National Insurance
Alliance Limited

11th April 2024

Everything You Need to Know About the Bitcoin and Ethereum Exchange Traded Notes (ETNs) and How They Will Affect Retail Investors

Following the London Stock Exchange's (LSE) announcement that it will begin accepting applications for Bitcoin and Ethereum linked Exchange Traded Notes (ETNs), the Financial Conduct Authority (FCA) stressed that these products are only available to credit institutions and/or investment firms that have the regulatory approval to conduct their operations in financial markets.

With this latest development, we will be taking a deeper look at what the new cryptocurrency-backed ETNs are and how the recent developments will impact retail investors. Cryptocurrency ETNs as the name suggests are financial instruments that, much like ETFs (please refer to our previous primer on ETFs that were, have underlying investments that are cherry-picked to mirror the performance of an index or other benchmarks. However, unlike ETFs, ETNs do not own the underlying asset, and the returns on these instruments are paid out based on the performance of that index/benchmark. Essentially, the ETNs will track the price performance of cryptocurrencies like Bitcoin which are traded on traditional stock exchanges. An ETN functions like an unsecured debt note and is similar to a bond which can be bought and sold at will or held to maturity. If the underwriter (usually a financial institution) were to go bankrupt, the investor risks losing the entire investment.

According to the released fact sheet on the proposed cryptocurrency ETNs, the instrument must be physically backed, i.e. non-leveraged, and possess a market price and/or other valuation metrics of the underlying asset that is reliable and publicly available. Additionally, the underlying cryptocurrency assets are required to be wholly or principally held in an offline depository wallet i.e. cold storage inclusive of cold staking or manage and process the assets that achieve an equivalent outcome to cold storage.

The LSE's approval of cryptocurrency ETNs will provide investors with an opportunity to gain exposure to the asset class albeit through a familiar and centrally regulated investment instrument. The decision by the LSE highlights the increasing demand for cryptocurrency investment products among traditional and institutional investors. As the popularity of the asset class continues to grow, traditional financial institutions are pursuing more ways to incorporate digital assets into their investment product offerings.

Even though the FCA has banned retail participation in the ETNs, retail investors could potentially benefit from the new developments in the cryptocurrency space. The first and most obvious way is from the direct price increase of Bitcoin. With the recent surge in Bitcoin prices boosted by the influx of fresh funds into Bitcoin ETFs, price levels will likely see further surges from the listing of ETNs and the prominent Bitcoin halving. If investors own the underlying asset, a surge in price movements will likely benefit retail investors as well. Additionally, investors with lower risk appetites will gain more confidence around cryptocurrency backed investment vehicles given that another financial regulatory body has approved the listing of ETNs. Lastly, there is a possibility that retail investors would be able to gain exposure to a wider array of cryptocurrency linked investment products further down the line with an ever changing regulatory landscape and a precedent in the US around the ETF approvals. NIACE looks forward to new developments in the industry and will closely monitor them as we eagerly anticipate the imminent halving event.

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