BUILD A BRIDGE TO BETTER RETURNS

ETP CRYPTO LENDING AT
21SHARES

Introduction

Crypto lending is a way that digital asset ETPs can potentially generate additional returns, benefitting investors through better performance or lower management fees, among other considerations.

This paper will outline the basics of crypto lending: how it works, the potential benefits to ETP investors, the risks involved, and 21Shares' approach to lending.

Summary

Crypto lending can unlock potential value for investors by utilizing an ETP's assets to generate additional returns. Through carefully structured lending arrangements, 21Shares can provide investors with potentially attractive returns while balancing the risks and costs inherent to lending.

ETP Crypto Lending 101

21Shares' ETPs are required to be 100% collateralized, which means they must hold digital assets equal to the value of the underlying ETP shares. For example, if the net asset value of an ETP share is $10, then the ETP must hold at least $10 in eligible collateral.

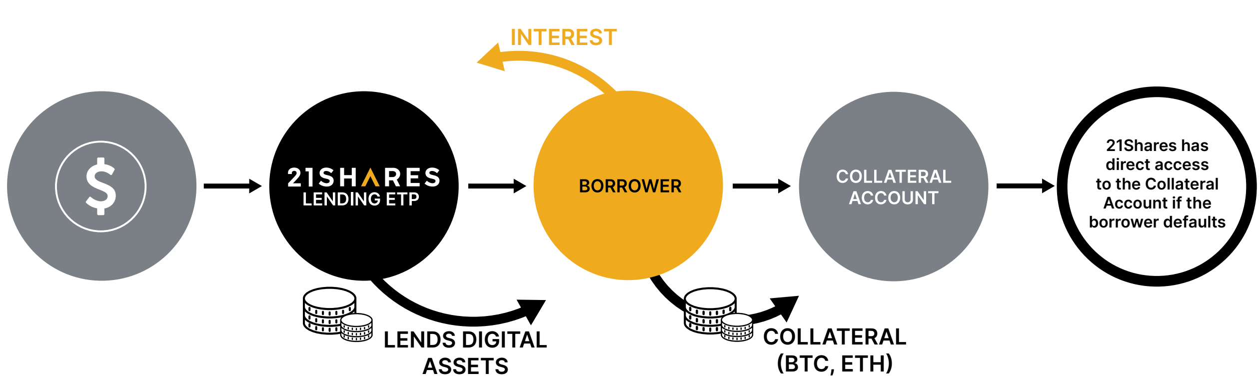
ETP Net Asset Value = Value of Collateral

21Shares holds this collateral in a secure, segregated environment at third-party custodians. This is the equivalent of holding cash in a vault - the assets are secure but generate no additional return for ETP investors. In the case of ETP products that lend, the collateral is lent out to generate additional performance for investors.

How does 21Shares ETP crypto lending work?

1. 21Shares enters into a lending arrangement with an institutional partner (e.g., the borrower).
2. Under the arrangement, cryptocurrency invested in the ETP is lent out to the borrower.
3. The borrower must post collateral (which is typically another cryptocurrency asset).
4. If the borrower does not pay back the loan, the ETP will execute on the collateral.

In traditional finance, the primary protection for lenders is the creditworthiness of the borrower which is measured by indicators such as the borrower's credit rating. In the crypto industry, the primary protection also typically includes a high level of collateral. A borrower may post 110-125% of the loan amount as collateral.



Benefits of ETP Crypto Lending

- Collateralized crypto lending offers a way for crypto-backed ETPs to generate additional returns from the assets it already holds. This can add to the overall performance of the ETP.
- This additional source of this income is not correlated with other assets investors typically hold and may provide diversification benefits.
- Yields are often quite attractive, depending on market conditions.
- The yield generated from crypto lending can often offset the costs of managing the ETP.

	Lends?	TER	Impact from lending	TER offset by lending vs non-lending product
21Shares Bitcoin ETP (ABTC)	No	1.49%	N/A	N/A
21Shares Ethereum ETP (AETH)	No	1.49%	N/A	N/A
21Shares Bitcoin Core ETP(CBTC)	Yes*	0.21%	1.28%	86%
21Shares Ethereum Core ETP (CETH)	Yes*	0.21%	1.28%	86%

*Comparison of 21Shares lending and non-lending single asset products as of 20 September 2022. The impact from lending is indirectly reflected in the lower Total Expense Ratio (TER). *CBTC and CETH do not currently engage in lending.*

	Lends?	TER	Net projected yield from lending	TER offset by lending
21Shares USD Yield ETP (USDY)	Yes	0.30%	5.34%	100%

Attractive yield generation through lending completely offsets the TER as of 20 September 2022.

ETP Crypto Lending Risks

Although crypto lending can generate additional returns, it is important to be aware of the risks associated with such lending. 21Shares has built proprietary risk models to evaluate the appropriate collateral levels and evaluates prospective partners before entering into lending arrangements. Some of the primary risks associated with crypto-backed lending include:

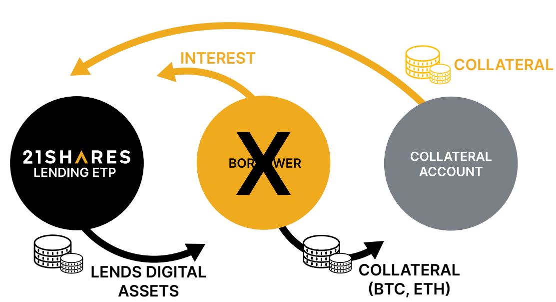
1. Borrower default risk
2. Crypto market risk

Details on additional risks are summarized below:

Borrower Default Risk

Although 21Shares lends only to vetted borrowers, there is always a risk that a borrower could fail to pay back what is owed or that 21Shares' vetting process does not uncover all risks associated with the borrower, among other potential risks. That is why collateral is required - to serve as a potential guardrail and protection. This collateral is held with one of our partner custodians (all of whom are third parties to the lending transaction) in a segregated account. In a default scenario, 21Shares ETPs are protected by the rules of the collateral account, which allow 21Shares to seize the collateral. We have outlined the default scenario in the diagram below.

If the borrower defaults...21Shares has direct access to the Collateral Account



Crypto Market Risk

Although all loans held by 21Shares ETPs are overcollateralized and priced ("marked-to-market") on a daily basis, the volatile nature of the crypto markets means that, in a default scenario, the collateral could prove to be worth less than the amount the borrower owes, resulting in a potential loss to the ETP. The high level of collateral and daily pricing act to mitigate this risk.

Other Potential Risks

Of course, there are other potential risks presented by crypto-backed lending, some of which may be unknown at this point or not otherwise covered in this document. We encourage investors to take caution when considering a future potential investment and assess their own potential risks.

Transparency and 21Shares' Approach to ETP Crypto Lending

Transparency is a hallmark of both ETPs and cryptocurrency. 21Shares is committed to sharing all relevant information regarding our lending practices to ensure investors can make fully informed decisions. Currently, 21Shares has three products that can engage in lending:

1. **21Shares USD Yield ETP (USDY)**
2. **21Shares Bitcoin Core ETP (CBTC)***
3. **21Shares Ethereum Core ETP (CETH)***

**CBTC and CETH do not currently engage in crypto-backed lending.*

Lending-related details for each ETP appear on the 21Shares website. Each ETP product web page also contains the following facts:

1. If a product is eligible to engage in lending.
2. The current share of the ETP's assets on loan.
3. The ratio of collateral posted to the outstanding loan amount.
4. The projected net yield for any loans.

For 21Shares' non-lending products, the ETP product webpage and fact sheet will also specify that they do not engage in lending. Please reach out to **sales@21.co** if you have any further questions regarding our lending practices. Additional information regarding lending practices can be found in the table below.

Lending Terms	
Eligible Borrowers	Institutional Borrowers (Currently BlockFi)
Eligible Collateral	[BTC, ETH, USDC]
Minimum Collateral Level	100%
Target Collateral Level	125% - 150%
Actual Collateral Level	Updated daily on each product's website: https://21shares.com/product/usdy
Collateral Account Terms	The collateral is stored in a custodian account with no right of withdrawal by the borrower. 21Shares will take ownership of the crypto assets in the collateral account in the event of default (e.g., if the borrower is unable to pay interest or meet a margin call). 21Shares can commence this process expeditiously. The level of collateral currently held can be found on the respective product's webpage. The information is updated daily. Collateral is marked to market daily with intraday margin call requirements. The borrower has 24 hours to fulfill a margin call otherwise deemed as default.
Maintenance Level	24/7 margin calls* at maintenance level over 100%
Lending Revenue Breakdown	Lending yields are shared differently depending on the product. For USDY, the yields are accrued to NAV with 21Shares retaining an arranger fee of up to 25%. Product-specific information can be found on the product's webpage as well as in the Final Terms.

*What is a margin call?

A demand by the lender (21Shares) that the borrower deposits further digital assets to ensure sufficient collateral.

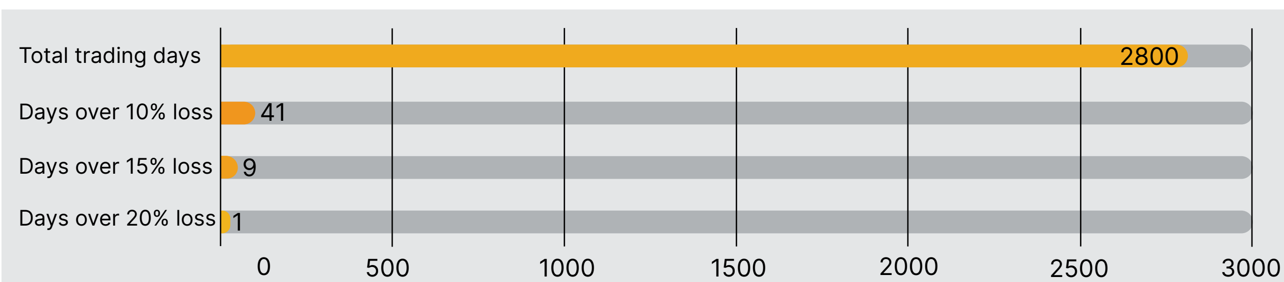
How does 21Shares determine how much an ETP can lend and is there a cap?

Lending is managed using 21Shares' internal risk management algorithm that employs historical redemption models to ensure the ETP can honor daily redemptions. The model considers several inputs rather than a static numerical target. The amount of collateral an ETP can lend varies by product.

21Shares ETPs primarily engage in loans where we can ask for the loan back at any time. This lending, therefore, should not impact the ability of an end investor to redeem their 21Shares ETP shares, although as discussed above, there is no such guarantee given the various risks presented.

How does 21Shares determine the appropriate collateralization level for each product?

We determine the appropriate level of collateralization based on a comparison of the expected volatility of the asset posted as collateral to the asset on loan. 21Shares models extreme price fluctuation scenarios to ensure loans are protected even in the most volatile crypto markets.



For example, when determining the collateralization ratio for USDY, 21Shares engaged in back-testing starting from October 2014 to ensure a broad range of conditions were modeled. The table above shows the amount of days in which bitcoin had a loss over 10%. There was no day with a loss over 25%. The single worst one-day return was -21.2% and happened on March 12, 2020.

This type of data was an important input in determining the appropriate overcollateralization ratio for USDY, which is currently 150%.

How does lending impact the liquidity of an ETP (e.g., the ability to process redemptions)?

Lending is structured to ensure the ETP can always honor daily redemptions. The risk management algorithm described above is one critical tool in that process. In addition, most lending is on an open-term basis, which allows for the immediate recall of assets on the loan if needed to satisfy redemptions.

How is lending revenue shared?

Lending yields are shared differently depending on the ETP. For USDY, the yields are accrued to NAV with 21Shares retaining an arranger fee of up to 25%. For CBTC, although it currently does not engage in lending, these yields will be shared with investors via reduced management fees, rather than directly. ETP-specific information can be found on the product's webpage as well as in the Final Terms.

Conclusion

21Shares set out to build bridges into crypto when it launched the first physically-backed crypto ETP in 2018. Since then, 21Shares has launched over 30 additional crypto-backed ETPs, giving investors optionality in their crypto exposure. As a pioneer in this space and a truly crypto-native firm, 21Shares has now built bridges into the crypto lending ecosystem. Although not without risks, crypto lending can give ETP investors exposure to new potential yields. By providing transparency, each investor can make informed decisions on which 21Shares products are right for them.

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