

To:

Ms. Vanessa Countryman
Secretary
Securities and Exchange
Commission
100 F Street NE
Washington, D.C. 20549-0609

February 21, 2024

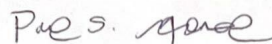
**Order Instituting Proceedings to Determine Whether
to Approve or Disapprove a Proposed Rule Change to
List and Trade Shares of the Grayscale Ethereum
Trust under NYSE Arca Rule 8.201-E
(Commodity-Based Trust Shares)
File No. SR-NYSEArca-2023-70
Release No. 34-99428**

Coinbase Global, Inc. (together with its subsidiaries, **Coinbase**) appreciates the opportunity to respond to the Securities and Exchange Commission's request for comments on the proposed rule change filed by NYSE Arca, Inc. (the **Exchange**) to list and trade shares (**Shares**) of the Grayscale Ethereum Trust (the **Trust**).

The characteristics of the Ether (**ETH**) market and the Exchange's surveillance-sharing agreement with the Chicago Mercantile Exchange Inc. (**CME**), as described in the data and analysis in this letter, support the position that the Exchange's proposed rule change should be approved for virtually identical reasons articulated by the Commission with respect to spot Bitcoin exchange-traded products (**ETPs**). For that and the other reasons described in this letter, approval of the Exchange's proposal is the appropriate action for the Commission to take.

We would be pleased to answer any questions the Commission or its staff may have on the data and analysis presented herein. We appreciate the Commission's continuing attention to this important matter and for allowing us an opportunity to present our views.

Yours sincerely,



Paul Grewal
Chief Legal Officer
Coinbase

Introduction

The Commission is considering the proposal's consistency with Section 6(b)(5) of the Securities Exchange Act of 1934, as amended (the **Exchange Act**), which requires, among other things, that the rules of a national securities exchange be "designed to prevent fraudulent and manipulative acts and practices" and "protect investors and the public interest."¹

Coinbase started in 2012 with the idea that anyone, anywhere, should be able to send and receive Bitcoin easily and securely. Today, we are publicly listed in the United States and provide a trusted and easy-to-use platform that millions of verified users in over 100 countries rely on to access the crypto economy.

Coinbase is also one of the digital asset trading platforms that provides pricing data to CoinDesk Indices, Inc. (**CoinDesk**) as index provider to the Trust.² In addition, Coinbase Custody Trust Company, LLC acts as custodian for the Trust's ETH.³ We believe that our experience in providing these services, and our broader expertise in digital asset markets generally, is directly relevant to the questions under consideration by the Commission.⁴

¹ SEC; [Release No. 34-99428](#); File No. SR-NYSEArca-2023-70; Self-Regulatory Organizations; NYSE Arca, Inc.; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to List and Trade Shares of Grayscale Ethereum Trust under NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares) (Jan. 25, 2024).

Similar to the Commission's finding with respect to Bitcoin ETPs, Coinbase notes that the Exchange's proposed rule change with respect to a spot ETH ETP is similarly consistent with Section 11A(a)(1)(C)(iii) of the Exchange Act, which sets forth Congress' finding that it is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities. See SEC; [Release No. 34-99306](#); File Nos. SR-NYSEARCA-2021-90; SR-NYSEARCA-2023-44; SRNYSEARCA-2023-58; SR-NASDAQ-2023-016; SR-NASDAQ-2023-019; SR-CboeBZX-2023-028; SR-CboeBZX-2023-038; SR-CboeBZX-2023-040; SR-CboeBZX-2023-042; SRCboeBZX-2023-044; SR-CboeBZX-2023-072; Self-Regulatory Organizations; NYSE Arca, Inc.; The Nasdaq Stock Market LLC; Cboe BZX Exchange, Inc.; Order Granting Accelerated Approval of Proposed Rule Changes, as Modified by Amendments Thereto, to List and Trade Bitcoin-Based Commodity-Based Trust Shares and Trust Units, 9-10 (Jan. 10, 2024) (the **Spot Bitcoin ETP Approval Order**).

² SEC; [Release No. 34-98780](#); File No. SR-NYSEArca-2023-70 Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing of Proposed Rule Change to List and Trade Shares of Grayscale Ethereum Trust Under NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares) (the **Spot ETH ETP Proposed Rule Change**) at 73894 (Oct. 23, 2023).

³ *Id.*

⁴ Coinbase previously submitted a comment letter in support of a proposed rule change to permit the listing and trading of Bitcoin ETPs. See [Letter of Paul Grewal](#), Chief Legal Officer, Coinbase Global, Inc., (Mar. 3, 2022).

Coinbase believes that the Exchange's proposed rule change to list and trade the Shares satisfies the requirements of Section 6(b)(5) of the Exchange Act, and therefore the Commission should approve the Exchange's request for the following reasons.

- First, the Exchange properly filed its proposal to list and trade the Shares as commodity-based trust shares. This is because ETH is a commodity, not a security. ETH's status as a commodity and not a security has been recognized in a variety of circumstances, including the CFTC's regulation of ETH futures, public statements by Commission officials, and rulings by federal courts. In addition, the Commission has never publicly taken the position that ETH is a security, and has not publicly objected to the CFTC's decision to permit ETH futures contracts to trade on the CME and other designated contract markets (**DCMs**).
- Second, the Commission's decision in approving spot Bitcoin ETPs applies with equal – and in some ways greater – force for listing and trading the Shares.
- Third, the technological and operational security mechanisms inherent in Ethereum's blockchain significantly limit ETH's susceptibility to fraud and manipulation.
- Fourth, ETH's market depth, tightness of spreads, and price correlation across spot markets are highly indicative of a market resilient to fraud and manipulation. ETH's notional dollar trading volume is significantly greater than the vast majority of the stocks that comprise the S&P 500, including when adjusted for aggregate market value.⁵
- Fifth, the Exchange has a comprehensive surveillance-sharing agreement with the CME via its common membership in the Intermarket Surveillance Group. The agreement facilitates the sharing of information that is available to the CME through its surveillance of the CME ETH futures market. The CME ETH futures market is consistently and highly correlated with the ETH spot market, in fact no less so than the recently approved spot Bitcoin ETPs. The surveillance-sharing agreement can therefore reasonably be expected to assist in surveilling for fraudulent and manipulative acts and practices in the ETH spot market.⁶

⁵ Our economic analysis and comparison to stocks within the S&P 500 in this letter is solely for purposes of demonstrating comparative market quality. It should not be viewed as indicating that Bitcoin or ETH are otherwise similar to equity securities.

⁶ The Commission reached an analogous conclusion with respect to surveillance sharing in the context of the CME Bitcoin futures and Bitcoin spot markets. See Spot Bitcoin ETP Approval Order (“[T]he Commission is able to conclude that fraud or manipulation that impacts prices in spot bitcoin markets would likely similarly impact CME bitcoin futures prices. And because the CME's surveillance can assist in detecting those impacts on CME bitcoin futures prices, the Exchanges' comprehensive surveillance-sharing agreement with the CME—a U.S. regulated market whose bitcoin futures market is consistently highly correlated to spot bitcoins' comprehensive

Responses to the Commission's questions

1. Given the nature of the underlying assets held by the Trust, has the Exchange properly filed its proposal to list and trade the Shares under NYSE Arca Rule 8.201-E (Commodity-Based Trust Shares)?

Although the question has not been directly posed, we understand the Commission to be asking, among other things, whether ETH is a commodity. An ETP that holds a commodity falls under NYSE Arca Rule 8.201-E, as filed here, whereas one referencing a security might fall under a different NYSE Arca listing rule.

We believe that the Exchange has properly filed its proposal to list and trade the Shares under NYSE Arca Rule 8.201-E. The underlying assets of the Trust are commodities and so the Shares fit within the Exchange's definition of, and rules for, Commodity-Based Trust Shares.⁷ We have explained in depth in other proceedings why digital assets like ETH that do not involve an ongoing contractual obligation related to a business enterprise are not "investment contracts" or otherwise "securities."⁸ ETH in particular benefits from additional corroborating factors, discussed further below. These factors continue to apply with equal force even after the Ethereum Network's September 2022 transition to a Proof-of-Stake (**PoS**) consensus mechanism (the **Merge**), notwithstanding equivocal statements by the current Commission Chair.⁹

surveillance-sharing agreement with the CME ... can be reasonably expected to assist in surveilling for fraudulent and manipulative acts and practices....").

⁷ "Commodity-Based Trust Shares" means a security (a) that is issued by a trust (**Trust**) that holds (1) a specified commodity deposited with the Trust, or (2) a specified commodity and, in addition to such specified commodity, cash; (b) that is issued by such Trust in a specified aggregate minimum number in return for a deposit of a quantity of the underlying commodity and/or cash; and (c) that, when aggregated in the same specified minimum number, may be redeemed at a holder's request by such Trust which will deliver to the redeeming holder the quantity of the underlying commodity and/or cash. NYSE Arca Rule 8.201-E(c)(1). This rule uses the definition of "commodity" under Section 1a(9) of the Commodity Exchange Act. NYSE Arca Rule 8.201-E(c)(2). The Commodity Exchange Act, in turn, defines "commodity" broadly and to include "all ... rights, and interests ... in which contracts for future delivery are presently or in the future dealt in." As the Commission is aware and as discussed below, contracts for future delivery of ETH are presently dealt in, including on CFTC-regulated platforms.

⁸ See, e.g., Coinbase, [Memorandum of Law in Support of Coinbase's Motion for Judgment on the Pleadings](#), No. 23 Civ. 4738 (S.D.N.Y. August 4, 2023); Coinbase, [Reply Memorandum of Law in Support of Coinbase's Motion for Judgment on the Pleadings](#), No. 23 Civ. 4738 (S.D.N.Y. Oct. 24, 2023).

⁹ See *infra* note 38.

ETH-based futures contracts

Futures contracts with ETH as the underlying asset have been approved for listing and trading by trading platforms regulated exclusively by the CFTC.¹⁰ These ETH futures contracts are not subject to the regulatory framework relevant to security futures contracts.¹¹ If ETH were a security, these futures contracts referencing ETH would be futures on a security, or “security futures,” subject to joint regulation by the CFTC and the Commission.¹² By voicing no objection to ETH futures contracts being listed on futures exchanges without treating them as security futures, we believe the Commission has effectively accepted the CFTC’s position that ETH is a commodity and not a security.

The basis for the Commission to have exerted its authority was established by the Commodity Futures Modernization Act of 2000.¹³ This act amended the Commodity Exchange Act (**CEA**)¹⁴ to establish a regulatory regime for *security* futures products, subjecting them to the joint jurisdiction of the CFTC and the Commission.¹⁵ Under the CEA, any market that seeks to provide a trading facility for futures, options on futures, or options on commodities (including securities) that is available to retail customers is subject to registration and regulation under the CEA by the CFTC as a DCM (more commonly known as a futures exchange).¹⁶ But because of the joint jurisdiction of the CFTC and the Commission over security futures, a futures contract on a security is also subject to the Commission’s oversight. Security futures “can be offered *only* by markets that are either regulated by the CFTC and notice-registered with the Commission or regulated by the Commission and notice-registered with the CFTC.”¹⁷

The Commission has had opportunities to challenge the status of ETH as solely a commodity and has not done so. The CME, a DCM that lists ETH futures contracts for trading, filed a self-certification for its ETH futures contracts on January 22, 2021¹⁸ and

¹⁰ See, e.g., Chicago Mercantile Exchange Inc., CFTC Regulation 40.2(a) Certification, [Notification Regarding the Initial Listing of the Ether Futures Contract](#), CME Submission No. 21-005 (Jan. 22, 2021); Chicago Mercantile Exchange Inc., CFTC Regulation 40.2(a) Certification, [Initial Listing of the Options on Micro Bitcoin Futures and Options on Micro Ether Futures Contracts](#), CME Submission No. 22-072 (30 of 30) (Mar. 8, 2022); Coinbase Derivatives, [CFTC Regulation 40.2\(a\) Certification: Listing of Ether Futures Contract Coinbase Derivatives Submission #2023-3E](#) (May 23, 2023).

¹¹ See, e.g., CME Group, [Ether Futures and Options](#).

¹² Commodity Exchange Act § 2(a)(1)(D), (E), 7 U.S.C. § 2(a)(1)(D), (E).

¹³ Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763A-365.

¹⁴ Commodity Futures Trading Commission Act, Pub. L. No. 93-463, 88 Stat. 1389 (1974).

¹⁵ See CFTC, [Security Futures Product](#); see also National Futures Association, [Security Futures Products](#) (“Security futures products (SFP) are futures whose underlying instrument is either a single security or a narrow-based security index. SFPs are considered both a futures and securities contract and are regulated by both the SEC and the CFTC.”).

¹⁶ See CFTC, [Designated Contract Markets \(DCMs\)](#).

¹⁷ *Id.* (emphasis added).

¹⁸ Chicago Mercantile Exchange Inc., CFTC Regulation 40.2(a) Certification, [Notification Regarding the Initial Listing of the Ether Futures Contract](#), CME Submission No. 21-005 (Jan. 22, 2021).

for its ETH mini futures contracts on March 8, 2022.¹⁹ On May 23, 2023 (notably, post-Merge), Coinbase Derivatives, LLC (**Coinbase Derivatives**), a CFTC-regulated DCM, filed a self-certification for its ETH nano futures contracts with the CFTC.²⁰ If these contracts were security futures products, then CME and Coinbase Derivatives would have also had to follow the notice-registration requirements for security futures, necessitating a filing with the Commission.²¹ While we understand that in 2002 the CME did notice-register as a national securities exchange solely for purposes of listing security futures products at that time,²² the CME has not treated ETH futures as security futures.²³ Coinbase Derivatives similarly does not treat ETH futures as security futures. It therefore has not notice-registered with the Commission.

To date, Coinbase Derivatives has received no indication from the CFTC or the Commission that the ETH futures contracts that it lists are security futures contracts or that the Commission believes Coinbase Derivatives should notice-register as a national securities exchange for purposes of listing security futures. The Commission's non-objection to the listing of ETH futures by Coinbase Derivatives and other CFTC-regulated DCMs that similarly have not notice-registered with the Commission as security-futures exchanges, and to the CME's classification of its ETH futures contracts as non-security futures,²⁴ reflects the Commission's acceptance of the broader market's conclusion – that ETH is not a security. The public has reasonably relied on these circumstances for many years, both before and after the Merge (i.e. when Ethereum successfully transitioned from a proof-of-work (**PoW**) to PoS consensus mechanism).

The Commission has otherwise not been shy to guard its turf against its sister agency. For example, last year the CFTC brought suit against Archegos Capital Management alleging that Archegos manipulated market prices in certain total return swaps on index-linked exchange-traded funds, on the basis that the total return swaps were “swaps” subject to CFTC jurisdiction. The Commission responded by submitting an amicus brief arguing that because the underliers were exchange traded funds, the instruments at issue were security-based swaps and thus subject to exclusive SEC

¹⁹ Chicago Mercantile Exchange Inc., CFTC Regulation 40.2(a) Certification, [Initial Listing of the Options on Micro Bitcoin Futures and Options on Micro Ether Futures Contracts](#), CME Submission No. 22-072 (30 of 30) (Mar. 8, 2022).

²⁰ Coinbase Derivatives, [CFTC Regulation 40.2\(a\) Certification: Listing of Ether Futures Contract Coinbase Derivatives Submission #2023-3E](#) (May 23, 2023).

²¹ See Exchange Act § 6(g).

²² See [Acknowledgement of Receipt of Notice of Registration as a National Securities Exchange Pursuant to Section 6\(g\) of the Securities Exchange Act of 1934 by the Chicago Mercantile Exchange Inc.](#), 67 Fed. Reg. at 65,155 (Oct. 16, 2002).

²³ For example, CME Rule 70001 sets forth the initial listing standards for security futures, including among other things that a security underlying a security future be registered under Section 12 of the Exchange Act, something ETH certainly is not.

²⁴ See, e.g., *id.*

jurisdiction.²⁵ The court agreed with the Commission, ruling that the CFTC had exceeded its regulatory jurisdiction with its claims.²⁶

Commission guidance

The market has long understood that ETH is not a security. Senior officials of the Commission have publicly said as much on several occasions over the past six years, and neither the Commission nor its staff has disavowed this position, even after the Merge.

In June 2018, the Commission’s then-Director of the Division of Corporation Finance, William Hinman, delivered a speech explaining why, based on “the present state of Ether, the Ethereum Network and its decentralized structure,” he did not believe that offers and sales of ETH were securities transactions under the federal securities laws, notwithstanding earlier characteristics of ETH and its manner of distribution that may have weighed in favor of it being viewed as a security.²⁷ For this reason, Mr. Hinman explained that it was appropriate to “put[] aside” ETH’s pre-sale, and in so doing expressed the view that “current offers and sales of ETH are not securities transactions.”²⁸ Although ostensibly the views only of Mr. Hinman, an SEC Commissioner at the time publicly suggested that the Commission and its then-Chair were also deeply involved in developing the views expressed in Mr. Hinman’s public statement and that it reflected the Commission’s official view on the status of ETH.²⁹ And based on documentation turned over in discovery in the *Ripple* litigation, it is clear that Mr. Hinman’s speech was reviewed and pre-approved by broad constituencies within the Commission’s staff.³⁰

Control over the Ethereum Network and ETH itself has become even more decentralized since Mr. Hinman’s speech. In June 2018, the Ethereum Foundation directly controlled approximately 668,000 ETH, accounting for only 0.66% of ETH’s circulating supply at the

²⁵ See SEC, [Brief of Amicus Curiae](#), *Commodity Futures Trading Commission v. Archegos Capital Management, LP and Patrick Halligan*, No. 22-cv-3401-JPO (Apr. 14, 2023).

²⁶ See [Commodity Futures Trading Commission v. Archegos Capital Management LP, et al.](#), No. 22-CV-3401 (S.D.N.Y. Sept. 19, 2023).

²⁷ William Hinman, Director, Division of Corporation Finance, SEC, [Digital Asset Transactions: When Howey Met Gary \(Plastic\)](#) (June 14, 2018) (discussing the application of the federal securities laws to crypto asset transactions).

²⁸ See *id.*

²⁹ Roslyn Layton, [The Crypto Uprising The SEC Didn’t See Coming](#), *Forbes* (updated Aug. 30, 2021) (“[V]ideos of then-SEC Commissioner Robert Jackson have surfaced showing him energetically asserting that not only that Hinman’s speech was market guidance, but that all such guidance was intended by then-Chairman Jay Clayton as regulatory clarity in place of ‘slow-moving’ formal rulemaking.”).

³⁰ See Katherine Ross, Casey Wagner & David Canellis, [SEC officials pushed Hinman to clarify ETH wasn’t a security: Court docs](#), *Blockworks* (June 13, 2023).

time.³¹ Since June 2018, the Ethereum Foundation’s ETH balance has decreased in linear fashion. So too has its percentage control over ETH’s circulating supply. As of February 10, 2024, the Ethereum Foundation holds the fewest ETH it has ever held, approximately 311,274 ETH, or only 0.26% ETH’s circulating supply.³² Vitalik Buterin, regarded as one of the principal founders of the Ethereum Network, has also reduced his publicly known holdings of ETH. In June 2018, he held approximately 370,000 ETH. As of September 22, 2023, he held approximately 243,000 ETH, or only 0.2% of ETH’s circulating supply.³³

ETH’s extensive decentralization and utility may be why a federal court has recently taken for granted that ETH is a “crypto commodit[y]”³⁴ and noted that courts have declined to “stretch the federal securities laws” to cover particular digital asset activities.³⁵ It may also be why then-Chairman Clayton confirmed that he agreed with the views expressed in Mr. Hinman’s speech.³⁶ It also is quite clear that the market interpreted Mr. Hinman’s speech to reflect the Commission’s view that ETH was not a security.

Even current Chair Gensler himself testified to Congress (before joining the Commission) that he (like the rest of the market) understood BTC and ETH to have “been designated

³¹ The Ethereum Foundation is believed to control the multisig contract address 0xde0b295669a9fd93d5f28d9ec85e40f4cb697bae (EthDev). See [0xde0B295669a9FD93d5F28D9Ec85E40f4cb697Bae \(EthDev\) Analytics](#), Etherscan (last visited Feb. 14, 2024) (showing that the largest ETH balance held by the Ethereum Foundation was 11,901,464.23948 ETH on August 7, 2015 and that on June 11, 2018, the Ethereum Foundation held 667,816.1635 ETH). At its peak, the Ethereum Foundation controlled approximately 11.9 million ETH, accounting for approximately 16% of ETH’s circulating supply at the time.

³² [0xde0B295669a9FD93d5F28D9Ec85E40f4cb697Bae \(EthDev\) Analytics](#), Etherscan (last visited Feb. 10, 2024).

³³ Vitalik Buterin holds his ETH in the contract address 0x220866b1a2219f40e72f5c628b65d54268ca3a9d (Vb 3), which, as of February 10, 2024, held 243,000 ETH. See [0x220866b1a2219f40e72f5c628b65d54268ca3a9d \(Vb 3\) Analytics](#), Etherscan (last visited Feb. 10, 2024). Vitalik Buterin also controls the user wallet 0x1Db3439a222C519ab44bb1144fC28167b4Fa6EE6 (Vb 2), which as of February 10, 2024, held 1,779 ETH, [0x1Db3439a222C519ab44bb1144fC28167b4Fa6EE6 \(Vb 2\) Analytics](#), Etherscan (last visited Feb. 10, 2024), and the user wallet 0xAb5801a7D398351b8bE11C439e05C5B3259aeC9B (Vb), which as of February 10, 2024, held 24.8 ETH, worth approximately \$113,000, [0xAb5801a7D398351b8bE11C439e05C5B3259aeC9B \(Vb\) Analytics](#), Etherscan (last visited Feb. 10, 2024).

³⁴ [Risley v. Universal Navigation Inc.](#), No. 1:22-cv-02780-KPF, 2023 WL 5609200, at *14 (S.D.N.Y. Aug. 23, 2023).

³⁵ *Id.* at *11.

³⁶ [Letter from Jay Clayton](#), Chairman, SEC, to Rep. Ted Budd (Mar. 7, 2019) regarding the application of the federal securities laws to digital assets (“[T]he analysis of whether a digital asset is offered or sold as a security is not static and does not strictly inhere to the instrument. A digital asset may be offered and sold initially as a security because it meets the definition of an investment contract, but that designation may change over time if the digital asset later is offered and sold in such a way that it will no longer meet that definition.”).

by the SEC as not securities.”³⁷ While Chair Gensler has since avoided publicly expressing a definitive view,³⁸ not once since Mr. Hinman’s speech has the Commission or any of its senior officials asserted a contrary view. Not in Congressional hearings, public speeches, interviews, or enforcement actions. Not before the Merge and not after the Merge. Even when alleging that certain digital asset trading platforms were trading securities, the Commission did not list ETH as one of them.³⁹ To the contrary, in the *Ripple* proceedings Commission staff explicitly distinguished between ETH and Bitcoin, on the one hand, and other digital assets that the Commission has alleged are securities, on the other hand.⁴⁰ Indeed, the Commission has even approved a fund registered under the Investment Company Act of 1940 that issues shares as digital asset securities on the Ethereum blockchain and must pay ETH as gas fees. This would raise significant legal issues if ETH is a security.⁴¹

Contrast all of this with the explicit statement of CFTC Chair Rostin Behnam before Congress in March 2023 that ETH is a commodity, not a security.⁴²

Putting aside the merits of why ETH is not a security, which we do not feel is significant enough of a question to discuss further, the undeniable fact is that the Commission has

³⁷ [Testimony of Gary Gensler](#), Senior Lecturer, MIT Sloan School of Management, Hearing before the House Committee on Agriculture on Cryptocurrencies: Oversight of New Assets in the Digital Age 115th Cong., 24 (July 18, 2018) (emphasis added).

³⁸ For example, in testimony before the House Financial Services Committee on April 19, 2023, Chair Gensler declined to answer direct questions regarding the status of ETH. Chair Gensler responded to Committee Chairman Patrick McHenry’s question about whether ETH is a security with “it depends on the facts and the law.” See Nikhilesh De, [SEC Chair Gensler Declines to Say if Ether Is a Security in Contentious Congressional Hearing](#), CoinDesk (Apr. 19, 2023). While this would have been an appropriate opportunity for Chair Gensler to reconfirm the Commission’s position that ETH is not a security, his decision not to do so cannot reasonably be viewed as a reversal of the Commission’s position.

³⁹ See [Complaint](#), *SEC v. Bittrex, Inc.*, No. 2:23-cv-00580 (W.D. Wash. Apr. 17, 2023); [Complaint](#), *Binance*, No. 1:23-cv-01599 (D.C. June 5, 2023); [Complaint](#), *Coinbase*, No. 1:23-cv-04738-KPF (S.D.N.Y. June 6, 2023).

⁴⁰ See [Transcript of Proceedings](#) at 54, *Ripple*, No. 1:20-cv-10832-AT-SN (Mar. 19, 2021) (explaining that the facts of *Ripple* are a “very different [] situation from Bitcoin and Ethereum. There is no centralized actor that we can point to that sort of meets three different characteristics; owns the majority of the assets that they created, is selling this asset, and then telling people I’m going to make efforts to create utility for your assets, so that, you know, this might be beneficial to you, and then ultimately actually engage in these efforts.”).

⁴¹ See ArCoin, [Arca U.S. Treasury Fund Prospectus](#) (May 1, 2023) (“When the Fund makes a distribution of a shareholder’s interest or pays a dividend, the gas will be the responsibility of the Fund.”). It is unclear, for example, whether a registered fund would be able to offer a product that required both itself and its investors to engage in ongoing purchases of illegally unregistered securities, or require that they purchase a security through unregistered exchanges or broker-dealers.

⁴² Jesse Hamilton, [U.S. CFTC Chief Behnam Reinforces View of Ether as Commodity](#), CoinDesk (Mar. 28, 2023).

allowed the market to accept this as the Commission’s own view, and hasn’t publicly changed its position, including following the Merge.⁴³

2. The Exchange raises substantially similar arguments to support the listing and trading of the Shares as those made in proposals to list and trade spot bitcoin exchange-traded products (“Bitcoin ETPs”). Do commenters agree that arguments to support the listing of Bitcoin ETPs apply equally to the Shares? Are there particular features related to ETH and its ecosystem, including its proof of stake consensus mechanism and concentration of control or influence by a few individuals or entities, that raise unique concerns about ETH's susceptibility to fraud and manipulation?

The arguments in support of listing and trading Bitcoin ETPs apply with equal – and in some ways greater – force for listing and trading the Shares. Below we compare ETH to Bitcoin across three critical metrics to demonstrate that ETH is no more susceptible to fraud and manipulation than Bitcoin.

On-chain consensus

The Ethereum Network’s PoS consensus mechanism is extremely secure and decentralized, both on an absolute basis and relative to the Bitcoin Network’s PoW consensus mechanism.

ETH plays an essential role in securing the Ethereum Network from malicious or dishonest actors. Rather than compete to solve random and increasingly complex mathematical problems, as on the Bitcoin Network, nodes today ensure the security of the Ethereum Network by “staking” ETH. The staked ETH serves as collateral to provide a way to penalize malicious behavior by a validator. Collectively, over 30.5 million ETH are staked, equivalent to approximately \$89 billion at current market values, or approximately 25.5% of all circulating ETH.⁴⁴ Over 9 million unique nodes have operated on the Ethereum

⁴³ Coinbase, like other market participants, remains puzzled by the announcement that Prometheus Inc. apparently intends to custody ETH through its subsidiary Prometheus Ember Capital LLC (**Prometheus**), which we understand has received approval from the Financial Industry Regulatory Authority (**FINRA**) to operate as a special purpose broker-dealer (**SPBD**). See Jesse Hamilton, [Prometheus, the Only U.S.-Registered Crypto Platform, Picks Ether as Its First Product](#), CoinDesk (Feb. 7, 2024). It is not clear how Prometheus’s SPBD expects to custody ETH, as an SPBD is only permitted to custody digital assets that are securities.

⁴⁴ [Open Source Ethereum Explorer](#), Beaconcha.in (last visited Feb 20, 2024).

Network since its launch.⁴⁵ The distribution of ETH validators is also significantly more decentralized than that of Bitcoin miners.⁴⁶

The system of rewards and penalties (denominated in ETH) inherent in the Ethereum Network’s PoS consensus mechanism is central to upholding the credibility and immutability of the Ethereum Network’s blockchain, the honesty of the validators and other nodes in the system, and the functioning of the wider Ethereum ecosystem. The transition of the Ethereum Network from PoW to PoS also made the operation of the system drastically less energy-intensive, reducing its carbon footprint by 99.9%.⁴⁷

Governance

There is no reason to believe that the current governance of the Ethereum Network could impair the security of the Network or should give rise to concerns with respect to fraud or manipulation.

A dispersed and unaffiliated community of Ethereum supporters has been actively involved in developing the Ethereum Network since its inception in November 2013. Ethereum’s robust, decentralized governance system further reduces ETH’s susceptibility to fraud and manipulation as there is no central actor responsible for its development.

Ethereum governance operates under the principle of rough consensus,⁴⁸ which was popularized by the Internet Engineering Task Force and is also used by the Bitcoin Network. Rough consensus ensures that only widely agreed-upon upgrades are made to the protocol. There is no token-based voting, so there’s no ability for well-capitalized actors or attackers to unduly influence Ethereum’s governance or development roadmap.

Anyone may propose an Ethereum Improvement Proposal (**EIP**) to modify the Ethereum Network’s protocols or its functionality.⁴⁹ According to the EIP process, and as demonstrated in practice, the “EIP author is responsible for building consensus within the community and documenting dissenting opinions.”⁵⁰ Once an EIP author has a potential update proposal, they are encouraged to⁵¹ (and indeed typically do) begin a thread on an online forum called Ethereum Magicians to discuss and vet the idea through rough

⁴⁵ [Nodes](#), Etherscan (last visited Feb. 9, 2024) (showing 9,160,675 nodes as of Feb. 9, 2024).

⁴⁶ *Compare* [Beacon Chain Deposits](#), Etherscan (last visited Feb. 9, 2024) (demonstrating a wide dispersion of ETH validators by entity) *with* [Hashrate Distribution](#), Blockchain.com (last visited Feb. 9, 2024) (demonstrating a relatively more concentrated group of Bitcoin mining pools).

⁴⁷ Zach Hale, [Ethereum’s 99% cut in energy use will curb crypto’s climate footprint](#), S&P Global (Sept. 16, 2022) (also noting that “the long-awaited change did not result in a sudden price action for ether”); *see also* [Ethereum’s energy expenditure](#), Ethereum.org; CCRI, [Ethereum’s Merge](#).

⁴⁸ [Rough Consensus](#), Wikipedia (last visited February 19, 2024).

⁴⁹ *See* Martin Becze, Hudson Jameson, et al., [EIP-1: EIP Purpose and Guidelines](#), Ethereum.org (Oct. 27, 2015).

⁵⁰ *Id.*

⁵¹ *Id.*

consensus.⁵² All of these threads are open to the public. Approximately 170 EIPs have been finalized and implemented.⁵³ A recent study offers a comprehensive analysis of Ethereum's decision-making, focusing on the transparency, openness, and decentralization of the governance process. The authors find that despite the fact that submissions of proposals are relatively concentrated, the discussion and approval of EIPs is broad, transparent, and open, with thousands of individuals commenting and approving governance proposals.⁵⁴

Token ownership concentration

A concern in traditional financial markets is that traders with a large ownership percentage could improperly influence the price of assets to their advantage.⁵⁵ The distribution of ownership is therefore an important factor in evaluating market manipulation risks. However, such a risk should be even less a concern for ETH than Bitcoin because ETH ownership is more broadly distributed than Bitcoin.⁵⁶

This conclusion is illustrated in **Figure 1**, below, which shows Lorenz curves comparing ownership concentration of Bitcoin and ETH held in Coinbase accounts. The shallower curve for ETH (lower and to the right) indicates that its ownership is *less* concentrated than that of Bitcoin.⁵⁷ This result is consistent with our response to Question 1 – ownership of ETH has become more decentralized in recent years as significant holders of ETH have decreased their relative holdings.

⁵² For examples of such threads, see Fellowship of Ethereum Magicians, [The Ethereum Magicians forum](#). To learn more about rough consensus, see Pete Resnick, [On Consensus and Humming in the IETF](#), Internet Engineering Task Force (June 2014).

⁵³ See [Ethereum Improvement Proposals](#), Ethereum.org (last visited Feb. 9, 2024).

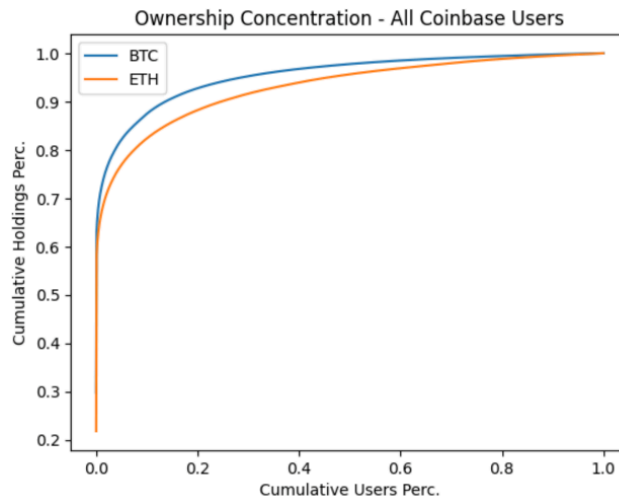
⁵⁴ Cesare Fracassi, Moazzam Khoja and Fabian Schär, [Decentralized Crypto Governance? Transparency and Concentration in Ethereum Decision-Making](#), SSRN (Jan. 22, 2024).

⁵⁵ See, e.g., [FINRA Regulatory Notice 22-25](#) (Nov. 17, 2022) (highlighting risk of fraud and manipulation in connection with offerings that result in a “concentration of shares being held in very few hands”); [FINRA Regulatory Notice 21-03](#) (Feb. 10, 2021) (highlighting risk of issuers that engage in activities that “appear to concentrate the shares into the hands of a small number of shareholders”).

⁵⁶ For example, a recent study by Grayscale shows that 40% of the Bitcoin supply is held by intermediaries like exchanges, custodians, large corporations, and miners, and 60% by individual investors. Among individual investors, Bitcoin is widely held, with 75% of addresses containing less than 0.01BTC (~ \$400) and only 0.5% of addresses with more than 10 BTC (~\$400K). See Will Ogden Moore, [Demystifying Bitcoin's Ownership Landscape](#), Grayscale (last updated Nov. 29, 2023). In contrast, for ETH, a study by CryptoVantage shows that if we exclude consensus and bridge addresses, no wallet holds more than 1.65% of the supply. See Evan Jones, [Who Are the Biggest Ethereum Holders? The ETH Rich List](#), CryptoVantage (Jan. 23, 2024).

⁵⁷ See Gastwirth, [A General Definition of the Lorenz Curve](#), *Econometrica*, Vol. 39, No. 6, 1037-1039, (Nov., 1971).

Figure 1



While this analysis is limited to only Bitcoin and ETH held in custody by Coinbase, it nevertheless represents a large fraction of total outstanding Bitcoin and ETH tokens (about 10.6% of Bitcoin and about 14.7% of ETH).⁵⁸ Hence, we expect these data points are likely to be broadly representative of the full population of token holders.⁵⁹ Moreover, this analysis does not suffer from the typical challenges of accurately measuring crypto ownership due to the pseudonymity of on-chain wallets, where it is generally not possible to connect holdings to common owners.

3. What are commenters’ views on whether the proposed Trust and Shares would be susceptible to manipulation? What are commenters’ views generally on whether the Exchange’s proposal is designed to prevent fraudulent and manipulative acts and practices? What are commenters’ views generally with respect to the liquidity and transparency of the ETH markets and the ETH markets’ susceptibility to manipulation?

As the Commission has long recognized, including with other commodity ETPs, the greater the liquidity, trading volume, and market capitalization of an asset, the lower the

⁵⁸ See Coinbase, [Q3 2023 Quarterly Report \(Form 10-Q\)](#), at 31.

⁵⁹ Of course, we recognize that Coinbase accounts may not be perfectly representative of the full population of owners. For example, Coinbase serves as custodian to some of the largest institutional market participants in addition to millions of retail clients. It is therefore possible that Coinbase accounts could be either more or less concentrated than that represented by the total population of owners. However, we do not see why any bias of this nature would impact the conclusions from the comparative analysis (i.e., any selection bias should apply equally to Bitcoin and ETH).

risk and likelihood that an asset can be manipulated by bad actors.⁶⁰ The ETH market benefits from very significant depth and liquidity. ETH's average global daily trading volume over the past 6 months has been in the range of \$1 to \$5 billion (excluding suspected wash trading),⁶¹ and its total market value as of February 13, 2024 is approximately \$315 billion.⁶² As a point of comparison, this notional dollar trading volume is orders of magnitude greater than the vast majority of the stocks that comprise the S&P 500, which as securities traded in the national market system, benefit from a deep and liquid stock market **[Figure 2]**.⁶³ When plotted against market capitalization, ETH like Bitcoin exhibits trading behavior that is characteristic of the largest U.S. equity securities.

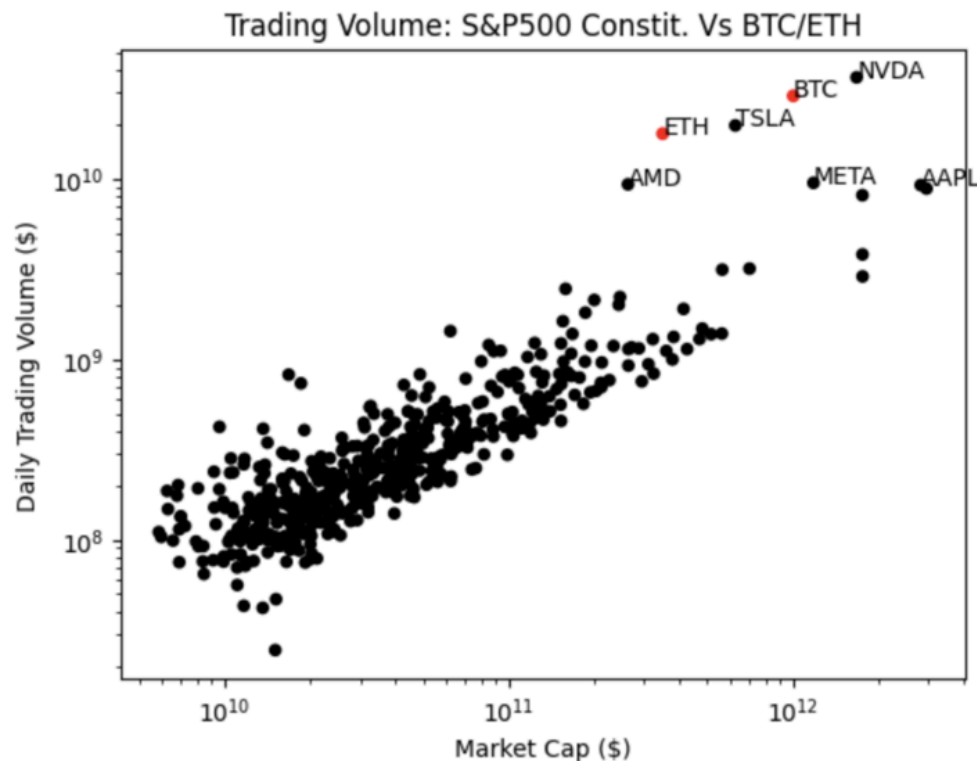
⁶⁰ See, e.g., SEC [Release No. 34-50603](#); File No. SR-NYSE-2004-22; Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendments No. 1 and No. 2 Thereto to the Proposed Rule Change by the New York Stock Exchange, Inc. Regarding Listing and Trading of streetTRACKS® Gold Shares, 65,619 (Oct. 28, 2004) (approving a gold ETP in part because the spot market was “extremely deep and liquid,” which “militated against manipulations through inter-market trading activity”).

⁶¹ The Block, [BTC and ETH Total Exchange Volume \(ZDMA\)](#), (last visited Feb. 16, 2024). The Block only incorporates data from crypto trading platforms with robust surveillance practices where wash trading is unlikely.

⁶² CoinMarketCap, [Ethereum \(ETH\)](#) (last visited Feb. 13, 2024).

⁶³ The equity and digital asset commodities data for Figure 2 is sourced from Yahoo Finance. Trading volume was calculated averaging the latest 10 trading days ending Feb. 12, 2024. Market capitalization was calculated as of Feb. 12, 2024. As explained supra note [5], and for the avoidance of doubt, we compare ETH and Bitcoin's trading volumes to equities solely as a point of reference to demonstrate their substantial depth and liquidity.

Figure 2



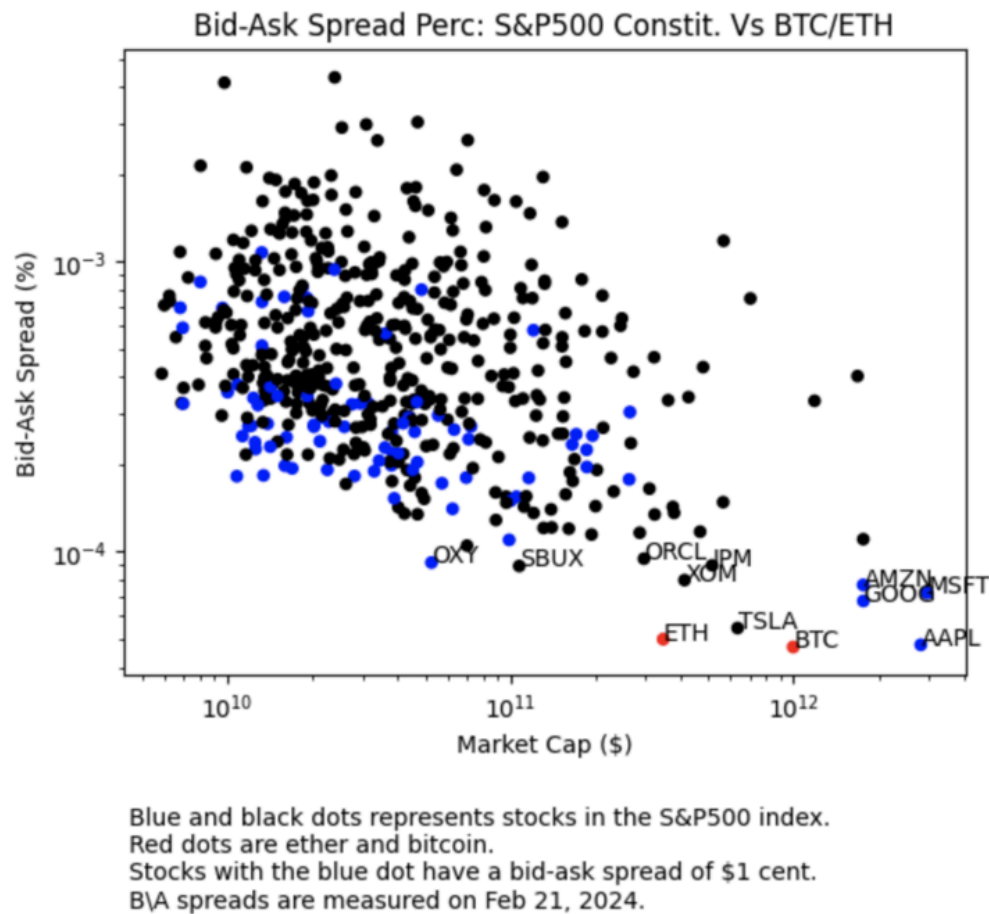
Superior market quality for ETH is also observed when looking at bid-ask spreads. Like Bitcoin, ETH also trades at considerably lower spreads as a percentage of market capitalization relative to the vast majority of stocks that comprise the S&P 500. Only a handful of the largest U.S. equity securities illustrated in Figure 3 trade at lower adjusted spreads.⁶⁴

As the Commission has itself recognized, tighter spreads are indicative of a well-functioning market with higher liquidity and lower adverse selection costs.⁶⁵ Tighter spreads should also indicate a lower risk of fraud and manipulation in the market. For example, if there were greater risks of fraud and manipulation, dealers and other traders seeking to make markets would require *wider* spreads to compensate for the additional risk.

⁶⁴ The blue dots in Figure 3 represent equities that trade at the minimum one penny tick size, and if not bound in this way, which ETH is not, could trade at a lower adjusted spread. Equity data is sourced from Yahoo Finance. Digital asset commodity data is sourced from Coinbase.

⁶⁵ See SEC, Staff Report on Algorithmic Trading in U.S. Capital Markets (Aug. 5, 2020).

Figure 3⁶⁶



We are unable to provide a similar analysis for spot markets of commodities such as precious metals given the opacity of the OTC markets on which they typically trade. Nevertheless, Coinbase believes available research and data indicate comparable trading volumes in the ETH spot market and other commodities for which ETPs have been approved. For example, with respect to the silver OTC market:

- London has the largest share of the global OTC market for silver;⁶⁷
- The London OTC market had an estimated trade reporting weekly turnover of \$42.94 billion for silver in the 12 weeks ending September 29, 2023; and⁶⁸
- The ETH market had an average weekly trading volume of \$35.2 billion in the same timeframe (12 weeks ending September 29, 2023).⁶⁹

⁶⁶ The spread for ETH and BTC is from Coinbase’s spot markets.

⁶⁷ The Silver Institute, [World Silver Survey 2023](#), 41 (2018).

⁶⁸ LBMA, [LBMA Daily Trade Reporting Data](#).

⁶⁹ Weekly average of data from Yahoo Finance on ETH volumes, sourced from CoinMarketCap.

Moreover, as the Commission previously recognized in its approval of the streetTRACKS Gold Trust, another commodity market with no direct regulation of spot trading – and as approvingly cited by the D.C. Circuit⁷⁰ – the depth and liquidity of underlying spot markets allay concerns about improper trading practices.⁷¹ To this end, the magnitude of the ETH trading market, with greater average trading volume than all but a handful of the largest U.S. single equity securities, should provide the Commission with equal comfort that any attempted manipulations would be mitigated through fundamental trading and intermarket trading activity, including the ETH futures market.⁷²

Our empirical research [**Figure 4**] supports this conclusion. In addition to the analysis above, we find that ETH spot prices do not deviate significantly across digital asset trading platforms. In a comparison of hour-end prices for ETH between Coinbase and three other trading platforms – Kraken, Gemini, and Bitstamp – the price on the platforms deviated less than 4 bps on average. The correlations of prices and hourly returns is well above 99%. Moreover, the deviation across these platforms was less than 10 bps [97]% of the time since the beginning of 2024, which is lower than the 20 bp deviation we reported in our prior analysis in support of Grayscale’s Bitcoin ETP.⁷³

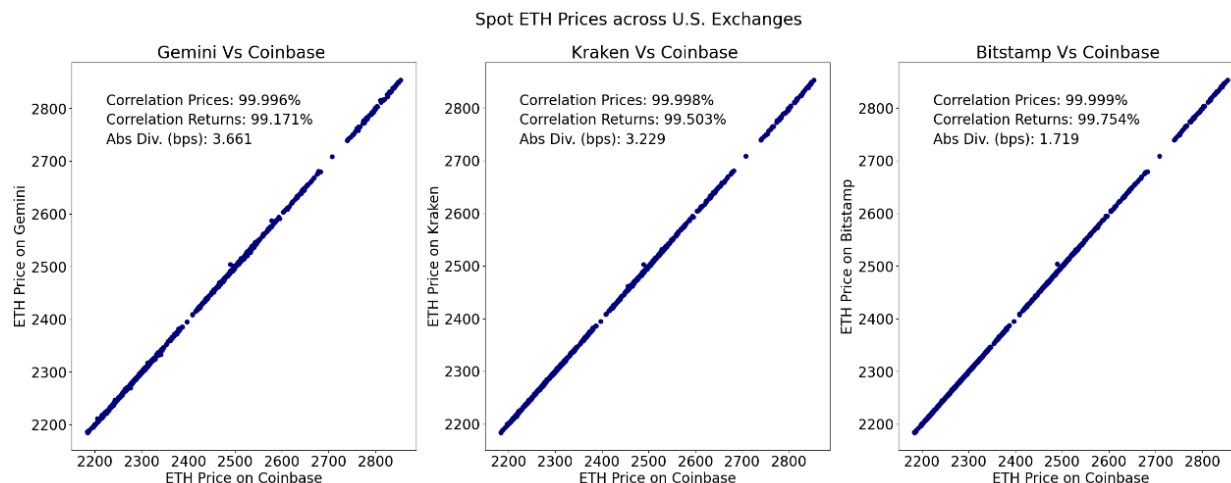
⁷⁰ [Grayscale Investments, LLC v. SEC](#), No. 11-1142, at 18 (D.C. Cir. Aug. 19, 2023) (“One comment included evidence that bitcoin had an average daily trading volume of approximately \$45 billion, which ... is significantly higher than that of the largest equity stocks. This is the kind of evidence the Commission has repeatedly relied on to approve other ETPs [citing the approval of the streetTRACKS Gold Trust].”) (internal citations omitted).

⁷¹ SEC; [Release No. 34-50603](#); File No. SR-NYSE-2004-22; Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendments No. 1 and No. 2 Thereto to the Proposed Rule Change by the New York Stock Exchange, Inc. Regarding Listing and Trading of streetTRACKS® Gold Shares at 65619 (Oct. 28, 2004).

⁷² *Id.*

⁷³ [Letter of Paul Grewal](#), Chief Legal Officer, Coinbase Global, Inc., (Mar. 3, 2022).

Figure 4



While there were instances where prices across these ETH trading platforms experienced higher deviations than 10 bps relative to Coinbase, the vast majority (97%) of these deviations returned to a level below 10 bps within two hours. This evidence is consistent with an efficient market, with well functioning arbitrage activity. Just as with any and all financial markets assets, deviations of a longer duration may occasionally occur, but they are ultimately arbitrated away.

These observations and interpretations are consistent with those expressed previously by the Commission – that a strong convergence of pricing across a broad market is present where spot markets are deep and liquid.⁷⁴ Given the significant spot market volume and efficiency of inter-market price correction in ETH spot markets, manipulating the price for shares of the Trust by manipulating spot markets would require a prohibitively large amount of trading volume and coordination across several large trading platforms. Further, activity on this scale would be readily detected as a result of surveillance activity, as discussed in response to Question 5.

⁷⁴ SEC; [Release No. 34-50603](#); File No. SR-NYSE-2004-22; Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendments No. 1 and No. 2 Thereto to the Proposed Rule Change by the New York Stock Exchange, Inc. Regarding Listing and Trading of streetTRACKS® Gold Shares (Oct. 28, 2004).

4. Based on data and analysis provided by the Exchange, do commenters agree with the Exchange that the Chicago Mercantile Exchange (“CME”), on which CME ETH futures trade, represents a regulated market of significant size related to spot ETH? What are commenters’ views on whether there is a reasonable likelihood that a person attempting to manipulate the Shares would also have to trade on the CME to manipulate the Shares? Do commenters agree with the Exchange that it is unlikely that trading in the Shares would be the predominant influence on prices in the CME ETH futures market?

The CME futures market represents a regulated market of significant size related to ETH futures. Given the correlation between ETH futures and spot ETH, this would enable the CME to detect attempted manipulation of spot ETH.

When assessing the futures and spot markets for Bitcoin, the Commission framed the significant market test as follows:

To allow the Commission to assess whether market manipulation will be detected in the surveilled market, the significant market test has two prongs. First, there must be a reasonable likelihood that a person attempting to manipulate the ETP would ... have to trade on [the related] market to successfully manipulate the ETP. In other words, the Commission will consider whether a person attempting to manipulate the ETP could simply bypass the related market and thus circumvent the surveillance. Second, it must be unlikely that trading in the ETP would be the predominant influence on prices in [the surveilled] market. If trading in the ETP dominated prices in the surveilled market, that market might be unable to pick up price discrepancies between the ETP and its underlying assets.⁷⁵

In the case of Bitcoin futures ETPs, the Commission found it was “unnecessary” for Bitcoin futures ETPs to establish that a “would-be manipulator would have to trade on the CME”⁷⁶ because their only holdings are securities traded directly on the surveilled exchange. The D.C. Circuit held, because the Bitcoin futures market was so tightly correlated with the Bitcoin spot market, and the Commission had already approved Bitcoin futures ETPs, that the Commission was arbitrary and capricious in not affording the same treatment for spot Bitcoin ETPs.⁷⁷

⁷⁵ [Grayscale Investments, LLC v. SEC](#), No. 11-1142, at 12 (D.C. Cir. Aug. 29, 2023) (internal citations omitted).

⁷⁶ [Teucrium Order](#), 87 Fed. Reg. at 21,679 (Apr. 12, 2022); *see also* [Valkyrie Order](#), 87 Fed. Reg. at 28,852 (May 11, 2022) (explaining “deficiencies” in Nasdaq’s evidence of whether there was “a reasonable likelihood that a would-be manipulator of the proposed ETP would have to trade on the CME” did not prevent approval).

⁷⁷ [Grayscale Investments, LLC v. SEC](#), No. 11-1142, at 13-17 (D.C. Cir. Aug. 29, 2023).

On remand, the Commission adjusted its analysis and found that “the CME bitcoin futures market has been consistently highly correlated with this subset of the spot bitcoin market.”⁷⁸ As a result:

[F]raud or manipulation that impacts prices in spot bitcoin markets would likely similarly impact CME bitcoin futures prices. And because the CME’s surveillance can assist in detecting those impacts on CME bitcoin futures prices, the Exchanges’ comprehensive surveillance-sharing agreement with the CME—a U.S. regulated market whose bitcoin futures market is consistently highly correlated to spot bitcoin ... can be reasonably expected to assist in surveilling for fraudulent and manipulative acts and practices in the specific context of the Proposals.⁷⁹

The same is true of ETH futures and spot ETH. As explained with more detail in response to Question 5 below, CME ETH futures prices are highly and consistently correlated with ETH spot prices, and no less so than between CME Bitcoin futures and Bitcoin spot prices. This high degree of correlation is unsurprising given that the reference price for the CME ETH futures ETP is driven by the same data that underlies the ETH spot market.

We expect that trading in the Shares would both inform and be informed by trading in the underlying ETH market, in light of transactions that would take place through the creation and redemption process. We expect that this too would both inform and be informed by transactions in the ETF futures market. However, as with the Bitcoin futures and spot markets, trading in the Shares would not be the predominant influence on prices in the CME ETH futures market. The Shares do not hold any futures contracts, meaning trading in the Shares could affect the CME ETH futures market only through the ETH spot market. Moreover, the Shares represent just 2.5% of outstanding ETH,⁸⁰ even less than the 3.4% represented by Grayscale’s spot Bitcoin ETP at the time of the D.C. Circuit’s holding and the Commission’s approval of the listing of Grayscale’s spot Bitcoin ETP.

The trading in the Shares will not have any impact on the price of ETH beyond what is a natural and beneficial consequence of a maturing market (i.e. by creating an additional method of gaining economic exposure to ETH through an ETP, which will further ‘complete’ markets and improve pricing efficiencies for all ETH-based products and instruments). Given this, it “necessarily follows that trading in [the Shares] will have a minimal impact on [ETH] futures”⁸¹ Moreover, the lack of an ETP redemption mechanism in the existing Trust has artificially caused at least some ETH to be locked in the Trust, so an

⁷⁸ Spot Bitcoin ETP Approval Order at 9.

⁷⁹ *Id.* at 10.

⁸⁰ As of February 9, 2024, the Trust had 310,158,500 Shares outstanding, each of which represented 0.00952592 ETH per share, for a total of 2,954,545.05832. See Grayscale, [ETHE: Grayscale Ethereum Trust](#). As of February 10, 2024, 120,171,971 ETH are in supply, meaning the Trust holds just 2.5% of outstanding ETH. See CoinMarketCap, [Ethereum](#).

⁸¹ [Grayscale Investments, LLC v. SEC](#), No. 11-1142, at 19 (D.C. Cir. Aug. 29, 2023).

approval to list and trade the Shares on the Exchange is likely to *reduce* the Trust’s relative holding of outstanding ETH, as doing so will allow redemptions for the first time and also open up competition from other ETPs.⁸²

5. Some sponsors of proposed ETH exchange-traded products (“ETPs”) have made statements regarding the correlation between ETH spot markets and the CME ETH futures market. What are commenters’ views on the correlation between the ETH spot market and the CME ETH futures market? What are commenters’ views on the extent to which a surveillance-sharing agreement with the CME would assist in detecting and deterring fraud and manipulation that impacts an ETP that holds spot ETH, and on whether correlation analysis provides any evidence to this effect? What are commenters’ views generally on whether an ETP that holds only CME ETH futures and an ETP that only holds spot ETH are similar products?

Correlation between the ETH spot market and CME ETH futures market

Given that the reference price for the CME ETH futures ETP is derived from transactions in the underlying ETH spot market, there is an unsurprisingly high and consistent correlation between the price of the ETH futures and spot ETH market. As the D.C. Circuit observed with respect to the correlation between the Bitcoin spot market and CME Bitcoin futures contract prices, “this tight correlation is not a coincidence,” as the futures prices are ultimately based on spot market prices.⁸³

Table 1 below illustrates the results of a Pearson correlation analysis for the spot ETH market and CME ETH futures market, compared against the Commission’s results for the Bitcoin market in the Spot Bitcoin ETP Approval Order. The analysis seeks to replicate the Commission’s methodology as described in the Spot Bitcoin ETP Approval order.⁸⁴ We used a time series of price returns data at hourly, five-minute, and one-minute intervals for the spot ETH/USD trading pair on Coinbase, as well as for the closest-to-maturity CME ETH futures contract sourced from DataBento.com. The sample period is from March 1, 2021, through January 31, 2024. Pearson correlation statistics were calculated for the full sample period as well as for rolling three-month segments within the sample period.

⁸² For example, the Grayscale Bitcoin Trust (BTC) has experienced outflows since its conversion into an ETP. See YCharts, [GBTC Total Assets Under Management](#) (last accessed Feb. 13, 2024).

⁸³ *Grayscale Investments, LLC v. SEC*, No. 11-1142 (D.C. Cir. 2023) at 10.

⁸⁴ Although the results are qualitatively similar, our comparative analysis of the Bitcoin spot market and CME Bitcoin Futures Market does not perfectly replicate the results published by the Commission in the Spot Bitcoin ETP Approval Order, including when we use an identical sample period (not reported). For completeness, we are making our analytical code publicly available on Github so that any difference or discrepancy can be identified.

<https://github.com/coinbase-policy/Grayscale-Ether-ETP-Application---Coinbase-Response-Letter-to-SEC>

The results of our analysis confirm that the CME ETH futures market has been consistently and highly correlated with the spot ETH market throughout the past (nearly) three years. The correlation between the CME ETH futures market and the spot ETH market for the full sample period is 99.3% using data at an hourly interval, 96.2% using data at a five-minute interval, and 84.7% using data at a one-minute interval. The rolling three-month correlation results are similar: ranging between 98.1% and 99.7% using data at an hourly interval, 93.8% and 97.1% using data at a five-minute interval, and 80.4% and 88% using data at a one-minute interval. These results show an even greater correlation than what was reported by the Commission – and also by our replication analysis – with respect to the CME Bitcoin futures market and Bitcoin spot market.

Table 1

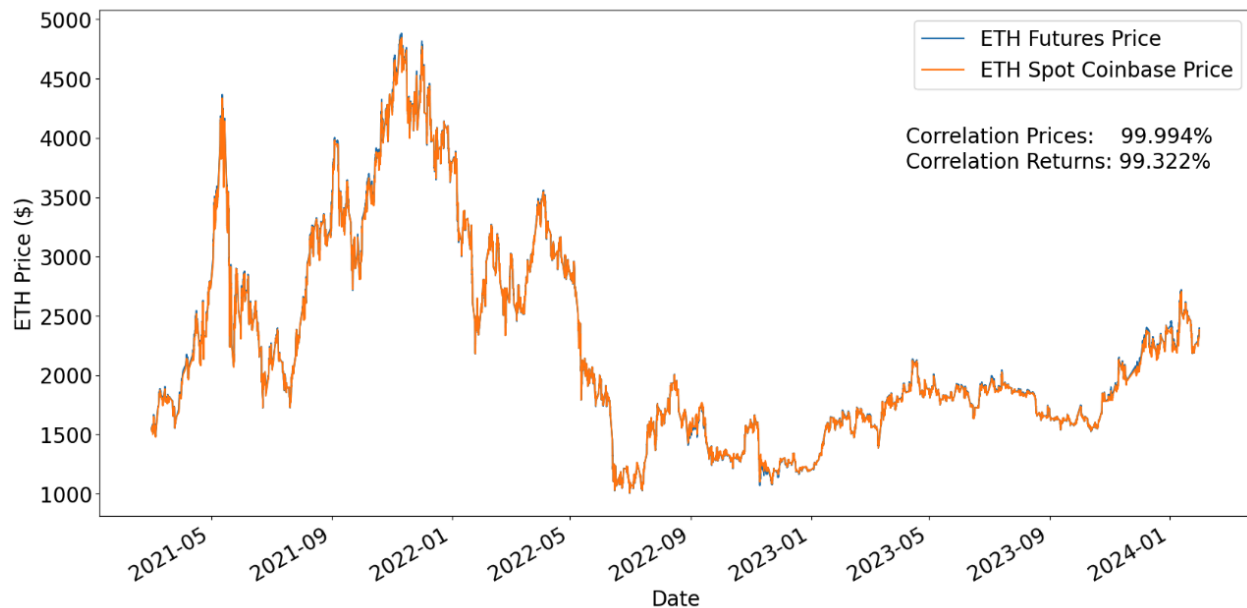
	Correlation between Coinbase Spot Bitcoin Market and CME Bitcoin Futures (Front Month) Market			Correlation between Coinbase Spot ETH Market and CME ETH Futures (Front Month) Market		
	Hourly	5 minutes	1 minutes	Hourly	5 minutes	1 minutes
Return Frequency	Hourly	5 minutes	1 minutes	Hourly	5 minutes	1 minutes
Commission Analysis⁸⁵						
Full Sample: 03/01/21 to 10/20/23	98.4	94.6	77.1			
Rolling Three-Month Correlations Over the Full Sample Period:						
Maximum	99.2	94.3	83.2			
Minimum	95.0	87.6	69.5			
Coinbase Replication Analysis						
Full Sample: 03/01/21 to 1/31/24	99.1	96.4	85.8	99.3	96.2	84.7
Rolling Three-Month Correlations Over the Full Sample Period:						
Maximum	99.6	97.1	88.6	99.7	97.1	88.0
Minimum	97.6	94.1	81.8	98.1	93.8	80.4

In **Figure 5** below we display these tabular results in graphical form, which show that the movement of ETH spot and ETH futures prices are nearly identical.

⁸⁵ See Spot Bitcoin ETP Approval Order at 9.

Figure 5

Spot Vs Futures ETH Prices



Overall, the results of Coinbase’s robust correlation analysis provide empirical evidence strongly supporting the Exchange’s conclusion that prices generally move in close alignment between the spot ETH market and the CME ETH futures market. As such, the Commission will be able to conclude, as it did with respect to spot Bitcoin ETPs, that fraud or manipulation that impacts prices in spot ETH markets would likely similarly impact CME ETH futures prices. And because the CME’s surveillance can assist in detecting those impacts on CME ETH futures prices (as further discussed below), the Exchange’s comprehensive surveillance-sharing agreement with the CME can be reasonably expected to assist in surveilling for fraudulent and manipulative acts and practices in the spot ETH market.

Exchange surveillance and monitoring practices

To address the risk of fraud and manipulation in the spot ETH market, the Exchange has a surveillance sharing agreement with the CME, on which CME ETH futures trade. The Commission has permitted ETH futures ETPs, presumably in part on the basis of the CME’s surveillance and monitoring procedures for the ETH futures market. The Exchange has a similar arrangement with CME for its spot Bitcoin ETP, and the Commission determined that CME’s procedures for the Bitcoin futures market satisfy the statutory

obligation under Exchange Act Section 6(b)(5) of being designed to prevent fraud and manipulation.⁸⁶

Just as with Bitcoin, this surveillance-sharing agreement between the Exchange and CME satisfies Exchange Act Section 6(b)(5) because the ETH spot and CME ETH futures markets are highly and consistently correlated, meaning that any fraud or manipulation in the spot ETH market that would impact the Trust would similarly impact the CME ETH futures market and be detected by the CME.⁸⁷

Similarity between CME ETH futures ETP and spot ETH ETP

As the Commission is aware, the D.C. Circuit held that “Grayscale advanced substantial evidence that its proposed bitcoin ETP was similar to the ... bitcoin futures ETPs [that were approved by the Commission]” and that the Commission approving a futures-based ETP while denying a spot-based ETP on the same asset would be arbitrary and capricious.⁸⁸ While addressing Bitcoin, the same is clearly true of ETH as well, and the facts mirror perfectly:

- the Commission has already permitted ETH futures-based ETPs and is now being asked to permit the listing of a spot ETH-based ETP;
- a spot ETH ETP tracks the same spot ETH market price as CME ETH futures ETPs; and
- CME’s surveillance can reasonably be relied upon to capture the effects on the CME ETH futures market caused by a person attempting to manipulate the CME ETH futures ETP, and because of the strong correlation with the spot ETH market, fraud in either market can be detected by CME.

Taken together, the Commission, as informed by the D.C. Circuit in *Grayscale*, can only reasonably arrive at one conclusion: an ETP that holds only CME ETH futures and an ETP that only holds spot ETH are inherently similar products, and it would be arbitrary and capricious to permit ETH futures ETPs but deny an ETH spot ETP.

Additional comments

1. Coinbase’s market surveillance practices

We have explained above in response to Question 5 why the Exchange’s surveillance-sharing agreement with the CME satisfies the requirements of Exchange Act Section 6(b)(5).

⁸⁶ [Teucrium Order](#), 87 Fed. Reg. at 21,679 (Apr. 12, 2022); [Valkyrie Order](#), 87 Fed. Reg. at 28,851 (May 11, 2022).

⁸⁷ See Spot Bitcoin ETP Approval Order at 10.

⁸⁸ [Grayscale Investments, LLC v. SEC](#), No. 11-1142 (D.C. Cir. Aug. 29, 2023).

The Commission also has consistently recognized that having a comprehensive surveillance-sharing agreement is not the *exclusive* means by which an ETP listing exchange can meet this statutory obligation.⁸⁹ The Commission has explained that a “listing exchange could, alternatively, demonstrate that other means to prevent fraudulent and manipulative acts and practices will be sufficient to justify dispensing with a surveillance-sharing agreement with a regulated market of significant size.”⁹⁰

In addition to the measures undertaken by CME and the Exchange, and in addition to the measures employed by CoinDesk to address the effect of potentially manipulative or fraudulent trading on the Index,⁹¹ Coinbase applies surveillance and monitoring measures for its spot digital asset trading platforms designed to identify and address potential manipulative or fraudulent trading activity on those platforms. We believe that the other digital asset exchanges that provide pricing data as inputs to the Index also employ measures to counter potential fraudulent or manipulative trading. In these comments, we describe our own approach.

Coinbase established its current market surveillance and monitoring program in 2018. Its market surveillance and monitoring team draws on a range of experience that includes former regulators (NYSE) and surveillance specialists from multinational, bulge-bracket banks, broker-dealers, technology companies, and crypto specialists. As part of this program, Coinbase uses a cutting-edge surveillance technology called Eventus. The program provides 24/7/365 market surveillance and monitoring across all Coinbase digital asset trading platforms and leverages machine learning and global coverage. The program monitors for the types of potentially manipulative or fraudulent trading activity that are at times observed in traditional financial markets – spoofing, wash trading, trade layering, front-running, churning, and quote stuffing.⁹² While traditional financial market surveillance often relies upon T+1 or T+2 (day) market data, the Coinbase surveillance program issues same-day alerts so that the Coinbase trade surveillance team can investigate and quickly address the triggering activity.

⁸⁹ See, e.g., Spot Bitcoin ETP Approval Order at 5 (citing other examples).

⁹⁰ *Id.* (internal citations omitted).

⁹¹ Spot ETH ETP Proposed Rule Change at 73899 (Oct. 23, 2023) (“The Index is a U.S. dollar-denominated composite reference rate for the price of ETH. The Index is designed to (i) mitigate the effects of fraud, manipulation and other anomalous trading activity from impacting the ETH reference rate, (ii) provide a real-time, volume-weighted fair value of ETH and (iii) appropriately handle and adjust for non-market related events. The Index Price is determined by the Index Provider through a process in which trade data is cleansed and compiled in such a manner as to algorithmically reduce the impact of anomalous or manipulative trading. This is accomplished by adjusting the weight of each data input based on price deviation relative to the observable set, as well as recent and long-term trading volume at each venue relative to the observable set.”).

⁹² The Coinbase Trade Surveillance Team, [How Coinbase thinks about market integrity and trade surveillance](#), Coinbase Blog (Oct. 11, 2021).

In addition to our surveillance program, Coinbase employs measures similar to circuit breakers and trading limits used in traditional financial markets to address potential manipulative or fraudulent trading activity. For example, Coinbase imposes a trading limit called the price protection point. An order on Coinbase that is large enough to move the price of ETH more than 2% is filled only up to that 2% amount, with the remainder of the order being canceled to mitigate non-fundamental price impact and avoid undue market swings.⁹³ Coinbase also monitors digital asset prices on other exchanges, and significant differences between the prices on Coinbase platforms and other exchanges trigger scrutiny and testing by the Coinbase team to assess whether these differences may reflect potential manipulative or fraudulent trading activity that should be addressed.

Coinbase has robust policies and procedures in place, many of which are available publicly, that describe our trade surveillance program and our practices to address potential market manipulation or fraudulent trading activity.⁹⁴

Finally, Coinbase participates in industry initiatives meant to further address potential manipulative and fraudulent trading activity in ETH, such as the Crypto Market Integrity Coalition, which is designed to facilitate cross-exchange surveillance and bolster the integrity and efficiency of digital asset markets.⁹⁵ Coinbase Derivatives is also in the process of applying for membership in the Intermarket Surveillance Group. Coinbase will continue to seek opportunities to collaborate with other digital asset market participants to improve cross-market surveillance.

2. Experience of Non-US ETH Spot ETPs

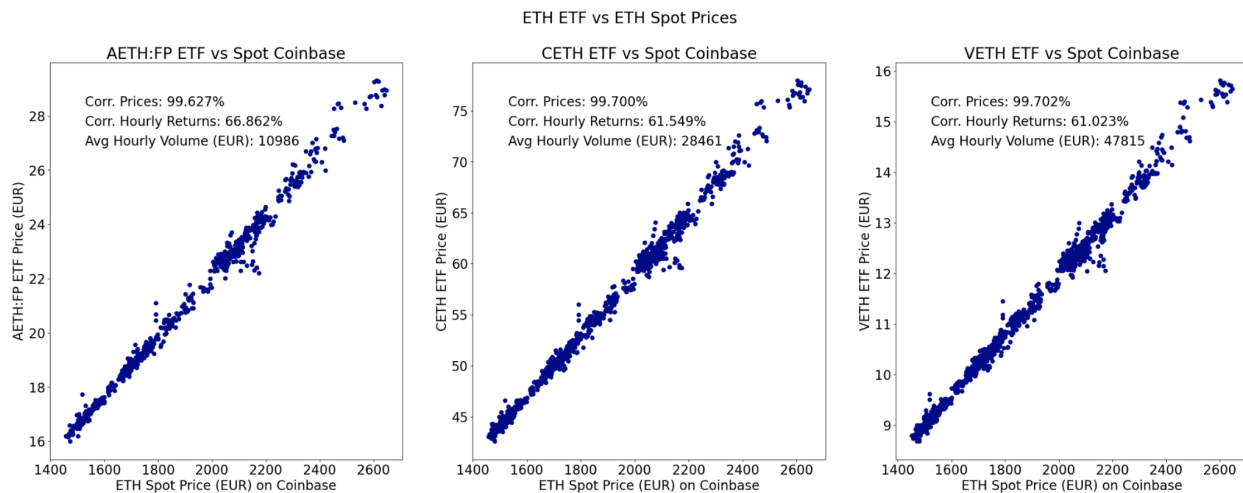
The performance of ETH spot ETPs in other countries is another helpful benchmark in assessing the ability of a US-traded ETH spot ETP to appropriately reflect the underlying ETH market. Coinbase has identified 5 countries that have approved a total of 13 ETH spot ETPs, with Canada, Jersey, Liechtenstein, and Switzerland each having approved multiple ETPs. Analysis of these non-US ETH spot ETPs demonstrates a high correlation between the ETP price and that of the underlying ETH market, as shown in **Figure 6** below. This indicates that ETH spot ETPs accurately reflect the underlying ETH market and provide investors exposure to ETH without the need to trade ETH itself.

⁹³ Coinbase Exchange, [Market Information](#) (last accessed Feb. 13, 2024). Coinbase offers dynamic protection against price movements that varies based on the trading pair, ranging from 1% to 5%. The 2% figure noted in the text applies for the ETH-USD trading pair.

⁹⁴ The Coinbase Trade Surveillance Team, [How Coinbase thinks about market integrity and trade surveillance](#), Coinbase Blog (Oct. 11, 2021); Coinbase Exchange, [Market Information](#).

⁹⁵ See Crypto Market Integrity Coalition, [Enabling a Safer Crypto Ecosystem](#).

Figure 6



These non-US ETH ETPs reflect a similarly high correlation with the ETH spot price when compared to the non-US Bitcoin ETPs that we reviewed in our prior letter.⁹⁶ Whereas the correlation for the price of Bitcoin ETPs to spot Bitcoin in that letter ranged from 99.4% to 99.9%, the correlation between the price of the above ETH ETPs and the price of spot ETH ranges from 99.6% to 99.7%.

There are global best practices that ETH spot ETPs can use to mitigate potential manipulation of their share prices and so that these prices more closely reflect the underlying ETH market. The Trust’s pricing methodology employs these best practices. The Trust (i) uses an index whose price is based upon data from multiple exchanges, (ii) weights pricing data by relative volumes, price deviations, and recency of activity, and (iii) uses an index that filters inputs to select exchanges and trade datasets that are more resistant to manipulation. The result is that the Trust should result in similar tracking of the underlying ETH market.

Conclusion

The ETH market and the Exchange’s surveillance-sharing agreement with CME support the position that the Exchange’s proposed rule change should be approved for virtually identical reasons articulated by the Commission with respect to spot Bitcoin exchange-traded products ETPs. For that and the other reasons described in this letter, approval of the Exchange’s proposal is the appropriate action for the Commission to take.

⁹⁶ See [Letter of Paul Grewal](#), Chief Legal Officer, Coinbase Global, Inc., at 20–25 (Mar. 3, 2022).