

MEMO# 33527

May 12, 2021

SEC Staff Issues Statement on Registered Fund Investments in Bitcoin Futures

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TO: ICI Members SUBJECTS: Alternative Investments

Closed-End Funds

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Exchange-Traded Funds (ETFs)

Fintech and Digital Assets

Valuation RE: SEC Staff Issues Statement on Registered Fund Investments in Bitcoin Futures

On Tuesday, the staff of the Securities and Exchange Commission's Division of Investment Management issued a statement on registered fund investments in cash-settled Bitcoin futures traded on CFTC-regulated exchanges ("Bitcoin futures").[\[1\]](#) The statement cautions funds investing in Bitcoin futures about concerns the staff has with such investments and cautions investors considering investments in those funds to carefully consider the risks.

Funds

The statement notifies mutual funds investing in Bitcoin futures that the SEC staff will closely monitor and assess: (1) such funds' and investment advisers' ongoing compliance with the Investment Company Act of 1940 and other federal securities laws; and (2) the impact of such investments on investor protection, capital formation, and the fairness and efficiency of the markets. Specifically, the staff expects to:

- Analyze the liquidity and depth (e.g., number of participants) of the Bitcoin futures market and consider whether it appropriately supports mutual fund investment in Bitcoin futures - particularly as additional mutual fund assets enter the market - given regulatory requirements relating to mutual fund liquidity;
- Analyze mutual funds' ability to liquidate Bitcoin futures positions to meet daily redemption demands, the efficacy of mutual funds' derivatives risk management, and the extent of any derivatives-related leverage;

- Monitor funds' valuations of Bitcoin futures holdings and consider the impact of mutual fund participation in the Bitcoin futures market on valuations in that market and the impact that disruptions in the Bitcoin markets have on valuations;
- Consider mutual funds' liquidity classification of any position in the Bitcoin futures market and the basis for such classification and the overall construction of a fund's liquidity risk management program, including consideration of the liquidity of a fund's strategy and portfolio investments during both normal and reasonably foreseeable stressed conditions, whether the investment strategy is appropriate for an open-end fund, and the extent to which the strategy involves a relatively concentrated portfolio or large positions in particular investments;
- Assess the ongoing impact of the potential for fraud or manipulation in the underlying Bitcoin markets and its possible influence on the Bitcoin futures market; and
- Consider whether, in light of the experience of mutual funds investing in the Bitcoin futures market, that market could accommodate exchange-traded funds, which, unlike mutual funds, cannot prevent additional investor assets from coming into the ETF if the ETF becomes too large or dominant in the market, or if the liquidity in the market starts to wane.

The staff acknowledges that the Bitcoin futures market has developed, gathering increasing trading volumes and open-interest positions since the staff issued its 2018 letter on Engaging on Fund Innovation and Cryptocurrency Holdings,^[2] and has consistently produced reportable prices. In addition, it confirms that the Bitcoin futures market has not presented the custody challenges associated with some cryptocurrency-based investing because the futures are cash-settled. Nevertheless, the staff states that at this time mutual funds only should invest in Bitcoin futures when they have appropriate strategies that support that type of investment and full disclosure of material risks.

The staff notes that, because closed-end funds do not provide for daily redemption of their shares, they do not present the same liquidity challenges as open-end funds. The staff encourages any closed-end fund that seeks to invest in Bitcoin futures to consult with them, prior to filing a registration statement, about the proposed investment, anticipated compliance, and how the fund would provide appropriate investor protection.

Investors

The statement strongly encourages any investor interested in investing in a mutual fund with exposure to the Bitcoin futures market to carefully consider the risk disclosure of the fund, the investor's own risk tolerance, and the possibility of investor loss. It cautions them that the investments are "highly speculative" and warns them to consider the volatility of Bitcoin and Bitcoin futures, the lack of regulation, and potential for fraud or manipulation in the market.

Kenneth Fang
Associate General Counsel

endnotes

^[1] See Division of Investment Management, Staff Statement on Funds Registered Under the Investment Company Act Investing in the Bitcoin Futures Market (May 11, 2021),

available at

<https://www.sec.gov/news/public-statement/staff-statement-investing-bitcoin-futures-market>.

[2] See Division of Investment Management, Engaging on Fund Innovation and Cryptocurrency-related Holdings (Jan. 18, 2018) (identifying five substantive areas of questions related to fund investments in digital assets: valuation; liquidity; custody; arbitrage mechanisms for ETFs; and potential for market manipulation), *available at* www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm. For a summary of the letter, see ICI Memorandum No. 31038, available at www.ici.org/memo31038.

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