BETTER MARKETS

May 15, 2024

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Ark 21Shares Ethereum ETF, File No. SR-CboeBZX-2023-070
VanEck Ethereum ETF, File No. SR-CboeBZX-2023-069
Hashdex Nasdaq Ethereum ETF, File No. SR-NASDAQ-2023-035

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to provide further comment on several proposed rule changes filed by the Cboe BZX Exchange, Inc., and The NASDAQ Stock Market, LLC (the "Exchanges") with the Securities and Exchange Commission ("SEC" or "Commission"), seeking to list and trade shares of spot ether exchange-traded products ("ETPs").[2]

In our prior comment letter, we said that the SEC's approval of spot bitcoin ETPs was a mistake that threatened to harm countless investors and that the SEC should not compound that mistake by approving spot ether ETPs.[3] Doing so would only further endanger investors:

> Now that key financial firms have bought into crypto, it's all the more essential that thoughtful, carefully crafted regulation be put in place. To protect investors, yes, but also to install a firewall limiting the contagion any future crypto disasters can transmit to the rest of the financial world. Careful limits on what assets can be sold, who they can be sold to and what disclosures are needed to go with them could help limit the damage to those who choose to engage with the sector . . . .[4]

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Ark 21Shares Ethereum ETF, SR-CboeBZX-2023-070; VanEck Ethereum ETF, SR-CboeBZX-2023-069; Hashdex Nasdaq Ethereum ETF, SR-NASDAQ-2023-035.

3 *See* Better Markets, Comment Letter re: Ark 21Shares Ethereum ETF, SR-CboeBZX-2023-070; VanEck Ethereum ETF, SR-CboeBZX-2023-069; and Hashdex Nasdaq Ethereum ETF, SR-NASDAQ-2023-035 (Jan. 12, 2024), https://bettermarkets.org/wp-content/uploads/2024/01/Better-Markets-Comment-Letter-Spot-Ether-ETP.pdf.

4 Molly White, *The State of Crypto is Anything But Strong*, Bloomberg (May 2, 2024), https://www.bloomberg.com/news/features/2024-05-02/crypto-is-anything-but-strong-right-now?sref=mQvUqJZj.

In terms of what assets should be sold, we opposed spot bitcoin ETPs on the ground that the SEC should not "unleash a speculative, volatile, and socially useless financial product on tens of millions of American investors and retirees."[5] Our prior comment letter with respect to spot ether ETPs similarly noted that ether's "extreme volatility" made it a "gamble" and that the SEC therefore could not approve the rule changes to list and trade spot ether ETPs and still fulfill its mission to protect investors and the public interest.[6] The reasons for denying the Exchanges' proposed rule changes to list and trade spot ether ETPs have only increased since that time.

I. The approval of spot bitcoin ETPs has done nothing to quell bitcoin's volatility, which threatens retail investors who may be unable to cope with such an unstable asset.

The experience with spot bitcoin ETPs in the four months since their approval shows why spot ether ETPs should not also be approved. Some predicted that the SEC's approval of spot bitcoin ETPs would dampen bitcoin's volatility.[7] But that has not proven to be the case. Inflows into spot bitcoin ETPs led bitcoin to reach a peak of $69,000 about two months after their approval, but the same day it reached that peak bitcoin "quickly reversed from the high, leading to an intraday swing of more than 14 percentage points," with an 8 percentage point swing the next day.[8] Cryptocurrencies such as bitcoin have always been "extremely risky and highly volatile assets that create serious dangers for investors."[9] This volatility is especially problematic now that retail investors can more easily invest in bitcoin by virtue of the spot bitcoin ETPs the SEC approved.

> "Hopefully, they were all warned this could happen, but even so, it was probably startling to many and unfortunately perhaps devasting to a few," wrote Noelle Acheson, author of the *Crypto Is Macro Now* newsletter. "If yesterday's moves permanently scared away many who do not want this kind of action in their portfolios, then that is good news for them and for the market."[10]

Indeed, it appears that, after the approval of spot bitcoin ETPs caused bitcoin to reach a record high, swings in the price of bitcoin are only "becoming more intense."[11] After reaching the high of $69,000 and then quickly falling, bitcoin reached a new high of $73,750 but again then fell by more than 12% over a few weeks, including a 6% drop in one day.[12] It is therefore unsurprising

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5 Better Markets, Comment Letter re: Ark21Shares Bitcoin ETF, et al. (Jan. 5, 2024), https://bettermarkets.org/wp-content/uploads/2024/01/Better-Markets-Supplemental-Comment-Letter-Bitcoin-ETF.pdf.

6 Better Markets, supra note 3.

7 David Lawant and Vivek Chauhan, *How the Launch of Spot ETFs Could Dampen Bitcoin's Volatility*, CoinDesk (Jan. 31, 2024), https://www.coindesk.com/markets/2024/01/31/how-the-launch-of-spot-etfs-could-dampen-bitcoins-volatility/.

8 Sunil Jagtiani, *Spike in Bitcoin Volatility Heralds an Early Test of US ETF Demand*, Bloomberg (Mar. 7, 2024), https://www.bloomberg.com/news/articles/2024-03-07/bitcoin-btc-volatility-spike-heralds-an-early-test-of-us-etf-demand?sref=mQvUqJZj.

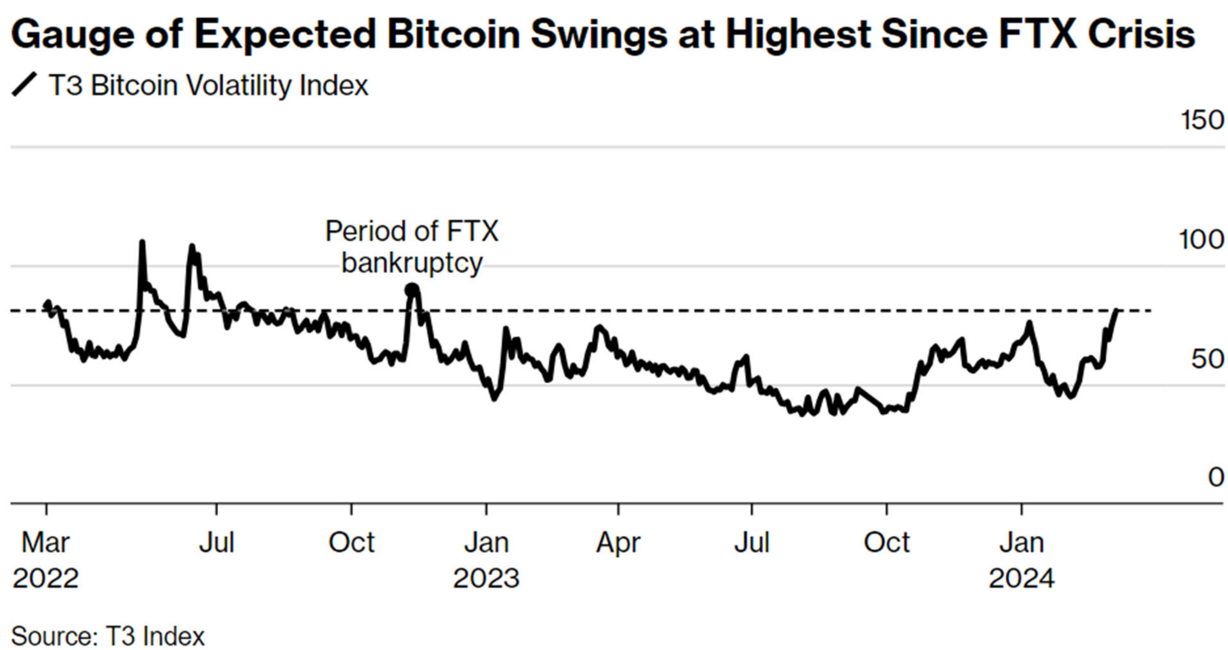
9 Arthur E. Wilmarth, Jr., *We Must Protect Investors and Our Banking System from the Crypto Industry*, 101 Wash. U. L. Rev. 235, 246 (2023).

10 Jagtiani, supra note 8.

11 *Id.*

12 Michael Adams, *Why is Bitcoin Down Today?*, Forbes Advisor (Apr. 2, 2024), https://www.forbes.com/advisor/investing/cryptocurrency/why-is-bitcoins-price-falling/; *see also Volatile*

that, a few months after the SEC's approval of spot bitcoin ETPs, the T3 Bitcoin Volatility Index, which uses option prices to give a sense of expected 30-day swings in the token, "jumped to its highest level since the aftermath of the collapse of Sam Bankman-Fried's FTX exchange."[13]



Bitcoin's volatility should not be surprising since there "'aren't any fundamentals to bitcoin which give an anchor to the price.'"[14] There is nothing to use "'as a base for a valuation.'"[15] This makes bitcoin "'more vulnerable than other assets to major swings.'"[16] And investing in bitcoin through a spot bitcoin ETP does not provide any greater protection against this volatility. The underlying spot bitcoin market remains largely unregulated, and investors in spot bitcoin ETPs are exposed to this market, regardless of how tightly regulated the issuer is, because the underlying asset is bitcoin.[17] The fact that spot bitcoin EPTs are issued by regulated entities "'is something that gives investors confidence, but it doesn't alter the fundamental nature of bitcoin itself.'"[18]

The spike in bitcoin's price following the approval of spot bitcoin EPTs also should not give anyone confidence—especially since it was the approval that drove the spike. "History also tells us the crypto markets go through major boom and bust cycles, each one bigger than before. In May 2022, just six months after bitcoin traded at $69,000, a now-infamous crypto platform

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bitcoin falls from record high as crypto frenzy hits pause, Reuters (Mar. 15, 2024), https://www.reuters.com/markets/currencies/volatile-bitcoin-falls-record-high-crypto-frenzy-hits-pause-2024-03-15/.

13 Jagtiani, supra note 8.

14 Scott Chipolina, *Should UK investors have easier access to crypto?*, Fin. Times (Apr. 12, 2024) (quoting Laith Khalaf, head of investment analysis at investment platform AJ Bell in London), https://www.ft.com/content/09ac764c-831f-49e2-8426-16b9e05b2f0a.

15 *Id.* (quoting Khalaf).

16 *Id.* (quoting Khalaf).

17 *See id.*

18 *Id.* (quoting Khalaf).

named Terraform Labs collapsed, kick-starting an unprecedented market crisis. The crash—which culminated in the collapse of then crypto kingpin Bankman-Fried and his exchange—pulled bitcoin down to $16,000, a 75 percent fall from its previous high."[19] The price of bitcoin has since recovered to a new high, due in large part to the SEC's approval of spot bitcoin ETPs. But if the chart below is any guide, the price is unlikely to remain there for long. And the fact that spot bitcoin ETPs are now widely available means that retail investors are more likely to suffer during the next crash. As a result, it appears that jurisdictions that do not open their markets to crypto are "'ahead when it comes to protecting consumers from an untested and volatile asset.'"[20]

II. The fact that ether is just as volatile as bitcoin means that a spot ether ETP would threaten retail investors by exposing them to another unstable asset.

That the SEC's approval of spot bitcoin ETPs has done nothing to damper bitcoin's volatility, and has therefore done nothing to lessen the risks to investors from that volatility, means the SEC should not further expose retail investors to another unstable asset by approving spot ether ETPs. Ether is no less "prone to extreme price volatility" than is bitcoin, and investing in either

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19 *Id.*

20 *Id.* (quoting Khalaf); *see also* Yousra Anwar Ahmed, *Singapore Says No to Retail Crypto ETFs*, Yahoo Finance (Jan. 18, 2024), https://finance.yahoo.com/news/singapore-says-no-retail-crypto-104547281.html (reporting that Singapore announced it would not allow the listing of spot bitcoin ETFs for retail investors due to "concerns over the high volatility and speculative nature of cryptocurrencies").

"requires a high risk tolerance."[21] "As shown in the graph below, both bitcoin and ether are far more volatile than the S&P 500, hardly suggestive that they are safe stores of value."[22]

Bitcoin (BTC / USD)	19,302.10	-27,953.80	↓59.15%
Ether (ETH / USD)	1,353.98	-1,969.02	↓59.25%
S&P 500	3,897.58	-460.15	↓10.56%

Bitcoin; Ether; and SP500 One Year Change in Value (Google Finance)

The fact that ether is just as volatile as bitcoin means that the SEC should not compound its mistake in approving spot bitcoin ETPs by approving spot ether ETPs. One study found that anyone who might need to convert ether to fiat currency, as might many retail investors, "undertakes incredible risk by transacting in Ether."[23] That is because ether's "massive volatility means that the need to cash out at a moment's notice could lead to substantial losses."[24] The study found that "a person with exquisitely unfortunate timing stood to lose $3,816.56 for each unit of Ether bought and sold solely due to fluctuations" in the rate of converting ether to dollars.[25] "Such volatility makes Ether an extremely risky store of value for anybody who might need to convert it

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21 Wayne Duggan, *Bitcoin vs. Ethereum: Which is the Better Buy?*, U.S. News & World Report (Mar. 6, 2024), https://money.usnews.com/investing/cryptocurrency/articles/bitcoin-vs-ethereum-which-is-a-better-buy.

22 Stephen J. Lubben, *We Got The Kingdom, We Got The Key: Corporate Bankruptcy and Cryptocurrency*, 6 Stan. J. Blockchain L. & Pol'y 219, 231 (2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4404167 (chart at page 18).

23 Thomas D. Haley, *Embracing Digital*, 101 N.C. L. Rev. 619, 665 (2023).

24 *Id.* at 664.

25 *Id.* at 666-67.

into a more useful currency in short order."[26] It is true that ether's volatility means that, for those "with the means to gamble," the possibility of high returns exists.[27] The problem is that "few possess the resources to buy and hold significant amounts of such a volatile asset."[28]

Ether's volatility recently had real-world consequences. Just last month, ether "experienced a significant downturn, losing 21% of its value between Apr. 9 and Apr. 14."[29] On April 12, it experienced an intraday drop of 12%.[30] Ether recovered on April 15 and then fell again. In the midst of this volatility, an investor sold $33 million of ether and incurred a $4 million loss. This investor had a long, leveraged position in ether, and that position "turned precarious as Ethereum prices began to swing wildly over the past month."[31] Ultimately, the investor needed to sell the position to pay off a debt. The sale "was executed as Ethereum's price dipped to $3,076, extending its loss from the Apr. 15 highs of $3,281."[32] The decision to liquidate during a downturn suggests that the investor "aimed to minimize further losses or possibly needed to free up capital quickly."[33] So the timing of the liquidation "points to the volatile nature of the crypto market."[34]

The fact that reports described this particular investor as a "whale" suggests the investor may have been able to bear the loss, but the incident should still serve as a warning for the SEC and retail investors. In addition to highlighting the risks of investing in ether, such large sales by significant holders "can exacerbate price volatility and lead to wider market repercussions."[35] An approval of spot ether ETPs would further expose retail investors to this "inherent risk[] of the cryptocurrency markets," where "decisions by a few can have far-reaching effects on many."[36]

Rather than exacerbating these risks, the SEC must protect retail investors from them. When it comes to ether specifically and crypto generally, the "current economic landscape [is] marked by uncertainty and rapid changes."[37] As it stands, the crypto market "remains a challenging environment."[38] The volatility in the industry underscores "the high stakes and

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26 *Id.* at 667.
27 *Id.*
28 *Id.*
29 Steven Walgenbach, *Ethereum (ETH) Investor Faces Losses in $33 Million Sell-Off*, Coinpaper (Apr. 17, 2024), https://coinpaper.com/3953/ethereum-eth-investor-faces-losses-in-33-million-sell-off.
30 David Pan and Maria Paula Mijares Torres, *Bitcoin Swoon Sets Off 'Cascade of Liquidations' of Bullish Bets*, Bloomberg (Ar. 12, 2024), https://www.bloomberg.com/news/articles/2024-04-12/bitcoin-declines-as-the-liquidation-of-bullish-bets-accelerate?sref=mQvUqJZj.
31 Walgenbach, supra note 29.
32 *Id.*
33 *Id.*
34 *Id.*; *see also* Ciaran Lyons, *$510M longs at risk if Ether repeats last weekend's volatility*, Cointelegraph (Apr. 26, 2024), https://cointelegraph.com/news/510-million-longs-at-risk-ether-weekend-volatility (reporting that, after ether fell nearly 9% on April 13 and 2.25% on April 20, if ether experienced a similar 2.25% drop the following week it would lead to "$510 million in long liquidations," and a "sharper decline similar to the 9% drop seen" previously "would result in $853 million being wiped in long liquidations").
35 Walgenbach, supra note 29.
36 *Id.*
37 *Id.*
38 *Id.*

speculative nature of this digital economic landscape."[39] In these circumstances, the SEC cannot approve spot ether ETPs consistently with its mission to protect investors and the public interest.

C. The concentration in the Ethereum network is especially risky for investors.

In our prior comment letter, we noted that the Ethereum network has features that make it risky. One such risk is concentration in the network, specifically the concentration of validators. Recently, S&P Global warned that the "prospect of a US approval of Ether exchange-traded funds threatens to exacerbate the Ethereum ecosystem's concentration problem."[40] That is because some of the spot ether ETP applications "are proposing to allow staking, that is when Ether holders lock their tokens to the Ethereum network to help validate transactions and to earn additional yields."[41] Because validating transactions is hard, many prefer to stake through exchanges.[42] The approval of spot ether ETPs could therefore lead to a concentration of ether staking on exchanges, which is a "big potential risk": "A few exchanges could gain outsize control over the entire ether market."[43]

Indeed, based on inflows to spot bitcoin ETPs after their approval, spot ether ETPs could become large enough to change validator concentrations, which "could expose the network to operational risks, such as inactivity resulting from a single point of failure, or malicious collusion."[44] "When a small group of stakers controls a considerable portion of the network's staked ETH, it can lead to a concentration of power and potential for abuse."[45] Risks include "the potential for increased security threats due to a single point of failure," and "limited transparency and the potential for fraud can also be a risk of centralization in staking pools."[46] Bad actors "may attempt to take advantage of the centralized nature of these pools for fraudulent purposes."[47]

There would also be risks even if those with control "did nothing nefarious."[48] That is because Ethereum "penalizes validators who make mistakes when checking transactions," which has already happened over 400 times.[49] As a result, any mistake in checking transactions from a big player "would imply a huge payout."[50] "If the ether was held for an ETF that got devalued as a result, 'confidence would drop through the floor, and regulators would step in.'"[51] So the risks

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39 *Id.*

40 Yuegi Yang, *Ether ETF Applications Spur S&P Warning on Concentration Risks*, Bloomberg (Feb. 21, 2024), https://www.bloomberg.com/news/articles/2024-02-21/ether-etf-applications-spur-s-p-warning-on-concentration-risks?sref=mQvUqJZj.

41 *Id.*

42 Jon Sindreu, *A Spot Bitcoin ETF is Easy. What Comes Next Could Get Dangerous.*, The Wall Street Journal (Dec. 11, 2023), https://www.wsj.com/finance/currencies/a-spot-bitcoin-etf-is-easy-what-comes-next-could-get-dangerous-03453072?mod=Searchresults_pos5&page=1.

43 *Id.*

44 Yang, supra note 40.

45 Jon Ganor, *Ethereum Staking Pools: The Risks of Lido's Centralization*, Hord (Jan. 14, 2024), https://www.hord.fi/blog/ethereum-staking-pools-the-risks-of-lidos-centralization.

46 *Id.*

47 *Id.*

48 Sindreu, supra note 42.

49 *Id.*

50 *Id.*

51 *Id.* (quoting Jim McDonald, chief technology officer at staking company Attestant).

from staking distinguish spot ether ETPs from spot bitcoin ETPs and provide a sufficient basis to find that spot ether ETPs are not consistent with the public interest and the protection of investors.[52]

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The stakes for retail investors are high. Traditional financial firms are now "pitching cryptocurrencies as a sound way to diversify," while "the crypto markets remain fraught with manipulation and scams."[53] Issuers of spot bitcoin ETPs "emphasize their due diligence in their prospectuses," but "the current crop of ETF hawkers" are not the first to promise safety and security.[54] "Before its collapse ruined many of its customers, 'safe and easy' was a tagline of FTX, too."[55] The difference now is that the crypto industry is "loudly promoting ETFs as well as the underlying assets to lay investors and institutional funds alike."[56] So retail investors will be the ones who suffer if products like spot ether ETPs are approved and another crash ensues. And "another crash seems inevitable, part of a vicious cycle that no one has had the strength to break."[57]

Moreover, the approval of spot ether ETPs would threaten not just investors but also the broader financial system. That is because the SEC's approval of spot bitcoin ETPs already "deepen[ed] ties between the volatile world of cryptocurrencies and the traditional finance system, potentially creating new unforeseen risks."[58] The International Monetary Fund previously warned, before the approval of spot bitcoin ETPs, that crypto assets "'could potentially pose financial stability risks due to their extreme volatility.'"[59] Spot bitcoin ETPs exacerbate these risks because the "differences with a plain-vanilla stock ETF are simply too large in terms of embedded risks.'"[60] These products, if widely adopted, "could pose risks to other parts of the financial system during times of market stress by exacerbating bitcoin price volatility, or creating dislocations between the price of the ETF and bitcoin."[61] That can "cause stress for institutions heavily exposed to the products or which rely on them for liquidity management."[62] Approving spot ether ETPs would further entangle the crypto industry with traditional finance and aggravate all of these risks.

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52 Christina Sciaudone, *Why Spot Ether ETFs Could Face a Difficult Path to Approval*, Investopedia (Mar. 26, 2024), https://www.investopedia.com/why-spot-ether-etfs-could-face-a-difficult-path-to-approval-8609104.

53 White, supra note 4.

54 *Id.*

55 *Id.*

56 *Id.*

57 *Id.*

58 Elizabeth Howcroft and Hannah Lang, *US bitcoin ETFs raise questions over broader financial system risks*, Reuters (Jan. 31, 2024), https://www.reuters.com/business/finance/us-bitcoin-etfs-raise-questions-over-broader-financial-system-risks-2024-01-31/.

59 Wilmarth, 101 Wash. U. L. Rev. at 245 (quoting Tara Iyer, IMF, Cryptic Connections: Spillovers Between Crypto and Equity Markets, at 3, Global Financial Stability Notes No. 2022/01 (Jan. 2022), https://www.imf.org/en/Publications/global-financial-stability-notes/Issues/2022/01/10/Cryptic-Connections-511776).

60 Howcroft and Lang, supra note 58 (quoting Antonio Sanchez Serrano, principal economist at the European Systemic Risk Board).

61 *Id.*

62 *Id.*

> The saving grace of the 2023 crypto winter was that average folks who opted to stay away suffered little or no fallout. . . . During the crypto downturn, as some speculators saw their life savings collapse along with token prices, the rest of the world went on relatively unscathed. If traditional finance becomes more entangled with crypto, the rest of us won't be so lucky next time.[63]

Conclusion

We hope these comments are helpful as the Commission considers these matters.

Sincerely,

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[63] White, supra note 4.