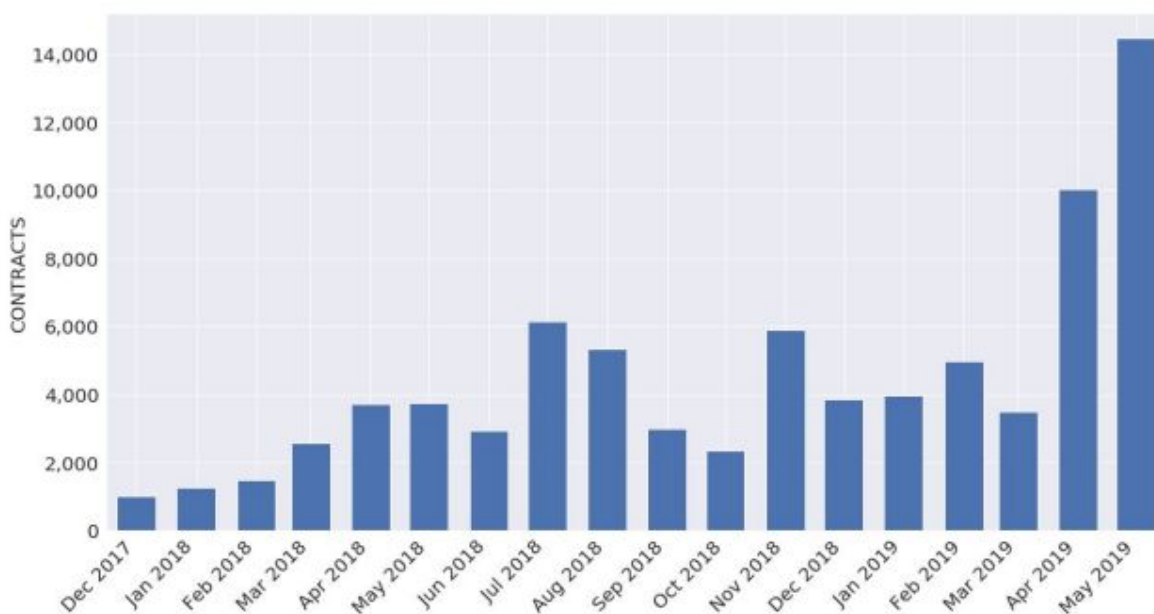


Figure 22: Average number of futures contracts traded daily by month since inception¹⁵⁴

It is common for futures volumes to concentrate on a single contract and a single exchange, as there is an advantage to aggregating liquidity. We anticipate that whatever residual real trading interest existed on the CFE contract will migrate over to the CME when the last CFE contract expires in June.

⁹ “New CFE Products Being Added In March 2019–Update,” CBOE, March 14, 2019. https://markets.cboe.com/resources/product_update/2019/New-CFE-Products-Being-Added-in-March-2019-Update.pdf

Conclusion

The regulated bitcoin futures market is large, robust and growing. Average daily trading volume set new records in May 2019, when the CME bitcoin futures market had a higher average daily trading volume than any of the ten real bitcoin spot exchanges.

The fact that the Cboe has stopped issuing new contracts on the CFE is simply a sign that it's ceding the market to the CME, and does not reflect on the long-term health of the bitcoin futures market in general

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Matthew Hougan', with a long horizontal flourish extending to the right.

Matthew Hougan
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