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The New Spot Bitcoin ETFs Aren't Actually ETFs

The misnomer has caused some confusion among both investors and financial professionals.

By **Ric Edelman** | February 07, 2024

In the flurry of excitement surrounding the launch of 11 spot bitcoin ETFs, an important detail has been overlooked: none of them are technically exchange-traded funds as defined by the Investment Company Act of 1940.

Instead, they are organized as exchange-traded products under the Securities Act of 1933. Says so in every S-1 filing by the products' sponsors.

The misnomer has caused some confusion among both investors and financial professionals.

Some sponsors (ARK Invest, Bitwise, Franklin Templeton, Grayscale, Hashdex, Invesco Galaxy, VanEck and WisdomTree) describe each of their offerings as a "Bitcoin ETF"; Valkyrie opts for "Bitcoin Fund," while BlackRock and Fidelity more accurately label theirs as a "Bitcoin Trust."

Does It Matter?

Well, there are differences. I'm not sure anyone cares, or ought to. But if you're finance geek like me, the definitions matter. The situation is akin to that old "dogs and animals" bit: All dogs are animals, but not all animals are dogs.

Likewise, all ETFs are ETPs, but not all ETPs are ETFs. Indeed, ETPs include not just ETFs but also exchange-traded commodities (ETCs) and notes (ETNs). ETCs enable investors to buy and sell precious metals, agricultural products and energy resources without having to hold or store them.

ETNs hold notes — debt securities — issued by banks. These are similar to corporate bonds and quite popular in Europe, though I don't know why. (ETNs have no underlying portfolio of assets; they merely promise to pay a return at maturity based on the performance of some benchmark. I'd rather own the asset than merely be promised a return based on it. But that's just me.)

Like dogs and animals, ETFs and ETPs are not always mutually exclusive. Both ETFs and ETPs, for example, always trade on exchanges (at least the E and the T are constant).

Nor are their differences always clear; the Financial Industry Regulatory Authority even notes that there is "no single definition of an exchange traded product." In a not-very-helpful posting on its site (https://www.finra.org/investors/investing/investment-products/exchange-traded-funds-and-products#:~:text=Exchange%2Dtraded%20products%20(ETPs),trading%20day%20like%20a%20stock.), FINRA says all ETPs are investment vehicles listed on an exchange, where they can be bought and sold throughout the trading day like stocks.

FINRA also says that while some ETPs provide cost-effective diversification, others — such as the new spot bitcoin ETFs — don't.

SEC Commissioner Caroline Crenshaw, who voted against approval of the spot bitcoin ETFs, wrote in her Statement of Dissent earlier this year that she is "concerned that there will be confusion about what exactly these products are — (they are *not* ETFs registered under the Investment Company Act of 1940, the ubiquitous products that today are used by millions saving for retirement) — and that investors may infer protections that do not in fact exist."

Yet, Crenshaw expressed no concern over the fact that these new investments are ETPs rather than ETFs. She noted that ETPs, like all securities, are subject to trading halts — and that bitcoin itself would continue to trade worldwide even though a spot bitcoin ETF might cease trading.

This could be a detriment to investors when the ETFs resume trading. But that's a market risk, not an ETF-versus-ETP risk. During a recent appearance on my The Truth About Your Future (https://www.thetayf.com/) podcast, SEC Commissioner Hester Peirce told me, "We typically use the term 'exchange-traded fund' when it's a fund that's under the protections of the Investment Company Act of 1940. That is an act that was put in place to make sure that products being offered to retail investors have certain protections around how they're managed and making sure that the managers are working for the fund, as opposed to working for their own interest."

What's an Advisor to Do?

Peirce further emphasized that, "No matter what, whether it's an exchange-traded fund under the 1940 Act or an exchange-traded product more broadly, you need to think about whether it's right for you. There is no SEC seal of approval on these products. We try to make sure that the disclosures match what actually happens at the fund. But beyond that, you really have to make a decision about whether it's right for you."

As a financial advisor, your job is to ensure that investors have a clear understanding of the risks and potential rewards associated with these investments. By being familiar with how these products are structured, you can help your clients navigate the complex investment world, interpret the dense technical language used in disclosures, and provide personalized advice for each client.

And yes, I'll continue to refer to these things as ETFs, not ETPs. That's because everyone is calling them ETFs — including the asset management firms that sponsored them! You'll do that, too, unless you're a finance geek.

Pictured: Ric Edelman

Ric Edelman is an author and founder of the RIA Edelman Financial Engines (earlier Edelman Financial Services). He now leads the Digital Assets Council of Financial Professionals (https://dacfp.com/).

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