How to choose the right crypto ETP issuer

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Key Takeaways

- Choosing an ETP issuer for a specific crypto exposure is not a straightforward task; there are many important questions that need to be answered.
- Transparency is key if investors want to compare available options side-by-side.
- Staking can be an opportunity for investors but involves risks, which many can easily overlook without a detailed understanding of how it works operationally.

Choosing the right exchange-traded product (ETP) issuer before allocating to a cryptocurrency ETP is like deciding on a new job. As this should be a long-term commitment, going with a company that has a good track record and reputation, is transparent, and evolves through time should be an important consideration.

While each of us could identify our own pros- and cons- for a specific job opportunity, there are certain questions that we need to ask, and we simply cannot gloss over responses that we receive. This is particularly true when it comes to selecting a crypto ETP issuer.

Trust and experience

To begin with, investors need to ensure they know the ETP provider and their track record in managing physically backed ETPs, such as physical gold exchange-traded commodities (ETCs). Physically backed products have a track record of approximately 20 years, and the most sensible approach is for the ETP provider to borrow the tried-and-tested structure for launching crypto ETPs. The longer the track record, the more experienced the ETP provider is, as they would have been tested by various commodity market crises.

A global and diversified business can be an overlooked benefit, as they will not be overexposed to cryptocurrencies which can be volatile. If their business is limited to just this asset class, then investors could be exposed to the risk of a business with a volatile revenue stream and of them terminating products if they go out of business because of a crypto winter. In addition, an ETP provider with a global and diversified business also has more flexibility to quickly adapt to new fee levels.

While a broad business can benefit investors, it is important to understand if they are dedicating sufficient resources to their crypto ETP efforts. This is because this nascent asset class is growing quickly, and crypto ETP providers need to be able to keep up and evolve products as required.

Cold storage best practice

All institutional investors selecting a physically backed crypto ETP should insist on an institutional operating model that takes security seriously.

Cryptocurrencies should be stored in cold storage, and each ETP should have a separate wallet dedicated to its underlying assets. Concerning cold storage, best practice is:

- Private keys stored in multiple secure physical locations
- Ensuring sufficient geographic and human redundancies to help ensure constant and secure access
- Multi-approval system to authorise the movement of assets

Once comfortable with cold storage arrangements, checking whether the ETP issuer uses at least two custodians should be the next step. This is because the multi-custodian model gives the ETP provider flexibility to take advantage of any custodian's:

- Expertise in a particular cryptocurrency
- Enhanced operational efficiency
- New or increased security measures and tools

Transparency: Pay attention to the detail

When investing in crypto ETPs, understand how and why coin entitlement changes. For example, management expense ratio (MER) should reduce, and staking (if applicable) should increase coin entitlement continuously. For the avoidance of any doubt, MER should encompass all direct costs of the ETP.

Investors should insist on transparency for staking, and it may be a red flag if key staking information is not presented on an issuer's website. Key information to know are:

- The risks that it introduces to crypto ETPs
- The staking return split between the crypto ETP (i.e., investors via the coin entitlement) and the ETP provider
- The staking return that the crypto ETP has achieved over various time periods (e.g., last quarter, last year, since staking was enabled, etc.)

ETP providers must implement a transparent and risk-managed approach to staking that they are comfortable discussing. Investors need to make sure they will be able to redeem when they want or need. As such, staking needs to be managed carefully, as it involves locking up a portion of the underlying assets to generate the staking yield. The ETP issuer needs to balance the time that it takes to 'unstake', the amount of ETP that they stake, and the redemption period of the ETP.

It is also very important to have clarity around coin lending, as this would expose investors to additional risks, such as:

- Credit/counterparty risk in relation to entities the cryptocurrencies are lent to
- Additional process risk regarding the transfer and the custody of the lent coins

Convenient access

Europe is a fragmented market where different investors use different exchanges and might need to trade crypto ETPs in their preferred currencies. For example, most crypto ETPs are listed on SIX, Euronext, Xetra and allow trading in USD, EUR, and CHF. Few cryptocurrency ETPs are listed on the LSE and allow trading in GBP. Subject to exchange and currency preferences, an investor may need to choose one crypto ETP over another.

When deciding between two ETPs listed on a preferred exchange and allowing trading in the currency required, comparing the trading costs (i.e., a combination of offer and bid spreads) of those ETPs is important. The best way to do this is by contacting the ETP provider's capital markets team and asking them to run a pre-trade analysis. If needed, they could also help to achieve the best execution.

In conclusion, while it is always good to have a choice, every investor must be able to compare available options side-by-side. To do this, transparency is required and should be demanded from ETP issuers.

WisdomTree: An established ETP provider to access cryptocurrencies

WisdomTree offers a curated range of eight physical crypto ETPs with an institutional-grade structure and provides spot price exposure to single coins and diversified crypto baskets. Please see the WisdomTree Crypto ETP centre for further details.

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