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Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
Rule-comments@sec.gov

Re: Bitcoin ETF proposals

Grayscale Bitcoin Trust	SR-NYSEArca-2021-90
ARK 21Shares Bitcoin ETF	SR-CboeBZX-2023-028
Bitwise Bitcoin ETF Trust	SR-NYSEARCA-2023-44
iShares Bitcoin Trust	SR-NASDAQ-2023-016
VanEck Bitcoin Trust	SR-CboeBZX-2023-040
WisdomTree Bitcoin Trust	SR-CboeBZX-2023-042
Invesco Galaxy Bitcoin ETF	SR-CboeBZX-2023-038
Wise Origin Bitcoin Trust	SR-CboeBZX-2023-044
Valkyrie Bitcoin Fund	SR-NASDAQ-2023-019
Global X Bitcoin Trust	SR-CboeBZX-2023-058
Hashdex Bitcoin ETF	SR-NYSEARCA-2023-58
Franklin Bitcoin ETF	SR-CboeBZX-2023-072
Pando Asset Spot Bitcoin ETF	SR-CboeBZX-2023-101

¹ All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else. I am very grateful to Georgetown University for financial support. Over the years I have served as a Visiting Academic Fellow at the NASD (predecessor to FINRA), served on the boards of the EDGX and EDGA stock exchanges, served as Chair of the Nasdaq Economic Advisory Board, and performed consulting work for brokerage firms, stock exchanges, other self-regulatory organizations, government agencies, market makers, industry associations, and law firms. I am the academic director for the FINRA Certified Regulatory and Compliance Professional (CRCP[®]) program at Georgetown University. I've also visited over 85 licensed financial exchanges around the world. As a finance professor, I practice what I preach in terms of diversification and own modest and well-diversified holdings in most public companies, including brokers, asset managers, market makers, and exchanges.

Summary

- Media reports indicate that we will soon have spot-bitcoin-based ETFs.
- In-kind creation/redemption reduces costs and risks to investors.
- Sponsors should be able to do in-kind creations/redemptions.
- My previous suggestions on crypto regulation are updated and attached.

Dear SEC:

Media reports indicate that the long overdue approval of a spot-bitcoin ETF is imminent.² Getting this done quickly and properly will free up SEC resources to do the other more important things in furtherance of the SEC's important mission.

I've noticed some reports that the SEC is considering allowing only cash creation/redemption.³ If the media reports are accurate, that would be a big mistake.⁴ Issuers and APs would not have the freedom to choose whether to create/redeem in-kind. This would impose costly frictions on the create/redeem process, resulting in wider bid-ask spreads and mispricing of an ETF relative to the spot price. This will result in higher costs and mispricing risk to investors.

In-kind creation/redemption eliminates trading costs and execution risks for the ETF.

With cash creation/redemption, the ETF (and thus the shareholders) suffers the transaction costs of buying and selling bitcoin. These costs include the bid-ask spread along with the operational costs from the labor and overhead involved in calculating, executing, monitoring, and accounting for transactions in the various bitcoin markets. Costs to ETF shareholders will be lower if the ETF does not have to pay to build a competent trading capacity in bitcoin.

Furthermore, there are timing costs involved in the risk that the bitcoin price moves between the time when the NAV is established for a creation/redemption and the time when the bitcoin is traded. Given the high volatility of bitcoin, this is a real risk. There is no reason to force the shareholders to bear this execution risk when it is not necessary.

Other commodity-based ETFs don't require cash creation/redemption.

² Kate Dore, CFP, "Spot bitcoin ETF approval by the SEC is approaching, experts say. What that means for investors" CNBC (Nov. 13, 2023), <https://www.cnbc.com/2023/11/13/spot-bitcoin-etf-approval-is-approaching-experts-say-what-to-know.html>.

³ Suzanne McGee and Hannah Lang, "US bitcoin ETF issuer talks with SEC have advanced to key details -sources," REUTERS (Dec. 7, 2023); <https://www.reuters.com/technology/us-bitcoin-etf-issuer-talks-with-sec-have-advanced-key-details-sources-2023-12-07/>.

⁴ In other words, issuers could only receive cash from an Authorized Participant (AP) and then be forced to buy bitcoin in the open market in order to create ETF shares. Likewise, the issuer would be required to sell bitcoin for cash when an AP wants to redeem ETF shares.

It's worth noting that other commodity-based ETFs such as GLD generally don't even offer cash creations/redemptions. They do this because in-kind creation/redemption is far more efficient and beneficial to shareholders.

The Commission may be concerned about custody/operational risk to the APs, the broker-dealers who are facilitating price formation and liquidity.⁵ They are the ones who need to have policies and procedures in place for assuring custody of their own assets. Indeed, it is important for these entities and the rest of the industry to gain operational experience with the safe handling of crypto assets because they are not going away.

As digital bearer assets, crypto assets have many of the same security risks as cash or physical commodities such as gold. The APs who make markets in gold ETFs have already demonstrated their capacity to make safe physical delivery to create/redeem gold ETFs.

The US traditional cash payment system is slow. Quite frankly, the crypto settlement system works faster and achieves finality within minutes and not the days sometimes required in the traditional finance system. Permitting in-kind creation/redemption thus reduces the problems that occur when operational glitches occur in our antiquated payment infrastructure and potentially result in price dislocations in the ETF.

ETF sponsors should have the freedom to accept bitcoin directly.

The SEC should resist the urge to micromanage how ETF sponsors do the creation/redemption process. It should be left to the professional judgment of the ETF sponsors. The SEC should listen to the ETF sponsors that have decades of daily hands-on experience with creating and redeeming ETFs. I believe they know what they are doing. . Blackrock has pointed out how an in-kind model offers lower transaction costs, superior resistance to market manipulation, reduction in risks of operating events, and simplicity.⁶ Fidelity has also pointed out the advantages of the in-kind model.⁷

Now that the Commission has seemingly become comfortable with allowing spot bitcoin ETFs to trade in the U.S., it should not squander this positive development by forcing a suboptimal product (cash-only creation/redemption) to come to market.

Respectfully submitted,

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⁵ <https://www.sec.gov/comments/s7-25-20/s72520.htm>.

⁶ <https://www.sec.gov/comments/sr-nasdaq-2023-016/srnasdaq2023016-303319-781202.pdf>.

⁷ <https://www.sec.gov/comments/sr-cboebzx-2023-044/srcboebzx2023044-308919-795162.pdf>.

In case you missed it

In my previous comment letter on bitcoin ETFs, I made some comments on bitcoin ETFs and crypto regulation.⁸ Here is an updated version of them.

The Creation Unit for a bitcoin ETF should be only 100 shares.

The creation unit is the minimum number of shares needed to create or redeem a basket of ETF shares. For ETFs that hold hundreds (e.g. SPY) or thousands (e.g. VTI) of assets, it makes sense to make the creation unit large. Otherwise, the creation basket could end up holding fractional shares of the smallest components. There is no good reason that the creation unit for a spot bitcoin-based ETF should be 50,000 shares. Bitcoins are easily divisible down to one satoshi, 0.00000001 BTC.

An overly large creation unit makes it unwieldy for arbitrageurs to create or redeem shares. This will force arbitrageurs to either hold larger inventories of either ETF shares or bitcoins, or wait further before stepping in to correct mispricing. This will lead to wider bid-ask spreads and more mispricing of the ETF relative to the spot price.

In general, smaller creation unit sizes make it easier for APs to create or redeem ETF shares. Smaller creation units can reduce transaction costs that get passed on to ETF investors. This can also help to reduce the endemic settlement failures we often see in ETFs by making it more cost effective to create shares rather than fail to deliver.

As only Authorized Participants (APs) can create or redeem shares, there is no danger of retail investors lining up to clog the system with create/redeem requests. The creation unit should be no larger than 100 shares for a bitcoin ETF. Any inefficiencies involved in handling smaller orders should be paid for by the transaction fees charged by the ETF sponsor for creations and redemptions.

Make Intraday Indicative Values (IIVs) easier to find by including them in core market data.

It is good that ETF issuers provide near real-time estimates of the value of the underlying portfolio. While some market professionals discount the usefulness of IIV data due to the 15-second time lags involved, they are still quite useful to retail investors to determine whether the current retail price of an ETF is reasonably related to the underlying portfolio value.

Alas, while the IIVs have ticker symbols, they are not carried in the standard quotation data feeds and are unavailable on many brokerage web sites. The Commission should require the IIV data to be carried in the standard core data quote feeds so that all investors can benefit from them.

The SEC should provide a common-sense path to compliance for crypto entities. “Just say no” is no longer in the public interest.

⁸ <https://www.sec.gov/comments/sr-cboebzx-2023-028/srcboebzx2023028-243979-514922.pdf>

Crypto assets (sometimes referred to as digital assets) are widely misunderstood. Some view crypto as a new asset class. Such a view is a gross oversimplification. Crypto assets include a broad range of financial assets designed for different applications that range from solid stablecoins to payment coins to corporate ownership tokens to dodgy tokens of doubtful utility. The main distinguishing feature is that their ownership is recorded and transferred on a public database known as a blockchain.

In short, crypto has pioneered a new settlement rail that can support a wide range of assets.

The crypto world has developed new techniques of capital formation, security trading, and settlement. These techniques use modern computer and communication technologies that show great promise in promoting capital formation. The SEC should embrace this promise and use a common-sense approach to make use of the good parts of this technology while keeping the fraudsters and manipulators out.

The honest and law-abiding parts of the financial services industry need common-sense guidance from the SEC on how to make use of this technology in an appropriate way. The “just say no” approach that the SEC has followed is no longer in the public interest. The time has come for the SEC to approach crypto regulation directly. Many other serious jurisdictions have adopted rules for the crypto industry. The SEC should learn from their experience and adopt appropriate common-sense rules without further delay.

Use a “Light Touch to Start” approach to crypto regulation – except for fraud and manipulation.

The SEC should take a “light touch to start” approach to the regulation of crypto assets. Regulations can always be tightened up later as more experience is gained. Registration and disclosure should be simple, while enforcement should focus on the genuine fraudsters. Using a common-sense approach will allow technological progress to occur while providing appropriate levels of investor protection. As always, the SEC can and should rely upon traditional enforcement when it finds evidence of fraud and manipulation.

The SEC should declare a truce with the crypto industry and cease enforcement action against firms that make good-faith efforts to comply with the following:

1. Issuers of crypto assets must register them with the SEC using a “Form Crypto Asset” that contains fundamental information regarding the identity and background of the issuers in plain English. This form will be comparable to the “white papers” used to sell digital assets but would generally include the information required by Rule 15c2-11. These details include:
 - a. Names of key participants, their background, their compensation, any criminal or regulatory charges against them, other crypto-asset projects they are associated with.
 - b. Description of the business and how it works
 - c. Description of the governance and legal status of the entity such as form of incorporation (if any) and jurisdiction of incorporation (if any).
 - d. Information concerning the number of digital assets to be issued in the current offering and future plans for additional offerings.
 - e. Information regarding the identities (if known) about anyone holding 1% or the rights to more than 1% of the assets.
 - f. Information concerning the secondary market for the asset such as markets that trade the asset, recent prices and trading volumes.
 - g. Clear information as to the legal rights of the asset holders.
 - h. Any plans or promises regarding distributions to asset holders or repurchases and/or burning of assets.

- i. Financial statements of the entity (balance sheet, income statement, and statement of cash flows for last two years or since inception) and whether or not they are audited.
 - j. Make continuing information regarding the operation of the project available in plain English via publicly accessible media that is reasonably expected to be globally available for an indefinite period. This includes regular reports on the operation of the project and prompt disclosure of any material changes in the information required above.
 - k. Conduct their activities with high standards of commercial honor.
2. One issue that arises is how to count the number of “shareholders of record” to see whether an entity is required to register with the SEC. The SEC needs to revisit § 240.12g5-1 (Definition of securities “held of record”) to determine how to properly count the number of shareholders of record.

The current rules make little sense, as the beneficial owners who hold their shares in street name are not counted as holders “of record.” Thus, there are many exchange-listed issuers with many thousands of beneficial shareholders but with only a handful of shareholders “of record” and that could delist and go dark if they wanted to.

The SEC should use its broad interpretive and exemptive authority to explicitly state that issuers in compliance with their disclosure obligations under this regulation are properly registered.

3. Brokers trafficking in crypto assets must apply the same customer protections as they do for securities, including compliance with Regulation Best Interest and the Customer Protection Rule.
4. Operators of centralized exchanges and decentralized exchanges (DEXs) must register with the SEC as special purpose Automated Trading Systems (ATS) that only trade crypto assets. The initial burden should be similar in spirit to the current requirements for ATS. They must demonstrate that they are building surveillance capabilities to prevent, detect, and punish manipulation on their platforms. They must also do due diligence similar to Rule 15c2-11 before listing crypto assets for trading. Exchanges that custody customer assets must have policies and procedures in place comparable to the Customer Protection Rule. They must segregate those assets from those of the exchange along with regular audits to verify customer holdings.

The SEC should start with simple rules and procedures. These should be examined and modified over time as experience dictates.

Broker-dealers and RIAs should have a Best Interest standard for all recommendations including crypto.

The SEC has broad authority under Dodd-Frank §914h to regulate all sales practices of RIAs and broker dealers. The statute does NOT limit its regulatory authority over broker-dealer sales practices to just securities. Thus, even if the courts rule that a particular crypto asset is not a security, the SEC can still regulate how broker-dealers and RIAs sell such products.

The SEC should widen the scope of Regulation Best Interest to cover all products sold by broker-dealers and RIAs to retail investors, not just “securities.” We expect a high standard of care from broker-dealers and RIAs. We should not create a loophole that would allow sleazoids to take advantage of the best-

interest halo provided by Regulation Best Interest to inflict bad products on unsuspecting investors, whether the bad products are unsuitable annuities or dodgy crypto magic beans.