The Only Thing to Fear is Fear Itself or Digital Asset Fund and Futures

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What is a Bitcoin (or digital asset) Future?

The Bulletin described Bitcoin as a “digital asset, or an asset that relies on blockchain technology” and a Bitcoin futures contract as a “standardized agreement to buy or sell a specific quantity of Bitcoin at a specified price on a particular date in the future.” Bitcoin is viewed by the SEC and the CFTC as a commodity. Commodity futures trading is required to take place on futures exchanges regulated and supervised by the CFTC.

What are Investment Companies or Funds?
Section 3(a)(1) of the Investment Company Act of 1940 defines an “investment company” as an issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting or trading in securities.[3] The definition also includes an issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities, and owns or proposes to acquire “investment securities” having a value exceeding 40 percent of the value of its total assets (exclusive of government securities and cash items) on an unconsolidated basis.[4] Investment companies are then divided into three types of entities - most relevant to this discussion are management companies which can be either open-end (mutual funds) or closed-end pooled investment vehicles offered to public investors.

Some of these regulated funds offer trading of Bitcoin Futures contracts as a way for investors to gain exposure to Bitcoin. While there are certain investor protections that are required of such funds, it is important for investors to understand that entering and exiting positions in Bitcoin or Bitcoin futures is highly speculative, volatile, and carry a degree of risk not prevalent in some other investment options. The Bulletin provides a number of points for an investor to consider in connection with regulated funds and their use of Bitcoin futures contracts:

- **The investor’s risk tolerance.** Investors should focus on their risk profile and define the level of risk they are taking compared to the level of risk they are comfortable taking.

- **The fund’s disclosure of its risks.** A fund is required to disclose the principal risks of investing in the fund in its prospectus. Investors should be diligent in reviewing a fund prospectus document, particularly the Investment Objective, Strategies, and Risks sections.

- **Potential loss of the investment.** All investments in funds involve risk of financial loss. This risk may be increased for positions in Bitcoin futures contracts because of the high volatility of Bitcoin and Bitcoin futures (meaning prices can fluctuate widely). There is also the potential for fraud and manipulation in the underlying cash or “spot” Bitcoin market.

- **Difference in investment outcome.** A rise in Bitcoin prices may not result in a similar increase in the value of a fund holding positions in Bitcoin futures contracts. This is in part because funds that trade commodity futures contracts may not have direct exposure to the contracts’ underlying assets. Futures contract prices can vary by delivery months and differ from the underlying commodity’s spot price. Futures contracts also expire periodically, resulting in fluctuations of portfolio exposure as expiring futures positions are typically rolled into new contracts. The value of a particular fund may be affected by this maintenance of futures contract exposure.

**Conclusion**

There are risks in investing in digital assets, digital asset futures, and digital asset funds, including volatility, potential for fraud, and manipulation. Bitcoin futures are highly speculative investments. Investors should thoroughly review their risk
profile, the investment objective of the fund, and other offering-related disclosure information prior to making investments in funds which trade in Bitcoin futures contracts. Fund managers should be cautious and take adequate steps to ensure that the investing public has full and fair disclosure of all relevant risk factors to mitigate any shortcomings in the public’s ability to understand the risks and potential rewards of such an investment. While there are risks associated with investing in digital assets, such investments should not to be feared by sophisticated investors that proceed with caution.


[4] See Section 3(a)(1)(C) of the Investment Company Act

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