NAVIGATING THE DIGITAL ASSETS WAVE
FOR WEALTH MANAGERS

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INTRODUCTION

The financial landscape, a realm that has remained fairly consistent for centuries, is undergoing a monumental shift. Traditional paper currency, metal coins, and physical banks, while still prevalent, are making way for their virtual counterparts. Leading the charge in this transformation are 'digital assets' – a term that encapsulates a wide array of virtual commodities, with cryptocurrencies like Bitcoin and Ethereum having become household names. As we build up towards our upcoming Hubbis Digital Assets Forums in Singapore and Dubai, we hope to demystify the biggest trends and considerations surrounding this oft touted, all-encompassing phase that is 'Digital Assets'. As wealth managers and their clients ponder at what level they will engage these assets as part of a diversified portfolio.

» When will big institutional clients engage digital assets with more depth and consistency?

When one draws perspective from various industry events and insights, highlighted the core issues shaping the digital assets world. A prevailing concern is the timeline for substantial institutional engagement in digital assets and the prerequisites to ensure a seamless and beneficial transition.

For a smooth integration of institutions into the digital asset domain, numerous factors warrant attention. A primary consideration is the establishment of transparent and consistent regulations across diverse jurisdictions. Large institutional entities, with operations spanning the globe, require confidence that asset transfers between jurisdictions won't lead to unexpected financial or tax repercussions. Additionally, there's a pressing need to determine if a digital asset should be recognized as a commodity, property, or financial instrument. The urgency to derive a globally recognized definition for digital assets is evident, as it would mitigate potential disputes and ambiguities.

Innovation of industry perspectives

Equally significant is ensuring that the existing financial infrastructure is equipped for scalability. This includes entities like third-party custodians and exchanges, all of which need to be structured to support the unhindered flow of these assets. Yet, as technologies like blockchain come to the fore, there's the potential that they might redefine this infrastructure, challenging the relevance of current systems and processes.

On the topic of asset valuation, tokenized assets, especially real estate, come into focus. While real estate valuations are conventionally done quarterly, tokenization offers the tantalising prospect of converting such assets into more liquid, tradable commodities, thereby accelerating transaction rates. This potential, however, is accompanied by hurdles. For these assets to be traded akin to equities, a swifter valuation method is necessary, especially given the volatility of markets.

Factors like the global trend of rising interest rates could dramatically influence the valuation of assets, including real estate. This brings added layers of complexity to the valuation of their tokenized counterparts. Addressing these challenges could pave the way for innovative solutions, possibly making fractional real estate ownership a more dominant element in investment portfolios.

Becoming mainstream

For large wealth management firms, the decision to venture into digital assets hinges not just on current trends but also on long-term beliefs about the future of finance. If the next evolutionary phase in the financial sector involves standardizing assets, possibly through tokenization, then wealth management firms must consider their role in this landscape. By not adapting to this potentially revolutionary change, these firms could restrict their clients' investment opportunities in an increasingly digital asset-based future. Thus, the central question isn't about "if" they should adapt, but rather "when."

Do decision makers in pivotal roles in wealth management or private banking departments already have well-thought-out strategies for introducing their high-net-worth clients to these digital asset opportunities? It's widely recognized that some large institutions' asset management division is devoted to creating suitable investment products for their clients. With many firms exploring the realm of tokenized funds and instruments, it becomes evident that there are wide-reaching views within the industry that the digital shift represents a chance for positive disruption. Recognising the potential challenges posed by emerging FinTech entities, established private wealth managers are strategizing ways to retain control over the entire investment process, spanning from product creation to distribution.

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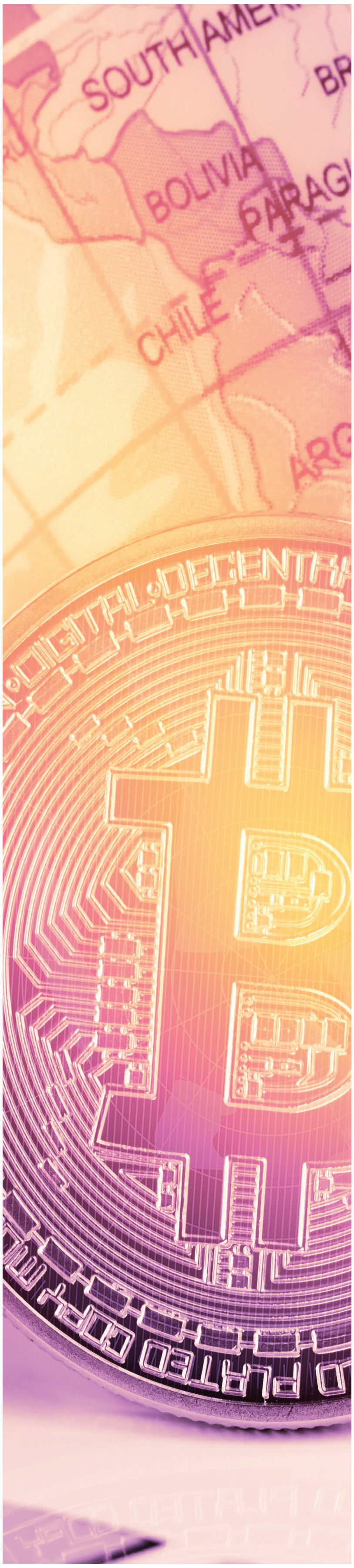

In viewing the broader picture, the pressing urgency becomes clear: as financial markets change, the very fabric of how businesses operate must also evolve. When the world's largest wealth managers are exploring these changes, it underscores the perceived threats and inherent opportunities in the horizon. There is a recognition of the transformative power of tokenization, along with the potential democratization of finance it heralds.

Should wealth managers be more engaged?

For a typical relationship manager or private banker currently uninvolved in the digital asset sector, should the idea of diversifying a client's portfolio with these assets be a more compelling proposition? It's essential to stress that this isn't about forcing them into a new investment realm, but rather providing them with insights based on comprehensive research. Data suggests that there's potential long-term value in gaining exposure to this sector.

Reflecting on the past few years, some of the world's most prominent money managers contemplated allocating a small fraction, say around 2%, of their global portfolios to cryptocurrencies. This minimal exposure isn't about putting all assets into one space but allowing a toe-dip into a burgeoning sector. Renowned macro managers, like Raul Powell, advocate for this approach, emphasizing that even if one isn't ready to commit their entire portfolio, there's merit in exploring the possibilities.

However, critics might argue that assets like Bitcoin have only witnessed a few market cycles, raising questions about their long-term viability. While it's true that we might not have sufficient data to cement their place in traditional portfolios, when seasoned commentators like Mike McGlone from Bloomberg highlight the potential of these assets, it calls for at least some serious consideration.

Regardless of one's position or investment horizon, it's prudent to stay informed. Even if someone operates with a short-term focus, perhaps influenced mainly by interest rates with an 18-month view, it's worth dedicating some thought to this evolving sector. After all, the primary objective for most money managers is ensuring the best possible returns for their clients. Neglecting to consider emerging asset classes might inadvertently deprive clients of potential opportunities and diversification.

Global regulatory inconsistencies

The regulatory landscape for digital assets is far from consistent across the globe. This inconsistency prompts various reactions and strategies from financial entities. For instance, Thailand and Singapore might view digital assets from different perspectives. This divergence can lead to regulatory arbitrage. Some entities perceive this as an opportunity, seeking jurisdictions with friendlier stances on digital assets. They may move assets across borders or even establish operations in these regions to leverage milder regulations and licensing.

In turn, Japan has been highlighted as an example, as it is actively working to incorporate the treatment of digital assets into regulatory frameworks designed for traditional assets, aiming to enhance clarity and security for investors and other stakeholders. This obviously differs from the approach taken by other nations in the region.

Such disparities in regulations pose challenges for global players. Institutional clients, who have fiduciary and reporting obligations to local regulators, prioritize asset fungibility across borders and consistent treatment of these assets. When the local requirements of one jurisdiction starkly contrast with another's, it significantly ramps up the operational overhead. This situation becomes less appealing for businesses as it necessitates expertise tailored to each jurisdiction, an expertise that may not be applicable elsewhere.

For global firms, this limitation boils down to the allocation of resources, expertise, and ensuring a favourable return on investment.

What therefore is the role of the regulator?

Regulators, after all, shoulder the responsibility of ensuring the safety of end investors, establishing necessary guardrails for both institutional and retail investors, and fostering a regulated, positive, and safe environment for investors. High-profile incidents involving platforms like FTX and Celsius have propelled regulators to take more proactive measures. However, it's essential that the broader industry collaborates with these regulators. Entities with extensive experience in financial markets can offer invaluable insights, ensuring a balance between traditional wisdom and innovative fintech solutions. The goal isn't necessarily to regulate technology but to understand and leverage the unique benefits it provides for a more holistic regulatory framework.

The optimistic horizon

Over the next two years, there are optimistic signs emerging from the digital asset industry. Drawing from recent regulatory consultations, there's an encouraging development in the form of a shared vocabulary and approach by regulatory authorities. For instance, both the Australian Treasury and the UK's FTA and PRA have exhibited similar wordings and perspectives in their communications. This semblance of congruence, even across geographically distant regulators, points towards a future where there might be more consistency in how digital assets are approached. While it's premature to claim that everything proposed is correct, the initial steps of speaking a common language and adopting standardised definitions are crucial. ■