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ETFs' 'Spider Woman' Argues for a Bitcoin Fund

Kathleen Moriarty, a top lawyer in the ETF business, intends to convince regulators that a bitcoin ETF is appropriate for the market

Kathleen Moriarty at her Midtown Manhattan office. She has spent more than two decades winning regulators' approval for new varieties of ETFs.
PHOTO: HEIDI GUTMAN FOR THE WALL STREET JOURNAL

By **LESLIE JOSEPHS**
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When one of the first exchange-traded funds launched in 1993, securities lawyer Kathleen Moriarty received a gift from her legal assistant: a Spider-Man comic-book cover altered to depict the superhero facing off against a hulking Securities and Exchange Commission.

Twenty-three years later, Ms. Moriarty's ability to navigate the arcane rules that govern financial markets and products has built her a reputation as a top lawyer in the ETF business and earned her the nickname "Spider Woman."

Her latest challenge is convincing regulators that a bitcoin ETF is appropriate for the market. That isn't necessarily an easy sell, given the explosion of ETFs across the market and their fraught role in a market meltdown last August.

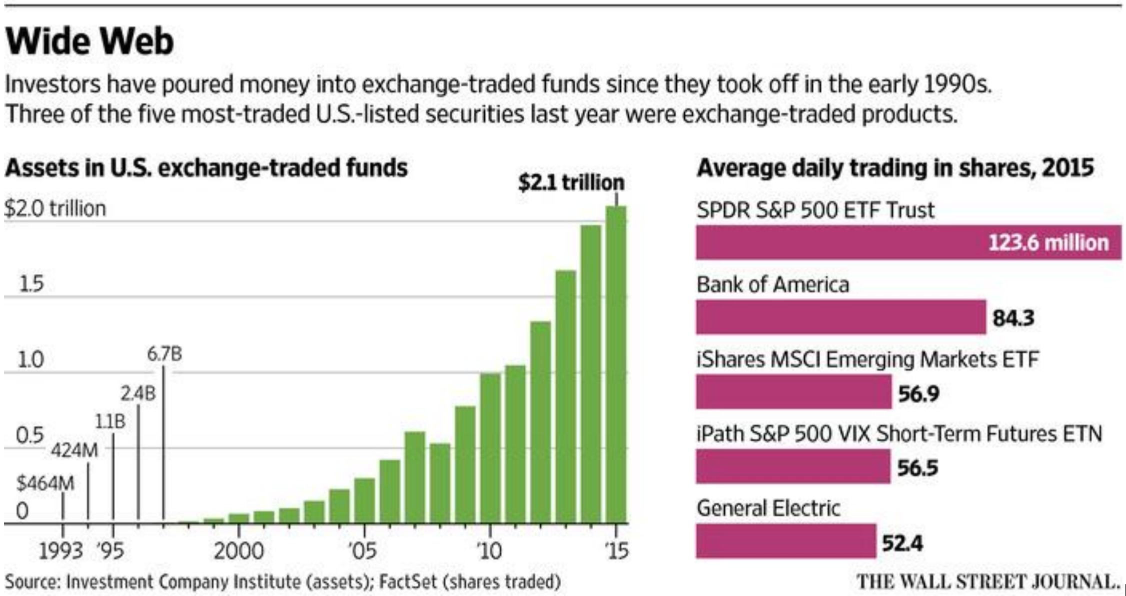
"I tend to concentrate on more exotic products," Ms. Moriarty said. "Zero of my plans include retirement."

ETFs have grown to become one of Wall Street's most popular product categories by offering investors low-fee access to wide swaths of the market.Investors had close to $3 trillion in assets across nearly 4,500 ETFs globally as of March, according to London-based research firm ETFGI.

"I don't think anyone would have thought it was going to be this big," said Ms. Moriarty, a partner at Kaye Scholer LLP, in an interview this year at her Midtown Manhattan office, which was adorned with decorative arachnids and the framed comic.

Ms. Moriarty, who turned 63 Tuesday, helped launch what is still the largest U.S.-listed exchange-traded fund—the SPDR S&P 500 ETF, or SPY—paving the way in 1993 for a booming industry.

"If you're going to try to do something unique and novel in that space, you're going to call Kathleen," said Jim Ross, who heads State Street Global Advisors' line of SPDR ETFs.



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Born near Chicago and raised in Manhattan, Ms. Moriarty often wears a gold brooch of a long-legged spider. She has won regulators' assent for several new products over the past two decades, from basic stock-market-tracking funds to those that seek to replicate the performances of bonds and gold, and those that use derivatives to amplify performance.

While on vacation last summer, Ms. Moriarty returned from a walk on the beach on New York's Fire Island, and noticed she had more than a dozen missed calls. That day, Aug. 24, marked one of the most volatile stock-market trading sessions in recent years, when several ETFs traded at sharp discounts to their underlying holdings.

The SEC had been looking into ETFs before August, but that trading session highlighted how the structure of the popular products could backfire in times of market stress. The Dow Jones Industrial Average dropped more than 1,000 points in early trade amid fears that China's economy was slowing. There were close to 1,300 trading halts, most of them in exchange-traded products, according to an SEC report.

"I fear that the risk presented by some of these new products may not be fully understood by those who have invested in them," said SEC Commissioner Kara Stein in a February speech. "Indeed, even plain-vanilla, equity-index ETFs may present risks that are not always anticipated or fully understood, as evidenced by the events of Aug. 24, 2015."

Last year, the agency proposed new rules that could limit ETFs' growth and even slim down the current lineup, such as curbing the use of derivatives by mutual funds and ETFs and limiting their holdings of assets that are illiquid, or tough to buy and sell.

An SEC spokeswoman declined to comment for this article.

Ms. Moriarty said regulators' concerns about the products' proliferation is "extreme."

"How many more mutual funds do we need? Nobody ever asks that question," said Ms. Moriarty. (There are more than 8,100 mutual funds and about 1,600 ETFs in the U.S. as of February, according to the Investment Company Institute, a fund industry group.)

"I don't necessarily see a risk," she said. Ms. Moriarty said she has about half of her personal retirement investments in ETFs.

Ms. Moriarty said it took roughly seven years to win SEC approval for what is now a small but controversial corner of the ETF world: leveraged ETFs. These products, which she helped ProShare Advisors launch in 2006, often use swap agreements, usually with investment banks, that amplify investors' gains and losses.

The top gainer among U.S.-listed exchange-traded products so far this year, according to FactSet, is a leveraged product, Direxion's Daily Junior Gold Miners Index Bull 3x Shares ETF, which aims to provide investors with three times the daily performance of a selection of gold mining companies. It is up more than 260% this year, compared with a loss of more than 74% in all of 2015.

In 2010, the SEC put a moratorium on new approvals for asset managers seeking to enter the leveraged ETF market. Then-SEC Chairman Mary Schapiro said it was "appropriate" because of the "questions surrounding the risks associated with the derivative instruments underlying many funds."

Ms. Moriarty cited bitcoin's volatility as a risk in the filing she co-wrote. She said her proposed ETF's structure is similar to that of the $32 billion exchange-traded gold product, the SPDR Gold Trust, that she helped launch in 2004 because it aims to give investors access to the commodity without having to hold it. The fund, GLD, has risen sharply along with gold prices this year.

"I'm optimistic," Ms. Moriarty said about the bitcoin application.

SPY remains the largest ETF around, with more than $188 billion in assets as of Friday, according to FactSet. But it is now facing competition from younger, cheaper rivals, such as Vanguard's S&P 500 ETF, which charges investors a fee of 0.05% on assets compared with SPY's more than 0.09%.

Fund companies are trying to slice the market into finer and finer pieces. Janus Capital Group said last month it was planning an ETF that tracks companies that produce or sell organic products and another that seeks to mirror the performance of firms that treat obesity and related diseases. While index-tracking funds make up the lion's share of ETFs, some asset managers are seeking approval for funds whose securities are chosen by a manager but don't disclose their holdings on a daily basis, veiling the portfolio manager's strategy from other traders.

Ms. Moriarty says fewer than half of the proposals she takes on are for simple ETFs, saying they tend to cruise to market on a well-worn regulatory path, but she says she has her limits.

"If it's really completely ludicrous you don't want to waste regulators' time," she said.

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