Crypto breaks Wall Street’s ETF barrier: A watershed moment or stopgap?

With the Bitcoin ETFs, investors won’t have to deal with hot/cold storage decisions, crypto exchanges, fraud, etc. “Convenience does the magic here.”

A lot of excitement radiated out of New York this week with the launch of the first Bitcoin exchange-traded fund (ETF) sanctioned by the United States Securities and Exchange Commission. The ProShares Bitcoin Strategy ETF (BITO) had a stunning debut on the New York
that a much-awaited crypto investment vehicle finally received regulatory approval — ending eight years of futility on the part of U.S. fund issuers — he had some misgivings about the product that finally met the approval of the SEC, specifically the fact that it was futures-based and didn't track the price of Bitcoin (BTC) directly.

“We do not think a futures ETF is a good way to get Bitcoin exposure,” he said in a blog, adding, “Futures based ETFs work for short term trading, but have massive tracking error issues over long periods, which is what most investors are looking for when it comes to Bitcoin exposure.”

Markus Hammer, an attorney and principal at Hammer Execution consulting firm, agreed with some others that the event was a milestone yet cautioned, “It is only one milestone with quite a journey ahead,” further informing Cointelegraph, “As an investor, if you want to go long in crypto — and many do — you prefer a fund that tracks ‘physical’ Bitcoin and not a derivative of it.”

The ProShares ETF is a bet on BTC’s future price movements. That is, “the product ultimately deviates from the BTC price itself, next to the fact that ProShares as the issuer is just another intermediary and thus counterparty risk to the investor.”

**Futures-based vs. physical ETF — Does it matter?**

Many institutional investors will probably wait for a physical Bitcoin ETF — tied to the spot market, not the derivatives market — that tracks the actual price of the cryptocurrency, Campbell Harvey, professor of international business at Duke University, told Cointelegraph. The BTC futures market is relatively small, he explained, “and the buying pressure in the futures will lead to a negative ‘roll return,’” meaning that:

“You are paying a premium to buy the futures each time you ‘roll over’ to the next contract. It is far more direct to buy the physical, but the SEC has given no indication they are willing to allow that.”

In an interview with CNBC shortly after the Oct. 19 launch, SEC Chair Gary Gensler suggested why the agency had permitted only this indirect path to the crypto space: “What you have here is a product that’s been overseen for four years by a U.S. federal regulator, the CFTC, and that has been wrapped in something that is within our jurisdiction [i.e., the SEC] by the Investment Company Act of 1940, so we have some ability to bring it inside of investor protection.”
In other words, the new product will have two layers of regulatory protection — the CFTC and the SEC — against potential hackers, manipulators and fraudsters.

Whatever its pedigree, the ProShares fund obviously resonated with investors — by the end of its second day of trading, it had reached $1 billion in assets under management, the earliest any ETF has reached that mark.

“This is the first American ETF that is designed to track Bitcoin, and that certainly means something,” Jeff Dorman, chief investment officer of Arca, told Cointelegraph, “but it definitely isn’t the product that the market wanted nor is it one that financial advisors feel comfortable selling, so it will likely lead to less adoption than a physical-backed ETF would have.”

Some, including Harvey, saw significance in the fact that Invesco, a leading ETF provider, announced on Monday that it was abandoning its bid to issue a BTC futures ETF — at least for the time being — and focus instead on “pursuing a physically backed, digital asset ETF,” an Invesco spokesperson told Bloomberg.

Will pension funds rush in?

Asked about pension funds, a cautious but huge subgroup within the institutional investor firmament, Dorman told Cointelegraph, “Pension funds have been doing their due diligence for years” with regard to crypto, but it is unlikely that a Bitcoin futures ETF “moves the needle” much with this investor class. “But if the ETF leads to larger market caps and increased liquidity, then the sheer growth in size of the market will make it easier for pensions to invest comfortably.”

“ProShares’ Bitcoin Futures ETF surely raises the profile of Bitcoin in the institutional investment community,” Ben Caselin, head of research and strategy at cryptocurrency exchange AAX, told Cointelegraph, and it might make it easier for pension funds to gain crypto exposure. “However, there would have to be a wider variety of different Bitcoin ETFs, including physically backed for larger players to enter the market on the back of an ETF,” said Caselin.

Related: Crypto and pension funds: Like oil and water, or maybe not?

Nigel Green, CEO of financial solutions company deVere Group, said in an emailed statement to subscribers that the ProShares futures-based ETF would “inevitably bring in a growing number and broader range of active market participants, including those using pension funds, and retirement and brokerage accounts,” but Dorman, for his part, stated that “ETFs aren’t really designed for institutional investors — it is more of a retail product.”
Any institutional investors that want exposure to Bitcoin would already have different ways to get this exposure, Dorman explained, “so this won’t change much. I do believe we’ll see more institutional adoption of all digital assets, but it’s likely that institutional adoption of Bitcoin will be less than that of other digital assets that can be more easily understood and valued. We’re already seeing new onramps gain traction — NFTs, gaming, DeFi.”

Will it attract individual users?

What about retail investors — will a futures-based Bitcoin ETF be attractive, or is it too technical?

“There are plenty of retail stock traders using trading apps who are not comfortable buying Bitcoin on the spot market, let alone withdrawing such funds into a private wallet,” Caselin said, adding, “In some jurisdictions, retail traders may not be allowed to trade on centralized crypto exchanges. ETFs open up new avenues to gain exposure to Bitcoin’s price action.”

On the other hand, the ProShares ETF’s “separately priced, complex underlying derivatives” might arguably add “an additional layer of complexity for those who have been wanting to easily and safely buy Bitcoin,” John Iadeluca, CEO of Banz Capital, told Cointelegraph, while Harvey added that “retail investors can easily get exposure to crypto by using existing brokers like Coinbase or Robinhood. They can bypass the ETF and avoid the futures.”

Still, “An ETF is a traditional financial product that can be publicly traded on the exchange like a stock,” noted Hammer. “This will certainly make it somewhat appealing to an unsophisticated retail customer to participate in crypto via their existing trading account and the familiar (centralized) banking system.” They don’t have to deal with hot/cold storage decisions, crypto exchanges, fraud, taxation issues, and the like. “Convenience does the magic here.”

Is an Ether ETF in the cards?

Bitcoin is not the only star in the crypto galaxy, of course. In fact, its dominance has been ebbing some over the past year, and there is even talk about an eventual BTC-ETH “flippening” in which Ether (ETH) surpasses Bitcoin in total market value. It bears asking: How far away is an SEC-approved Ether ETF?

“Given that Ethereum is the second-largest cryptocurrency in the world, the possibility for an Ethereum ETF is high,” Jay Hao, CEO of cryptocurrency exchange OKEx, told Cointelegraph, “but it still needs time to mature.”
“Ethereum has a track record of following Bitcoin in terms of price action and attention,” said Caselin. “However, unlike Bitcoin, Ethereum would not be suitable as legal tender. Also,

Ethereum is still in its experimental phase, and while the project has done exceptionally well, there are still questions around what the transition to proof-of-stake [consensus protocol] will look like.” For now:

“Ethereum is more about the platform than it is about the asset. I don’t see an Ethereum ETF on the horizon anytime soon until the space has matured more.”

Iadeluca disagrees. “I think the approval of an Ethereum futures ETF is much more likely now” particularly since Ethereum-based investment products have closely followed the institutional product developments of Bitcoin within the mainstream markets. “However, this may take some time.”

**A critical turning point?**

All in all, where do the week’s events figure on the crypto historical-significance scale? Was this, indeed, a “watershed” moment where everything changed?

“This is no doubt a significant milestone for the continuous development of the crypto industry,” Hao told Cointelegraph. More attention and participation from institutional investors can only help mainstream acceptance. “As the adoption rate of Bitcoin and crypto grows, the industry will continue to flourish.”

Harvey, however, warned about succumbing to hype. “Overall, the entire space is held back by the regulatory uncertainty, and additional guidance is necessary,” he told Cointelegraph, while Hammer added that “what the market is looking for is a physical ETF rather than a crypto futures ETF.” He also agreed the market still lacks regulatory clarity:

“As long as no uniform crypto taxonomy is defined, the responsibilities between the supervisory authorities are not clearly assigned, and there is no legislative framework that regulates crypto in general, and especially DeFi and stablecoins, then nothing is gained.”

ProShares’ breaking of the ETF barrier remains a “bittersweet” moment for Dorman. On one
hand, it’s “great to see another milestone achieved,” but it’s also disappointing because “it is yet another flawed product with high fees and significant tracking error that trades exclusively on a handpicked exchange by the SEC.”

By the same token, one doesn’t want to lose sight of the forest because of the trees. This week’s events could arguably be viewed as a sort of test — “to see if mainstream investors are ready to include cryptocurrencies in their portfolios alongside other assets such as stocks and bonds,” said Green. “And it appears, judging by the reaction, that they are.”
What has been standing in the way of a pure-Bitcoin ETF?

SEC Chair Gary Gensler actually is pro-Bitcoin, Volt Equity CEO argues

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ProShares Bitcoin ETF to debut on NYSE on Oct. 19