MEMORANDUM

TO: File No. SR-NYSEARCA-2021-90

FROM: David Remus
              Office of Market Supervision, Division of Trading and Markets

DATE: December 8, 2023

SUBJECT: Meeting with Grayscale re: Grayscale Bitcoin Trust (BTC)

On December 8, 2023, Molly Kim, Thomas McGowan, Ray Lombardo, Sarah Schandler, Edward Cho, Stacia Sowerby, and David Remus from the Division of Trading and Markets, and Justin Dobbie and Andrew Schoeffler from the Division of Corporation Finance, participated in a meeting with Joseph Hall, Lucy Farr, Dan Gibbons, and Zachary Zweihorn from Davis Polk, and Craig Salm, David LaValle, John Hoffman, and Krista Lynch from Grayscale.

The discussion concerned NYSE Arca's proposed rule change to list and trade shares of the Grayscale Bitcoin Trust (BTC) under NYSE Arca Rule 8.201-E. Grayscale also provided the attached presentation.

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GBTC Workflows

Objective

Spot Bitcoin ETPs* should offer both in-kind and cash creations and redemptions

- All else equal, in-kind creations and redemptions are more efficient, and therefore more beneficial, for ETP investors

- However, in the context of spot Bitcoin ETPs, not all Authorized Participants (APs) can facilitate in-kind creations and redemptions

- Even for those APs that can facilitate in-kind creations and redemptions, we understand that the Staff has raised questions regarding regulatory challenges

We believe offering both in-kind and cash creations and redemptions is in the best interest of investors, because it supports a deeper, more robust primary market, resulting in a more efficient ETP market structure

Grayscale stands ready to offer both in-kind and cash creations and redemptions. Today, we would like to walk through some of the factors we have considered, how we have addressed the Staff's expected concerns, as well as important tax considerations.

* We refer to ETP and Trust interchangeably throughout this presentation

Contents & Agenda

- Grantor Trust Tax Status Considerations

- In-Kind Creation/Redemption Model

- Broker-Dealer Regulatory Considerations

- Proposed Cash Creation/Redemption Model

  - Key Takeaways

- Questions, Comments, and Discussion

# Grantor Trust Tax Status Considerations

Considerations for Spot Bitcoin ETPs:

- ETPs containing spot commodities are substantially all structured as grantor trusts, which are pass-through vehicles for US federal income tax purposes

- Grantor trusts cannot operate a trade or business, or "vary" the investment of the trust estate for which beneficial owners have exposure

- Therefore, accepting cash in a grantor trust designed for exposure to Bitcoin would introduce uncertainty and risk to the trust's status as a grantor trust for US federal income tax purposes

  - If a spot Bitcoin ETP failed to qualify as a grantor trust, there is uncertainty as to whether it could continue to be treated as a pass-through for US federal income tax purposes, and thus be subject to taxation at the spot Bitcoin ETP level

  - Taxation at the spot Bitcoin ETP level (i.e. double taxation to the investor) would introduce tracking error and tax inefficiencies for investors

In–Kind Creation Model
This process is reversed for in-kind redemptions
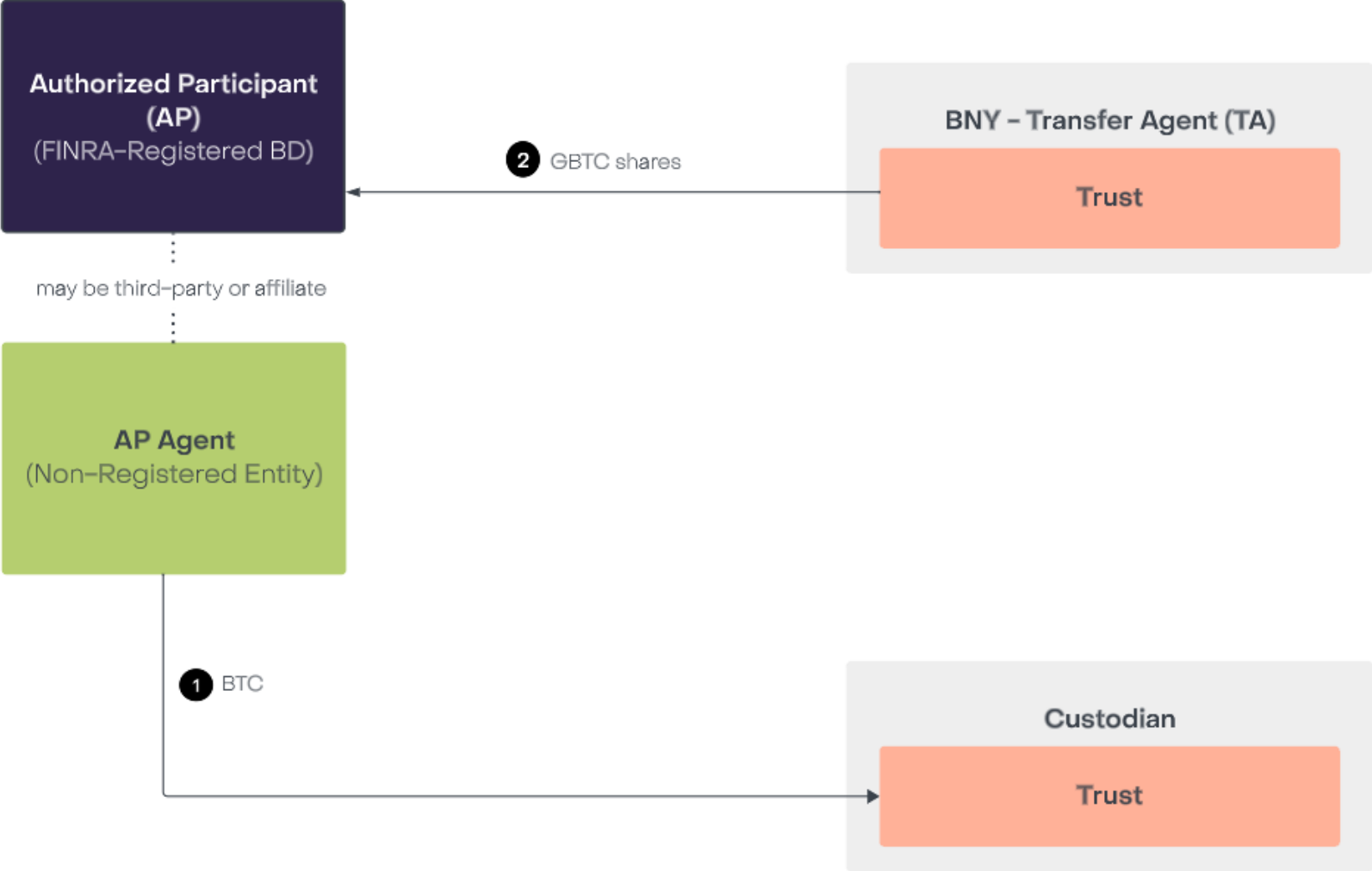
Broker-Dealer Regulatory Considerations

Considerations for Spot Bitcoin ETPs:

- Only Authorized Participants (APs) can create and redeem ETP shares and they must be FINRA-registered, self-clearing broker-dealers, among other requirements

- There has yet to be definitive regulatory guidance on whether and how registered broker-dealers can own or custody Bitcoin for themselves or others, raising questions around compliance with broker-dealer net capital, customer protection, and recordkeeping rules

- We believe these questions should not arise in a spot Bitcoin ETP structure where:

  - Broker-dealer does not own Bitcoin, nor is Bitcoin held on its balance sheet
  - Broker-dealer does not custody Bitcoin for itself or any other party
  - Broker-dealer does not have exposure to the price movement of Bitcoin (other than through ownership of the spot Bitcoin ETP)

Cash Creation Model

Grayscale's proposed creation workflow results in ETP receiving Bitcoin and AP receiving shares without owning Bitcoin*:

Trade Date

❶ Price for Creation Unit is set based on (i) NAV**, plus (ii) Variable Rate (i.e., spread)

❷ Sponsor, as "Liquidity Engager," arranges for third party "Liquidity Provider" to principally buy Bitcoin and deliver to Trust

Settlement Date

❶ AP sends cash to "Liquidity Administrator," an affiliate of the Sponsor

❷ Liquidity Provider delivers Bitcoin to Trust's wallet at Custodian

(3a) Trust issues shares, held at Transfer Agent for AP

(3b) Liquidity Administrator sends cash to the Liquidity Provider

❹ AP receives shares

Key Takeaways

- **Satisfaction of Grantor Trust Tax Considerations:** Trust creates shares in exchange for Bitcoin and never holds cash

- **Satisfaction of Broker–Dealer Regulatory Considerations:** AP creates shares in exchange for cash and never holds Bitcoin directly or through an agent
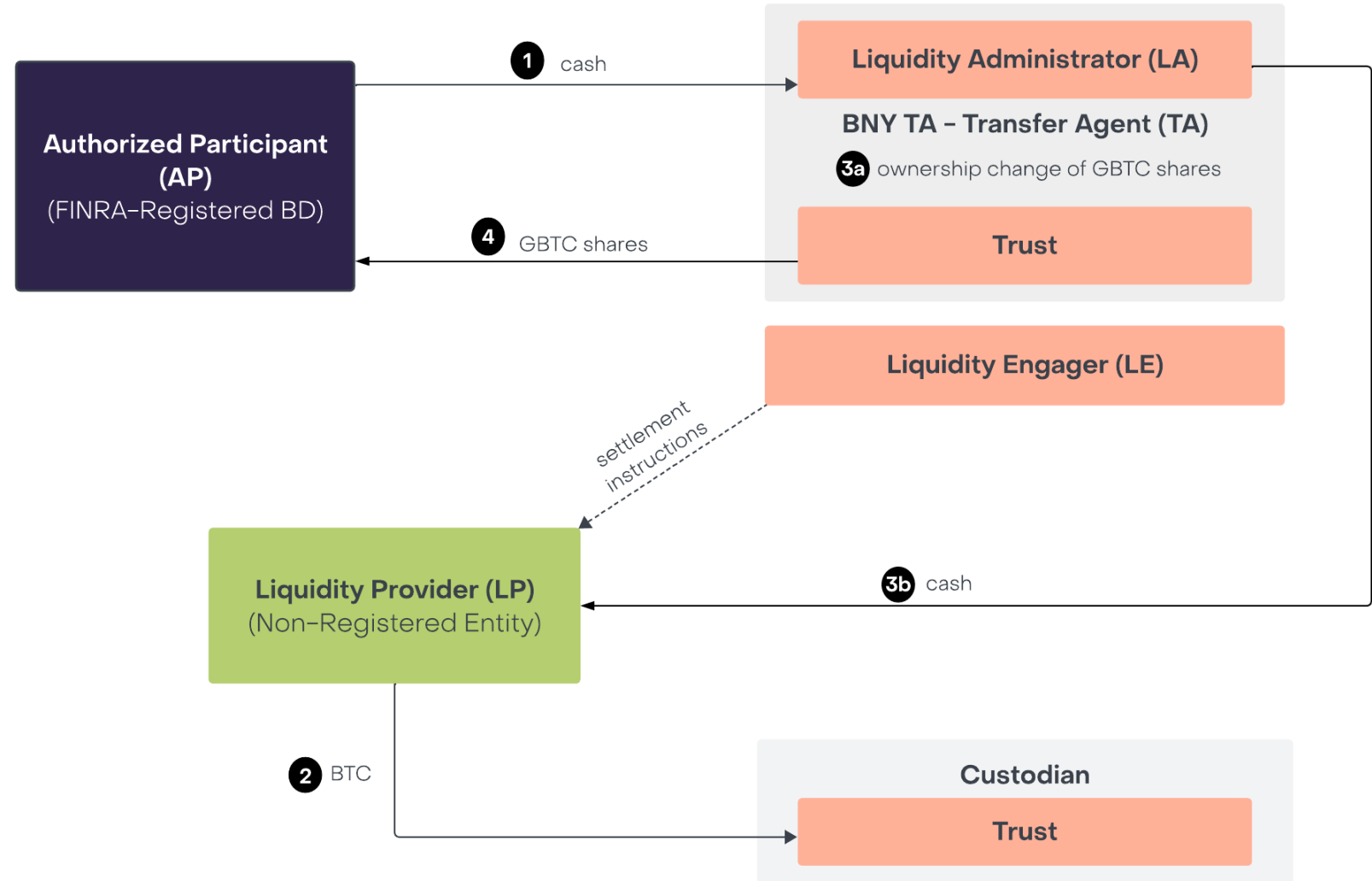
*This process is reversed for redemptions
**Based on the CoinDesk Price Index (XBX) as of 4:00 PM EST

Cash Creation/Redemption: Trade Date
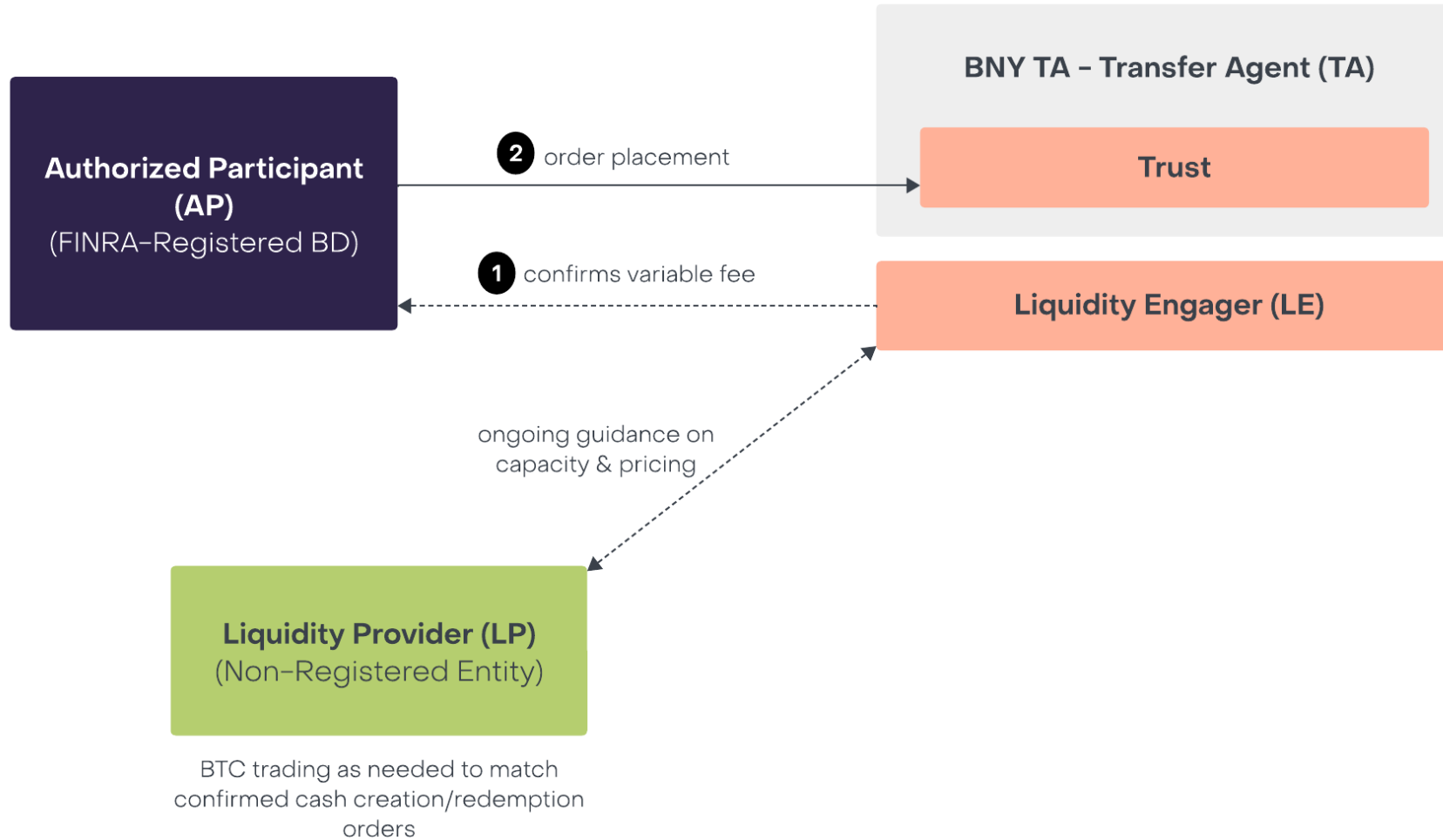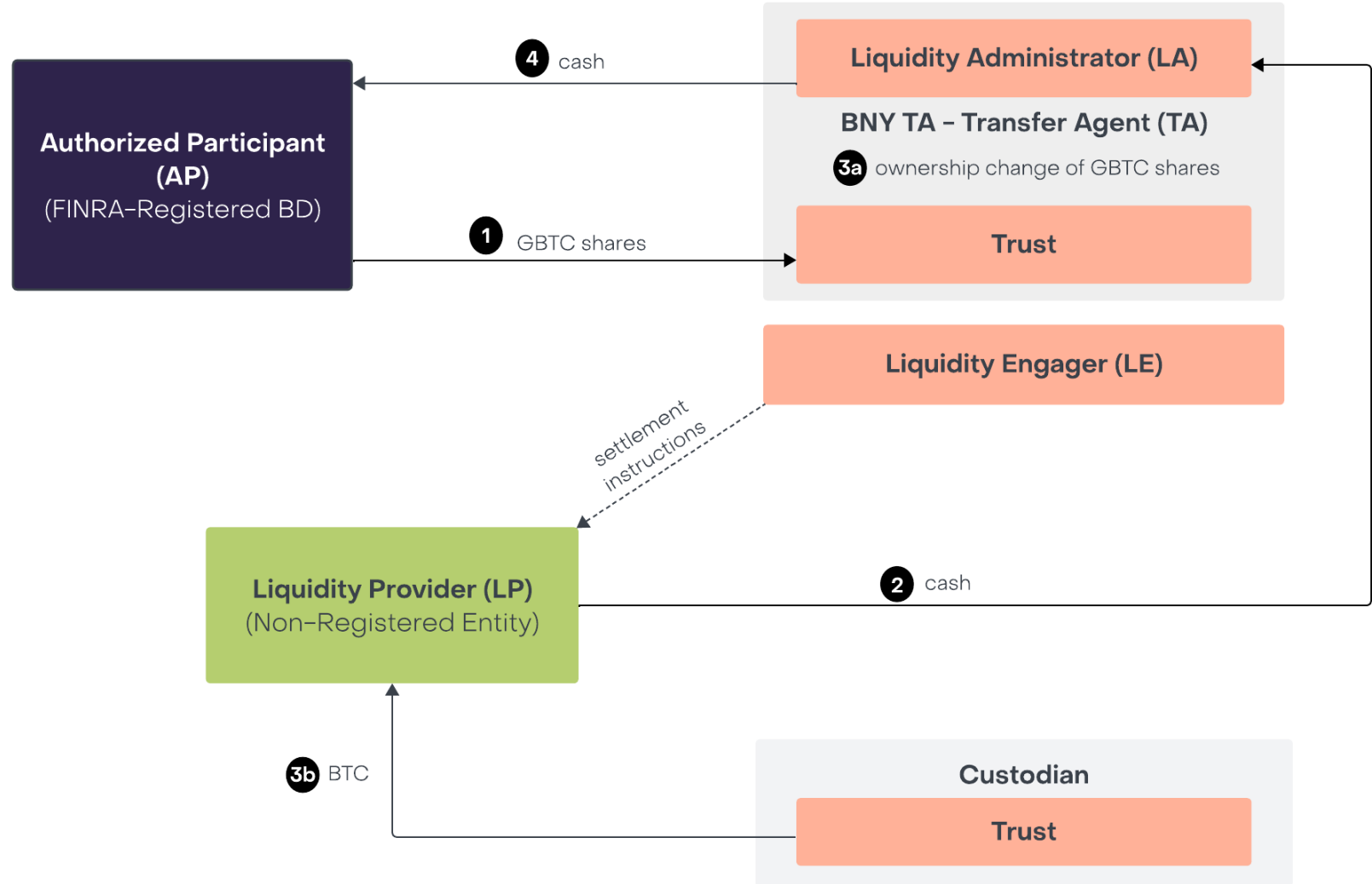
Cash Creation: Settlement Date

Settlement Steps:

1. AP sends cash to LA

2. LP sends Bitcoin to Trust wallet at Custodian

3a. Trust issues shares for AP, held at BNY for AP

3b. LA sends cash to LP

4. BNY delivers shares to AP

Authorized Participant (AP)
(FINRA–Registered BD)

Liquidity Administrator (LA)

BNY TA – Transfer Agent (TA)

3a ownership change of GBTC shares

Trust

1 cash

4 GBTC shares

Liquidity Engager (LE)

settlement instructions

Liquidity Provider (LP)
(Non–Registered Entity)

3b cash

2 BTC

Custodian

Trust

Cash Redemption: Settlement Date

Settlement Steps:

1. AP sends shares to BNY

2. LP sends cash to LA

3a. BNY cancels shares

3b. Custodian sends Bitcoin from Trust wallet to LP

4. LA sends cash to AP

Authorized Participant (AP)
(FINRA–Registered BD)

Liquidity Administrator (LA)

BNY TA – Transfer Agent (TA)

3a ownership change of GBTC shares

Trust

4 cash

1 GBTC shares

Liquidity Engager (LE)

settlement instructions

Liquidity Provider (LP)
(Non–Registered Entity)

2 cash

3b BTC

Custodian

Trust

Cash Creation Procedures: Key Takeaways

This process is reversed for in-kind redemptions

Trust

- Trust only creates shares upon receipt of Bitcoin, never holds cash, and does not itself engage an LP, satisfying grantor trust tax considerations and mitigating uncertainty and the potential for tracking error and tax inefficiencies for investors

Authorized Participant (AP)

- AP broker-dealer never has ownership of, custody of, or exposure to, Bitcoin, satisfying broker-dealer regulatory considerations

- AP receives firm price quote for shares based on NAV, receives shares before dollars are released – from AP's point of view, it knows on Trade Date that it is paying $[x] for [y] shares on Settlement Date

Liquidity Administrator (LA)

- LA is a registered broker-dealer and only processes cash portion of procedures

- Cash maintained in LA's Special Account for the Exclusive Benefit of Customers at a third-party bank (BNY), which it promptly transmits to LP (consistent with Rule 15c3-3(k)(2)(i))

Liquidity Provider (LP)

- LP bears any risk of Bitcoin price movement between Trade Date and Settlement Date, which it manages through the Variable Fee

- No contractual privity between AP and LP

- Each of Trust, AP, and LP acts as principal, not agent

Thank You

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