MarketWatch

Opinion: The SEC is illogical in its continued refusal to OK a bitcoin ETF

The SEC's stance feels like 'Groundhog Day'

By Jennifer J. Schulp
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To those waiting on the Securities and Exchange Commission to approve a bitcoin exchange-traded fund, it feels a bit like the classic 1993 movie "Groundhog Day."
Instead of Bill Murray waking up destined to relive the same day no matter what changes he makes, proponents of a bitcoin ETF keep receiving SEC denials of the investment product, no matter what has changed. Whatever merits the SEC's rationale initially had, the commission's recent acceptance of bitcoin *futures* ETFs puts it long past time to approve a bitcoin ETF.
An ETF is a security that tracks the performance of something else, like an index, a commodity or another asset. Shares of an ETF are purchased and sold on an exchange, the same way a regular stock is. A bitcoin ETF—sometimes called a bitcoin *spot* ETF—tracks the price of bitcoin **BTCUSD, 1.32%** by investing in the cryptocurrency.

It is not unusual for investors to seek indirect exposure to a commodity through an ETF; lots of ETFs track precious metals or baskets of commodities. Through an ETF, investors gain exposure to the commodity but don't have to deal with the realities of owning the underlying resource. In the case of bitcoin, it can be complicated to directly own the asset and the option may not be available to incorporate into some retirement savings plans or institutional portfolios.
The SEC first rejected a proposed Bitcoin ETF in 2017; its latest rejection was just last week. Multiple proposals remain pending, with decisions expected over the next several months.

Although varying proposals have been made by different issuers and exchanges, the SEC has consistently cited in its denials concerns about the potential for fraud and manipulation in the underlying market for bitcoin. Yet the SEC was apparently able to overlook these same so-called investor protection concerns when it approved several bitcoin futures ETFs last autumn.
A bitcoin futures ETF is different from a bitcoin ETF, but not in the way that should matter for the SEC's purported concern. A bitcoin futures ETF tracks bitcoin futures, which are commodities derivatives traded on exchanges regulated by the Commodity Futures Trading Commission. Because futures are a tool for speculating on the price of bitcoin, they are not meant to track the current price of bitcoin. But what bitcoin futures ETFs and bitcoin ETFs have in common is that they both refer back to the same markets to get pricing data that the SEC cites as unacceptable when denying bitcoin ETFs.

How is it fair that bitcoin ETFs continue to be denied by the SEC while bitcoin futures ETFs are allowed to trade? It's not.

Investors want to invest in bitcoin, whether the SEC is in favor of the cryptocurrency or not. Right now investors generally have three options: directly hold bitcoin, invest in a non-exchange traded investment fund, or invest in a bitcoin futures ETF.

Each of these options has drawbacks. Bitcoin ownership is less straightforward than owning a stock and an investor generally must take a more active role in securing their investment.

The other two options impose fewer burdens on investors, but neither provide ideal exposure to bitcoin. Non-exchange-traded investment funds have limitations on which investors can access them, and they often trade at a premium or a discount to the price of bitcoin because they cannot continuously create and redeem shares.

The bitcoin futures ETF, however, presents arguably greater risks to the average investor due to its design. The futures market is largely institutional and has been described as "obtuse" for the average investor. A bitcoin futures ETF is also likely to lose value just from the process of managing the fund, a risk the SEC obliquely highlighted to investors by saying the value "may be affected by the maintenance of futures contract exposure." In addition, such an ETF may be subject to higher management costs and may have difficulties if its popularity exceeds the capacity for futures contracts.

For those reasons, some see a bitcoin futures ETF as more suited to short-term investing. That's not to criticize the SEC's approval; it's a fine product for the appropriate investor. But by artificially limiting investors' choices, the SEC is leaving many with a product that is inferior for their needs.

Moreover, denying bitcoin ETFs prevents further maturation in the underlying bitcoin market. Permitting a bitcoin ETF, as SEC Commissioner Hester Peirce recognized, would increase institutional participation in the underlying market, leading to more robust protections for investors and more effective surveillance for market manipulation and other fraudulent activity. Rather than protecting investors, the SEC's continued denials leave them less protected.

Bill Murray eventually broke the Groundhog Day cycle by becoming a better man and falling in love. It might be too much to ask the SEC to fall in love with bitcoin ETFs, but fortunately, it doesn't have to. Fair treatment by the SEC should lead to a bitcoin ETF approval, breaking the Groundhog Day cycle and giving investors the opportunity to make their own choices about how to invest in bitcoin.

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