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Barclays VIX ETN Turmoil Looks Linked to \$591 Million Note Error  
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(Bloomberg) -- Wall Street traders are finally making sense of the turmoil rocking two popular exchange-traded notes after Barclays Plc abruptly suspended sales and issuance earlier this month.

On Monday, the bank revealed it had made a \$591 million blunder by exceeding the amount of structured notes and ETNs it was permitted to issue in a move labeled by one analyst as "bizarre."

The statement announcing it had launched \$15.2 billion more notes over the course of about a year than it had registered for didn't specifically mention two offerings tied to stock volatility and oil, respectively, known as the iPath Series B S&P 500 VIX Short-Term Futures ETN (ticker VXX) and the iPath Pure Beta Crude Oil ETN (OIL).

But on March 14 the issuer moved to block new money flowing into the products, which at the time had a combined \$1 billion in assets -- spurring wild price moves while disconnecting their market values from underlying assets.

In the case of VXX, which allows traders to wager on gyrations in stock prices, the market fallout is potentially significant, with Goldman Sachs Group Inc. strategists among those noting its size and influence among short sellers and options traders.

There's still no clarity on when issuance for the products will restart, with Barclays saying it "intends to file a new automatic shelf registration statement with the SEC as soon as practicable." A spokesperson for the bank declined to comment beyond the statement.

"It implies that VXX would have been halted quicker if they'd been paying attention to their credit limits," said Steve Sosnick, chief strategist at Interactive Brokers LLC.

ETNs trade just like ETFs, but are in fact debt obligations backed by a bank. That means investors using them are exposed to counterparty risk, often thought of in terms of the default risk of the issuer. In this case, Barclays's creditworthiness isn't in question but its error has had knock-on effects to the price and liquidity of a product like VXX for investors, short sellers and options holders.

Major banks typically file for blanket registrations that allow them to regularly issue notes giving clients a chance to bet on everything from stock swings to the performance of Tesla Inc. shares. How Barclays managed to go so far beyond its issuance limit is unclear.

The bank said it has commissioned its own independent review and “regulatory authorities are conducting inquiries.” It will repurchase affected securities -- a so-called rescission offer -- at their original price.

“For years I have been telling investors to ignore the products and remove them from your screen,” said Christian Fromhertz, chief executive officer of Tribeca Trade Group, of investing in ETNs in general. “There is horrible tracking and there is that counterparty risk.”

While the issuance halt initially triggered outsize moves for VXX -- including a 45% jump then reversal in a single session -- the ETN has been calmer as volatility across U.S. stocks retreated, helping prevent a potentially vicious short squeeze in the product.

All the same, since new cash can’t be added to either note the distortions can be significant. VXX closed at a record 24% premium on Friday, according to data compiled by Bloomberg. OIL has swung between a premium and discount amid major moves in the crude market in the past two weeks. It closed Friday at a 1.1% discount to assets.

VXX gained 2.4% in early trading as of 9:02 a.m. in New York. OIL was 3.2% lower.

“This is a rare case of an exchange-traded product issuer dropping the ball and mismanaging their products,” said Todd Rosenbluth, head of research at ETF Trends. “Although it is no more likely to occur again this is another red flag for trading ETNs and not ETFs.”

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