The Rise of the Machines- Will Digital Assets Transform the Global Financial Landscape?

Is the wealth management industry in Asia gravitating towards digital assets and the application of blockchain for transfer and other mechanisms? Is the regulatory environment globally and locally accommodative, or obstructive? Is there a viable ecosystem to enable the development, such as custody/safeguarding digital assets? What are the risks, both financial and cybersecurity? A remarkably knowledgeable panel of experts assembled at the Hubbis Digital Wealth Asia Forum to dig deep under the skin of this fascinating and rapidly evolving sector of the global markets.

These were the topics discussed:

- *What regulatory changes have we seen recently and what opportunities and challenges will this create?*
- *Blockchain - what are the real applications and implications in financial services?*
- *Roadblocks/Challenges for greater adoption in the capital markets / wealth management?*
- *Dive into the Eco-system, what exists, what is being built, what is needed?*
- *How will it affect the wealth management industry + Investment Opportunities?*
- *How do we safeguard digital assets like the security we get with traditional investment in shares and bonds?*

PANEL SPEAKERS

- **Christophe Lee,** Founder & CEO, Lotus Asset Management
- **Alexandre Kech,** Chief Executive Officer & Co-Founder, Onchain Custodian
- **Avril Rae,** Head of Fintech, Hong Kong, KPMG
- **Henri Arslanian,** FinTech & Crypto Leader, Asia, PwC
- **Stephanie Luo,** Client Solutions & Partnerships, InvestaX
- **Lars Rottmann,** Director of Business Development, Skyhook Capital

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THE KEY TAKEAWAYS

Digital assets, for some, are the future of finance

In a world in which all traditional financial instruments can be digitalised, and all transfer and settlement processes can also be digitalised, there are many who are staking their future on the future world of digital assets, empowered by public and private blockchain, or distributed digital ledger, technology.

The implications for the wealth management industry could be widespread

Turning illiquid assets such as famous works of art, or unlisted private equity liquid is a goal for those proponents of tokenisation. The holders of those digital tokens - virtual manifestations of 'real' assets - would then theoretically enjoy both liquidity, transferability and security, as blockchain technology would indelibly confirm their ownership.

Want to buy into a hotel?

A guest gave a theoretical example of the purchase of a major hotel in Hong Kong, via tokenisation, then selling those tokens in bite-sized chunks to wealthy investors, down to perhaps only USD100000, or smaller, per token.

Andy Warhol was always avant-garde

A guest highlighted a project his firm had been working on in the form of tokenising an Andy Warhol painting. He explained that this is a prime example of the potential for asset diversification for investors, and for the owners, for example, a museum, it allows for the raising of funds without losing majority ownership.

The regulatory bodies must keep pace with technology

This is one segment of the global wealth markets that is actually crying out for more focus from the regulators, as the lack of consistent and enabling regulation is an impediment to the democratisation of digital finance.

Regulation will also improve confidence in digital wallets and digital custodians

Better and more comprehensive regulation of the world of digital assets will also help the market's confidence in the digital custodians which are eagerly building their capabilities, and that will be so essential to keeping digital wallets and digital assets safe from cyber-criminals.

A robust digital custodian infrastructure will also enhance transparency

As with mainstream financial assets where the asset managers need to be able to report to their investors on a regular basis, so too the digital custodians will be able to enhance transparency with reporting at the click of a mouse. And, for example, the striking of NAV for traditional funds at the end of each trading day remains archaic, this could easily soon be available real-time.

Asia appears keen to be at the forefront of the digital revolution

A panellist noted that Asian regulators in the leading markets in the region are both increasingly knowledgeable and encouraging of a robust digital assets infrastructure.

From tiny acorns, mighty oaks do grow

To put the progress thus far in context, an expert noted that the total digitised cryptocurrency industry, including for passive funds, active funds, and hedge funds is estimated to be worth less than USD20 billion, according to available data, and the average AUM of the typical crypto hedge fund today is only USD21.4 million, in other words minuscule. And in a world where there are many, many trillions of financial assets, the potential is clearly immense.

For the wealth management industry, the implications are immense

Digitised onboarding and then ownership and trading of digital assets will help revolutionise wealth management, which in reality has changed little in the past several decades.

Education will be a catalyst for digital evolution

As well as better regulation and oversight, greater education is required to boost knowledge of and confidence in the nascent digital asset market. And for those in the financial markets and the wealth management sector, ignorance will certainly not be bliss.

CHRISTOPHE LEE
Lotus Asset Management

"**WE CAN FRAME THE DISCUSSION TODAY AROUND THREE KEYWORDS, NAMELY WEALTH MANAGEMENT,** digital assets, and also blockchain," an expert began. He added that the term digital assets is far more relevant than just cryptocurrencies, as technology and the market has moved on to allow digital assets to encompass a far wider range of alternatives.

"Agreed," came another voice, "as today we can digitalise all the traditional financial instruments that you may be familiar with, so that means debt, or shares, all the way to loan notes, convertible bonds, warrants, so we are actually exploring the possibility of moving this all into the digital world. By digital world, we are talking about the use of blockchain technology, which is distributed ledger technology - both public and private ledgers."

A market in its infancy

As to the applications for wealth managers, the same specialist conceded that the market is still in its very earliest stages. "For example, they explained, "we are seeing a lot of venture capital firms setting up a fund, they digitalise those funds, and that allows the investors to have earlier exits, it allows for a secondary market. When the market really kicks, built on liquidity we can really see, we will be able to compare the pricing in that segment versus the traditional OTC market we have at the moment."

ALEXANDRE KECH
Onchain Custodian

AVRIL RAE
KPMG

Another exponent said that 2019 has not been the hoped-for year of industrial-scale adoption, but that the technical capabilities and the commercialisation elements are moving together gradually, as regulations change to allow more roads and bridges to the destinations many see for this market that will allow wealth managers and institutions to participate.

Custody a vital key

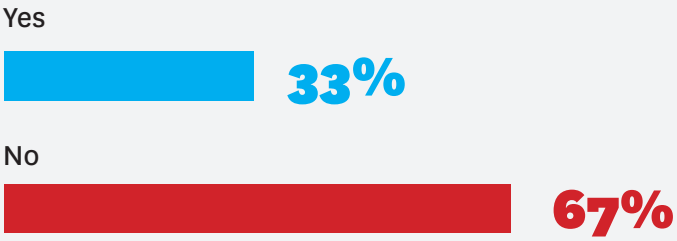
Is custody the key catalyst that will change everything? "Part of the infrastructure required for the arrival mainstream of tokenised assets is the availability of custodians," another guest stated. "This is not only to secure those assets in terms of cybersecurity - because those assets can be easily hacked and stolen from digital wallets - but also in terms of transparency, as with mainstream financial assets where the asset managers need to be able to report to their investors on a regular basis."

He explained that his firm, for example, ensures that technology for custodising those digital assets is current and efficient and of course, unbreachable.

"We are indeed seeing the digital future," said another panellist, "and for the future digital native generations, they will expect digitalisation, even of a house perhaps, or gold or any other financial assets. Regulations recently passed in Hong Kong market shows the world that we can start to have frameworks that work in a regulated way and that should really help move things forward."

HENRI ARSLANIAN
PwC

DO YOU OR YOUR CLIENTS INVEST IN CRYPTO OR DIGITAL ASSETS?



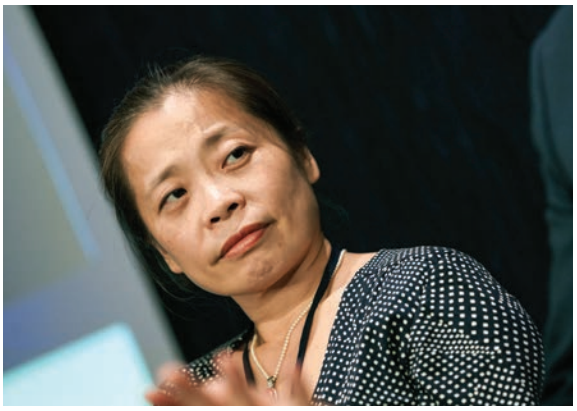
Source: Digital Wealth Asia Forum Hong Kong 2019

Bite-sized chunks

A guest gave an example of the purchase of a major hotel in Hong Kong, via tokenisation. "We can, in theory, take a major, illiquid asset, tokenise it and sell it in bite-sized chunks to wealthy investors, down to perhaps only USD100000 per token. Or it could be a classic Ferrari or a well-known work of art. These developments will also allow us to completely streamline corporate actions. To achieve all this we need more regulation, and actually, this industry is the only one globally that actually lobbies for more regulations, and as those arrive there is definitely a growth opportunity for the wealth management industry, much like the start of the alternative assets industry two or so decades ago."

He added that Asia is ahead of the world already. "The regulators here are way more knowledgeable than people think about digital assets. Only recently, the SFC clarified its regulation on crypto funds and exchanges, so the standards are as high, if not higher, than for traditional asset management firms. The SFC evidently wants to attract well-capitalised, institutional-grade exchanges."

Another voice expressed concerns that the SFC's new opt-in rules are tough to meet - for example, he said that 95% insurance sets the bar too high. "I think they know they will have to evolve the rules," he commented, "if they really want the market to be more workable."



STEPHANIE LUO
InvestaX

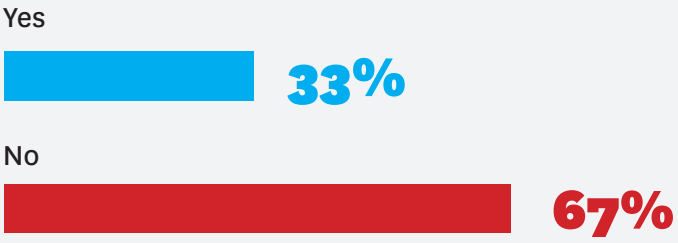
Stepping back to practical applications, a panellist said the mainstream financial market already does a good job of making assets accessible-citing, for example, the ETF industry or the REIT sector, the latter of which clearly makes large commercial property assets buyable in bite-sized chunks.

Don't get stuck in the analogue world

"Major banks are announcing they are moving away from paper for their private securities market, using blockchain," came a response, "so the implications for competitors are they might be left behind if they do not do the same."

"Yes," said another guest, "we are a specialist

DO YOU REALLY UNDERSTAND HOW THE BLOCKCHAIN WILL INFLUENCE WEATH MANAGEMENT?



Source: Digital Wealth Asia Forum Hong Kong 2019

digital assets firm, and people use our services because the private wealth management sector cannot yet help them. "We have private banks talking to us to ask how they can use us as a custodian, saying they have the trust of their clients, we have the expertise, let's work together. Same for the trustees, they are also talking to companies like ours, with assets such as Bitcoin mostly, and Ethereum, in their customers' sights."

A tiny market... as yet

Another expert put this all in context, noting that the total digitised crypto industry including for passive funds, active funds, and hedge funds is less than USD20 billion, according to available data, and the average AUM of the typical crypto hedge fund today is only USD21.4 million, on other words minuscule. "But things will change rapidly," he commented, "as so many more of the younger generations are either already in or soon to be in digital currency assets."

"For the wealth management industry as a whole," another expert reported, "we are having many discussions with them as to how they can incorporate digital assets into the range of offerings for their current and future clients." As an example, this guest cited a new debt/equity fund being set up, with the client wanting to take a digital securities offering (DSO) approach, with the objective being to end up with an outcome as good as analogue, with the technology allowing diligent risk management and enhanced management flexibility for the fund manager. Fees can fall, they said, speed of execution can improve, liquidity can be enhanced, transparency too.

Another expert pointed to improved onboarding. "For example," he remarked, "to prove the client is a professional investor, the way we are doing that hasn't changed in the last 20 years. The beauty now of the digital assets is you can actually have an address, so once we know that someone is on this address, that is it, we can save hugely on all the back-office work for tokenised fund assets, for instance." In short, there are plenty of corporate actions that can be rationalised, saving time, money and stress for all parties.

Immediate information

"Think about how we strike NAV for a fund nowadays," he added. "It is ridiculous, whereas with digital assets, we should be able to get this on an immediate, real-time basis. I believe that in my career, we will have not only quarterly dividends but actually daily, if not hourly dividends, thereby significantly improving tings and transparency of digital assets."

LARS ROTTMANN
Skyhook Capital

He also addressed money laundering. "If you want to launder money, very simply do not use digital assets, because technology can capture transactions, so cash is still best for that, and the traditional banking system. Whereas in the digital world, we can have almost real-time auditing in the future. The major accounting firms see this transformation coming. And legally, computer code representing digital assets is becoming recognised and public and private keys can replace signatures. This is a very much game-changing technological innovation from a legal community which is super conservative."

Transparency is a core virtue

Tokenised assets can also easily be transferred for and used as collateral, another guest added, as

the price is transparent and in real-time. "The reality is we have an intellectual duty to actually spend some time to understand all this," he said. "With Chinese New Year coming up, why not, for example, give digital assets as a gift? It will help everyone understand it all a bit better."

"Yes," agreed another expert, "these processes can significantly help your clients to offer a better experience, can improve their operating models internally and prepare them for the future."

Another guest highlighted a project his firm had been working on for fine art tokenisation. "They tokenised an Andy Warhol last year, and will do a Picasso soon," he reported. "Through tokenisation, it allows me either as a qualified investor or as an individual to invest or to diversify my portfolio into a valuable product, assets that have performed well in past decades and that are likely to grow in terms of value in the long term. For the issuer of the tokens, for example, a museum, they get liquidity without having to sell the piece of art, or for an art collector, they get liquidity to buy something else, while keeping majority ownership of your painting. There are also a lot of companies looking at tokenising existing bars of gold that they hold in custody."

Gaming issues

A panellist remarked on the USD160 billion global gaming industry, in which the game creators can issuing new weapons or skin via non-fungible tokens. "For the first time in history we can issue certain assets," he said, "and mathematically prove there is only one of them and this is a whole new world right now. We are seeing the rise of asset managers managing these assets and creating markets for these, it is an industry that will grow tremendously over the next couple of years."

He added that private data can also be monetised. "Today all of you, you put all your data on Facebook, Instagram and other platforms for free just to be able to use this platform. I guarantee you in our lifetime we will be able to monetise our platform, using crypto payments, or micropayments that are powered by 5G. These are things you have to keep an eye on."

Another key element, he explained, is that nearly three-quarters of central banks are doing research of digital assets, "This is the most exciting time in financial history," he stated, "and I think its great opportunity for us managers who are intellectually curious and have the courage to jump into it."

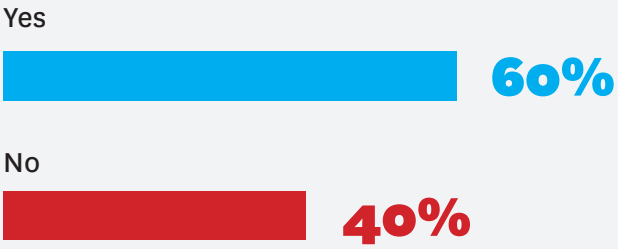
A world of opportunity

Another guest agreed, noting that cross-border payments, for example, worker remittances, suffer huge fees in Asia, of 5% or more, and in Africa of 15% or more. "One of the biggest tokenisation benefits will be seen in micropayments, fees can be slashed very low, and speed enhanced."

"So," came a question, "we are clearly close, but not quite there yet, so what are the things that need to happen for wealth managers get really involved in digital assets?"

"There are now viable custodian solutions that were not there six or 12 months ago," came a reply. "Regulation and compliance are a vital requirement

DO YOU THINK CRYPTO AND DIGITAL ASSETS WILL HAVE A DRAMATIC INFLUENCE ON TRADITIONAL WEALTH MANAGERS IN THE NEXT THREE YEARS?



Source: Digital Wealth Asia Forum Hong Kong 2019

for institutional investors to come in the market. Regulatory clarity and tax clarity are also essential, and those are improving. Regulatory clarity is one thing, but the tax authorities need to be able to tax, and that is finally changing, so very recently the US IRS put out the first guidance in five years from the US side on this topic. However, from a business perspective, there are challenges, for example, counterparty risk, there is a minimal track record to help you choose funds as well. For example, we found that only 25% of crypto hedge funds had independent directors, so there can be major conflict of interest issues."

Better education

Education is also essential, another expert remarked. "Through better education," he said, "we can help dispel any bad reputation." A fellow panellist concurred, adding that there has been a reputational problem in relation to ICOs, tokens sold by a start-up with an idea but no assets or income. "So many of them failed, and had no substance," he said, "so of course you shouldn't buy just based on the internet and invest into a company just based on something that you get via the chat apps. In short, education can help and common sense."

The final word came from an expert who conceded that the market is in its infancy, but that the potential is enormous for both the mainstream financial world as well as the wealth management industry. Those who ignore this whole potential universe, as it expands, will be doing so with their heads in the sand. ■