Securities Regulation Daily Wrap Up, TOP STORY—Pair of Bitcoin trusts file registrations seeking to overcome regulatory hurdles to ETPs, other offerings, (Jan. 11, 2019)

Securities Regulation Daily Wrap Up

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Bitwise Asset Management filed a registration statement for Bitwise Bitcoin ETF Trust that, if a soon-to-be-filed exchange rule change proposal is approved by the SEC, would allow it to operate a Bitcoin exchange traded fund (ETF). Although the filing potentially faces an uphill battle in light of the SEC's recent disapprovals of many Bitcoin ETF applicants, Bitwise claims that custody options, and virtual currency markets more generally, have evolved in ways that may help it garner regulatory approval. Wilshire Phoenix Funds, LLC also filed a registration statement to offer shares of its United States Bitcoin and Treasury Investment Trust, which boasts a novel way to provide investors exposure to Bitcoin with less risk than would arise from directly holding Bitcoin.

Bitwise ETF. John Hyland, Global Head of Exchange-Traded Funds at Bitwise seemingly acknowledged the challenge of creating an operational Bitcoin ETF while also suggesting 2019 may be a transformative year for such ETFs. "While there can be no assurance that the 19b-4 application will be granted or the SEC will review and ultimately accelerate the registration statement, we are optimistic that 2019 should be the year that a bitcoin ETF launches," said Hyland in a press release.

Bitwise said in its Form S-1 that the objective of the Bitwise Bitcoin ETF Trust is to track the performance of the Bitwise Bitcoin Total Return index, created by Bitwise Index Services, LLC. Specifically, index pricing will be obtained from a subset of virtual currency exchanges selected from a pool of more than 200 such exchanges. Exchange selection criteria focus on seven factors, including eliminating exchanges in emerging markets and those exchanges that do not meet volume requirements (although the volume requirement can be waived). Bitwise said it currently is focused on ten exchanges.

Bitwise also lists numerous risk factors. Bitcoin price volatility and the newness (and lack of regulation) of Bitcoin exchanges are prominently discussed. Hard forks also are listed as a risk factor because the trust could potentially have to decide which of two virtual currencies to continue to hold; that decision would be based on several factors by which two virtual currencies would be compared: (1) market value and liquidity; (2) computing power of miners; and (3) whether the new virtual currency is capable of supporting a "technical and commercial ecosystem."

The trust's Bitcoin assets would be held in cold storage such that private keys would be held in a digital wallet that is not linked to the Internet. Although not announcing the trust's custodian in the Form S-1, Hyland suggested that banks may be capable of holding Bitcoin. "We believe the crypto trading ecosystem has evolved in significant ways in the past year. Having a regulated bank or trust company hold physical assets of a fund has been the standard under U.S. fund regulation for the last 80 years, and we believe that is now possible with bitcoin," said Hyland.

Wilshire registration statement. Wilshire Phoenix Funds's United States Bitcoin and Treasury Investment Trust seeks to manage investors' Bitcoin exposure by employing an "Index to Bitcoin" that would allocate the trust's assets between Bitcoin and U.S. Treasuries on a monthly basis, although the index would not reflect Bitcoin's actual performance. As a result, the trust would hold assets that include Bitcoin, U.S. Treasuries, and U.S. dollars. This method, the trust's registration statement said, could allow investors to obtain exposure to Bitcoin without some of the risks of holding Bitcoin directly.

Wilshire Phoenix Funds's registration statement also recites many of the same risk factors cited by Bitwise's filing. However, where Bitwise has deferred its tax risk factors until a future filing, Wilshire Phoenix Funds notes the uncertainty associated with the tax treatment of Bitcoin. For example, Wilshire Phoenix Funds cited the many unanswered questions following the Internal Revenue Service's 2014 guidance as well as questions about whether virtual currencies created via hard forks would be treated as commodities under tax law, whether Bitcoin is a collectible, and how to determine the holding period and tax basis of investments in Bitcoin. Late in the 115th Congress, several bills were introduced that would have potentially clarified some of the issues surrounding hard forks and collectibles while also aiding taxpayers until the IRS issues additional virtual currency guidance. It is unclear if these bills will be re-introduced in the 116th Congress. (For a summary of Congressional developments, see the "Blockchain legislation" section in the *Securities Regulation Daily* year-end review of blockchain issues).

Wilshire Phoenix Funds said it also plans to conduct private offerings. The fund has submitted a Form D in which it contemplates a Regulation D Rule 506(c) offering using general solicitation and advertising. This type of offering requires the issuer to take reasonable steps to verify the accredited investor status of any buyers of the securities offered.

Prior disapprovals. Last summer, the Commission disapproved a proposal by Cboe BZX Exchange, Inc. to list and trade shares of the Winklevoss Bitcoin Trust because of the potential for fraud in virtual currency markets and the inability of the exchange to obtain surveillance sharing agreements. Commissioner Hester Peirce dissented from the Winklevoss disapproval, arguing that allowing Bitcoin ETFs would help virtual currency markets to mature.

The SEC's Division of Trading and Markets last year also disapproved bids by three exchanges to list and trade shares of proposed Bitcoin ETFs (ProShares, GraniteShares, and Direxion). All three funds would track Bitcoin futures contracts permitted by CFTC rules and would allow long and short (inverse) investments; Direxion's fund, however, would employ leverage. The Commission has indicated that it will review the disapprovals (ProShares, GraniteShares, and Direxion).

Bitcoin ETFs tend to be ineligible to register with the Commission as investment companies, like more traditional ETFs do, because, among other things, they do not invest in or trade securities. As a result, Bitcoin ETFs must seek out an exchange that will then go to the SEC on its behalf and propose to list and trade the underlying Bitcoin trust's shares. In addition to concerns about fraud and market surveillance, regulators are concerned about the size of Bitcoin exchanges and whether these exchanges have enough trading volume to support the arbitrage mechanism by which shares in a Bitcoin ETF would be created and redeemed. In the Winklevoss disapproval, for example, the Commission majority cited testimony by CFTC Chairman J. Christopher Giancarlo nearly a year ago now as stating that Bitcoin futures markets were "quite small."

Companies: Bitwise Asset Management; Wilshire Phoenix Funds, LLC

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