

Crypto ETPs and UCITS Eligibility



In Short

1. Are 21Shares' ETPs UCITS funds?

21Shares' ETPs are not UCITS funds. Instead they are structured as physically backed debt obligations.

2. Are 21Shares' ETPs UCITS eligible?

There is no conclusive answer to this question. 21Shares' analysis of the legal framework suggests that 21Shares' physically backed cryptocurrency ETPs could be considered eligible investments for UCITS funds. Further information can be found in the assessment below.

3. What is the difference between UCITS compliant and UCITS eligible?

UCITS compliant products are funds that operate in compliance with the [UCITS Regulations](#). A lot of mutual funds and Exchange Traded Funds ("ETFs") are designed to be UCITS compliant and carry UCITS in their name.

UCITS eligible refers to whether something can be invested in by a UCITS under the UCITS regulatory framework - specifically the [Eligible Assets Directive](#) ("EAD"). The portfolio of a UCITS fund consists of UCITS eligible assets, but these assets do not have to be UCITS funds themselves.

Full Details

Are 21Shares ETP's Eligible Assets for UCITS?

The universe of investments a UCITS fund can make is restricted under the UCITS regime by the UCITS Directive¹ and the Eligible Asset Directive², which is often supplemented by local regulator guidance.

According to the UCITS Directive, these investments include but are not limited to: *Article 50(1)(a): "transferable securities*

admitted to or dealt in on a regulated market as defined in Article 4(1)(14) of Directive 2004/39/EC;"

In the case of "Transferable Securities" under Article 50(1)(a), there is a further requirement that the relevant securities do not embed a derivative that refer to an ineligible asset. The following table applies the definition of Transferable Security (according to the EAD, Article 2) to the 21Shares' ETPs:

EAD Definition	Application to 21Shares ETPs	
	Requirement Met	Explanation
<i>i. the potential loss which the UCITS may incur with respect to holding those instruments is limited to the amount paid for them;</i>	Yes	<i>21Shares' ETPs meet these criteria due to their unleveraged structure.</i>
<i>ii. their liquidity does not compromise the ability of the UCITS to re-purchase or redeem its units (for example, when they are dealt or traded on a regulated market);</i>	Yes	<i>21Shares' ETPs are open-ended and listed on multiple regulated stock exchanges across Europe, where liquidity is provided by market makers.</i>
<i>iii. a reliable valuation is available (for example, in the case of securities admitted to or dealt in on a regulated market, in the form of accurate, reliable and regular prices which are either market prices or prices made available by valuation systems independent from issuers);</i>	Yes	<i>Market prices for the ETPs are available from the regulated exchanges on which 21Shares' ETPs trade. 21Shares employs third party calculation agents that further facilitate reliable pricing.</i>
<i>iv. appropriate information is available for them (for example, in the case of securities admitted to or dealt in on a regulated market, in the form of regular, accurate and comprehensive information to the market on the security);</i>	Yes	<i>Due to their availability on regulated markets, 21Shares is required to publish regular information updates on its ETPs. This includes for example the Base Prospectus or the Key Information Documents.</i>
<i>v. they are negotiable;</i>	Yes	<i>21Shares' ETPs meet this negotiability requirement by virtue of being dealt and traded on regulated markets.</i>
<i>vi. their acquisition is consistent with the investment objectives or the investment policy, or both;</i>	<i>Dependent on the UCITS funds' own investment objectives and policy</i>	<i>Depending on the aims of the UCITS fund, 21Shares' ETPs may fall within the relevant objectives and policies. This should be evaluated by the UCITS fund itself.</i>
<i>vii. their risks are adequately captured by the risk management process of the UCITS.</i>	<i>Dependent on the UCITS funds' own risk management process</i>	<i>The risk of 21Shares' ETPs may be captured adequately by a UCITS risk management policy. This should be evaluated by the UCITS itself.</i>

Based on the above, it is our view that 21Shares' ETPs meet the definition of "Transferable Securities" under the EAD.

Do 21Shares' ETPs Embed a Derivative?

Article 10(1)(a) of the EAD considers a security to embed a derivative, if: *“by virtue of that component some or all of the cash flows that otherwise would be required by the transferable security or approved money-market instrument which functions as host contract can be modified according to a specified interest rate, financial instrument price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, and therefore vary in a way similar to a stand-alone derivative.”*

ETPs could be deemed to embed a derivative where their returns are not linear to the assets they track. 21Shares' ETPs track their underlying assets on a linear basis, as each ETP represents an entitlement to an amount of the relevant cryptocurrency(ies) and once an initial payment has been made upon creation no further investments (e.g. margin transfers) are required. 21Shares therefore believes that its ETPs do not embed derivatives.

The 10% “Trash Bucket”

Even if 21Shares ETPs did not meet the Article 50(1) definition of the UCITS directive, Article 50(2)(a) provides an alternative route for investment of UCITS into ETPs that use cryptocurrencies as their underlyings. It stipulates that a UCITS shall not *“invest more than 10 % of its assets in transferable securities or money market instruments other than those referred to in paragraph 1”*.

While ESMA's Opinion³ on Article 50(2)(a) UCITS provides certain limitations on eligible investments for the so-called “trash bucket”, these limitations were not extended to ETPs that use cryptocurrencies as their underlyings. 21Shares' ETPs may therefore be eligible for investment by a UCITS in this 10% trash ratio.

Conclusion

Our analysis of the Eligible Assets Directive leads us to conclude that 21Shares' physically backed crypto ETPs are not excluded from UCITS investments. It is our view that 21Shares' physically backed crypto ETPs are considered Transferable Securities and do not embed derivatives that refer to ineligible assets and are therefore eligible UCITS investments. Even though regulators' opinions on classification of digital assets across the European Union still varies, the ‘trash bucket’ exception in the UCITS Directive should still allow UCITS funds to have a limited exposure to 21Shares' physically backed crypto ETPs.

Other Relevant Regulatory Guidance

- On March 2nd 2020, the Federal Financial Supervisory Authority of Germany (‘BaFin’), classified certain crypto assets as financial instruments.⁴ Based on this definition, cryptocurrency based ETPs can be interpreted in the same way as currency and other ETPs which are generally deemed eligible assets for UCITS.
- The Spanish financial regulator, the Comisión Nacional del Mercado de Valores (CNMV), commented that UCITS can have exposure to financial instruments with performance linked to cryptocurrencies, provided the market price of the instrument is determined daily by a third party⁵.
- In March 2022, the *Commission de Surveillance du Secteur Financier of Luxembourg* publication answering frequently asked questions on virtual assets, stated that collective investment schemes (including UCITS) addressing non-professional customers and pension funds are not allowed to invest directly or indirectly in virtual assets.⁶

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¹[Directive 2009/65/EC](#) of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS). ²[Commission Directive 2007/16/EC](#) of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions. ³[ESMA OPINION](#) Article 50(2)(a) of Directive 2009/65/EC, 12 November 2012. ⁴[BaFin Guidance notice](#), Guidelines concerning the statutory definition of crypto custody business (section 1 (1a) sentence 2 no. 6 of the German Banking Act (Kreditwesengesetz – KWG), 2 March 2020. ⁵[CNMV Questions and answers](#), Questions and answers on regulations on CISs, Venture Capital Firms and other collective investment vehicles, 24 May 2022. ⁶Commission de Surveillance du Secteur Financier, [FAQ Virtual Assets - Undertakings for collective investment](#), March 2022.