

Bitcoin Exchange Traded Fund

A Shariah Analysis

ETF

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INTRODUCTION

The approval of 11 Bitcoin ETFs (BTC ETFs) by the U.S. Securities and Exchange Commission (SEC) on January 10, 2024, marks a significant evolution in the digital asset investment landscape. This historic and long-awaited decision underscores the increasing acceptance of digital assets or cryptocurrencies in mainstream finance, with BTC ETFs acting as a bridge for investors to access the digital currency market through traditional investment mechanisms. This move has prompted substantial inflows into BTC ETFs, signalling strong investor interest and confidence in the growth potential of Bitcoin (BTC) as an asset class.

BTC's journey in the investment landscape saw a significant moment early Wednesday, as it surged above USD 73,000 (approximately RM 306,600), marking a 2.5% increase within 24 hours. This upward movement effectively countered Tuesday's downturn, which resulted from a liquidation event amounting to USD 360 million (approximately RM 1.512 billion), underscoring the volatile nature of digital currency markets.

This resurgence in BTC's value was mirrored by an unprecedented day of inflows into BTC ETFs, both in terms of monies and the cryptocurrency itself. According to BitMEX Research, spot BTC ETFs experienced net inflows of 14,706 BTC, equivalent to over USD 1 billion (approximately RM 4.2 billion), on Tuesday. This remarkable influx surpassed a previous record set in February of USD 673 million (approximately RM 2.827 billion), highlighting the growing investor confidence and interest in BTC as an asset class.

Blackrock, a leading asset management firm, reported a record inflow of USD 849 million (approximately RM 3.565 billion) into its BTC ETF, standing out as a significant contributor to the day's total inflows. Conversely, Grayscale observed outflows amounting to USD 79 million (approximately RM 331.8 million), indicating a shifting landscape of investor preferences within the digital currency space. Overall, total inflows into BTC ETFs crossed the USD 4 billion mark (approximately RM 16.8 billion), signalling a robust appetite for BTC exposure among investors and marking a new milestone in the acceptance and integration of cryptocurrencies into mainstream financial instruments.[1]

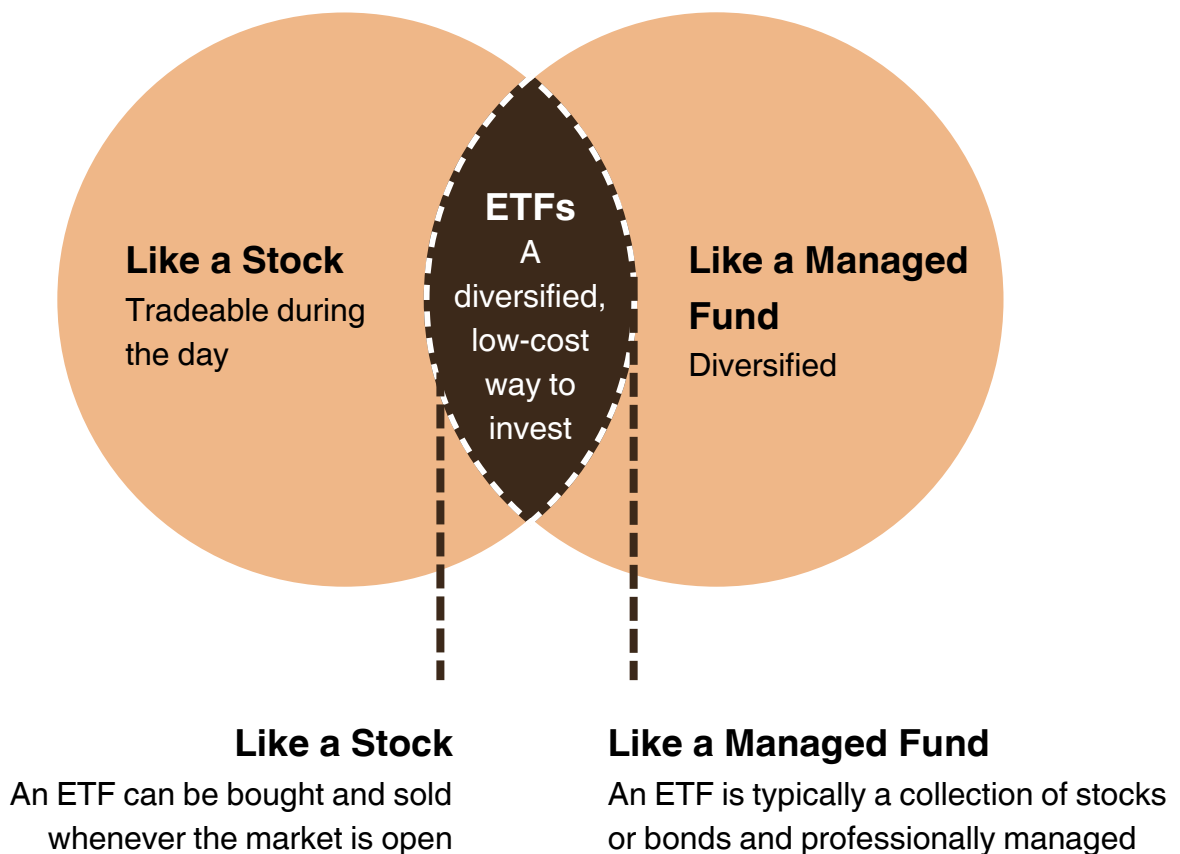
This year-to-date performance of BTC ETFs not only reflects the volatile yet upward trajectory of BTC's market value but also underscores the strategic importance of BTC ETFs in providing investors with a regulated, accessible means of participating in the digital currency market. As these BTC ETFs continue to attract significant capital, they represent a pivotal component of the evolving narrative around cryptocurrency investment, blending traditional financial mechanisms with the revolutionary potential of digital assets.



[1] Coindesk

WHAT IS BITCOIN ETF?

Moving backward, let us look at what is ETF? An ETF is a type of investment fund and financial product that is traded on public stock exchanges, much like individual shares or stocks. ETFs are designed to track the performance of a particular index, commodity, sukuk/bonds, or a basket of assets. Unlike unit trust or mutual funds, which are priced at the end of each trading day, ETFs are bought and sold throughout the trading day at market price, offering flexibility and liquidity similar to that of shares trading.



Source: iShares Blackrock

Creation: An ETF is created by a sponsor—typically a financial institution or investment company. The sponsor decides the investment objective of the ETF, such as tracking the performance of a specific index. To form the ETF, the sponsor secures assets that align with the ETF's investment objective, like shares, sukuk/bonds, or commodities.

Buying and Selling Shares: Investors do not directly buy the assets in the ETF; instead, they buy shares of the ETF itself. These shares are traded on public stock exchanges, allowing investors to buy and sell them during trading hours at current market prices.

Market Price vs. Net Asset Value (NAV): The price of an ETF's share is determined by supply and demand dynamics in the market, similar to shares. However, an ETF's share price closely tracks its NAV which is the total value of the assets in the ETF divided by the number of shares outstanding. ETF providers and market participants work to ensure that the share price does not deviate significantly from the NAV.

Advantages

Diversification

ETFs offer a way to invest in a wide array of assets or an entire sector, providing instant diversification with a single transaction.

Lower Cost

ETFs have lower fees compared to unit trust or mutual funds.

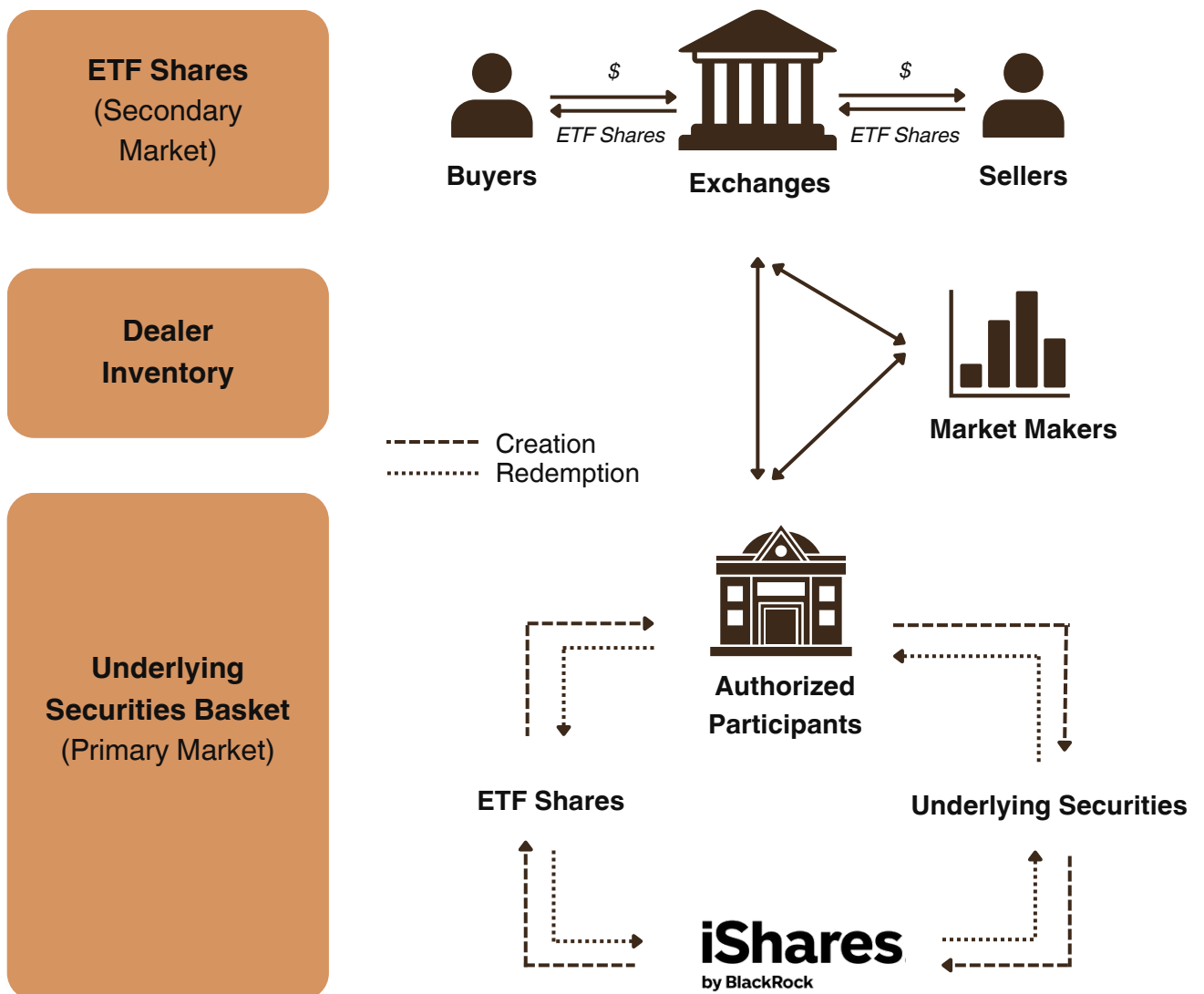
Transparency

ETFs disclose their holdings daily, providing investors with clear visibility into where their money is invested.



So moving on to BTC ETF, BTC ETFs are financial instruments that track the market price of BTC as the underlying assets, allowing investors to buy shares of the ETF through public stock exchanges without the complexities of directly purchasing, holding, or managing cryptocurrencies. This structure provides a regulated, secure, and straightforward avenue for traditional investors to tap into the burgeoning potential of BTC, aligning with the growing demand for digital asset exposure within diversified investment portfolios.

How does a Bitcoin Spot ETF work?



Source: iShares Blackrock

The Significance of SEC Approval

The SEC's endorsement of BTC ETFs is pivotal, lending legitimacy to BTC and cryptocurrencies at large. It opens the door for major financial institutions to offer BTC ETFs, significantly expanding the cryptocurrency's accessibility to a broader investor base. This regulatory approval enhances market stability, transparency, and investor protection, setting the stage for increased capital inflows and fostering an environment conducive to the growth and maturation of the cryptocurrency market.

2008	"Satoshi Nakamoto" introduces the concept of BTC.
2010	The first retail transaction takes place when a user pays 10,000 BTC for two Papa John's pizzas.
2013	As BTC popularity grows, Cameron and Tyler Winklevoss, co-founders of crypto exchange Gemini, file their first application with the SEC to create a spot BTC ETF. Grayscale Investments launches the BTC Investment Trust, an open-ended private BTC trust.
2016	The Winklevoss brothers adjust their application numerous times, such as the exchange on which the product would be traded. They also file amendments naming State Street as administrator. Grayscale files with the SEC to convert its BTC trust into a spot BTC ETF.
2017	The SEC rejects the Winklevoss application on the grounds BTC markets where not mature enough. Grayscale withdraws its first attempt to convert its trust into an ETF, saying the regulatory environment was not developed enough.
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2020	Grayscale transforms its trust into an SEC-reporting entity, and its shares begin trading on the "pink sheets." Although not an ETF, it is the first publicly traded BTC fund in the U.S.



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2022

The SEC rejects several applications from would-be spot BTC ETF issuers, including SkyBridge, Fidelity and Bitwise. The SEC also rejects Grayscale's application, prompting the company to sue the agency. Amid crashing crypto prices, multiple crypto companies file for bankruptcy, including Three Arrows Capital, Celsius Network and FTX, whose founder Sam Bankman-Fried is also charged with fraud.

2023**May**

Cathie Woods' ARK Investments files for a spot BTC ETF, giving the SEC a maximum of 240 days to approve or reject the application. June: BlackRock files a spot BTC ETF application with the SEC, raising industry hopes the agency may approve the product and sending the price of BTC to a one-year high. A flurry of other issuers, including Fidelity and Invesco, file BTC ETF applications in the subsequent weeks and months.

2023**August**

A federal appeals court in Washington D.C. rules in favor of Grayscale, saying the SEC did not justify why it had rejected its proposal. Europe's first spot BTC ETF begins trading on the Euronext Amsterdam stock exchange.

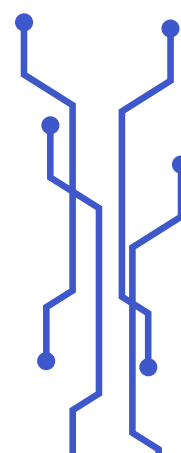
2023**October**

A federal appeals court in Washington D.C. rules in favor of Grayscale, saying the SEC did not justify why it had rejected its proposal. Europe's first spot BTC ETF begins trading on the Euronext Amsterdam stock exchange.

2024**January**

The SEC approves 11 proposals from issuers including BlackRock, Fidelity and VanEck, among others, to launch spot BTC ETFs.[2]

[2] Yahoo! Finance



INVESTING IN BITCOIN ETF

Investing in BTC ETFs offers a more accessible and less complex route to gaining exposure to BTC's price movements compared to direct cryptocurrency transactions. This method alleviates the need for investors to manage digital wallets or navigate the security risks associated with cryptocurrency exchanges. It encapsulates the convenience and regulatory safeguards of traditional investment vehicles while capturing the investment potential of BTC.

Here's a detailed look at the 11 SEC-approved BTC ETFs, outlining their key attributes, including type, expense ratio/fee waivers, index benchmarks, and fund strategies.

ETF Name	Expense Ratio	Index Benchmark	Brief Fund Strategy
Greyscale Bitcoin Trust (GBTC)	1.5%	Greyscale Bitcoin Trust (GBTC)	Focuses on BTC holdings and operational efficiency with Authorized Participants facilitating Share creation/redemption. Custody by Coinbase, aiming for alignment with BTC's performance.
VanEck Bitcoin Trust (HODL)	0.2%	MarketVector™ Bitcoin Benchmark Rate	Aims for exposure to BTC performance, net of expenses, through direct BTC holdings. Shares represent proportional ownership in BTC. Custodian: Gemini Trust Company.
Fidelity Wise Origin Bitcoin Trust (FBTC)	0.25%	Fidelity Wise Origin Bitcoin Trust (FBTC)	Directly holds BTC to mirror its performance, valuing shares using the Fidelity Bitcoin Reference Rate. Custodian: Fidelity Digital Asset Services.

iShares Bitcoin Trust (IBIT)	0.25%	CME CF Benchmark Index	Offers indirect BTC exposure, aiming to mirror market performance before expenses/liabilities. Trades like shares, with custody solutions for security.
Ark 21Shares Bitcoin ETF (ARKB)	0.21%	CME CF Bitcoin Reference Rate	Emphasizes market risks associated with digital assets, aiming for exposure solely to BTC. Authorized Participants manage creation/redemption.
Invesco Galaxy Bitcoin ETF (BTCO)	0.25% - 0.39%	Lukka Prime Bitcoin Reference Rate	Holds BTC as its primary asset, focusing on ownership and safekeeping over active trading or diversification. Custodian: Coinbase Custody Trust Company.
Hashdex Bitcoin ETF[3]	0.9%	Hashdex U.S. Bitcoin Futures Fund Benchmark	Invests in futures contracts and cash equivalents, with assets committed as margin for futures contracts. Custodian: US Bank National Association.
Bitwise Bitcoin ETF	0.95%	CME CF Bitcoin Reference Rate - New York Variant (BRRNY)	Invests directly in BTC, enabling exposure to its price movement while minimizing administrative costs. Custodian: Fidelity Digital Asset Services.

[3] Hashdex is listed as approved Spot BTC ETF but hasn't yet converted its futures ETF to a spot ETF

Franklin Bitcoin ETF	0.19%	CME Bitcoin Reference Rate - New York Variant (BRRNY) CF	Provides a simple way to gain exposure to BTC's performance, with each share backed by BTC held by a custodian.
WisdomTree Bitcoin Fund	0.25%	CME Bitcoin Reference Rate - New York Variant (BRRNY) CF	Tracks the price of BTC, holding the cryptocurrency directly. Aims to reflect BTC's price through a passive investment strategy.
Valkyrie Bitcoin Fund[4]	0.25%	CME Bitcoin Reference Rate - New York Variant (BRRNY) CF	Aims to reflect the performance of BTC's value less the Trust's expenses and liabilities. The fund also invest in Ethereum futures contract, cash or high quality securities ie. US Treasuries and corporate bonds.

Source: Company's Website

Difference with Traditional Crypto Wallet

The primary distinction between investing in a BTC ETF and using a traditional crypto wallet is the level of direct interaction with BTC. ETFs offer exposure to BTC's price movements without the need to directly own the cryptocurrency, eliminating the challenges of digital wallet management and security risks associated with cryptocurrency exchanges.

Potential and Risk

The appeal of BTC ETFs lies in their potential to simplify cryptocurrency investments while offering a regulatory safety net. However, investors must be cognizant of market volatility, the evolving regulatory landscape, and the inherent risks of cryptocurrency investments. These factors play a crucial role in the decision-making process for potential investors.

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Shariah Analysis : Asset Allocation and Fund Strategy

An Islamic ETF is deemed Shariah-compliant if its underlying assets adhere to Shariah principles. [4]

This adherence is crucial as Muslim investors, when investing in BTC ETFs, are entitled to certain types of returns that align with Islamic finance guidelines. Our analysis delves into the prospectuses of each BTC ETF to assess its asset allocation and fund strategy, ensuring compliance with Shariah requirements.

The **core principle** guiding this evaluation is that an Islamic ETF's assets must consist solely of holdings that meet Shariah standards. Here's how this principle impacts investors in the context of BTC ETFs:

Capital Gains

Investors in a Shariah-compliant BTC ETF should earn returns primarily through capital gains. This occurs when the ETF disposes of BTC at a higher value than its purchase price, passing on the profits to investors.

Interest (Riba) and Other Prohibited Earnings

The asset allocation of a Shariah-compliant ETF should not include futures, placements in money markets, or other financial instruments that yield interest. Gains from such instruments, contrary to Shariah, should not be distributed to investors.

[4] Securities Commission Malaysia's Guidelines on Exchange-Traded Funds as approved by the Shariah Advisory Council of Securities Commission Malaysia

Upon reviewing the available BTC ETFs, it's observed that nine out of the eleven ETFs are primarily invested in BTC, with minimal cash holdings dedicated to covering operational costs and expenses. Importantly, these ETFs do not distribute interest to their investors, focusing solely on capital gains derived from BTC's valuation. Therefore, they align with Shariah principles and are considered Shariah-compliant.

However, two ETFs, namely the Hashdex Bitcoin ETF and the Valkyrie Bitcoin Fund, which have exposure to futures contracts, cash, and bonds, do not meet the Shariah compliance criteria due to their asset composition.

It's also pertinent to reference the Securities Commission Malaysia's Guidelines on Exchange-Traded Funds, which stipulate:

"An Islamic ETF must utilize Islamic derivatives for hedging purposes. Should Islamic derivatives not be available or commercially viable, the use of conventional derivatives is permissible, provided there's prior approval from the Shariah adviser."

Unfortunately, this condition does not apply to the aforementioned non-compliant funds.

Additionally, the Wisdom Tree Bitcoin Fund's strategy merits attention for its commitment to passive investment without the use of leverage, derivatives, or speculative practices. The fund's straightforward focus on tracking BTC's price, coupled with a prohibition against loaning or pledging Trust assets, offers a heightened level of assurance for Muslim investors. This approach by Wisdom Tree Bitcoin Fund, especially in the absence of a Shariah adviser, suggests a fund strategy that might be considered compliant with Shariah principles.

ETF Name	Shariah Status
● Greyscale Bitcoin Trust (GBTC)	
● VanEck Bitcoin Trust (HODL)	
● Fidelity Wise Origin Bitcoin Trust (FBTC)	
● iShares Bitcoin Trust (IBIT)	
● Hashdex Bitcoin ETF	
● Ark 21Shares Bitcoin ETF (ARKB)	
● Bitwise Bitcoin ETF	
● Franklin Bitcoin ETF	
● WisdomTree Bitcoin Fund	
● Valkyrie Bitcoin Fund	
● Invesco Galaxy Bitcoin ETF (BTCO)	

CONCLUSION

The SEC's approval of Spot BTC ETFs in 2024 signifies a pivotal moment akin to the introduction of gold-backed ETFs in 2004 and the Shariah certification of SPDR Gold Trust back in 2017. This milestone enhances the legitimacy, accessibility, and exposure of cryptocurrencies, setting the stage for significant capital inflows and market maturation. For investors, the convenience, regulated framework, and exposure to real-time BTC prices through traditional investment accounts present compelling advantages, including lower fees and streamlined trading.

However, the decision to include a Spot BTC ETF in an investment portfolio requires careful consideration of market volatility, regulatory challenges, and counterparty risks. The positive performance of BTC in 2023 underscores its potential for significant returns, yet the inclusion of BTC ETFs in a portfolio should align with individual risk profiles, financial objectives, and, importantly, Shariah compliance.

The potential emergence of Shariah-compliant BTC ETFs opens new avenues for the Islamic finance sector, providing an opportunity to bridge traditional ethical investing principles with modern financial innovations. As the financial landscape evolves, the integration of cryptocurrencies into Shariah-compliant investment vehicles will be crucial in ensuring that investments not only offer financial returns but also adhere to ethical and moral standards.

This detailed analysis underscores the transformative impact of BTC ETFs on the investment world, offering a novel approach for investors to gain exposure to the cryptocurrency market within a regulated framework. For Muslim investors, the development of Shariah-compliant BTC ETFs represents a significant opportunity to participate in the burgeoning cryptocurrency space while adhering to Islamic finance principles.

Looking ahead as the global financial ecosystem continues to evolve, the interplay between digital assets like BTC and traditional financial instruments will likely become more pronounced. The integration of Islamic finance principles with emerging digital assets offers a promising path forward, potentially paving the way for a new era of ethical, compliant, and innovative investing.

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