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March 10, 2024

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

Re: Bitcoin ETF options
Files:
SR-CBOE-2024-005
SR-NYSEArca-2024-06
SR-NYSEAMER-2024-10

Summary

- Options already trade on the futures-based bitcoin ETF (BITO).
- Options on the spot bitcoin ETFs are fundamentally the same.

[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.

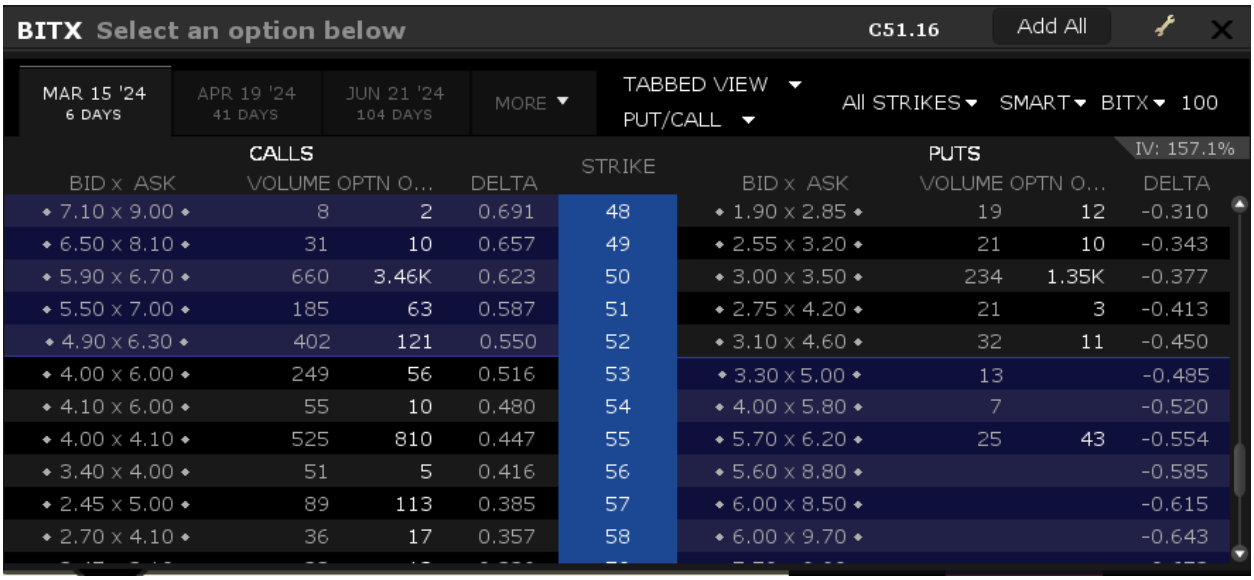
- There is no reason for the SEC to delay approval of options on spot bitcoin ETFs.
- The SEC has lost tremendous credibility with Congress and the general public as a result of its handling of spot bitcoin ETFs.
- Further delay in approving options on bitcoin ETF will further compound the damage to the SEC's credibility.
- Rule 15c2-11 provides a good model for regulating trading crypto tokens.

Dear SEC:

Don't you have better things to do than waste time through extended navel-gazing on these rule filings?

Introduction

A long time ago, inside a Beltway not far away, issuers petitioned the SEC to permit spot bitcoin-based ETFs. For years and years they tried to get approval. The SEC adopted a "just say no" approach. Except then the SEC permitted bitcoin futures-based ETFs (e.g. BITO). It permitted options trading on futures-based ETFs. Then it permitted leveraged futures-based bitcoin ETFs (BITX). And it permits options on leveraged futures bitcoin ETFs! Talk about risk! Here is a screen shot of options activity on BITX:



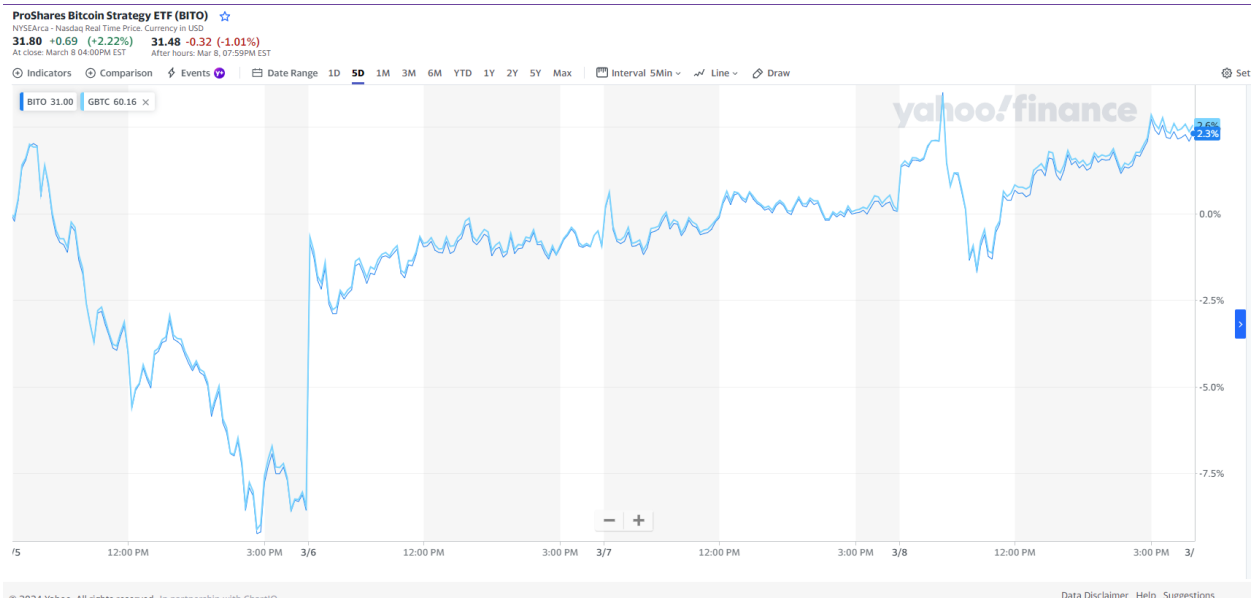
Alas, the SEC permitted this speculative activity on a futures-based ETF but it repeatedly denied applications for similar ETFs based on spot bitcoin. As a spot-bitcoin-based ETF is virtually indistinguishable from a bitcoin-futures-based ETF, it made no sense to permit one but not the other. The innovator sued, and the DC Circuit rightfully handed the SEC a humiliating defeat for its incomprehensibly arbitrary and capricious policy. I felt sorry for the SEC's lawyers who were stuck with defending such an indefensible position. The SEC looked very silly and squandered its once-proud reputation as an intelligent and effective regulator.

In an act of regulatory retaliation, the SEC punished the innovator that dared sue it and win. It held up approvals of all spot-based ETFs so that they would all launch on the same day. This allowed imitators to free ride on the expensive regulatory investment that had been made by the pioneers, and thus deprived the pioneers of the first-mover fruits of their innovation and their investments.

In doing so, the SEC also unleashed the mighty marketing machine of Wall Street on bitcoin. If the SEC had done its job properly years ago and quietly approved the spot-bitcoin ETF, there would have been little notice. By setting up the bitcoin ETF horse race the way it did, it created a fanfare of buzz, speculation, and marketing. If the SEC had intentionally tried to shove bitcoin into Mr. and Ms. Retail Investors' IRA accounts, it could not have done a better job. Congratulations.

Options on spot-based bitcoin ETFs are nearly identical to options on futures-based bitcoin ETFs.

And now, the industry has filed proposed rule changes to trade options on these ETFs. This should be as routine as options on any other newly issued IPO. It does not take a rocket scientist to see that the price trajectories of the spot- and futures-based bitcoin ETFs are virtually identical. Given the nearly identical price behavior of the underlying assets, it should not take any time to figure out that options on these extremely similar NMS securities should have the same regulatory treatment. The following graph shows the recent price trajectory of the futures-based BITO and spot-based GBTC.



This delay is embarrassing to the SEC.

And yet, the SEC has delayed approval because it needs more time? It is not like some rule filings where the SEC has to wade through thousands of comment letters. Not a single comment letter has been filed in opposition.

This delay mystifies me and many others. Is the SEC searching for another fig-leaf of an excuse to reject this? If so, it must have a masochistic desire for yet another humiliating defeat in court. Is the SEC trying to make the case to justify the

elimination of *Chevron* deference? Is the SEC retaliating again against the issuers just to show that it has the power to punish by inflicting death by a thousand paper cuts? Is the SEC dragging it out in order to increase the hype and speculation like it did with the spot ETFs? Or is the SEC staff swamped with writing 586-page rule

filings filled with repetitious redundancies?[2] No matter what the reason, this does not make the SEC look good. It will not win any friends among the general public or in Congress.

The SEC has too many other more important things to do than waste scarce resources on dragging out these proceedings. This rule filing should have been approved right away. Indeed, it should not even have needed a rule filing. Option trading should be automatic for any NMS security that otherwise meets an exchange's quantitative listing standards. The SEC can save itself a lot of work by not requiring separate rule filings for options on weird things after it has approved the weird things to trade in the cash market.

It is well known that the SEC has an extremely important mission and that it is a severely underfunded agency. Yet it is extremely hard to make the case to Congress for a more adequate budget when the SEC wastes its resources in such a blatant manner.

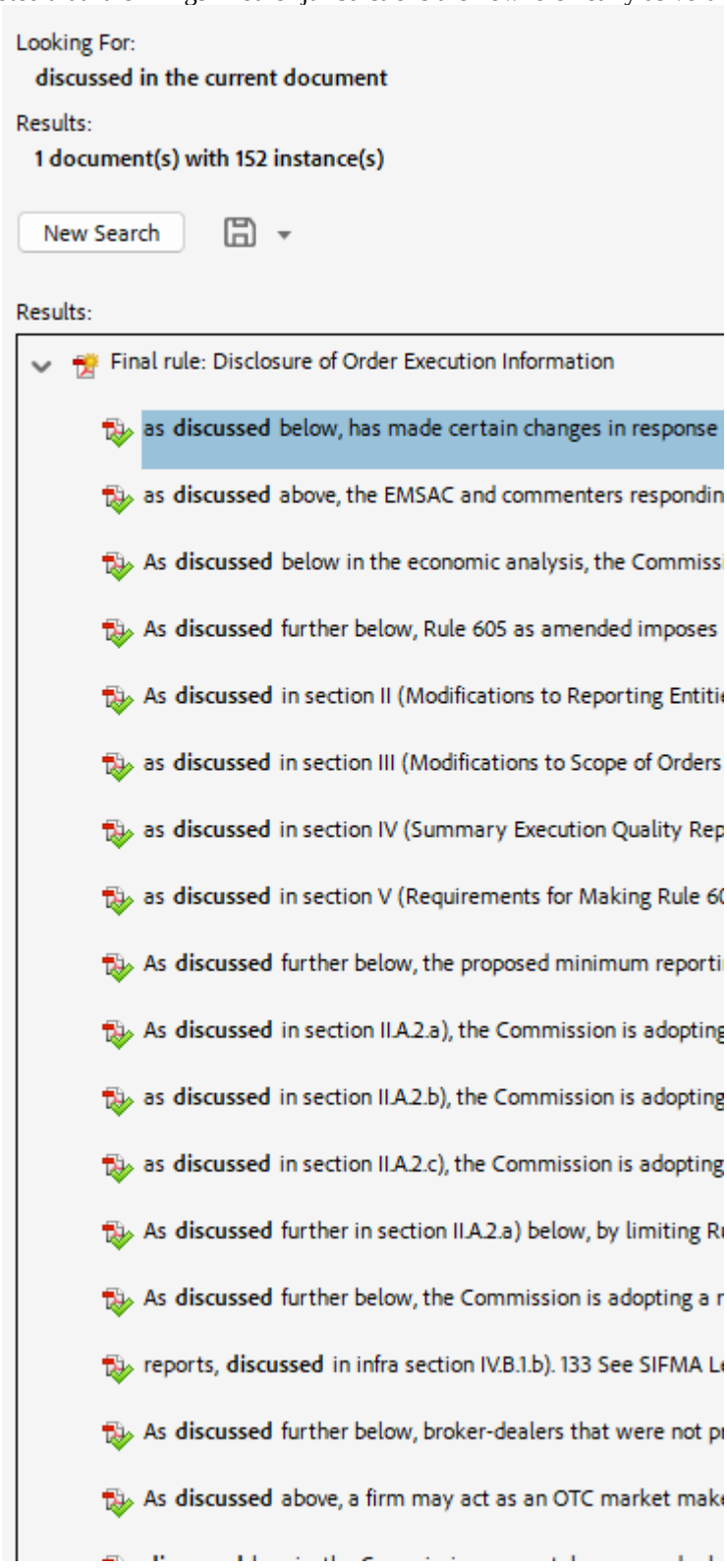
The market treats bitcoin like a risky tech stock, and the SEC should too.

I sympathize with the SEC's reluctance to encourage speculation in something as speculative as bitcoin. I have long been, and still am, a bit skeptical about bitcoin. I am dubious of the many claims of the bitcoin maximalists. While Bitcoin 1.0 pioneered peer-to-peer blockchain-based transfers, its technology has been superseded by many more advanced technologies with more flexibility, faster throughput, smaller carbon footprint, and more sensible governance. Stablecoins provide many of the payment and short-term store-of-value benefits attributed to bitcoin. The major advantage of bitcoin appears to be its network effect along with a QWERTY-type technology lock-in, but even that is questionable.

Others hold a different opinion. As the saying goes, differences of opinion lead to a horse race. The market treats bitcoin like a speculative technology stock, with a significant positive correlation to the S&P500 and Nasdaq indices.

Our economy and capital markets have thrived because the United States has adopted an economic system that promotes investment. Many of these investments are highly risky and come to nothing. The fact that they may be worth zero at the end of the day should not prevent investors from voluntarily taking risks.

[2] For example, see https://www.sec.gov/files/rules/final/2024/34-99679.pdf. That final rule references itself at least 152 times. It should be noted that rule filings in other jurisdictions are nowhere nearly as voluminous or self-referential as the SECs.



As Chair Gensler recently remarked,

> "Our federal securities laws lay out a basic bargain. Investors get to decide which risks they want to take so long as companies raising money from the public make what President Franklin Roosevelt called "complete and truthful disclosure.""[3]

To reiterate what Chair Gensler has said, "Investors get to decide which risks they want to take…." While bitcoin's origins are indeed murky, the bitcoin protocol and network are extremely transparent. Indeed, they are far more transparent than the typical tech stock. What more disclosure is needed to make it "complete and truthful?"

Options, like all derivatives, have built in leverage, and sometimes in extreme amounts. This makes them very risky. They are also very efficient risk management tools that give investors the ability to take on or to shed risk. Indeed, they can be part of hedging strategies to actually reduce risk. For example, one can purchase a put option to protect against downside risk. Similarly, they can be useful in strategies such as covered-call writing.

I sympathize with the Commission's reluctance to let investors take yet more risk, especially on crypto-related products. Investing in a tech stock directs capital into the technology sector, while spending money to push up the price of bitcoin does not. If risk to investors or capital formation were the concern, the Commission should never have allowed BITO and its derivatives to trade. Now that it has let the bitcoin genie out of the bottle, there is no turning back. The Commission should apply the "same risk = same regulation" principle and treat spot- and futures- based products comparably. To do otherwise will further damage the Commission's reputation.

The SEC needs to think about crypto *regulation* in addition to enforcement.

Speaking of reputation, the Commission's regulatory approach to crypto has been underwhelming. Industry participants complain that they get little or no timely guidance from the SEC when they are trying to comply. I hear over and over again, "I just wish they would tell us what the rules are." SEC officials maintain that the rules are clear, but many practitioners complain about the lack of guidance

[3] https://www.sec.gov/news/statement/gensler-statement-mandatory-climate-risk-disclosures-030624

they have received from the SEC on how to comply. The SEC needs to have a clear, transparent, and common-sense regulatory approach to crypto.

Blockchain technology has created a new settlement rail, not a new asset class.

The SEC has had plenty of time to understand what digital assets are or are not. Crypto assets (sometimes referred to as digital 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 NFTs to dodgy tokens of dubious value. 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 in many different asset classes.

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 rather than engage in regulation by enforcement. 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. 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.

It is tempting to say that the rules already exist and that the crypto world just needs to follow them. That is true to a certain extent, but it is not completely in the public interest. Old rules are not necessarily optimal for new technology. For example, traditional NY taxi regulation requires taxis to have a meter, be painted

yellow, and have a bullet-resistant shield to protect the driver. Ride sharing services like Uber and Lyft also provide rides for hire, but they don't need to be painted yellow, don't need to have a meter, and don't need to have a bullet-resistant shield. Customers know the fare in advance and can identify the car and driver from the information in the app. Because they do not carry cash and the identity of the passenger has been authenticated in the app, the risk to the driver is very low and thus no bullet-resistant shield is necessary.

Similarly, the technology of information dissemination has changed dramatically since the passage of the Securities Act of 1933. The crypto world has developed new methods of capital formation, and it is time to adopt rules that facilitate, not inhibit, such capital formation. Indeed, it is time to rethink how information is provided to investors.

Rule 15c2-11 provides a good model for trading crypto tokens.

However, there is still a need to protect investors from fraud, to make sure that they get sufficient information, and to make sure that intermediaries are solvent and honest.

The SEC should approach the trading of crypto assets in the same way as it approaches the trading of other OTC assets. Industry participants should only be publicly trafficking in assets for which there is at least a base level of public information. At least one intermediary would have to file a Form Crypto 15c2-11 that attests to the public availability of information similar to that required by Rule 15c2-11. Once such information is public, the intermediaries can traffic in the instrument.

Registration for the smallest and newest of entities should be super simple.

We would not be entangled in endless debates about whether a particular financial product is a security or a some other thingie if the cost of SEC compliance weren't so high. The SEC can better perform its twin mandates of capital formation and investor protection by finding ways to reduce compliance costs for the newest and smallest entities to the bare minimum.

Registration for the newest and smallest entities should be a simple online form that can be filled out and submitted in one hour by a person with only standard

business skills instead of a requiring a securities lawyer. Think of this as Regulation A-.

The SEC should re-think disclosure for smaller and newer enterprises – both crypto and tradfi.

At this point there is little doubt that most tokens are securities and that their investors deserve the protection of our securities laws. Clearly there must be full and fair disclosure for markets to work properly. But how much is enough?

Over the years, the SEC has attempted, with little success, to appropriately scale registration and disclosure requirements for smaller enterprises. The result has been that the regulatory overhead to become a public company is excessively high. There are two major contributors to the failure:

1. Many market observers and regulators think of information as a free good, and thus see nothing wrong in demanding lots of information. It is actually quite costly for enterprises to collect, analyze, audit, file, and disseminate information. Each required line item adds compliance costs and regulatory risks to the company, its attorneys, and its auditors. These are taxes on public companies that weigh disproportionately on smaller enterprises. If one views information as intellectual property, the question to ask becomes: Is a particular line item so important to the public interest that it requires confiscation of the intellectual property of the company?
2. Attempts to scale regulation generally start with a large-company bias and ask what can be eliminated. That is like taking a suit custom tailored for a six-foot tall NFL linebacker and scaling it down to fit a five-foot tall racing jockey. It just doesn't fit right. A far better approach would be to start from the ground up with a clean sheet of paper and ask what investors really want in order to make a proper investment decision.

Allow shareholders to decide what level of disclosure they want by voting.

Better yet, let investors themselves decide the level of disclosure. Shareholders routinely vote on executive compensation. Why not let them vote to choose what level of accounting standards they want? The SEC could create several levels of

accounting standards and let shareholders decide by voting. One possible embodiment could look like this:

> Level 1: No audited financial statements, but the company must publicly disclose its income tax returns. This would be appropriate for the smallest of companies such as crowdfunded ventures and very early-stage companies.
>
> Level 2: Company reports unaudited semi-annual report and an audited annual report. Only very limited disclosures are required beyond the income statement, balance sheet, and cash flow statement. XBRL would be optional.
>
> Level 3. A few more disclosures are required, with XBRL.
>
> Level 4: Company reports unaudited quarterly reports and an audited annual report, with XBRL. More disclosures such as a detailed MD&A, but no Sarbanes-Oxley §404 internal control requirements.
>
> Level 5: Current large company reporting standards with full Sarbanes-Oxley §404.

Shareholders could also vote on the frequency of the required to vote, anywhere from every year to every five years. Exchange listing standards could also require a specific level. Exchange listing should require at least Level 3 and the top tier of an exchange should require Level 5.

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.

Respectfully submitted,

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