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7/7/23- Marcel Kasumovich, Deputy CIO

1. "The Commission applies the same analytical framework used…to assess whether a listing exchange of an exchange-traded product ("ETP") can meet its obligations under Exchange Act Section 6 (b)(5). As the Commission has explained, an exchange that lists bitcoin-based ETPs can meet its obligations under Exchange Act Section 6(b)(5) by demonstrating that the exchange has a **comprehensive** surveillance-sharing agreement with a **regulated market** of **significant size**," the SEC offered (emphasis added).

2. Blackrock's S1 submission for a spot bitcoin ETF breaks the logjam of previously rejected filings by resolving the surveillance-sharing agreement. It has always been the SEC's stated preference: "Although surveillance-sharing agreements are not the exclusive means by which a listing ETP can meet its obligations…such agreements have previously provided the basis for the exchanges…and the Commission has historically recognized their importance."

3. Other applicants didn't ignore the SEC's guidance. They couldn't execute. Blackrock did. Now, a backlog of existing and refiled applications is waiting for consideration. The timing is interesting to say the least. There's a fresh push from US legislators to pass a stablecoin bill. Optimism is running high enough that there's also momentum to table a comprehensive Digital Asset Market Structure proposal. The SEC is left to make qualitative judgments. **Comprehensive. Regulated market. Significant size**.

4. Traditional players were always to be second movers. After all, they have the most to lose. That they are acting now is not a small step. Yes, social media can dig up old pronouncements that are counter to the new plan. Yesterday's history. Nobody is obliged to believe tomorrow what they believed yesterday. And the pressure for regulatory clarity is rising all around – through domestic legislative and international commercial channels. It'll come by choice, by requirement of law, or by capital flight.

5. Let's put things into context of market size. Bitcoin is roughly $600 billion market capitalization. Around $25 billion is currently in asset management products, with the Grayscale Bitcoin Trust (GBTC) garnering a 77% share. GBTC has operated like a closed-end fund since the SEC shuttered its redemption feature in 2016. The Trust could not reduce its bitcoin holdings during the crypto downturn, so investors had to find a willing buyer of shares at a suitable discount. That discount crested at 49% last year.

6. The GBTC discount is greatly reduced, now at 27%, with the enthusiasm of a potential spot ETF. It is presumed that the Grayscale Trust would be eligible for entry into the ETF ecosystem, thus bringing the return of a redemption feature. That would allow the Trust to sell bitcoin and retire GBTC shares – the discount would disappear, to the benefit of investors. It would also bring an

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end to the legal dispute between GBTC and the SEC, where the presiding judge said that "the SEC has not offered any explanation."

7. But why an ETF? After all, the point of crypto assets is to build independence from existing intermediation. It's a familiar onramp. It's what investors know. It's easily integrated into existing portfolio management tools. And it's also familiar to regulators, who have a long working history with the latest traditional entrants into the bitcoin ETF arena. It's almost surely not the right tool forever. But it may be the perfect adoption tool for now.

8. Be mindful of the historical context. Just as crypto assets aim to press middleman intermediaries for efficiency benefits to investors, so were ETFs an efficiency improvement to mutual funds. From taxes to access and implementation, ETFs greatly reduced barriers to entry. ETF assets have grown more than 10-times since 2009 compared to roughly 2-times for mutual funds (Figure 1). Yet, mutual fund assets are still nearly 3x greater than ETFs, at $18.2 trillion versus $6.8 trillion (Figure 2). Habits are slow to break.

9. Legacy mutual funds are far more vulnerable to crypto asset innovations than ETFs. The chief argument for mutual funds is the active nature of their management. True. Fixed income assets are a particularly large segment, accounting for nearly two-thirds of mutual fund holdings at more than $10 trillion. At that size, the aggregate of the mutual fund industry's commitment to actively managed assets is unlikely to improve upon the broader market experience. Bonds are a financial repression tax.

10. Assets will gradually migrate into tokenized forms. Traditional early adopters are more likely to adapt, leading to more efficient asset management, especially in the active sphere. ETFs, with their tax advantages, may have a unique role to play in digital rails. But it's the infrastructure in this transition where native digital players win big. And that's a patience game, just as the growth in ETFs through the early 2000s.

11. Think of the latest push for spot ETFs as signaling. What if it doesn't happen? The growth will find alternative paths. US dollar stablecoins are still the benchmark despite regulatory frictions. The first and only institutional version of stablecoins was issued in Hong Kong, not America. Canada, hardly a crypto cowboy country, quietly approved an ETH-staking ETF with sensible, favorable tax considerations. Innovation follows the path of least resistance, just like water.

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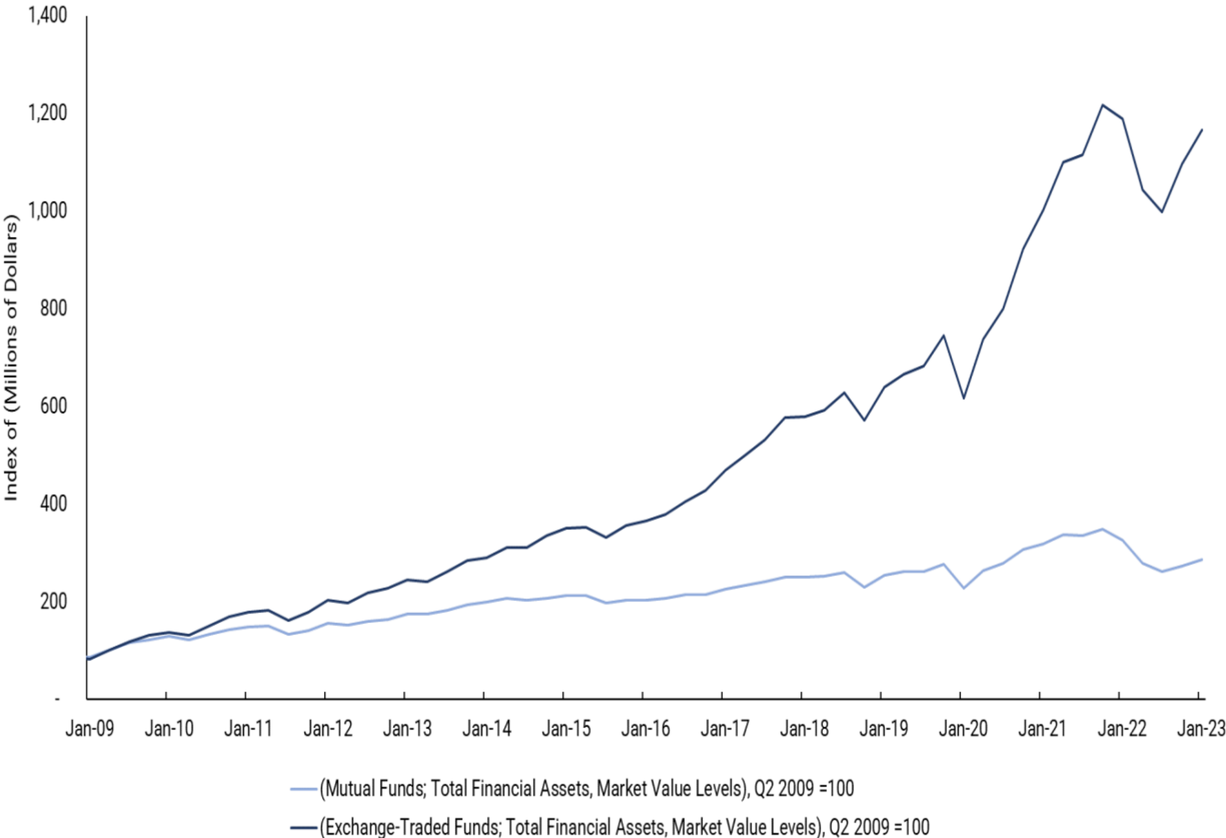
Figure 1: ETF Growth v Mutual Funds – A Sign for Crypto Asset Growth



Source: Federal Reserve Board. St. Louis Federal Reserve Bank.

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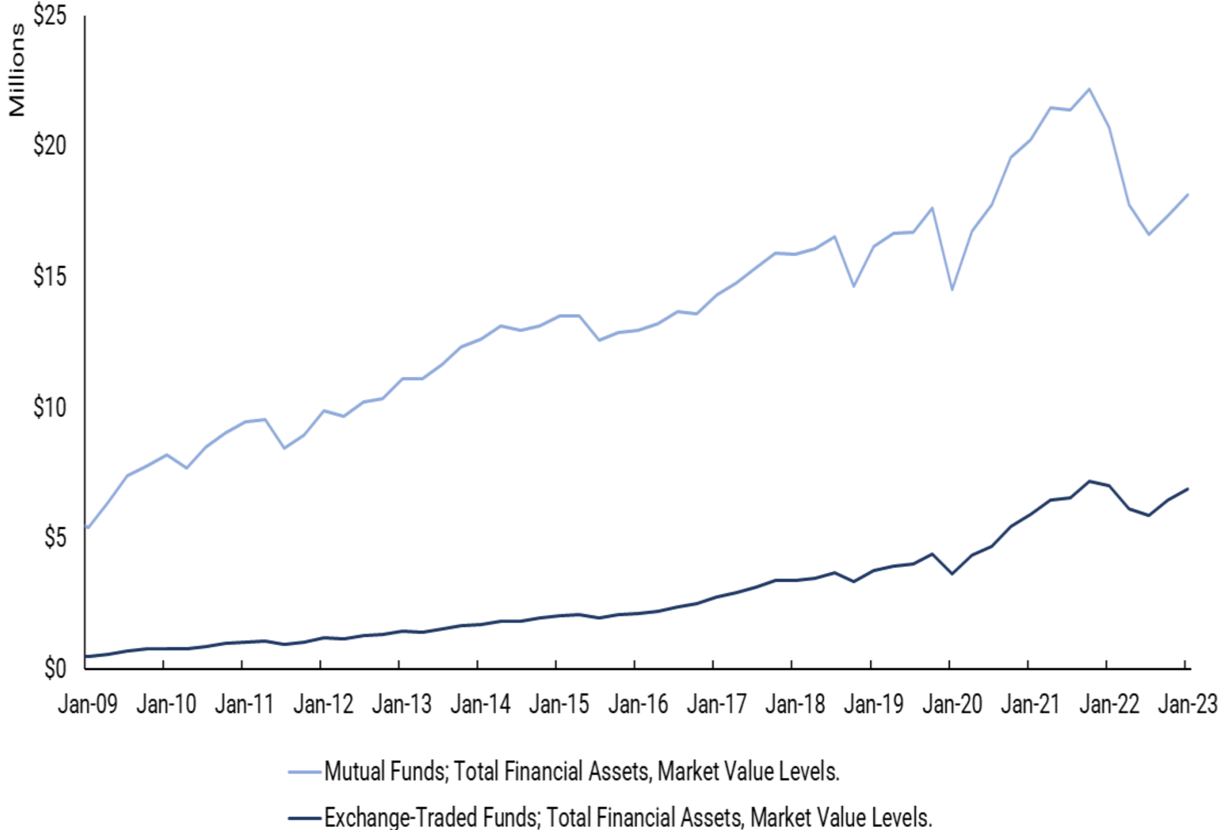
Figure 2: Mutual Fund AUM Still Large – Ripe for Disruption



Source: Federal Reserve Board. St. Louis Federal Reserve Bank.

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