SPECTRUM®

A RISK WORTH TAKING

Cryptocurrencies come with a reputation attached; a highly volatile asset class with prohibitive barriers to entry. Is this reputation well deserved? What does the answer mean to retail investors tempted to gain exposure to crypto-assets? And how are investors best protected from shocks? **Michael Hall, Spectrum Markets' Head of Distribution**, answers questions on Spectrum Markets' approach to enabling trading with crypto-asset underlyings.

Michael, why do you think is it necessary to offer highly speculative financial instruments such as knock-out certificates on cryptocurrencies that are already very volatile - isn't that too much of a risk?

A specific feature of turbo warrants is that the inherent risk is predeterminable and limited. For traders of knock-out certificates such as the Turbo24, volatility or non-market-consistent fluctuations are generally not undesirable. What matters here is the individual's assessment of the range limits of such fluctuations and the specific product characteristics chosen based on this expectation. In relation to the risk associated with the volatile asset class of cryptocurrencies, a transparent, liquid and possibly uninterrupted trading environment is important. This applies both in terms of the efficient and reactive replacement of knocked-out instruments, as well as the overall trading hours schedule. Spectrum Markets satisfies both of these requirements, making intraday issuance and 24-hour trading possible.

What is Spectrum Markets' target clientele - institutional or retail investors – bearing in mind the loss-bearing capacity of the latter group of clients?

Our target group are brokers who, by connecting to Spectrum Markets, enable their retail investor clients to take a view on the market and benefit from rising or falling prices in the respective crypto-asset without having to invest directly in that underlying asset. Our goal was to open up a 24/5 trading experience for retail investors that wasn't available to them before.

How can a private investor protect themselves from a possible total loss if they trade derivatives on cryptocurrencies?

Trading turbo certificates is associated with only the loss of the capital invested as soon as the respective knock-out thresholds are reached. Traders of these products are aware of this, but within these thresholds, they can reduce their loss compared to direct investment by the respective leverage factor or, on the other hand, increase their profit by this factor compared to direct investment. Especially in the case of cryptocurrencies, which are still subject to very large fluctuations due to numerous factors, the transparent and secure trading environment of a regulated trading venue such as Spectrum Markets which, by the way, offers institutional-style trading conditions, results in various advantages over active direct trading with crypto-assets. This also includes the supervisory perspective, because in contrast to trading bitcoin via one of the relevant crypto trading platforms, trading securitised derivatives via a multilateral trading facility is subject to a strict, protective regulatory framework. With regard to investor protection aspects, a transparent and non-discriminatory environment is preferable over direct trading of crypto-assets, which is still unregulated. The Turbo24 is a supervisorily approved product, it is issued under a base prospectus framework and each instrument has an own ISIN and comes with final terms and a key investor information document (KID) – which is not marketing material but a mandatory document that supports the investor in understanding the nature, risk, costs, potential rewards and losses of the product, including its risk compared to other products.

Can derivative approaches for cryptocurrencies also be used for hedging strategies and if so, how complex is this procedure and how can a private investor find out about it?

In addition to generating trading profits, hedging is generally a primary motive for trading derivatives. There are a large number of products on the market and not all derivatives are the same. Many brokers provide extensive background information to their retail investor clients. However, this cannot replace professional advice, particularly with regard to individual loss-bearing capacity and personal risk profile. As far as securitised derivatives are concerned, investors can build a hedge exposure that is equal to what they could enter into with a standard derivative, however, through leverage with only a fraction of the capital needed and based on fair, transparent trading conditions.

What are the associated costs for securitised derivatives on cryptocurrencies on Spectrum Markets, which are relatively high when buying cryptocurrencies in the traditional way?

The transaction fee in direct crypto investments is a reward for their miners which becomes more important over time because the other reward, the block reward, is halving every four years. Here, transaction fees depend on factors such as blockchain utilisation, transaction size and execution speed. These fees are irrelevant for the securitised derivatives trader. As a trading platform, we do not charge any transaction costs to brokers. Commitment fees may vary from broker to broker, but they're rather low and are usually dropped once a minimum turnover is reached.In addition to the DLT Pilot Regime and the MiCA-VO, there are various regulatory initiatives in the EU. But specifically at German level, with regard to the offer of crypto investments with a derivative component, do you think that these regulatory advances sufficiently address derivative crypto investment challenges?

In addition to the DLT Pilot Regime and the MiCA-VO, there are various regulatory initiatives in the EU. But specifically at German level, with regard to the offer of crypto investments with a derivative component, do you think that these regulatory advances sufficiently address derivative crypto investment challenges?

What is often overlooked in the debate is that securitised derivatives on cryptocurrencies, as financial instruments, are subject to the Markets in Financial Instruments Directive (MiFID) or the German Securities Trading Act (WpHG) in Germany as an example. Accordingly, as far as trading on regulated venues such as Spectrum Markets is concerned, strict requirements apply on order book transparency, trading rules, IT resilience, contingency plans, prevention of market abuse and much more. The aim of these rules is a high level of investor protection, financial market stability and a level playing field for companies. Trading securitised derivatives on crypto-assets is no exception here, i.e., it is already subject to a strict supervisory regime. Plus, the safety aspect is not limited to trading but includes downstream processes which, among other things, must include a regulated and safe settlement counterparty – which is a stark contrast to entering into trading via non-custodial wallets.

The cryptocurrency market is currently extremely volatile. Will volatility persist in the short to medium term, or will the market gradually become more predictable?

The cryptocurrency market is a comparatively young market that is still rather small compared to the stock market, for example. And it is a market with which many investors are still not fully familiar. Plus, it is structurally far from being fully developed. However, while parameters such as liquidity, investor expertise and governance frameworks will change as the crypto market becomes more mature, it's my personal belief that fluctuations, as with any financial market, will continue, albeit somewhat milder than has historically been the case. Irrespective of shorter-term developments, crypto investments will make their way into every investor's portfolio, as is the case with equities today.

Michael Hall is Head of Distribution at Spectrum Markets, a pan-European trading venue for securitised derivatives aimed at financial institutions and their retail investors. Since May 2022, financial institutions connected to Spectrum can offer their retail clients long and short leveraged exposure to bitcoin and Ethereum as underlying markets.

Get in touch today to discuss how the seamless market access that our venue provides, can help to grow your retail client business.

Please don't hesitate to get in touch if you wish to receive further detail.

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