Hashdex

HASHDEX RESEARCH

Crypto ETPs: An Overview of Protections Under the Securities Act of 1933

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Bitcoin and other crypto assets are becoming increasingly popular with US investors. As more individuals and institutions consider allocating to this emerging asset class—many for the first time—access to safe, regulated products is paramount.

Much of the attention around crypto investment products has centered around the SEC's lack of approval for a spot bitcoin exchange traded fund (ETF), while also approving bitcoin futures products regulated under the Investment Company Act of 1940.

Crypto assets, however, can follow a different regulatory path that provides protections in line with those under the '40 Act. Exchange traded products (ETPs) regulated under the Securities Act of 1933 provide a level of operational diligence and disclosure consistent with—and in some cases exceeding—'40 Act ETFs, while also having some key differences that make ETPs more appropriate for crypto assets.

Operational Similarities

- The operational characteristics of a '33 Act ETP are entirely consistent with ETFs. ETPs create and redeem baskets of shares, announce portfolio holdings at the start of the day, and use the same third-party service providers (e.g., market makers, administrators, stock exchanges). The structure of the secondary market for ETFs and ETPs is also the same. Authorized participants may create or redeem shares throughout the day, seeking to take advantage of arbitrage opportunities or to fulfill customers' buy or sell orders.

Registration Requirements

- ETPs and ETFs are required to register the offering of their shares under the '33 Act, meaning that investors in both ETPs and ETFs are covered by all of the '33 Act's investor protections, including the requirement to provide full and fair disclosure and the ability for investors to sue if prospectuses contain material omissions or misstatements.

Disclosure Standards

- The '33 Act requires both ETF and ETP share purchasers to receive prospectuses. While SEC forms for registration statements differ for ETPs and ETFs, both require disclosure for fees and expenses, investment objectives, strategies and risks, and other material factors. However, while ETF and ETP investors regularly receive updated financial and other information through SEC reporting requirements, ETP shareholders actually receive more information more frequently than ETF shareholders. This is because ETPs are listed and traded on a national stock exchange and must register under the Securities Exchange Act of 1934 and regularly file 10-Ks, 10-Qs, and 8-Ks. These reports provide investors information regarding management, market analysis, and financial statements (including quarterly interim financial statements). ETF shareholders only receive financial statements twice per year.

Tax Efficiency

- ETFs regulated under the Securities Act of 1933 ('33 Act) have a tax structure where 60% of capital gains are taxed as long-term gains and 40% are taxed as short-term gains, regardless of the investor's holding period. This blended rate structure, and the fact that unrealized losses get pass-through treatment in a '33 Act ETF, is in contrast to funds regulated under the Investment Company Act of 1940 ('40 Act) where unrealized gains are taxed as ordinary income and there is no tax credit for losses. As a result of the consistent tax treatment in a '33 Act ETF, investors in these funds can benefit from a more favorable effective tax rate.

Better Exposure

- A '40 Act ETF that offers commodity exposure via futures or swaps must do so by holding these commodity-linked investments in an offshore subsidiary. Diversification requirements limit these ETFs to holding 25% of their assets in this type of subsidiary. This limit requires ETFs and other '40 Act funds that wish to gain exposure to bitcoin through futures contracts to utilize leverage to obtain full investment exposure (because of the high margin requirements for bitcoin futures). The structure of the Hashdex Bitcoin Futures ETF means that it does not need to take on additional leverage to remain fully invested. This capital efficiency helps maintain a value more in line with bitcoin.

President Biden's Executive Order on digital assets is a clear sign the US is becoming more serious about the regulation of bitcoin and other crypto assets. As demand grows, we believe investors should have access to these assets in a simple and secure way. Going forward, the operational and other similarities between '33 Act ETPs and '40 Act ETFs are important factors that investors should consider as they select bitcoin and crypto asset investment products.

This material must be preceded or accompanied by a prospectus. Please read the prospectus carefully before investing.

Hashdex Bitcoin Futures ETF (the "Fund") is a commodity pool that issues Shares that may be purchased and sold on NYSE Arca. The Fund's investment objective is for changes in the Shares' NAV to reflect the daily changes of the price of the Benchmark, less expenses from the Fund's operations. Under normal market conditions, the Fund invests in Benchmark Component Futures Contracts and cash and cash equivalents. Because the Fund's investment objective is to track the price of the Benchmark by investing in Benchmark Futures Contracts rather than bitcoin, changes in the price of the Shares will vary from changes in the spot price of bitcoin. The Fund will invest in BTC Contracts and MBT Contracts to the extent necessary to achieve maximum exposure to the bitcoin futures market. Because the Fund's investment objective is to track the price of the Benchmark by investing in Benchmark Futures Contracts rather than bitcoin, changes in the price of the Shares will vary from changes in the spot price of bitcoin.
The Fund employs Foreside Fund Services, LLC as the Distributor for the Fund. The Distribution Services Agreement among the Distributor, the Sponsor, and the Trust calls for the Distributor to work with the Custodian in connection with the receipt and processing of orders for Creation Baskets and Redemption Baskets and the review and approval of all Fund sales literature and advertising material. The Distributor's principal business address is Three Canal Plaza, Suite 100, Portland, Maine 04101. The Distributor is a broker-dealer registered with the U.S. Securities and Exchange Commission ("SEC") and a member of FINRA.

Bitcoin Risks
Bitcoin and bitcoin futures are a relatively new asset class and the market for bitcoin is subject to rapid changes and uncertainty. Bitcoin and bitcoin futures are subject to unique and substantial risks, including significant price volatility and lack of liquidity. The value of an investment in the ETF could decline significantly and without warning, including to zero. You should be prepared to lose your entire investment. The ETF does not invest directly in or hold bitcoin. The price and performance of bitcoin futures should be expected to differ from the current "spot" price of bitcoin. These differences could be significant. Bitcoin futures are subject to margin requirements, collateral requirements and other limits that may prevent the ETF from achieving its objective. Margin requirements for futures and costs associated with rolling (buying and selling) futures may have a negative impact on the fund's performance and its ability to achieve its investment objective. Bitcoin is largely unregulated and bitcoin investments may be more susceptible to fraud and manipulation than more regulated investments. Bitcoin and bitcoin futures are subject to rapid price swings, including as a result of actions and statements by influencers and the media.

Futures Risk
Commodities and futures investing is generally volatile and risky which may not be suitable for all investors. Futures may be affected by Backwardation: a market condition in which a futures price is lower in the distant delivery months than in the near delivery months. As a result, the fund may benefit because it would be selling more expensive contracts and buying less expensive ones on an ongoing basis; and Contango: A condition in which distant delivery prices for futures exceeds spot prices, often due to costs of storing and inuring the underlying commodity. Opposite of backwardation. As a result, the Fund's total return may be lower than might otherwise be the case because it would be selling less expensive contracts and buying more expensive one.
Commodities and futures generally are volatile, and instruments whose underlying investments include commodities and futures are not suitable for all investors.

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- The Fund is a commodity pool regulated by the Commodity Futures Trading Commission.
- The Fund, which is an ETP, is not a mutual fund or any other type of investment company within the meaning of the Investment Company Act of 1940, as amended, and is not subject to regulation thereunder.
- Because the Fund will invest primarily in BITCOIN futures contracts and other derivative instruments based on the price of BITCOIN, an investment in the Fund will subject the investor to the risks of the BITCOIN market, and this could result in substantial fluctuations in the price of the Fund's shares.
- Shares of the Fund are not insured by the Federal Deposit Insurance Corporation ("FDIC"), may lose value and have no bank guarantee.
- Unlike mutual funds, the Fund generally will not distribute dividends to its shareholders. Investors may choose to use the Fund as a means of investing indirectly in bitcoin, and there are risks involved in such investments.

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Hashdex Team

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