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The Development of the Digital Assets Ecosystem & the Middle East – a Hubbis Discussion Event

In early May, Hubbis hosted a private discussion in Dubai amongst experts on the development of the digital assets market in the UAE and further afield in the Middle East. The small gathering was organised in collaboration with Saxo Markets and the assembled experts included wealth management leaders in private banks, EAMs, MFOs, life insurers, emerging digital asset brokerages, niche exchanges and tokenisation platforms, as well as other specialists in the nascent but rapidly evolving digital assets ecosystem. The guest highlighted many positive and interesting developments, including new regulations and new bodies to promote these markets in the UAE, but many acknowledged that traditional financial institutions including private banks remain wary, and reported that much more education is required amongst intermediaries, advisors and investors, especially the smaller players and private clients.

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The mainstream, traditional private banks remain reluctant to embrace cryptocurrencies and other digital assets. Why should this still be the case, and will it change?

An expert opened the discussion by highlighting the continuing reluctance amongst the 'established' private banks and wealth managers to engage in advice on or in promoting products related to cryptocurrencies or other digital assets.

He explained that they do not understand the market, products or technologies well enough to feel comfortable, and they are concerned about poor or uncoordinated regulation, hence worried about being unable to guarantee the protection of client assets.

The very well-documented collapse of the cryptos exchange FTX and some other high-profile crises in the digital asset ecosystem have also served to entrench their reluctance to become involved.

But on the other hand, this expert also observed that the collapse of several major banks this year shows that the mainstream world of finance can be precarious as well, even though it is purportedly well-regulated and regulation around the globe is very consistent in approach.

Some argue that the main hurdle is education, and that a greater understanding of digital assets will lead to greater adoption

Education is vital, according to many. A guest representing an APAC-based crypto asset fund manager that focuses mainly on family offices client investors, and the institutional crypto fund of fund space. He explained that they work hard to help those in the world of traditional finance understand crypto assets better by looking at traditional asset classes and seeing how they actually derive value and then applying that to digital, or crypto, assets. He and colleagues promote these investments as deriving value from cash flows/ code through smart contracts, utility comes from smart blockchains like Ethereum, and perceived value exists in cryptocurrencies such as the bellwether Bitcoin.

"It is a lack of understanding that holds so many back," he reported. "It's the breakthrough innovation of blockchain that people just don't understand, because you need quite some time to see the fundamentals of it and the beauty of decentralisation, on which the whole foundation of kind of trust or 'trustlessness' is built. It is a matter of education about what is such a new and difficult-to-fathom asset class.

Nevertheless, the firm has made headway with investors such as family offices that have rising allocations to alternative assets, although again the lack of education and understanding hampers growth and potential.

Regulation is key to any jurisdiction's credibility in the digital assets universe, but support is inconsistent and subject to change - while Switzerland has been leading the way, Hong Kong and the UAE have become increasingly visible proponents, but Singapore's previously very supportive position of recent years appears to have been tapered back

A guest pointed to Singapore as having been a major centre of digital assets some two years ago, but said the government and regulator (MAS) have pulled back due to the collapse of FTX and other digital asset investments, with high-profile actions such as the banning of crypto/digital assets advertisements aimed at retail investors. In Hong Kong, some of the slack has been taken up by the HKMA, the financial regulator, encouraging the banks to open accounts with crypto firms again.

Meanwhile, Dubai, Abu Dhabi, and Bahrain to a certain extent, as well as Switzerland, have become relatively more high profile and are working hard to increase their appeals.

For example, in the UAE, Dubai's Virtual Assets Regulatory Authority (VARA) has now issued its Virtual Assets and Related Activities Regulations for 2023, setting out what they hope is a comprehensive Virtual Asset (VA) Framework built on principles of economic sustainability and cross-border financial security.

VARA is a beacon of hope for digital assets in the UAE

As the world's first independent regulator for virtual assets, VARA aims to serve as a transparent guiding authority for the emerging world of Virtual Assets. The stated goals are to position Dubai as a regional and international hub for Virtual Assets and related services and to develop a digital economy in the city to boost its competitive edge locally and internationally, to empower investors and increase awareness about Virtual Asset services and products and encourage innovation to promote real opportunity, to attract more businesses in this space to Dubai, and to help develop the regulations, rules and standards required for regulating, supervising and overseeing Virtual Asset Platforms, Virtual Asset Service

Providers and all other matters related to Virtual Assets.

But an expert noted that VARA is one entity within the UAE, which has other bodies and free trade zones and so forth, all sending out different messages. "You need to move all this to the Federal level," he said, "whereas now you have different jurisdictions within the overall UAE jurisdiction. However, there are many parts in the ecosystem that are much more difficult to regulate, because decentralised finance by definition is very hard to regulate, and this is all based on code, on smart contracts and computer code."

The capital markets will evolve with the arrival of the blockchain and tokenisation. But how, when and why?

An expert observed that digital assets and associated technology are accelerating the journey from the traditional custodian model into digital assets using blockchain. He explained that investors adopt more rapidly when they see tangible backing for digital assets through the tokenisation process.

"For me, the fundamental question is how we bring people on that journey to give them comfort that they can trust, and they know that things are tangible underneath," he said. He said cryptos such as Bitcoin are first movers and have built some trust, and can be used for a variety of utilities, including settlement instead of fiat currencies, but for other coins, some of which are just pure ideas with nothing tangible behind them, there is an understandable lack of trust.

Another expert referred back to earlier comments on categorising digital assets by stored value, utility or perceived value. For some assets such as XRP for payments, there is no logic in seeing it appreciate. For others, like Bitcoin, there is clearly significant stored value in the market valuation and perceived value in its potential for price growth.

XRP, another guest reported, can be seen as a much quicker, less costly version of a SWIFT system or a payment system. "But while some four years ago, 61 banks around the world signed up to a pilot scheme based on XRP, nobody has yet implemented it," he added. "And there lies the issue - there remains a lack of trust and a lack of proven cases to support these positive developments."

Time waits for no one - the experts gazed into their crystal ball and imagined the next phases of the digital assets market's evolution

A guest commented how in the crypto universe, time moves incredibly fast, almost like dog years with one year representing seven years of life as we understand it. "The ecosystem is going to develop very rapidly, and my view is you cannot afford not to be involved," he stated. "There are market leaders and market regulators – for example, the Swiss – who are leading the way, and there is growing support for the traditional private banks as well to get their crypto products on the platforms. But they [cryptos] will remain a very volatile asset class as these developments take place."

He explained that traditional players – and here he mentioned a number of global brand asset management firms as examples - have been investing "massively" in the past few years, and there is a lot of movement amongst the authorities in the US, Europe and elsewhere to recognise these inevitable changes and to facilitate these developments in what is as manageable and controlled way as possible.

"The market ahead will be dramatically more professional, far more institutionalised, and I believe a lot of the traditional banks [many of which have thus far been reluctant] will eventually start offering trading services, including custodian services," he concluded.

Another perspective came from a fellow expert who agreed about the incredible pace of this journey. He said that the more examples we can have, especially around the tokenisation of real-world assets from gold to real estate or a host of mainstream financial or physical assets, basically things people understand in their daily lives, then the quicker the adoption and the faster the development of the overall ecosystem.

He said the more that cryptos such as the bellwether Bitcoin or others can be adopted for payments, including those related to credit cards, the more the traditional banks will gravitate to adapt their systems to accommodate, thereby speeding up the journey. And he added that the more the regulators see mainstream adoption, the greater their comfort will be and the faster the overall evolution will take place. ■