

# Digital Immersion

## Convergence of Tradfi & Digital Assets - Catalysts & Roadblocks

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As 2023 comes to a close, it's a good opportunity to reflect on the trends that have developed throughout the year.

Many refer to 2023 as a “washout” for digital assets. With the continued bear market, systemic shocks – including the collapse of Silicon Valley Bank – and high-profile lawsuits, it has certainly been a difficult year for the digital assets space.

That said, we have seen significant progress in the application of existing and new technologies. With increasing digital asset use cases and product types, as well as regulatory clarity in key jurisdictions, traditional financial institutions have become increasingly interested in digital assets and blockchain innovations.

The flurry of applications to register spot Bitcoin ETFs in the U.S. is testament to the uptick in TradFi involvement in digital assets. Is this simply a sign of institutions trying to capitalize on the potential bull market upside, or the start of a broader convergence between TradFi and digital assets?

As we look forward to 2024, this article will explore the extent to which we can see the blurring of the lines between traditional finance and the digital assets ecosystem.

## **The ETF catalyst**

2023 has marked a turning point in TradFi institutions' attitudes towards digital assets. TradFi entities have ramped up their experimentation with blockchain technology in a bid to open up new investment products, drive efficiencies and ultimately boost profitability.

Many of these traditional financial institutions were once skeptical about digital assets yet are now actively piloting different products with the use of DLT and other technology within Web3. Giant banks such as Citibank, JPMorgan and Standard Chartered have all created a digital assets arm to either pilot new blockchain platforms, create their own tokens (such as JPM Coin) or make investments into infrastructure such as [DeFi exchanges](#).

The wave of spot Bitcoin ETF applications in the U.S. has arguably been the most influential example of TradFi involvement in the crypto space in 2023. Many crypto advocates see the likes of BlackRock's push for a BTC ETF as validation for the sector and a critical step towards mass adoption.

The much-anticipated approval of the ETF applications has not only helped to fuel bull market speculation, but could transform how wealth managers use cryptocurrency as part of their overall asset allocation. If approved, spot BTC ETFs could introduce billions of dollars of crypto to the market, providing exposure via a traditional investment product for the first time.

While the expected ETF approvals will continue to drive positive sentiment in early 2024, it is by no means the only mechanism for TradFi to leverage DLT. While ETFs undoubtedly open up the crypto space to a broader investor base, they will do little to unlock the full potential of DLT for traditional banking institutions.

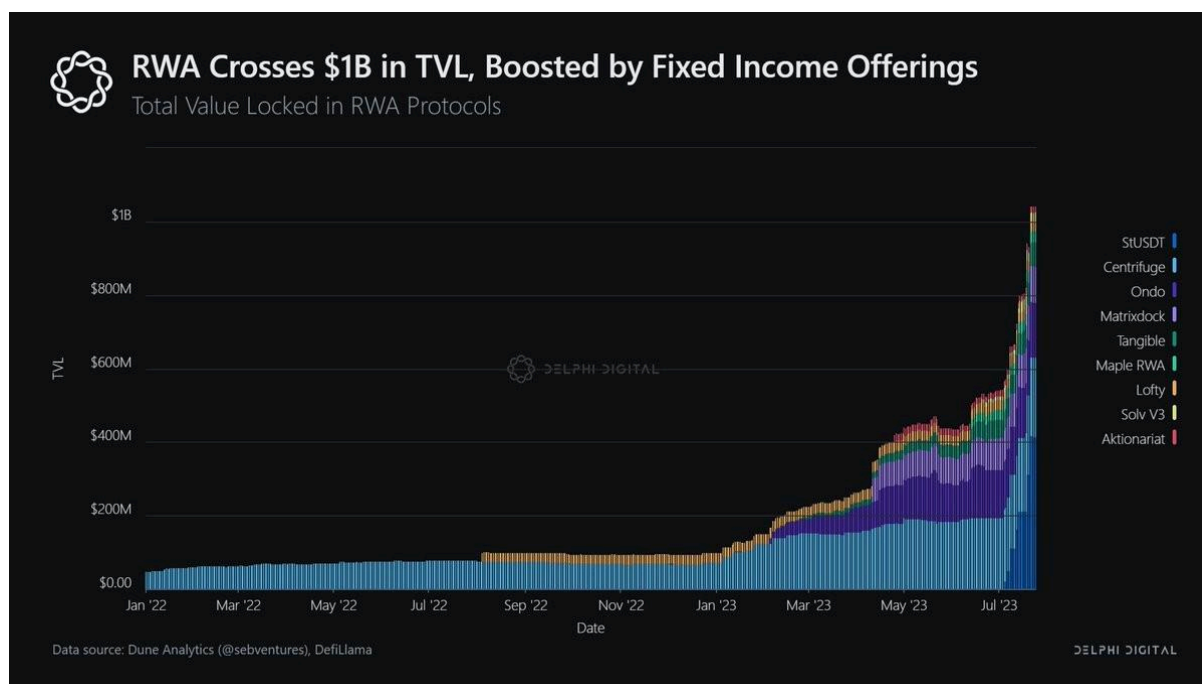
## **The transformative impact of tokenization**

Tokenization has been a growing trend during 2023 and with good reason. It not only helps to open up new investment opportunities – providing a much-needed boost to the real economy – but also enables potentially game-changing efficiencies for financial institutions.

Tokenization of money market fund shares as collateral in clearing and margining transactions can dramatically reduce the operational friction in meeting margin calls. A recent example where [JPMorgan](#) through its Onyx blockchain and the bank's Tokenized Collateral Network (TCN) was used by BlackRock to tokenize shares in one of its money market funds. Tokenization occurred within a matter of minutes through connectivity between the fund's Transfer Agent and TCN.

Leveraging tokenization in this way could dramatically reduce settlement times across the traditional financial system, which often still relies on legacy infrastructure. Having transactions settle within minutes rather than hours or days – and having an on-chain single source of truth for all entities involved in a transaction – could be truly transformative for TradFi institutions.

The tokenization of real world assets (RWA) is another major area of experimentation. According to [Delphi Digital's research](#), RWA tokenization has shown impressive growth over the last year, demonstrating the resilience and potential of this asset class.



RWA tokenization not only enables a broader set of investors to access products and opportunities, but it can also have tangible, positive impacts on the real economy. For example, Japanese real estate firm Kenedix announced its fifth digital security backed by a hotel in Sapporo City. The particular innovation with this issuance is that, in addition to the digital security, securities owners are given a **utility token** that can only be exchanged for souvenirs on-site at the hotel, therefore encouraging in-person visits and driving growth. Thailand has also witnessed notable tokenization projects across several sectors, including real estate, entertainment and the media.

Given the cost savings and operational efficiencies to be gained, TradFi entities are expected to experiment more with tokenization in 2024, regardless of whether or not they believe in crypto as an asset class. According to a recent report by PWC, 25% of traditional hedge funds – including those not currently invested in crypto – are said to be exploring tokenization. A recent survey of [Goldman Sachs'](#) clients, published in September, also found that almost one-fifth expect more than 10% of the financial market to be tokenized in the next three to five years.

## Convergence drivers beyond tokenization

Beyond the operational efficiencies to be gained from DLT technology, there is growing demand for digital asset-focused products from institutional investors. A recent report from [KPMG and the Private Wealth Management Association](#) found that the percentage of clients looking to allocate virtual assets in their portfolio has doubled since the last report.

This demand will continue to spur innovation and new virtual asset products. TradFi institutions have already started to experiment with how they can integrate with DeFi platforms and services. Nomura's investment into DeFi protocol Infinity is a testament to how the lines might blur between traditional and decentralized finance.

Beyond offering new products and services, central banks around the world have been working with the industry to consider how the concept of money can evolve in the digital age. In Hong Kong, the [Financial Services and the Treasury Bureau \(FSTB\)](#) and [Hong Kong Monetary Authority \(HKMA\)](#) have just jointly published a consultation paper on the legislative proposal to implement the regulatory regime for stablecoin issuers in Hong Kong. This has been much anticipated by the market following the HKMA's conclusion in Jan 2023 and the MAS announcing its stablecoin framework in August 2023.

A number of banks are also said to be participating in the stablecoin license pilot in a sandbox-like environment in the first half of 2024 ahead of the stablecoin regime being finalised later on in the year.

## Roadblocks ahead

Despite the potential for TradFi to become even more intertwined with the digital asset ecosystem, there are inevitably challenges that lie ahead.

Regulators around the world continue to grapple with how to regulate digital assets. This is particularly true in the U.S., which is one of the major institutions lacking clarity and could threaten innovation in the space. Other jurisdictions such as Singapore have banned exchanges from providing lending or staking services to its retail users, which acts as a limiting factor for providing DeFi-like services to a wider audience.

Retail access to virtual assets products has been a source of regulatory contention in other jurisdictions, including Hong Kong. Following the JPEX scandal, the local regulators are trying to strike a balance between investor protection and continue signalling HK's support to virtual assets to develop HK as a digital asset hub. Some of the more recent announcements include allowing SFC authorised retail funds to invest in crypto and inviting applications for crypto-based spot ETFs from financial institutions.

Regulation is clearly critical to the convergence between TradFi and digital assets. Regulatory frameworks can either encourage or stifle innovation. If traditional financial institutions are to reap the rewards that come with becoming more embedded in the digital assets ecosystem, they need to work closely with regulators to ensure the frameworks are in place to enable scalability.

## **Conclusion**

Digital assets are ushering in a transformative shift in the world of finance. As traditional and digital assets continue to merge, the possibilities are boundless, and the future is undeniably exciting. The convergence creates new technology and revenue sources, drives efficiencies and breaks down borders.

2024 will undoubtedly see a large uptick in digital asset experimentation, particularly in the tokenization space. We will likely see new innovations that can open up exciting possibilities for both investors (retail and institutional) and banks.

While 2024 will see more convergence between TradFi and digital assets, we are still a long way off DLT playing a pivotal role in the traditional financial system. As [Goldman Sachs'](#) global head of digital assets recently commented, replicating the majority of financial markets exclusively on blockchain is a long way off.

That said, the much-anticipated approval of spot BTC ETFs in the U.S. in early 2024 is likely to spur a year of innovation in the space. The extent to which 2024 will mark the integration between TradFi and digital assets remains to be seen, and will in large part be guided by how regulators navigate this space.