

# A Spot Bitcoin ETP?

## Understanding the SEC’s Process for Reviewing an Exchange’s ETP Proposal

One important regulatory hurdle for bringing to market a new exchange-traded product (“ETP”)—such as a spot bitcoin ETP—is the listing exchange’s receipt of Securities and Exchange Commission (“SEC”) approval to list and trade the product. The potential launch of a spot bitcoin ETP has sparked widespread interest. Yet the procedural requirements governing an exchange’s submission for SEC review, and the review itself, have garnered less attention and are not widely understood. The following is a “Frequently Asked Questions” guide to how the SEC process works.

### WHY DOES AN EXCHANGE HAVE TO SUBMIT A PROPOSED RULE CHANGE TO THE SEC IN THE FIRST PLACE?

The Securities Exchange Act of 1934 (the “Exchange Act”) generally provides that a self-regulatory organization (“SRO”), such as an SEC-registered exchange, cannot add to or change its rules unless the Commission has approved such changes, subject to limited exceptions. In the context of exchanges, this applies not only to proposals to list and trade a spot bitcoin ETP, but also to other significant and market-defining initiatives, including but not limited to mechanisms to establish or permit direct listings, “primary” direct listings, new issuer listing standards and new order types for trading on the exchange. There are limited exceptions, not covered in this guide, for certain types of rule changes that may become immediately effective upon filing (*e.g.*, rule changes that establish or change fees).

Conceptually, the Commission’s review of exchanges’ proposed rule changes is a cornerstone of the framework that Congress established for the SEC’s oversight of the securities markets. The review process helps ensure that exchanges—which are

major trading centers and regularly seek to expand and modify their services in response to market demands—continue to operate in compliance with all applicable standards under the federal securities laws and SEC rules. In practice, the review process also helps the SEC stay abreast of new trends and dynamics in the marketplace.

Reviewing and acting on proposed rule changes submitted by exchanges and other types of SROs, such as FINRA and clearing agencies, keeps the SEC extremely busy. There are 24 exchanges currently registered with the SEC. In fiscal year 2021, the SEC received well over 2,000 proposed rule changes and related filings from exchanges and other SROs.

### PROCEDURALLY, WHAT DO THE MECHANICS OF THE SUBMISSION AND REVIEW PROCESS LOOK LIKE, AND HOW LONG BEFORE A DECISION WILL BE MADE?

The process requirements governing exchanges’ submissions of proposed rule changes and the substantive standards that the SEC must apply in its review are set out across various provisions of the

Exchange Act, SEC rules and regulations (including the SEC’s Rules of Practice) and SEC Form 19b-4, which is the form that exchanges must complete and submit for a proposed rule change.

Over the years, Congress and the SEC (sometimes in response to court decisions) have modified and refined the process and requirements governing the system for rule change submissions and reviews. The specific length of time that the SEC can take to review and issue a decision on a filing is governed by the Exchange Act, although in practice the timeline can vary greatly and be quite drawn out:

- When an exchange formally submits a filing to the SEC, the SEC staff will review the submission to confirm that it contains all the information required by Form 19b-4 and that all information is presented in a “clear and comprehensible manner.”
- An important milestone in the process is the Federal Register’s publication of notice of a proposed rule change because the statutory timeline, described below, governing the Commission’s review of a filing is keyed off the Federal Register publication date (the “Publication Date”). The Commission is required to send notice of a proposed rule change to the Federal Register for publication within 15 days of the date on which the exchange—after filing with the Commission—posts notice of the proposed rule change on the exchange’s public website.
- However, in practice there is some variance around when the Commission will send the notice to the Federal Register. This is because the Exchange Act states that a proposed rule change has not officially “been received by the Commission” if the filing is deemed deficient—*e.g.*, the form’s requirements are not met or there is a view that the information is not presented in a “clear and comprehensible way.” The Commission commonly asks exchanges to clarify aspects of a proposal or provide further elaboration in Form 19b-4 and then resubmit. This introduces some uncertainty into the broader timeline.
- Once the Commission forwards a notice to the Federal Register and the notice is published, the Exchange Act states that the Commission must ultimately take one of four actions within 45 days of the Publication Date. The Commission must either:

- approve the proposed rule change;
- disapprove the proposed rule change;
- extend the review period up to an additional 45 days (to a maximum of 90 days total), which can occur through the exchange’s consent or Commission order; or
- “institute proceedings” to determine whether the proposed rule change should be disapproved.

If proceedings are instituted (which can occur at any time in the process), the Commission must approve or disapprove the rule change not later than 240 days (180 days initially, which can be extended by up to 60 more days) after the Publication Date.

If the Commission fails to act within the specified time frames, then the proposed rule is deemed approved by statute. Throughout the process, the SEC’s Division of Trading and Markets staff—which acts for the Commission, as explained below—confers with other SEC Divisions and Offices as appropriate and reviews and analyzes comment letters and relevant submissions.

#### WHAT OPPORTUNITY DO INDUSTRY PARTICIPANTS AND THE PUBLIC HAVE TO ENGAGE IN THE PROCESS?

The SEC posts exchanges’ proposed rule change submissions on the “Self-Regulatory Organization Rulemaking” section of the SEC’s public website (<https://www.sec.gov/rules/sro.shtml>), along with comment letters submitted for each submission. The Federal Register’s publication of the notice, together with the SEC’s and exchange’s website postings, are intended to help keep the marketplace informed of potential rule changes and to facilitate public comment.

The Commission encourages interested parties to submit written comments on proposals during the designated comment period. Interested parties can also respond to other commenters’ submissions. The SEC posts all submissions without redaction (except for personal identifiable information and inappropriate material) in the public comment file for a given rule proposal on the SEC website.

Generally speaking, the most effective and impactful comment submissions are those that specifically address the applicable statutory and regulatory standards, discuss any particular issues or

considerations that the Commission has identified regarding a proposal, and provide data and analysis to support the arguments and points made.

### WHAT DOES IT MEAN FOR THE COMMISSION TO “INSTITUTE PROCEEDINGS,” AND WHAT DOES THIS ENTAIL IN PRACTICE?

As noted, during its review of an exchange’s proposed rule change, the Commission can “institute proceedings” to determine whether the proposal should be disapproved. This entails the Commission’s issuance of a public notice that identifies the “grounds for disapproval under consideration”—and includes a brief statement of the “matters of fact and law” that the Commission is considering in its determination of whether to disapprove the filing.

When instituting proceedings, the Commission is required to provide the exchange with an “opportunity for hearing.” Ordinarily, this occurs solely through the opportunity for submission of written materials (*e.g.*, data, analysis, arguments). All parties, including the exchange, are given a specified amount of time to submit supporting or opposing materials, in writing, for the Commission’s consideration. The Commission has “sole discretion” to determine whether there will be an opportunity for an oral presentation, which occurs very rarely.

At the conclusion of the initial opportunity to submit written materials, the exchange is provided with a rebuttal period—an opportunity to respond to any comments received on its proposal. Based on the record before it, the Commission will then issue a written order approving or disapproving the proposed rule change (with a written statement of the reasons therefor), no later than 240 days after the Publication Date.

### SUBSTANTIVELY, WHAT IS THE SEC’S FOCUS WHEN REVIEWING AN EXCHANGE’S PROPOSED RULE CHANGE?

The Exchange Act states that the Commission “shall approve” a proposed rule change if it finds that the proposal is consistent with the Exchange Act and the rules and regulations thereunder.

Most significantly, this includes Section 6(b) of the Exchange Act, which articulates a broad set of principles that all exchanges must satisfy to be registered with the SEC—*e.g.*, the exchange’s rules

cannot “impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act” and the exchange’s rules must provide for the “equitable allocation of reasonable dues, fees and other charges among its members and issuers and other persons using its facilities.” Section 6(b)(5) is of particular relevance to the Commission’s consideration of an exchange’s proposal to list a new product. It states that an exchange’s rules must, among other things, be designed to “prevent fraudulent and manipulative acts and practices” and “protect investors and the public interest.”

Burden of proof is critically important in SEC administrative proceedings. Under the statute and SEC rules, the exchange proposing the rule change bears the burden of demonstrating that the proposal is consistent with all relevant standards. Put another way, a proposed change is not simply presumed to be consistent with relevant standards; the exchange must actively demonstrate that is the case. The statute states that in the absence of it finding that a proposal is consistent with the Exchange Act and the rules and regulations thereunder, the Commission “shall disapprove” the proposal.

### WHAT ARE THE ROLES OF THE SEC STAFF AND COMMISSIONERS IN THE REVIEW AND APPROVAL PROCESS?

Over the years, the Commission has delegated to the SEC staff a wide range of functions that Congress assigned to the Commission. The Commission has stated that these delegations, which are articulated in the Commission’s Rules of Organization and Program Management, are intended to conserve Commission resources and increase the efficiency and effectiveness of Commission processes. As noted above, by way of illustration, in fiscal year 2021, the SEC received over 2,000 proposed rule changes and related filings from exchanges and other SROs.

Among other things, the Commission has delegated to the Director of the SEC’s Division of Trading and Markets the review and disposition of exchanges’ proposed rule changes. This means that the Division of Trading and Markets staff, *acting for the Commission*, handles the functions discussed above—*i.e.*, managing the procedural aspects of the rule filing review process, determining whether proceedings should be instituted and ultimately determining

whether a proposed rule change should be approved or disapproved.

There is a mechanism that enables the Commission to withdraw this delegated authority from the Director of Trading and Markets for a given proposal: The SEC Rules of Practice provide that when the Director of Trading and Markets intends to disapprove a proposed rule change, the Director must provide the Commissioners with at least five days' advance notice of that intent to disapprove. If two Commissioners object in writing within five business days of receiving such notice, then the delegation of authority to the Division Director is withdrawn, and the proposal is "pulled up" to the Commission to handle directly. When that occurs, the Director will present the Commission with a staff recommendation that will be subject to a Commission vote—all of which must occur within the statutorily-imposed deadlines detailed above.

Thus, for the vast majority of proposed rule changes submitted to the SEC annually, the rule filing reviews and decisions are handled by the Division of Trading and Markets staff acting for the Commission pursuant to delegated authority. In performing this duty, the Trading and Markets staff acts in close coordination with, and at the direction of, the SEC Chair (to whom the Division Director reports). The staff consults with, and listens to the views of, the non-Chair Commissioners regarding proposed rule changes. But unless two Commissioners move to withdraw the delegated authority for a given rule filing as described above, the non-Chair Commissioners' authority on proposed rule changes is generally limited to non-binding consultations with the Division of Trading and Markets staff and the SEC Chair.

#### WHAT IS THE STATUS OF THE RECENT INITIATIVES TO LAUNCH SPOT BITCOIN ETFS?

On July 13, 2023, the Commission posted on its website two separate notices: (1) that on June 29, 2023, the Nasdaq Stock Market [filed](#) proposed rule changes with the Commission to list and trade shares of the iShares Bitcoin Trust, which is sponsored by a subsidiary of BlackRock, and (2) that on June 30, 2023, Cboe BZX Exchange [filed](#) proposed rule changes with the Commission to list and trade shares of the Wise Origin Bitcoin Trust, which is sponsored by a subsidiary of Fidelity. Comments on each

submission will be due to the Commission within 21 days of the date of publication of the relevant notice in the Federal Register, which has not yet occurred for either filing. As explained above, for each proposal, the Commission will be required to take one of four actions within 45 days of the given Publication Date:

- approve the proposed rule change;
- disapprove the proposed rule change;
- extend the review period up to an additional 45 days (to a maximum of 90 days total), which can occur through the exchange's consent or Commission order; or
- "institute proceedings" to determine whether the proposed rule change should be disapproved.

The two notices also state that the shares of the Trusts will not trade on the exchanges until their Registration Statements on Form S-1 are effective, which has not yet occurred.

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