For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.\textsuperscript{16}

Eduardo A. Aleman, Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–83913; File No. SR–CboeBZX–2018–001]

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

August 22, 2018.

I. Introduction

On January 5, 2018, Cboe BZX Exchange, Inc. (“BZX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)\textsuperscript{1} and Rule 19b–4 thereunder,\textsuperscript{2} a proposed rule change to list and trade the shares (“Shares”) of the GraniteShares Bitcoin ETF (“Long Fund”) and the GraniteShares Short Bitcoin ETF (“Short Fund”) (each a “Fund” and, collectively, “Funds”) issued by the GraniteShares ETF Trust (“Trust”)\textsuperscript{3} under BZX Rule 14.11(f)(4).\textsuperscript{4} The proposed rule change was published for comment in the \textit{Federal Register} on January 18, 2018.\textsuperscript{5} The comment period for the Notice of Proposed Rule Change closed on February 8, 2018.

On February 22, 2018, pursuant to Section 19(b)(2) of the Exchange Act,\textsuperscript{6} the Commission designated a longer

period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.\textsuperscript{7} On April 5, 2018, the Commission instituted proceedings under Section 19(b)(2)(B) of the Exchange Act\textsuperscript{8} to determine whether to approve or disapprove the proposed rule change.\textsuperscript{9} The comment period and rebuttal comment period for the Order Instituting Proceedings closed on May 1, 2018, and May 15, 2018, respectively.\textsuperscript{10} Finally, on June 18, 2018, the Commission extended the period for consideration of the proposed rule change to September 15, 2018.\textsuperscript{11} As of August 21, 2018, the Commission had received 15 comments on the proposed rule change.\textsuperscript{12} This order disapproves the proposed rule change. Although the Commission is disapproving this proposed rule change, the Commission emphasizes that its disapproval does not rest on an evaluation of whether bitcoin, or blockchain technology more generally, has utility or value as an innovation or an investment. Rather, the Commission is disapproving this proposed rule change because, as discussed below, the Exchange has not met its burden under the Exchange Act and the Commission’s Rules of Practice to demonstrate that its proposal is consistent with the requirements of the Exchange Act Section 6(b)(5), in particular the requirement that a national securities exchange’s rules be designed to prevent fraudulent and manipulative acts and practices.\textsuperscript{13}

Among other things, the Exchange has offered no record evidence to demonstrate that bitcoin futures markets are “markets of significant size.” That failure is critical because, as explained below, the Exchange has failed to establish that other means to prevent fraudulent and manipulative acts and practices will be sufficient, and therefore surveillance-sharing with a regulated market of significant size related to bitcoin is necessary to satisfy the statutory requirement that the Exchange’s rules be designed to prevent fraudulent and manipulative acts and practices.\textsuperscript{14}

II. Description of the Proposal

The Exchange proposes to list and trade the Shares under BZX Rule 14.11(f)(4), which governs the listing and trading of Trust Issued Receipts on the Exchange.\textsuperscript{15} Each Fund will be a series of the Trust, and the Trust and the Funds will be managed and controlled by GraniteShares Advisors LLC (“Sponsor”). Bank of New York Mellon will serve as administrator, custodian, and transfer agent for the Funds. Foreside Fund Services, LLC will serve as the distributor of the Shares (“Distributor”). The Trust will offer Shares of the Funds for sale through the Distributor in “Creation Units” in transactions with “Authorized Participants” who have entered into agreements with the Distributor.\textsuperscript{16}

According to the Exchange, the Long Fund’s investment objective will be to seek results (before fees and expenses) that, for a single day and over time, correspond to the performance of lead month bitcoin futures contracts listed and traded on the Cboe Futures Exchange, Inc. (“CFE”) (“Benchmark Futures Contracts”). Conversely, the Short Fund’s investment objective will be to seek results (before fees and expenses) that, on a daily basis, correspond to the inverse (−1x) of the daily performance of the Benchmark Futures Contracts for a single day. Each Fund generally intends to invest substantially all of its assets in the Benchmark Futures Contracts and cash and cash equivalents (which would be used to collateralize the Benchmark Futures Contracts), but may invest in other U.S. exchange listed bitcoin futures contracts, as available (together


\textsuperscript{3} The Trust filed a registration statement with the Commission on December 15, 2017. See \textit{Registration Statement on Form S–1}, dated December 15, 2017 (File No. 333–222109) (“Registration Statement”). The Registration Statement “will be effective as of the date of any offer and sale pursuant to the Registration Statement.” Notice, infra note 5, 83 FR at 2705 n.7.

\textsuperscript{4} On August 21, 2018, the Exchange filed Amendment No. 1 to the proposal, and on August 22, 2018, the Exchange filed Amendment No. 2 to the proposal. As discussed below, however, see Section III.E, infra, the Commission views these amendments as untimely. Furthermore, even if these amendments had been timely filed, they would not alter the Commission’s conclusion that the Exchange’s proposal is not consistent with the Exchange Act. See id.


\textsuperscript{10} See id. at 15426.


\textsuperscript{14} See infra notes 31–33 and accompanying text.

\textsuperscript{15} BZX Rule 14.11(f)(4) applies to Trust Issued Receipts that invest in “Financial Instruments.” The term “Financial Instruments,” as defined in BZX Rule 14.11(f)(4)(A)(iv), means any combination of investments, including cash; securities; options on securities and indices; futures contracts; options on futures contracts; forward contracts; equity caps, collars, and floors; and swap agreements.

\textsuperscript{16} See Notice, supra note 5, 83 FR at 2707.
with Benchmark Futures Contracts, collectively, “Bitcoin Futures Contracts”)

The Exchange represents that no more than 10% of the net assets of a Fund in the aggregate invested in Bitcoin Futures Contracts shall consist of Bitcoin Futures Contracts whose principal market is neither a member of the Intermarket Surveillance Group nor a market with which the Exchange does not have a comprehensive surveillance-sharing agreement.

Further, according to the Notice, in the event that position, price, or accountability limits are reached with respect to Bitcoin Futures Contracts, each Fund may invest in U.S. listed swaps on bitcoin or the Benchmark Futures Contracts (“Listed Bitcoin Swaps”). The Notice also states that, in the event that position, price, or accountability limits are reached with respect to Listed Bitcoin Swaps, each Fund may invest in over-the-counter swaps on bitcoin or the Benchmark Futures Contracts (“OTC Bitcoin Swaps,” and together with Listed Bitcoin Swaps, collectively, “Bitcoin Swaps”).

The Exchange asserts that “policy concerns related to an underlying reference asset and its susceptibility to manipulation are mitigated as it relates to bitcoin because the very nature of the bitcoin ecosystem makes manipulation of bitcoin difficult.” According to the Exchange:

The geographically diverse and continuous nature of bitcoin trading makes it difficult and prohibitively costly to manipulate the price of bitcoin and, in many instances, that the bitcoin market is generally less susceptible to manipulation than the equity, fixed income, and commodity futures markets. There are a number of reasons this is the case, including that there is not inside information about revenue, earnings, corporate activities, or sources of supply; it is generally not possible to disseminate false or misleading information about bitcoin in order to manipulate; manipulation of the price on any single venue would require manipulation of the global bitcoin price in order to be effective; a substantial over-the-counter market provides liquidity and shock-absorbing capacity; bitcoin’s 24/7/365 nature provides constant arbitrage opportunities across all trading venues; and it is unlikely that any one actor could obtain a dominant market share.

Further, bitcoin is arguably less susceptible to manipulation than other commodities that underlie ETPs; there may be inside information relating to the supply of the physical commodity such as the discovery of new sources of supply or significant disruptions at mining facilities that supply the commodity that simply are inapplicable as it relates to bitcoin. Further, the Exchange believes that the fragmentation across bitcoin exchanges, the relatively slow speed of transactions, and the capital necessary to maintain a significant presence on each exchange make manipulation of bitcoin prices through continuous trading activity unlikely. Moreover, the linkage between the bitcoin markets and the presence of arbitrageurs in those markets means that the manipulation of the price of bitcoin price on any single venue would require manipulation of the global bitcoin price in order to be effective. Arbitrageurs must have funds distributed across multiple bitcoin exchanges in order to take advantage of temporary price dislocations, thereby making it unlikely that there will be strong concentration of funds on any particular bitcoin exchange. As a result, the potential for manipulation on a particular bitcoin exchange would require overcoming the liquidity supply of such arbitrageurs who are effectively eliminating any cross-market pricing differences. For all of these reasons, bitcoin is not particularly susceptible to manipulation, especially as compared to other approved ETP reference assets.

The Notice also asserts that the susceptibility of the underlying futures contracts to manipulation is mitigated by the “significant liquidity that the Exchange expects to exist in the market for Bitcoin Futures Contracts.” The Notice asserts that the market for bitcoin futures will be “sufficiently liquid to support numerous ETPs shortly after launch,” citing “numerous conversations with market participants, issuers, and discussions with personnel of CFE.”

III. Discussion

A. The Applicable Standard for Review

The Commission must consider whether the Exchange's proposal is consistent with Exchange Act Section 6(b)(5), which requires, in relevant part, that the rules of a national securities exchange be designed “to prevent fraudulent and manipulative acts and practices” and “to protect investors and the public interest.” Under the Commission’s Rules of Practice, the “burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization [‘SRO’] that proposed the rule change.”

The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.

Moreover, “unquestioning reliance” on an SRO’s representations in a proposed rule change is not sufficient to justify Commission approval of a proposed rule change.

B. Preventing Fraudulent and Manipulative Practices

1. Applicable Legal Standard

To approve the Exchange’s proposal to list the Shares, the Commission must be able to find that the proposal is, consistent with Exchange Act Section 6(b)(5), “designed to prevent fraudulent and manipulative acts and practices.” As the Commission recently explained in an order disapproving a listing proposal for the Winklevoss Bitcoin Trust (“Winklevoss Order”), although surveillance-sharing agreements are not the exclusive means by which an exchange-traded product ("ETP") listing exchange can meet its obligations under Exchange Act Section 6(b)(5), such agreements are a widely used means for exchanges that list ETPs to meet their obligations, and the Commission has historically recognized their importance.

The Commission has therefore determined that, if the listing exchange for an ETP fails to establish that other means to prevent fraudulent and manipulative acts and practices will be sufficient, the listing exchange must enter into a surveillance-sharing agreement with a regulated market of significant size because “[s]uch agreements provide a necessary deterrent to manipulation because they facilitate the availability of information needed to fully investigate a manipulation if it were to occur.”
Accordingly, a surveillance-sharing agreement with a regulated market of significant size is required to ensure that, in compliance with the Exchange Act, the proposal is “designed to prevent fraudulent and manipulative acts and practices.” 32 In this context, the Commission has interpreted the terms “significant market” and “market of significant size” to include a market (or group of markets) as to which (a) there is a reasonable likelihood that a person attempting to manipulate the ETP would also have to trade on that market to successfully manipulate the ETP, so that a surveillance-sharing agreement would assist the ETP listing market in detecting and deterring misconduct, and (b) it is unlikely that trading in the ETP would be the predominant influence on prices in that market.33 Thus, a surveillance-sharing agreement must be entered into with a “significant market” to assist in detecting and deterring manipulation of the ETP, because someone attempting to manipulate the ETP is reasonably likely to also engage in trading activity on that “significant market.”  34 Although the Winklevoss Order applied these standards to a commodity-trust ETP based on bitcoin, the Commission believes that these standards are also appropriate for an ETP based on bitcoin futures. When approving the first commodity-futures ETP, the Commission specifically noted that “[i]nformation sharing agreements with primary markets trading index components underlying a derivative product are an important part of a self-regulatory organization’s ability to monitor for trading abuses in derivative products.” 35 And the Commission’s approval orders for commodity-futures ETPs consistently note the ability of an ETP listing exchange to share surveillance information either through surveillance-sharing agreements or through membership by the listing exchange and the relevant futures exchanges in the Intermarket Surveillance Group. 36 While the Commission in those orders did not explicitly undertake an analysis of whether the related futures markets were of “significant size,” the exchanges proposing commodity-futures ETPs on a single reference asset or benchmark generally made representations regarding the trading volume of the other trading venues on which current Index components are traded are members of the ISG”); Securities Exchange Act Release No. 53105 (Jan. 11, 2006), 71 FR 3129, 3136 (Jan. 19, 2006) (SR–Amex–2005–059) (approval order noted that Amex’s “Information Sharing Agreement with the NYMEX and Amex’s Memorandum of Understanding with the LME, along with the Exchange’s participation in the ISG, in which the CBOT creates the basis for the Amex to monitor for fraudulent and manipulative practices in the trading of the Shares”: Securities Exchange Act Release No. 53582 (Mar. 31, 2010), 75 FR 17518 (Apr. 6, 2010) (SR–Amex–2005–127) (approval order noted that Amex’s “comprehensive surveillance sharing agreements with the NYMEX and ICE Futures . . . create the basis for the NYSE to monitor fraudulent and manipulative practices and information, including customer identity information, from ICE [Futures] and CME, which are members of the Intermarket Surveillance Group”); Securities Exchange Act Release No. 66553 (Mar. 9, 2012), 77 FR 15440, 15444 (Mar. 15, 2012) (SR–NYSEArca–2012–04) (approval order noted that NYSEArca “can obtain market surveillance information, including customer identity information, from ICE Futures and CME, which are members of the ISG”); Securities Exchange Act Release No. 62223 (June 20, 2012), 77 FR 38117, 38124 (June 26, 2012) (NYSEAmex–2012–24) (approval order noted that NYSEAmex “can obtain market surveillance information, including customer identity information, with respect to futures contracts traded on exchanges that are members of ISG, including CBOE, CME, and NYSE,” and that “the Fund may invest in oil derivatives traded on markets that are not members of ISG or with which NYSEArca has in place a comprehensive surveillance sharing agreement”) (approval order noted that “FINRA may obtain trading information regarding trading in the Shares and Coal Futures from such markets and other entities that are members of ISG or with which [NYSEArca] has in place a comprehensive surveillance sharing agreement” and that “CME is a member of the ISG”); Securities Exchange Act Release No. R-2390 (Dec. 22, 2017), 82 FR 61625, 61631, 61634 (Dec. 28, 2017) (NYSEArca–2017–107) (approval order noted that NYSEArca “may obtain information regarding the FDIC and NYSEArca has in place a comprehensive surveillance sharing agreement and that they “may invest in oil derivatives traded on markets that are not members of ISG or with which [NYSEArca] has in place a comprehensive surveillance sharing agreement” and that “CME is a member of the ISG”).
underlying futures markets,36 and the

36 See, e.g., Securities Exchange Act Release No. 62213 (June 3, 2010), 75 FR 32828 (June 9, 2010) (SR–NYSEArca–2010–22) (notice of proposed rule change included NYSE Arca’s representations that: (i) front-month futures and open interest in front-month futures was 1,136,103 contracts, and open interest for near month futures was 447,354 contracts; (ii) the corn futures price range was $3.50 per bushel and $2.65 per bushel per contract, and the approximate value of all outstanding contracts was $20.5 billion; (iii) as of March 16, 2010, open interest in corn swaps cleared on CBOT was approximately $38.5 million; and (iv) the position limits for all months is 22,000 corn contracts, and the total value of contracts if position limits were reached would be approximately $403.5 million (based on the $18,317.50 contract price), Securities Exchange Act Release No. 61954 (Apr. 21, 2010), 75 FR 22663, 22664, 22688 (Apr. 22, 2010); Securities Exchange Act Release No. 63610 (Dec. 27, 2010), 76 FR 19919 (Jan. 13, 2011) (SR–NYSEArca–2010–101) (notice of proposed rule change included NYSE Arca’s representations that: (i) corn futures volume on NYMEX for 2009 and 2010 (through May 31, 2010) was 1,392,856 contracts, and the total average daily volume for the two years was 3,588,190 contracts; (ii) position accountability limits were reached would be approximately $28,600,000 million (based on the $4.405 contract price); and (v) as of March 15, 2012, as of March 16, 2010, open interest in natural gas swaps cleared on NYMEX was $14.8 million; and (vi) as of March 15, 2012, open interest for soybean futures contracts traded on CME was $4.99 billion, and USD futures contracts had an average daily trading volume in 2011 of 32,960 contracts; (vii) as of December 30, 2011, open interest in EUR/USD futures contracts traded on ICE Futures was $5.44 billion, and USD futures contracts had an average daily trading volume in 2011 of 40,955 contracts; and (viii) futures contracts based on the U.S. Dollar Index ("USDX") were listed on November 20, 1985, and open interest for USDX futures contracts expired on March 16, 2010).
Commission was in each of those cases dealing with a large futures market that had been trading for a number of years before an exchange proposed an ETP based on those futures. The Commission has considered a proposed ETP based on futures that had only recently begun trading. The Commission specifically addressed whether the futures on which the ETP was based—which were futures on an index of well-established commodity futures—were illiquid or susceptible to manipulation.

Accordingly, the Commission examines below whether the representations by the Exchange, and the comments received from the public, support a finding that the Exchange has entered into a surveillance-sharing agreement with a market of significant size relating to bitcoin, the asset underlying the proposed ETPs, or that alternative means of preventing fraud and manipulation would be sufficient to satisfy the requirement of Exchange Act Section 6(b)(5) that the proposed rule change be designed to prevent fraudulent and manipulative acts and practices.

2. Comments Received

One commenter asserts that data on a week’s activity on the Gemini exchange, which provides a critical input for the CFE bitcoin futures, show substantial quantities of bitcoin are bought and sold all at once. The commenter believes that this behavior does not appear to be the result of natural trading and in the long run would prevent true price discovery.

One commenter states that commencing an ETP without allowing the market to adjust to the cash-settled futures products would be akin to “putting the cart before the horse” and seems to be an attempt to appease institutional investors.

One commenter states that the market for bitcoin derivatives other than bitcoin exchange-traded futures appears to be developing and that financial institutions are reportedly moving toward launching bitcoin-related trading desks and other operations. This commenter believes that the proposed offering of both long and short ETPs raises the possibility that market makers in bitcoin-related derivatives could make two-sided markets if interest in the long and short ETPs is similar in magnitude. The commenter further believes that interest outside of the bitcoin ETPs may be sufficient to motivate market makers to maintain bitcoin derivatives desks. In addition, the commenter suggests that questions about bitcoin derivatives markets can be addressed through market depth analyses, discussions with potential bitcoin derivatives liquidity providers, and analyses of order and trade data across CME and CFE to determine the plausibility of simultaneous liquidity collapses on both bitcoin future markets.

Six commenters assert that there is manipulation in the bitcoin market. One commenter states that it is widely known in the cryptocurrency market.
community that volatility in the bitcoin market is the result of manipulation through the coordinated use of high-frequency trading across multiple exchanges.\(^45\) Another commenter asserts that it is common knowledge that the bitcoin market is being manipulated and asserts that BitConnect, which was recently shut down and had promised risk-free annual returns of up to 120%, is an example of Ponzi and multi-level marketing schemes that are too common. This commenter argues that the Commission should not send the warning signal to bitcoin manipulators—who, the commenter asserts, currently operate with impunity—by approving a bitcoin ETP.\(^46\)

One commenter asserts that, in an unregulated market, a small minority can manipulate the price of bitcoin and other “altcoins” and that bitcoin and other cryptocurrencies are freely manipulated by players who hold a disproportionate amount of cryptocurrencies or access to fiat currencies. This commenter cites data showing that 4.11% of bitcoin addresses own 96.53% of all the bitcoin in bitcoin markets.\(^51\) The commenter believes that the emergence of institutionalized market surveillance on both futures and spot markets is a positive sign for the long-term future of bitcoin markets.\(^51\) The commenter suggests that the Commission, in coordination with the CFTC, self-regulatory organizations, bitcoin futures exchanges, and bitcoin spot market platforms, could gather market surveillance data to conduct an independent analysis of trade and settlement patterns and determine whether potentially manipulative trading practices occur on bitcoin spot and futures markets.\(^52\)

A commenter asserts that bitcoin ETPs should be structured in such a way that the bitcoin directly, this commenter believes that cryptocurrency ETPs that are based on futures or other derivatives would invite manipulation of prices. A bitcoin ETP that holds the underlying cryptocurrency directly, this commenter states, would be simpler, more transparent, and less subject to complex and destabilizing trading strategies.\(^53\)

The Sponsor asserts that the operation of, and risks posed by, an ETP that seeks to track the performance of a bitcoin futures contract, are relatively straightforward and similar to the operation and risks involved with many existing commodity-futures-based ETPs, and that the Commission has not raised concerns about the risk of market manipulation in the underlying commodity markets, even when the risk is disclosed in the offering document for a commodity-futures-based ETP, or when the production of the underlying commodity is dominated by relatively few players operating under a common organization.\(^54\) The Sponsor also asserts that CFE and CME surveil their markets to ensure that they are free from manipulation, other price distortion, or disorderly trading or expiration of futures contracts and that it is not necessary for the Exchange to enter into surveillance-sharing agreements with the underlying bitcoin spot markets.\(^55\) The Sponsor states that investors should only consider the price of the Bitcoin Futures Contracts, rather than the price of bitcoin itself,\(^56\) but also concedes that, to the extent price manipulation is possible in the underlying market and affects the price of the futures contracts, the NAV of the Funds would be affected as well.\(^57\)

One commenter asserts that cryptocurrency directly, this commenter believes that cryptocurrency ETPs that are based on futures or other derivatives would invite manipulation of prices. A bitcoin ETP that holds the underlying cryptocurrency directly, this commenter states, would be simpler, more transparent, and less subject to complex and destabilizing trading strategies.\(^53\)

\(^45\) See Barnwell Letter, supra note 12, at 2.
\(^46\) See Kumar Letter, supra note 12.
\(^47\) See Fitzgerald Letter, supra note 12, at 1–2.
\(^48\) See id. at 2.
\(^49\) See id.

\(^51\) See NERA Letter, supra note 12, at 4–5.
\(^52\) See id. at 6, 8.
\(^53\) See id.
\(^54\) See Granitis Letter, supra note 12, at 1–2.
\(^55\) See id. at 2 & n.2, 6.
\(^56\) See id. at 8.
\(^57\) See id. at 6, 8.
development of the bitcoin futures market.61

3. Analysis

The Exchange asserts that the price of bitcoin is inherently resistant to manipulation,62 offering, in summary fashion, a list of arguments that are exactly the same as arguments that it or commenters already raised with respect to previous proposals for bitcoin-based ETPs.63 The Commission comprehensively addressed each of these arguments in the Winklevoss Order, finding in each case that the Exchange had failed to carry its burden to demonstrate that the argument was correct.64 and finding overall that the Exchange “ha[d] not demonstrated that the structure of the spot market for bitcoin is uniquely resistant to manipulation.”65 Given that the Exchange has merely repeated these arguments, providing no elaboration or support, the Commission would have no basis—other than “unquestioning reliance” on the Exchange’s representations—on which to come to a different conclusion here.66

The Sponsor concedes that manipulation of the underlying bitcoin markets may affect the value of the Shares,67 but argues that the risk of manipulation has been disclosed to investors and that the Commission has not raised similar concerns in connection with previously approved commodity-futures ETPs, even when the risk of manipulation has been disclosed to investors or when the underlying commodity market was controlled by relatively few players.68 But the Commission, as it stated in the Winklevoss Order, is not applying a “cannot be manipulated” standard to ETPs.69 Rather, the Commission has held that—absent a showing that the underlying assets for an ETP are inherently resistant to manipulation, or that other means of surveillance will suffice—a listing exchange must demonstrate that it has entered into a surveillance-sharing agreement with a regulated market of significant size relating to the underlying asset.70

The Exchange asserts that its existing surveillance procedures and its ability to share surveillance information with U.S. futures exchanges are sufficient to meet the requirements of Exchange Act Section 6(b)(5).71 One commenter also asserts that the exchange’s own surveillance procedures, along with market surveillance and oversight by the CFTC, can mitigate manipulation.72

While the Exchange would, pursuant to its listing rules, be able to obtain certain information regarding trading in the Shares and in the underlying bitcoin or any bitcoin derivative through registered market makers,73 this trade information would be limited to the activities of market participants who trade on the Exchange. Furthermore, neither the Exchange’s ability to surveil trading in the Shares nor its ability to share surveillance information with other securities exchanges trading the Shares would give the Exchange insight into the activity and identity of market participants who trade in bitcoin futures contracts or other bitcoin derivatives or who trade in the underlying bitcoin spot markets, where a substantial majority of trading, the Commission concluded in the Winklevoss Order, “occurs on unregulated venues overseas that are relatively new and that, generally, appear to trade only digital assets.”74 Thus, consistent with its determination in the Winklevoss Order,75 and with the Commission’s previous orders approving commodity-futures ETPs, the Commission believes that the Exchange must demonstrate that it has in place a surveillance-sharing agreement with a regulated market of significant size related to bitcoin, because “[s]uch agreements provide a necessary deterrent to manipulation because they facilitate the availability of information needed to fully investigate a manipulation if it were to occur.”77

The Exchange represents that it is able to share surveillance information with CME and CFE, which are bitcoin futures markets regulated by the CFTC, through membership in the Intermarket Surveillance Group. And the Sponsor asserts that CFE and CME surveil their markets to ensure that they are free from manipulation, other price distortion, or disorderly trading,79 and that CFE and CME are “significant markets” based on their structure and volume.80 Nonetheless, the Commission must disapprove the proposal, because the evidence in the record does not support a conclusion that CME’s and CFE’s bitcoin futures markets are markets of significant size.

The Order Instituting Proceedings sought comment on whether the CME and CFE bitcoin futures markets are markets of significant size,81 but the Exchange has not responded to any of the questions in the Order Instituting Proceedings, and the only analysis of
the underlying futures markets the Notice provides is the generic statement that, “based on numerous conversations with market participants, issuers, and discussions with personnel of CFE,” the Exchange “expects that the market for Bitcoin Futures Contracts will be sufficiently liquid to support numerous ETPs shortly after launch.” 82 The Sponsor argues that the daily volume in the Bitcoin Futures Contracts, based on a two-month sample period, exceeds that of the futures contracts underlying a previously approved commodity-futures ETP investing in freight futures, adding that the Bitcoin Futures Contracts trade on an electronic order book, whereas the freight futures trade by voice, and that the trading infrastructure of the CME and CFE makes them significant markets.83 The Sponsor further asserts that, if the Funds hit position limits in the Bitcoin Futures Contracts, although it could impact trading and liquidity in the Shares, the interest in the Shares would support further development of the bitcoin futures market.84 Whether an underlying market is a “market of significant size,” however, does not depend on whether a market operates by electronic or voice trading, and it does not depend solely on trading volume in isolation from the broader context of the underlying market. Moreover, to the extent that isolated trading volume is relevant, the Commission does not believe that a two-month sample is sufficient to establish that a market is of significant size. Instead, as noted above and stated in the Winklevoss Order, the Commission interprets a “significant market” or “market of significant size” to be “a market (or group of markets) as to which (a) there is a reasonable likelihood that a person attempting to manipulate the ETP would also have to trade on that market to successfully manipulate the ETP, so that a surveillance-sharing agreement would assist the ETP listing market in detecting and deterring misconduct, and (b) it is unlikely that trading in the ETP would be the predominant influence on prices in that market.” 85 Neither the Exchange nor the Sponsor has provided an analysis of whether the CME or CFE meets this standard, and the Sponsor’s assertion that the bitcoin futures markets will grow to accommodate demand for the Funds (which are two of nine recently proposed bitcoin futures ETPs), this speculative statement does not provide a basis for the Commission to conclude that CME and CFE are currently markets of significant size.86 Thus, there is no basis in the record on which the Commission can conclude that the bitcoin futures markets are markets of significant size.

Publicly available data show that the median daily notional trading volume, from inception through August 10, 2018, has been 14,185 bitcoins on CME and 5,184 bitcoins on CFE, and that the median daily notional value of open interest on CME and CFE during the same period has been 10,145 bitcoins and 5,601 bitcoins, respectively.88 But while these futures contract figures are readily available, meaningful analysis of the size of the CME or CFE markets relative to the underlying bitcoin spot market is challenging, because reliable data about the spot market, including its overall size, are not publicly available.89 The Commission also notes that in recent testimony CFTC Chairman Giancarlo characterized the volume of the bitcoin futures markets as “quite small.” 90 Additionally, the President


88 Instead, as noted above and stated in the Notice, supra note 5, 83 FR at 2710; see also supra note 23 and accompanying text. The Exchange sought to remove this representation from its proposal in Amendment No. 2. See infra note 128.

89 See supra notes 59–60 and accompanying text.

90 See supra note 61 and accompanying text.

91 See supra note 33 and accompanying text (quoting Winklevoss Order, supra note 30, 83 FR at 37594).
Commission cannot conclude that surveillance-sharing would be available, that the related markets would be regulated, or that the related markets would be of significant size.94

Additionally, while one commenter suggests that the market for bitcoin derivatives other than exchange-traded futures appears to be developing—and that the offering of long and short Bitcoin ETPs “raises the possibility that market makers in Bitcoin derivatives could make two-sided markets if interest in the long and short ETFs is similar in magnitude”95—these speculative statements do not provide a basis for the Commission to conclude that the non-exchange-traded bitcoin derivatives market is now, or may eventually be, of significant size.

The Commission therefore concludes that Exchange has not demonstrated that it has entered into a surveillance-sharing agreement with a regulated market of significant size related to bitcoin, or that, given the current absence of such an agreement, the exchange’s own surveillance procedures described above would, by themselves, be sufficient to satisfy the requirement of Exchange Act Section 6(b)(5) that an exchange’s rules be designed to prevent fraudulent and manipulative acts and practices.96 While CME and CFE are regulated markets for bitcoin derivatives, there is no basis in the record for the Commission to conclude that these markets are of significant size. Additionally, because bitcoin futures have been trading on CME and CFE only since December 2017, the Commission has no basis on which to predict how these markets may grow or develop over time, or whether or when they may reach significant size.

Although the Exchange has not demonstrated that a regulated bitcoin futures market of significant size currently exists, the Commission is not suggesting that the development of such a market would automatically require approval of a proposed rule change seeking to list and trade shares of an ETP holding bitcoins as an asset. The Commission would need to analyze the facts and circumstances of any particular proposal and examine whether any unique features of a bitcoin futures market would warrant further analysis before approval.

C. Protecting Investors and the Public Interest

1. Comments Received

One commenter believes that, while the Commission should deny the proposed ETPs, it should regulate this environment to stop individual consumers from coming to financial harm.97

One commenter suggests that the Commission could address some of its concerns about the proposed ETPs by working with self-regulatory organizations, and in particular FINRA, to create bitcoin and cryptocurrency-related asset suitability requirements. In addition, this commenter suggests that targeted disclosure requirements could make investors aware of volatility, discourage retail investors from investing more than a small portion of their portfolio in cryptocurrency-related assets, and present historical scenarios to retail investors to demonstrate how an instrument such as a particular bitcoin ETP would have performed over time. This commenter believes that suitability requirements are less prescriptive than an effective ban on a class of product and that they could balance the Commission’s interest in protecting retail investors against its interest in allowing cryptocurrency-related asset markets to continue to develop in regulated markets where the Commission can observe their performance closely.98

Several commenters assert that the Commission should deny the proposed ETPs to help protect the public from exposure to financial risk from an unregulated market.99 One commenter asserts that, while the risk posed by the cash-settled futures products is mostly contained, a bitcoin ETP would expose the public to significant financial risk due to a highly volatile, unregulated, and manipulated market in bitcoin as well as cryptocurrencies in general.100 Several commenters further believe that before the Commission approves a bitcoin ETP, there should be a proper legal and regulatory framework put in place by a suitable governmental body to prevent manipulation and protect the public.101

2. Analysis

The Exchange asserts that approval of the proposal would enhance competition among market participants, to the benefit of investors and that it would protect investors by permitting them to seek exposure to bitcoin through efficient and transparent ETPs.102 The Exchange also states that the Funds would enhance the security afforded to investors as compared to a direct investment in bitcoin.103 Other commenters suggest that the Commission should either seek to regulate the underlying bitcoin markets,104 or should seek to protect investors through disclosure requirements or suitability standards, rather than disapproving a bitcoin-ETP proposal.105 Several other commenters, however, assert that approval of a bitcoin-based ETP would expose investors to risks from unregulated bitcoin markets.106

The Commission acknowledges that, compared to trading in unregulated bitcoin spot markets, trading a bitcoin-based ETP on a national securities exchange may provide some additional protection to investors, but the Commission must consider this potential benefit in the broader context of whether the proposal meets each of the applicable requirements of the Exchange Act. Pursuant to Section 19(b)(2) of the Exchange Act, the Commission must disapprove a proposed rule change filed by a national securities exchange if it does not find that the proposed rule change is consistent with the applicable requirements of the Exchange Act—including the requirement under Section 6(b)(5) that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices.

Thus, even if a proposed rule change would provide certain benefits to investors and the markets, the proposed rule change may still fail to meet other requirements under the Exchange Act. For the reasons discussed above, the Exchange has not met its burden of demonstrating an adequate basis in the record for the Commission to find that the proposal is consistent with the Exchange Act Section 6(b)(5), and, accordingly, the Commission must disapprove the proposal.

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94 As discussed below, see Section III.E, infra the exchange has filed two untimely amendments to the proposal, each of which would have limited the Funds’ investments to the Bitcoin Futures Contracts. Even if these amendments had been timely, however, the Commission would still determine that the proposal was not consistent with the Exchange Act. See id.

95 See supra notes 42–43 and accompanying text.


98 See supra notes 99–101 and accompanying text.

99 See supra note 12, at 1.

100 See supra note 12, at 1, 2; Kumar Letter, supra note 12; Malkin Letter, supra note 12, at 2.

101 See Desai Letter, supra note 12, at 1.

102 See Notice, supra note 5, 83 FR at 2710–11.

103 See id. at 2710.

104 See supra note 97 and accompanying text.

105 See supra note 98 and accompanying text.

106 See supra notes 99–101 and accompanying text.
D. Other Comments

Comment letters also addressed the following topics:

- The desire of investors to gain access to bitcoin through an ETP; \textsuperscript{107}
- Investor understanding about bitcoin; \textsuperscript{108}
- The valuation of bitcoin and price differentials across bitcoin trading venues; \textsuperscript{109}
- The intrinsic value of bitcoin; \textsuperscript{110}
- The reliability of bitcoin as a store of value; \textsuperscript{111}
- The volatility of bitcoin prices; \textsuperscript{112}
- The regulation of bitcoin spot markets; \textsuperscript{113}
- The operation and valuation of the proposed ETPs; \textsuperscript{114}
- Arbitrage between the price of the bitcoin and the underlying portfolio instruments; \textsuperscript{115}
- The ability of the Funds to meet redemption orders; \textsuperscript{116}
- The custody of the assets of the Funds; \textsuperscript{117}
- The effect on the Funds of a fork in the bitcoin blockchain; \textsuperscript{118}
- The potential impact of Commission approval of the proposed ETP on the price of bitcoin and on the U.S. economy; \textsuperscript{119}
- The leadership role that the United States might play in the cryptocurrency space if the Commission were to approve the proposed ETP; \textsuperscript{120}
- The utility of a bitcoin ETP as a global tool for wealth distribution; \textsuperscript{121}
- And the legitimacy that Commission approval of the proposed ETP might confer upon bitcoin as a digital asset.\textsuperscript{122}

Ultimately, however, additional discussion of these tangential topics is unnecessary, as they do not bear on the basis for the Commission’s decision to disapprove the proposal.

E. The Exchange’s Untimely Amendments to the Proposal

As noted above, the deadline for rebuttal comments in response to the Order Instituting Proceedings was May 15, 2018.\textsuperscript{123} On August 21, 2018, however, the Exchange filed Amendment No. 1 with the Commission, stating that the amendment “amends and replaces in its entirety the proposal as originally submitted on January 5, 2018.” Then, on August 22, 2018, the Exchange filed Amendment No. 2 with the Commission, stating that the amendment “amends and replaces in its entirety Amendment No. 1 as submitted on August 21, 2018, which amended and replaced in its entirety the proposal as originally submitted on January 5, 2018.” Because these amendments were filed months after the deadline for comments on the proposed rule change, the Commission deems Amendment No. 1 and Amendment No. 2 to have been untimely filed.

Even if these amendments had been timely filed, however, the Commission would still conclude that the Exchange had not met its burden to demonstrate that its proposal is consistent with Exchange Act Section 6(b)(5). The change that the amendments made to the proposal was to limit the investments of the Funds to Bitcoin Futures Contracts, which trade on CFE and CME, eliminating the Funds’ ability to invest in listed or unlisted swaps on bitcoin or on the Benchmark Futures Contracts.\textsuperscript{124} Although CFE and CME are “regulated markets,” the record, as discussed above, does not provide a basis for the Commission to conclude that CFE and CME are regulated markets “of significant size” in Bitcoin Futures Contracts.\textsuperscript{125} Therefore, even if the Exchange’s amendments were timely filed, the Commission would be unable to find, based on the record, that the Exchange had entered into a surveillance-sharing agreement with a regulated market of significant size related to bitcoin.\textsuperscript{126}

SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; Cboe BZX Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Certain Representations Relating to the Listing and Trading of Shares of the Innovator S&P 500 Buffer ETDs

August 22, 2018

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),\textsuperscript{1} and Rule 19b–4 thereunder,\textsuperscript{2} notice is hereby given that on August 16, 2018, Cboe BZX Exchange, Inc. (the “Exchange” or “BZX”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II.