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The Digital Regulator

USA once again rejects an ETF on bitcoin

Abstract

The US Securities and Exchange Commission (SEC) has rejected the last outstanding Bitcoin (BTC) ETF proposal. It was the ninth rejection in a row. The decision taken by the SEC attests to the controversial decision-making process within the SEC, which contrasts with the pragmatic, inclusive and innovation-friendly approach taken by other jurisdictions such as Switzerland. Furthermore, it stifles financial innovation and delays the adoption of cryptocurrencies in the country, promoting an unregulated perimeter. The approval of the first BTC ETF emerged as a watershed moment for cryptofinance adoption in the USA.

Regulators around the globe multiplied their pronouncements and initiatives in the area of stablecoins during February 2020. Stablecoins are seen as a promising way to enhance the cross-border payment system and remedy related inefficiencies. However, the pronouncements also indicate that the approval of any stablecoins will be subject to strict evaluation and approval criteria, including KYC and AML aspects.

SEC rejection of the last outstanding BTC ETF proposal: an appraisal

The rejection^{link1} of Wilshire-Phoenix's BTC ETF proposal^{link1} by the SEC on 26 February 2020 was the ninth denial of such proposals in a row. It came after multiple postponements and was followed by official dissent^{link1} by SEC Commissioner H. Peirce¹.

The decision taken by the SEC stifles financial innovation, delays the adoption of cryptocurrencies and promotes an unregulated perimeter in the USA. It attests to the controversial decision-making process within the SEC, which contrasts with the pragmatic, inclusive and innovation-friendly approach taken by other jurisdictions such as Switzerland (where the world's first listed cryptocurrencies exchange traded product (ETP) was introduced in 2018).

- ✓ *Hopes betrayed:* The SEC has rejected all BTC ETFs proposed so far. Rejection decisions are normally taken within the announced deadline. About a year ago, however, the agency began postponing its decisions to allow more time to consider the proposed rule change. These events led the industry to hope that an approval would be near. Individual statements by officials lent support to such hopes.

The first postponement was announced in March 2019 and concerned the BTC ETF proposed by VanEck and SolidX. In May 2019 the agency shifted the deadline for reviewing the Bitwise proposal to an undisclosed date, while during the summer, SEC officials such as commissioner H. Peirce went on record in support of the approval. In August 2019, the SEC once again postponed the decision on three pending BTC ETF proposals: to 29 September for Wilshire Phoenix, 13 October for Bitwise and 18 October for VanEck/SolidX. The SEC opened up wider consultation to support the final decision. The delays led to the voluntary withdrawal of the BTC ETF proposed by VanEck and SolidX (the proponents decided to offer the vehicle to institutional investors by leveraging a SEC exemption rule). A further decision to delay the Bitwise proposal led Bitwise Asset Management to withdraw the application on 14 January 2020. Wilshire Phoenix updated their filing in October 2019, but eventually the SEC rejected the proposal on 26 February 2020.

- ✓ *Insufficient compliance:* The SEC has rejected all proposals on the basis that none of them guarantees compliance with Section 6(b)(5) of the Securities Exchange Act of 1934. The provision was designed to prevent fraudulent and manipulative market acts and practices. The SEC proxied the BTC ETF proposals with commodities ETPs. In the latter space, each exchange listing the ETP has entered a surveillance-sharing agreement with a regulated market that trades the underlying commodity.

The SEC concluded that only BTC ETF proposals that demonstrate a comprehensive surveillance-sharing agreement with a regulated and sizeable market trading the underlying assets would be deemed compliant with the provision of the Securities Exchange Act of 1934. The SEC deemed as insufficient the arguments produced by the proponents of BTC ETFs which aimed to demonstrate that other means besides surveillance-sharing agreements would effectively prevent fraudulent and

manipulative acts and practices. The SEC has systematically asserted that the proposed BTC ETFs have not established that the relevant BTC market is resistant to manipulations beyond that of traditional security or commodity markets. Furthermore, it has reiterated the belief that the BTC market is prone to fraudulent and manipulative acts and practices that could unduly hurt retail investors.

- ✓ *Internal dissent:* The SEC is currently governed by four commissioners, including the Chairman. Following the rejection of the last pending BTC ETF proposal, SEC Commissioner H. Peirce publicly dissented to the SEC decision. Her key arguments were:
 - ✓ The Securities Exchange Act provision requires the SEC to look at the rules of the exchange seeking to list the product. It does not require the SEC to look at the attributes of the assets or markets underlying the product to be traded. Yet, the Commission did not look at the rules of the listing exchange, but only at the BTC market.
 - ✓ The Commission is holding the BTC market to standards never applied to commodities markets before, for example the requirement for the BTC market to have in place surveillance-sharing agreements with the exchange listing the ETF. Commissioner H. Peirce concludes that these further refinements of the standard expressed in the Commission's demands appear to be designed for the sole purpose of keeping BTC out of the markets.

The SEC has denied all BTC ETF proposals so far. The internal decision-making process has witnessed increasing disagreement within the agency, culminating over time in multiple delays, additional consultations and public dissent by one of the three Commissioners. The systematic increase in the qualifying requirements have created standards for approval of BTC ETF proposals that are higher than for ETP proposals in any other alternative asset class (e.g. commodities). Against the backdrop of the steady adoption of cryptocurrencies, the absence of an approved BTC ETF vehicle is obliging US investors to seek access to such products outside the safety net that securities laws would provide. Such access is likely to be found outside the US jurisdiction, fuelling financial innovation outside the country. On

balance, the history of BTC ETF rejections in the USA contrasts with the more inclusive, innovation-friendly and pragmatic approach followed by a jurisdiction such as Switzerland (home of the world's first listed cryptocurrencies ETP).

Stablecoins and CBDCs dominated regulatory pronouncements during February 2020

Global regulators renew their focus on stablecoins and recognise the need to enhance the cross-border payment system

- ✓ The Financial Stability Board (FSB) has announced [link1](#) a consultative report on stablecoins (public consultation to start in April). The report will set out an evaluation process and approval criteria for stablecoin projects. The Financial Action Task Force (FATF) has set as a strategic priority for 2020 the mitigation of money laundering (ML) and terrorist financing (TF) risks of virtual assets and will report to the G20 in July 2020 on its analysis regarding stablecoins. Both global standard setters recognise the need to enhance global cross-border payment arrangements and facilitate swifter transfers at a lower cost.

Pronouncements by regulators about Central Bank Digital Currency (CBDC) continue and suggest CBDC will remain a key topic during 2020

- ✓ The Bank of England [link1](#) has urged central banks to research digital currencies, fearing that private companies could be swifter and dominate the space.
- ✓ The former governor of the Banque de France [link1](#), Jean-Claude Trichet, expects wholesale payments to happen fairly soon. CBDCs that are directly available to consumers, however, will not emerge soon.
- ✓ Sweden's central bank [link1](#) has announced the launch of a pilot project of its proposed e-krona. The project will use blockchain technology.

- ✓ Lithuania^{link1} has openly supported CBDCs, highlighting inclusion aspects and reduced costs. The authorities have emphasised the need to ensure adequate consumer protection.
- ✓ Cambodia^{link1} has announced the issuance of a government-backed cryptocurrency on an open blockchain-based payment and money transfer platform. The aim is to make it easier for end-users to pay each other regardless of the institutions they bank with.

Other noteworthy developments

SEC Commissioner H. Peirce proposes ways to enhance the legal security of digital assets

- ✓ The Commissioner has proposed^{link1} the introduction of a ‘sandbox period’ for newly issued digital assets. This would ensure that during this period, the assets would not be treated legally as securities. The purpose of the new rule would be to promote innovation in a legally secure context.

The International Organisation of Securities Commissions (IOSCO) has addressed secondary trading venues for crypto-assets

- ✓ The report^{link1} assists IOSCO members in evaluating the issues and risks relating to secondary crypto-asset trading platforms. It focuses on platforms which the regulatory authority has determined to have legal authority to regulate the assets and related activities.

Conclusion

The month of February 2020 was marked by the US SEC rejection of the last outstanding BTC ETF proposal. The event vividly illustrates the different approach followed by the US jurisdiction towards cryptofinance innovations, compared for instance to jurisdictions such

as Switzerland. It also points to growing tensions in the decision-making process within the SEC. In the end, the approval of the first BTC ETF proposal has emerged as the watershed event for the development of cryptofinance in the USA.

¹ Also known as "Crypto Mom".

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