A FLURRY OF SPOT US BITCOIN ETF FILINGS

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The following is a part 1 of 2 of a summary of an episode of WisdomTree's [Crypto Clarified podcast](). The discussion is between Benjamin Dean, Director of Digital Assets; Ryan Louvar, Chief Legal Officer and Head of Business and Legal Affairs; and Jeremy Schwartz, Global Chief Investment Officer at WisdomTree.

Part 1 covers the recent flurry of spot Bitcoin ETF applications.

Benjamin Dean:

Everybody's speculating, what do the recent Bitcoin exchange-traded fund (ETF) applications in the US mean? Can you give us some history to help put it in context?

Ryan Louvar:

In the US, spot Bitcoin ETFs have faced regulatory hurdles for over a decade, with multiple filings being disapproved by the U.S. Securities and Exchange Commission (SEC). However, in recent years, as the Bitcoin market has matured and more exchanges and service providers have entered the space, there has been a notable increase in new filings. Around two years ago, some issuers attempted to add Bitcoin futures to portfolios and, after a gradual approval process, ETFs were allowed to hold 100% Bitcoin futures. This development sparked hope that spot Bitcoin ETFs might also see approval, as Bitcoin futures ETFs and proposed spot Bitcoin ETFs would be using similar pricing mechanisms.

Some of the previous rejections for spot Bitcoin ETFs were due to concerns about potential market manipulation. Although Bitcoin futures ETFs were approved, the SEC still raised concerns about the lack of regulation and surveillance sharing agreements in the spot Bitcoin market.

Recently, one of the spot Bitcoin filers indicated that they had entered into a surveillance sharing agreement with a spot Bitcoin exchange, and other filers followed suit, hoping this would address the SEC's concerns. Now, the industry is awaiting the SEC's reaction to these developments and whether spot Bitcoin ETFs will finally be approved.

Benjamin Dean:

For those who don't fully understand the differences between a spot and a futures based ETF, Jeremy, could you just quickly run people through why or how they're different?

Jeremy Schwartz:

It's really interesting. Our firm considered allocating 3% of Bitcoin to some of our commodity strategies, viewing Bitcoin futures as comparable to gold. In client portfolios, Bitcoin served as a competitor to gold, with limited supply due to the digital mining process, and it had potential as a currency.

Considering it within the commodity framework, we integrated Bitcoin into several strategies. Initially, there were concerns about Bitcoin futures funds, particularly the 100% funds, due to the upward sloping curve of futures prices being higher than current prices. This curve is expected, as interest rates also follow an upward sloping pattern, reflecting the opportunity cost of keeping money in the bank earning interest.

The worries were primarily related to the cost of rolling futures when the curve is upward sloping, as it does not provide current spot prices. Besides the raw interest rate differential, additional factors like storage costs, security costs, and implied capital interest were to be considered when buying in the future. Initially, some predicted a 10 to 15% cost for rolling these futures.

Ryan, can you tell us about the SEC’s concerns around market manipulation and the subsequent, proposed surveillance sharing arrangements? People said similar things when gold was first launched. Is there something that makes Bitcoin different?

Ryan Louvar:

It’s an interesting point of criticism directed towards the SEC. If the concern is manipulation, then how can they approve Bitcoin futures products and not spot Bitcoin products?

There are a couple of potential reasons for this. Futures products have natural size limitations due to position limits, which have kept them from growing beyond a billion dollars. So, the SEC has been incrementally allowing futures products with these limits in place. On the other hand, in the spot market (such as a potential spot Bitcoin ETF), there wouldn't be such limitations.

Another difference is that there's data available from a regulated futures marketplace for understanding how futures trade, whereas the SEC is concerned about the lack of data from historical spot Bitcoin exchanges. The SEC has been actively seeking to regulate crypto exchanges more broadly, and this is an important aspect they are focusing on.

The SEC's requirement for a comprehensive surveillance sharing agreement from a regulated market of significant size is crucial. The term 'comprehensive' is essential, and while the regulated market doesn't necessarily have to be overseen by the SEC (like gold ETFs or oil ETFs), the current problem is that the exchanges in question are not regulated to the SEC's satisfaction.

The question now is whether the surveillance sharing agreement and other information provided by the exchanges and issuers can overcome these regulatory concerns. That remains one of the key questions to address.

Benjamin Dean:

When we say surveillance agreement who is doing it, how does that work and how does it potentially alleviate the perceived problem?

Ryan Louvar:

Some parties, particularly Coinbase, have entered into agreements with regulated exchanges like NASDAQ and CBOE. This requires Coinbase to share significant data, which will then be examined to determine if there's any manipulative conduct or untoward activity happening on the exchange.

However, it remains uncertain what exactly the SEC expects from this data and whether it will be sufficient. The hope is that a comprehensive surveillance sharing agreement with a regulated market of significant size may meet the SEC's requirements.

The delay in approving spot Bitcoin ETFs compared to other types of ETFs (which typically take 75 days to market) is due to the filing process required of the exchange. Most ETFs in the US are governed by the Investment Company Act of 1940, which oversees funds investing in securities like stocks and bonds.

In the past, there were no specific listing standards for all types of ETFs, so they had to apply through the exchange for special listing rules. This process involves Rule 19b-4 under the Securities Exchange Act of 1934, which allows the exchange to apply on behalf of the issuer to create listing rules satisfying the SEC's requirements to prevent fraudulent and deceptive conduct.

The reason for the longer approval time is that the filing process is at the SEC's discretion. Though there are specific timelines, the SEC may extend, approve, or reject the filing. Existing ETFs that meet generic exchange listing standards can automatically go effective in 75 days without going through this process.

This is not a new process, as many ETFs, from gold to oil and those investing in commodity futures, have had to go through similar steps. However, the SEC has the power to dictate its expectations, creating uncertainty about what they truly want.

Jeremy Schwartz:

In terms of the key timelines and milestones, how should people think about it? Do you think there will be a group of these applications approved together?

Ryan Louvar:

Initially, some filings were rejected because the exchanges mentioned they would enter into a surveillance sharing agreement without providing the actual name of the exchange or the agreement. So, they had to refile with at least the name of the exchange included. After the SEC accepts the filing, it gets published in the federal register, marking the start of the timeline for the SEC's response. Generally, this timeline extends well into the nine months timeframe.

In addition to the exchange filing, there's also the prospectus process that needs to be considered. Prospectuses have been filed, but there will be a dialogue with the SEC regarding the content, with updates and responses to comments made by the issuer to gain SEC approval for the prospectus.

The prospectus process may vary for different ETF issuers, depending on factors like custodians used and price sources. The extent and timing of the SEC's comments and the issuer's response will affect how quickly an ETF can ultimately be approved and launched. Considering these factors, the entire timeline for approval could take up to a year and a half, even under the best circumstances.

Benjamin Dean:

Are there any sticking points that you think that folks should keep an eye on? Where else might there be obstacles or roadblocks?

Ryan Louvar:

Once the applications are in a more advanced stage, the SEC may have questions from a prospectus standpoint. As the prospectus filings are updated, it will provide insight into the specific issues the SEC is considering. One of the reasons the Bitcoin futures ETFs were approved is because the futures are custodied through SEC or CME regulated entities. However, spot Bitcoin doesn't have the same custodial oversight. Therefore, the SEC will likely focus on the custodial aspect and how Bitcoin is being overseen to ensure there are sufficient controls in place for its protection and oversight.

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