

THE DIGITAL ASSET REVOLUTION

Digital assets are an emerging asset class that are supported by technology that will revolutionize how financial markets operate. The term is broad but typically used to describe assets stored on distributed ledgers. Digital assets include cryptocurrencies and non-currency assets such as utility and security tokens. Some examples of cryptocurrencies are Bitcoin, Ethereum and Ripple and unlike traditional ledger-based assets, digital assets are supported by a blockchain which is a series of connected ledgers where the details of executed transactions are recorded.

The digital asset market is characterized by increasing investor interest and the technology supporting it has a number of applications that can bring material benefits to the financial markets. Benefits extending from immutable audit trails to increased settlement efficiency and reduced settlement timelines and costs; to informing new operating models and enterprise architectures with significant potential for market infrastructure and organizational systems interoperability.

At an investor level the transformational role of digital assets is evidenced by the accessibility of new products or assets which would not ordinarily be available to the traditional investor in an easy transferable manner. The concept of owning a fraction of an endangered species of wildlife, a Renoir, an exotic car, real estate and a variety of luxury goods many of us can only dream about is now a reality with distributed ledger technology.

The nature of markets as we know it is changing rapidly and the creation of new markets where none existed before increases the number of asset classes available for investment and importantly the number of participants.

Early adopters of distributed ledger technology have extended its use to transform their operating environments. ASX in Australia for example is in the process of replacing its legacy system CHES with a distributed network of nodes as a managed service while also providing infrastructure support for its operations. This forward-thinking application of digital technology can transform the operations landscape from exchanges, payments and treasury services to the settlement and custody of assets.

One might ask in view of all of these benefits, why have cryptocurrencies not replaced national fiat? Whilst the benefits of crypto assets have been enumerated upon many times, it is only fair to balance this picture with the challenges facing the widespread acceptance of this asset class. The current investments and securities regulation governing digital assets does not meet the standards required for institutional investors. At an industry level a coordinated response is required to develop a clear set of universal rules that can stand side by side with existing regulation to support this growing asset class.

That said, significant strides have been across various jurisdictions with regulators and authorities calling for commentary and input into a variety of areas relevant to digital assets. Enhancing current KYC and AML requirements; the monitoring and reporting of suspicious transactions; and the harmonization of regulation across multiple jurisdictions is a significant task and with the US leading the way with the proposed Crypto-Currency Act of 2020, it is a positive signal for the industry. The proposed Act is possibly the most comprehensive piece of legislation dealing with digital assets and covers crypto-currencies,

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crypto securities and crypto-commodities and the relevant regulatory body for each of these digital asset types. There has been much debate and challenges associated with trying to retrofit digital assets into existing regulation governing traditional securities and perhaps now more than a decade after Bitcoin was introduced, the full potential and benefits of digital assets can be embraced by investors globally.

Given the above digital assets have primarily attracted retail investors who, as a subset of investors, are less risk averse and limited by regulation in its current form. In fact, the value of such investors is being elevated and this can be exemplified by the recent announcement regarding Singapore state investor Temasek joining the Facebook-backed digital currency project Libra. Such partnerships are a strong signal in terms of corporate and institutional acceptance of this new asset class and its potential to transform the industry overall.

Similarly, in China the Central Bank is driving the development of its own digital currency and is in advanced stages of testing a front-end interface for CBDC transactions with one of the four large state-owned banks. This would make China one of the leading central banks in the world in creating its own digital currency and electronic payment system. China has made blockchain a national priority and its cryptocurrency developments have been six years in the making.

The value chain for digital assets is broad and extends from digital exchanges to digital asset custodians. As the proposition for this asset class develops, if executed successfully, the specialist functions within the integrated value chain can be ramped up in-house or by collaborating and partnering as required. Whether it is providing clients direct connectivity to the various exchanges; the development of products structured around a basket of digital assets or providing a digital asset custody solution, this is a growth business that will have transformative effects on both investors and service providers, as well as the economics of the business.

Companies are under increasing pressure to remain competitive and relevant in an environment that can be characterized by increasing price pressure and narrowing margins and there is a direct correlation between new financial technologies, the rise of Fintech providers and the level of innovation and disruption which is accelerating the digital transformation of financial services globally. The intended use and application of digital architecture is much broader than initially envisaged and multi-application and interoperability can be applied to support other areas of the environment.

For example, digital technology once implemented not only has the ability to support new digital assets and create new business ventures but also has the potential to replace legacy systems and redefine operating models and processes resulting in enhanced capability, efficiency, cost reduction and competitive advantage.

Companies that successfully develop for the future whilst dealing with the legacy of the past will be the real winners moving forward. A coordinated approach to improve the knowledge and understanding of this nascent asset class across all market participants, from regulators, to industry bodies, service providers and ultimately the investor is critical. Market education is part of the fundamental shift required to move digital assets from the ether into the mainstream. There is no question that the direction the market needs to take is bold and the benefits are compelling.

Author

Fiona Green

Adapa Advisory (Pty) Ltd