

MEMORANDUM

December 19, 2023

TO: Registration No. 333-275079

FROM: Taylor Asher
Office of Commissioner Mark T. Uyeda

RE: Meeting with Representatives of Grayscale

On December 19, 2023, Counsel, Steven B. Levine, and Policy Advisor and Confidential Assistant, Taylor Asher, had a meeting with Grayscale over Webex. The Grayscale representatives in attendance consisted of:

- Craig Salm, Chief Legal Officer, Grayscale

Among other matters, the participants discussed Grayscale's Spot ETP application. Attached is a slide deck that Grayscale provided for the meeting.



GRAYSCALE™

Meeting with Office of SEC Commissioner Mark Uyeda

December 19, 2023

Objective

Spot Bitcoin ETPs* should offer both in-kind and cash creations and redemptions

- All else equal, in-kind creations and redemptions are more efficient, and therefore more beneficial, for ETP investors
- However, in the context of spot Bitcoin ETPs, not all Authorized Participants (APs) can facilitate in-kind creations and redemptions
- Even for those APs that can facilitate in-kind creations and redemptions, we understand that the Staff has raised questions regarding regulatory challenges

We believe offering both in-kind and cash creations and redemptions is in the best interest of investors, because it supports a deeper, more robust primary market, resulting in a more efficient ETP market structure

Grayscale stands ready to offer both in-kind and cash creations and redemptions. Today, we would like to walk through some of the factors we have considered, how we have addressed the Staff's expected concerns, as well as important tax considerations.



** We refer to ETP and Trust interchangeably throughout this presentation*

Landscape Overview

- Today, the U.S. ETP marketplace boasts 86 commodity ETFs totaling \$132B in AUM, offering a wide array of different investment objectives as the category continues to grow.
- Of the 86 products, **only 15 ETPs are true, physically-backed commodity ETPs** – these products primarily cover the precious metals market, specifically gold and silver.
- All of these products have Create/Redeem processes that are **in-kind only** – and all of these products are **organized as Delaware statutory trusts and taxed as grantor trusts**.
- These 15 ETPs, while a smaller cohort in terms of product count, account for **\$110B in combined assets under management, or 83.3% of the category**.

<u>Issuer</u>	<u>Ticker</u>	<u>Name</u>	<u>Inception Date</u>	<u>Assets (in \$M)</u>	<u>Reg. Structure</u>	<u>Create / Redeem</u>
State Street ETFs	GLD	SPDR Gold Shares	11/18/2004	\$57,469.88	Grantor Trust	In-kind
iShares ETFs	IAU	iShares Gold Trust	1/28/2005	\$26,061.28	Grantor Trust	In-kind
iShares ETFs	SLV	iShares Silver Trust	4/28/2006	\$10,657.07	Grantor Trust	In-kind
State Street ETFs	GLDM	SPDR Gold MiniShares Trust	6/26/2018	\$6,269.88	Grantor Trust	In-kind
Aberdeen Standard Investments	SGOL	abrdn Physical Gold Shares ETF	9/9/2009	\$2,763.78	Grantor Trust	In-kind
iShares ETFs	IAUM	iShares Gold Trust Micro	6/29/2021	\$1,204.03	Grantor Trust	In-kind
Aberdeen Standard Investments	SIVR	abrdn Physical Silver Shares ETF	7/24/2009	\$1,083.01	Grantor Trust	In-kind
Aberdeen Standard Investments	GLTR	abrdn Physical Precious Metals Basket Shares ETF	10/22/2010	\$947.55	Grantor Trust	In-kind
Aberdeen Standard Investments	PPLT	abrdn Physical Platinum Shares ETF	1/8/2010	\$943.83	Grantor Trust	In-kind
GraniteShares ETFs	BAR	Graniteshares Gold Trust	8/31/2017	\$942.52	Grantor Trust	In-kind
Merk ETFs	OUNZ	VanEck Merk Gold Shares	5/16/2014	\$758.01	Grantor Trust	In-kind
Goldman Sachs ETFs	AAAU	Goldman Sachs Physical Gold ETF	8/15/2018	\$622.50	Grantor Trust	In-kind
Aberdeen Standard Investments	PALL	abrdn Physical Palladium Shares ETF	1/8/2010	\$218.21	Grantor Trust	In-kind
Franklin Templeton	FGDL	Franklin Responsibly Sourced Gold ETF	6/30/2022	\$57.02	Grantor Trust	In-kind
GraniteShares ETFs	PLTM	GraniteShares Platinum Trust	1/22/2018	\$37.20	Grantor Trust	In-kind



Concerns Presented by Not Permitting In-Kind Creations and Redemptions

In the 30-year history of the US ETP marketplace, all spot commodity ETPs have employed in-kind only primary market transactions. Caution should be exercised before breaking with this convention, for the first time, as it relates to the approval of spot Bitcoin ETPs.

Some areas of potential concern:

- Secondary market ETP pricing decoupling from intrinsic value
- Inability of secondary market liquidity needs to be met in the primary market
- Resulting in diminished investor protections due to:
 - Impaired liquidity
 - Wider bid/ask spreads
 - Greater costs
 - Potential for halting/suspension of creations or redemptions during times of market stress

Offering both in-kind and cash creations and redemptions would avoid introducing these unwanted inefficiencies into the time-tested ETP product architecture and would therefore support a deeper and more robust primary market, which in turn enables an efficient spot Bitcoin ETP secondary market — and is therefore in the best interest of investors..



Contents & Agenda

- Grantor Trust Tax Status Considerations
- In-Kind Creation/Redemption Model*
- Broker-Dealer Regulatory Considerations
- Proposed Cash Creation/Redemption Model
 - Key Takeaways
- Questions, Comments, and Discussion



**Based on previous framing to the Staff. A true in-kind model would involve the AP sending bitcoin directly to the ETP rather than relying on another party, as shown in our model. Since that meeting, Grayscale has adjusted the description of its model in response to Staff comments.*

Grantor Trust Tax Status Considerations

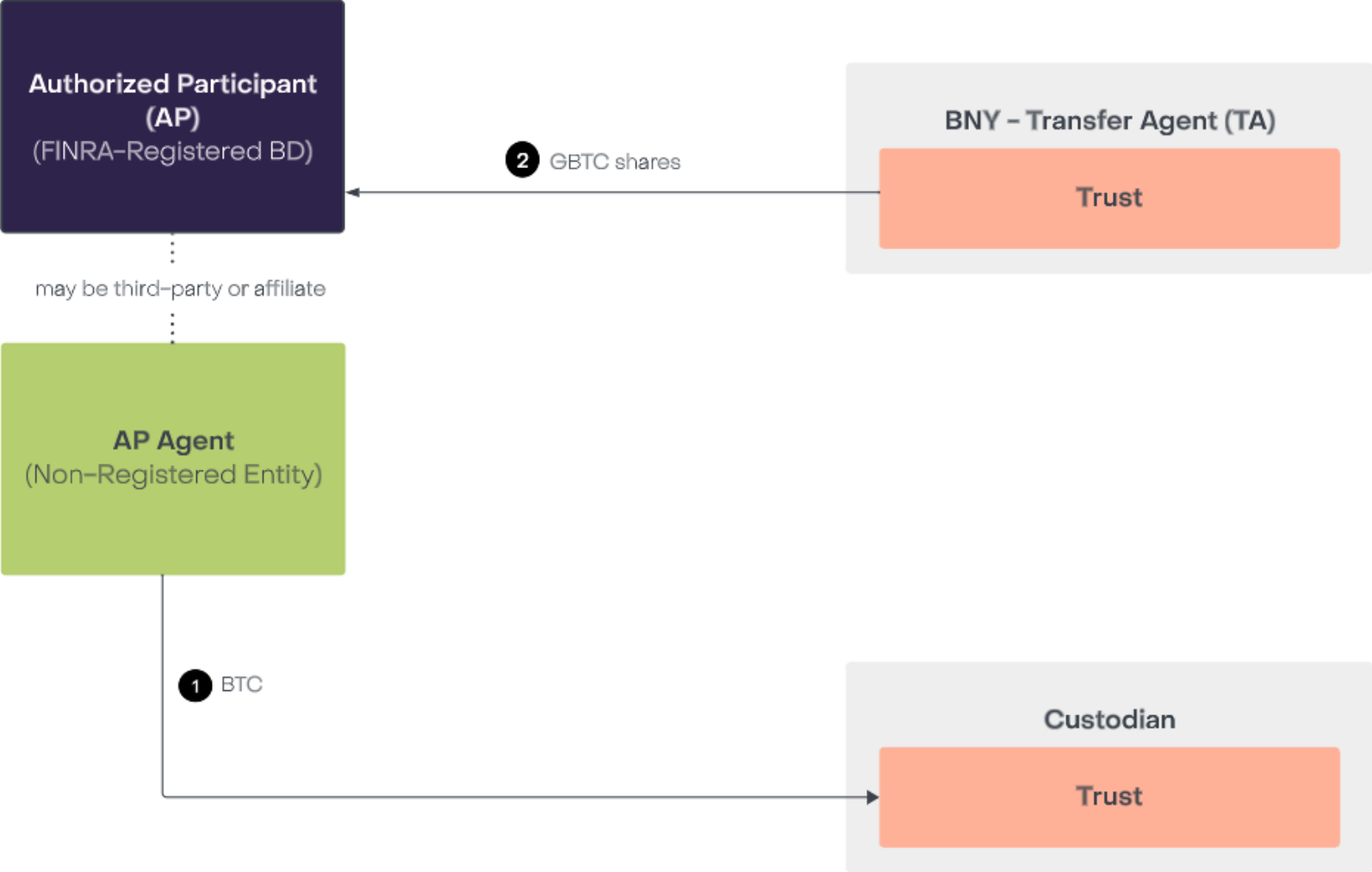
Considerations for Spot Bitcoin ETPs:

- ETPs containing spot commodities are substantially all structured as grantor trusts, which are pass-through vehicles for US federal income tax purposes
- Grantor trusts cannot operate a trade or business, or “vary” the investment of the trust estate for which beneficial owners have exposure
- Therefore, accepting cash in a grantor trust designed for exposure to Bitcoin would introduce uncertainty and risk to the trust’s status as a grantor trust for US federal income tax purposes
 - If a spot Bitcoin ETP failed to qualify as a grantor trust, there is uncertainty as to whether it could continue to be treated as a pass-through for US federal income tax purposes, and thus be subject to taxation at the spot Bitcoin ETP level
 - Taxation at the spot Bitcoin ETP level (i.e. double taxation to the investor) would introduce tracking error and tax inefficiencies for investors



In-Kind Creation Model

This process is reversed for in-kind redemptions



Broker-Dealer Regulatory Considerations

Considerations for Spot Bitcoin ETPs:

- Only Authorized Participants (APs) can create and redeem ETP shares and they must be FINRA-registered, self-clearing broker-dealers, among other requirements
- There has yet to be definitive regulatory guidance on whether and how registered broker-dealers can own or custody Bitcoin for themselves or others, raising questions around compliance with broker-dealer net capital, customer protection, and recordkeeping rules
- We believe these questions should not arise in a spot Bitcoin ETP structure where:
 - Broker-dealer does not own Bitcoin, nor is Bitcoin held on its balance sheet
 - Broker-dealer does not custody Bitcoin for itself or any other party



Cash Creation Model

Grayscale's proposed creation workflow results in ETP receiving Bitcoin and AP receiving shares without owning Bitcoin*:

Trade Date

- 1 Price for Creation Unit is set based on (i) NAV**, plus (ii) Variable Rate (i.e., spread)
- 2 Sponsor, as "Liquidity Engager," arranges for third party "Liquidity Provider" to principally buy Bitcoin and deliver to Trust

Settlement Date

- 1 AP sends cash to "Liquidity Administrator," an affiliate of the Sponsor
- 2 Liquidity Provider delivers Bitcoin to Trust's wallet at Custodian
- 3a Trust issues shares, held at Transfer Agent for AP
- 3b Liquidity Administrator sends cash to the Liquidity Provider
- 4 AP receives shares

Key Takeaways

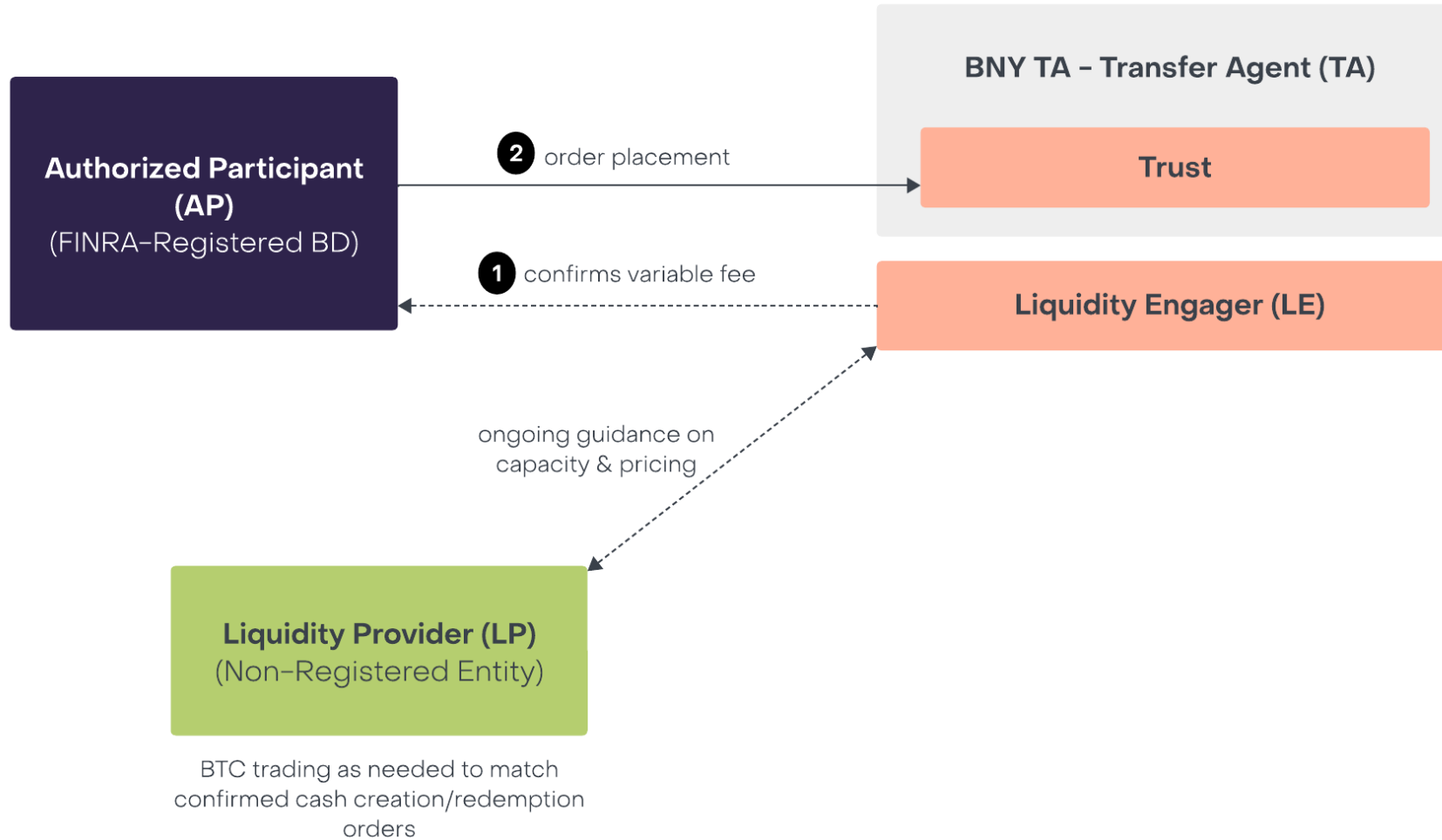
- **Satisfaction of Grantor Trust Tax Considerations:** Trust creates shares in exchange for Bitcoin and never holds cash
- **Satisfaction of Broker-Dealer Regulatory Considerations:** AP creates shares in exchange for cash and never holds Bitcoin directly or through an agent



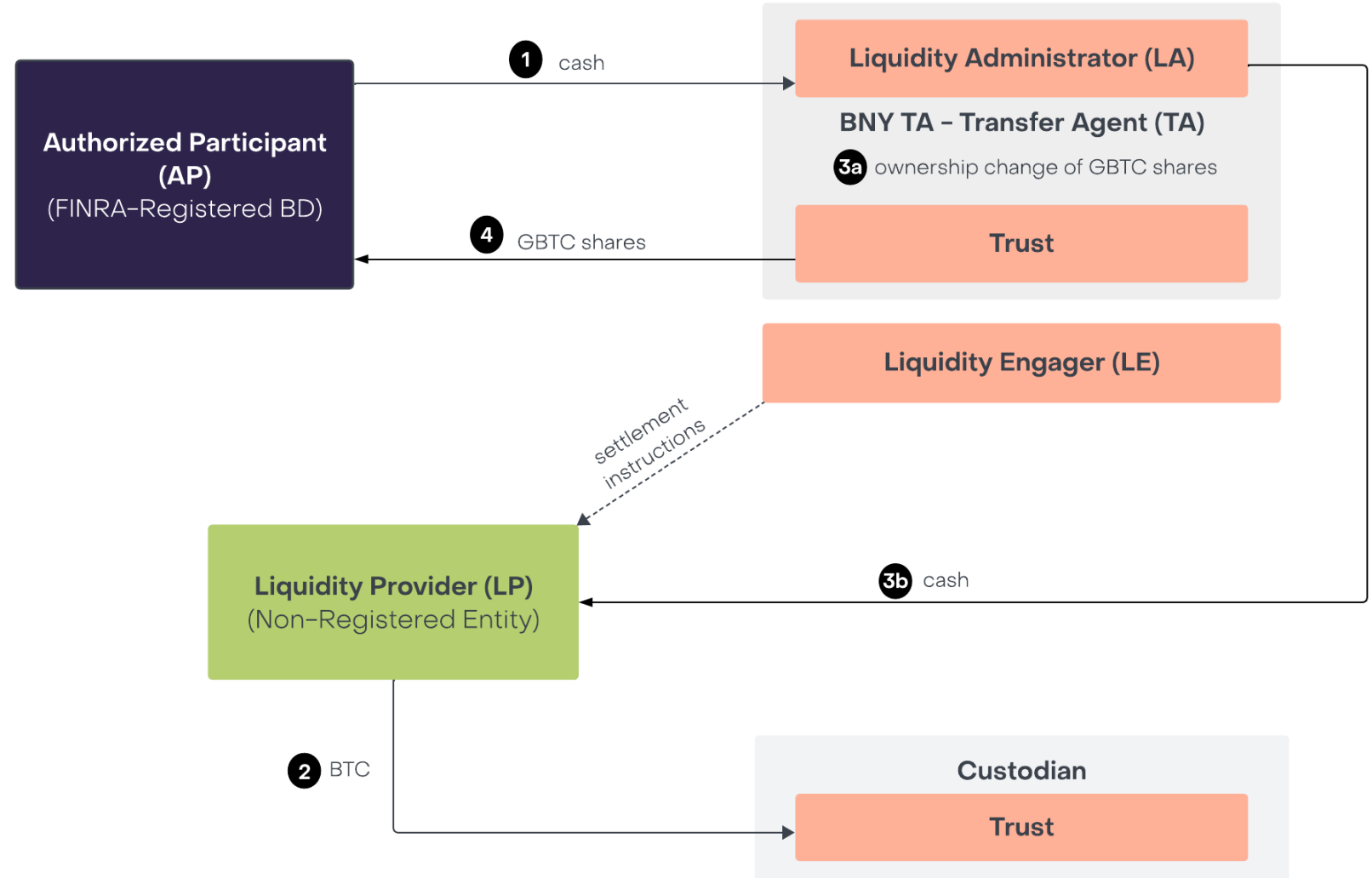
**This process is reversed for redemptions*

***Based on the CoinDesk Price Index (XBK) as of 4:00 PM EST*

Cash Creation/Redemption: Trade Date



Cash Creation: Settlement Date

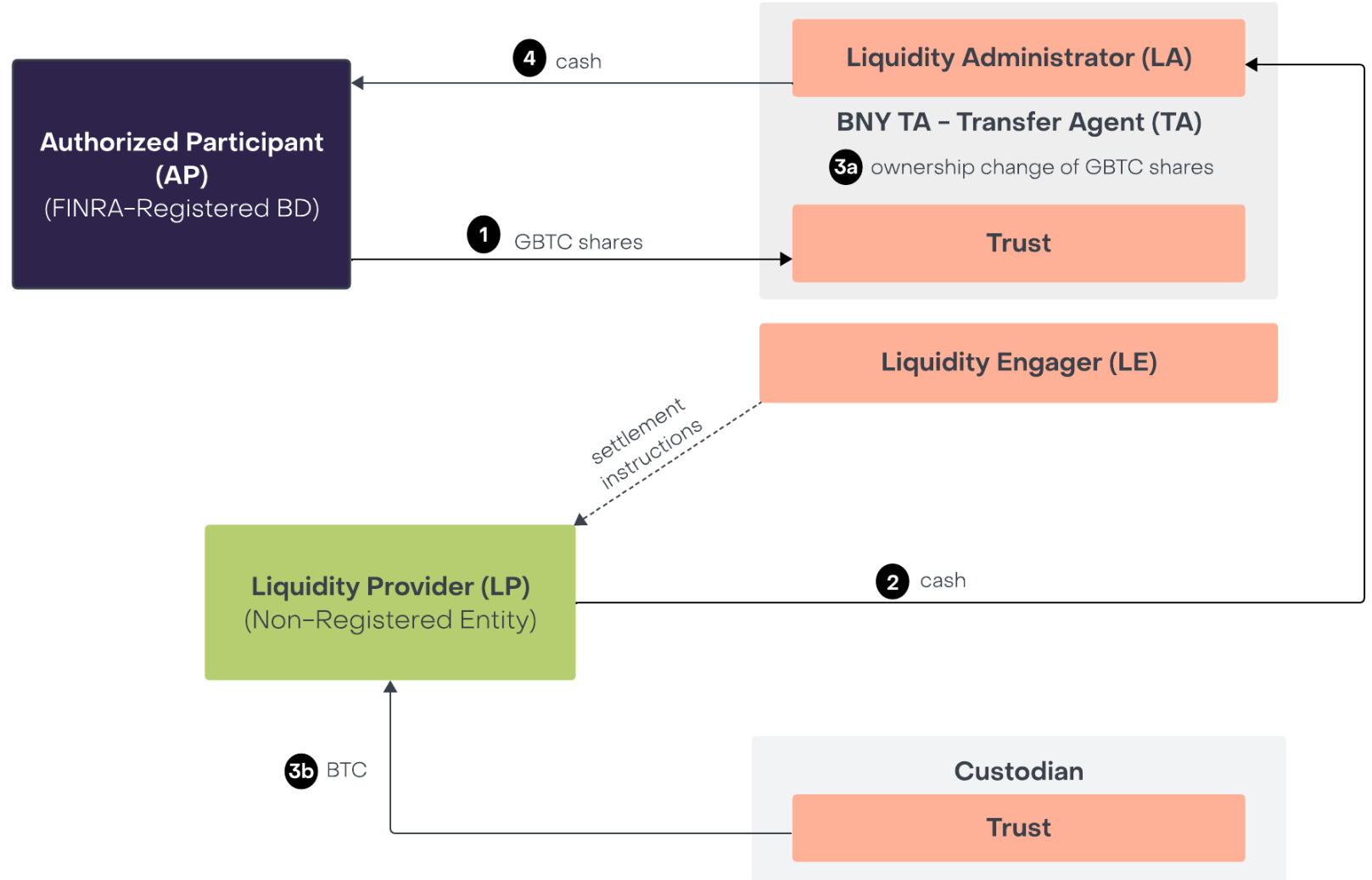


Settlement Steps:

- 1** AP sends cash to LA
- 2** LP sends Bitcoin to Trust wallet at Custodian
- 3a** Trust issues shares for AP, held at BNY for AP
- 3b** LA sends cash to LP
- 4** BNY delivers shares to AP



Cash Redemption: Settlement Date



Settlement Steps:

- 1 AP sends shares to BNY
- 2 LP sends cash to LA
- 3a BNY cancels shares
- 3b Custodian sends Bitcoin from Trust wallet to LP
- 4 LA sends cash to AP



Cash Creation Procedures: Key Takeaways

This process is reversed for in-kind redemptions

Trust

- Trust only creates shares upon receipt of Bitcoin, never holds cash, and does not itself engage an LP, satisfying grantor trust tax considerations and mitigating uncertainty and the potential for tracking error and tax inefficiencies for investors

Authorized Participant (AP)

- AP broker-dealer never has ownership of, custody of, or exposure to, Bitcoin, satisfying broker-dealer regulatory considerations
- AP receives firm price quote for shares based on NAV, receives shares before dollars are released – from AP's point of view, it knows on Trade Date that it is paying \$[x] for [y] shares on Settlement Date

Liquidity Administrator (LA)

- LA is a registered broker-dealer and only processes cash portion of procedures
- Cash maintained in LA's Special Account for the Exclusive Benefit of Customers at a third-party bank (BNY), which it promptly transmits to LP (consistent with Rule 15c3-3(k)(2)(i))

Liquidity Provider (LP)

- LP bears any risk of Bitcoin price movement between Trade Date and Settlement Date, which it manages through the Variable Fee
- No contractual privity between AP and LP
- Each of Trust, AP, and LP acts as principal, not agent



Thank You

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