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The Evolution of the Digital Assets Universe and Key Trends for the Future

The digital assets revolution is in full swing again, with Bitcoin and other crypto prices soaring again since early 2023 after the collapse of prices, which had scaled to impressive new all-time highs in November 2021. With the collapse of several high-profile brokerages and exchanges – most notably FTX - and with private equity and digital asset investors adopting a dramatically more cautious and rigorous approach to selectivity, governance and best practices, the market is back on a considerably more stable footing. Regulators have intensified their licensing, compliance and oversight efforts, and private clients are increasingly taking more exposures, emboldened by a greater institutional presence and also by new vehicles to offer them better access and (hopefully) greater safety, such as cryptocurrency ETFs that trade on TradFi exchanges. A panel of experts ran their magnifying glasses over recent events and key trends during the opening panel discussion of the Hubbis Digital Assets Forum in Singapore in December. With the crypto winter now well and truly over and spring in the market's air, the experts painted a picture of significant progress whilst highlighting further advances required to cement these advances.

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KEY FINDINGS & OBSERVATIONS IN BRIEF

Excitement surrounds the expansion of programmable digital securities, signaling a new phase in optionality around the issuance, trading, and servicing of a wide variety of assets, with significant origination and asset servicing and custody implications for traditional finance (TradFi) banks and brokerages.

There is a very gradual convergence of TradFi and digital assets that will likely accelerate and snowball, with issuance, trading, and settlement increasingly powered by blockchain technology and opening the door for private investors to all types of assets that might otherwise have been out of reach, such as through the tokenization of collectible art, commercial real estate, sustainable energy projects and many others. This shift towards tokenizing real-world assets is leading TradFi financial institutions to build the right infrastructure - including for custody, trading, and client lifecycle management - so they can participate in democratizing finance and blending access to traditional assets with digital representation.

Some would say that the use of the blockchain is driving the 'redesign' of money tokenized issuance, stablecoins, and virtual asset ETFs, at the same time reshaping operations and enhancing client experience. The foundations of the new Digital Asset Infrastructure means that incumbent TradFi institutions need very careful strategies around future infrastructure requirements.

Chair:

Lasanka Perera
Chief Executive Officer, Singapore
Independent Reserve

Panel Members:

Christopher Ngoi
Director of Blockchain
KPMG

Rajeev Tummala
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Silvia Wong
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Richard Swainston
APAC Market Director
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Jia Yng Wee
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There is a gradual convergence of Decentralised Finance (DeFi) and TradFi taking place that will see both more aligned rather than in direct competition, all leading to practical, operational and compliance enhancements and mitigating risks around accessing digital assets and crypto liquidity. Each segment will take valuable elements of the other, in other words the blockchain will become more prevalent in TradFi practices, and established, well-proven practices from TradFi will be applied to the world of digital assets.

One such area that needs development for digital assets is better valuation parameters and improved risk management. The volatility and 24/7 activity in crypto markets necessitate a far more rigorous approach to risk mitigation for investors.

The Institutionalization of digital assets is underway: The arrival of mission-critical and regulatory-approved infrastructure is helping to achieve more institutional participation and a more professional digital asset ecosystem.

Improving regulation, rising regulator clarity, growing maturity, and practical real-world applications of blockchain technology are becoming more evident.

Realignment of Traditional and Digital Assets: The future involves aligning TradFi and digital assets to deliver private investors with alpha-generating solutions in various formats, ensuring seamless client experiences across asset types, different issuance formats, and alternative distribution methodologies.

The path ahead for the nascent digital assets markets will likely be far from smooth. There will be unforeseen crises that will dent confidence, but the mission, the journey, will remain intact. For now, the crypto winter is mostly over; many lessons have been learned and proponents of this evolution – from new entrants to regulators – are far more aligned that before in aiming to create an ecosystem that is reputable, trustworthy and fit-for-purpose. And that augurs well.

These are some of the questions the panel addressed:

- Is the crypto winter now over? In the aftermath of the FTX collapse, and a host of other negative news, is the worst over for investors in cryptocurrencies?
- What are the infrastructure building blocks required for institutional investors, asset managers, private banks who want to work with digital assets?
- What are the various risks to manage when working with digital assets and what are institutions doing to mitigate each of them (counterparty risk vs. tech risk vs op risk vs reg risk vs settlement risk vs credit risk, etc. etc.)?
- How has regulation evolved since the crypto exchange chaos, and are the current safety measures adequate for investors within the existing digital assets ecosystem?
- What are the regulatory updates we need to consider?
- What measures have been undertaken to mitigate regulatory inconsistencies and arbitrage in the financial sector?

KEY OBSERVATIONS IN MORE DETAIL

One of the most exciting developments is the arrival of programmable security issuance of a diverse range of real-world assets

An expert opened the discussion by explaining that from his viewpoint, the great potential ahead is for programmable digital securities to change the landscape of how real-world assets are issued, traded and, of course, serviced.

He explained that from the viewpoint of banks and brokerages, this has significant implications for how the business of origination and asset servicing and distribution can change, which is incredibly important for any universal bank that conducts all three activities in the world of traditional finance. "We need to be positioning ourselves so that our clients have access to all the current and future asset formats," he told guests.

A fellow panelist concurred, adding that from their perspective as a B2B technology infrastructure provider that powers the full lifecycle of digital asset trading, they are excited about this convergence between TradFi and Decentralised Finance (DeFi) in the form of digital assets technology and blockchain.

Greater and better risk mitigation protocols and approaches and more optimal infrastructure are required to manage the often-extreme volatility of crypto trading

A portfolio and risk management specialist agreed, noting that the 24/7 activity and the huge volatility in crypto prices lend themselves to a rigorous approach to risk mitigation for investors.

Mission critical infrastructure is needed to achieve a more institutionalized digital assets ecosystem, said another specialist. "We can call this current leap towards the internet of value, and building the strong foundations for these developments is vital to the future," he stated.

Redesigning 'money', operations and the customer experience

Another guest said there are several key pillars or trends that fascinate him, all driven by the blockchain. One is the 'redesign' of money in the form of tokenized deposits, stablecoins, virtual asset ETFs and so forth. Additionally, there is the redesigning of operations and client experiences.

He said that there is a clear impetus towards convergence between decentralized finance (DeFi) and traditional finance (TradFi). This convergence is finally becoming a reality, leading to greater pressure for anyone competing in the digital assets ecosystem to improve their capabilities around key operational and compliance issues, and to emulate the best practices in the TradFi sector globally.

At the same time, TradFi companies are redefining their processes and assessing new risks to access the liquidity and assets available in the crypto space. "There is growing activity and interaction in the area of convergence between the two sectors, indicating a significant shift in how financial services and assets are managed and accessed across both traditional and emerging financial landscapes," he observed.

He offered three key points regarding the evolution and impact of blockchain technology.

First, there is growing regulatory clarity, helping to drive both institutional and broader adoption of blockchain technology worldwide. Second, there is improving maturity and understanding, with a growing recognition that blockchain is a design and technology choice. Real-world applications of blockchain are becoming more common, and in many cases, users might not even be aware they are interacting with blockchain-powered systems.

Third, there are more and more practical use cases: an example is Singapore Airlines' KrisFlyer miles and its Kris+ App, which integrates blockchain technology

to connect with thousands of merchants, demonstrating blockchain's practical utility in everyday applications.

Looking over the edge of the world to a whole new landscape ahead

Another expert offered his views, focusing on the rapidly expanding tokenization of real-world assets. "We are on the cusp of a significant shift with the tokenization of real-world assets, with many major financial institutions building infrastructure for tokenizing securities, signaling a move towards mainstream adoption," he said. "This trend could democratize finance by lowering barriers to entry, allowing broader participation in wealth management."

He said a new hybrid investment approach is emerging, blending traditional assets with digital assets – for example, cryptocurrency ETFs, all driven by client interest and demand. "More broadly, we anticipate a future where digital and traditional assets are interwoven, driven by client demand and facilitated by major financial institutions," he reported.

Expanding on these thoughts, a TradFi wealth management specialist explained that digital assets must satisfy the basic tenets of private wealth management, namely Wealth Preservation as the fundamental goal, the search for Alpha via smart portfolio management and advice, and secure diversification in a compliant and 'sensible' manner for private clients venturing into digital assets.

Trust is also essential, and no wealth manager worth his bonus can compromise on safety to achieve diversification into any form of traditional or digital assets. Hence, trustworthy service providers and counterparties are

essential, as are best practices around governance and due diligence: Ensuring proper governance and having robust processes in place is essential, particularly when investing in newer areas like digital assets.

The building blocks (are coming into place) for the attainment of a genuinely robust and effective digital assets infrastructure

An expert explained that digital asset markets are really different from TradFi - they operate 24/7, there is fragmented liquidity across crypto exchanges, OTC dealers, blockchain is irreversible. "Once institutions actually understand the digital assets market structure, they need to carefully consider their approach to establishing their digital asset infrastructure," this specialist opined.

They said there are several main building blocks required – custody, the right infrastructure to power the full lifecycle of digital asset trading from price discovery, trade executions, and settlements, the operating model and also access to yield products, lending and borrowing, and fiat banking connections.

Into the future – the realignment of traditional assets and digital assets in a harmonious coexistence

There is more work to be done. Two very different value chains in TradFi and digital assets need to align more closely in the years ahead.

A speaker observed that clients would be seeking alpha in whatever safe and realizable format, not simply allocating a portion of their money to digital assets. In other words, as choice increases, wealth management providers will be empowered to deliver alpha-generating solutions in any practical format, providing the basic tenets of sensible wealth management are observed, as articulated by an earlier speaker.

"We are thinking how we can offer a seamless experience to clients irrespective of the asset format," he explained. "We have been thus far thinking of the world in two distinct buckets – digital assets, and TradFi assets - but we need to sort of bring them together." In this way, the end investor has a wider range of choices but does not need to worry about different practices and operating models as the two strands converge.

Regulatory acceleration and greater oversight will help boost confidence amongst institutions and retail investors

Another expert pointed to two key drivers for evolution ahead in the form of better and more tightly supervised regulations, which are crucial for the proper adoption and growth of the digital asset industry.

"Regulations ensure responsible behaviour among industry players, and developments such as the approval of cryptocurrency ETFs will help move practices more mainstream," he stated. "Those not focusing on regulatory compliance may not be moving in the right direction." He also highlighted the need for better risk management in the digital asset space.

A speaker noted that while many successful digital asset projects and deals appear to be overnight successes, they are actually the result of years of behind-the-scenes work and plenty of proof-of-concept endeavour. He said the coming few years will see much more integration and more partnerships between TradFi wealth management, FinTechs, digital assets intermediaries and exchanges, and the large institutions, leading to significant advances in the industry.

The stars are gradually aligning in the new digital assets universe, but watch out for black holes

The final word went to a guest who summarized key developments ahead. These are the promulgation of greater regulatory clarity, and the convergence in the form of a gradual merging of technologies and practices in the digital asset space. The transition process will see a shift from private chains to hybrid (TradFi and DeFi) models, eventually moving towards public chains as challenges are resolved. And all these developments will be the result of massive efforts taking place behind the scenes, propelled by increasing comfort and awareness in the industry that digital assets are here to stay, leading to their integration into portfolios for strategic benefits like alpha generation or specific exposures.

But the path ahead will likely be a lot bumpier and more difficult than many proponents might hope for. Whether this means there are black holes out there or simply a few nasty meteorites remain, as yet, uncertain. The collective efforts of the nascent digital assets industry exponents and the regulators will determine the speed and safety of the progress ahead. ■