January 5, 2024

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Ark21Shares Bitcoin ETF, File No. SR-CboeBZX-2023-028
Invesco Galaxy Bitcoin ETF, File No. SR-CboeBZX-2023-038
iShares Bitcoin Trust, File No. SR-NASDAQ-2023-016
Valkyrie Bitcoin Fund, File No. SR-NASDAQ-2023-019
VanEck Bitcoin Trust, File No. SR-CboeBZX-2023-040
WisdomTree Bitcoin Trust, File No. SR-CboeBZX-2023-042
Wise Origin Bitcoin Trust, File No. SR-CboeBZX-2023-044

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to provide additional comment on several proposed rule changes filed by the Cboe BZX Exchange, Inc., and The NASDAQ Stock Market, LLC (collectively referred to as the "Exchanges") with the Securities and Exchange Commission ("SEC" or "Commission"), seeking to list and trade shares of spot bitcoin-based exchange-traded products ("ETPs").[2]

We submit this supplemental comment letter (which Better Markets very rarely does) because it would be a grave if not historic mistake almost certainly leading to massive investor harm if the SEC approves the pending rule changes. As discussed below, the law and policy considerations compel the Commission to disapprove the rule changes. While all consequential decisions are difficult, this is not a close call.

The D.C. Circuit's decision in *Grayscale Investments, LLC, v. SEC*, 82 F.4th 1239 (D.C. Cir. 2023), should not cause the SEC to deviate from its previous well-grounded decisions disapproving multiple spot bitcoin-based ETPs from multiple exchanges. We also highlight the

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Ark21Shares Bitcoin ETF, File No. SR-CboeBZX-2023-028; Invesco Galaxy Bitcoin ETF, File No. SR-CboeBZX-2023-038; iShares Bitcoin Trust, File No. SR-NASDAQ-2023-016; Valkyrie Bitcoin Fund, File No. SR-NASDAQ-2023-019; VanEck Bitcoin Trust, File No. SR-CboeBZX-2023-040; WisdomTree Bitcoin Trust, File No. SR-CboeBZX-2023-042; Wise Origin Bitcoin Trust, File No. SR-CboeBZX-2023-044.

grave threat that the exchange trading of these products would pose to investors.[3] Indeed, it would be a historic mistake for the SEC to reverse course and unleash a speculative, volatile, and socially useless financial product on tens of millions of American investors and retirees.[4] The massive and unrelenting fraud and manipulation in the bitcoin market means that approving these products would expose those investors to the very harms that the SEC exists to prevent.

The approval of these spot bitcoin-based ETPs would not only expose investors to a market thoroughly contaminated with fraud and manipulation, it would also enable the crypto industry to claim or imply that their products are now approved by the United States government. The crypto industry will almost certainly flood Americans with marketing propaganda suggesting that the SEC's action legitimized crypto and that retail investors should feel secure in investing in crypto as a result. And if the SEC approves these products, it will also set a dangerous precedent that will increase the difficulty for the SEC to protect the public interest in a variety of other related and unrelated contexts.

Whether its stated reasoning for previously disapproving the proposed rule changes was perfect or not, the SEC's prior decision was the right one, that adhered to the legal standards, and that protected the public interest. The SEC should not now de facto admit that its prior decision was wrong, that it acted arbitrarily and capriciously, that it failed to consider the administrative record, and that it was not in fact protecting the public interest. The SEC also should not overweigh litigation risk; it must continue to follow the law, prioritize making the right decision, fulfill its statutory missions, and maximize the protection of the public.

As is well known, the SEC's mission is investor protection. It is literally why it exists.[5] It must not now open the floodgates for crypto products to be peddled to ordinary retail investors—almost certainly including countless retirement savers urged to "diversify their portfolios." The SEC must not facilitate the financial carnage that will follow if the crypto industry is allowed to repackage, add a veneer of legitimacy to, and widely disseminate a financial product that is little more than a socially worthless gambling chip.

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[3] *See also* Better Markets, Comment Letter re: Ark21Shares Bitcoin ETF, et al. (Aug. 8, 2023), https://bettermarkets.org/wp-content/uploads/2023/08/Better_Markets_Comment_Letter_BitcoinETPs.pdf.

[4] *See, e.g.*, Cheryl Winokur Munk, *The spot bitcoin ETF race could quickly reach your 401(k) retirement plan*, CNBC (Dec. 22, 2023), https://www.cnbc.com/2023/12/22/the-spot-bitcoin-etf-race-could-quickly-reach-your-401k-plan.html.

[5] See, e.g., DIANA B. HENRIQUES, TAMING THE STREET: THE OLD GUARD, THE NEW DEAL, AND FDR'S FIGHT TO REGULATE AMERICAN CAPITALISM (2023), https://www.penguinrandomhouse.com/books/611070/taming-the-street-by-diana-b-henriques/

The Grayscale Decision

The crux of the *Grayscale* decision was that the SEC

> "failed to adequately explain why it approved the listing of two bitcoin futures ETPs but not Grayscale's proposed bitcoin ETP."[6]

That clearly does not mean the Commission's disapproval was wrong on the merits or that it must now approve spot bitcoin ETPs. It just means that the Commission must more clearly explain why it would deny a spot bitcoin ETP while previously approving bitcoin futures ETPs. And that it can certainly do, because spot bitcoin ETPs and bitcoin futures ETPs are not the same thing. The industry itself recognizes that the products are not the same. Spot ETFs "aim to track the price of Bitcoin by holding the actual cryptocurrency," so they are "designed to provide investors with direct exposure to Bitcoin."[7] In contrast, bitcoin futures ETFs "do not hold the actual cryptocurrency" but rather "track the price of Bitcoin through futures contracts, which allow traders to speculate on the future price of an asset without actually owning it."[8]

So "the difference between buying a bitcoin futures ETF and a bitcoin spot ETF" is "like the difference between buying a lottery ticket from the State of New Jersey and buying a lottery ticket from Tony Soprano."[9] Although bitcoin futures ETPs themselves carry risks, the "futures contracts underlying the bitcoin futures ETF are indeed regulated, surveilled, and overseen by registered futures exchanges."[10] But "the underlying bitcoin of any bitcoin spot ETF would not be overseen by any registered entity" and would instead be "wholly dependent upon a dangerous assortment of enigmatic crypto-exchanges, all of which operate with no transparency, no U.S. oversight and no U.S. customer protections of any kind."[11]

In fact, just the opposite. As the SEC itself has repeatedly stated, the crypto industry is largely a "noncompliant" industry that routinely breaks the law by, among other things, offering, selling, dealing, and trading unregistered securities on unregistered exchanges. Thus, not only are the markets full of fraud and manipulation, but the market participants are lawbreakers as well. That is the "assortment of enigmatic crypto-exchanges" overseeing the market. So, contrary to the decision of the court in *Grayscale*, the two products are not fundamentally similar, and the SEC need not approve a spot bitcoin ETP simply because it approved a bitcoin futures ETP.

With this understanding, the issue is whether a spot bitcoin ETP merits approval. And the answer is surely no. As the Grayscale decision recognized, the rules of an exchange must be

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6 *Grayscale*, 82 F.4th at 1252.

7 Bitcoin Spot vs Futures ETFs Explained, Crypto.com (Nov. 29, 2023), https://crypto.com/university/bitcoin-spot-vs-futures-etfs-explained.

8 *Id.*

9 John Reed Stark, *Why the SEC's Rejection of a Bitcoin ETF was Spot-on*, Linkedin (July 20, 2022), https://www.linkedin.com/pulse/why-secs-rejection-bitcoin-etf-spot-on-john-reed-stark/.

10 *Id.*

11 *Id.*

designed to "'prevent fraudulent and manipulative acts and practices'" and "'protect investors and the public interest.'"[12] The potential for fraud in the spot bitcoin market is so great that the rules of an exchange cannot permit the listing and trading of a spot bitcoin ETP and still be consistent with the requirement that the exchange's rules be designed to prevent fraud and manipulation and protect investors and the public interest.

Although the Commission has stated that concerns about fraud and manipulation may be allayed through a comprehensive surveillance-sharing agreement with a regulated market of significant size, there is no such market, as we explain below. But even more fundamentally, spot bitcoin trading is so profoundly susceptible to fraud and manipulation, given its structure, that the concerns cannot be cured by any surveillance-sharing agreement. Specifically, the spot bitcoin markets (1) have a history of artificially inflated trading volumes due to rampant manipulation and wash trading; (2) are highly concentrated; and (3) rely on a select group of individuals and entities to maintain bitcoin's network. These characteristics make it impossible for any proposed rule change to list and trade shares of spot bitcoin ETPs in accordance with the requirements that an exchange's rules be designed to prevent fraud and manipulation and protect investors and the public interest.

<u>History of Bitcoin Market Manipulation and Wash Trading</u>

Long used by unscrupulous traders, wash trading is a form of market manipulation where a trader and/or its affiliates create the appearance of high trading interest and trading volume by placing buy and sell orders in the market without actually in effect taking a position. In securities law, wash trading is strictly prohibited and enforced as securities fraud. However, in crypto markets, it has quickly become a frequent mainstream practice. An in-depth analysis of 29 major crypto exchanges found that, on average, as much as 77.5 percent of the total trading volume on unregulated exchanges was due to wash trading.[13] In fact, wash trading was so common and pervasive that it was referred to as an "industry-wide phenomenon."[14] As for wash trading in bitcoin specifically, experts have suggested that a majority of the trading volume in bitcoin and as much as 95 percent could be due to wash trading.[15]

A recent SEC complaint alleges that affiliates of Binance.US engaged in wash trading on the platform to artificially inflate the trading volume of select cryptocurrencies. The complaint notes that Binance.US senior officials acknowledged not only that wash trading was possible on

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[12] *Grayscale*, 82 F.4th at 1242 (quoting 15 U.S.C. § 78f(b)(5)).

[13] Lin William Cong, Xi Li, Ke Tang, Yang Yang, "Crypto Wash Trading," NAT'L BUREAU OF ECON. RSCH. 4 (December 2022), https://www.nber.org/papers/w30783. Notably, the study makes a distinction between "regulated" and "unregulated" exchanges. The study includes Bitstamp, Coinbase, and Gemini as regulated exchanges and, generally, finds little evidence of wash trading on those exchanges.

[14] *Id.*

[15] *See e.g.* Bitwise Asset Management, Presentation to the SEC (Mar. 19, 2019), srnysearca201901-5164833-183434.pdf (sec.gov); *see also* Javier Paz, More than Half of All Bitcoin Trades Are Fake, FORBES (Aug. 26, 2022), https://www.forbes.com/sites/javierpaz/2022/08/26/more-than-half-of-all-bitcoin-trades-are-fake/?sh=1a9340576681. "A new Forbes analysis of 157 crypto exchanges finds that 51% of the daily bitcoin trading volume being reported is likely bogus."

their platform but also that they did not have any systems in place to monitor such trading.[16] The complaint alleges that in its first hour of operations, 99 percent of the trading on Binance.US in at least one cryptocurrency was due to wash trading and that after the first day wash trading accounted for nearly 70 percent of the trading in at least one cryptocurrency.[17] Recent news reports suggest that the cryptocurrency that was being wash traded was bitcoin.[18] Although a spot bitcoin ETP would have to comply with the rules and regulations governing ETPs, those rules and regulations will not prevent investors in spot bitcoin ETPs from suffering harm due to the fraud and manipulation rampant in the bitcoin market. The value of their investment in the spot bitcoin ETP will depend on the value of bitcoin; despite the form of the investment as an ETP, essentially these investors will be investing in bitcoin.

It is important to remember that investors are not adequately protected from the risk of fraud and manipulation in the bitcoin market. To the extent that market is regulated at all, it is regulated by the Commodity Futures Trading Commission ("CFTC") rather than the SEC, and the CFTC is not able to police that market effectively. The CFTC's entire budget for 2023 was $365 million, and it had just 688 full-time employees. Its enforcement budget is just $67 million with 172 full-time employees, which it needs to police the multi-trillion-dollar derivatives and commodities markets in addition to the bitcoin market. As a result, the rampant fraud and manipulation in the bitcoin market is no less threatening to investors in spot bitcoin ETPs than in bitcoin.

Highly Concentrated Ownership

The bitcoin market has other attributes that pose other serious risks to investors and are inconsistent with rules that must be designed to protect investors and the public interest. Despite the claims of decentralization in bitcoin and cryptocurrencies more generally, a cursory review of the concentration of tokens and governance power in the cryptocurrency markets match or surpass the concentration of money and power in traditional financial markets. In an industry where the number of tokens often equates with the ability to govern the cryptocurrency network, tokens equal power. In particular, the concentration of bitcoin in the hands of a select few individual wallets poses real risk to the network and, in turn, to potential investors in a spot bitcoin ETF.

For example, a study from 2021 found that the top 10,000 bitcoin accounts hold 5 million bitcoins and the top 1,000 bitcoin accounts hold 3 million bitcoins.[19] In other words, the top 1

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16 Complaint at 64, SEC v. Binance Holdings Ltd., 1:23-cv-01599 (U.S.D.C. 2023).

17 Complaint at 66, SEC v. Binance Holdings Ltd., 1:23-cv-01599 (U.S.D.C. 2023).

18 Patricia Kowsmann, *Some Binance.US Crypto Trading Was a Mirage, the SEC Alleges*, WALL S. J. (July 24, 2023), https://www.wsj.com/articles/some-binance-us-crypto-trading-was-a-mirage-the-sec-alleges-55a6e321 (discussing an internal email sent by Binance CEO Changpeng Zhao regarding the almost $70,000 of bitcoin changing hands within the first hour of Binance.US commencing operations when he said, "That was ourself, I think"); *see also* CFTC Orders Coinbase Inc. to Pay $6.5 Million for False, Misleading, or Inaccurate Reporting and Wash Trading, Release Number 8369-21 (Mar. 19, 2021) (discussing findings that a former Coinbase employee engaged in wash trading in Bitcoin), https://www.cftc.gov/PressRoom/PressReleases/8369-21. .

19 Igor Makarov and Antoinette Schoar, "Blockchain Analysis of the Bitcoin Market," NAT'L BUREAU OF ECON. RSCH. 29 (Oct. 2021), https://www.nber.org/system/files/working_papers/w29396/w29396.pdf.

percent of bitcoin holders own 27 percent of the 19 million bitcoin in circulation.[20] The study also found that the top 10 percent of bitcoin miners control 90 percent of bitcoin mining capacity.[21] Not only do a small percentage of miners control a vast majority of the mining capacity, but between 60-80 percent of bitcoin miners are located outside the U.S. in China.[22]

The study concluded that "the Bitcoin ecosystem is still dominated by large and concentrated players…[t]his inherent concentration makes Bitcoin susceptible to systemic risk and also implies that the majority of the gains from further adoption are likely to fall disproportionately to a small set of participants."[23] The concentration in the bitcoin market increases the risk that a few significant players in the market could manipulate the price of bitcoin. So not only does such concentration in bitcoin pose systemic risk and benefit the few, but it raises significant risks to the investing public if a spot bitcoin ETF were able to list and trade on a national securities exchange.

<u>Bitcoin Relies on Few Select Individuals to Maintain Network</u>

Because bitcoin has no centralized governance or employees per se, the network relies on a system of incentives and goodwill to effectively maintain and run the code necessary for the network to exist.

For example, a select group of individuals known as "maintainers" are critical to the functioning of the $500 billion cryptocurrency. In an article in the Wall Street Journal, Paul Kiernan shed light on the five maintainers of the Bitcoin Core program that have the ability to make changes to the software code that helps keep the bitcoin network up-to-date.[24] Like any software program, coders must patch and update bitcoin's source code in order to protect it from cyberattacks and any lag in its usefulness. The article notes how important these five individuals are to the operation of the bitcoin network, stating "[a]t least once, the maintainers secretly patched a bug that bitcoin proponents say could have destroyed the cryptocurrency's value."[25]

This power placed in the hands of such a select few individuals to maintain a $500 billion network raises significant risks. For example, if any one of those five maintainers were to be corrupted, those risks would flow through to investors if the SEC approved a spot bitcoin ETF.

<u>A Rule to List and Trade Shares of Spot Bitcoin ETPs Is Not Designed to Prevent Fraud and Manipulation and Protect Investors and the Public Interest</u>

For these reasons, a rule to list and trade shares of spot bitcoin ETPs cannot satisfy the clear statutory standard because it is not designed to prevent fraud and manipulation and protect

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20 Tor Constantino, *Recent Study Finds Bitcoin Ownership Could Be Too Concentrated*, MOTLEY FOOL (Dec. 28, 2021), https://www.fool.com/the-ascent/cryptocurrency/articles/recent-study-finds-bitcoin-ownership-could-be-too-concentrated/.

21 Makarov and Schoar, supra note 19, at 4.

22 *Id.* at 5.

23 *Id.* at 30.

24 Paul Kiernan, *Bitcoin's Future Depends on Handful of Mysterious Coders*, WALL S. J. (Feb. 16, 2023), https://www.wsj.com/articles/bitcoin-core-maintainers-crypto-7b93804#:~:text=Their%20role%20is%20critical%20to.

25 *Id.*

investors and the public interest. A simple chart showing that the price of bitcoin can lie flat for prolonged periods of time and then suffer from wild fluctuations during other periods of time indicates that a spot bitcoin ETP poses risks to the public that are inconsistent with the obligation to protect investors and the public interest:[26]

So, for 12 of bitcoin's 15 years of existence, there was very little and only sporadic trading. Then, the price of bitcoin rose dramatically at the end of 2020 and closed at a high of almost $59,000 in February 2021, only to crash to $35,000 just a few months later in May 2021. The price of bitcoin then skyrocketed back up to $61,000 a few months later in September 2021, only to crash again to $16,500 in August 2022.

The SEC should not approve rule changes that allow the Exchanges to list and trade spot bitcoin ETPs when "Bitcoin and other cryptocurrencies are today, as a factual matter, not objectively prudent as an investment class."[27] As the above analysis shows, there is "good reason to believe that the digital asset market is riskier than most participants realize, especially for retail

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26 Brian Nibley, Bitcoin Price History: 2009-2023, SoFi (Mar. 1, 2023), https://www.sofi.com/learn/content/bitcoin-price-history/.

27 Edward A. Zelinksy, *Is Bitcoin Prudent? Is Art Diversified? Offering Alternative Investments to 401(k) Participants*, 54 CONN. L. REV. 509, 532-33 (2022).

investors."[28] Retail investors "should not be subject to markets that are at risk of catastrophic failure or are rigged against them thanks to the disproportionate power of certain players."[29]

The CME Bitcoin Futures Market Is Not a Regulated Market of Significant Size

As demonstrated above, the bitcoin market is so thoroughly contaminated with fraud and manipulation, so concentrated in ownership and control, and so vulnerable to catastrophic systemic risks that the proposed ETPs necessarily fail the statutory test: They can neither prevent fraud and manipulation nor serve the interests of investors or the public interest. Moreover, although the Commission has stated that concerns about fraud and manipulation *may* be allayed through a comprehensive surveillance-sharing agreement with a regulated market of significant size, that is not possible here. To the extent this inquiry is even relevant here, with respect to spot bitcoin ETPs, there are ample grounds for the Commission to find that there is no comprehensive surveillance-sharing agreement with a regulated market of significant size that could satisfy the Exchanges' obligation to have rules to prevent fraud and manipulation and protect investors and the public interest. For example, the CME futures bitcoin market is certainly not such a market.

The Commission has defined the terms "significant market" and "market of significant size" to include a market where:

> "(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 the surveilled market."[30]

As to the first prong of the test, and contrary to the claims in the Exchange proposals, the CME futures bitcoin market is not such a market. As discussed above, the spot bitcoin market is deeply concentrated among a few large holders and fraught with manipulative wash trading outside the U.S., which interferes with true price discovery. In this environment, a would-be manipulator would not have to trade on the CME bitcoin futures market to manipulate a spot bitcoin ETF. In fact, with more than 90 percent of all spot bitcoin trading volume occurring on unregulated exchanges outside the U.S., there are ample opportunities to manipulate the price of spot bitcoin—and through it a spot bitcoin ETP—outside the CME futures market. As to the second prong of

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28 Kevin Werbach, *Digital Asset Regulation: Peering into the Past, Peering into the Future*, 64 WM. & MARY L. REV. 1251, 1265 (2023).

29 *Id.* at 1267.

30 *Order Setting Aside 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*, Exchange Act Release No. 837213, 2018 WL 3596768, at *23 (July 26, 2018) (emphasis added).

the test, it is actually *likely* that trading in the spot ETP would dominate, if not dwarf, the impact of the bitcoin futures market on bitcoin prices.[31]

Here too, the court in *Grayscale* erred. It failed to apply these two tests appropriately, instead focusing primarily on postulated price correlations between the bitcoin futures and spot markets. Even assuming the correlations posited by the court were accurate, they are beside the point. The proper focus of the test is on whether a manipulator ***would have to trade*** in the surveilled market to manipulate the spot price and whether trading in the spot market would be the ***predominant influence on prices*** in the surveilled market. Under these legally required criteria, and as with past Commission orders disapproving the listing and trading of spot bitcoin ETPs, the Exchanges cannot establish—as is their burden—that the CME bitcoin futures market is a regulated market of significant size to detect and deter manipulation in a spot bitcoin ETF.

The Surveillance-Sharing Agreement with Coinbase Is Also Insufficient

The Exchanges seek to supplement their proffered surveillance-sharing agreements with the CME bitcoin futures market with yet another surveillance-sharing agreement with Coinbase, Inc. While the Exchanges are correct that a majority of spot bitcoin trading in the U.S. occurs on the Coinbase platform, only a small percentage of overall, global spot bitcoin trading occurs on the platform (perhaps as little as 5 percent).[32] Hence, relying on an exchange that represents such a small fraction of the overall trading of bitcoin for market surveillance of a commodity that has a reputation for being heavily manipulated via wash trading would add very little, if any, value to detecting or deterring manipulation of a spot bitcoin ETP.

Furthermore, Coinbase is not registered with the CFTC or SEC. And it is subject to an ongoing enforcement action by the SEC for knowingly and intentionally breaking the law by operating an unregistered exchange. It would be wholly inappropriate for any national securities exchange to enter into a surveillance-sharing agreement with an entity performing exchange-like functions that is not registered with the SEC or CFTC and that appears to have flouted – and continues to flout – the registration requirements under the securities laws. While it is true that the SEC's case against Coinbase is pending and unresolved, we draw the Commission's attention to the recent decision in the Terraform Labs case finding the tokens at issue there to be unregistered

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31 *See Order Disapproving a Proposed Rule Change, as Modified by Amendment No. 1, to List and Trade Shares of Grayscale Bitcoin Trust under NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares),* Exchange Act Release No. 95180, 2022 WL 2439359, at 40,314 (July 6, 2022) (stating that the exchange did not address "why a spot bitcoin ETP whose assets under management would . . . exceed the value of all open interest in CME bitcoin futures contracts is not likely to be the predominant influence on prices in that market").

32 James Cirrone, *Less than 10% of all bitcoin trading volume happens in the US: CCdata*, BLOCKWORKS (July 5, 2023), https://blockworks.co/news/bitcoin-trading-volume-us. According to CCData, only 9.49 percent of spot bitcoin trading occurs on U.S.-based crypto exchanges. Of this 9.49 percent of spot bitcoin trading on U.S.-based exchanges, Coinbase represents 61 percent of the spot bitcoin trading volume on U.S. exchanges.

securities.[33] We respectfully submit that the court's thorough and well-reasoned determination, while not controlling, is persuasive authority here.

Moreover, Coinbase's platform itself has proven unable to prevent fraud and manipulation. For example, just this last summer, a cryptocurrency developer used Coinbase's platform to launch a meme coin called BALD. Within a day after its launch, the token rose in price by 3,000 percent reaching nearly $85 million in market cap, only to see the original developer pull $25.6 million of liquidity out of the token. Predictably, the price of the token crashed—a classic case of manipulation and fraud known in the cryptocurrency industry as a "rug pull."[34] It would be an indefensible mistake for the Commission to attach any value to the Exchanges' proposed surveillance-sharing agreement with an alleged unregistered securities exchange, particularly one whose products not only fail to detect or deter manipulation but also actually enable fraudsters and manipulators to defraud investors.

Approval of a Spot Bitcoin ETF Would Be a Regulatory Mistake of Historic Proportions

For all these reasons, it would be a profound legal error and a policy travesty for the Commission to approve the Exchanges' proposed rule changes and conclude that rules that allow the listing and trading of spot bitcoin ETPs are designed to prevent fraud and manipulation and protect investors and the public interest. Such an unwarranted decision would be an admission that the Commission was wrong to deny Grayscale's application for a spot bitcoin ETP. But the Commission was not wrong then, and the court did not require that it grant that application or any other future application for a spot bitcoin ETP. It said that the Commission needed to better explain why such an application should be denied. As discussed above, there are ample reasons why denial is clearly warranted and the Commission should provide exactly what the court sought: a better explanation for making the right decision.

The adverse consequences of an approval cannot be overstated:

> "A host of new institutional investors including pension funds and registered investment adviser-based vehicles will flock to Bitcoin assets if US regulators approve the first-ever spot exchange-traded fund for the cryptocurrency."[35]

This will expose countless hardworking Americans to the risks inherent in investing in bitcoin. Those risks have not only been obvious over the last three years, but those risks have materialized repeatedly, resulting in many billions of dollars of losses. The fact that the investment vehicle will

[33] *SEC v. Terraform Labs Pte. Ltd.*, No. 23-cv-1346, __ F. Supp. 3d __, 2023 WL 8944860, at *13-15 (Dec. 28, 2023).

[34] Matt Di Salvo, *BALD Meme Coin on Coinbase Layer-2 Goes to Zero as Dev Pulls Liquidity*, DECYPT (July 31, 2023), https://decrypt.co/150693/following-meme-coin-mania-on-coinbases-base-one-token-appears-to-be-a-rug.

[35] Yuegi Yang, CBOE Digital Sees Bitcoin Spot ETFs Drawing New Institutional Investors, BLOOMBERG (Jan. 2 2024), https://www.bloomberg.com/news/articles/2024-01-02/cboe-digital-sees-bitcoin-spot-etfs-drawing-pension-funds-rias?utm_source=website&utm_medium=share&utm_campaign=email?sref&sref=mQvUqJZj.

be an ETP will not protect these investors – in fact, the supposed protections related to the ETP will be worse than irrelevant because they will probably provide false and misleading comfort to unsuspecting investors who fall for the marketers' claims that the SEC has approved if not endorsed the product. The value of their investment will be subject to the same risks of fraud and manipulation in the bitcoin market as investors who hold bitcoin directly. The SEC should not subject investors to these risks and should instead find that the proposed rule changes would not allow the Exchanges to prevent fraud and manipulation and protect investors and the public interest.

History will harshly judge any contrary outcome – we can think of no precedent where an SEC action would have unleashed such extensive investor harm, directly contrary to its statutory mandate and, indeed, its very reason for existing.

Conclusion

We hope these comments are helpful as the Commission considers this highly consequential matter.

Sincerely,

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