SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-83904; File No. SR-NYSEArca-2017-139)

August 22, 2018

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Disapproving a Proposed Rule Change to List and Trade the Shares of the ProShares Bitcoin ETF and the ProShares Short Bitcoin ETF

I. INTRODUCTION

On December 4, 2017, NYSE Arca, Inc. ("NYSE Arca" 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")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to list and trade the shares ("Shares") of the ProShares Bitcoin ETF and the ProShares Short Bitcoin ETF (each a "Fund" and, collectively, the "Funds") issued by the ProShares Trust II ("Trust") under NYSE Arca Rule 8.200-E, Commentary .02. The proposed rule change was published for comment in the Federal Register on December 26, 2017.[3] The comment period for the Notice of Proposed Rule Change closed on January 16, 2018.

On January 30, 2018, pursuant to Section 19(b)(2) of the Exchange Act,[4] 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.[5] On March 23, 2018, the Commission instituted proceedings under Section 19(b)(2)(B) of the Exchange Act[6] to determine whether to approve or disapprove the

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 82350 (Dec. 19, 2017), 82 FR 61100 (Dec. 26, 2017) ("Notice").

4 15 U.S.C. 78s(b)(2).

5 See Securities Exchange Act Release No. 82602 (Jan. 30, 2018), 83 FR 4941 (Feb. 2, 2018).

6 15 U.S.C. 78s(b)(2)(B).

proposed rule change.[7] The comment period and rebuttal comment period for the Order Instituting Proceedings closed on April 19, 2018, and May 3, 2018, respectively. Finally, on June 15, 2018, the Commission extended the period for consideration of the proposed rule change to August 23, 2018.[8] As of August 21, 2018, the Commission had received 13 comments on the proposed rule change.[9]

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.[10] 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

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7 See Securities Exchange Act Release No. 82939 (Mar. 23, 2018), 83 FR 13537 (Mar. 29, 2018) ("Order Instituting Proceedings").

8 See Securities Exchange Act Release No. 83452 (June 15, 2018), 83 FR 28894 (June 21, 2018).

9 See Letters from Abe Kohen, AK Financial Engineering Consultants, LLC (Dec. 27, 2017) ("Kohen Letter"); Anita Desai (Apr. 6, 2018) ("Desai Letter"); Ed Kaleda (Apr. 6, 2018) ("Kaleda Letter"); Scott Moberg (Apr. 6, 2018) ("Moberg Letter"); Adam Malkin (Apr. 8, 2018) ("Malkin Letter"); Gisan Mohammed (Apr. 11, 2018) ("Mohammed Letter"); Shravan Kumar (Apr. 11, 2018) ("Kumar Letter"); Louise Fitzgerald (Apr. 19, 2018) ("Fitzgerald Letter"); Joshua Rousseau (Apr. 30, 2018) ("Rousseau Letter"); Thomas W. Fink (May 3, 2018) ("Fink Letter"); Sharon Brown-Hruska, Managing Director, and Trevor Wagener, Consultant, NERA Economic Consulting (May 18, 2018) ("NERA Letter"); Sami Santos (Aug. 9, 2018) ("Santos Letter"); and Sam M. Ahn (Aug. 16, 2018) ("Ahn Letter"). All comments on the proposed rule change are available on the Commission's website at: https://www.sec.gov/comments/sr-nysearca-2017-139/nysearca2017139.htm.

10 See 15 U.S.C. 78f(b)(5).

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.[11]

II. DESCRIPTION OF THE PROPOSAL

The Exchange proposes to list and trade the Shares under NYSE Arca Rule 8.200-E, Commentary .02, which governs the listing and trading of Trust Issued Receipts on the Exchange.[12] Each Fund will be a series of the Trust, and the Trust and the Funds will be managed and controlled by ProShare Capital Management LLC ("Sponsor"). Brown Brothers Harriman & Co. will be the custodian and administrator for the Trust. SEI Investments Distribution Co. 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."[13]

According to the Notice, the ProShares Bitcoin ETF's investment objective will be to seek results (before fees and expenses) that, both for a single day and over time, correspond to the performance of lead-month bitcoin futures contracts[14] listed and traded on either the Cboe Futures Exchange ("CFE") or the Chicago Mercantile Exchange ("CME") ("Benchmark Futures Contract"). This Fund generally intends to invest substantially all of its assets in the Benchmark

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11 See infra notes 29–31 and accompanying text.

12 See NYSE Arca Rule 8.200-E, Commentary .02. NYSE Arca Rule 8.200-E permits the listing and trading of "Trust Issued Receipts," defined as a security (1) that is issued by a trust which holds specific securities deposited with the trust; (2) that, when aggregated in some specified minimum number, may be surrendered to the trust by the beneficial owner to receive the securities; and (3) that pay beneficial owners dividends and other distributions on the deposited securities, if any are declared and paid to the trustee by an issuer of the deposited securities. Commentary .02 applies to Trust Issued Receipts that invest in 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.

13 See Notice, supra note 3, 82 FR at 61101.

14 According to the Exchange, lead-month futures contracts are the monthly contracts with the earliest expiration date. See Notice, supra note 3, 82 FR at 61101, n.6.

Futures Contracts, but may invest in other U.S. exchange-listed bitcoin futures contracts, if available (together with Benchmark Futures Contracts, collectively, "Bitcoin Futures Contracts").[15]

According to the Notice, the ProShares Short Bitcoin ETF's investment objective will be to seek results, for a single day, that correspond (before fees and expenses) to the inverse of the daily performance of the Benchmark Futures Contract. This Fund generally intends to invest substantially all of its assets through short positions in Benchmark Futures Contracts, but may invest through short positions in Bitcoin Futures Contracts, if available.[16]

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.[17] 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 listed options on Bitcoin Futures Contracts (should such listed options become available) and OTC swap agreements referencing Bitcoin Futures Contracts (collectively, "Financial Instruments").[18] The Notice also states:

> Bitcoin Futures Contracts are a new type of futures contract to be traded on the CFE and CME or other U.S. exchanges (if available). Unlike the established futures markets for traditional physical commodities, the market for Bitcoin Futures Contracts is in the development stage and has very limited trading and operational history. As such, the liquidity of the market for Bitcoin Futures Contracts will depend on, among other things, the supply and demand for Bitcoin Futures Contracts, the adoption of bitcoin and the commercial and speculative interest in the market for Bitcoin Futures Contracts and the potential ability to

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15 See Notice, supra note 3, 82 FR at 61101.

16 See id.

17 See id. at 61105.

18 See id. at 61102.

> hedge against the price of bitcoin with exchange-traded Bitcoin Futures Contracts.[19]

The Exchange represents that trading in the Shares of each Fund will be subject to the existing trading surveillances administered by the Exchange, as well as cross-market surveillances administered by FINRA on behalf of the Exchange, which are designed to detect violations of Exchange rules and applicable federal securities laws.[20] The Exchange asserts that these procedures are adequate to properly monitor Exchange trading of the Shares in all trading sessions and to deter and detect violations of Exchange rules and federal securities laws applicable to trading on the Exchange.[21]

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."[22] 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."[23]

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

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19 Id. at 61103.

20 See id. at 61105.

21 See id.

22 15 U.S.C. 78f(b)(5).

23 Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

and specific to support an affirmative Commission finding,[24] 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.[25] 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.[26]

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."[27] 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.[28]

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

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24 See id.

25 See id.

26 See Susquehanna Int'l Group, LLP v. Securities and Exchange Commission, 866 F.3d 442, 447 (D.C. Cir. 2017).

27 15 U.S.C. 78f(b)(5).

28 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, Securities Exchange Act Release No. 83723 (July 26, 2018), 83 FR 37579, 37580 (Aug. 1, 2018) (SR-BatsBZX-2016-30).

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."[29] 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."[30] 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.[31] 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."

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

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[29] Id. (citing Amendment to Rule Filing Requirements for Self-Regulatory Organizations Regarding New Derivative Securities Products, Securities Exchange Act Release No. 40761 (Dec. 8, 1998) 63 FR 70952, 70954, 70959 (Dec. 22, 1998) (File No. S7-13-98)).

[30] 15 U.S.C. 78f(b)(5).

[31] See Winklevoss Order, supra note 28, 83 FR at 37594. This definition is illustrative and not exclusive. There could be other types of "significant markets" and "markets of significant size," but this definition is an example that will provide guidance to market participants. See id.

components underlying a derivative product are an important part of a self-regulatory organization's ability to monitor for trading abuses in derivative products."[32] 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.[33] While the Commission in those orders did not explicitly

[32] Securities Exchange Act Release No. 53105 (Jan. 11, 2006), 71 FR 3129, 3136 (Jan. 19, 2006) (SR-Amex-2005-059). Additionally, the Winklevoss Order discusses the broader history and importance of surveillance-sharing agreements relating to derivative securities products, quoting Commission statements dating from 1990 on. See Winklevoss Order, supra note 28, 83 FR at 37592–94.

[33] See, e.g., 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 the CBOT and [Amex's] Memorandum of Understanding with the LME, along with the Exchange's participation in the ISG, in which the CBOT participates … create 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, 2006), 71 FR 17510, 17518 (Apr. 6, 2006) (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 Amex to monitor for fraudulent and manipulative practices in the trading of the Units" and that "[s]hould the USOF invest in oil derivatives traded on markets such as the Singapore Oil Market, the Exchange represents that it will file a proposed rule change pursuant to Section 19(b) of the [Exchange] Act, seeking Commission approval of [Amex's] surveillance agreement with such market"); Securities Exchange Act Release No. 54013 (June 16, 2006), 71 FR 36372, 36378–79 (June 26, 2006) (NYSE-2006-17) (approval order noted that NYSE's "comprehensive surveillance sharing agreements with the NYMEX, the Kansas City Board of Trade, ICE Futures, and the LME … create the basis for the NYSE to monitor for fraudulent and manipulative trading practices" and that "all of the other trading venues on which current Index components and CERFs are traded are members of the ISG"); Securities Exchange Act Release No. 54450 (Sept. 14, 2006), 71 FR 55230, 55236 (Sept. 21, 2006) (SR-Amex-2006-44) (approval order noted that "CME, where the futures contract for each of the current Index components is traded, is a member of the ISG" and that in the event of new fund investments in "foreign currency futures contracts traded on futures exchanges other than CME, [Amex] must have a CSSA with that futures exchange or the futures exchange must be an ISG member"); Securities Exchange Act Release No. 55029 (Dec. 29, 2006), 72 FR 806, 809–10 (Jan. 8, 2007) (SR-Amex-2006-76) (approval order noted that Amex's "Comprehensive Surveillance Sharing Agreement with the ICE Futures, LME, and NYMEX, … and membership in the Intermarket Surveillance Group ('ISG') creates the basis for the Amex to monitor fraudulent and manipulative practices in the trading of the Shares"); Securities Exchange Act Release No. 56880 (Dec. 3, 2007), 72 FR 69259, 69261 (Dec. 7, 2007) (SR-Amex-2006-96) (approval order noted that Amex has "information sharing agreements with the InterContinental Exchange, the Chicago Mercantile Exchange, and the New York Mercantile Exchange and may obtain market surveillance information from other exchanges, including the Chicago Board of Trade, London Metals Exchange, and the New York Board of Trade through the Intermarket Surveillance Group"); Securities Exchange Act Release No. 55632 (Apr. 13, 2007), 72 FR 19987, 19988 (Apr. 20, 2007) (SR-Amex-2006-112) (approval order noted that Amex "currently has in place an Information Sharing Agreement with the NYMEX and ICE Futures" and that if "USNG invests in Natural Gas Interests traded on other exchanges, the Amex represented that it will seek to enter into Information Sharing arrangements with those particular exchanges"); Securities Exchange Act Release No. 57456 (Mar. 7, 2008), 73 FR 13599, 13601 (Mar. 13, 2008) (NYSEArca-2007-91) (approval order noted that NYSEArca "can obtain market surveillance information, including customer identity information, with respect to transactions occurring
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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 underlying futures markets,[34]

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on the NYM, the Kansas City Board of Trade, ICE, and the LME, pursuant to its comprehensive information sharing agreements with each of those exchanges" and that "[a]ll of the other trading venues on which current Index components are traded are members of the ISG"); Securities Exchange Act Release No. 57838 (May 20, 2008), 73 FR 30649, 30652, (May 28, 2008) (SR-NYSEArca-2008-09) (approval order noted that NYSEArca "may obtain information via the ISG from other exchanges who are members or affiliate members of the ISG," that NYSEArca "has an information sharing agreement in place with ICE Futures," and that NYSEArca will file a proposed rule change "if the Fund invests in EUAs … that constitute more than 10% of the weight of the Fund where the principal trading market for such component is not a member or affiliate member of the ISG or where the Exchange does not have a comprehensive surveillance sharing agreement with such market"); Securities Exchange Act Release No. 63635 (Jan. 3, 2011), 76 FR 1489, 1491 (Jan. 10, 2011) (NYSEArca-2010-103) (approval order noted that "with respect to Fund components traded on exchanges, not more than 10% of the weight of such components in the aggregate will consist of components whose principal trading market is not a member of the Intermarket Surveillance Group or is a market with which [NYSEArca] does not have a comprehensive surveillance sharing agreement"); 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 Intermarket Surveillance Group"); Securities Exchange Act Release No. 67223 (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 transactions occurring on exchanges that are members of ISG, including CME, CBOT, COMEX, NYMEX … and ICE Futures US," that NYSEAmex "currently has in place a comprehensive surveillance sharing agreement with each of CME, NYMEX, ICE Futures Europe, and KCBOT," and that "while the Fund may invest in futures contracts or options on futures contracts which trade on markets that are not members of ISG or with which [NYSEAmex] does not have in place a comprehensive surveillance sharing agreement, such instruments will never represent more than 10% of the Fund's holdings"); Securities Exchange Act Release No. 73561 (Nov. 7, 2014), 79 FR 68329, 68330 (Nov. 14, 2014) (NYSEArca-2014-102) (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. 82390 (Dec. 22, 2017), 82 FR 61625, 61631, 61634 (Dec. 28, 2017) (NYSEArca-2017-107) (approval order noted that NYSEArca "may obtain information regarding trading in the Shares and Freight Futures from markets and other entities that are members of ISG or with which [NYSEArca] has in place a CSSA" and that "not more than 10% of the net assets of the Fund in the aggregate invested in Freight Futures or options on Freight Futures shall consist of derivatives whose principal market is not a member of the ISG or is a market with which [NYSEArca] does not have a CSSA").

34 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) corn futures volume on Chicago Board of Trade ("CBOT") for 2008 and 2009 (through November 30, 2009) was 59,934,739 contracts and 47,754,866 contracts, respectively, and as of March 16, 2010, CBOT open interest for corn futures was 1,118,103 contracts, and open interest for near month futures was 447,554 contracts; (ii) the corn futures contract price was $18,337.50 ($3.6675 per bushel and 5,000 bushels 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 2,100 contracts, with an approximate value of $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 $18,337.50 contract price), Securities

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Exchange Act Release No. 61954 (Apr. 21, 2010), 75 FR 22663, 22664 n.10 (Apr. 29, 2010)); Securities Exchange Act Release No. 63610 (Dec. 27, 2010), 76 FR 199 (Jan. 3, 2011) (SR-NYSEArca-2010-101) (notice of proposed rule change included NYSE Arca's representations that: (i) as of June 14, 2010, there was VIX futures contracts open interest on CFE of 88,366 contracts, with a contract price of $25.55 and value of open interest of $2,257,751,300; (ii) total CFE trading volume in 2009 in VIX futures contracts was 1,143,612 contracts, with average daily volume of 4,538 contracts; and (iii) total volume year-to-date (through May 31, 2010) was 1,399,709 contracts, with average daily volume of 13,458 contracts, Securities Exchange Act Release No. 63317 (Nov. 16, 2010), 75 FR 71158, 71159 n.9 (Nov. 22, 2010)); Securities Exchange Act Release No. 63753 (Jan. 21, 2011), 76 FR 4963 (Jan. 27, 2011) (SR-NYSEArca-2010-110) (notice of proposed rule change included NYSE Arca's representations that: (i) natural gas futures volume on New York Mercantile Exchange ("NYMEX") for 2009 and 2010 (through October 29, 2010) was 47,864,639 contracts and 52,490,180 contracts, respectively; (ii) as of October 29, 2010, NYMEX open interest for natural gas futures was 794,741 contracts, and open interest for near month futures was 47,313 contracts; (iii) the contract price was $40,380 ($4.038 per MMBtu and 10,000 MMBtu per contract), and the approximate value of all outstanding contracts was $32.1 billion; (iv) the position limits for all months is 12,000 natural gas contracts and the total value of contracts if position limits were reached would be approximately $484.56 million (based on the $40,380 contract price); and (v) as of October 29, 2010, open interest in natural gas swaps cleared on NYMEX was approximately 2,618,092 contracts, with an approximate value of $26.4 billion ($4.038 per MMBtu and 2,500 MMBtu per contract), Securities Exchange Act Release No. 63493 (Dec. 9, 2010), 75 FR 78290, 78291 n.11 (Dec. 15, 2010)); Securities Exchange Act Release No. 63869 (Feb. 8, 2011), 76 FR 8799 (Feb. 15, 2011) (SR-NYSEArca-2010-119) (notice of proposed rule change included NYSE Arca's representations that: (i) WTI crude oil futures volume on NYMEX for 2009 and 2010 (through November 30, 2010) was 137,352,118 contracts and 156,155,620 contracts, respectively; (ii) as of November 30, 2010, NYMEX open interest for WTI crude oil was 1,342,325 contracts, and open interest for near month futures was 323,184 contracts; (iii) the position limits for all months is 20,000 WTI crude oil contracts and the total value of contracts if position limits were reached would be approximately $1.68 billion (based on the $84.11 contract price); and (iv) the contract price was $84,110 ($84.11 USD per barrel and 1,000 barrels per contract), and the approximate value of all outstanding contracts was $112.9 billion, Securities Exchange Act Release No. 63625 (Dec. 30, 2010), 76 FR 807, 808 n.11 (Jan. 6, 2011)); Securities Exchange Act Release No. 65134 (Aug. 15, 2011), 76 FR 52034 (Aug. 19, 2011) (SR-NYSEArca-2011-23) (notice of proposed rule change included NYSE Arca's representations that: (i) as of January 31, 2011, there was VIX futures contracts open interest on CFE of 163,396 contracts with a value of open interest of $3,461,984,900; (ii) total CFE trading volume in 2010 in VIX futures contracts was 4,402,616 contracts, with average daily volume of 17,741 contracts; and (iii) total volume year-to-date (through January 31, 2011) was 779,493 contracts, with average daily volume of 38,975 contracts, Securities Exchange Act Release No. 64470 (May 11, 2011), 76 FR 28493, 28494 n.12 (May 17, 2011)); Securities Exchange Act Release No. 65136 (Aug. 15, 2011), 76 FR 52037 (Aug. 19, 2011) (SR-NYSEArca-2011-24) (notice of proposed rule change included NYSE Arca's representations that: (i) natural gas futures volume on NYMEX for 2009 and 2010 (through December 31, 2010) was 47,864,639 contracts and 64,350,673 contracts, respectively; (ii) as of December 31, 2010, NYMEX open interest for all natural gas futures was 772,104 contracts, and the approximate value of all outstanding contracts was $35,664,257,310 billion [sic]; (iii) open interest as of December 31, 2010 for the near month contract was 166,757 contracts and the near month contract value was $7,345,645,850 ($4.405 per MMBtu and 10,000 MMBtu per contract); (iv) the position accountability limits for all months is 12,000 natural gas contracts and the total value of contracts if position accountability limits were reached would be approximately $528,600,000 million (based on the $4.405 contract price); and (v) as of December 31, 2010, open interest in natural gas swaps cleared on NYMEX was approximately 1,493,013 contracts, with an approximate value of $16,463,384,003 ($4.411 per MMBtu and 2,500 MMBtu per contract), Securities Exchange Act Release No. 64464 (May 11, 2011), 76 FR 28483, 28484 n.11 (May 17, 2011)); Securities Exchange Act Release No. 65344 (Sept. 15, 2011), 76 FR 58549 (Sept. 21, 2011) (SR-NYSEArca-2011-48) (notice of proposed rule change included NYSE Arca's representations that: (i) wheat futures volume on CBOT for 2010 and 2011 (through April 29, 2011) was 23,058,783 contracts and 8,860,135 contracts, respectively; (ii) as of April 29, 2011, open interest for wheat futures was 456,851 contracts; (iii) the wheat contract price was $40,062.50 (801.25 cents per bushel and 5,000 bushels per

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contract), and the approximate value of all outstanding contracts was $18.3 billion; (iv) the position limits for all months was 6,500 wheat contracts and the total value of contracts if position limits were reached would be approximately $260.4 million (based on the $40,062.50 contract price); (v) soybean futures volume on CBOT for 2010 and 2011 (through April 29, 2011) was 36,962,868 contracts and 16,197,385 contracts, respectively; (vi) as of April 29, 2011, open interest for soybean futures was 572,959 contracts; (vii) the soybean contract price was $69,700.00 (1394 cents per bushel and 5,000 bushels per contract), and the approximate value of all outstanding contracts was $39.9 billion; (viii) the position limits for all months is 6,500 soybean contracts and the total value of contracts if position limits were reached would be approximately $453 million (based on the $69,700.00 contract price); (ix) sugar futures volume on ICE Futures for 2010 and 2011 (through April 29, 2011) was 27,848,391 contracts and 9,045,069 contracts, respectively; (x) as of April 29, 2011, open interest for sugar futures was 570,948 contracts; (xi) the sugar contract price was $24,920.00 (22.25 cents per pound and 112,000 pounds per contract), and the approximate value of all outstanding contracts was $14.2 billion; and (xii) the position limits for all months is 15,000 sugar contracts and the total value of contracts if position limits were reached would be approximately $373.8 million (based on the $24,920.00 contract price), Securities Exchange Act Release No. 64967 (July 26, 2011), 76 FR 45885, 45886 n.10, 45888 n.20, 45890 n.24 (Aug. 1, 2011)); Securities Exchange Act Release No. 66553 (Mar. 9, 2012), 77 FR 15440 (Mar. 15, 2012) (SR-NYSEArca-2012-04) (notice of proposed rule change included NYSE Arca's representations that: (i) as of December 30, 2011, open interest in AUD/USD futures contracts traded on CME was $11.56 billion, and AUD/USD futures contracts had an average daily trading volume in 2011 of 123,006 contracts; (ii) as of December 30, 2011, open interest in CAD/USD futures contracts traded on CME was $11.66 billion, and CAD/USD futures contracts had an average daily trading volume in 2011 of 89,667 contracts; (iii) as of December 30, 2011, open interest in CHF/USD futures contracts traded on CME was $4.99 billion, and CHF/USD futures contracts had an average daily trading volume in 2011 of 40,955 contracts; (iv) futures contracts based on the U.S. Dollar Index ("USDX") were listed on November 20, 1985, and options on the USDX futures contracts began trading on September 3, 1986; (v) as of December 30, 2011, open interest in USDX futures contracts traded on ICE Futures was $5.44 billion, and USDX futures contracts had an average daily trading volume in 2011 of 30,341 contracts; (vi) as of December 30, 2011, open interest in EUR/USD futures contracts traded on CME was $46.12 billion, and EUR/USD futures contracts had an average daily trading volume in 2011 of 336,947 contracts; and (vii) as of December 30, 2011, open interest in JPY/USD futures contracts traded on CME was $25.75 billion, and JPY/USD futures contracts had an average daily trading volume in 2011 of 113,476 contracts, Securities Exchange Act Release No. 66180 (Jan. 18, 2012), 77 FR 3532, 3534–35 (Jan. 24, 2012)); Securities Exchange Act Release No. 68165 (Nov. 6, 2012), 77 FR 67707 (Nov. 13, 2012) (SR-NYSEArca-2012-102) (notice of proposed rule change included NYSE Arca's representations that: (i) gold and silver futures contracts traded on Commodity Exchange, Inc. ("COMEX") are the global benchmark contracts and most liquid futures contracts in the world for each respective commodity; (ii) as of March 15, 2012, open interest in gold futures contracts and silver futures contracts traded on CME was $23.7 billion and $8.5 billion, respectively; (iii) gold futures contracts and silver futures contracts had an average daily trading volume in 2011 of 138,964 contracts and 63,913 contracts, respectively; (iv) CME constitutes the largest regulated foreign exchange marketplace in the world, with over $100 billion in daily liquidity; (v) as of March 15, 2012, open interest in Euro futures contracts and Yen futures contracts traded on CME and, for Dollar futures contracts, on ICE Futures, were $42.7 billion, $20.8 billion, and $4.8 billion, respectively; and (vi) Euro futures contracts, Yen futures contracts, and Dollar futures contracts had an average daily trading volume in 2011 of 325,103, 106,824, and 27,258 contracts, respectively, Securities Exchange Act Release No. 67882 (Sept. 18, 2012), 77 FR 58881, 58883 n.10, 58883 n.14 (Sept. 24, 2012)); Securities Exchange Act Release No. 81686 (Sept. 22, 2017), 82 FR 45643, 45646 (Sept. 29, 2017) (SR-NYSEArca-2017-05) (order approving the listing and trading of the Direxion Daily Crude Oil Bull 3x Shares and Direxion Daily Crude Oil Bear 3x Shares, citing to NYSE Arca's representations that: (i) the oil contract market was of significant size and liquidity, and had average daily volume of 650,000 contracts and daily open interest of 450,000 contracts; (ii) the Sponsor is registered as a commodity pool operator with the CFTC and is a member of the National Futures Association, and (iii) the CFTC has regulatory jurisdiction over the trading of futures contracts traded on U.S. markets); Securities Exchange Act Release No. 82390 (Dec. 22, 2017), 82 FR 61625 (Dec. 28, 2017) (SR-NYSEArca-2017-107) (notice of proposed rule change included NYSE Arca's

(footnote continued…)

and the 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.[35] And

(…footnote continued)

representations that: (i) freight futures liquidity has remained relatively constant, in lot terms, over the last five years with approximately 1.1 million lots trading annually; (ii) open interest currently stood at approximately 290,000 lots across all asset classes representing an estimated value of more than $3 billion, and, of such open interest, Capesize contracts accounted for approximately 50%, Panamax for approximately 40%, and Handymax for approximately 10%, Securities Exchange Act Release No. 81681 (Sept. 22, 2017), 82 FR 45342, 45345 (Sept. 28, 2017)). See also Securities Exchange Act Release No. 53582 (Mar. 31, 2006), 71 FR 17510 (Apr. 6, 2006) (SR-Amex-2005-127) (notice of proposed rule change included Amex's representations that: (i) WTI light, sweet crude oil contract, listed and traded at NYMEX, trades in units of 42,000 gallons (1,000 barrels), and annual daily contract volume on NYMEX from 2001 through October 2005 was 149,028, 182,718, 181,748, 212,382 and 242,262, respectively; (ii) annual daily contract volume on ICE Futures for Brent crude contracts from 2001 through October 2005 was 74,011, 86,499, 96,767, 102,361 and 120,695 respectively; (iii) annual daily contract volume on NYMEX for heating oil futures from 2001 through October 2005 was 41,710, 42,781, 46,327, 51,745 and 52,334, respectively; (iv) annual daily contract volume on NYMEX for natural gas contracts from 2001 through October 2005 was 47,457, 97,431, 76,148, 70,048 and 77,149, respectively; and (v) annual daily contract volume on NYMEX for gasoline contracts from 2001 through October 2005 was 38,033, 43,919, 44,688, 51,315 and 53,577, respectively, Securities Exchange Act Release No. 53324 (Feb. 16, 2006), 71 FR 9614, 9618 (Feb. 24, 2006)); Securities Exchange Act Release No. 55632 (Apr. 13, 2007), 72 FR 19987 (Apr. 20, 2007) (SR-Amex-2006-112) (notice of proposed rule change included Amex's representations that annual daily contract volume on NYMEX for natural gas contracts from 2001 through October 2006 was 47,457, 97,431, 76,148, 70,048, 76,265, and 102,097, respectively, Securities Exchange Act Release No. 55372 (Feb. 28, 2007), 72 FR 10267, 10268 (Mar. 7, 2007)).

[35] For example, corn futures began trading in 1877, see https://www.cmegroup.com/media-room/historical-first-trade-dates.html, and the first ETP based on corn futures was approved for listing and trading in 2010. See Securities Exchange Act Release No. 62213 (June 3, 2010), 75 FR 32828 (June 9, 2010) (SR-NYSEArca-2010-22). VIX futures began trading in 2004, see http://cfe.cboe.com/cfe-products/vx-cboe-volatility-index-vix-futures/contract-specifications, and the first ETPs based on VIX futures were approved for listing and trading in 2010. See Securities Exchange Act Release No. 63610 (Dec. 27, 2010), 76 FR 199 (Jan. 3, 2011) (SR-NYSEArca-2010-10). Natural gas futures began trading in 1990, see https://www.cmegroup.com/media-room/historical-first-trade-dates.html, and the first ETP based on natural gas was approved for listing and trading in 2007. See Securities Exchange Act Release No. 55632 (Apr. 13, 2007), 72 FR 19987 (Apr. 20, 2007) (SR-Amex-2006-112). Crude oil futures began trading in 1983, see https://www.cmegroup.com/media-room/historical-first-trade-dates.html, and the first ETP based on crude oil futures was approved for listing and trading in 2006. See Securities Exchange Act Release No. 53582 (Mar. 31, 2006), 71 FR 17510 (Apr. 6, 2006) (SR-Amex-2005-127). Wheat futures, sugar futures, and soybean futures began trading in 1877, 1914, and 1936, respectively, see https://www.cmegroup.com/media-room/historical-first-trade-dates.html and https://www.theice.com/publicdocs/ICE_Sugar_Brochure.pdf, and the first ETPs based on each of these commodity futures were approved for listing and trading in 2011. See Securities Exchange Act Release No. 65344 (Sept. 15, 2011), 76 FR 58549 (Sept. 21, 2011) (SR-NYSEArca-2011-48). U.S. Dollar Index futures began trading in 1985, https://www.theice.com/publicdocs/futures_us/ICE_Dollar_Index_FAQ.pdf, and the first ETPs based on U.S. Dollar Index futures was approved for listing and trading in 2007. See Securities Exchange Act Release No. 55292 (Feb. 14, 2007), 72 FR 8406 (Feb. 26, 2007) (SR-Amex-2006-86). Australian Dollar futures and Euro futures began trading in 1987 and 1999, respectively, and Canadian Dollar futures, Swiss Franc futures, and Yen futures began trading in 2002, see https://www.cmegroup.com/media-room/historical-first-trade-dates.html, and the first ETPs based on each of these individual currency futures were approved for listing and trading in 2012. See Securities Exchange Act Release No. 66553 (Mar. 9, 2012), 77 FR 15440 (Mar. 15, 2012) (SR-NYSEArca-2012-04). Silver futures and gold futures began trading in 1933 and 1974, respectively, see https://www.cmegroup.com/media-room/historical-first-trade-dates.html, and the first ETPs

(footnote continued…)

where the Commission has considered a proposed ETP based on futures that had only recently begun trading,[36] 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.[37]

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.

(…footnote continued)

based on each of these commodity futures were approved for listing and trading in 2006. See Securities Exchange Act Release No. 55029 (Dec. 29, 2006), 72 FR 806 (Jan. 8, 2007) (SR-Amex-2006-76). Freight futures have been cleared since 2005, and the first ETP based on freight futures was approved for listing and trading in 2017. See Securities Exchange Act Release No. 82390 (Dec. 22, 2017), 82 FR 61625, 61626 n.6 (Dec. 28, 2017) (SR-NYSEArca-2017-107) (noting that "Freight Futures have been cleared since 2005").

36 The Exchange filed its proposal before bitcoin futures began trading on either CME or CFE.

37 At issue were futures on an index comprising futures on crude oil, Brent crude oil, natural gas, heating oil, gasoline, gas oil, live cattle, wheat, aluminum, corn, copper, soybeans, lean hogs, gold, sugar, cotton, red wheat, coffee, standard lead, feeder cattle, zinc, primary nickel, cocoa, and silver. See Securities Exchange Act Release No. 53659 (Apr. 17, 2006), 71 FR 21074, 21080 (Apr. 24, 2006) (SR-NYSE-2006-17) (notice of proposed rule change to list shares of iShares GSCI Commodity-Indexed Trust). The Commission concluded that requirements of Exchange Act Section 6(b)(5) had been met because concerns about manipulation would be addressed by the arbitrage relationship between the new index futures and the existing component futures, as well as the ETP listing exchange's comprehensive surveillance-sharing agreements not only with the market for the index futures, but also with the markets for the component futures. See Securities Exchange Act Release No. 54013 (June 16, 2006), 71 FR 36372, 36379 (June 26, 2006) (SR-NYSE-2006-17) (order approving listing of shares of iShares GSCI Commodity-Indexed Trust). Additionally, the approval order for the ETP noted that, if the volume in any futures contract that was part of the reference index fell below a specified multiple of production of the underlying commodity, that contract's weight in the index would decrease. See id. at 36374.

2. Comments Received

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.[38]

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.[39] 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.[40]

Three commenters assert that there is manipulation in the bitcoin market.[41] One commenter states 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 wrong signal to bitcoin

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38 See Desai Letter, supra note 9, at 1.

39 See NERA Letter, supra note 9, at 2.

40 See id. at 2.

41 See Desai Letter, supra note 9, at 1; Fitzgerald Letter, supra note 9, at 1; Kumar Letter, supra note 9.

manipulators—who, the commenter asserts, currently operate with impunity—by approving a bitcoin ETP.[42] Another commenter believes that the volatility of bitcoin trading does not appear to be the result of natural trading and in the long run would prevent true price discovery.[43]

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 circulation, that the top four addresses control 3.13% of all bitcoin currently in distribution (worth over $4 billion), and that 115 individuals control bitcoin worth over $24 billion.[44] In contrast, another commenter states that, although a small number of wallets may own 90% of available bitcoin, exchanges own some of these wallets and may hold bitcoin on behalf of hundreds, thousands, or millions of people.[45]

One commenter asserts that widespread pump-and-dump schemes organized through the messaging platform "Telegram" are evidence of manipulation.[46] This commenter further cites an inquiry by then-New York Attorney General Eric Schneiderman into cryptocurrency exchanges and the use of trading "bots" on those exchanges to manipulate the market, and asserts that such activity can drive prices above fair market value by over 300%. The commenter notes the Kraken exchange's refusal to cooperate with this inquiry and believes that this refusal should pose serious questions for investors and the Commission about the Kraken exchange's operations,

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42 See Kumar Letter, supra note 9.

43 See Malkin Letter, supra note 9, at 1–2.

44 See Fitzgerald Letter, supra note 9, at 1–2.

45 See Rousseau Letter, supra note 9.

46 See Fitzgerald Letter, supra note 9, at 2.

particularly after the Kraken exchange recently exited the Japanese market due to regulatory requirements.[47]

One commenter states that a commonly cited factor mitigating possible susceptibility to manipulation is the securities exchanges' own surveillance procedures, in addition to the futures exchanges' surveillance procedures and market surveillance and oversight by the Commodity Futures Trading Commission ("CFTC"). This commenter cites statements by the CFTC that it has the legal authority and means to police certain spot markets for fraud and manipulation through "heightened review" collaboration with exchanges, that exchanges will provide the CFTC surveillance team with trade settlement data upon request, and that the exchanges will enter into information-sharing agreements with spot market platforms and monitor trading activity on the spot markets. The commenter also states that the Gemini exchange has announced that it would use Nasdaq's market surveillance system to monitor its marketplace.[48]

This commenter further asserts that market surveillance is generally a prerequisite to identifying potential market manipulation and discourages market manipulation. 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.[49] 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.[50]

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[47] See id. at 2.

[48] See NERA Letter, supra note 9, at 4–5.

[49] See id. at 5.

[50] See id.

3. Analysis

Unlike previous proposals for bitcoin-based ETPs,[51] the Exchange does not assert here that bitcoin prices or markets are inherently resistant to manipulation. A number of commenters, however, have noted the potential for manipulation in bitcoin markets.[52] Instead, the Exchange asserts that its existing surveillance procedures (including its ability to review activity by its members) 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).[53] One commenter also asserts that the exchange's own surveillance procedures, along with market surveillance and oversight by the CFTC, can mitigate manipulation.[54]

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,[55] 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

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51 See Winklevoss Order, supra note 28, 83 FR at 37582 (noting exchange argument that "intrinsic properties of bitcoin and bitcoin markets make manipulation 'difficult and prohibitively costly'"); Order Disapproving Proposed Rule Change, as Modified by Amendment No. 1, Relating to the Listing and Trading of Shares of the SolidX Bitcoin Trust, Securities Exchange Act Release No. 80319 (Mar. 28, 2017), 82 FR 16247, 16251 (Apr. 3, 2017) (SR-NYSEArca-2016-101) (noting that study commissioned by trust sponsor argues that "the underlying market for bitcoin is inherently resistant to manipulation").

52 See supra notes 41–47 and accompanying text.

53 See Notice, supra note 3, 82 FR at 61105.

54 See supra notes 48–49 and accompanying text. This commenter also suggests that the Commission—in coordination with the CFTC, SROs, futures markets, and bitcoin spot platforms—could gather market surveillance data to independently analyze whether manipulative practices occur on bitcoin spot and futures platforms. See supra note 50 and accompanying text. As noted above, however, it is the Exchange that bears the burden to demonstrate that its proposal is designed to "prevent fraudulent and manipulative acts and practices." See supra notes 23–26 and accompanying text.

55 See Notice, supra note 3, at 82 FR 61105 ("The Exchange is also able to obtain information regarding trading in the Shares, the commodity underlying futures or options on futures through ETP [Exchange Trading Permit] Holders, in connection with such ETP Holders' proprietary or customer trades which they effect through ETP Holders on any relevant market.").

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."[56] Thus, consistent with its determination in the Winklevoss Order,[57] and with the Commission's previous orders approving commodity-futures ETPs,[58] 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."[59]

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.[60] Nonetheless, the Commission must disapprove the proposal, because there is no evidence in the record demonstrating that CME's and CFE's bitcoin futures markets are markets of significant size.

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[56] Winklevoss Order, supra note 28, 83 FR at 37580.

[57] See id. at 37591 (finding that "traditional means" of surveillance were not sufficient in the absence of a surveillance-sharing agreement with a regulated market of significant size related to the underlying asset).

[58] See supra note 33 and accompanying text (noting previous commodity-futures ETPs where surveillance sharing in place between ETP listing exchange and underlying futures exchanges).

[59] Winklevoss Order, supra note 28, 83 FR at 37580 (quoting Amendment to Rule Filing Requirements for Self-Regulatory Organizations Regarding New Derivative Securities Products, Securities Exchange Act Release No. 40761 (Dec. 8, 1998), 63 FR 70952, 70954, 70959 (Dec. 22, 1998) (File No. S7-13-98)).

[60] See https://www.isgportal.org/isgPortal/public/members.htm (listing the current members and affiliate members of the Intermarket Surveillance Group).

The Order Instituting Proceedings sought comment on whether the CME and CFE bitcoin futures markets are markets of significant size,[61] 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 Exchange has provided in its proposed rule change are the generic statements that the market for bitcoin futures contracts "has very limited trading and operational history" and that the liquidity of these markets will depend on supply and demand, the adoption of bitcoin, and interest in the market for these futures.[62] 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.[63] 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 unavailable.[64]

The Commission also notes that in recent testimony CFTC Chairman Giancarlo characterized the volume of the bitcoin futures markets as "quite small."[65] Additionally, the

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61 See Order Instituting Proceedings, supra note 7, 83 FR at 13539.

62 Notice, supra note 3, 82 FR at 61103; see also supra note 19 and accompanying text.

63 These volume figures were calculated by Commission staff using data published by CME and CFE on their websites.

64 See Winklevoss Order, supra note 28, 83 FR at 37601.

65 CFTC Chairman Giancarlo testified: "It is important to put the new Bitcoin futures market in perspective. It is quite small with open interest at the CME of 6,695 bitcoin and at Cboe Futures Exchange (Cboe) of 5,569 bitcoin (as of Feb. 2, 2018). At a price of approximately $7,700 per Bitcoin, this represents a notional amount of about $94 million. In comparison, the notional amount of the open interest in CME's WTI crude oil futures was more than one thousand times greater, about $170 billion (2,600,000 contracts) as of Feb[.] 2, 2018 and the notional amount represented by the open interest of Comex gold futures was about $74 billion (549,000

(footnote continued…)

President and COO of CFE, recently acknowledged in a letter to the Commission staff that "the current bitcoin futures trading volumes on Cboe Futures Exchange and CME may not currently be sufficient to support ETPs seeking 100% long or short exposure to bitcoin."[66] These statements reinforce the Commission's conclusion that there is insufficient evidence to determine that the CME and CFE bitcoin futures markets are markets of significant size.

Furthermore, while the Exchange represents that no more than 10% of the net assets of a Fund in the aggregate invested in bitcoin futures contracts will be invested in contracts whose principal market is neither a member of the Intermarket Surveillance Group nor a market with whom the Exchange has a comprehensive surveillance-sharing agreement,[67] this does not function as a meaningful limitation where, as here, there is no minimum amount of a Fund that must be invested in such contracts. According to the Notice, in the event position, price, or accountability limits are reached with respect to bitcoin futures contracts, each Fund may invest in listed options on bitcoin futures contracts (should such listed options become available) and OTC swap agreements referencing bitcoin futures contracts.[68] The Notice does not establish any limit on the Funds' holdings of these other bitcoin-related derivatives; it provides no analysis of the size and liquidity of markets for those derivatives; and it does not discuss whether the Exchange has the ability to share surveillance information with the markets for these derivatives. Thus, as to what might be a substantial proportion of the Funds' portfolios, the Commission is

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contracts)." See Written Testimony of J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission, Before the Senate Banking Committee at text accompanying nn. 14–15 (Feb. 6, 2018). See also Winklevoss Order, supra note 28, 83 FR at 37601 (citing Giancarlo testimony).

66 Letter from Chris Concannon, President and COO, Cboe Global Markets, to Dalia Blass, Director, Division of Investment Management, Commission, at 5 (Mar. 23, 2018), available at https://www.sec.gov/divisions/investment/cboe-global-markets-innovation-cryptocurrency.pdf.

67 See supra note 17 and accompanying text.

68 See Notice, supra note 3, 83 FR at 61102; see also supra note 18 and accompanying text.

unable to conclude that surveillance-sharing will be available, that the related markets are regulated, or that the related markets are of significant size.

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 both the long and short ETFs is similar in magnitude"[69]—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.[70] 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

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[69] See supra notes 39–40 and accompanying text.

[70] See 15 U.S.C. 78f(b)(5).

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 states that approval of a bitcoin ETP on a U.S.-regulated exchange would protect small traders and increase exposure to a new asset class in a safe manner.[71] Another commenter states that if the Commission rejects bitcoin ETPs, it will push investors to unregulated and possibly unsafe environments.[72]

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.[73]

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

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71 See Mohammed Letter, supra note 9.

72 See Fink Letter, supra note 9.

73 See Fitzgerald Letter, supra note 9, at 2.

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.[74]

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.[75] 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.[76] 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.[77] Another commenter refers to the proposed ETPs as a "house of cards" and expresses concern that the Funds' attempt to replicate the bitcoin futures markets, which are related to underlying cryptocurrencies that trade on unregulated exchanges, will lead to losses for retail investors, and that the inclusion of an inverse Fund will add to the risk.[78]

2. Analysis

The Exchange asserts that approval of the proposal would enhance competition among market participants, to the benefit of investors,[79] and two commenters assert that approval would protect investors by permitting them to seek exposure to bitcoin through a safer, regulated

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74 See NERA Letter, supra note 9, at 5–6.

75 See Desai Letter, supra note 9, at 1; Kohen Letter, supra note 9; Kumar Letter, supra note 9; Malkin Letter, supra note 9, at 2.

76 See Desai Letter, supra note 9, at 1.

77 See Desai Letter, supra note 9, at 1, 2; Kumar Letter, supra note 9; Malkin Letter, supra note 9, at 2.

78 See Kohen Letter, supra note 9.

79 See Notice, supra note 3, 82 FR at 61106.

market.[80] Other commenters suggest that the Commission should either seek to regulate the underlying bitcoin markets,[81] or should seek to protect investors through disclosure requirements or suitability standards, rather than disapproving a bitcoin-ETP proposal.[82] Several other commenters, however, assert that approval of a bitcoin-based ETP would expose investors to risks from unregulated bitcoin markets.[83]

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 Exchange Act Section 6(b)(5), and, accordingly, the Commission must disapprove the proposal.

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80 See supra notes 71–72 and accompanying text.

81 See supra note 73 and accompanying text.

82 See supra note 74 and accompanying text.

83 See supra notes 75–78 and accompanying text.

D. Other Comments

Comment letters also addressed the intrinsic value of bitcoin[84]; the desire of investors to gain access to bitcoin through an ETP;[85] investor understanding about bitcoin;[86] the volatility of bitcoin prices,[87] the regulation of bitcoin spot markets,[88] the operation and valuation of the proposed ETPs,[89] the potential impact of Commission approval of the proposed ETP on the price of bitcoin,[90] and the legitimacy that Commission approval of the proposed ETP might confer upon bitcoin as a digital asset.[91] 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. Basis for Disapproval

The record before the Commission does not provide a basis for the Commission to conclude that the Exchange has met its burden under the Exchange Act and the Commission's Rules of Practice to demonstrate that its proposed rule change is consistent with Exchange Act Section 6(b)(5).[92]

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84 See Ahn Letter, supra note 9.

85 See Fink Letter, supra note 9; Kaleda Letter, supra note 9; Moberg Letter, supra note 9; Rousseau Letter, supra note 9; Santos Letter, supra note 9.

86 See Desai Letter, supra note 9, at 1; Kumar Letter, supra note 9.

87 See Desai Letter, supra note 9, at 1; Malkin Letter, supra note 9, at 1.

88 See Desai Letter, supra note 9, at 1; Fitzgerald Letter, supra note 9, at 1; Kumar Letter, supra note 9; Malkin Letter, supra note 9, at 1; Mohammed Letter, supra note 9.

89 See Desai Letter, supra note 9, at 1; Malkin Letter, supra note 9, at 1; Kumar Letter, supra note 9; NERA Letter, supra note 9, at 1–2, 3, 5.

90 See Santos Letter, supra note 9.

91 See Desai Letter, supra note 9, at 1, 2; Kumar Letter, supra note 9; Santos Letter, supra note 9.

92 In disapproving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

IV. CONCLUSION

For the reasons set forth above, the Commission does not find, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange, and in particular, with Section 6(b)(5) of the Exchange Act.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act, that proposed rule change SR-NYSEArca-2017-139 is disapproved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[93]

Eduardo A. Aleman
Assistant Secretary

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[93] 17 CFR 200.30-3(a)(12).