SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-94396; File No. SR-CboeBZX-2021-052)

March 10, 2022

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Disapproving a Proposed Rule Change to List and Trade Shares of the Global X Bitcoin Trust under BZX Rule 14.11(e)(4), Commodity-Based Trust Shares

I. INTRODUCTION

On August 3, 2021, Cboe BZX Exchange, Inc. ("BZX" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to list and trade shares ("Shares") of the Global X Bitcoin Trust ("Trust") under BZX Rule 14.11(e)(4), Commodity-Based Trust Shares. The proposed rule change was published for comment in the Federal Register on August 23, 2021.[3]

On September 29, 2021, pursuant to Section 19(b)(2) of the Exchange Act,[4] the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.[5] On November 18, 2021, the Commission instituted proceedings under Section 19(b)(2)(B) of the Exchange Act[6] to determine whether to approve or disapprove the

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 92689 (Aug. 17, 2021), 86 FR 47176 ("Notice"). Comments on the proposed rule change can be found at: https://www.sec.gov/comments/sr-cboebzx-2021-052/srcboebzx2021052.htm.

4 15 U.S.C. 78s(b)(2).

5 See Securities Exchange Act Release No. 93174, 86 FR 55043 (Oct. 5, 2021).

6 15 U.S.C. 78s(b)(2)(B).

proposed rule change.[7] On February 9, 2022, the Commission designated a longer period for Commission action on the proposed rule change.[8]

This order disapproves the proposed rule change. The Commission concludes that BZX has not met its burden under the Exchange Act and the Commission's Rules of Practice to demonstrate that its proposal is consistent with the requirements of Exchange Act Section 6(b)(5), and in particular, the requirement 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."[9]

When considering whether BZX's proposal to list and trade the Shares is designed to prevent fraudulent and manipulative acts and practices, the Commission applies the same standard used in its orders considering previous proposals to list bitcoin[10]-based commodity trusts and bitcoin-based trust issued receipts.[11] As the Commission has explained, an exchange

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7 See Securities Exchange Act Release No. 93608, 86 FR 67094 (Nov. 24, 2021).

8 See Securities Exchange Act Release No. 94202, 87 FR 8628 (Feb. 15, 2022).

9 15 U.S.C. 78f(b)(5).

10 Bitcoins are digital assets that are issued and transferred via a decentralized, open-source protocol used by a peer-to-peer computer network through which transactions are recorded on a public transaction ledger known as the "bitcoin blockchain." The bitcoin protocol governs the creation of new bitcoins and the cryptographic system that secures and verifies bitcoin transactions. See, e.g., Notice, 86 FR at 47177.

11 See 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, Securities Exchange Act Release No. 83723 (July 26, 2018), 83 FR 37579 (Aug. 1, 2018) (SR-BatsBZX-2016-30) ("Winklevoss Order"); Order Disapproving a Proposed Rule Change, as Modified by Amendment No. 1, To Amend NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares) and To List and Trade Shares of the United States Bitcoin and Treasury Investment Trust Under NYSE Arca Rule 8.201-E, Securities Exchange Act Release No. 88284 (Feb. 26, 2020), 85 FR 12595 (Mar. 3, 2020) (SR-NYSEArca-2019-39) ("USBT Order"); Order Disapproving a Proposed Rule Change To List and Trade Shares of the WisdomTree Bitcoin Trust Under BZX Rule 14.11(e)(4), Commodity-Based Trust Shares, Securities Exchange Act Release

that lists bitcoin-based exchange-traded products ("ETPs") can meet its obligations under Exchange Act Section 6(b)(5) by demonstrating that the exchange has a comprehensive surveillance-sharing agreement with a regulated market of significant size related to the underlying or reference bitcoin assets.[12]

No. 93700 (Dec. 1, 2021), 86 FR 69322 (Dec. 7, 2021) (SR-CboeBZX-2021-024) ("WisdomTree Order"); Order Disapproving a Proposed Rule Change to List and Trade Shares of the Valkyrie Bitcoin Fund under NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares), Securities Exchange Act Release No. 93859 (Dec. 22, 2021), 86 FR 74156 (Dec. 29, 2021) (SR-NYSEArca-2021-31) ("Valkyrie Order"); Order Disapproving a Proposed Rule Change to List and Trade Shares of the Kryptoin Bitcoin ETF Trust under BZX Rule 14.11(e)(4), Commodity-Based Trust Shares, Securities Exchange Act Release No. 93860 (Dec. 22, 2021), 86 FR 74166 (Dec. 29, 2021) (SR-CboeBZX-2021-029) ("Kryptoin Order"); Order Disapproving a Proposed Rule Change to List and Trade Shares of the First Trust SkyBridge Bitcoin ETF Trust under NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares), Securities Exchange Act Release No. 94006 (Jan. 20, 2022), 87 FR 3869 (Jan. 25, 2022) (SR-NYSEArca-2021-37) ("SkyBridge Order"); and Order Disapproving a Proposed Rule Change to List and Trade Shares of the Wise Origin Bitcoin Trust under BZX Rule 14.11(e)(4), Commodity-Based Trust Shares, Securities Exchange Act Release No. 94080 (Jan. 27, 2022), 87 FR 5527 (Feb. 1, 2022) (SR-CboeBZX-2021-039) ("Wise Origin Order"). See also Order Disapproving a Proposed Rule Change, as Modified by Amendment No. 1, Relating to the Listing and Trading of Shares of the SolidX Bitcoin Trust Under NYSE Arca Equities Rule 8.201, Securities Exchange Act Release No. 80319 (Mar. 28, 2017), 82 FR 16247 (Apr. 3, 2017) (SR-NYSEArca-2016-101) ("SolidX Order"). The Commission also notes that orders were issued by delegated authority on the following matters: Order Disapproving a Proposed Rule Change To List and Trade the Shares of the ProShares Bitcoin ETF and the ProShares Short Bitcoin ETF, Securities Exchange Act Release No. 83904 (Aug. 22, 2018), 83 FR 43934 (Aug. 28, 2018) (SR-NYSEArca-2017-139) ("ProShares Order"); Order Disapproving a Proposed Rule Change To List and Trade the Shares of the GraniteShares Bitcoin ETF and the GraniteShares Short Bitcoin ETF, Securities Exchange Act Release No. 83913 (Aug. 22, 2018), 83 FR 43923 (Aug. 28, 2018) (SR-CboeBZX-2018-001) ("GraniteShares Order"); Order Disapproving a Proposed Rule Change To List and Trade Shares of the VanEck Bitcoin Trust Under BZX Rule 14.11(e)(4), Commodity-Based Trust Shares, Securities Exchange Act Release No. 93559 (Nov. 12, 2021), 86 FR 64539 (Nov. 18, 2021) (SR-CboeBZX-2021-019) ("VanEck Order").

12 See USBT Order, 85 FR at 12596. See also Winklevoss Order, 83 FR at 37592 n.202 and accompanying text (discussing previous Commission approvals of commodity-trust ETPs); GraniteShares Order, 83 FR at 43925-27 nn.35-39 and accompanying text (discussing previous Commission approvals of commodity-futures ETPs).

The standard requires such surveillance-sharing agreements since they "provide a necessary deterrent to manipulation because they facilitate the availability of information needed to fully investigate a manipulation if it were to occur."[13] The Commission has emphasized that it is essential for an exchange listing a derivative securities product to enter into a surveillance-sharing agreement with markets trading the underlying assets for the listing exchange to have the ability to obtain information necessary to detect, investigate, and deter fraud and market manipulation, as well as violations of exchange rules and applicable federal securities laws and rules.[14] The hallmarks of a surveillance-sharing agreement are that the agreement provides for the sharing of information about market trading activity, clearing activity, and customer identity; that the parties to the agreement have reasonable ability to obtain access to and produce requested information; and that no existing rules, laws, or practices would impede one party to the agreement from obtaining this information from, or producing it to, the other party.[15]

In the context of this standard, the terms "significant market" and "market of significant size" include a market (or group of markets) as to which (a) there is a reasonable likelihood that a person attempting to manipulate the ETP would also have to trade on that market to successfully manipulate the ETP, so that a surveillance-sharing agreement would assist in

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13 See Amendment to Rule Filing Requirements for Self-Regulatory Organizations Regarding New Derivative Securities Products, Securities Exchange Act Release No. 40761 (Dec. 8, 1998), 63 FR 70952, 70959 (Dec. 22, 1998) ("NDSP Adopting Release"). See also Winklevoss Order, 83 FR at 37594; ProShares Order, 83 FR at 43936; GraniteShares Order, 83 FR at 43924; USBT Order, 85 FR at 12596.

14 See NDSP Adopting Release, 63 FR at 70959.

15 See Winklevoss Order, 83 FR at 37592-93; Letter from Brandon Becker, Director, Division of Market Regulation, Commission, to Gerard D. O'Connell, Chairman, Intermarket Surveillance Group (June 3, 1994), available at https://www.sec.gov/divisions/marketreg/mr-noaction/isg060394.htm.

detecting and deterring misconduct, and (b) it is unlikely that trading in the ETP would be the predominant influence on prices in that market.[16] 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."[17]

Consistent with this standard, for the commodity-trust ETPs approved to date for listing and trading, there has been in every case at least one significant, regulated market for trading futures on the underlying commodity—whether gold, silver, platinum, palladium, or copper—and the ETP listing exchange has entered into surveillance-sharing agreements with, or held Intermarket Surveillance Group ("ISG") membership in common with, that market.[18] Moreover, the surveillance-sharing agreements have been consistently present whenever the Commission has approved the listing and trading of derivative securities, even where the underlying securities were also listed on national securities exchanges—such as options based on an index of stocks traded on a national securities exchange—and were thus subject to the Commission's direct regulatory authority.[19]

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16 See Winklevoss Order, 83 FR at 37594. This definition is illustrative and not exclusive. There could be other types of "significant markets" and "markets of significant size," but this definition is an example that will provide guidance to market participants. See id.

17 See USBT Order, 85 FR at 12597.

18 See Winklevoss Order, 83 FR at 37594.

19 See USBT Order, 85 FR at 12597; Securities Exchange Act Release No. 33555 (Jan. 31, 1994), 59 FR 5619, 5621 (Feb. 7, 1994) (SR-Amex-93-28) (order approving listing of options on American Depository Receipts ("ADRs")). The Commission has also required a surveillance-sharing agreement in the context of index options even when (i) all of the underlying index component stocks were either registered with the Commission or exempt from registration under the Exchange Act; (ii) all of the underlying index component stocks traded in the U.S. either directly or as ADRs on a national securities exchange; and (iii) effective international ADR arbitrage alleviated concerns over the

Listing exchanges have also attempted to demonstrate that other means besides surveillance-sharing agreements will be sufficient to prevent fraudulent and manipulative acts and practices, including that the bitcoin market as a whole or the relevant underlying bitcoin market is "uniquely" and "inherently" resistant to fraud and manipulation.[20] In response, the Commission has agreed that, if a listing exchange could establish that the underlying market inherently possesses a unique resistance to manipulation beyond the protections that are utilized by traditional commodity or securities markets, it would not necessarily need to enter into a surveillance-sharing agreement with a regulated significant market.[21] Such resistance to fraud and manipulation, however, must be novel and beyond those protections that exist in traditional commodity markets or equity markets for which the Commission has long required surveillance-

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relatively smaller ADR trading volume, helped to ensure that ADR prices reflected the pricing on the home market, and helped to ensure more reliable price determinations for settlement purposes, due to the unique composition of the index and reliance on ADR prices. See Securities Exchange Act Release No. 26653 (Mar. 21, 1989), 54 FR 12705, 12708 (Mar. 28, 1989) (SR-Amex-87-25) (stating that "surveillance-sharing agreements between the exchange on which the index option trades and the markets that trade the underlying securities are necessary" and that "[t]he exchange of surveillance data by the exchange trading a stock index option and the markets for the securities comprising the index is important to the detection and deterrence of intermarket manipulation."). And the Commission has required a surveillance-sharing agreement even when approving options based on an index of stocks traded on a national securities exchange. See Securities Exchange Act Release No. 30830 (June 18, 1992), 57 FR 28221, 28224 (June 24, 1992) (SR-Amex-91-22) (stating that surveillance-sharing agreements "ensure the availability of information necessary to detect and deter potential manipulations and other trading abuses").

[20] See USBT Order, 85 FR at 12597.

[21] See Winklevoss Order, 83 FR at 37580, 37582-91 (addressing assertions that "bitcoin and bitcoin [spot] markets" generally, as well as one bitcoin trading platform specifically, have unique resistance to fraud and manipulation); see also USBT Order, 85 FR at 12597.

sharing agreements in the context of listing derivative securities products.[22] No listing exchange has satisfied its burden to make such demonstration.[23]

Here, BZX contends that approval of the proposal is consistent with Section 6(b)(5) of the Exchange Act, in particular Section 6(b)(5)'s requirement 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.[24] As discussed in more detail below, BZX asserts that the proposal is consistent with Section 6(b)(5) of the Exchange Act because the Exchange has a comprehensive surveillance-sharing agreement with a regulated market of significant size,[25] and there exist other means to prevent fraudulent and manipulative acts and practices that are sufficient to justify dispensing with the requisite surveillance-sharing agreement.[26]

Although BZX recognizes the Commission's focus on potential manipulation of bitcoin ETPs in prior disapproval orders, BZX argues that such manipulation concerns have been sufficiently mitigated, and that the growing and quantifiable investor protection concerns should be the central consideration of the Commission.[27] Specifically, as discussed in more detail below, the Exchange asserts that the significant increase in trading volume in bitcoin futures on the Chicago Mercantile Exchange ("CME"), the growth of liquidity in the spot market for bitcoin, and certain features of the Shares mitigate potential manipulation concerns to the point that the investor protection issues that have arisen from the rapid growth of over-the-counter ("OTC")

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22 See USBT Order, 85 FR at 12597.

23 See supra note 11.

24 See Notice, 86 FR at 47183.

25 See id. at 47183-84.

26 See id. at 47184.

27 See id. at 47179.

bitcoin funds, including premium/discount volatility and management fees, should be the central consideration as the Commission determines whether to approve this proposal.[28]

Further, BZX believes that the proposal would give U.S. investors access to bitcoin in a regulated and transparent exchange-traded vehicle that would act to limit risk to U.S. investors. According to BZX, the proposed listing and trading of the Shares would mitigate risk by: (i) reducing premium and discount volatility; (ii) reducing management fees through meaningful competition; (iii) reducing risks associated with investing in operating companies that are imperfect proxies for bitcoin exposure; and (iv) providing an alternative to custodying spot bitcoin.[29]

In the analysis that follows, the Commission examines whether the proposed rule change is consistent with Section 6(b)(5) of the Exchange Act by addressing: in Section III.B.1 assertions that other means besides surveillance-sharing agreements will be sufficient to prevent fraudulent and manipulative acts and practices; in Section III.B.2 assertions that BZX has entered into a comprehensive surveillance-sharing agreement with a regulated market of significant size related to bitcoin; and in Section III.C assertions that the proposal is consistent with the protection of investors and the public interest.

Based on its analysis, the Commission concludes that BZX has not established that other means to prevent fraudulent and manipulative acts and practices are sufficient to justify dispensing with the requisite surveillance-sharing agreement. The Commission further concludes that BZX has not established that it has a comprehensive surveillance-sharing agreement with a regulated market of significant size related to bitcoin. As discussed further below, BZX repeats

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28 See id. at 47183.

29 See id. at 47179.

various assertions made in prior bitcoin-based ETP proposals that the Commission has previously addressed and rejected—and more importantly, BZX does not respond to the Commission's reasons for rejecting those assertions but merely repeats them. As a result, the Commission is unable to find that the proposed rule change is consistent with the statutory requirements of Exchange Act Section 6(b)(5).

The Commission again emphasizes that its disapproval of this proposed rule change does not rest on an evaluation of whether bitcoin, or blockchain technology more generally, has utility or value as an innovation or an investment. Rather, the Commission is disapproving this proposed rule change because, as discussed below, BZX has not met its burden to demonstrate that its proposal is consistent with the requirements of Exchange Act Section 6(b)(5).

II. DESCRIPTION OF THE PROPOSED RULE CHANGE

As described in more detail in the Notice,[30] the Exchange proposes to list and trade the Shares of the Trust under BZX Rule 14.11(e)(4), which governs the listing and trading of Commodity-Based Trust Shares on the Exchange.

The investment objective of the Trust is to reflect the performance of the price of bitcoin less the expenses of the Trust's operations. The Trust would not be actively managed and would not seek to reflect the performance of any benchmark or index.[31] Each Share would represent a fractional undivided beneficial interest in the bitcoin held by the Trust. The Trust's assets would

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30 See Notice, supra note 3. See also Registration Statement on Form S-1, dated July 21, 2021, submitted to the Commission by Global X Digital Assets, LLC ("Sponsor") on behalf of the Trust ("Registration Statement").

31 See Notice, 86 FR at 47184-85. Delaware Trust Company is the trustee. The Sponsor will select the administrator, transfer agent, and marketing agent in connection with the creation and redemption of the Shares, and a third-party regulated custodian that will be responsible for custody of the Trust's bitcoin. See id. at 47184.

consist of bitcoin held by the custodian on behalf of the Trust. The Trust generally does not intend to hold cash or cash equivalents; however, there may be situations where the Trust will hold cash on a temporary basis.[32] In seeking to achieve its investment objective, the Trust would hold bitcoin and value its assets daily in accordance with Generally Accepted Accounting Principles ("GAAP"), which generally value bitcoin by reference to orderly transactions in the principal active market for bitcoin.[33]

The net asset value ("NAV") for the Trust would be calculated by the administrator once a day and would be disseminated daily to all market participants at the same time.[34] The Sponsor would use fair value standards according to GAAP to value the assets and liabilities of the Trust. According to the Exchange, the fair value of an asset that is traded on a market would be generally measured by reference to the orderly transactions on an active market. Among all active markets with orderly transactions, the market that is used to determine the fair value of an asset is the principal market (with exceptions), which is either the market on which the Trust actually transacts or, if there is sufficient evidence, the market with the most trading volume and level of activity for the asset.[35] Where there is no active market with orderly transactions for an

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32 See id. at 47184.

33 See id. at 47185.

34 See id. at 47186.

35 The Sponsor would first determine which markets are likely to be active markets with orderly transactions for bitcoin. Currently, the Sponsor has determined that such markets are those that provide relevant and reliable price and volume information because the venues that support such markets: (1) conduct trading for bitcoin in U.S. dollars; (2) are appropriately licensed to engage in bitcoin trading involving New York-based customers; and (3) otherwise have sufficient indicia of an active market with orderly transactions. Next, among the venues supporting active markets with orderly transactions, the Sponsor would determine to which such venues the Trust has access, and refer to these as eligible venues. Eligible venues consist of eligible OTC venues and eligible exchanges. The Sponsor would then determine the principal market for bitcoin as either the market that

asset, the Sponsor's valuation committee would follow policies and procedures to determine the fair value.[36]

The Trust will provide information regarding the Trust's bitcoin holdings, as well as an Intraday Indicative Value ("IIV") per Share updated every 15 seconds, as calculated by the Exchange or a third-party financial data provider during the Exchange's Regular Trading Hours (9:30 a.m. to 4:00 p.m. E.T.). The IIV will be calculated by using the prior day's closing NAV per Share as a base and updating that value during Regular Trading Hours to reflect changes in the value of the Trust's bitcoin holdings during the trading day.[37]

When the Trust sells or redeems its Shares, it will do so in "in-kind" transactions in blocks of Shares (in an amount to be determined). When creating the Shares, authorized participants will deliver, or facilitate the delivery of, bitcoin to the Trust's account with the custodian in exchange for Shares, and when redeeming the Shares, the Trust, through the custodian, will deliver bitcoin to such authorized participants.[38]

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the Trust normally transacts in for bitcoin, or, if the Trust does not normally transact in any market or the Sponsor has sufficient evidence that a particular market has the highest trading volume and level of activity, such market. The Trust will not purchase or, barring the liquidation of the Trust or the Trust incurring certain extraordinary expenses or liabilities not contractually assumed by the Sponsor, sell bitcoin directly. As a result, the Sponsor expects that the principal market will generally be the market with the highest trading volume and level of activity, which the Sponsor expects will typically be an eligible exchange. The Sponsor would determine the principal market for bitcoin at least quarterly and more frequently as circumstances warrant. See id. at 47185.

36 See id.

37 See id. at 47185-86.

38 See id. at 47184.

III. DISCUSSION

A. <u>The Applicable Standard for Review</u>

The Commission must consider whether BZX's proposal is consistent with the Exchange Act. Section 6(b)(5) of the Exchange Act requires, in relevant part, 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."[39] Under the Commission's Rules of Practice, the "burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization ['SRO'] that proposed the rule change."[40]

The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,[41] and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the

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39 15 U.S.C. 78f(b)(5). Pursuant to Section 19(b)(2) of the Exchange Act, 15 U.S.C. 78s(b)(2), the Commission must disapprove a proposed rule change filed by a national securities exchange if it does not find that the proposed rule change is consistent with the applicable requirements of the Exchange Act. Exchange Act Section 6(b)(5) states that an exchange shall not be registered as a national securities exchange unless the Commission determines that "[t]he rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this title matters not related to the purposes of this title or the administration of the exchange." 15 U.S.C. 78f(b)(5).

40 Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

41 <u>See</u> <u>id.</u>

applicable rules and regulations.[42] Moreover, "unquestioning reliance" on an SRO's representations in a proposed rule change is not sufficient to justify Commission approval of a proposed rule change.[43]

B. <u>Whether BZX Has Met Its Burden to Demonstrate That the Proposal Is Designed to Prevent Fraudulent and Manipulative Acts and Practices</u>

(1) Assertions That Other Means Besides Surveillance-Sharing Agreements Will Be Sufficient to Prevent Fraudulent and Manipulative Acts and Practices

As stated above, the Commission has recognized that a listing exchange could demonstrate that other means to prevent fraudulent and manipulative acts and practices are sufficient to justify dispensing with a comprehensive surveillance-sharing agreement with a regulated market of significant size, including by demonstrating that the bitcoin market as a whole or the relevant underlying bitcoin market is uniquely and inherently resistant to fraud and manipulation.[44] Such resistance to fraud and manipulation must be novel and beyond those protections that exist in traditional commodities or securities markets.[45]

BZX asserts that bitcoin is resistant to price manipulation. According to BZX, the geographically diverse and continuous nature of bitcoin trading render it difficult and prohibitively costly to manipulate the price of bitcoin.[46] Fragmentation across bitcoin platforms,

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42 <u>See</u> <u>id.</u>

43 <u>Susquehanna Int'l Group, LLP v. Securities and Exchange Commission</u>, 866 F.3d 442, 447 (D.C. Cir. 2017) ("Susquehanna").

44 <u>See</u> USBT Order, 85 FR at 12597 n.23. The Commission is not applying a "cannot be manipulated" standard. Instead, the Commission is examining whether the proposal meets the requirements of the Exchange Act and, pursuant to its Rules of Practice, places the burden on the listing exchange to demonstrate the validity of its contentions and to establish that the requirements of the Exchange Act have been met. <u>See</u> <u>id.</u>

45 <u>See</u> <u>id.</u> at 12597.

46 <u>See</u> Notice, 86 FR at 47183 n.54.

the relatively slow speed of transactions, and the capital necessary to maintain a significant presence on each trading platform make manipulation of bitcoin prices through continuous trading activity challenging.[47] To the extent that there are bitcoin platforms engaged in, or allowing, wash trading or other activity intended to manipulate the price of bitcoin on other markets, such pricing does not normally impact prices on other platforms because participants will generally ignore markets with quotes that they deem non-executable.[48] BZX further argues that the linkage between the bitcoin markets and the presence of arbitrageurs in those markets means that the manipulation of the price of bitcoin on any single venue would require manipulation of the global bitcoin price in order to be effective.[49] Arbitrageurs must have funds distributed across multiple trading platforms in order to take advantage of temporary price dislocations, thereby making it unlikely that there will be strong concentration of funds on any particular bitcoin trading venue.[50] As a result, BZX concludes that "the potential for manipulation on a [bitcoin] trading platform would require overcoming the liquidity supply of such arbitrageurs who are effectively eliminating any cross-market pricing differences."[51]

As with the previous proposals, the Commission here concludes that the record does not support a finding that the bitcoin market is inherently and uniquely resistant to fraud and manipulation. BZX asserts that, because of how bitcoin trades occur, including through continuous means and through fragmented platforms, arbitrage across the bitcoin platforms

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47 See id.

48 See id.

49 See id.

50 See id.

51 See id.

essentially helps to keep global bitcoin prices aligned with one another, thus hindering manipulation. The Exchange, however, does not provide any data or analysis to support its assertions, either in terms of how closely bitcoin prices are aligned across different bitcoin trading venues or how quickly price disparities may be arbitraged away.[52] As stated above, "unquestioning reliance" on an SRO's representations in a proposed rule change is not sufficient to justify Commission approval of a proposed rule change.[53]

Efficient price arbitrage, moreover, is not sufficient to support the finding that a market is uniquely and inherently resistant to manipulation such that the Commission can dispense with surveillance-sharing agreements.[54] The Commission has stated, for example, that even for equity options based on securities listed on national securities exchanges, the Commission relies on surveillance-sharing agreements to detect and deter fraud and manipulation.[55] Here, the Exchange provides no evidence to support its assertion of efficient price arbitrage across bitcoin platforms, let alone any evidence that price arbitrage in the bitcoin market is novel or unique so as to warrant the Commission dispensing with the requirement of a surveillance-sharing

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52 Indeed, the Registration Statement states that "[b]itcoin faces significant scaling obstacles that can lead to high fees or slow settlement times, and attempts to increase the volume of transactions may not be effective." See Registration Statement at 14. BZX does not, however, provide data or analysis to address, among other things, whether such risks of increased fees and bitcoin transaction settlement times may affect the arbitrage effectiveness that BZX asserts. See also infra note 67 and accompanying text (referencing statements made in the Registration Statement that contradict assertions made by BZX).

53 See supra note 43.

54 See Winklevoss Order, 83 FR at 37586; SolidX Order, 82 FR at 16256-57; USBT Order, 85 FR at 12601; WisdomTree Order, 86 FR at 69325; Valkyrie Order, 86 FR at 74159-60; Kryptoin Order, 86 FR at 74170; Wise Origin Order, 87 FR at 5531.

55 See, e.g., USBT Order, 85 FR at 12601; WisdomTree Order, 86 FR at 69329; Valkyrie Order, 86 FR at 74160; Kryptoin Order, 86 FR at 74170; Wise Origin Order, 87 FR at 5531.

agreement. Moreover, BZX does not take into account that a market participant with a dominant ownership position would not find it prohibitively expensive to overcome the liquidity supplied by arbitrageurs and could use dominant market share to engage in manipulation.[56]

In addition, the Exchange makes the unsupported claim that bitcoin prices on platforms with wash trades or other activity intended to manipulate the price of bitcoin do not influence the "real" price of bitcoin. The Exchange also asserts that, to the extent that there are bitcoin platforms engaged in or allowing wash trading or other manipulative activities, market participants will generally ignore those platforms.[57] However, without the necessary data or other evidence, the Commission has no basis on which to conclude that bitcoin platforms are insulated from prices of others that engage in or permit fraud or manipulation.[58]

Additionally, the continuous nature of bitcoin trading does not eliminate manipulation risk, and neither do linkages among markets, as BZX asserts.[59] Even in the presence of continuous trading or linkages among markets, formal (such as those with consolidated quotations or routing requirements) or otherwise (such as in the context of the fragmented, global

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56 See, e.g., Winklevoss Order, 83 FR at 37584; USBT Order, 85 FR at 12600-01; WisdomTree Order, 86 FR at 69325; Valkyrie Order, 86 FR at 74160; Kryptoin Order, 86 FR at 74170; SkyBridge Order, 87 FR at 3783-84; Wise Origin Order, 87 FR at 5531. See also Registration Statement at 29 (stating that "[i]t is possible, and in fact, reasonably likely, that a small group of early bitcoin adopters hold a significant proportion of the bitcoin that has been created to date. There are no regulations in place that would prevent a large holder of bitcoin from selling bitcoin it holds. To the extent such large holders of bitcoin engage in large-scale sales or distributions…it could result in a reduction in the price of bitcoin and adversely affect an investment in the Shares.").

57 See Notice, 86 FR at 47183 n.54.

58 See USBT Order, 85 FR at 12601. See also WisdomTree Order, 86 FR at 69325; Kryptoin Order, 86 FR at 74170; Wise Origin Order, 87 FR at 5531.

59 See Winklevoss Order, 83 FR at 37585 n.92 and accompanying text. See also WisdomTree Order, 86 FR at 69325-26; Kryptoin Order, 86 FR at 74170; SkyBridge Order, 87 FR at 3783-84; Wise Origin Order, 87 FR at 5531.

bitcoin markets), manipulation of asset prices, as a general matter, can occur simply through trading activity that creates a false impression of supply or demand.[60]

BZX also argues that the significant liquidity in the bitcoin spot market and the impact of market orders on the overall price of bitcoin mean that attempting to move the price of bitcoin is costly and has grown more expensive over the past year.[61] According to BZX, in January 2020, for example, the cost to buy or sell $5 million worth of bitcoin averaged roughly 30 basis points (compared to 10 basis points in February 2021) with a market impact of 50 basis points (compared to 30 basis points in February 2021). For a $10 million market order, the cost to buy or sell was roughly 50 basis points (compared to 20 basis points in February 2021) with a market impact of 80 basis points (compared to 50 basis points in February 2021). BZX contends that as the liquidity in the bitcoin spot market increases, it follows that the impact of $5 million and $10 million orders will continue to decrease.[62]

However, the data furnished by BZX regarding the cost to move the price of bitcoin, and the market impact of such attempts, are incomplete. BZX does not provide meaningful analysis pertaining to how these figures compare to other markets or why one must conclude, based on the numbers provided, that the bitcoin market is costly to manipulate. Further, BZX's analysis of the market impact of a mere two sample transactions is not sufficient evidence to conclude that the bitcoin market is resistant to manipulation.[63] Even assuming that the Commission agreed

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60 See Winklevoss Order, 83 FR at 37585.

61 See Notice, 86 FR at 47184.

62 See id.

63 Aside from stating that the "statistics are based on samples of bitcoin liquidity in USD (excluding stablecoins or Euro liquidity) based on executable quotes on Coinbase Pro, Gemini, Bitstamp, Kraken, LMAX Exchange, BinanceUS, and OKCoin during February 2021," the Exchange provides no other information pertaining to the methodology used

with BZX's premise, that it is costly to manipulate the bitcoin market and it is becoming increasingly so, any such evidence speaks only to establish that there is some resistance to manipulation, not that it establishes unique resistance to manipulation to warrant dispensing with the standard surveillance-sharing agreement.[64] The Commission thus concludes that the record does not demonstrate that the nature of bitcoin trading renders the bitcoin market inherently and uniquely resistant to fraud and manipulation.

Moreover, BZX does not sufficiently contest the presence of possible sources of fraud and manipulation in the bitcoin spot market generally that the Commission has raised in previous orders, which have included (1) "wash" trading,[65] (2) persons with a dominant position in bitcoin manipulating bitcoin pricing, (3) hacking of the bitcoin network and trading platforms, (4) malicious control of the bitcoin network, (5) trading based on material, non-public information, including the dissemination of false and misleading information, (6) manipulative activity involving the purported "stablecoin" Tether ("USDT"), and (7) fraud and manipulation at bitcoin trading platforms.[66]

In addition, BZX does not address risk factors specific to the bitcoin blockchain and bitcoin platforms, described in the Trust's Registration Statement, that undermine the argument that the bitcoin market is inherently resistant to fraud and manipulation. For example, the

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to enable the Commission to evaluate these findings or their significance. See id. at 47184 nn.59-60.

64 See USBT Order, 85 FR at 12601. See also Kryptoin Order, 86 FR at 74171.

65 See supra notes 57-58 and accompanying text.

66 See USBT Order, 85 FR at 12600-01 & nn.66-67 (discussing J. Griffin & A. Shams, Is Bitcoin Really Untethered? (October 28, 2019), available at https://ssrn.com/abstract=3195066 and published in 75 J. Finance 1913 (2020)); Winklevoss Order, 83 FR at 37585-86; Valkyrie Order, 86 FR at 74160; SkyBridge Order, 87 FR at 3872.

Registration Statement acknowledges that "[t]he venues through which bitcoin trades are relatively new and may be more exposed to operational problems or failure"; that "[o]ver the past several years, a number of bitcoin exchangs have been closed due to fraud, failure or security breaches"; that "[s]ecurity breaches, computer malware, ransomware and computer hacking attacks have been a prevalent concern in relation to digital assets"; that "the Trust's bitcoin held in the Trust's account with the [custodian] will be an appealing target to hackers or malware distributors seeking to destroy, damage or steal the Trust's bitcoin and will only become more appealing as the Trust's assets grow"; that the bitcoin blockchain could be vulnerable: to exploitation of flaws in the bitcoin source code, to a "51% attack," in which a malicious actor or actors that control a majority of the processing power on the bitcoin network would be able to gain full control of the network and the ability to alter the blockchain, to "cancer nodes," through which a malicious actor can disconnect users from the bitcoin network, and to "double-spend" attacks; that it is "reasonably likely" that a "small group of early bitcoin adopters hold a signficiant proportion of the bitcoin that has been created to date," there are "no regulations in place that would prevent a large holder from selling the bitcoin it holds," and such large holders could engage in "large-scale sales" that would affect the "price of bitcoin"; and that "[t]he trading for spot bitcoin occurs on multiple trading venues that have various levels and types of regulation, but are not regulated in the same manner as traditional stock and bond exchanges," and if these spot markets "do not operate smoothly or face technical, security or regulatory issues, that could impact the ability of Authorized Participants to make markets in the

Shares" which could lead to "trading in the Shares [to] occur at a material premium or discount against the NAV."[67]

BZX also asserts that other means to prevent fraud and manipulation are sufficient to justify dispensing with the requisite surveillance-sharing agreement. The Exchange mentions that the methodology that it uses to value the Trust's bitcoin[68] is itself resistant to manipulation.[69] Simultaneously, the Exchange also states that, because the Trust will engage in in-kind creations and redemptions only, "the valuation methodology [is] significantly less important."[70] The Exchange elaborates further that, "because the Trust will not accept cash to buy bitcoin in order to create new shares, will charge fees as a percentage of the Trust's bitcoin holdings measure[d] in bitcoin and not in dollars, and … will not be forced to sell bitcoin to pay cash for redeemed shares, the price that the Sponsor uses to value the Trust's bitcoin is not particularly important."[71] According to BZX, when authorized participants create Shares with the Trust, they would need to deliver a certain number of bitcoin per share (regardless of the valuation used), and when they redeem with the Trust, they would similarly expect to receive a certain number of bitcoin per share.[72] As such, BZX argues that, even if the price used to value the Trust's bitcoin is manipulated, the ratio of bitcoin per Share does not change, and the Trust will either accept (for creations) or distribute (for redemptions) the same number of bitcoin regardless of the

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67 See Registration Statement at 21, 27, 29, 34, 44-45. See also Winklevoss Order, 83 FR at 37585.

68 See supra notes 34-36 and accompanying text.

69 See Notice, 86 FR at 47184.

70 See id.

71 See id.

72 See id.

value.[73] This, according to BZX, not only mitigates the risk associated with potential manipulation, but also discourages and disincentivizes manipulation of the valuation methodology because there is little financial incentive to do so.[74]

Based on assertions made and the information provided, the Commission can find no basis to conclude that BZX has articulated other means to prevent fraud and manipulation that are sufficient to justify dispensing with the requisite surveillance-sharing agreement. First, the record does not demonstrate that the proposed valuation methodology would make the proposed ETP resistant to fraud or manipulation such that a surveillance-sharing agreement with a regulated market of significant size is unnecessary. The Exchange states that both “certain” bitcoin venues and “the OTC market” have met the Sponsor’s criteria to be considered “active markets with orderly transactions for bitcoin” and thus to potentially be deemed the “principal market” whose prices the Sponsor will, generally, use to value its bitcoin.[75] However, the Exchange does not identify which bitcoin venues, or what portions of “the OTC market,” meet its criteria, nor does the Exchange assess the possible influence that spot platforms that do not meet the Sponsor’s criteria would have on the “principal market” that is ultimately used for valuation.[76] In addition, as discussed above, the record does not establish that the broader bitcoin market is inherently and uniquely resistant to fraud and manipulation. Accordingly, to the extent that trading on platforms not directly used to value the Trust’s bitcoin affects prices on the

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73 See id.

74 See id.

75 See id. at 47185.

76 As discussed above, while the Exchange asserts that bitcoin prices on platforms with wash trades or other activity intended to manipulate the price of bitcoin do not influence the “real” price of bitcoin, the Commission has no basis on which to conclude that bitcoin platforms are insulated from prices of others that engage in or permit fraud or manipulation. See supra notes 57-58 and accompanying text.

market(s) that the Sponsor does use for such valuation, the characteristics of those other platforms – where various kinds of fraud and manipulation from a variety of sources may be present and persist – may affect whether the valuation methodology is resistant to manipulation.

Moreover, the Exchange's assertions that the valuation methodology is resistant to manipulation are contradicted by the Registration Statement's own statements. Specifically, the Registration Statement states that "[o]ver the past several years, a number of bitcoin exchanges have been closed due to fraud, failure or security breaches."[77] And both the Registration Statement and the Exchange acknowledge that: "[w]hether the principal market for bitcoin is an eligible exchange or the OTC market, the price on such principal market may not always represent fair value or the transactions on such market may not always represent orderly transactions."[78] As such, the valuation methodology allows for "subjective determinations" by the Sponsor's valuation committee[79] "based on consideration of any information or factors the Sponsor's valuation committee deems appropriate."[80] Although the Sponsor raises concerns regarding fraud and security of bitcoin platforms in the Registration Statement, leading to the potential need for "subjective" fair value determinations, the Exchange does not explain how or why such concerns are consistent with its assertion that the valuation methodology is resistant to fraud and manipulation.

In addition, among the criteria that the Sponsor would use to identify "active markets with orderly transactions" is whether a venue is "appropriately licensed to engage in bitcoin

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77 See Registration Statement at 27.

78 See Registration Statement at 48; Notice, 86 FR at 47185.

79 See Registration Statement at 49.

80 See Registration Statement at 48; Notice, 86 FR at 47185.

trading involving New York-based customers (and therefore, among other things, have programs to effectively detect, prevent, and respond to fraud)."[81] However, even assuming that this means that the venue would be regulated by the New York State Department of Financial Services ("NYSDFS"), the level of oversight of bitcoin spot platforms is not equivalent to the obligations, authority, and oversight of national securities exchanges or futures exchanges and therefore is not an appropriate substitute.[82] National securities exchanges are required to have rules that are "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest."[83] Moreover, national securities exchanges must file proposed rules with the Commission regarding certain material aspects of their operations,[84] and the Commission has the authority to disapprove any such rule that is not consistent with the requirements of the Exchange Act.[85] Thus, national

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81 See Notice, 86 FR at 47185.

82 See also USBT Order, 85 FR at 12603-05; VanEck Order, 86 FR at 64545; WisdomTree Order, 86 FR at 69328; Kryptoin Order, 86 FR at 74173.

83 See 15 U.S.C. 78f(b)(5).

84 17 CFR 240.19b-4(a)(6)(i).

85 Section 6 of the Exchange Act, 15 U.S.C. 78f, requires national securities exchanges to register with the Commission and requires an exchange's registration to be approved by the Commission, and Section 19(b) of the Exchange Act, 15 U.S.C. 78s(b), requires national securities exchanges to file proposed rules changes with the Commission and provides the Commission with the authority to disapprove proposed rule changes that are not consistent with the Exchange Act. Designated contract markets ("DCMs") (commonly called "futures markets") registered with and regulated by the Commodity Futures Trading Commission ("CFTC") must comply with, among other things, a similarly comprehensive range of regulatory principles and must file rule changes with

securities exchanges are subject to Commission oversight of, among other things, their governance, membership qualifications, trading rules, disciplinary procedures, recordkeeping, and fees.[86] Bitcoin spot trading platforms, on the other hand, have none of these requirements (none are registered as a national securities exchange)[87]—even if they may be "licensed to engage in bitcoin trading involving New York-based customers."[88]

The Commission thus concludes that the Exchange has not demonstrated that the proposed valuation methodology makes the proposed ETP resistant to manipulation. While the proposed valuation methodology may be intended to provide some degree of protection against manipulation in bitcoin markets, the methodology is not sufficient for the Commission to

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the CFTC. See, e.g., Designated Contract Markets (DCMs), CFTC, available at http://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/index.htm.

86 See Winklevoss Order, 83 FR at 37597. The Commission notes that the NYSDFS has issued "guidance" to supervised virtual currency business entities, stating that these entities must "implement measures designed to effectively detect, prevent, and respond to fraud, attempted fraud, and similar wrongdoing." See Maria T. Vullo, Superintendent of Financial Services, NYSDFS, Guidance on Prevention of Market Manipulation and Other Wrongful Activity (Feb. 7, 2018), available at https://www.dfs.ny.gov/docs/legal/industry/il180207.pdf. The NYSDFS recognizes that its "guidance is not intended to limit the scope or applicability of any law or regulation" (id.), which would include the Exchange Act. Further, as stated previously, there are substantial differences between the NYSDFS and the Commission's regulation. Anti-Money Laundering ("AML") and Know-Your-Customer ("KYC") policies and procedures, for example, have been referenced in other bitcoin-based ETP proposals as a purportedly alternative means by which such ETPs would be uniquely resistant to manipulation. The Commission has previously concluded that such AML and KYC policies and procedures do not serve as a substitute for, and are not otherwise dispositive in the analysis regarding the importance of, having a surveillance sharing agreement with a regulated market of significant size relating to bitcoin. For example, AML and KYC policies and procedures do not substitute for the sharing of information about market trading activity or clearing activity and do not substitute for regulation of a national securities exchange. See USBT Order, 85 FR at 12603 n.101. See also, e.g., WisdomTree Order, 86 FR at 69328 n.95; Kryptoin Order, 86 FR at 74173 n.98.

87 See 15 U.S.C. 78e, 78f.

88 See Notice, 86 FR at 47185.

dispense with the requisite surveillance-sharing agreement with a regulated market of significant size.

Second, the Exchange does not explain the significance of the valuation methodology's purported resistance to manipulation to the overall analysis of whether the proposal to list and trade the Shares is designed to prevent fraud and manipulation. Even assuming that the Exchange's argument is that, if the valuation methodology is resistant to manipulation, the Trust's NAV, and thereby the Shares as well, would be resistant to manipulation, the Exchange has not established in the record a basis for such conclusion. That assumption aside, the Commission notes that the Shares would trade at market-based prices in the secondary market, not at NAV, which then raises the question of the significance of the NAV calculation to the manipulation of the Shares.

Third, the Exchange's arguments are contradictory. While arguing that the valuation methodology is resistant to manipulation, the Exchange simultaneously downplays its importance in light of the Trust's in-kind creation and redemption mechanism.[89] The Exchange points out that the Trust will create and redeem Shares in-kind, not in cash, which renders the valuation methodology, and thereby the ability to manipulate NAV, "significantly less important."[90] In BZX's own words, the Trust will not accept cash to buy bitcoin in order to create shares or sell bitcoin to pay cash for redeemed shares, so the price that the Sponsor uses to

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89 See supra notes 70-74 and accompanying text.

90 See Notice, 86 FR at 47184 ("While the Sponsor believes that the methodology which it uses to value the Trust's bitcoin is itself resistant to manipulation based on the methodology further described below, the fact that creations and redemptions are only available in-kind makes the valuation methodology significantly less important.").

value the Trust's bitcoin "is not particularly important."[91] If the methodology that the Trust uses to value the Trust's bitcoin "is not particularly important," it follows that the methodology's resistance to manipulation is not material to the Shares' susceptibility to fraud and manipulation. As the Exchange does not address or provide any analysis with respect to these issues, the Commission cannot conclude that the valuation methodology aids in the determination that the proposal to list and trade the Shares is designed to prevent fraudulent and manipulative acts and practices.

Finally, the Commission finds that BZX has not demonstrated that in-kind creations and redemptions provide the Shares with a unique resistance to manipulation. The Commission has previously addressed similar assertions.[92] As the Commission stated before, in-kind creations and redemptions are a common feature of ETPs, and the Commission has not previously relied on the in-kind creation and redemption mechanism as a basis for excusing exchanges that list ETPs from entering into surveillance-sharing agreements with significant, regulated markets

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91 See id. (concluding that "because the Trust will not accept cash to buy bitcoin in order to create new shares, will charge fees as a percentage of the Trust's bitcoin holdings measure[d] in bitcoin and not in dollars, and, barring a forced redemption of the Trust or under other extraordinary circumstances, will not be forced to sell bitcoin to pay cash for redeemed shares, the price that the Sponsor uses to value the Trust's bitcoin is not particularly important.").

92 See Winklevoss Order, 83 FR at 37589-90; USBT Order, 85 FR at 12607-08; VanEck Order, 86 FR at 64546; WisdomTree Order, 86 FR at 69329; Kryptoin Order, 86 FR at 74174; SkyBridge Order, 87 FR at 3874; Wise Origin Order, 87 FR at 5533.

related to the portfolio's assets.[93] Accordingly, the Commission is not persuaded here that the Trust's in-kind creations and redemptions afford it a unique resistance to manipulation.[94]

(2) Assertions That BZX Has Entered Into a Comprehensive Surveillance-Sharing Agreement with a Regulated Market of Significant Size

As BZX has not demonstrated that other means besides surveillance-sharing agreements will be sufficient to prevent fraudulent and manipulative acts and practices, the Commission next examines whether the record supports the conclusion that BZX has entered into a comprehensive surveillance-sharing agreement with a regulated market of significant size relating to the underlying assets. In this context, the term "market of significant size" includes a market (or group of markets) as to which (i) there is a reasonable likelihood that a person attempting to manipulate the ETP would also have to trade on that market to successfully manipulate the ETP, so that a surveillance-sharing agreement would assist in detecting and deterring misconduct, and

93 See, e.g., iShares COMEX Gold Trust, Securities Exchange Act Release No. 51058 (Jan. 19, 2005), 70 FR 3749, 3751-55 (Jan. 26, 2005) (SR-Amex-2004-38); iShares Silver Trust, Securities Exchange Act Release No. 53521 (Mar. 20, 2006), 71 FR 14969, 14974 (Mar. 24, 2006) (SR-Amex-2005-072).

94 Putting aside the Exchange's various assertions about the nature of bitcoin and the bitcoin market, the valuation methodology, and the Shares, the Exchange also does not address concerns the Commission has previously identified, including the susceptibility of bitcoin markets to potential trading on material, non-public information (such as plans of market participants to significantly increase or decrease their holdings in bitcoin; new sources of demand for bitcoin; the decision of a bitcoin-based investment vehicle on how to respond to a "fork" in the bitcoin blockchain, which would create two different, non-interchangeable types of bitcoin), or to the dissemination of false or misleading information. See Winklevoss Order, 83 FR at 37585. See also USBT Order, 85 FR at 12600-01; WisdomTree Order, 86 FR at 69329 n.114; Kryptoin Order, 86 FR at 74174 n.107; SkyBridge Order, 87 FR at 3872; Wise Origin Order, 87 FR at 5533 n.89.

(ii) it is unlikely that trading in the ETP would be the predominant influence on prices in that market.[95]

As the Commission has stated in the past, it considers two markets that are members of the ISG to have a comprehensive surveillance-sharing agreement with one another, even if they do not have a separate bilateral surveillance-sharing agreement.[96] Accordingly, based on the common membership of BZX and the CME in the ISG,[97] BZX has the equivalent of a comprehensive surveillance-sharing agreement with the CME. However, while the Commission recognizes that the CFTC regulates the CME futures market,[98] including the CME bitcoin futures market, and thus such market is "regulated," in the context of the proposed ETP, the record does not, as explained further below, establish that the CME bitcoin futures market is a "market of significant size" as that term is used in the context of the applicable standard here.

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95 See Winklevoss Order, 83 FR at 37594. This definition is illustrative and not exclusive. There could be other types of "significant markets" and "markets of significant size," but this definition is an example that provides guidance to market participants. See id.

96 See id. at 37580 n.19.

97 See Notice, 86 FR at 47183 n.56 and accompanying text. BZX also states that it has surveillance-sharing agreements with "several spot bitcoin exchanges" with "material volume." See id. at 47183 & n.55. BZX does not identify the platforms with which it has such agreements and does not provide any information on the scope, terms, or enforcement authority for such surveillance-sharing agreements. Further, as described above, spot bitcoin platforms are not "regulated." They are not registered as "exchanges" and lack the obligations, authority, and oversight of national securities exchanges. See supra notes 82-88 and accompanying text.

98 While the Commission recognizes that the CFTC regulates the CME, the CFTC is not responsible for direct, comprehensive regulation of the underlying bitcoin spot market. See Winklevoss Order, 83 FR at 37587, 37599. See also WisdomTree Order, 86 FR at 69330 n.118; Kryptoin Order, 86 FR at 74174 n.119; SkyBridge Order, 87 FR at 3874 n.80; Wise Origin Order, 87 FR at 5534 n.93.

(i) Whether There is a Reasonable Likelihood That a Person Attempting to Manipulate the ETP Would Also Have to Trade on the CME Bitcoin Futures Market to Successfully Manipulate the ETP

The first prong in establishing whether the CME bitcoin futures market constitutes a "market of significant size" is the determination that there is a reasonable likelihood that a person attempting to manipulate the ETP would have to trade on the CME bitcoin futures market to successfully manipulate the ETP.

BZX notes that the CME began to offer trading in bitcoin futures in 2017.[99] According to BZX, nearly every measurable metric related to CME bitcoin futures contracts, which trade and settle like other cash-settled commodity futures contracts, has "trended consistently up since launch and/or accelerated upward in the past year."[100] For example, according to BZX, there was approximately $28 billion in trading in CME bitcoin futures in December 2020 compared to $737 million, $1.4 billion, and $3.9 billion in total trading in December 2017, December 2018, and December 2019, respectively.[101] Additionally, CME bitcoin futures traded over $1.2 billion per day in December 2020 and represented $1.6 billion in open interest compared to $115 million in December 2019.[102] Similarly, BZX contends that the number of large open interest

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99 According to BZX, each contract represents five bitcoin and is based on the CME CF Bitcoin Reference Rate. See Notice, 86 FR at 47181.

100 See id.

101 See id.

102 See id.

holders[103] has continued to increase, even as the price of bitcoin has risen, as have the number of unique accounts trading CME bitcoin futures.[104]

BZX argues that the significant growth in CME bitcoin futures across each of trading volumes, open interest, large open interest holders, and total market participants since the USBT Order was issued is reflective of that market's growing influence on the spot price. BZX asserts that where CME bitcoin futures lead the price in the spot market such that a potential manipulator of the bitcoin spot market would have to participate in the CME bitcoin futures market, it follows that a potential manipulator of the Shares would similarly have to transact in the CME bitcoin futures market "because the NAV is based on the price of bitcoin on the principal market, which identified market must be an active market with orderly transactions."[105]

BZX further states that academic research corroborates the overall trend outlined above and supports the thesis that CME bitcoin futures pricing leads the spot market. BZX asserts that academic research demonstrates that the CME bitcoin futures market was already leading the spot price in 2018 and 2019.[106] BZX concludes that a person attempting to manipulate the Shares would also have to trade on that market to manipulate the ETP.[107]

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103 BZX represents that a large open interest holder in CME bitcoin futures is an entity that holds at least 25 contracts, which is the equivalent of 125 bitcoin. According to BZX, at a price of approximately $30,000 per bitcoin on December 31, 2020, more than 80 firms had outstanding positions of greater than $3.8 million in CME bitcoin futures. See id. at 47181 n.50.

104 See id. at 47181.

105 See id. at 47183.

106 See id. at 47182 & n.51 (citing Y. Hu, Y. Hou & L. Oxley, What role do futures markets play in Bitcoin pricing? Causality, cointegration and price discovery from a time-varying perspective, 72 Int'l Rev. of Fin. Analysis 101569 (2020) (available at: https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7481826/) ("Hu, Hou & Oxley")).

107 See id. at 47183.

The Commission disagrees. The record does not demonstrate that there is a reasonable likelihood that a person attempting to manipulate the proposed ETP would have to trade on the CME bitcoin futures market to successfully manipulate it. Specifically, BZX's assertions about the general upward trends from 2018 to February 2021 in trading volume and open interest of, and in the number of large open interest holders and number of unique accounts trading in, CME bitcoin futures do not establish that the CME bitcoin futures market is of significant size. While BZX provides data showing absolute growth in the size of the CME bitcoin futures market, it provides no data relative to the concomitant growth in either the bitcoin spot markets or other bitcoin futures markets (including unregulated futures markets). Moreover, even if the CME has grown in relative size, as the Commission has previously articulated, the interpretation of the term "market of significant size" or "significant market" depends on the interrelationship between the market with which the listing exchange has a surveillance-sharing agreement and the proposed ETP.[108] BZX's recitation of data reflecting the size of the CME bitcoin futures market, alone, either currently or in relation to previous years, is not sufficient to establish an interrelationship between the CME bitcoin futures market and the proposed ETP.[109]

108 See USBT Order, 85 FR at 12611. See also WisdomTree Order, 86 FR at 69330; Kryptoin Order, 86 FR at 74175; SkyBridge Order, 87 FR at 3875; Wise Origin Order, 87 FR at 5534.

109 See USBT Order, 85 FR at 12612. The Commission has previously considered and rejected similar arguments. See, e.g., VanEck Order, 86 FR at 64547; Kryptoin Order, 86 FR 74175-76; SkyBridge Order, 87 FR 3875-76; Wise Origin Order, 87 FR at 5534-35. As for the Exchange's statement that a potential manipulator of the Shares would have to transact in the CME bitcoin futures market "because the NAV is based on the price of bitcoin on the principal market, which identified market must be an active market with orderly transactions," the Exchange does not elaborate further, and the statement is nonsensical. The Exchange does not explain, for example, the connection between the CME bitcoin futures market and the principal market or the NAV. Moreover, the Trust does not create or redeem in cash based on NAV and the Shares do not trade based on NAV but on market-based prices in the secondary market.

Further, the econometric evidence in the record for this proposal also does not support a conclusion that an interrelationship exists between the CME bitcoin futures market and the bitcoin spot market such that it is reasonably likely that a person attempting to manipulate the proposed ETP would also have to trade on the CME bitcoin futures market to successfully manipulate the proposed ETP.[110] While BZX states that CME bitcoin futures pricing leads the spot market,[111] it relies on the findings of a price discovery analysis in one section of a single academic paper to support the overall thesis.[112] However, the findings of that paper's Granger causality analysis, which is widely used to formally test for lead-lag relationships, are concededly mixed.[113] In addition, the Commission considered an unpublished version of the

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110 See USBT Order, 85 FR at 12611. Listing exchanges have attempted to demonstrate such an "interrelationship" by presenting the results of various econometric "lead-lag" analyses. The Commission considers such analyses to be central to understanding whether it is reasonably likely that a would-be manipulator of the ETP would need to trade on the CME bitcoin futures market. See id. at 12612. See also VanEck Order, 86 FR at 64547; WisdomTree Order, 86 FR 69330-31; Kryptoin Order, 86 FR 74176 n.144; SkyBridge Order, 87 FR at 3876 n.101; Wise Origin Order, 87 FR at 5535 n.107.

111 See Notice, 86 FR at 47182.

112 See supra note 106 and accompanying text. BZX references the following conclusion from the "time-varying price discovery" section of Hu, Hou & Oxley: "There exist no episodes where the Bitcoin spot markets dominates the price discovery processes with regard to Bitcoin futures. This points to a conclusion that the price formation originates solely in the Bitcoin futures market. We can, therefore, conclude that the Bitcoin futures markets dominate the dynamic price discovery process based upon time-varying information share measures. Overall, price discovery seems to occur in the Bitcoin futures markets rather than the underlying spot market based upon a time-varying perspective…" See Notice, 86 FR at 47182 n.51.

113 The paper finds that the CME bitcoin futures market dominates the spot markets in terms of Granger causality, but that the causal relationship is bi-directional, and a Granger causality episode from March 2019 to June/July 2019 runs from bitcoin spot prices to CME bitcoin futures prices. The paper concludes: "[T]he Granger causality episodes are not constant throughout the whole sample period. Via our causality detection methods, market participants can identify when markets are being led by futures prices and when they might not be." See Hu, Hou & Oxley, supra note 106.

paper in the USBT Order, as well as a comment letter submitted by the authors on that record.[114] In the USBT Order, as part of the Commission's conclusion that "mixed results" in academic studies failed to demonstrate that the CME bitcoin futures market constitutes a market of significant size, the Commission noted the paper's inconclusive evidence that CME bitcoin futures prices lead spot prices—in particular that the months at the end of the paper's sample period showed that the spot market was the leading market—and stated that the record did not include evidence to explain why this would not indicate a shift towards prices in the spot market leading the futures market that would be expected to persist into the future.[115] The Commission also stated that the paper's use of daily price data, as opposed to intraday prices, may not be able to distinguish which market incorporates new information faster.[116] BZX has not addressed either issue.[117]

Moreover, BZX does not provide results of its own analysis and does not present any other data supporting its conclusion. BZX's unsupported representations constitute an insufficient basis for approving a proposed rule change in circumstances where, as here, the Exchange's assertion would form such an integral role in the Commission's analysis and the assertion is subject to several challenges.[118] In this context, BZX's reliance on a single paper, whose own lead-lag results are inconclusive, is especially lacking because the academic literature on the lead-lag relationship and price discovery between bitcoin spot and futures

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114 See USBT Order, 85 FR at 12609.

115 See id. at 12613 n.244.

116 See id.

117 See VanEck Order, 86 FR at 64547; WisdomTree Order, 86 FR at 69331; Kryptoin Order, 86 FR 74176; Wise Origin Order, 87 FR 5535.

118 See Susquehanna, 866 F.3d at 447.

markets is unsettled.[119] In the USBT Order, the Commission responded to multiple academic papers that were cited and concluded that, in light of the mixed results found, the exchange there had not demonstrated that it is reasonably likely that a would-be manipulator of the proposed ETP would transact on the CME bitcoin futures market.[120] Likewise, here, given the body of academic literature to indicate to the contrary, the Commission concludes that the information that BZX provides is not a sufficient basis to support a determination that it is reasonably likely that a would-be manipulator of the proposed ETP would have to trade on the CME bitcoin futures market.[121]

119 See, e.g., D. Baur & T. Dimpfl, Price discovery in bitcoin spot or futures?, 39 J. Futures Mkts. 803 (2019) (finding that the bitcoin spot market leads price discovery); O. Entrop, B. Frijns & M. Seruset, The determinants of price discovery on bitcoin markets, 40 J. Futures Mkts. 816 (2020) (finding that price discovery measures vary significantly over time without one market being clearly dominant over the other); J. Hung, H. Liu & J. Yang, Trading activity and price discovery in Bitcoin futures markets, 62 J. Empirical Finance 107 (2021) (finding that the bitcoin spot market dominates price discovery); B. Kapar & J. Olmo, An analysis of price discovery between Bitcoin futures and spot markets, 174 Econ. Letters 62 (2019) (finding that bitcoin futures dominate price discovery); E. Akyildirim, S. Corbet, P. Katsiampa, N. Kellard & A. Sensoy, The development of Bitcoin futures: Exploring the interactions between cryptocurrency derivatives, 34 Fin. Res. Letters 101234 (2020) (finding that bitcoin futures dominate price discovery); A. Fassas, S. Papadamou, & A. Koulis, Price discovery in bitcoin futures, 52 Res. Int'l Bus. Fin. 101116 (2020) (finding that bitcoin futures play a more important role in price discovery); S. Aleti & B. Mizrach, Bitcoin spot and futures market microstructure, 41 J. Futures Mkts. 194 (2021) (finding that relatively more price discovery occurs on the CME as compared to four spot exchanges); J. Wu, K. Xu, X. Zheng & J. Chen, Fractional cointegration in bitcoin spot and futures markets, 41 J. Futures Mkts. 1478 (2021) (finding that CME bitcoin futures dominate price discovery). See also C. Alexander & D. Heck, Price discovery in Bitcoin: The impact of unregulated markets, 50 J. Financial Stability 100776 (2020) (finding that, in a multi-dimensional setting, including the main price leaders within futures, perpetuals, and spot markets, CME bitcoin futures have a very minor effect on price discovery; and that faster speed of adjustment and information absorption occurs on the unregulated spot and derivatives platforms than on CME bitcoin futures).

120 See USBT Order, 85 FR at 12613 nn.239-244 and accompanying text.

121 In addition, the Exchange fails to address the relationship (if any) between prices on other bitcoin futures markets and the CME bitcoin futures market, the bitcoin spot market,

The Commission accordingly concludes that the information provided in the record for this proposal does not establish a reasonable likelihood that a would-be manipulator of the proposed ETP would have to trade on the CME bitcoin futures market to successfully manipulate the proposed ETP. Therefore, the information in the record also does not establish that the CME bitcoin futures market is a "market of significant size" with respect to the proposed ETP.

(ii) Whether It is Unlikely that Trading in the Proposed ETP Would Be the Predominant Influence on Prices in the CME Bitcoin Futures Market

The second prong in establishing whether the CME bitcoin futures market constitutes a "market of significant size" is the determination that it is unlikely that trading in the proposed ETP would be the predominant influence on prices in the CME bitcoin futures market.[122]

BZX asserts that trading in the Shares would not be the predominant force on prices in the CME bitcoin futures market (or spot market) because of the significant volume in the CME bitcoin futures market, the size of bitcoin's market capitalization, which is approximately $1 trillion, and the significant liquidity available in the spot market.[123] BZX provides that, according to February 2021 data, the cost to buy or sell $5 million worth of bitcoin averages roughly 10 basis points with a market impact of 30 basis points.[124] For a $10 million market order, the cost

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and/or any particular spot platform that could be the "principal market" for purposes of the Trust's valuation methodology, or where price formation occurs when the entirety of bitcoin futures markets, not just CME, is considered. See VanEck Order, 86 FR at 64547-48; WisdomTree Order, 86 FR at 69331; Kryptoin Order, 86 FR 74176; Wise Origin Order, 87 FR 5535.

122 See Winklevoss Order, 83 FR at 37594; USBT Order, 85 FR at 12596-97.

123 See Notice, 86 FR at 47184.

124 See id. According to BZX, these statistics are based on samples of bitcoin liquidity in U.S. dollars (excluding stablecoins or Euro liquidity) based on executable quotes on Coinbase Pro, Gemini, Bitstamp, Kraken, LMAX Exchange, BinanceUS, and OKCoin during February 2021. See id. at 47184 nn.59-60.

to buy or sell is roughly 20 basis points with a market impact of 50 basis points. Stated another way, BZX states that a market participant could enter a market buy or sell order for $10 million of bitcoin and only move the market 0.5 percent.[125] BZX further asserts that more strategic purchases or sales (such as using limit orders and executing through OTC bitcoin trade desks) would likely have less obvious impact on the market, which is consistent with MicroStrategy, Tesla, and Square being able to collectively purchase billions of dollars in bitcoin.[126] Thus, BZX concludes that the combination of CME bitcoin futures leading price discovery, the overall size of the bitcoin market, and the ability for market participants (including authorized participants creating and redeeming in-kind with the Trust) to buy or sell large amounts of bitcoin without significant market impact, will help prevent the Shares from becoming the predominant force on pricing in either the bitcoin spot or the CME bitcoin futures market.[127]

The Commission does not agree. The record does not demonstrate that it is unlikely that trading in the proposed ETP would be the predominant influence on prices in the CME bitcoin futures market. As the Commission has already addressed and rejected one of the bases of BZX's assertion—that CME bitcoin futures leads price discovery[128]—it will only address below the other two bases: the overall size of, and the impact of buys and sells on, the bitcoin market.

BZX's assertions about the potential effect of trading in the Shares on the CME bitcoin futures market and bitcoin spot market are general and conclusory, repeating the aforementioned trade volume of the CME bitcoin futures market and the size and liquidity of the bitcoin spot market, as well as the market impact of a large transaction, without any analysis or evidence to

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125 See id. at 47184.

126 See id.

127 See id.

128 See supra notes 110-121 and accompanying text.

support these assertions. For example, there is no limit on the amount of mined bitcoin that the Trust may hold. Yet BZX does not provide any information on the expected growth in the size of the Trust and the resultant increase in the amount of bitcoin held by the Trust over time, or on the overall expected number, size, and frequency of creations and redemptions—or how any of the foregoing could (if at all) influence prices in the CME bitcoin futures market. Thus, the Commission cannot conclude, based on BZX's statements alone and absent any evidence or analysis in support of BZX's assertions, that it is unlikely that trading in the ETP would be the predominant influence on prices in the CME bitcoin futures market.[129]

The Commission also is not persuaded by BZX's assertions about the minimal effect a large market order to buy or sell bitcoin would have on the bitcoin market.[130] While BZX concludes by way of a $10 million market order example that buying or selling large amounts of bitcoin would have insignificant market impact, the conclusion does not analyze the extent of any impact on the CME bitcoin futures market. Even assuming that BZX is suggesting that a single $10 million order in bitcoin would have immaterial impact on the prices in the CME bitcoin futures market, this prong of the "market of significant size" determination concerns the influence on prices from trading in the proposed ETP, which is broader than just trading by the proposed ETP. While authorized participants of the Trust might only transact in the bitcoin spot market as part of their creation or redemption of Shares, the Shares themselves would be traded in the secondary market on BZX. The record does not discuss the expected number or trading

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129 See VanEck Order, 86 FR at 64548-59; WisdomTree Order, 86 FR at 69332-33; Kryptoin Order, 86 FR at 74177; SkyBridge Order, 87 FR at 3879; Wise Origin Order, 87 FR at 5537.

130 See Notice, 86 FR at 47184 ("For a $10 million market order, the cost to buy or sell is roughly 20 basis points with a market impact of 50 basis points. Stated another way, a market participant could enter a market buy or sell order for $10 million of bitcoin and only move the market 0.5%.").

volume of the Shares, or establish the potential effect of the Shares' trade prices on CME bitcoin futures prices. For example, BZX does not provide any data or analysis about the potential effect the quotations or trade prices of the Shares might have on market-maker quotations in CME bitcoin futures contracts and whether those effects would constitute a predominant influence on the prices of those futures contracts.[131]

Thus, because BZX has not provided sufficient information to establish both prongs of the "market of significant size" determination, the Commission cannot conclude that the CME bitcoin futures market is a "market of significant size" such that BZX would be able to rely on a surveillance-sharing agreement with the CME to provide sufficient protection against fraudulent and manipulative acts and practices.

The requirements of Section 6(b)(5) of the Exchange Act apply to the rules of national securities exchanges. Accordingly, the relevant obligation for a comprehensive surveillance-sharing agreement with a regulated market of significant size, or other means to prevent fraudulent and manipulative acts and practices that are sufficient to justify dispensing with the requisite surveillance-sharing agreement, resides with the listing exchange. Because there is insufficient evidence in the record demonstrating that BZX has satisfied this obligation, the Commission cannot approve the proposed ETP for listing and trading on BZX.

C. Whether BZX Has Met Its Burden to Demonstrate That the Proposal Is Designed to Protect Investors and the Public Interest

BZX contends that, if approved, the proposed ETP would protect investors and the public interest. However, the Commission must consider these potential benefits in the broader context

131 See VanEck Order, 86 FR at 64549; WisdomTree Order, 86 FR at 69333; Kryptoin Order, 86 FR at 74177; SkyBridge Order, 87 FR at 3879; Wise Origin Order, 87 FR at 5537.

of whether the proposal meets each of the applicable requirements of the Exchange Act.[132] Because BZX has not demonstrated that its proposed rule change is designed to prevent fraudulent and manipulative acts and practices, the Commission must disapprove the proposal.

BZX asserts that, with the growth of U.S. investor exposure to bitcoin through OTC bitcoin funds, so too has grown the potential risk to U.S. investors.[133] Specifically, BZX argues that premium and discount volatility, high fees, insufficient disclosures, and technical hurdles are putting U.S. investor money at risk on a daily basis and that such risk could potentially be eliminated through access to a bitcoin ETP.[134] As such, the Exchange believes that approving this proposal (and comparable proposals submitted hereafter) would give U.S. investors access to bitcoin in a regulated and transparent exchange-traded vehicle that would act to limit risk to U.S. investors by: (i) reducing premium and discount volatility; (ii) reducing management fees through meaningful competition; (iii) providing an alternative to custodying spot bitcoin; and (iv) reducing risks associated with investing in operating companies that are imperfect proxies for bitcoin exposure.[135]

According to BZX, OTC bitcoin funds are generally designed to provide exposure to bitcoin in a manner similar to the Shares. However, unlike the Shares, BZX states that "OTC

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132 See Winklevoss Order, 83 FR at 37602. See also GraniteShares Order, 83 FR at 43931; ProShares Order, 83 FR at 43941; USBT Order, 85 FR at 12615. See also WisdomTree Order, 86 FR at 69333; Valkyrie Order, 86 FR at 74163; Kryptoin Order, 86 FR at 74178; SkyBridge Order, 87 FR at 3880; Wise Origin Order, 87 FR at 5537.

133 See Notice, 86 FR at 47179.

134 See id. BZX states that while it understands the Commission's previous focus on potential manipulation of a bitcoin ETP in prior disapproval orders, it now believes that "such concerns have been sufficiently mitigated and that the growing and quantifiable investor protection concerns should be the central consideration as the Commission reviews this proposal." See id.

135 See id.

bitcoin funds are unable to freely offer creation and redemption in a way that incentivizes market participants to keep their shares trading in line with their NAV and, as such, frequently trade at a price that is out-of-line with the value of their assets held."[136] BZX represents that, historically, OTC bitcoin funds have traded at a significant premium to NAV.[137] Although the Exchange concedes that trading at a premium (or potentially a discount) is not unique to OTC bitcoin funds and not inherently problematic, BZX believes that it raises certain investor protections issues. First, according to BZX, investors are buying shares of a fund for a price that is not reflective of the per share value of the fund's underlying assets.[138] Second, according to BZX, because only accredited investors, generally, are able to create or redeem shares with the issuing trust and can buy or sell shares directly with the trust at NAV (in exchange for either cash or bitcoin) without having to pay the premium or sell into the discount, these investors that are allowed to interact directly with the trust are able to hedge their bitcoin exposure as needed to satisfy holding requirements and collect on the premium or discount opportunity. BZX argues, therefore, that the premium in OTC bitcoin funds essentially creates a direct payment from retail investors to more sophisticated investors.[139]

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136 See id. BZX also states that, unlike the Shares, because OTC bitcoin funds are not listed on an exchange, they are not subject to the same transparency and regulatory oversight by a listing exchange. BZX further asserts that the existence of a surveillance-sharing agreement between BZX and the CME bitcoin futures market would result in increased investor protections for the Shares compared to OTC bitcoin funds. See id. at 47179 n.38.

137 See id. at 47179. BZX further represents that the inability to trade in line with NAV may at some point result in OTC bitcoin funds trading at a discount to their NAV. According to BZX, while that has not historically been the case, trading at a discount would give rise to nearly identical potential issues related to trading at a premium. See id. at 47179 n.39.

138 See id. at 47180.

139 See id.

BZX also asserts that exposure to bitcoin through an ETP also presents advantages for retail investors compared to buying spot bitcoin directly.[140] BZX asserts that, without the advantages of an ETP, an individual retail investor holding bitcoin through a cryptocurrency trading platform lacks protections.[141] BZX explains that, typically, retail platforms hold most, if not all, retail investors' bitcoin in "hot" (Internet-connected) storage and do not make any commitments to indemnify retail investors or to observe any particular cybersecurity standard.[142] Meanwhile, a retail investor holding spot bitcoin directly in a self-hosted wallet may suffer from inexperience in private key management (e.g., insufficient password protection, lost key, etc.), which could cause them to lose some or all of their bitcoin holdings.[143] BZX represents that the custodian would, by contrast, use "cold" (offline) storage to hold private keys, employ a certain degree of cybersecurity measures and operational best practices, be highly experienced in bitcoin custody, and be accountable for failures.[144] In addition, BZX represents that the custodian would be a chartered trust company that carries insurance covering both hot and cold storage, and "will custody the Trust's bitcoin assets in a manner so that it meets the definition of qualified custodian" under the Investment Advisers Act of 1940, as amended.[145] Thus, with respect to custody of the Trust's bitcoin assets, BZX concludes that, compared to owning spot bitcoin

140 See id.

141 See id.

142 See id.

143 See id.

144 See id.

145 See id.

directly, the Trust presents advantages from an investment protection standpoint for retail investors.[146]

BZX further asserts that a number of operating companies engaged in unrelated businesses have announced investments as large as $1.5 billion in bitcoin.[147] Without access to bitcoin ETPs, BZX argues that retail investors seeking investment exposure to bitcoin may purchase shares in these companies in order to gain the exposure to bitcoin that they seek.[148] BZX contends that such operating companies, however, are imperfect bitcoin proxies and provide investors with partial bitcoin exposure paired with additional risks associated with whichever operating company they decide to purchase. BZX concludes that investors seeking bitcoin exposure through publicly traded companies are gaining only partial exposure to bitcoin and are not fully benefitting from the risk disclosures and associated investor protections that come from the securities registration process.[149]

BZX also states that investors in many other countries, including Canada, are able to use more traditional exchange-listed and traded products to gain exposure to bitcoin, disadvantaging U.S. investors and leaving them with more risky and more expensive means of getting bitcoin exposure.[150]

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146 See id.

147 See id.

148 See id.

149 See id. at 47181.

150 See id. at 47179. BZX represents that the Purpose Bitcoin ETF, a retail bitcoin-based ETP launched in Canada, reportedly reached $421.8 million in assets under management in two days, demonstrating the demand for a North American market listed bitcoin ETP. BZX contends that the Purpose Bitcoin ETF also offers a class of units that is U.S. dollar denominated, which could appeal to U.S. investors. BZX also argues that, without an approved bitcoin ETP in the U.S. as a viable alternative, U.S. investors could seek to purchase these shares in order to get access to bitcoin exposure. BZX believes that, given

In essence, BZX asserts that the risky nature of direct investment in the underlying bitcoin and the unregulated markets on which bitcoin and OTC bitcoin funds trade compel approval of the proposed rule change. The Commission disagrees. Pursuant to Section 19(b)(2) of the Exchange Act, the Commission must approve a proposed rule change filed by a national securities exchange if it finds that the proposed rule change is consistent with the applicable requirements of the Exchange Act—including the requirement under Section 6(b)(5) that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices—and it must disapprove the filing if it does not make such a finding.[151] Thus, even if a proposed rule change purports to protect investors from a particular type of investment risk—such as the susceptibility of an asset to loss or theft—the proposed rule change may still fail to meet the requirements under the Exchange Act.[152]

Here, even if it were true that, compared to trading in unregulated bitcoin spot markets, trading a bitcoin-based ETP on a national securities exchange provides some additional protection to investors, the Commission must consider this potential benefit in the broader context of whether the proposal meets each of the applicable requirements of the Exchange Act.[153] As explained above, for bitcoin-based ETPs, the Commission has consistently required that the listing exchange have a comprehensive surveillance-sharing agreement with a regulated

the separate regulatory regime and the potential difficulties associated with any international litigation, such an arrangement would create more risk exposure for U.S. investors than they would otherwise have with a U.S. exchange-listed ETP. See id. at 47179 n.36. BZX also notes that regulators in other countries have either approved or otherwise allowed the listing and trading of bitcoin-based ETPs. See id. at 47179 n.37.

151 See Exchange Act Section 19(b)(2)(C), 15 U.S.C. 78s(b)(2)(C).

152 See SolidX Order, 82 FR at 16259; VanEck Order, 86 FR at 54550-51; WisdomTree Order, 86 FR at 69344; Kryptoin Order, 86 FR at 74179; Valkyrie Order, 86 FR at 74163; SkyBridge Order, 87 FR at 3881; Wise Origin Order, 87 FR at 5538.

153 See supra note 132.

market of significant size related to bitcoin, or demonstrate that other means to prevent fraudulent and manipulative acts and practices are sufficient to justify dispensing with the requisite surveillance-sharing agreement. The listing exchange has not met that requirement here. Therefore, the Commission is unable to find that the proposed rule change is consistent with the statutory standard.

Pursuant to Section 19(b)(2) of the Exchange Act, the Commission must disapprove a proposed rule change filed by a national securities exchange if it does not find that the proposed rule change is consistent with the applicable requirements of the Exchange Act—including the requirement under Section 6(b)(5) that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices.[154]

For the reasons discussed above, BZX has not met its burden of demonstrating that the proposal is consistent with Exchange Act Section 6(b)(5),[155] and, accordingly, the Commission must disapprove the proposal.[156]

D. Other Comments

One comment letter also addresses the general nature and uses of bitcoin.[157] Ultimately, however, additional discussion of these topics is unnecessary, as they do not bear on the basis for the Commission's decision to disapprove the proposal.

154 See 15 U.S.C. 78s(b)(2)(C).

155 15 U.S.C. 78f(b)(5).

156 In disapproving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

157 See letter from Sam Ahn (Aug. 31, 2021).

IV. CONCLUSION

For the reasons set forth above, the Commission does not find, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange, and in particular, with Section 6(b)(5) of the Exchange Act.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act, that proposed rule change SR-CboeBZX-2021-052 be, and hereby is, disapproved.

By the Commission.

Eduardo A. Aleman
Deputy Secretary