

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-93559; File No. SR-CboeBZX-2021-019)

November 12, 2021

Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; 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

**I. INTRODUCTION**

On March 1, 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to list and trade shares (“Shares”) of the VanEck 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 March 19, 2021.<sup>3</sup>

On April 28, 2021, pursuant to Section 19(b)(2) of the Exchange Act,<sup>4</sup> 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.<sup>5</sup> On June 16, 2021, the Commission instituted proceedings under Section 19(b)(2)(B) of the Exchange Act<sup>6</sup> to determine whether to approve or disapprove the proposed

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 91326 (Mar. 15, 2021), 86 FR 14987 (“Notice”). Comments on the proposed rule change can be found at: <https://www.sec.gov/comments/sr-cboebzx-2021-019/srcboebzx2021019.htm>.

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> See Securities Exchange Act Release No. 91695, 86 FR 24066 (May 5, 2021).

<sup>6</sup> 15 U.S.C. 78s(b)(2)(B).

rule change.<sup>7</sup> On September 8, 2021, the Commission designated a longer period for Commission action on the proposed rule change.<sup>8</sup>

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), 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.”<sup>9</sup>

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<sup>10</sup>-based commodity trusts and bitcoin-based trust issued receipts.<sup>11</sup> As the Commission has explained, an exchange

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<sup>7</sup> See Securities Exchange Act Release No. 92196, 86 FR 32985 (June 23, 2021).

<sup>8</sup> See Securities Exchange Act Release No. 92894, 86 FR 51203 (Sept. 14, 2021). On September 30, 2021, the Exchange filed Amendment No. 1 to the proposed rule change and withdrew it on October 1, 2021. On October 1, 2021, the Exchange filed Amendment No. 2 to the proposed rule change; and on November 4, 2021, the Exchange filed Amendment No. 3 to the proposed rule change. As discussed below, see Section III.E, infra, the Commission views these amendments as untimely. These amendments also do not materially alter the substance of the proposed rule change, and therefore they are not subject to notice and comment. Furthermore, even if these amendments had been timely filed, they would not alter the Commission’s conclusion that the Exchange’s proposal is not consistent with the Exchange Act. See Section III.E.

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 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 14988.

<sup>11</sup> 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

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.<sup>12</sup>

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.”<sup>13</sup> The Commission has emphasized that it

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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”). 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) (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”).

<sup>12</sup> 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).

<sup>13</sup> 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.

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.<sup>14</sup> 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.<sup>15</sup>

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 detecting and deterring misconduct, and (b) it is unlikely that trading in the ETP would be the predominant influence on prices in that market.<sup>16</sup> A surveillance-sharing agreement must be entered into with a “significant market” to assist in detecting and deterring manipulation of the

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<sup>14</sup> See NDSP Adopting Release, 63 FR at 70959.

<sup>15</sup> 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>.

<sup>16</sup> 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.*

ETP, because a person attempting to manipulate the ETP is reasonably likely to also engage in trading activity on that “significant market.”<sup>17</sup>

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.<sup>18</sup> 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.<sup>19</sup>

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<sup>17</sup> See USBT Order, 85 FR at 12597.

<sup>18</sup> See Winklevoss Order, 83 FR at 37594.

<sup>19</sup> 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). 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 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

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.<sup>20</sup> 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.<sup>21</sup> 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-sharing agreements in the context of listing derivative securities products. No listing exchange has satisfied its burden to make such demonstration.<sup>22</sup>

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

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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”).

<sup>20</sup> See USBT Order, 85 FR at 12597.

<sup>21</sup> 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.

<sup>22</sup> See supra note 11.

protect investors and the public interest.<sup>23</sup> 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,<sup>24</sup> 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.<sup>25</sup>

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.<sup>26</sup> 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 and the Benchmark (as defined herein) mitigate potential manipulation concerns to the point that the investor protection issues that have arisen from the rapid growth of over-the-counter (“OTC”) bitcoin funds, including premium volatility and management fees, should be the central consideration as the Commission determines whether to approve this proposal.<sup>27</sup>

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.

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<sup>23</sup> See Notice, 86 FR at 14993-95.

<sup>24</sup> See id. at 14994-95.

<sup>25</sup> See id. at 14995.

<sup>26</sup> See id. at 14990.

<sup>27</sup> See id. at 14994.

According to BZX, the proposed listing and trading of the Shares would mitigate risk by: (i) reducing premium 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.<sup>28</sup>

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. As discussed further below, BZX repeats 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. 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 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

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<sup>28</sup> See id. at 14990.

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,<sup>29</sup> 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 for the Shares to reflect the performance of the MVIS® CryptoCompare Bitcoin Benchmark Rate (“Benchmark”), less the expenses of the Trust’s operations.<sup>30</sup> The Benchmark will be used to calculate the Trust’s net asset value (“NAV”). The Benchmark is designed to be a U.S. dollar price for bitcoin, and there is no component other than bitcoin in the Benchmark.<sup>31</sup>

The Benchmark is derived from trade prices of bitcoin on certain bitcoin spot platforms. The current platform composition of the Benchmark is Bitstamp, Coinbase, Gemini, itBit, and

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<sup>29</sup> See Notice, supra note 3. See also draft Registration Statement on Form S-1, dated December 30, 2020, submitted to the Commission by VanEck Digital Assets, LLC (“Sponsor”) on behalf of the Trust, and Amendment No. 1 thereto, filed June 4, 2021 (“Amended Registration Statement”).

<sup>30</sup> Delaware Trust Company is the trustee, and State Street Bank and Trust Company will be the administrator (“Administrator”) and transfer agent. Van Eck Securities Corporation will be the marketing agent in connection with the creation and redemption of Shares. Van Eck Securities Corporation provides assistance in the marketing of the Shares. A third-party regulated custodian (“Custodian”) will be responsible for custody of the Trust’s bitcoin. See Notice, 86 FR at 14995. The Amended Registration Statement indicates that Gemini Trust Company, LLC is the Custodian. See Amended Registration Statement at (i).

<sup>31</sup> See Notice, 86 FR at 14995-96.

Kraken.<sup>32</sup> The Benchmark is calculated using a methodology that captures trade prices and sizes from the aforementioned platforms. The methodology examines twenty three-minute periods leading up to 4:00 p.m. E.T. and calculates an equal-weighted average of the volume-weighted median price of these twenty three-minute periods, removing the highest and lowest contributed prices.<sup>33</sup>

Each Share represents a fractional undivided beneficial interest in the Trust's net assets. The Trust's assets will 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 unexpectedly hold cash on a temporary basis.<sup>34</sup>

The Administrator will determine the NAV and NAV per Share of the Trust on each day that the Exchange is open for regular trading, as promptly as practical after 4:00 p.m. E.T. The NAV of the Trust is the aggregate value of the Trust's assets less its estimated accrued but unpaid liabilities (which include accrued expenses). In determining the Trust's NAV, the Administrator values the bitcoin held by the Trust based on the price set by the Benchmark as of 4:00 p.m. E.T.<sup>35</sup>

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<sup>32</sup> According to BZX, the Benchmark constituents are the same constituent platforms as the CME CF Bitcoin Reference Rate and are selected using a methodology that utilizes a combination of qualitative and quantitative metrics to analyze a data set across eight categories of evaluation: legal/regulation, “know-your-customer”/transaction risk, data provision, security, team/platform, asset quality/diversity, market quality, and negative events. Based on these evaluations, the top five platforms by rank are selected for inclusion in the Benchmark, and the constituent platforms are reassessed on a semi-annual basis. See id. at 14996 n.65.

<sup>33</sup> See id. at 14996.

<sup>34</sup> See id. at 14995.

<sup>35</sup> See id. at 14996.

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.<sup>36</sup>

When the Trust sells or redeems its Shares, it will do so in “in-kind” transactions in blocks of 50,000 Shares. 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 the Shares, and, when redeeming the Shares, the Trust, through the Custodian, will deliver bitcoin to such authorized participants.<sup>37</sup>

### **III. DISCUSSION**

#### **A. The Applicable Standard for Review**

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.”<sup>38</sup> Under the Commission’s Rules of Practice, the

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<sup>36</sup> See id.

<sup>37</sup> See id. at 14995.

<sup>38</sup> 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,

“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.”<sup>39</sup>

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,<sup>40</sup> 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 applicable rules and regulations.<sup>41</sup> 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.<sup>42</sup>

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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).

<sup>39</sup> Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

<sup>40</sup> See id.

<sup>41</sup> See id.

<sup>42</sup> Susquehanna Int’l Group, LLP v. Securities and Exchange Commission, 866 F.3d 442, 447 (D.C. Cir. 2017) (“Susquehanna”).

**B. Whether BZX Has Met its Burden To Demonstrate That the Proposal Is Designed to Prevent Fraudulent and Manipulative Acts and Practices**

(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.<sup>43</sup> Such resistance to fraud and manipulation must be novel and beyond those protections that exist in traditional commodities or securities markets.<sup>44</sup>

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.<sup>45</sup> Fragmentation across bitcoin platforms, 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.<sup>46</sup> 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

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<sup>43</sup> See 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. See id.

<sup>44</sup> See id. at 12597.

<sup>45</sup> See Notice, 86 FR at 14994 n.54.

<sup>46</sup> See id.

markets, such pricing does not normally impact prices on other platforms because participants will generally ignore markets with quotes that they deem non-executable.<sup>47</sup> 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.<sup>48</sup> 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.<sup>49</sup> 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.<sup>50</sup>

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<sup>47</sup> See id.

<sup>48</sup> See id.

<sup>49</sup> See id.

<sup>50</sup> See id.

Several commenters share BZX’s view that the nature of the bitcoin market makes it resistant to price manipulation.<sup>51</sup> One commenter, in particular, agrees that arbitrage would very quickly close any bitcoin price disparities between trading platforms.<sup>52</sup>

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

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<sup>51</sup> See letters from: Bryan B. Solstin, dated June 17, 2021; Anthony Ellis, dated June 17, 2021 (“Ellis Letter”); Courtney Rye, dated June 17, 2021 (“Rye Letter”); and Frank Rose, dated June 17, 2021 (“Rose Letter”). These commenters assert that, in addition to arbitrage, bitcoin’s large market capitalization, liquidity, decentralized design, finite quantity, and transparent public ledger make it less susceptible to fraud and manipulation. Another commenter remarks that, unlike other commodities on which exchange-traded funds are based, bitcoin has a non-manipulable monetary supply. See letter from Erik Aronesty, dated June 17, 2021 (“Aronesty Letter”). The Custodian, in a comment letter, asserts that the growth of the overall bitcoin market and related growth of regulated bitcoin derivatives demonstrate that the depth of the market prevents manipulation of the price of bitcoin in a manner that could affect the share price of an ETP. See letter from Gemini Trust Company, LLC, dated October 15, 2021 (“Gemini Letter”), at 2.

Other commenters disagree. These commenters view the bitcoin market to be prone to fraud and manipulation. These commenters described the bitcoin market as: fraught with manipulation from memes and tweets that can move its price significantly (see letter from Eddie, dated March 28, 2021 (“Eddie Letter”)); a haven for money laundering, wash trading, and other criminal and/or collusive activity (see letters from: Anonymous, dated June 16, 2021; A. Peterson, dated June 17, 2021 (“Peterson Letter”)); a pyramid scheme that is heavily rigged (see Peterson Letter) and from which the only way to profit is to sell to a “greater fool” who comes later at a higher price (see letter from Mark Pile, dated June 17, 2021 (“Pile Letter”)); fraught with accounting and liquidity irregularities (see Pile Letter); leading to prices pumped up by fraudulent tokens (see Peterson Letter) and questionable “stablecoin” (see Petterson Letter; Pile Letter; letter from Michael Mims, dated June 17, 2021); and, along with other digital assets and the blockchains on which they rely, as having complexity that makes users vulnerable to fraud (see letter from Lourdes Ciao, dated June 24, 2021 (“Ciao Letter”), at 1). Finally, some commenters acknowledged that bitcoin prices are susceptible to attempted influence, but no more than other highly volatile stocks, and thus they contend that bitcoin is suitable as an underlying asset for an ETP (see letters from: Mike Bofman, dated June 16, 2021 (“Bofman Letter”); Matthew Apodaca, dated July 13, 2021 (“Apodaca Letter”)).

<sup>52</sup> See Ellis Letter.

continuous means and through fragmented platforms, arbitrage across the bitcoin platforms 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.<sup>53</sup> Likewise, the commenter who concurs with BZX that arbitrage would very quickly close any bitcoin price disparities between trading platforms provides no empirical evidence to substantiate the commenter’s claim. 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.<sup>54</sup>

Further, efficient price arbitrage 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.<sup>55</sup> 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.<sup>56</sup> Here, the

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<sup>53</sup> For example, the Amended Registration Statement states that “[i]f increases in throughput on the Bitcoin network lag behind growth in usage of bitcoin, average fees and settlement times may increase considerably . . . which could adversely impact the value of the Shares.” See Amended Registration Statement at 20. BZX does not 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 70 and accompanying text (referencing statements made in the Amended Registration Statement that contradict assertions made by BZX).

<sup>54</sup> See supra note 42.

<sup>55</sup> See Winklevoss Order, 83 FR at 37586; SolidX Order, 82 FR at 16256-57; USBT Order, 85 FR at 12601.

<sup>56</sup> See, e.g., USBT Order, 85 FR at 12601.

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 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.<sup>57</sup>

In addition, the Exchange makes the unsupported claim that bitcoin prices on platforms with fake volume 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. However, without the necessary data, such as lead-lag or other similar analyses, 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.<sup>58</sup>

Additionally, the continuous nature of bitcoin trading does not eliminate manipulation risk, and neither does linkages among markets, as BZX asserts.<sup>59</sup> 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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<sup>57</sup> See, e.g., Winklevoss Order, 83 FR at 37584; USBT Order, 85 FR at 12600-01.

<sup>58</sup> See USBT Order, 85 FR at 12601. See also infra notes 114-115 and accompanying text (explaining the lead-lag analysis as central to understanding whether it is reasonably likely 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).

<sup>59</sup> See Winklevoss Order, 83 FR at 37585 n.92 and accompanying text.

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.<sup>60</sup>

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.<sup>61</sup> 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).<sup>62</sup> 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.<sup>63</sup>

One commenter concurs with BZX. The commenter asserts that the amount of money it would take to actually manipulate the bitcoin spot market would be “unfathomable” and so cost-prohibitive that it would be a losing strategy. The commenter also asserts that, given the daily trading volume of bitcoin futures, including those traded on CME, it would be extraordinarily difficult for a single entity to manipulate the market.<sup>64</sup>

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<sup>60</sup> See id. at 37585.

<sup>61</sup> See Notice, 86 FR at 14995.

<sup>62</sup> On the other hand, regarding the amounts needed to move the bitcoin spot price, one commenter cites a Bank of America March 2021 research report that provides that \$93 million in net inflows increases the bitcoin price by one percent, compared with nearly \$1.87 billion for a corresponding increase in the price of gold. See Eddie Letter.

<sup>63</sup> See Notice, 86 FR at 14995.

<sup>64</sup> See Ellis Letter.

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<sup>65</sup> 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.<sup>66</sup> Even assuming that the Commission agreed 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.<sup>67</sup> 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,<sup>68</sup> (2) persons with a dominant position in bitcoin

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<sup>65</sup> While one commenter makes a comparison to the gold market (see Eddie Letter and supra note 62), this comparison undercuts BZX’s argument that the bitcoin market is costly to manipulate by citing to a report that purports to show that it is far less costly to move the price of bitcoin than gold.

<sup>66</sup> 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 to enable the Commission to evaluate these findings or their significance. See Notice, 86 FR at 14494-95 nn.60-61.

<sup>67</sup> See USBT Order, 85 FR at 12601.

<sup>68</sup> See supra note 58 and accompanying text.

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.<sup>69</sup>

In addition, BZX does not address risk factors specific to the bitcoin blockchain and bitcoin platforms, described in the Trust’s Amended Registration Statement, that undermine the argument that the bitcoin market is inherently resistant to fraud and manipulation. For example, the Amended Registration Statement acknowledges that “bitcoin [platforms] on which bitcoin trades are relatively new and, in some cases, unregulated, and, therefore, may be more exposed to fraud and security breaches than established, regulated exchanges for other financial assets or instruments”; 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”; that the bitcoin network “is at risk of vulnerabilities and bugs that can potentially be exploited by malicious actors”; that the bitcoin blockchain could be vulnerable to a “51% attack,” in which a bad actor that controls a majority of the processing power dedicated to mining on the bitcoin network may be able to alter the bitcoin blockchain on

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<sup>69</sup> 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.

which the bitcoin network and bitcoin transactions rely; that the nature of the assets held at bitcoin platforms makes them “appealing targets for hackers” and that “a number of bitcoin platforms have been victims of cybercrimes”; and that bitcoin trading platforms “have been closed or faced issues due to fraud, failure” and “security breaches.”<sup>70</sup>

BZX also asserts that other means to prevent fraud and manipulation are sufficient to justify dispensing with the requisite surveillance-sharing agreement. First, the Exchange mentions that the Benchmark, which is used to value the Trust’s bitcoin, is itself resistant to manipulation based on the Benchmark’s methodology.<sup>71</sup> The Exchange states that the Benchmark is calculated by capturing twenty three-minute periods of trade prices and sizes leading up to 4:00 p.m. E.T. from the constituent platforms. An equal-weighted average of the volume-weighted median price of these twenty three-minute periods is then calculated, removing the highest and lowest contributed prices.<sup>72</sup> According to BZX, “[u]sing twenty consecutive three-minute segments over a sixty-minute period means malicious actors would need to sustain efforts to manipulate the market over an extended period of time, or would need to replicate efforts multiple times across exchanges, potentially triggering review.”<sup>73</sup> Further, according to BZX, the “use of a median price reduces the ability of outlier prices to impact the NAV,” and the “use of a volume-weighted median (as opposed to a traditional median) serves as an additional protection against attempts to manipulate the NAV by executing a large number of low-dollar trades, because any manipulation attempt would have to involve a majority of global spot bitcoin

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<sup>70</sup> See Amended Registration Statement at 7, 13, 17, 19 and 31. See also Winklevoss Order, 83 FR at 37585.

<sup>71</sup> See Notice, 86 FR at 14995.

<sup>72</sup> See id. at 14996.

<sup>73</sup> See id.

volume in a three-minute window to have any influence on the NAV.”<sup>74</sup> BZX also asserts that “removing the highest and lowest prices further protects against attempts to manipulate the NAV, requiring bad actors to act on multiple [platforms] at once to have any ability to influence the price.”<sup>75</sup>

The Custodian, in a comment letter, agrees that BZX’s choice of the Benchmark, which includes a composite of bitcoin prices from underlying spot bitcoin platforms, including the Custodian’s platform, is a further factor in support of the proposed ETP.<sup>76</sup> The Custodian asserts that it and other “regulated digital asset exchanges” and custodians have a history of operations in compliance with a regulatory framework developed specifically to address activities in digital assets, including guidance by the New York State Department of Financial Services (“NYSDFS”) regarding the implementation of anti-fraud measures. The Custodian states that it meets this obligation through automated systems and robust internal controls and surveillance, and that the growing sophistication of market surveillance tools and strategies in the bitcoin market as well as the growing proportion of bitcoin activity occurring on “regulated exchanges” is a key development to mollify concerns about price manipulation or other manipulative practices in the bitcoin market.<sup>77</sup>

Simultaneously with the Exchange’s and the Custodian’s assertions regarding the Benchmark, the Exchange also states that, because the Trust will engage in in-kind creations and

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<sup>74</sup> See id.

<sup>75</sup> See id.

<sup>76</sup> See Gemini Letter at 2.

<sup>77</sup> See id. But see infra note 148 and accompanying text. The Custodian also states that it is registered with FinCEN as a money service business and maintains money transmitter licenses (or the statutory equivalent) in all states where this is required. See Gemini Letter at 3 and infra note 89.

redemptions only, the “manipulability of the Benchmark [is] significantly less important.”<sup>78</sup> The Exchange elaborates further that, “because the Trust will not accept cash to buy bitcoin in order to create new shares or … 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.”<sup>79</sup> 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.<sup>80</sup> 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 value.<sup>81</sup> This, according to BZX, not only mitigates the risk associated with potential manipulation, but also discourages and disincentivizes manipulation of the Benchmark because there is little financial incentive to do so.<sup>82</sup>

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 Exchange’s assertions that the Benchmark’s methodology helps make the Benchmark resistant to manipulation are contradicted by the Amended Registration Statement’s own statements. In the

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<sup>78</sup> See Notice, 86 FR at 14999.

<sup>79</sup> See id.

<sup>80</sup> See id. at 15000.

<sup>81</sup> See id.

<sup>82</sup> See id.

Amended Registration Statement, the Sponsor states that the Benchmark is “based on various inputs which may include price data from various third-party exchanges and markets” and that these inputs may be subject to “technological error, manipulative activity, or fraudulent reporting from their initial source.”<sup>83</sup>

Second, the Custodian asserts that the growing sophistication of market surveillance tools and strategies used by the Benchmark’s constituent platforms, as well as the growing proportion of bitcoin activity occurring on “regulated exchanges,” “mollify concerns about price manipulation or other manipulative practices.”<sup>84</sup> However, the level of regulation on the Benchmark’s constituent platforms is not equivalent to the obligations, authority, and oversight of national securities exchanges or futures exchanges and therefore is not an appropriate substitute.<sup>85</sup> 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.”<sup>86</sup> Moreover, national securities exchanges must file proposed rules with the Commission regarding certain material

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<sup>83</sup> See Amended Registration Statement at 23. The Amended Registration Statement further states that “[b]itcoin [platforms] on which bitcoin trades . . . may be more exposed to fraud and security breaches than established, regulated exchanges for other financial assets or instruments, which could have a negative impact on the performance of the Trust.” See id. at 7 and 19.

<sup>84</sup> See Gemini Letter at 2.

<sup>85</sup> See also USBT Order, 85 FR at 12603-05.

<sup>86</sup> See 15 U.S.C. 78f(b)(5)

aspects of their operations,<sup>87</sup> and the Commission has the authority to disapprove any such rule that is not consistent with the requirements of the Exchange Act.<sup>88</sup> Thus, national securities exchanges are subject to Commission oversight of, among other things, their governance, membership qualifications, trading rules, disciplinary procedures, recordkeeping, and fees.<sup>89</sup>

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<sup>87</sup> 17 CFR 240.19b-4(a)(6)(i).

<sup>88</sup> 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 the CFTC. See, e.g., Designated Contract Markets (DCMs), CFTC, available at <http://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/index.htm>.

<sup>89</sup> 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. Nothing in the record evidences whether the Benchmark’s constituent platforms have complied with this NYSDFS guidance.

Further, as stated previously, there are substantial differences between the NYSDFS and FinCEN versus the Commission’s regulation. AML and 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.

The Benchmark’s constituent platforms, on the other hand, have none of these requirements (none are registered as a national securities exchange).<sup>90</sup> Further, although the Custodian claims that the constituent platforms have market surveillance tools and strategies that are growing in sophistication, the Custodian provides no supporting evidence. Moreover, even assuming that the constituent platforms are as vigilant towards fraud and manipulation as the Custodian describes, neither the Exchange nor the Custodian attempts to establish that only the Benchmark constituent platforms’ ability to detect and deter fraud and manipulation would matter, exclusive of other bitcoin spot markets. In other words, neither addresses how fraud and manipulation on other bitcoin spot markets may influence the price of bitcoin.

Third, the Exchange does not explain the significance of the Benchmark’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 Benchmark 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.

Fourth, the Exchange’s arguments are contradictory. While arguing that the Benchmark is resistant to manipulation, the Exchange simultaneously downplays the importance of the Benchmark in light of the Trust’s in-kind creation and redemption mechanism.<sup>91</sup> The Exchange points out that the Trust will create and redeem Shares in-kind, not in cash, which renders the

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<sup>90</sup> See 15 U.S.C. 78e, 78f.

<sup>91</sup> See supra notes 78-82 and accompanying text.

NAV calculation, and thereby the ability to manipulate NAV, “significantly less important.”<sup>92</sup> 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 value the Trust’s bitcoin “is not particularly important.”<sup>93</sup> If the Benchmark that the Trust uses to value the Trust’s bitcoin “is not particularly important,” it follows that the Benchmark’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 Benchmark aids in the determination that the proposal to list and trade the Shares is designed to prevent fraudulent and manipulative acts and practices.<sup>94</sup>

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.<sup>95</sup> As the Commission stated before, in-kind creations

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<sup>92</sup> See Notice, 86 FR at 14995 and 14999 (“While the Sponsor believes that the Benchmark 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 manipulability of the Benchmark significantly less important.”).

<sup>93</sup> See *id.* (concluding that “because the Trust will not accept cash to buy bitcoin in order to create new shares or, barring a forced redemption of the Trust or under other extraordinary circumstances, 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.”).

<sup>94</sup> In addition, with respect to the valuation of bitcoin according to a benchmark or a reference price, the Commission has previously considered and rejected similar arguments. See SolidX Order, 82 FR at 16258; Winklevoss Order, 83 FR at 37589-90. Among other things, the Exchange fails to explain why prices and volumes of bitcoin platforms that are not constituents of the Benchmark do not affect the prices of the constituent platforms. Likewise, the Exchange also fails to establish how the Benchmark’s methodology eliminates fraudulent or manipulative activity that is not transient. See USBT Order, 85 FR at 12607.

<sup>95</sup> See Winklevoss Order, 83 FR at 37589-90; USBT Order, 85 FR at 12607-08.

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 related to the portfolio’s assets.<sup>96</sup> Accordingly, the Commission is not persuaded here that the Trust’s in-kind creations and redemptions afford it a unique resistance to manipulation.<sup>97</sup>

(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

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<sup>96</sup> 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).

<sup>97</sup> Putting aside the Exchange’s various assertions about the nature of bitcoin and the bitcoin market, the Benchmark, 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.

(ii) it is unlikely that trading in the ETP would be the predominant influence on prices in that market.<sup>98</sup>

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.<sup>99</sup> Accordingly, based on the common membership of BZX and CME in the ISG,<sup>100</sup> BZX has the equivalent of a comprehensive surveillance-sharing agreement with CME. However, while the Commission recognizes that the CFTC regulates the CME futures market,<sup>101</sup> 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.<sup>102</sup>

- (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

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<sup>98</sup> 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.*

<sup>99</sup> See *id.* at 37580 n.19.

<sup>100</sup> See Notice, 86 FR at 14994 n.56 and accompanying text.

<sup>101</sup> 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.

<sup>102</sup> As described above (see *supra* notes 85-90 and accompanying text), in the context of the proposed ETP, the Benchmark’s constituent platforms are not “regulated.” They are not registered as “exchanges” and lack the obligations, authority, and oversight of national securities exchanges.

person attempting to manipulate the ETP would have to trade on the CME bitcoin futures market to successfully manipulate the ETP.

BZX notes that CME began to offer trading in bitcoin futures in 2017.<sup>103</sup> 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.”<sup>104</sup> 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.<sup>105</sup> 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.<sup>106</sup> Similarly, BZX contends that the number of large open interest holders<sup>107</sup> has continued to increase, even as the price of bitcoin has risen, as have the number of unique accounts trading CME bitcoin futures.<sup>108</sup>

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

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<sup>103</sup> According to BZX, each contract represents five bitcoin and is based on the CME CF Bitcoin Reference Rate. See Notice, 86 FR at 14991.

<sup>104</sup> See id.

<sup>105</sup> See id.

<sup>106</sup> See id.

<sup>107</sup> 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 14992 n.50.

<sup>108</sup> See id. at 14992.

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 (beyond just the constituents of the Benchmark) 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.<sup>109</sup>

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.<sup>110</sup> BZX concludes that a person attempting to manipulate the Shares would also have to trade on that market to manipulate the ETP.<sup>111</sup>

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. 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

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<sup>109</sup> See id. at 14994.

<sup>110</sup> See id. at 14994 and 14993 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”).

<sup>111</sup> See id. at 14994.

listing exchange has a surveillance-sharing agreement and the proposed ETP.<sup>112</sup> 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.<sup>113</sup>

Further, the evidence in the record also does not support a conclusion that the CME bitcoin futures market leads the bitcoin spot market in such a manner that the CME bitcoin futures market is a “market of significant size.” As the Commission has previously explained, establishing a lead-lag relationship between the bitcoin futures market and the spot market is “central to understanding whether it is reasonably likely that a would-be manipulator of the ETP would need to trade on the bitcoin futures market to successfully manipulate prices on those spot platforms that feed into the proposed ETP’s pricing mechanism.”<sup>114</sup> The Commission has previously stated that, in particular, if the spot market leads the futures market, this would indicate that it would not be necessary to trade on the futures market to manipulate the proposed ETP, because the futures price would move to meet the spot price.<sup>115</sup>

While BZX states that CME bitcoin futures pricing leads the spot market,<sup>116</sup> it relies on the findings of a price discovery analysis in one section of a single academic paper to support the overall thesis.<sup>117</sup> However, the findings of that paper’s Granger causality analysis, which is

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<sup>112</sup> See USBT Order, 85 FR at 12611.

<sup>113</sup> See id. at 12612.

<sup>114</sup> See id.

<sup>115</sup> See id.

<sup>116</sup> See Notice, 86 FR at 14993.

<sup>117</sup> See supra note 110 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

widely used to formally test for lead-lag relationships, are concededly mixed.<sup>118</sup> In addition, the Commission considered an unpublished version of the paper in the USBT Order, as well as a comment letter submitted by the authors on that record.<sup>119</sup> 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.<sup>120</sup> 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.<sup>121</sup> BZX has not addressed either issue.

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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 14993 n.51.

<sup>118</sup> 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 110.

<sup>119</sup> See USBT Order, 85 FR at 12609.

<sup>120</sup> See id. at 12613 n.244.

<sup>121</sup> See id.

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.<sup>122</sup> 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 markets is unsettled.<sup>123</sup> In the USBT Order, the Commission responded to multiple academic

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<sup>122</sup> See Susquehanna, 866 F.3d at 447.

<sup>123</sup> 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. Katsampa, 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 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) (“Alexander & Heck”). One commenter states they have updated the Alexander & Heck study using data from June 1, 2020 to April 30, 2021, and they found that CME bitcoin futures now have a far more pronounced price

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.<sup>124</sup> 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.<sup>125</sup>

The Commission accordingly concludes that the information provided in the record 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.

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leadership role, but also that, similar to Alexander & Heck’s findings, Huobi and OKEx futures are the leading instruments in bitcoin’s price discovery. See letter from Vetle Andreas Gusgaard Lunde, dated July 2, 2021, and weblink cited therein: <https://www.research.arcane.no/blog/the-regulated-tail-that-wags-the-honey-badger>.

<sup>124</sup> See USBT Order, 85 FR at 12613 nn.239-244 and accompanying text.

<sup>125</sup> In addition, the Exchange fails to address the lead-lag relationship (if any) between prices on other bitcoin futures markets and the CME bitcoin futures market, the bitcoin spot market, and/or the particular Benchmark constituent platforms, or where price formation occurs when the entirety of bitcoin futures markets, not just CME, is considered.

(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.<sup>126</sup>

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.<sup>127</sup> 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.<sup>128</sup> 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, 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.<sup>129</sup> 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

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<sup>126</sup> See Winklevoss Order, 83 FR at 37594; USBT Order, 85 FR at 12596-97.

<sup>127</sup> See Notice, 86 FR at 14999.

<sup>128</sup> 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 14999 n.80.

<sup>129</sup> See *id.* at 14999.

bitcoin.<sup>130</sup> 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.<sup>131</sup>

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<sup>132</sup>—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 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. Moreover, in the

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<sup>130</sup> See id.

<sup>131</sup> See id.

<sup>132</sup> See supra notes 123-125 and accompanying text.

Trust's Amended Registration Statement, the Sponsor acknowledges that the Trust may acquire large size positions in bitcoin, which would increase the risk of illiquidity in the underlying bitcoin. Specifically, the Sponsor, in the Amended Registration Statement, states that the Trust may acquire large size positions in bitcoin, which will increase the risk of illiquidity by both making the positions more difficult to liquidate and increasing the losses incurred while trying to do so, or by making it more difficult for authorized participants to acquire or liquidate bitcoin as part of the creation and/or redemption of Shares of the Trust.<sup>133</sup> Although the Trust's Amended Registration Statement concedes that the Trust could negatively affect the liquidity of bitcoin, BZX does not address this in the proposal or discuss how impacting the liquidity of bitcoin can be consistent with the assertion that the Shares are unlikely to be the predominant influence on the prices of 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.

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.<sup>134</sup> 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

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<sup>133</sup> See Amended Registration Statement at 26.

<sup>134</sup> See Notice, 86 FR at 14994-95 (“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%.”).

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 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.

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 of whether the proposal meets each of the applicable requirements of the Exchange Act.<sup>135</sup> 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.<sup>136</sup> Specifically, BZX argues that premium 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.<sup>137</sup> 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 volatility; (ii) reducing management fees through meaningful competition; (iii) providing an alternative to custodying spot bitcoin; and (iv) reducing risks

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<sup>135</sup> See Winklevoss Order, 83 FR at 37601. See also GraniteShares Order, 83 FR at 43931; ProShares Order, 83 FR at 43941; USBT Order, 85 FR at 12615.

<sup>136</sup> See Notice, 86 FR at 14990.

<sup>137</sup> 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.*

associated with investing in operating companies that are imperfect proxies for bitcoin exposure.<sup>138</sup>

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 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.”<sup>139</sup> BZX represents that, historically, OTC bitcoin funds have traded at a significant premium to NAV.<sup>140</sup> 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 in excess of the per-share value of the fund’s underlying assets; the price of bitcoin could stay exactly the same from market close on one day to market open the next, yet the value of the shares held by the investor could decrease only because of the fluctuation of the premium.<sup>141</sup> Second, according to BZX, only accredited investors, generally, are able to create new shares with the OTC bitcoin fund and can purchase the shares at NAV. While they are forced to hold the shares for at least six months

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<sup>138</sup> See id.

<sup>139</sup> 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 14990 n.38.

<sup>140</sup> See id. at 14990. 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 14990 n.39.

<sup>141</sup> See id. at 14990.

before selling, in reality they can immediately hedge any exposure to the price of bitcoin and simply wait six months to sell the shares to a retail investor and collect the premium.<sup>142</sup>

Several commenters also express support for the approval of bitcoin ETPs because they believe such ETPs would have lower premium/discount volatility<sup>143</sup> and lower management fees<sup>144</sup> than an OTC bitcoin fund.

Another commenter argues that a bitcoin ETP has the potential to reduce volatility in the price of bitcoin itself, which the commenter believes would generate positive externalities for existing investors and ultimately for financial stability. The commenter asserts, with no supporting evidence, that marginal demand for a bitcoin ETP is likely to come from relatively more conservative investors—for example, retail traders unwilling to trade on unregulated markets, as well as institutional traders who lack a “mandate” or the risk tolerance to do so. The commenter states that a shift in the marginal investor’s risk aversion, as well as increased attention from sophisticated institutions, would lead to a bitcoin price that is less susceptible to wild swings that are often driven by social media.<sup>145</sup>

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<sup>142</sup> See id.

<sup>143</sup> See Ellis Letter; Apodaca Letter; letters from: Anonymous, dated June 16, 2021 (“Anonymous 6 Letter”); Anonymous, dated June 17, 2021 (“Anonymous 9 Letter”); Brian Havermann, dated July 6, 2021 (“Havermann Letter”).

<sup>144</sup> See Anonymous 6 Letter; Anonymous 9 Letter; Havermann Letter; Apodaca Letter; letter from Chris Kim, dated June 17, 2021 (“Kim Letter”).

<sup>145</sup> See letter from Marius Zoican, Assistant Professor of Finance, University of Toronto Mississauga, Rotman School of Management, dated June 17, 2021 (“Zoican Letter”). Another commenter puts forward a different reason why an approval of a bitcoin ETP could reduce bitcoin price volatility. This other commenter asserts that bitcoin ETPs (and other crypto ETPs) would allow non-institutional investors to more easily take “short” positions on crypto assets. The commenter believes some of the price volatility is caused by asymmetric buy/sell-side access in crypto markets that has added unnecessary tailwind to a standard asset bubble. See letter from Christian Lewis, dated June 16, 2021.

BZX also asserts that exposure to bitcoin through an ETP also presents advantages for retail investors compared to buying spot bitcoin directly.<sup>146</sup> BZX asserts that, without the advantages of an ETP, an individual retail investor holding bitcoin through a cryptocurrency trading platform lacks protections.<sup>147</sup> 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.<sup>148</sup> 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.<sup>149</sup> 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.<sup>150</sup> Thus, with respect to custody of the Trust's bitcoin assets, BZX concludes that, compared to owning spot bitcoin directly, the Trust presents advantages from an investment protection standpoint for retail investors.<sup>151</sup>

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<sup>146</sup> See Notice, 86 FR at 14991.

<sup>147</sup> See id.

<sup>148</sup> See id.

<sup>149</sup> See id.

<sup>150</sup> See id.

<sup>151</sup> See id. Likewise, several commenters cite risks and difficulties associated with the self-custody of bitcoin as part of the basis for their support for the proposed ETP. See Ellis Letter; Havermann Letter; Apodaca Letter; letters from: Michael Anderson, dated June 16, 2021; Joshua Park, dated June 16, 2021; John, dated June 17, 2021; Taylor Ailshie, dated June 17, 2021 ("Ailshie Letter"); Sebastian Aroca, dated July 6, 2021 ("Aroca Letter"); Michael Althaus, dated June 24, 2021 and June 28, 2021.

The Custodian, in a comment letter, echoes some of the descriptions of the custodial arrangement.<sup>152</sup> The Custodian also specifies that it employs a multi-signature system which requires a quorum of unique private key signatures before transactions can be effectuated on the bitcoin blockchain and that this approach allows for constant monitoring and auditability of the Trust's holdings.<sup>153</sup> Also, according to the Custodian, it maintains digital asset insurance, is regularly audited by major financial and audit firms, and is subject to independent third-party verification that the Custodian's operations and security compliance structures meet the most robust of industry standards.<sup>154</sup>

BZX further asserts that a number of operating companies engaged in unrelated businesses have announced investments as large as \$1.5 billion in bitcoin.<sup>155</sup> 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.<sup>156</sup> 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

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<sup>152</sup> See Gemini Letter at 3-4.

<sup>153</sup> See id. at 3.

<sup>154</sup> See id. at 3-4.

<sup>155</sup> See Notice, 86 FR at 14991.

<sup>156</sup> See id. One commenter disagrees with the contention that investors would pay a premium to gain exposure to bitcoin by investing in companies that have decided to invest in bitcoin. See Eddie Letter.

and are not fully benefitting from the risk disclosures and associated investor protections that come from the securities registration process.<sup>157</sup>

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 means of getting bitcoin exposure.<sup>158</sup>

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. BZX, however, offers no limiting principle to this argument, under which, by logical extension, the Commission would be required to approve the listing and trading of any ETP that arguably presents marginally less risk to investors than a direct investment in the underlying asset or in an OTC-traded product.

The Commission disagrees with this reading of the Exchange Act. 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)

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<sup>157</sup> See Notice, 86 FR at 14991. The Custodian, in its comment letter, agrees that the proposed ETP would offer greater customer protection and transparency than existing alternatives for retail customers to gain proxy exposure to bitcoin. See Gemini Letter at 2.

<sup>158</sup> See Notice, 86 FR at 14990. 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 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 14990 n.36.

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.<sup>159</sup> 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.<sup>160</sup>

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.<sup>161</sup> 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 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

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<sup>159</sup> See Exchange Act Section 19(b)(2)(C), 15 U.S.C. 78s(b)(2)(C).

<sup>160</sup> See SolidX Order, 82 FR at 16259.

<sup>161</sup> See supra note 135.

requirement under Section 6(b)(5) that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices.<sup>162</sup>

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),<sup>163</sup> and, accordingly, the Commission must disapprove the proposal.<sup>164</sup>

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<sup>162</sup> See 15 U.S.C. 78s(b)(2)(C).

<sup>163</sup> 15 U.S.C. 78f(b)(5).

<sup>164</sup> 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). Three commenters argue that, for competitive reasons, the Commission should approve several bitcoin-based ETPs together. See Zoican Letter; letters from: Jared Henry, dated March 18, 2021 (“Henry Letter”); Ge De, dated July 4, 2021 (“Ge De Letter”). The Zoican Letter states that network externalities are particularly strong for exchange-traded funds with identical underlying portfolios, conferring large advantages to the first mover by enabling it to command higher management fees than subsequent entrants. According to this commenter, this effect leads to segmentation of investors, with short-horizon traders preferring liquid products and long-horizon investors focusing on cheaper products. This commenter believes that allowing for several products to be launched simultaneously would help investors coordinate on the product with the lowest fees, stimulating both liquidity and competition on management fees between issuers.

Another commenter argues, for efficiency reasons, against approving a bitcoin ETP. This commenter asserts that the adoption of multiple digital assets would force merchants to deal with “complexity [that] doesn’t foster [the] modularity which is needed to gain economic efficiency.” See Ciao Letter at 1.

For the reasons discussed throughout, however, see supra note 38, the Commission is disapproving the proposed rule change because it does not find that the proposed rule change is consistent with the Exchange Act. See also USBT Order, 85 FR at 12615.

#### **D. Other Comments**

Comment letters also address the general nature and uses of bitcoin;<sup>165</sup> the state of development of bitcoin as a digital asset;<sup>166</sup> the state of regulation of bitcoin markets;<sup>167</sup> the inherent value of, and risks of investing in, bitcoin;<sup>168</sup> the desire (or not) of investors to gain access to bitcoin through an ETP;<sup>169</sup> the potential impact of Commission approval of the proposed ETP on the price of bitcoin and on bitcoin markets;<sup>170</sup> the potential impact of Commission approval of bitcoin ETPs on the economy, jobs, U.S. monetary policy, U.S. innovation, and/or U.S. geopolitical position;<sup>171</sup> the tax and/or retirement investment benefits or

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<sup>165</sup> See, e.g., Eddie Letter; Anonymous 6 Letter; Pile Letter; Ciao Letter; Ge De Letter; letters from: Anonymous, dated March 27, 2021 (“Anonymous 1 Letter”); Sam Ahn, dated April 8, 2021; Darrin Donithorne, dated April 10, 2021 (“Donithorne Letter”); JC, dated May 16, 2021 (“JC Letter”); Lourdes Ciao, dated June 2, 2021; Anonymous, dated June 10, 2021; Roger Lowenstein, dated June 28, 2021 (“Lowenstein Letter”).

<sup>166</sup> See, e.g., Ellis Letter; Gemini Letter at 1-2; letters from: Courtney, dated April 1, 2021; Nicolas Casal, dated June 9, 2021; James Cook, dated June 17, 2021 (“Cook Letter”); Jason Green, dated June 17, 2021 (“Green Letter”).

<sup>167</sup> See, e.g., Bofman Letter; Aronesty Letter; Pile Letter.

<sup>168</sup> See, e.g., Bofman Letter; Rye Letter; Lowenstein Letter; Havermann Letter; Apodaca Letter; letters from: Bradley M. Kuhn, dated April 15, 2021 (“Kuhn Letter”); Anonymous, dated May 7, 2021 (“Anonymous 2 Letter”); James Monroe, dated June 7, 2021; Ken Morgan, dated June 17, 2021; Sam Ahn, dated July 14, 2021.

<sup>169</sup> See, e.g., Henry Letter; Anonymous 1 Letter; Kuhn Letter; Bofman Letter; Cook Letter; Ailshie Letter; Gemini Letter at 1-2; letters from: Michael Ort, dated April 10, 2021; Chez, dated June 16, 2021; Anonymous, dated June 16, 2021 (“Anonymous 8 Letter”); Bill Meyers, dated June 16, 2021; Jarron Jackson, dated June 16, 2021; Jacob, dated June 16, 2021 (“Jacob Letter”); Charles E. Haluska, dated June 17, 2021; Travis, dated June 17, 2021; Scott Davis, dated June 23, 2021; Ryan I, dated June 27, 2021.

<sup>170</sup> See, e.g., Green Letter; Ailshie Letter; Aronesty Letter; letter from Steve Condrill, dated July 4, 2021.

<sup>171</sup> See, e.g., Donithorne Letter; Anonymous 2 Letter; Bofman Letter; Anonymous 8 Letter; Jacob Letter; Kim Letter; Ciao Letter; Aroca Letter; Apodaca Letter; letters from: Chris McMurphy, dated April 2, 2021 (“McMurphy Letter”); Praveen Javali, dated April 9, 2021; Khaled Khan, dated April 20, 2021; Ramesh Patel, dated June 16, 2021; Anonymous, dated June 21, 2021.

risks of a bitcoin ETP;<sup>172</sup> and the bitcoin network’s effect on the environment.<sup>173</sup> 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.

#### **E. The Exchange’s Untimely Amendments to the Proposal**

The deadline for rebuttal comments in response to the Order Instituting Proceedings was July 28, 2021.<sup>174</sup> On September 30, 2021, the Exchange filed Amendment No. 1 to the proposed rule change and withdrew it on October 1, 2021. On October 1, 2021, the Exchange filed Amendment No. 2 with the Commission to amend and replace in its entirety Amendment No. 1 to the proposal as submitted on September 30, 2021, and as originally submitted on March 1, 2021. Subsequently, on November 4, 2021, the Exchange filed Amendment No. 3 with the Commission to amend and replace in its entirety Amendment No. 2 to the proposal as submitted on October 1, 2021, and as originally submitted on March 1, 2021. Because these amendments were filed months after the deadline for comments on the proposed rule change, the Commission deems Amendments No. 1, 2, and 3 to have been untimely filed.

Even if these amendments had been timely filed, the Commission would still conclude that the Exchange has not met its burden to demonstrate that its proposal is consistent with Exchange Act Section 6(b)(5). The primary change that the Exchange makes in the amendments is to argue that it would be inconsistent for the Commission to allow the launch of exchange-traded funds registered under the Investment Company Act of 1940 (“1940 Act”) that provide

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<sup>172</sup> See, e.g., Kuhn Letter; JC Letter; Rose Letter; Ciao Letter; Lowenstein Letter; Havermann Letter; Apodaca Letter.

<sup>173</sup> See, e.g., Eddie Letter; Donithorne Letter; McMurphy Letter; Ge De Letter; letter from Anonymous, dated June 10, 2021.

<sup>174</sup> See supra note 7.

exposure to bitcoin through CME bitcoin futures (“Bitcoin Futures ETFs”) while disapproving this proposal.

In the amendments, the Exchange asserts that, if the Commission does not deem the CME bitcoin futures market a regulated market of significant size, permitting Bitcoin Futures ETFs to list and trade would be inconsistent with the requirement under the Exchange Act—namely, the requirement that the listing and trading of the Bitcoin Futures ETFs be designed to prevent fraudulent and manipulative acts and practices as articulated in the Winklevoss Order and other disapproval orders. The Exchange states that, while one may argue that the 1940 Act provides certain investor protections, those protections relate primarily to the composition of board of directors, limitations on leverage, and transactions with affiliates, among others, and thus do not confer additional protections to investors in relation to the underlying CME bitcoin futures market to justify different regulatory outcomes for Bitcoin Futures ETFs and non-1940 Act-regulated ETPs that hold spot bitcoin. The Exchange also adds that the largest Bitcoin Futures ETF has contracts representing about 37 percent of open interest in CME bitcoin futures, which, according to the Exchange, “seems to directly contradict” the “predominant influence” prong in establishing whether the CME bitcoin futures market constitutes a market of significant size.

The Commission disagrees with the premise of the Exchange’s argument. The proposed rule change does not relate to a product regulated under the 1940 Act, nor does it relate to the same underlying holdings as the Bitcoin Futures ETFs. The Commission considers the proposed rule change on its own merits and under the standards applicable to it. Namely, with respect to this proposed rule change, the Commission must apply the standards as provided by Section 6(b)(5) of the Exchange Act, which it has applied in connection with its orders considering previous proposals to list bitcoin-based commodity trusts and bitcoin-based trust issued

receipts.<sup>175</sup> Accordingly, even if the Exchange’s Amendments No. 1, 2, and 3 had been timely filed, there is no additional information in such amendments that would enable the Commission to approve the proposed rule change as amended.

#### **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-2021-019 be, and hereby is, disapproved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>176</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>175</sup> See supra note 11.

<sup>176</sup> 17 CFR 200.30-3(a)(12).