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December 18, 2019

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F St., N.E.
Washington, DC 20549-1090

Bitwise Asset Management, Inc. (collectively and with its affiliates, "Bitwise") submits this Letter in response to the Securities and Exchange Commission's October 15, 2019 notification to NYSE Arca[1] that, pursuant to Commission Rule of Practice 431,[2] the Commission would review the action taken by the Division of Trading and Markets, pursuant to delegated authority, disapproving the proposed rule change,[3] as modified by Amendment No. 1,[4] to list and trade the shares of the Bitwise Bitcoin ETF Trust under NYSE Arca Rule 8.201-E.

Dear Commissioners,

Thank you for the opportunity to provide additional commentary in support of NYSE Arca's proposed rule change to list and trade the shares of the Bitwise Bitcoin ETF Trust (the "Trust"). We deeply appreciate the time, care and thoughtfulness with which the Commission has approached both this application specifically and the broader question of how U.S. investors can safely access the bitcoin market.

We also appreciate the detailed analysis the Staff provided in its October 9, 2019 order disapproving the proposed rule change ("the Order").[5] While we were disappointed with the Staff's decision, the thoroughness of the Order reflects the Staff's deep engagement with the topic and careful consideration of NYSE Arca's application and the research provided by Bitwise and others in support of that application.

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1 https://www.federalregister.gov/documents/2019/11/18/2019-24874/self-regulatory-organizations-nyse-arca-inc-order-scheduling-filing-of-statements-on-review-for-an

2 See 17 CFR 201.431

3 See Securities Exchange Act Release No. 87267 (Oct. 9, 2019), 84 FR 55382 (Oct. 16, 2019)

4 See Securities Exchange Act Release No. 85854 (May 14, 2019), 84 FR 23125 (May 21, 2019)

5 See Footnote 3

Our goal in this letter is to provide additional context for the Commission to consider as it reviews the Staff's decision. While the Staff presented many well-developed arguments in its Order, we continue to believe that there are currently, or that there can be designed and developed through dialogue and discussion, manners in which the concerns raised under the Securities Exchange Act of 1934 ("Exchange Act") Rule 6(b)(5) can be met.

Why Does A Bitcoin ETF Matter?

Before providing our thoughts on the Order, it's worth stepping back for a moment to ask: Why do we need a bitcoin ETF, anyway?

The answer is simple: Because a large number of U.S. investors are today investing in bitcoin, and the question of whether they are able to access the market safely and efficiently, and with the protections offered by the federal securities laws, is critical.

The number of U.S. investors—particularly younger investors—making allocations to bitcoin can surprise people who don't focus on this market on a day-to-day basis.

Charles Schwab, for instance, recently published a study of self-directed retirement plans held at the firm.[6] The study showed that the Grayscale Bitcoin Trust—a Trust that issues shares to accredited investors in private placements under Regulation D of the Securities Act of 1933 and allows those shares to trade on the OTCQX under Rule 144 with the ticker "GBTC" —is currently the fifth largest holding in millennial[7] retirement accounts, ahead of companies like Berkshire Hathaway, Walt Disney, and Microsoft.

Charles Schwab Self-Directed 401(k) Balances:
Top Ten Equity Holdings As A Percentage Of Assets Across Generations

MILLENIALS		GEN X		BABY BOOMERS	
AMAZON.COM INC	7.87%	APPLE INC	10.52%	APPLE INC	9.19%
APPLE INC	6.18%	AMAZON.COM INC	7.16%	AMAZON.COM INC	5.32%
TESLA INC	3.22%	BERKSHIRE HATHAWAY	2.37%	BERKSHIRE HATHAWAY	2.75%
FACEBOOK INC	3.03%	FACEBOOK INC	2.26%	MICROSOFT CORP	2.69%
GRAYSCALE BITCOIN TRUST	1.84%	MICROSOFT CORP	2.16%	FACEBOOK INC	1.43%
BERKSHIRE HATHAWAY	1.73%	TESLA	1.45%	VISA INC	1.25%
WALT DISNEY CO	1.68%	ALPHABET INC.	1.30%	ALPHABET INC.	1.23%
NETFLIX INC	1.58%	NETFLIX	1.29%	AT&T INC	1.17%
MICROSOFT CORP	1.53%	ALIBABA GROUP HOLDING	1.23%	BOEING	1.08%
ALIBABA GROUP HOLDING	1.39%	VISA INC	1.23%	ALIBABA GROUP HOLDING	0.98%

Source: Charles Schwab SDRB Report. Data as of September 30, 2019

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[6] "Schwab Report: Self-Directed 401(k) Balances Hold Steady; Millennials Allocate More to ETFs and Cash Than Gen X, Boomers," Dec. 4, 2019. The study looked at the accounts of plan participants with balances between $5,000 and $10 million.
[7] Charles Schwab defines "millennials" as individuals between the ages of 27-38.

GBTC is currently the only tool that retail investors can use to access bitcoin through a traditional brokerage account, and is therefore a strong proxy for demand to invest in bitcoin in these accounts. As a Rule 144 product, however, GBTC's ability to offer high-fidelity exposure to bitcoin is limited: Since inception in 2015, GBTC has traded on the secondary market at a premium to its net asset value (NAV) that has ranged as high as 140% and as low as 0%.[8] At the time this letter was written, on Dec. 18, 2019, GBTC was trading at a 29% premium to NAV, meaning it only offered $0.71 worth of bitcoin exposure for every dollar invested in the trust.[9]

Beyond GBTC, the primary means retail investors have for accessing bitcoin is through crypto investing apps. These apps are incredibly popular: The most popular, Coinbase, has 30 million accounts, which is more than the number of active brokerage accounts at Charles Schwab, TD Ameritrade, and E*Trade combined.[10]

Apps offer a user-friendly experience for retail investors looking to purchase cryptoassets like bitcoin, but come with their own challenges, including high fees, limited disclosures, and security risk. This security risk is particularly acute at the individual level, where the loss of a password or the illicit porting of a cellphone can lead to a complete loss of assets.

We raise these facts not to suggest that either GBTC or crypto investing apps are flawed; both aim to provide high-quality exposure within the limitations of their product and regulatory structures. Instead, our goal is to demonstrate that there is significant retail demand for bitcoin exposure, and to note that this demand is currently forced into products that forgo the protections and disclosure requirements that would be required of an ETF.

We acknowledge, as the Staff pointed out in its Order, that this tangible benefit does not mean the Commission can overlook the requirements under the Exchange Act in approving such a product. It does, however, add urgency to the process, which is why we deeply appreciate the Commission's decision to further review NYSE Arca's proposed rule change, and why we are excited to engage in a dialogue that explores a pathway toward approval.

Commentary On The Staff's Order Disapproving NYSE Arca's Proposed Rule Change

In its disapproval order, the Staff found that NYSE Arca did not meet its burden under the Exchange Act "to demonstrate that its proposal is consistent with the requirements of Exchange Act Section 6(b)(5), and, in particular, the requirement that the rules of a national securities

[8] YCharts, data as of 12/17/2019

[9] Bloomberg, data as of 12/18/2019

[10] Source for Coinbase data reporting 30 million accounts: Coinbase.com, data as of 12/18/2019. Source of Charles Schwab data reporting 12 million active brokerage accounts: Schwab.com, data as of 6/30/2019. Source of TD Ameritrade data reporting 11.5 million brokerage accounts: TD Ameritrade 2018 Annual Report, data as of 12/31/2018. Source of E*Trade data reporting 4.9 million brokerage accounts: Wikipedia, data as of 12/31/2018.

exchange be ‘designed to prevent fraudulent and manipulative acts and practices.’”

The Staff previously articulated that an exchange could satisfy those requirements by either showing that: a) the bitcoin market is uniquely resistant to market manipulation and fraudulent activity; or, b) the listing exchange has entered into a surveillance sharing agreement with a regulated market of significant size.[11]

Our research submitted in support of NYSE Arca’s proposed rule change argued that the bitcoin market satisfied both requirements.

Regarding the first requirement, we noted, for instance, that the fact that bitcoin’s price is set in the open market makes it uniquely resistant to the kind of market manipulation scandals that have occurred in markets that rely on coordinated fix pricing, such as the London Interbank Offered Rate (LIBOR) Scandal of 2012[12] or the Global Forex Scandal of 2013.[13] We further noted that bitcoin’s inherent fungibility and the market’s distributed nature allowed for effective arbitrage to take place between different trading venues, which helped insulate bitcoin from attempts to manipulate individual markets. Supporting this argument, we demonstrated that the quality of arbitrage between various real bitcoin spot markets was high.

In responding to these arguments in its disapproval Order, the Staff clearly articulated that the bar for demonstrating that a market is uniquely resistant to market manipulation and fraudulent activity is quite high. While our research argued that the bitcoin market is uniquely resistant to certain forms of manipulation, the Order made it clear that the market would need to be uniquely resistant to a comprehensive set of market manipulation vectors to qualify. This is a standard that, historically, even the most well-regulated, arbitraged, and liquid markets, such as the U.S. equity index options market, have not met. We encourage the Commission to consider whether or not this interpretation is the appropriate standard for making this determination.

Given the challenges associated with proving unique resistance when interpreted in this manner, the remainder of this Letter focuses on additional items we would like to highlight related to the second avenue for meeting the requirements of the Exchange Act; namely, demonstrating that a regulated market of significant size exists and that NYSE Arca has surveillance sharing agreements in place with that market.

A Regulated Market Of Significant Size

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[11] In, for instance, the July 26, 2018, “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”. https://www.sec.gov/rules/other/2018/34-83723.pdf

[12] “Libor scandal”. https://en.wikipedia.org/wiki/Libor_scandal

[13] “Three Former Traders for Major Banks Indicted in Foreign Currency Exchange Antitrust Conspiracy,” Department of Justice, press release, January 10, 2017. https://www.justice.gov/opa/pr/three-former-traders-major-banks-indicted-foreign-currency-exchange-antitrust-conspiracy

In the research we submitted in support of NYSE Arca's application, we argued that the CME bitcoin futures market is a regulated market of significant size, and noted that NYSE Arca has a surveillance sharing agreement in place with CME through its participation in the Intermarket Surveillance Group.

The CME bitcoin futures market is today the largest U.S. bitcoin market by notional volume, exceeding all U.S.-domiciled spot bitcoin exchanges. It is also among the largest bitcoin markets in the world.[14] In our research supporting the NYSE Arca application, we argued that this large size relative to other bitcoin markets showed that the CME bitcoin futures market is significant.

In its disapproval Order, the Staff clarified its interpretation of a "regulated market of significant size," noting that "[t]he relative size of the bitcoin futures market … [does not] establish the interrelationship between the futures market and the proposed ETP, or directionality of that interrelationship."[15]

In other words, relative size isn't enough to establish significance. Instead, the Staff said that what's needed is an analysis of the "lead-lag relationship" between exchanges. This lead-lag relationship "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."[16]

The disapproval Order also noted that this test could help clarify whether the prices reported on exchanges that we believe have significant wash trading or fake volume have any influence on the real spot market for bitcoin, another area of Staff concern.

We appreciate the clarity of this guidance. We are pursuing research into the lead-lag relationship for all bitcoin markets, and look forward to sharing our findings with the Commission and the Staff when appropriate. We would also encourage the Commission to consider whether the "lead-lag" relationship is the central determinant of identifying a "market of significant size."

Beyond the CME bitcoin futures market, however, there is additionally a robust and growing surveillance and data sharing environment surrounding spot bitcoin exchanges.

For instance, starting in 2018, the New York State Department of Financial Services' BitLicense

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[14] For the 24 hours ending on Dec. 17, 2019, for instance, the CME futures market had a trailing 24-hour trading volume of $591 million. This compared with $324 million for Binance, the largest bitcoin spot exchange, and $114 million for Coinbase, the largest U.S. bitcoin spot exchange. Source: http://bitcointradevolume.com/.
[15] See Securities Exchange Act Release No. 87267 (Oct. 9, 2019), 84 FR 55382 (Oct. 16, 2019), page 98.
[16] See Securities Exchange Act Release No. 87267 (Oct. 9, 2019), 84 FR 55382 (Oct. 16, 2019), page 102.

program began requiring spot bitcoin exchanges operating under the BitLicense to “implement measures designed to effectively detect, prevent, and respond to fraud, attempted fraud, and similar wrongdoing,” to report any wrongdoing to the NYSDFS immediately upon discovery, and to take action to prevent a repeat of similar events.[17] The exchanges operating under the BitLicense program include Coinbase, Bitstamp, Bitflyer, ItBit and Gemini.

As another example, the CME CF Bitcoin Reference Rate that is used to settle the CFTC-regulated CME bitcoin futures contracts relies on a robust set of rules that account for data sharing and concerns about market manipulation. This rate is governed by an Oversight Committee, chaired by the CME, and draws prices from five spot bitcoin exchanges: Bitstamp, Coinbase, Gemini, itBit, and Kraken. The constituent exchange criteria[18] stipulates that the Oversight Committee makes sure that each exchange “has policies to ensure fair and transparent market conditions at all times and has processes in place to identify and impede illegal, unfair or manipulative trading practices” and “cooperates with inquiries and investigations of regulators and the Administrator upon request and must execute data sharing agreements with CME Group.”[19]

We urge the Commission to consider whether data sharing agreements such as the kind required by the BitLicense program or leveraged by the CME CF Bitcoin Reference Rate satisfy the concerns raised by the Staff, and if not, in what material ways such agreements are deficient.

Conclusion

Bitwise is committed to creating a bitcoin ETF that provides all investors with the ability to

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[17] “DFS Takes Action To Deter Fraud And Manipulation In Virtual Currency Markets,” New York State Department of Financial Services, press release, Feb. 7, 2018.
https://www.dfs.ny.gov/about/press/pr1802071.htm

[18] “CME CF Cryptocurrency Pricing Products - Constituent Exchange Criteria,” CF Benchmarks Ltd, October 2019.
https://www.cryptofacilities.com/cms/storage/resources/cme-cf-constituent-exchanges-criteria.pdf

[19] Of note, earlier this month, the SEC allowed a registration statement to go effective that permits the launch of an interval fund that intends to invest substantially all of its assets in CFTC-regulated bitcoin futures, likely from CME. As discussed in Director Blass’s December 3, 2019 keynote address to the ICI Securities Law Developments Conference, this will be the first Investment Company Act of 1940 Registered Investment Company fund that invests substantially all of its assets in bitcoin-related instruments. The fund has an initial asset cap of $25 million.

While there are many differences between an asset-capped interval fund and an open-ended ETF, we are encouraged by the SEC’s implicit finding that, with adequate disclosure, the pricing mechanism for cash-settled futures, such as the CME CF Bitcoin Reference Rate, can be sufficiently insulated from manipulation to allow periodic NAV-based redemptions and creations in an SEC-registered investment vehicle. We would encourage the Commission to consider whether this decision has bearing, not on the full approval of a bitcoin ETF, but on the narrow question of whether pricing drawn from bitcoin spot markets can be consistent with a rule change that satisfies Exchange Act Section 6(b)(5).

access bitcoin in a regulated and familiar fund format with the transparent and robust disclosures required by the federal securities laws.

We believe such an ETF would add material protections for the millions of U.S. investors who currently use other avenues to access the bitcoin market, as well as for any future investors who may choose to do so.

Our hope is that the approval of a bitcoin ETF will ensure that these investors have access to all of the information they need to make independent investment decisions, and believe that the rules of the exchange can be designed to provide transparency while protecting against market manipulation.

Thank you for your consideration.

Sincerely,

Hunter Horsley, Chief Executive Officer
Hong Kim, Chief Technology Officer
Teddy Fusaro, Chief Operating Officer
Matt Hougan, Global Head of Research