

SEC approves spot bitcoin ETFs

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The long-awaited exchange-traded fund for spot bitcoin became available to investors on Jan. 11. Previously, bitcoin exposure was limited to direct asset custody in a digital wallet, Chicago Mercantile Exchange futures contracts or open-ended private trusts, all offering various pros and cons.

The Securities and Exchange Commission's approval of spot bitcoin ETFs was a lengthy process, with the regulator rejecting several prior proposals. Previously, the SEC had voiced concerns over the security of custody and trading of bitcoin and the potential manipulation of the asset class. The news cycle has also provided examples of misconduct by several cryptocurrency exchanges, most notably FTX. Cryptocurrency exchanges are one of the most common avenues to access bitcoin directly.

As of Jan. 18, investor interest in spot bitcoin ETFs has been high. According to Suzanne McGee of *Reuters*, "Investors have poured \$1.9 billion into nine new exchange-traded funds tracking the spot price of bitcoin in their first three days of trading...with fund giants BlackRock and Fidelity

pulling the lion's share of flows."¹ This is not the first digital asset ETF, as the ProShares Bitcoin Strategy ETF (BITO) was launched in October 2021, but with investments in bitcoin futures contracts.

However, there is a key distinction between the newly approved spot bitcoin ETFs and older bitcoin futures ETFs. The newly approved ETFs offer investors more direct bitcoin exposure, as spot bitcoin ETFs "securely hold bitcoins in a secure digital vault, which registered custodians manage. The purpose of this kind of ETF is to mirror the price of bitcoins in the crypto market."² Bitcoin futures ETFs, by contrast, are invested in derivatives (futures) of an asset, which can be based on multiple factors beyond the price of the underlying asset.

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¹ McGee, Susan. Spot bitcoin ETFs draw nearly 2 billion in first three days of trading. *Reuters*. Jan. 18, 2024. <https://www.reuters.com/technology/spot-bitcoin-etfs-draw-nearly-2-billion-first-three-days-trading-2024-01-18/>

² Hayes, Adam, Kindness, David & Kvilhaug, Suzanne. Spot Bitcoin ETFs Explained: Everything You Need to Know. *Investopedia*. Jan. 12, 2024. <https://www.investopedia.com/spot-bitcoin-etfs-8358373#:~:text=Spot%20bitcoin%20ETFs%20securely%20hold,or%20through%20authorized%20cryptocurrency%20exchanges>

It is important to note that just because spot bitcoin ETFs have been approved by the SEC does not mean they are without significant risk. Due diligence is crucial for investors considering investing in a relatively new product such as bitcoin ETFs. Currently, the fund's ability to provide a low tracking error relative to the native currency (bitcoin) is untested. Moreover, eight out of 11 ETF providers selected Coinbase as custodian of their assets. As Yueqi Yang and Olga Kharif of *Bloomberg* explain, "The majority of these ETF issuers will be dependent on Coinbase for the functioning of their funds in one way or the other...Yet even as Coinbase stands to gain from Bitcoin's leap into traditional markets, the arrangements highlight what some see as a potentially dangerous concentration of risk."³ The SEC is currently pursuing litigation against Coinbase, alleging the exchange "abused its discretion... for years evaded its rules by illegally operating an unregistered exchange, brokerage, and clearing agency."⁴

Created in 2009, bitcoin provides a relatively short track record compared to other asset classes

and therefore its performance in a variety of market environments remains untested. In our opinion, bitcoin and other digital assets should not be offered in retirement plan investment menus due to its higher volatility, which has proven to be extreme at times, and the lack of a clear role it can play in portfolio construction and for long-term diversification of benefits (see [*Does cryptocurrency have a place in retirement plans?*](#)).

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Lastly, it's important to note that these ETFs apply to bitcoin only. While it is possible ETFs tracking other cryptocurrencies such as Ethereum (ETH) may be approved in the future, there are no ETFs currently publicly available for these assets.

While the approval of spot bitcoin ETFs will provide a more "complete" market and help meet investor demand, how such a product should be used in a prudent asset allocation framework is unclear. Currently, TruePlan does not recommend retirement plan allocations or investment offerings in bitcoin or any spot ETFs. Whether the demand and inflows for bitcoin ETFs will sustain will be an interesting area to watch in financial markets.

³Yang, Yueqi & Kharif, Olga. Coinbase at the Center of Bitcoin ETF Draws Envy and Risks. *Bloomberg*. Jan. 15, 2024. <https://www.bloomberg.com/news/articles/2024-01-15/coinbase-coin-at-center-of-bitcoin-btc-etf-machine-raises-concerns>

⁴Willmer, Sabrina & Versprille, Allyson. SEC Puhses Ahead With Case Against Coinbase Crypto Exchange. *Bloomberg*. October 3, 2023. <https://www.bloomberg.com/news/articles/2023-10-03/sec-doubles-down-on-its-case-against-crypto-exchange-coinbase>

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