

Crypto, Tech and Slow Evolution Forward

Crypto currency continues to be debated – some believe in it; others do not. The decision by the founder of Tesla to exit the market recently seems to have added a new element, however. Now the question is if crypto is energy efficient. Crypto mining does in fact require a great deal of energy. One solution recently offered is to do the mining at the foot of a dam in China that apparently generates a great deal of environmentally friendly energy since it comes from hydro power, according to a news report. Absent that option, the environmental question may be a challenge.

The staff of the Commission's Investment Management Division recently addressed a more pressing crypto issue that is closer to home. In a recently released [statement](#) the Division discussed key questions regarding funds registered under the Investment Company Act and investing in the Bitcoin futures market.

Initial concerns of the Division, reflected in a release issued in 2018, focused on liquidity. Since that time the markets in this area have significantly evolved. The Division has also benefitted from information obtained from funds and investors. Now, for example, there are a number of registered funds that have focused on cash-settled Bitcoin futures that are traded on an exchange regulated by the CFTC. Those instruments represent a potential method of giving the fund and its investors crypto currency exposure while addressing the liquidity questions that have been raised since the initial letter was issued shortly after Bitcoin began trading.

Now some mutual funds are “investing or seek to invest in Bitcoin futures . . . [and] believe they can do so consistent with the substantive requirements of the Investment Company Act. . . .” In view of these events the Division plans to closely monitor and assess compliance in conjunction with the Division of Exams. There will be six areas of focus:

1. *Liquidity and depth* represent key areas of focus; the question is whether the “Bitcoin futures market . . . is appropriately supporting mutual fund investment in Bitcoin Futures; . . .”

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2. *Ability to liquidate* Bitcoin futures positions as required is a critical point of concern to be monitored;
3. *Valuations* are also key; the funds' valuations of Bitcoin futures will be monitored as well as the overall impact of participating in the Bitcoin futures markets;
4. *Compliance* with the open-end fund liquidity rule and mutual funds' liquidity classification of any position in the Bitcoin futures market will be assessed; the fund's liquidity risk management program will also be evaluated;
5. *Fraud* and the impact for it or manipulation in the underlying Bitcoin markets and the impact on the fund will be assessed;
6. *ETFs present* a key question to be evaluated; a question is if, based on the experience of the mutual fund investing, the Bitcoin futures markets could accommodate ETFs.

Finally, for open ended funds the Division staff "believes at this time that investment in the Bitcoin futures market should be pursued only by mutual funds with appropriate strategies that support this type of investment . . ." coupled with full disclosure. Closed end funds do not present these types of issues.

Comment

The statement by the Division is consistent with the careful, considered approach of the agency to crypto from the beginning. Liquidity is a key issue for an open-ended fund in view of its redemption obligations. Bitcoin futures that settle for cash may present an opportunity to begin solving that question. Yet the historic volatility in crypto markets may present a difficulty despite the fact that Bitcoin may be more mature than other forms of crypto. A good example of this is the volatility of Bitcoin during the week of May 17 when the price dropped significantly. Those kinds of price gyrations could make it difficult for an open-ended fund to comply with its redemption requirements.

In the end, as crypto continues to evolve along with all of tech, it is clear that the Commission will ultimately have little choice except to move forward with it within the framework of its statutory mandate.