

The Investment Lawyer

Covering Legal and Regulatory Issues of Asset Management

VOL. 25, NO. 12 • DECEMBER 2018

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*"In a world that keeps on pushin' me around, I stand my ground and I won't back down." —Tom Petty*¹*

As Main Street investors have become more aware of the rise of Bitcoin, Ether, and other cryptocurrencies and digital assets over the past several years, much attention has been given to whether the US Securities and Exchange Commission (SEC) will approve an exchange-traded financial product focused on cryptocurrency assets. A cryptocurrency-based exchange-traded product (ETP) would potentially solve a number of problems that investors face when investing directly in cryptocurrencies. For instance, the availability of cryptocurrency ETP shares would greatly simplify asset acquisition, custody, disposition, valuation, and hedging. Additionally, it would improve liquidity for cryptocurrency assets by deepening institutional investor participation in cryptocurrency investment through the ETP, permit margin financing for cryptocurrency exposures, and offer certain tax efficiencies. Finally, it would mitigate cybersecurity and other risks attendant with investor blockchain private key security through ETP institutionalization of cybersecurity measures and insurance coverage of ETP assets. Notwithstanding multiple listing proposals for cryptocurrency ETPs in the past two years, the SEC has repeatedly rejected such products and has been consistent in its rationale

Cryptocurrency ETPs...*continued from page 1*

for doing so. While the regulatory hurdles are not insignificant, persistent market demand and efforts by a number of market participants to create novel solutions for trading and custodying cryptocurrencies make us optimistic for the eventual possibility of a cryptocurrency-focused ETP.

To date, sponsors have sought approval for two types of ETPs, both of which have been based on Bitcoin exclusively. One type would hold Bitcoin directly. The other would invest in Bitcoin-related futures contracts. The SEC has consistently rejected listing rules for these products because: (1) the exchange on which the ETP would trade cannot have surveillance-sharing agreements² with significant markets that host trading in Bitcoin, and (2) the underlying markets for Bitcoin are not regulated, or not regulated in a manner comparable to a national securities or futures exchange. The SEC is concerned that Bitcoin pricing is unreliable because its underlying markets are unregulated (or not comparably regulated to national securities exchanges), opaque in their operations, and susceptible to manipulation. Without reliable pricing, the pricing of the ETP products also might be unreliable, potentially resulting in investor harm.

The consistency of the SEC's reasons for rejecting repeated ETP listing rules indicates that no cryptocurrency-based ETP will be available to US investors until cryptocurrency exchanges subject themselves to regulation comparable to what is required of national securities exchanges. As discussed below, a jurisdictional quandary exists in the United States as to whether the SEC or the US Commodity Futures Trading Commission (CFTC) might regulate these markets or whether individual states might set forth a regulatory framework. Before the US jurisdictional questions sort themselves out, a foreign jurisdiction might set forth a coherent regulatory pathway for cryptocurrency markets. Even if

a foreign jurisdiction does so, it remains uncertain whether the SEC's concerns about market manipulation in the underlying cryptocurrency market will be satisfied.

This article endeavors to provide a "state of play" of where we have been, where we are, and where we are going with respect to US retail investor products focusing on cryptocurrency assets. First, we address the cryptocurrency investment products and structures currently in existence. Second, we identify the variety of potential ETP structures applicable to cryptocurrencies and the regulatory nuances of such structures. Third, we delve into the SEC's rationales for rejecting ETP proposals. Fourth, we elaborate on the concerns that the SEC's Division of Investment Management (the IM Division) has expressed for investment company products (that is, mutual funds and certain exchange-traded funds). Fifth, we analyze the jurisdictional quandary between the SEC and the CFTC for cryptocurrency markets, which clouds the issue of how existing digital asset exchanges might subject themselves to federal regulation. Finally, we look to the future of how a cryptocurrency ETP might come to market, and we note that such a product might first become available overseas.

"Alright for Now"³—Currently Available Cryptocurrency Investment Vehicles

Currently, cryptocurrency investment vehicles are available in the United States only to certain sophisticated investors, either as hedge-fund-style vehicles privately offered under Regulation D strictly to "accredited investors" and certain other sophisticated investors or as certain privately offered grantor trusts, such as Grayscale's Bitcoin Investment Trust (Ticker: GBTC). Such vehicles are neither publicly offered nor exchange traded.

GBTC, which appears most akin to an ETP, sells its shares only to qualified accredited investors pursuant to a registration exemption under Rule 506(c) of Regulation D promulgated under the Securities Act

of 1933 (Securities Act).⁴ GBTC's shares are quoted on an over-the-counter dealer quotation market called OTCQX. Grayscale attempted to register a public offering of its shares that were to trade on the NYSE Arca⁵ but withdrew that registration statement on October 25, 2017.⁶ Apparently, Grayscale abandoned its effort to make GBTC an ETP because it encountered headwinds from the SEC's Division of Trading and Markets (T&M Division) during the NYSE Arca's effort to procure a listing rule for GBTC.⁷

Certain other investment vehicles offer exposure to cryptocurrency futures, which have been approved by the CFTC since December 2017.⁸ These vehicles are privately offered commodity pools whose offerings and portfolio operations are regulated under the Securities Act and the Commodities Exchange Act (CEA).

Grayscale's effort highlights certain features of the regulatory landscape that surround any potential cryptocurrency ETP. The SEC and CFTC consider Bitcoin and certain virtual currencies like Bitcoin to be "commodities." Accordingly, a vehicle like GBTC is said to have a "spot" exposure to the cryptocurrency commodity.⁹ An investment vehicle's spot exposure to a commodity (for example, where a grantor trust vehicle like GBTC directly holds only Bitcoin) represents neither a commodity future subject to regulation by the CFTC nor a security that would subject the vehicle to regulation under the Investment Company Act of 1940 (the 1940 Act).¹⁰ Nevertheless, if GBTC were to offer and sell its shares publicly as an ETP without any restrictions, GBTC's offering would be governed by the Securities Act (and potentially state securities registration laws). Such offerings could only be made pursuant to a registration statement declared "effective" by the SEC.

Because of GBTC's regulatory posture, Grayscale's registration statement for GBTC, unlike sponsors of many other ETP products, did not involve public notice or public comment. Rather, the SEC's criteria for effectiveness for such

registration statements focuses on the completeness and accuracy of prospectus disclosures with such disclosures reviewed by the SEC Staff in the Division of Corporation Finance. Grayscale may have been close to completing this registration process before it abandoned the effort after facing pressure from the T&M Division.

"Running Down a Dream"¹¹—The Variety of Potential Cryptocurrency ETP Structures

How ETPs Come to Market

Because generic listing rules do not exist that would permit any national exchange (for example, NYSE Arca, NASDAQ, or Cboe) to allow trading in cryptocurrency ETP's shares, the listing exchange must submit for the SEC's approval a listing rule specifically applicable to such ETP. Such applications typically are made under Rule 19b-4 promulgated under the Securities Exchange Act of 1934 (Exchange Act). The Rule 19b-4 process is subject to public notice and public comment, and the SEC must make specific findings that the issuance of the exchange's listing rule would comport with the public policies furthered by the Exchange Act. The SEC has a fixed period in which to approve a 19b-4 application, at the end of which it must either issue the listing rule or deny the application. Generally, the SEC has delegated this approval authority to the Staff of the T&M Division, although an exchange could appeal the Staff's decision to the SEC commissioners.

Commonalities Between Various ETP Structures & the ETP Arbitrage Mechanism

We discuss below a variety of different ETP structures applicable to cryptocurrencies, each of which has its own regulatory nuances. All ETPs considered herein share certain common features. One such commonality is exchange tradability. Another is the ongoing issuance and redemption of securities. The principal, and perhaps most important,

feature of ETPs is their reliance on an “arbitrage mechanism” performed by market participants that influences the supply and demand of ETP shares and, thus, trading prices. This arbitrage mechanism disciplines ETP share trading prices to the net asset value (NAV) per share of the ETP but depends on the pricing transparency and liquidity of the ETP’s underlying assets.

To appreciate the arbitrage mechanism, one should remember that ETPs have two separate markets:

1. the primary market between the ETP and certain broker-dealer firms that have agreed to act as authorized participants (authorized participants); and
2. the secondary market represented by the securities exchanges and markets upon which all other investors buy and sell the ETP’s shares.

In the primary market, ETPs sell shares to and redeem shares from authorized participants in large aggregations (for example, 25,000 or 50,000 shares), called creation units, at the next calculated NAV per share. An ETP’s NAV is typically calculated as of the close of trading on its primary listing exchange. Any investor in ETP shares, including authorized participants, can also buy and sell ETP shares in any quantity at current market prices through brokered orders on exchanges and markets listing the shares.

The arbitrage mechanism operates by offering authorized participants a profit opportunity arising from any differential between ETP trading prices and NAV. For instance, if an ETP’s shares are trading at a discount to the ETP’s expected NAV, authorized participants have an incentive to purchase shares on the market and then redeem them for the higher NAV value. By doing so, authorized participants reduce the supply of shares on the market, which generally results in a higher market price. When ETP shares are trading at a premium to NAV, authorized participants have an incentive to create shares at the lower NAV and then sell them on the

market, thereby increasing the supply of the ETP’s shares until trading prices fall to meet the current NAV. In each case, authorized participant activity generally continues until market prices and expected NAV reach equilibrium.

Because the arbitrage mechanism depends on market participants’ expectation of the ETP’s NAV, authorized participants’ arbitrage share creation and redemption activity depends on the transparency of the value of the ETP’s underlying portfolio assets to all market participants at the time that NAV is struck. The SEC and its Staff regard the arbitrage mechanism and the transparency of the values of the ETP’s underlying assets as probably the ETP industry’s most crucial feature. Arbitrage and transparency reduce premium and discount conditions, and allow market makers to effectively hedge their exposures to ETP shares, thereby reducing bid-ask spreads on their ETP share price quotations. Thus, retail investors are generally assured that they are obtaining the benefit of their bargain: Their share prices will generally track the value of the ETP’s underlying assets.

As we discuss below, arbitrage represents an exciting possibility for the evolution and advancement of the cryptocurrency markets, but the efficiency and effectiveness of the arbitrage mechanism typically require underlying cryptocurrency markets to maintain some degree of dependable and transparent infrastructure.

Not All ETPs Are Exchange-Traded Funds

If the ETP trades securities in its portfolio as well as exposures to spot cryptocurrencies or cryptocurrency futures, it is an investment company under the 1940 Act. ETPs that are 1940 Act investment companies are categorized as exchange-traded funds (ETFs). Many market participants erroneously call almost all ETPs ETFs; however, conflating the two obscures the different regulatory regimes applicable to general ETPs and ETFs.¹²

ETFs are regulated by the SEC’s IM Division. The IM Division is authorized to issue exemptive relief orders from the provisions of, and rules

under, the 1940 Act if such relief is in accord with the public policy rationales of the 1940 Act. All ETFs to date must obtain exemptive relief because ETFs function essentially as open-end investment companies or mutual funds, and exchange-traded mutual funds did not exist in 1940. The SEC has proposed a rule that would allow ETFs to exist if specified conditions are met, but the rule has yet to be adopted.¹³

For instance, ETFs must seek exemptive relief:

- to have ETF shares trade at exchange prices because Section 22(d) of the 1940 Act and the related rules thereunder prohibit brokers from selling shares of mutual funds for a price different from their NAVs; and
- from the affiliate-prohibited transaction provisions of Section 17(a) and (d) of the 1940 Act that would prevent certain market participants that accrue more than five percent of an ETF's shares and become ETF affiliates under the 1940 Act from creating or redeeming ETF shares through in-kind transactions.

Nevertheless, ETPs lack many of the protections afforded to ETF investors under 1940 Act regulation. For instance, sponsors of ETPs not subject to the 1940 Act are not subject to the oversight of an independent board and have greater latitude to engage in transactions that would generate fees for themselves and their affiliates that would otherwise be limited under the 1940 Act. Further, the 1940 Act requires that ETFs be able to redeem their shares daily. ETPs not subject to the 1940 Act are under no such statutory obligation and may suspend rights to redeem shares at their sponsor's discretion.

Some ETPs Also May Be Regulated by the CFTC

ETPs proposed as commodity pools, as many cryptocurrency-focused ETPs might be, are also subject to regulation by the CFTC and the National Futures Association. Such pools' sponsors

are regulated as commodity pool operators and may employ regulated commodity trading advisers. As a commodity pool, this type of ETP must observe a variety of CFTC prospectus disclosure obligations in addition to those imposed by the SEC. The CFTC also imposes periodic reporting, record-keeping, and advertising requirements. Further, the CFTC's regulation of the futures markets results in ETP futures trading limitations, such as position limits.

Commodity pool ETPs typically do not create and redeem their shares in-kind because the futures contracts that they hold cannot easily be broken into "odd" lots and not all authorized participants can engage in futures transactions with ETPs due to position limits, among other reasons. Thus, commodity pool ETPs create and redeem their creation units wholly in cash. To the extent that ETPs hold cash or cash equivalents, they do so primarily to support margin requirements, although these holdings also can be used to service redemption requests.

Grantor Trust ETPs—The Typical Proposed Structure for Many Cryptocurrency ETPs

One type of proposed cryptocurrency ETP, a "physically backed" ETP, is typically formed as a grantor trust without a governing board. In lieu of a governing board, the sponsors of the physically backed ETPs operate them within the strictures of the governing trust agreements. As grantor trusts, these ETPs are not subject to ETP-level taxation. In order to qualify as a grantor trust, these ETPs are limited to issuing shares for their referenced commodity, holding their referenced commodity as trust assets, and delivering their referenced commodity upon share redemption. Thus, physically backed ETPs create and redeem their shares in-kind. They typically pay their sponsor's fees in-kind as well. While there may be latitude to liquidate the ETP's asset under certain circumstances, such sales activities and cash holdings may jeopardize the ETP's tax status as a grantor trust.

"You Wreck Me"¹⁴—The SEC's Repeated and Consistent Rejections of Cryptocurrency ETP Listing Rule Proposals

In the following discussion, we highlight the SEC's and its Staff's concerns with (1) the cryptocurrency ETPs proposed in the last two years, whether a spot exposure or cryptocurrency futures ETP; and (2) registered investment companies investing significantly in cryptocurrencies. At root, the most serious of these concerns focus on the potential harm to retail ETP investors due to perceptions about cryptocurrency exchanges' lack of transparency and risks for pricing manipulation.

In the past two years, the SEC has published a significant record of its concerns about cryptocurrency ETPs. Two Rule 19b-4 applications for cryptocurrency ETPs remain pending before the SEC as of the date of this article (for example, the GraniteShares proposal¹⁵ and the VanEck SolidX proposal¹⁶). The only other ETP proposal, the Winklevoss Bitcoin Trust, was denied by the Staff of the T&M Division in 2017¹⁷ and again by the SEC in 2018.¹⁸ The T&M Division Staff denied the GraniteShares proposal, but the SEC has decided to reconsider it. The T&M Division Staff denied a listing rule change request for the SolidX Bitcoin ETP.

The SEC and the T&M Division have been remarkably consistent in their rationale for disapproving the various cryptocurrency ETPs, despite the differing structures of such ETPs. Primarily, the T&M Division has made it clear that it is not convinced that the exchanges for such ETPs are able to enter into meaningful market surveillance-sharing agreements with the underlying significant markets that trade cryptocurrencies or derivatives based on those cryptocurrencies.¹⁹ This viewpoint has for the most part been endorsed by the SEC's Commissioners²⁰ but is not uncontroversial and requires some unpacking.

First, the SEC notes that the underlying Bitcoin exchanges or markets are not inherently or demonstrably resistant to fraud and manipulation.

Arguments that blockchain technology somehow inherently mitigates such risk have proven unpersuasive, as the technology itself has no bearing on the integrity of markets hosting trading in blockchain-based digital assets, many of which have proven susceptible to costly hacks causing significant losses.²¹ Second, the SEC finds that, currently, no Bitcoin spot market exists with governmental oversight comparable to a US national securities exchange that has rules to detect and deter price manipulations and fraud. Further, no regulated Bitcoin derivatives market exists of significant size. The vast majority of Bitcoin spot and derivatives trading occurs offshore in mainly unregulated foreign markets.²² The SEC regards the CFTC's oversight of Chicago Mercantile Exchange and CFE Bitcoin futures contracts as a non-sequitur because such markets are not significant in size.²³ Thus, the SEC concludes that no significant, regulated Bitcoin markets exist with which an ETP listing exchange could enter into a meaningful market surveillance-sharing agreement.

Commissioner Hester Peirce's dissent from the Winklevoss Bitcoin Trust denial asserts that an exchange's rules concerning market participant trading activities should be sufficient and that the SEC's focus on Bitcoin spot markets is misplaced, deriving from misinterpretation of the SEC's authority in applying Rule 19b-4 of the Exchange Act.²⁴ In her dissent, Commissioner Peirce suggests that the SEC's denial of such products prevents institutional participation, which could foster just the liquidity that the SEC says Bitcoin currently lacks and that, therefore, the denial actually undermines investor protection. Finally, her dissent notes that the denial thwarts market innovation.

"Breakdown"²⁵—Dalia Blass' Letter to SIFMA and ICI Regarding 1940 Act Cryptocurrency-Related Products

As mentioned above, ETPs that are 1940 Act-registered investment companies are categorized as

ETFs. ETFs, like other investment companies, are subject to regulatory oversight by the SEC's IM Division (not the T&M Division), and they must submit a registration statement to be approved by the IM Division.²⁶

On January 18, 2018, Dalia Blass, Director of the IM Division, issued a Staff letter, titled "Engaging on Fund Innovation and Cryptocurrency-related Holdings," applicable to ETF cryptocurrency products.²⁷ The letter, addressed to the Investment Company Institute and the Securities Industry and Financial Markets Association, enumerates a number of questions that the IM Division has about how funds holding substantial amounts of cryptocurrencies and related products would satisfy the 1940 Act's requirements and rules. The questions focus on valuation, liquidity, custody, arbitrage considerations for ETFs, and concerns about market manipulation and investor risks. The letter draws a proverbial line in the sand for 1940 Act cryptocurrency-related products until satisfactory answers can be obtained. We would note that satisfactory answers to many of the letter's questions do not yet exist.

Director Blass' concerns about valuation, arbitrage, and potential manipulation also bear significantly on the T&M Division's concerns for ETPs in general about the operations and opacity of underlying cryptocurrency markets, particularly with respect to their perceived susceptibility to price manipulation. It would appear that the IM Division is aligned with the T&M Division in not approving a retail investment product any time in the near future, including through a basic mutual fund format as well as through ETFs.

"Don't Pull Me Over"²⁸—Seeking a Regulatory Framework for Cryptocurrency Exchanges

The SEC has made clear that a threshold issue for approving cryptocurrency ETPs is for the underlying cryptocurrency exchanges being subject to meaningful governmental regulation. However, in the United States, jurisdictional questions between

the SEC and CFTC have clouded how the exchanges might subject themselves to such regulation.

In the United States, the question of which federal agency might have jurisdiction over an exchange ties directly to whether the assets trading on such exchange are securities, commodities, or something else. The CFTC found virtual currencies to be commodities in 2015, granting them jurisdiction over virtual currencies and, specifically, Bitcoin and Bitcoin-related option products.²⁹ In a preliminary order issued on March 7, 2018, a federal district court supported the CFTC's assertion of jurisdiction.³⁰ However, whether a blockchain-based digital asset is a commodity or a security is subject to an often ambivalent facts-and-circumstances-based test.³¹ Many digital assets issued in so-called initial coin offerings (ICOs) would appear to be securities.³² Many digital asset exchanges would thus appear to be hosting trading in both commodities and securities.

On February 6, 2018, SEC Chairman Clayton and CFTC Chairman J. Christopher Giancarlo testified before the Senate Committee on Banking, Housing, and Urban Affairs on the subject of inter-agency coordination with respect to cryptocurrencies.³³ During that testimony, Chairman Clayton acknowledged that the SEC could exercise jurisdiction only over a cryptocurrency exchange that hosts trading securities. Chairman Giancarlo acknowledged that, even if a cryptocurrency exchange hosted trading in cryptocurrencies deemed to be commodities (that is, Bitcoin), the CFTC's regulatory jurisdiction does not extend to spot commodity trading, although it does have authority to police fraud and manipulation in spot markets.³⁴ It thus remains unclear which federal agency, if any, would be the principal regulator for exchanges hosting trading in cryptocurrencies that are spot commodities.

In other words, if an exchange hosts trading only in Bitcoin or other similar cryptocurrencies, such exchange would appear not to be subject to the SEC's or CFTC's jurisdiction. However, if an exchange hosts trading in a digital asset deemed to

be a security, then that exchange must register with the SEC as a national securities exchange or alternative trading system (ATS) or be exempt from such registration.³⁵ Nevertheless, no national securities exchange or ATS yet exists that is equipped to host trading in digital assets. In the absence of clear guidance from a federal agency on how a federal regulatory framework might apply to digital asset exchanges, the possibility exists that one or more of the states might fill the vacuum.

The SEC and the New York Attorney General, in particular, have expressed concern about the quality of digital asset exchanges. On March 7, 2018, the SEC's Divisions of Enforcement and Trading and Markets released the "Statement on Potentially Unlawful Online Platforms for Trading Digital Assets," cautioning investors that many such exchanges offering ICOs are not registered as a national securities exchange or as an ATS. The statement specifically called into question the trading protocols, the integrity of such exchanges, pricing transparency, and fairness to users. While the statement specifically targeted exchanges offering ICOs, some commenters have suggested that the concerns expressed also could apply to many exchanges for traditional cryptocurrencies.

On September 18, 2018, the New York Attorney General's office published its Virtual Markets Integrity Initiative Report (OAG report).³⁶ The OAG report includes findings from the OAG's April 2018 fact-finding inquiry into the policies and practices of various digital asset trading platforms. The OAG report expressed a number of concerns based on the following key findings: (1) many exchanges conduct business lines and operational roles creating potential conflicts of interest; (2) trading platforms have yet to implement serious efforts to impede abusive trading activity; and (3) protections for customer funds are often limited or illusory. In other words, while acknowledging that "some virtual currency platforms have taken steps to police the fairness of their platforms and safeguard the integrity of their exchange," some other exchanges have not;

thus, the OAG report further echoes the SEC's concerns about the risks of market manipulation in certain cryptocurrency markets.

Given the initiative of the New York Attorney General's office in this arena, one might reasonably foresee that the State of New York might attempt to fill the federal regulatory gap for cryptocurrency markets. In some sense, it already attempted to do so when New York State's Department of Financial Services imposed the BitLicense regime on businesses engaged in cryptocurrency business activity in 2015.³⁷ We would further note that, in July 2017, the National Conference of Commissioners on Uniform State Laws also proposed a uniform statutory framework for the regulation of cryptocurrency businesses that may prove helpful in this respect.³⁸

Given the complexities surrounding potential regulatory regimes for digital asset exchanges, it very well might be the case that a non-US jurisdiction first proposes a coherent regulatory framework that mitigates the SEC's concerns about the risk of price manipulation in the underlying spot cryptocurrency markets.

"Something Good Coming"³⁹— An Outlook for the Possibility of Cryptocurrency-Related Retail Investor Products

The fact that cryptocurrency exchanges have not subjected themselves to sufficient governmental regulation appears to have stalled the near-term launch of a cryptocurrency ETP in the United States. Retail investor enthusiasm for digital assets and digital asset investment products, however, remains persistent. A significant number of investors continue to invest directly in digital assets through various cryptocurrency exchanges. Coinbase, for example, reported that it had 13.3 million users as of October 2017, greater than the number of brokerage accounts maintained by Charles Schwab.⁴⁰ In the world of private funds, which are limited to select sophisticated investors, one source estimates that 198 cryptocurrency-focused private funds were created

in 2017 and forecasts that 220 private funds will be created in 2018.⁴¹ This source estimates that assets under management for such private funds reached USD\$7.1 billion as of July 2018, a 3,642% increase since January 1, 2016.⁴²

Digital asset exchanges, reading the regulatory landscape, are beginning to recognize the need and value of regulatory oversight. Coinbase, for example, has announced that it is seeking to operate a regulated broker-dealer so that it can offer digital asset securities, under the oversight of the SEC and the Financial Industry Regulatory Authority.⁴³ We anticipate other competing exchanges will follow suit. Fidelity Investments also has announced that it is working on setting up a trading platform and a custody solution for digital assets.⁴⁴ We also anticipate meaningful policy work both in the United States and abroad to tailoring existing regulatory regimes to facilitate compliance and mitigate investor risk.

As blockchain technology evolves and creates new investment opportunities, regulators in the United States and abroad will continue wrestling with the challenges and risks posed by such technology. We are already seeing nascent regulatory frameworks at the state level for cryptocurrency businesses. Given the jurisdictional complexity between the SEC and the CFTC, it also may very well be that a state or non-US jurisdiction proves to be the first mover in enunciating a regulatory framework for digital asset exchanges that mitigates the concerns that the SEC has expressed about market manipulation in the cryptocurrency markets. It also might be possible that a retail investor product for cryptocurrencies is first created overseas. That said, we remain optimistic that appropriately tailored regulatory frameworks that foster compliance by cryptocurrency exchanges with applicable law will develop and the possibility of a cryptocurrency-focused ETP will eventually be realized.

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Derek Steingarten are partners in the New York office of the firm. **Dan Cohen** is an associate in the Washington, DC, office of the firm. The authors would like to thank Tom Petty and the Heartbreakers and apologize in advance to the reader for the authors' humble homage herein.

NOTES

- * This article was written on October 19, 2018.
- ¹ Tom Petty, "I Won't Back Down," *Full Moon Fever* (MCA Records 1989).
- ² A surveillance-sharing agreement is an agreement between a commodity exchange operator and a self-regulatory organization that oversees that commodity exchange operator to share information about market trading activity, clearing activity, and customer identity. Moreover, under such agreements, parties to the agreement are reasonably able to access and produce requested information to each other, and no existing rules, laws or practices impede one party's capability of obtaining this information from or producing it to another party. See *Winklevoss Bitcoin Trust* SEC decision, *infra* n.18, at 37593.
- ³ Tom Petty, "Alright for Now," *Full Moon Fever* (MCA Records 1989).
- ⁴ Grayscale Investments, LLC, <https://grayscale.co/investors/> (last visited Oct. 13, 2018). GBTC focuses exclusively on Bitcoin. Grayscale has other cryptocurrency-related grantor trusts.
- ⁵ The NYSE Arca is a US-based, all electronic exchange through which exchange-traded products and equities are listed and traded.
- ⁶ Grayscale Investments, LLC, Form FWP (July 14, 2017) and Form RW (Oct. 25, 2017), <https://www.sec.gov/Archives/edgar/data/1588489/000119312517228591/d411511dfwp.htm> and https://www.sec.gov/Archives/edgar/data/1588489/000095010317010239/dp81942_rw.htm.
- ⁷ *Id.* The filing of GBTC's FWP indicates that Grayscale made a presentation to the T&M Division Staff in summer 2017 in connection with an effort to obtain a listing rule for GBTC. The withdrawal

of the registration statement occurred a few months later.

⁸ CME Group, Inc., *Bitcoin Futures Quotes Globex*, <https://www.cmegroup.com/trading/equity-index/us-index/bitcoin.html> (last visited Oct. 13, 2018); and Chicago Board Options Exchange, *XBT-Cboe Bitcoin Futures*, <http://cfe.cboe.com/cfe-products/xbt-cboe-bitcoin-futures> (last visited Oct. 13, 2018).

⁹ See *in re* Coinflip, Inc., CFTC. No. 15-29 (Sept. 17, 2015), <http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinflip-rorder09172015.pdf>. See also CFTC v. Cabbagetechn, 18-CV-361 (E.D.N.Y. Mar. 6, 2018), <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoindro-rorder030618.pdf>. Based on public statements by SEC Chairman Jay Clayton, it would appear that Chairman Clayton, at least, is not interested in contesting the CFTC's jurisdiction over Bitcoin and other cryptocurrencies. See, e.g., Press Release, Securities and Exchange Commission, Public Statement of Chairman Jay Clayton on Cryptocurrencies and Initial Coin Offerings, at n.2 (Dec. 11, 2017), <https://www.sec.gov/news/public-statement/state-statement-clayton-2017-12-11>; "SEC Chairman on Cryptocurrencies and Investing," CNBC (June 6, 2018), <https://www.cnbc.com/video/2018/06/06/sec-chairman-on-investing-cryptocurrencies.html>. In speaking of cryptocurrencies, we do not refer to so-called initial coin offerings (ICOs), for which Chairman Clayton has stated that "every ICO I've seen is a security." See "Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission Before the S. Comm. on Banking, Housing, and Urban Affairs" (Feb. 6, 2018), <https://www.banking.senate.gov/hearings/virtual-currencies-the-oversight-role-of-the-us-securities-and-exchange-commission-and-the-us-commodity-futures-trading-commission>.

¹⁰ Generally, US markets offer two different types of exchange-traded commodity products: (1) an exchange-traded commodity pool that invests in commodity futures or (2) a grantor trust or similar

pass-through tax vehicle that owns a physical commodity (or spot commodity) whose shares are traded on an exchange. An example of the former would be the Invesco DB Agriculture Fund (f/k/a PowerShares DB Agriculture Fund) (ticker: DBA). An example of the latter would be SPDR Gold Trust (ticker: GLD). Both types of exchange-traded commodities register their share offerings under the Securities Act but do not fall under the 1940 Act, as any securities in their portfolios are merely "incidental" in the eyes of the SEC. Consequently, these ETPs register fixed amounts of shares on SEC registration statements used by ordinary operating companies (SEC Forms S-1 or S-3).

¹¹ Tom Petty, "Running Down a Dream," *Full Moon Fever* (MCA Records 1989).

¹² ETPs are understood best as a subset of the larger ETP universe, which contains exchange-traded commodity pools, physically backed commodity ETP, exchange-traded notes, and other exchange-traded investment vehicles.

¹³ Exchange-Traded Funds, 83 Fed. Reg. 37332 (proposed July 31, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-07-31/pdf/2018-14370.pdf>.

¹⁴ Tom Petty, "You Wreck Me," *Wildflowers* (Warner Bros. 1994).

¹⁵ The GraniteShares proposal involves commodity pool ETPs that hold Cboe Futures Exchange (CFE) Bitcoin futures as well as cash and cash equivalents for margin purposes. The comment period closed on February 8, 2018. The NAV of these ETPs would reflect the CFE daily Bitcoin futures prices. The T&M Division Staff denied the GraniteShares proposal in August 2018. See "Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Disapproving a Proposed Rule Change To List and Trade the Shares of the GraniteShares Bitcoin ETF and the GraniteShares Short Bitcoin ETF," 83 Fed. Reg. 43923 (Aug. 28, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-08-28/pdf/2018-18578.pdf> (GraniteShares decision).

On August 23, 2018, the Secretary of the SEC notified Cboe BZX that the SEC would review T&M

Division's action pursuant to delegated authority and that T&M Division's action pursuant to delegated authority had been automatically stayed. On October 4, 2018, the SEC opened a public comment period for the proposed listing rule. Public comments were due by November 5, 2018. *See* "Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Notice of Filing of Amendment No. 2 to a Proposed Rule Change To List and Trade Shares of the GraniteShares Bitcoin ETF and the GraniteShares Short Bitcoin ETF, a Series of the GraniteShares ETP Trust, Under Rule 14.11(f)(4), Trust Issued Receipts," 83 Fed. Reg. 51521 (Oct. 11, 2018), <https://www.federal-register.gov/documents/2018/10/11/2018-22096/self-regulatory-organizations-cboe-bzx-exchange-inc-notice-of-filing-of-amendment-no-2-to-a-proposed-notice-and-in-re-cboe-bzx-exchange-inc-sec-no-34-84368> (order effecting notice and stay of Staff disapproval).

- ¹⁶ The VanEck SolidX proposal involves an indexed physically backed ETP that holds Bitcoin directly. *See* "Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To List and Trade Shares of SolidX Bitcoin Shares Issued by the VanEck SolidX Bitcoin Trust Under BZX Rule 14.11(e)(4), 'Commodity-Based Trust Shares,'" 83 Fed. Reg. 48665 (Sept. 26, 2018) <https://www.gpo.gov/fdsys/pkg/FR-2018-09-26/pdf/2018-20884.pdf>. As of September 19, 2018, the SEC has received more than 1,400 comment letters on the Van Eck Solid X proposal. On September 20, 2018, the SEC instituted public proceedings to determine whether it should issue or deny the proposed listing rule. Public comments were due by October 17 and rebuttals were due by October 31.

SolidX, without Van Eck, attempted to procure a NYSE Arca listing rule in 2017 but was denied. *See* "Self-Regulatory Organizations; NYSE Arca, Inc.; 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," 82 Fed. Reg. 16247 (April 3, 2017), <https://www.gpo.gov/fdsys/pkg/FR-2017-04-03/pdf/2017-06441.pdf>.

- ¹⁷ "Self-Regulatory Organizations; Bats BZX Exchange, Inc.; Order Disapproving a Proposed Rule Change, as Modified by Amendments No. 1 and 2, to BZX Rule 14.11(e)(4), Commodity-Based Trust Shares, To List and Trade Shares Issued by the Winklevoss Bitcoin Trust," 82 Fed. Reg. 14076 (Mar. 16, 2017), <https://www.gpo.gov/fdsys/pkg/FR-2017-03-16/pdf/2017-05213.pdf> (Winklevoss Bitcoin Trust Staff decision).
- ¹⁸ "Self-Regulatory Organizations; Bats BZX Exchange, Inc.; Order Setting Aside Action by Delegated Authority and Disapproving a Proposed Rule Change, as Modified by Amendments No. 1 and 2, To List and Trade Shares of the Winklevoss Bitcoin Trust," 83 Fed. Reg. 37579 (Aug. 1, 2018), <https://www.gpo.gov/fdsys/pkg/FR-2018-08-01/pdf/2018-16427.pdf> (Winklevoss Bitcoin Trust SEC decision).
- ¹⁹ Some market participants have expressed concern that the uniqueness of cryptocurrency-related ETPs could potentially raise systemic questions about the infrastructure of ETP markets, particularly with respect to existence of appropriate trade order forms and clearance and settlement. While the SEC and the T&M Division have not explicitly expressed such concerns, such issues also likely would need to be addressed before a cryptocurrency-related ETP comes to market.
- ²⁰ As discussed below, we would note that Commissioner Hester Peirce dissented from the SEC's denial of the Winklevoss Bitcoin Trust. *See* Press Release, Securities and Exchange Commission, Dissent of Commissioner Hester M. Peirce to Release No. 34-83723; File No. SR-BatsBZX-2016-30 (July 26, 2018), <https://www.sec.gov/news/public-statement/peirce-dissent-34-83723>.
- ²¹ In particular, the SEC found that no data exists that show that: (1) various Bitcoin markets experience inter-market arbitrage to reduce price disparities; (2)

Bitcoin spot markets are not subject to spoofing or other deceptive quote practices; (3) insider trading and manipulative systems hacking do not occur in the Bitcoin markets; and (4) recent studies about Bitcoin price manipulation or potential for price manipulation are wrong. *See* Winklevoss Bitcoin Trust SEC decision, *supra* n.18, at 37582–87. *See also* GraniteShares Decision, *supra* n.15, at 43929–30 (SEC Staff concluded that BZX Exchange had not met its burden of showing that bitcoin markets are inherently not susceptible to manipulation); and Winklevoss Bitcoin Trust Staff decision, *supra* n.17, at 14078–85 (same).

²² Winklevoss Bitcoin Trust SEC decision, *supra* n.18, at 37596–37601. *See also* GraniteShares Decision, *supra* n.15, at 43927–31 and Winklevoss Bitcoin Trust Staff decision, *supra* n.17, at 14086–87.

²³ *See* Winklevoss Bitcoin Trust SEC decision, *supra* n.18, at 37580. *See also* Winklevoss Bitcoin Trust Staff decision, *supra* n.17, at 14086–87. Moreover, the SEC noted that the CFTC has different policy goals in regulating futures markets compared to those under the Exchange Act. The SEC seems to be implying that CFTC oversight is not sufficient for Exchange Act purposes, which implication seems at odds with its approvals for other ETPs that track or use commodity futures. *See* Winklevoss Bitcoin Trust SEC decision, *supra* n.18, at 37587.

²⁴ *See supra* n.19.

²⁵ Tom Petty, “Breakdown,” *Tom Petty and the Heartbreakers* (Shelter 1976).

²⁶ ETFs must also have an exchange listing rule for their shares to trade, which is separately subject to T&M Division approval. Most ETFs use a “generic” listing created for most securities-based ETFs. As in the days before the creation of generic ETF listing rules, each cryptocurrency-based ETP must obtain its own bespoke listing rule.

²⁷ Letter, Securities and Exchange Commission, Staff Letter: Engaging on Fund Innovation and Cryptocurrency-related Holdings, (Jan. 18, 2018), <https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm>.

²⁸ Tom Petty, “Don’t Pull Me Over,” *Mojo* (Reprise Records 2010).

²⁹ *See in re* Coinflip, Inc., *supra* n.9. We would note that the first Form S-1 filing by the Winklevoss Bitcoin Trust on July 1, 2013, exhibits an informal determination made jointly by the Staff of the SEC and the CFTC that Bitcoin was a commodity.

³⁰ *See* CFTC v. Cabbageteach, *supra* n.9. Based on public statements by SEC Chairman Jay Clayton, it would appear that Chairman Clayton, at least, is not interested in contesting the CFTC’s jurisdiction over Bitcoin and other virtual currencies. *See, e.g.,* Public Statement of Chairman Jay Clayton on Cryptocurrencies and Initial Coin Offerings, *supra* n.9; *SEC Chairman on Cryptocurrencies and Investing*, *supra* n.9.

³¹ *See* SEC Exchange Act Rel. No. 81207, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO, at 16 (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf>.

³² S. Comm. on Banking, Housing, and Urban Affairs, *supra* n.9.

³³ *See* Written Testimony of Chairman J. Christopher Giancarlo, Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission Before the S. Comm. on Banking, Housing, and Urban Affairs (Feb. 6, 2018), <https://www.banking.senate.gov/imo/media/doc/Giancarlo%20Testimony%202-6-18b.pdf>.

³⁴ *See id.* (“In 2015, the CFTC determined that virtual currencies, such as Bitcoin, met the definition of ‘commodity’ under the [Commodity Exchange Act]. Nevertheless, the CFTC does NOT have regulatory jurisdiction under the CEA over markets or platforms conducting cash or ‘spot’ transactions in virtual currencies or other commodities or over participants on such platforms.”). A spot commodity is a commodity available for delivery within 28 days, as opposed to a contract for delivery at a future date.

³⁵ Press Release, Securities and Exchange Commission, SEC Public Statement on Potentially Unlawful

Online Platforms for Trading Digital Assets (Mar. 7, 2018), <https://www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading>.

³⁶ Office of the New York State Attorney General, Virtual Markets Integrity Initiative Report (Sept. 18, 2018), <https://virtualmarkets.ag.ny.gov/>.

³⁷ N.Y.Comp. Codes R. & Regs. tit. 23, § 200.1ff. (2015).

³⁸ Uniform Law Commission, Regulation of Virtual-Currency Business Act (last visited Oct. 13, 2018), <http://www.uniformlaws.org/Act.aspx?title=Regulation%20of%20Virtual-Currency%20Businesses%20Act>.

³⁹ Tom Petty, “Something Good Coming,” *Mojo* (Reprise Records 2010).

⁴⁰ Evelyn Cheng, “Bitcoin exchange Coinbase has more users than stock brokerage Schwab,” CNBC (No.

27, 2017), <https://www.cnn.com/2017/11/27/bitcoin-exchange-coinbase-has-more-users-than-stock-brokerage-schwab.html>.

⁴¹ See Crypto Fund Research, “Cryptocurrency Investment Fund Industry Graphs and Charts,” <https://cryptofundresearch.com/cryptocurrency-funds-overview-infographic/> (last visited Oct. 15, 2018).

⁴² *Id.*

⁴³ Asiff Hirji, “Our Path to listing SEC-regulated crypto securities,” Medium, *The Coinbase Blog*, (June 6, 2018), <https://blog.coinbase.com/our-path-to-listing-sec-regulated-crypto-securities-a1724e13bb5a>.

⁴⁴ “Fidelity Launches New Company for Trading and Storing Cryptocurrencies,” *N.Y. Times* (Oct. 15, 2018), <https://www.nytimes.com/reuters/2018/10/15/business/15reuters-crypto-currencies-fidelity-advisor.html?partner=IFTTT>.