

Public Statement

Staff Statement on Funds Registered Under the Investment Company Act Investing in the Bitcoin Futures Market

Division of Investment Management Staff

May 11, 2021

The Division of Investment Management (“IM”) staff strongly encourages any investor interested in investing in a mutual fund with exposure to the Bitcoin futures market, as discussed below, to carefully consider the risk disclosure of the fund, the investor’s own risk tolerance, and the possibility, as with all investing, of investor loss.^[1] Among other things, investors should understand that Bitcoin, including gaining exposure through the Bitcoin futures market, is a highly speculative investment. As such, investors should consider the volatility of Bitcoin and the Bitcoin futures market, as well as the lack of regulation and potential for fraud or manipulation in the underlying Bitcoin market. As with any fund investment, investors should focus on the level of risk they are taking on, and the level of risk they are comfortable taking on, prior to making an investment.

In January 2018, IM staff issued a letter on Engaging on Fund Innovation and Cryptocurrency Related Holdings (“Cryptocurrency Holdings Letter”).^[2] In that letter, IM staff identified five substantive areas of questions implicated by funds registered under the Investment Company Act of 1940 (“Investment Company Act”) (“registered funds”) potentially investing in digital assets, including cryptocurrencies or cryptocurrency-related investments. The areas identified related to substantive requirements regarding valuation, liquidity, custody, arbitrage mechanisms for exchange traded funds (“ETFs”), as well as potential manipulation and other risks associated with cryptocurrency-related markets.

IM staff appreciates the public input provided in response to the Cryptocurrency Holdings Letter,^[3] as well as feedback from registered funds seeking to invest in cryptocurrency-related investments in a manner that is compliant with the Investment Company Act and its rules. In providing input, a number of registered funds have particularly focused on cash-settled Bitcoin futures, traded on an exchange regulated by the U.S. Commodity Futures Trading Commission (“CFTC”) (“Bitcoin futures”), believing it to be a potential method of gaining cryptocurrency exposure while addressing some of the questions raised in the Cryptocurrency Holdings Letter.

IM staff issued the Cryptocurrency Holdings Letter shortly after Bitcoin futures began trading in December 2017. The Cryptocurrency Holdings Letter acknowledged that the Bitcoin futures market, at that time, was in a nascent state with limited trading volume. The Bitcoin futures market has developed since then, with increased trading volumes and open-interest positions.^[4] In addition, the Bitcoin futures market consistently has produced a reportable price for Bitcoin futures. The Bitcoin futures market also has not presented the custody challenges associated with some cryptocurrency-based investing because the futures are cash-settled.^[5] The Commission also adopted a new exemptive rule relating to funds’ use of derivatives whose conditions generally include limits on derivatives leverage risk and the adoption and implementation of a derivatives risk management program.^[6]

IM staff understands that some mutual funds are investing or seek to invest in Bitcoin futures and that these funds believe they can do so consistent with the substantive requirements of the Investment Company Act and its rules and other federal securities laws. IM staff, in coordination with staff from the Division of Examinations, will closely monitor and assess such mutual funds’ and investment advisers’ ongoing compliance with the

Investment Company Act and the rules thereunder and the other federal securities laws. Investor protection and assessing the ongoing compliance of these funds is a top priority for the staff.

In addition, IM staff, in coordination with staff from the Division of Economic and Risk Analysis and Division of Examinations, will closely monitor the impact of mutual funds' investments in Bitcoin futures on investor protection, capital formation, and the fairness and efficiency of markets. As part of this monitoring, the staff among other things expect to

- Analyze the liquidity and depth (e.g., number of participants) of the Bitcoin futures market and consider whether it is appropriately supporting mutual fund investment in Bitcoin futures – particularly as additional mutual fund assets enter the market – given regulatory requirements relating to mutual fund liquidity;
- Analyze mutual funds' ability to liquidate Bitcoin futures positions as necessary to meet daily redemption demands, as well as the efficacy of mutual funds' derivatives risk management and the extent of any leverage obtained through derivatives;
- Monitor funds' valuations of holdings in the Bitcoin futures market and consider the impact of mutual fund participation in the Bitcoin futures market on valuations in that market, as well as the impact on valuation of any disruptions in the underlying Bitcoin markets;
- As part of funds' compliance with the open-end fund liquidity rule, consider mutual funds' liquidity classification of any position in the Bitcoin futures market and the basis for such classification and also consider the overall construction of a fund's liquidity risk management program, including consideration of the liquidity of a fund's strategy and portfolio investments during both normal and reasonably foreseeable stressed conditions, whether the investment strategy is appropriate for an open-end fund, and the extent to which the strategy involves a relatively concentrated portfolio or large positions in particular investments;^[7]
- Assess the ongoing impact of the potential for fraud or manipulation in the underlying Bitcoin markets and its possible influence on the Bitcoin futures market;^[8] and
- Consider whether, in light of the experience of mutual funds investing in the Bitcoin futures market, the Bitcoin futures market could accommodate ETFs, which, unlike mutual funds, cannot prevent additional investor assets from coming into the ETF if the ETF becomes too large or dominant in the market, or if the liquidity in the market starts to wane.

Among open-end funds, IM staff believes at this time that investment in the Bitcoin futures market should be pursued only by mutual funds with appropriate strategies that support this type of investment and full disclosure of material risks. The staff welcomes further input from ETFs and other market participants, particularly input that focuses on efforts to ensure compliance with the Investment Company Act and its rules and promote investor protection. Because closed-end funds do not provide for daily redemption of their shares, they do not present the same types of liquidity challenges as open-end funds. Therefore, staff encourages any closed-end fund that seeks to invest in the Bitcoin futures market to consult with the staff, prior to filing a registration statement, about the fund's proposed investment, anticipated compliance with the Investment Company Act and its rules, and how the fund would provide for appropriate investor protection.

IM staff will be transparent about its approach to registered funds' investment in the Bitcoin futures market, as well as other types of cryptocurrency and digital asset investing. Such transparency will be designed to avoid market uncertainty and promote a level playing field for funds, consistent with the protection of investors.

[1] This statement represents staff views and is not a rule, regulation, or statement of the Commission. The SEC has neither approved nor disapproved its content. This statement, like all SEC Staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person.

[2] Division of Investment Management, Engaging on Fund Innovation and Cryptocurrency-related Holdings, Jan. 18, 2018, is available at <https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm>.

[3] Public input on the Cryptocurrency Holdings Letter is available at <https://www.sec.gov/investment/fund-innovation-cryptocurrency-related-holdings>.

[4] See, e.g., CME Group Bitcoin Futures Liquidity Report, which is available at <https://www.cmegroup.com/education/bitcoin/futures-liquidity-report.html>.

[5] Nothing in this statement is a determination that the Bitcoin futures market is a significant market or market of significant size related to Bitcoin as those terms are used in the context of the requirements under Exchange Act Section 6(b)(5). See 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 (Aug. 1, 2018).

[6] Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. 34084 (Nov. 2, 2020) [85 FR 83162 (Dec. 21, 2020)]. The new rule is effective, with a compliance date of August 19, 2022.

[7] See Rule 22e-4 under the Investment Company Act.

[8] See Order Disapproving a Proposed Rule Change, as Modified by Amendment No. 1, To Amend NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares) and To List and Trade Shares of the United States Bitcoin and Treasury Investment Trust Under NYSE Arca Rule 8.201-E, 85 FR 12595-01, at 12600-601 & nn.66-67 (March 3, 2020).