Bitcoin ETFs in the US: The long wait is over, what's next?

February 2024

IMPORTANT INFORMATION

- The value of investments and the income from them can go down as well as up so you/the client may get back less than you/they invest.
- Investors should note that the views expressed may no longer be current and may have already been acted upon.

Fidelity INTERNATIONAL

The U.S. Securities & Exchange Commission's (SEC) approval of spot Bitcoin ETFs in January 2024 marks a significant and long-awaited milestone that has been pursued by the asset management industry for over a decade. Giselle Lai, Associate Investment Director, Digital Assets, explores the implications of the decision for the asset class, while highlighting investment rationales, implementation options, and, importantly, regulatory progress in the EU.

The approval of spot Bitcoin ETFs in the US will have a profound impact on the cryptocurrency market, expanding its appeal and accessibility to a wider range of investors. For those who were hesitant to invest due to the complexities of trading on unfamiliar platforms or choosing custody solutions, this approval offers an alternative investment avenue.

However, it is worth noting that regulated spot Bitcoin ETPs have already been listed globally outside the US since 2019. As a result, while the US listing may lead to short-term price volatility and increased demand from both retail and institutional investors in the long run, significant market demand may not materialise immediately.

In light of these developments, our aim is to provide investors with a comprehensive overview of the available investment options for Bitcoin, alongside key upcoming events that investors should be monitoring closely throughout the rest of the year.

Accessing Bitcoin: What are the options?

Investors have three primary avenues to gain exposure to the Bitcoin market: direct holding with third-party custody, Bitcoin futures, or Bitcoin ETPs/ETFs. Each option offers unique characteristics, which are illustrated in the table below.

Bitcoin ETPs/ETFs provide regulated and convenient access to physical Bitcoin exposure, with the added benefit of third-party custody. However, trading is limited to the opening hours of the stock exchange.

On the other hand, direct holdings offer the advantage of round-the-clock Bitcoin trading, but require either self-custody or third-party custody, which may involve account setup or custody fees. Investors must also consider the nuances of crypto cybersecurity and management. Lastly, futures can be a cost-effective solution for hedging or portfolio management, but they are subject to higher tracking error due to roll-over costs.

Comparing the different ways to access Bitcoin

	ETP	Direct holding	Futures
Fees	Single OCF	Custody fee (third party)	No direct fees, roll costs can be significant
Execution venue	Traditional regulated exchange	Cryptocurrency exchange	Traditional regulated exchange
Trading access	Generally during local market hours	24/7	23 hours, 6 days a week
Tracking error	N/A Each unit corresponds to a direct holding in bitcoin	N/A	Due to roll costs
Liquidity	As liquid as the underlying investment	Bitcoin is highly liquid	Less liquid
Operational ease	Standard execution method	New relationships / technical integrations may be required	Standard

Source: Fidelity International, Fidelity Digital Assets, 2023.

Spot the difference: US domiciled ETFs vs EU domiciled ETPs

While both US-domiciled spot Bitcoin ETFs and EU-domiciled spot Bitcoin ETPs are designed to track the price of Bitcoin, there are few structural advantages of investing in the latter for European and Asian investors.

1. **More convenient trading hours**: European Bitcoin ETPs typically have trading hours that overlap more with Asian and European clients. This provides greater accessibility, convenience and limit overnight risk for these regions.
2. **A more efficient subscription/redemption model**: The SEC has mandated that all Bitcoin ETFs in the US must be cash-settled. This means that Authorised Participants (APs) are required to fund any creation of ETF shares with 100% cash, which can be capital intensive. Additionally, cash settlement requires the delivery of cash on T+1 for settlement of the ETF on T+2, resulting in one day funding. These requirements could lead to additional costs for the ETF compared to the European model. On the other hand, the European model is structured to be 100% backed by Bitcoin, with no other assets involved. The movement of Bitcoin occurs directly between the AP and the custodian, allowing for efficient risk management and trading/pricing mechanics.
3. **Physical redemption as an option**: In the US, physical redemption is not available due to the cash redemption model. However, European Bitcoin ETPs offer in-kind redemption, which provides more options and flexibility for clients who prefer to keep physical ownership of Bitcoin without the need to cash out their holdings. This can be particularly advantageous for those who want to retain physical ownership of the asset.
4. **Taxation considerations**: Non-US investors should carefully analyse taxation implications for their respective jurisdictions to ensure capital efficiency. Each jurisdiction may have different tax laws and regulations related to Bitcoin investments, and investors should understand the potential implications.

Progress towards regulatory clarity in the EU

While exploring the difference between US spot Bitcoin ETFs and European ETPs, it becomes evident that regulatory clarity plays a crucial role in shaping the investment landscape. Europe has taken a significant step forward with the implementation of Markets in Crypto Assets (MiCA) regulation this year.

This is an EU-wide regulatory framework for digital assets, aiming to set standards across the EU and bridging gaps in existing financial services regulatory framework regulating all types of Crypto-Assets Service Providers (CASPs) and other intermediaries with digital assets including custodians and administrators, asset managers, payment providers and platforms, trading and execution platforms, brokerages as well as token issuers. In short, MiCA could be viewed as the MiFid for cryptos, with the following implementation timeline and transition periods.

MiCA could be key to unlocking cryptocurrency opportunities in the EU over the coming months and years, given that legal clarity helps satisfy institutional compliance frameworks and enables them to explore new revenue models to drive product innovation and scale, positioning Europe as an attractive home for blockchain innovation.

We hope that you found this of interest. To learn more about digital assets and how Fidelity can support you, please consult your usual Fidelity representative and visit our dedicated site:
www.fidelity.lu/investment-themes/digital-assets

Timeline: Markets in Crypto Assets (MiCA) Regulation

2023

- **June 2023** – MiCA Publication in the OJEU
- **October 2023** – Consultation Package 1 publication
- **October 2023** – Consultation Package 2 publication

2024

- **Q1 2024** – Consultation Package 3 publication
- **June 2024** – Entry into application Titles III and IV
- **December 2024** – Entry into application Titles I, II, V, VI and VII

Source: Fidelity Digital Assets (FDAS), Markets in Crypto-Assets Regulation (Europa.eu).