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The Evolution of Digital Assets, Tokenisation and Crypto in Asia's Wealth and Asset Management Markets

Along with our cost-host for the event, blockchain data platform Chainalysis, Hubbis invited a panel of experts and selected delegates to a virtual thought leadership discussion to analyse the evolution of digital assets, cryptocurrencies and tokenisation. The event was entirely off-the-record, except for some key insights and observations from co-host Philip Gradwell, the Chainalysis Chief Economist and author of the highly respected Chainalysis 'Market Intel' weekly report, all of which he supported by a detailed but easy to follow slide presentation.

Chainalysis is a blockchain data platform. They provide data, software, services, and research to government agencies, exchanges, financial institutions, and insurance and cybersecurity companies in over 60 countries. Their data powers investigation, compliance, and market intelligence software that has been used to solve some of the world's most high-profile criminal cases and grow consumer access to cryptocurrency safely.

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THESE ARE SOME OF THE TOPICS THE EXPERTS DEBATED:

- What do you see as the evolution of digital assets, tokenisation and crypto?
- What is their current and anticipated relevance for the Asian wealth management industry?
- How are digital assets affecting the asset and wealth management community?
- Is the market evolving to become much more professional and institutional?
- Bitcoin is sometimes described as the digital substitute for gold. What role does Bitcoin, or other cryptos, play in hedging against macroeconomic events, such as inflation, fiat currency depreciation, political or geopolitical turmoil and so forth?
- How is the broader and expanding universe of cryptocurrencies evolving, and what should we take seriously?
- For those private clients buying into these assets, or thinking of doing so, how should they buy safely and efficiently, and how should they hold/store/custody these invisible assets?
- What detailed, professional research and data are available on the market, and what should and should not be taken seriously?

More and more private banks operating in Asia climbing on board the cryptos and digital assets express

Some of the global and boutique international private banks are already committed, some are detractors who say they will not join in, but the trend line is clear, said a leading Asian digital transformation consultant with a global firm. He pointed to rising investor demand, some of them 'playing' with cryptos to gain a bit of knowledge and perhaps decent returns, others more professionally through funds or other vehicles. Some are investing indirectly in businesses or technologies related to the digital assets revolution, not only cryptos, but also the wider range of tokens and digital coins. There has been a concomitant rise in licensed exchanges and intermediaries, as we as the development of a professional crypto custodian market.

Realistically, there are still many major hurdles to overcome for some of the major global intermediaries

Another expert observed how whilst many clients of the major banks are keen to participate in cryptos and other digital assets, their own systems are too traditional – archaic is the word he used – to accommodate digital assets, to have them properly represented in the documentation and reporting, and to lace them into the bigger fabric of their mainstream public and other private assets infrastructures. He said it there tends to be the smaller banks and others who have the agility and who might, for example, White Label some third-party offerings. But generally, he said there is an inevitability that the digitalisation of traditional wealth management products will expand, and that pretty much everyone is already looking at the space.

Compliance is a key issue for everyone, regulation is nascent, and regulators also take very different approaches

Whatever size the bank or financial institution, compliance is a key concern, and the bigger the banks usually the more cautious they are. Moreover, as there is no cohesive view from regulators and governments on digital assets, and as regulation is very much in its early stages, it is very difficult to hit such a fast-moving target. An expert observed that some banks will transact fiat currency to cryptos, but are extremely wary of crypto to crypto, because of difficulties tracking those assets which will then be within the wallets and could easily but perhaps not compliantly be shifted from wallet to digital wallet, with no means of tracing the movement of those funds, raising a major compliance and due diligence problem for the banks.

"The big fear is very much around the source of wealth and the source of those assets, so this brings focus on KYC, AML and it is difficult to verify and track," he reported. "So, in a number of firms, we've seen the leaders saying no we won't go into this, but yes, we will work on reverse enquiry and work out how to help them go in with safe access and safe transactions. But there are still many complexities, including around professional level custody."

In summary, he said the majority of private banks or wealth managers his firm talks to or consults for

are somewhere along their cryptos journey. "But we haven't seen that many getting licensed in providing full service," he said. "However, clearly there is an opportunity, not just in crypto, or in stable coins, but of course, in the wider token economy, particularly as we can now tokenise a number of assets."

To be in the digital assets game, and properly engaged, you need to be forward-thinking and committed

A major custodian explained how they have been gearing up to digital assets, including making related acquisitions, in order to capture a decent share of this market in the future, alongside their global mainstream asset custody businesses. "We're going far beyond just crypto," he reported. He said digital assets from their viewpoint cover the spectrum in terms of the digitisation of all sorts of public and private assets. "And we are building capabilities for custody, and for the treasury services and payment systems, deploying distributed ledger technology (DLT) to get into that space. "For major intermediaries such as us, we are certainly getting up to speed, and looking at ways to actually start doing more in this space," he told delegates.

Some clearly believe that there is too much reputational risk for major institutions

Another banker, also representing a big north American name with a major global wealth business, agreed with those comments, and added that they are cautious about the regulatory side and worried that major benchmark cryptos such as Bitcoin have no inherent value that they can determine as yet. "As we cannot in any way judge fair value or evaluate such assets, it's very hard for us to put it on the shelf or to offer advice," he reported. "All this requires research, requires specialists and it involves responsibility, as we have a fiduciary duty to clients. We have been trying to explore these issues but right now it is very difficult to be able to put the bank's reputation at risk by vouching for these. We are nowhere near being able to do that. In short, right now we are just accepting on a reverse inquiry."

The investor clients are evolving as well, and widening their horizons in the expanding universe of digital assets

A senior banker representing the Asian arm of a boutique international bank said they were indeed working on reverse enquiry, rather than attention any advisory around these topics. Clients, he said, are also venturing well beyond their traditional interest in Bitcoin and perhaps one or two other cryptos, toward the world of DeFi and NFTs. "We're enthusiastic and happy to be a part of this ecosystem where everyone's trying to innovate and develop solutions and help people become part of this market.," he stated. "Things have changed in the past six months, we much more activity amongst clients, who are actually participating, not just enquiring with us. They take really small exposures, seeing cryptos as an alternative investment. So, if they have a 10% allocation to alternative investment class, be it gold or hedge funds or long short funds, they are allocating slice of that pool into the crypto side."

Chicken or the egg? Building the right level of in-house expertise and infrastructure at the banks is another major challenge

A banker from a mid-sized Swiss boutique investment bank reported that thus far they only offer execution-only access products, with no advisory in the crypto and digital asset space. "The challenges that we currently face and I think most other private banks are in the same situation include relatively low levels of in-house knowledge, and we also need more ownership of this space within the institution at board and senior management level. More training is needed, for sure, throughout the bank and certainly for the client-facing bankers. It remains still a challenge to understand what the risk appetite is, because now there is a lot of noise in the market, it seems everybody wants to be involved. The infrastructure is another key issue, and the discussion on building versus buying or renting. And, of course, one of the bigger themes that has already been raised here is compliance and regulation, which are always the scary part when we try to get more traction. In a nutshell, the bank is still trying to figure out where we want to be. But there is not a huge amount of activity happening, although clients are more and more requesting to have access to crypto and digital assets. So, we are in the process of defining the next steps really."

Volumes, liquidity and fees also play a major part in the decision-making process on participation – or rather non-participation - by the bigger banks

Another guest agreed with the comments thus far as to the reluctance of the biggest institutions to participate full-on in this space, but he noted that according to a glance at one cryptos data website, the total volume is about USD150 billion a day. "Compare that to foreign exchange, which is more than USD6.6 trillion," he remarked. "By providing advisory services and trading services for cryptos to clients, the banks are not going to make a lot of money. On the other hand, and I was looking at the Hubbis website earlier today, the amount of intergenerational wealth transfer that's going to take place in Asia is between USD8 to USD10 trillion in the next 10 years, so it stands to reason it would be much more profitable for banks if they spend time and energy in providing family governance services, outsourced CIO services, family counselling services and so forth to those clients. Relative size is a key factor, so too the fee levels available in the digital asset spaces."

INSIGHTS FROM PHILIP GRADWELL OF CHAINALYSIS

Gradwell then took the virtual stage and offered his insights, supported by his slides.

Look at the fundamentals first, and analyse the real activity in the market

"As Chief Economist at Chainalysis, we spend a lot of time in deep analysis of the true data underlying the cryptocurrency markets, also talking in depth with the leading financial institutions to mine down into the actual fundamentals and analysing how cryptocurrencies are actually used."

Indelible evidence on the blockchain provides fundamental guidance

He explained that the truly incredible reality about cryptocurrency transactions is they are all recorded on the blockchain, so you can with the right skills actually follow funds all the way back. "We at Chainalysis service all of that data, and we tag all the cryptocurrency addresses with what type of business they are, the result of which is we can actually check often automatically in a programmatic automated way, if you've just received Bitcoin, and where it came from, for example from a high risk source or a low risk source? And we provide that compliance solution of over 500 customers, some of them are actually the largest financial institutions in the world, in other words to those that have started to offer digital asset custody."

The reputation of cryptos might be unfairly tarnished, whereas perhaps cash and cyber-crime are the real tool of the gangsters and underworld

Gradwell acknowledged that cryptocurrencies had earned a bad reputation through early involvement with the dark net, but he told the guests that his data shows that only about 1% of all of the cryptocurrency that's transferred is related to illicit activity. "Still a very large number," he said, "but actually a pretty low percentage, because most people are actually trading, speculating, investing in the assets. And the vast majority of cryptocurrency now comes from sources that have already been subject to an AML check, for example from a licensed exchange or intermediary. And it's already a regulatory requirement in most jurisdictions to do AML for these assets, and the technology is available to do so. And there's already a good network of counterparties who have strong AML policies in place."

Look at the real evidence to see what road you are on and which direction you are headed

He reported that as to trading and pricing of key cryptos, from his analysis of onchain data and actual transactions, some 78% of all Bitcoin is held by investors in their digital wallets, and that compares to 55% of Ethereum. "What does this tell us? Well, if you are buying Bitcoin, you will almost certainly have to be buying it off existing investors, and that's why the prices have been rising over the last year or two, simply because other people had already bought up all the liquid Bitcoin. But Ethereum and others are actually more liquid, so there is more available for new entrants."

Mining the data to derive valuation and direction

And he reported that the industry has changed dramatically. "We can measure the cost basis of these assets, so those who entered at the back end of Q3 in 2020 have a cost basis of about USD10000 for Bitcoin, whereas today it is about USD46000, so put simply, people have been willing to buy and hold at much higher prices than they ever did before. There is a lot of scepticism around fundamental valuation models for cryptos, but the one thing I actually do find really convincing is the price that other people are willing to buy and hold at, which I call the price floor, this cost basis of recent investors."

He added that a truly huge amount of money has poured into this industry really in the last 12 months, and an associated result is the public visibility of the vast energy required to mine the remaining Bitcoin, bringing with that some ESG concerns. "But such is the visibility and activity now," he reported, "that there is growing pressure to reduce energy usage for the mining. This is akin to shareholder pressure coming into the crypto industry, especially now there is more professional scale money involved."

The new phase of digital assets – the expanding world of DeFi and NFTs

Gradwell also tackled the topic of De-centralised finance or DeFi, reporting that about 11% of all Ethereum has moved into DeFi since January of 2020, driven from the centralised exchanges mainly. DeFi he reported represents essentially the next wave of cryptocurrencies, championed most visibly by Ethereum, and also supported by a cast of cryptos such as Solana and Uniswap and Aave. Bitcoin has gone up significantly and other cryptos such as these DeFi names might have underperformed relative to Bitcoin, so people are increasingly interested in assets such as Ethereum or other decentralised finance assets. It is more of a new frontier, even if this is a more speculative area.

And he also observed that the private wealth community has tended to question whether crypto is the start of a broader trend in digital asset management. "Will we see more assets move on to the blockchain, and what does that enable?" he ponders. "What are NFTs, or non-fungible tokens, and why are people putting money into those, and will they become mainstream? In short, what is outside the world of Bitcoin and Ethereum that will emerge as more important, potentially more mainstream in the coming years? Even bigger picture, people are wondering if the blockchain is the place to go to in the future to acquire more and more assets."

Picking your assets for digital slicing, dicing and trading

He explained that looking somewhat further to the future, stable coins are really the first example of real-world assets being digitised. "Some people took a big pile of dollars and they digitised them, represented on the blockchain in a token that's supposed to be worth around one dollar," he told delegates. "There might be some controversy, as not all of the stable coin issuers, for example Tether, are necessarily the best at being transparent on their reserves, but the key thing to understand is that stable coins actually provide about 50% of all crypto liquidity at the moment. Accordingly, we can look at the number of stable coins that are coming on to exchanges relative to Bitcoin and Ethereum, for example. And it's typically enough to buy about half of all of the Bitcoin, Ethereum that's being sold."

He explained that Ethereum is also facing lot of competition from new blockchains such as Solana. "And that's because people have suddenly realised they can actually do things on Ethereum or on cryptocurrencies such as a DeFi platform or a non-fungible token, but the fees are really expensive, and the bandwidth is limited, so let's go to other services that provide that. So, if you're thinking about this more advanced world of digital assets, we need to understand there are actually technology constraints at the moment, and as a result it gets quite expensive to share distributed assets in this decentralised way."

UniSwap a perfect example of a digital disruptor with a clear path to market

Gradwell then moved on to his final observation on the evolution of DeFi and non-fungible tokens, reporting that Uniswap had developed a remarkably good service like Uniswap, essentially as a place where investors can go to swap any cryptocurrency for "pretty much any other cryptocurrency". "It's best to think of that as a large foreign exchange market and if you wanted to set up a huge FX market turning over billions of dollars of volume each year, and to do that mainstream, you'd have to get a lot of regulatory licenses, you'd have to have a lot of capital, it would take a long time. But Uniswap does it effectively and much cheaper, and because they can issue a token that guarantees people who commit some capital a rate of return in exchange, they've been able to fund that market, fund the liquidity in a much easier and cheaper manner than a traditional market could imagine."

However, he said that actually, DeFi is really implementing traditional finance applications on the blockchain. "Time will tell if that is actually that exciting," he observed, "as there are cost and bandwidth constraints. However, non-fungible tokens are really exciting, as they can, for example, digitise a collectable painting or other precious asset, then sold on to the retail market."

Mining down further into the deepening shafts of tokenisation to unearth more nuggets and gems, but they must be extracted carefully

"We are still at the very early days of the whole evolution of tokenisation," a leading wealth management technology consultant opined. "We've heard a few examples raised already but clearly tokenisation gives us a number of options from both a primary and secondary tokenisation perspective. It could be for funding unlisted SMEs or other companies, it could be the rare whisky we heard about, or paintings or other collectables, and so forth," he noted. "The potential is there, but we've got to bring it together into a safe environment. We need trust, to make sure the assets or the underlying targets are secure and concrete and protected, so we need a robust chain of trust. If we do that, there are really phenomenal opportunities."

He added that more work needs doing on the ecosystem, so that new players work well with traditional players, so that fiat to token, token to fiat and token to token exchange work properly. "The operating model, the regulatory aspects, the accounting and tax implications, all these and more need to be elevated. In short, there's still a good way to go."

Test the waters and build confidence

A representative from a sizable family office then reported that they had begun testing the cryptos water in 2017, and that he had himself advised on some ICO issues, which he said generally went nowhere over the longer term, but that also provided an interesting learning experience. He explained how momentum and activity had surged in the last couple of years.

"We agree with Philip's observations, and indeed we have expanded from Bitcoin to holding stable coins and to having an Altcoin in each of the interesting subsectors. I think of it as venture capital or direct investment in the tech space for us. It all remains a very small part of the portfolio, about 1% at cost, but generally, even factoring the volatility, they've all done extremely well and actually therefore today represent 5% of the portfolio overall, due to the price increases. We think it remains an interesting class for high return high volatility, high intelligence in terms of figuring out where the future of finance is heading. And if you want to look at an inclusive finance part of the industry, in the broader sense, we think from a philanthropic point of view, it doesn't get much bigger than the crypto side when it comes to the S in ESG. So, we're very keen on crypto actually."

A perspective from China – onshore cryptos roadblocked, but offshore activity still possible

A China expert based in Singapore and part of a major Chinese conglomerate pointed out that as a Chinese asset manager and distributor, they had seen the exactment for some years in China and now the gate had been slammed shut by the government. But for the offshore Chinese money, the avenues are still open, although there is now a strong impression and feeling amongst many that if they buy into cryptos

offshore, they are entering an illicit world of activity. For that reason, he maintained that tokenisation is a more approachable route, because with something behind the coins there is underlying value that can be identified. Accordingly NFTs are more in favour now, for example tokenisation of collectable casks of whisky, a favourite amongst wealthy Asians. "You can imagine them more like traditional financial instruments, so we expect a lot more activity ahead," he reported.

For those opting for cryptos, he said the professional funds that had been proliferating of late offered a middle ground, as they are institutional level funds targeting a new and complex, actually somewhat opaque, asset class. "This is the middle ground," he observed, "as they do not need any deep understanding of the cryptos, yet they still achieve the diversification for their portfolios, with professional managers selecting the particular balance of exposures."

For the new wave of asset management FinTech disruptors, digital assets represent another new frontier

"Within our different client segments, retail client interest in crypto and digital assets has been growing by the day," a guest who leads a robo-advisory platform in Singapore reported. Although there are regulatory headwinds, he explained that the platform had been able to give clients access to crypto and blockchain related technologies in some indirect ways, for example in Singapore launching the first custom portfolio builder in September, which provides access to over 100 top ETFs from across asset managers; within that they were able to create certain thematic portfolios, such as disruptive technologies, which underneath had exposures to companies such as Coinbase and Square. "Hence the indirect way to get you exposure to companies which are involved in blockchain and related technologies," he said. "We were also able to include certain ETFs where clients can then get access to companies which are actively involved in the development and utilisation of these blockchain technologies."

He said the response of these offerings has just been phenomenal. He said disruptive technologies represents more than 25% of their different thematic portfolios, and the BLOK ETF listed on the NYSE [full name: Amplify Transformational Data Sharing ETF) is one of the most popular ETFs on the platform. "We certainly cannot ignore how interested clients are in this space, so this is how we present indirect access. As to a more direct access for clients, we are right now more in a research mode to analyse how we offer these solutions within the regulatory frameworks that are applicable today."

The need to understand the fundamentals and the evolutionary trends ahead grows greater by the day

Philip Gradwell rounded out the discussion by thanking participants for joining in and for their forthright views and reminding everyone that this is the new world of cryptos and blockchain and that valuation metrics are not the same as for mainstream assets and markets. "We cannot necessarily say this is the fundamental value for this crypto, but what we can do is try to understand why the price

is such," he said. "What we can do, as I said earlier, is look forensically at how much it's used, how deep the markets are, and start to understand what the medium-term outlook is going to be. And we can extrapolate from information on the diversity of the investors, how long they hold for, their cost of entry and so forth. How many investors are there? What's their buy and hold price? What's their cost basis? How much is being bought in stablecoins versus fiat? These data points inform us of the big picture and the reality, and if we can also identify which bigger investors are in, staying in or coming in or getting out, then we can be even more helpful."

He conceded this is a very momentum driven market. "But at least it helps people understand if they are missing out, if they are not trusting the collective judgement of everyone in the market. I used to work in the oil and energy data and research world before Chainalysis, and I now see cryptos to some extent as a sort of a commodity, and we can really track all of these different key movements in order to get a sense of the deeper market."

The Final Word

When Hubbis interviewed Philip recently for a feature article on Chainalysis and his views (see link), he closed the conversation by remarking that they know very well that investors, obviously including those advisors and investors in the private wealth community, don't want to invest on rumours and news. They want a more fact-based, and data-driven perspective," he commented. "And there is a real and substantial gap in this regard, which we are filling."

He told us that Chainalysis is not a brokerage, indeed not an intermediary of any kind. ""Our mission is information and analysis, genuine data and insights," he reported. "The more we can help governments, regulators, authorities, and private market participants to institutionalise, professionalise and advance this relatively new but rapidly expanding market, the better it is for all parties concerned. The type of rigorous and disciplined approach we apply to data allows us to form the insights we can then share with the key participants, and for investors, this really helps guide them towards the best-informed decisions." ■