RSIS COMMENTARY

www.rsis.edu.sg

No. 083 – 20 June 2024

Making Sense of Bitcoin Exchange-Traded Products

By Tan Teck Boon

SYNOPSIS

Spot bitcoin exchange-traded funds are all the rage these days. As regulators give the thumbs up to these products, there are important considerations. Boosting public awareness of the significant risks involved is chief among them.

COMMENTARY

It is not a race to see who launches a spot bitcoin exchange-traded funds (ETF) first. But if it were, Thailand would be one of the winners. Beating out top financial centres across the globe to the punch, the Land of Smiles became one of the first few countries to launch a spot bitcoin ETF. As others waited, the Thai Securities and Exchange Commission (SEC) surprised pundits by approving the ONE Bitcoin ETF for trading in early June.

2024 marks a watershed moment for bitcoin as countries around the world scramble to launch their own spot bitcoin ETF. Besides Thailand, the United States, Australia and Hong Kong have also launched their own spot bitcoin ETFs this year. Meanwhile, other Asia-Pacific countries like Japan and South Korea look set to greenlight theirs.

As one country after another launch their spot bitcoin ETFs, the big question is: why are they all jumping on the crypto bandwagon? To answer this question, one must first have a sense of what bitcoin and the ETFs tied to it are.

When Bitcoin Meets a Stock Exchange

Called "worthless", "rat poison" and even "turds" on various occasions, bitcoin has actually performed pretty well as an asset class since 2009 when it was first launched. Indeed, if you had purchased one thousand bitcoins at ten cents apiece then, your initial investment of US$100 would be worth about US$66 million today (with bitcoin trading at US$66,000). That same US$100 invested in the ever-popular S&P 500 index would be worth only about US$600.

Nowadays, even leading tech companies like Tesla and Block, Inc. *hodl* (or "hold on for dear life") the cryptocurrency in their books. Not bad for a digital token that nobody wanted to begin with.

ETFs are financial instruments that track a basket of stocks, currencies or commodities. The SPY ETF, for example, tracks the S&P 500 Index. Traded on a stock exchange, ETFs offer a simple way for investors to get exposure to the underlying assets with no need for direct ownership. So, in the case of a spot bitcoin ETF, it lets investors gain price exposure to the cryptocurrency without having to own it directly. The word "spot" just means the current price of bitcoin.

The Case for Bitcoin ETFs

There are three main reasons why spot bitcoin ETFs get the thumbs up.

Firstly, it protects bitcoin investors. Before these funds came along, investors had to go through crypto exchanges to trade bitcoin. The problem is that some of these trading platforms are unregulated and offer investors little to no protection. Stock exchanges, in contrast, operate under close regulatory supervision and adhere to strict guidelines. Consequently, investors have better protection.

This point became patent when FTX Trading Ltd collapsed in 2022. Based in the Bahamas and not regulated by the US Securities and Exchange Commission, FTX did not segregate clients' assets from its own. So when the crypto firm suddenly folded, client accounts were thought to be wiped clean too. Since spot bitcoin ETFs are listed on a stock exchange, they tend to offer investors better protection against problems like this.

Then there is the first-mover advantage. The firm that issues the spot bitcoin ETF first tends to have a higher chance of outcompeting those that launched their funds later. As a spot bitcoin ETF issuer, the firm must go out and acquire the equivalent amount of bitcoin from a crypto exchange when investors purchase the fund.

Getting a head start means that the issuer may begin to attract assets and investors before others can. As a result, it often ends up winning more assets and investors than issuers that arrived late on the scene. On the other hand, latecomers must convince investors that their funds are somehow superior – not an easy thing to do since these ETFs are generally quite similar.

Thirdly, it is the branding. As global competition for capital gets more intense, it is most helpful for a country to be recognised as investor-friendly. Today, investors are no longer just interested in traditional financial products like stocks, gold and bonds. Increasingly they are embracing decentralised financial products like bitcoin as the future looks more uncertain. Having a brand that says "I am friendly to investors" goes a long way in terms of capturing some of this bitcoin FOMO (or "fear of missing out").

By giving the ONE Bitcoin ETF the thumbs up, Thailand has demonstrated that it is friendly to a new breed of investors. For all we know, besides exotic beaches and cuisines, Thailand may one day be known internationally for its crypto innovations too.

Same Same but Different

Notably, the ONE Bitcoin ETF is only offered to wealthy and institutional investors. There is good reason for that. Bitcoin is not a considered a productive asset, per se. Unlike a stock or bond, it does not generate a dividend or interest payment, respectively. But it is the present value of this cashflow generated over time that determines what an asset is really worth, or in other words, its *intrinsic value*. And that's the problem with bitcoin – it has none.

The implication is that bitcoin is only worth what others are willing to pay for it. If everyone thinks that bitcoin is just a scarcity of nothing, then its bottom will fall out. Whether it is an ETF or not won't make a difference. However, wealthy and institutional investors are going to feel less pain if they suffer a permanent capital loss. Less wealthy and smaller investors will definitely be hurt much more if their bitcoin investments tank. Therefore, restricting the ONE Bitcoin ETF to only wealthy and institutional investors makes sense.

Additionally, as bitcoin and products tied to it become more accessible to the public, it is necessary to boost general awareness of the significant risks involved. While the bitcoin spring may be back, sound financial knowledge is needed to steer clear of its many pitfalls. Unfortunately, the majority of people understand neither bitcoin nor finance (let alone both), so more public education will go a long way to level the playing field.

Tan Teck Boon, PhD, is Research Fellow in the Office of the Executive Deputy Chairman, S. Rajaratnam School of International Studies (RSIS), Nanyang Technological University (NTU), Singapore.