Cryptocurrency & blockchain

November 2018

Slow but steady for crypto firms

Digital asset custody solution

Swiss regulated crypto fund
In this issue…

03 Crypto and blockchain continue with slow but steady progress
By Beverly Chandler

07 Digital Asset Custody solution
Interview with Mark Lally, Swisscom Blockchain

08 Investors embrace crypto assets
By Nicholas Cooper & Dr Hartmut Neff, Crypto Fund AG
Since the last publication of a crypto/blockchain report across Global Fund Media’s sites in August, news has come that Fidelity Investments, which administers more than USD7.2 trillion in client assets, has launched a company dedicated to digital assets.

Fidelity Digital Asset Services will handle custody for cryptocurrencies such as bitcoin and will execute trades on multiple exchanges for investors such as hedge funds and family offices.

“Our goal is to make digitally native assets, such as bitcoin, more accessible to investors,” said Abigail Johnson, Fidelity Investments Chairman and CEO.

Huhnsik Chung, a partner at Stroock & Stroock & Lavan LLP in New York, commented on the move from Fidelity saying: “This is demand driven. Hedge funds and others have been looking for a custody solution for these assets – as they exist in the cloud with a key providing access. The lack of such services has stifled the growth of the digital asset class. Entry of Fidelity lends creditability to the asset class and there has been much demand for a custody service and trading platform.”

Since Global Fund Media last published on the Crypto & Blockchain space, pressure has been gathering on the sector for the development of quality infrastructure. In the last iteration, firms such as Silver 8, Veridium, Kryptoin, JP Integra, Protos

By Beverly Chandler
Asset Management and DMS Governance displayed their skills in the crypto space, and supported development of formal infrastructure for this new asset class.

This edition sees them joined by Swisscom Blockchain, an initiative run by three founders with an extensive background in consulting with Ernst & Young, and joint ventured with Swiss telecoms giant Swisscom, plus Crypto Finance AG’s Crypto Fund.

Since the last Crypto & Blockchain Special Report, in the UK, crypto assets have not had such a good run, with the publication of the UK Treasury Committee’s unanimously agreed upon report from the Digital Currencies inquiry which saw Rt Hon Nicky Morgan MP, Chair of the Treasury Committee, commenting that crypto assets exist in the ‘Wild West’.

The report found that problems including volatile prices, hacking vulnerabilities, minimal consumer protection, and anonymity aiding money laundering. At a minimum, regulation should address consumer protection and Anti-Money Laundering (AML), the committee said.

Blockchain was deemed currently slow, costly and energy-intensive, but there was potential for data storage uses.

The report said: “There are a number of examples of blockchain being deployed in the financial services industry and supply chain management. The Committee is supportive of good innovation, but notes that blockchain should not be pursued for its own sake. Rather, Government and industry should identify what problems exist and consider whether blockchain offers the most appropriate solution. The Committee recognises that blockchain technology may have the potential to solve problems caused by a lack of trust in data integrity and may be a more efficient method of managing certain types of data in the long term, offering higher levels of security than centralised databases.

“However, at present – although small scale uses for blockchain may exist – the Committee has not been presented with any evidence to suggest that universal applications of the technology are currently reliably operational.”

In answer to this, Jamie Burke, CEO of Outlier Ventures (OV), a firm that was launched in 2014 as the first European VC focused on blockchain technologies and has since extended activities into North America, said: “We completely agree with the Committee’s view that there would be benefits from greater regulatory oversight in this area, and that the implementation of an appropriate and proportionate regulatory environment for crypto assets could position the UK well to become a global centre for this activity.

“However, we have concerns that the report fails to account for the broad spectrum of possible functions for crypto assets. For example, adopting a one-size fits all approach to the regulation of ICOs (such as, through treating all crypto assets in the same way as equity or debt under the Regulated Activities Order) isn’t necessarily appropriate. Such an approach risks ‘throwing the baby out with the bathwater’ for those crypto-assets that have serious use cases for advancing a particular industry, or digital ecosystem.”
The path to the launch of a crypto ETF has not got any smoother since the publication of the last crypto report either. The SEC has now knocked back nine applications to list a crypto ETF from the great and the good, including VanEck and Silicon Valley darlings, the Winklevoss twins. Even the merest rumour that Coinbase was in talks with BlackRock about establishing a crypto ETF whipped up excitement in the industry.

BlackRock, the world’s biggest provider of ETFs, is rumoured to have been investigating blockchain and cryptocurrency but the potential launch of an ETF based on these assets was pretty thoroughly dismissed by BlackRock CEO Larry Fink, who stated that his clients had ‘zero interest’ in trading cryptocurrency.

More bad news came in September when the SEC suspended the trading of Bitcoin Tracker One (CXBTF) and Ether Tracker One (CETHF) issued by XBT Provider AB in Sweden, the closest thing to crypto ETNs available in the market, citing a lack of current, consistent and accurate information which has resulted in confusion amongst market participants regarding these financial instruments.

Mike Venuto, CIO of Toroso Investments and co-founder of the TETF index, which is designed to mirror the ETF industry, commented on the news, saying: “I think this is a normal reaction by the SEC. They haven’t shut down the tracking shares, they took a pause to clarify the messaging. It makes sense, most of the media misunderstood what these tracking securities actually tracked. Additionally, many of the custodians like TD and Schwab had not made them available yet anyway. Fidelity was the most progressive in allowing access and trading to these securities even before the tracking stocks were issued. This is a tracking security of an ETN listed in Europe that is designed to track specific crypto assets. That clarity was lost in the US media.”

All of these developments and news since August this year make it extra clear that in order for the crypto/blockchain industry to continue to develop, it needs firms such as those featured here to build sensible infrastructure and practical offerings.
Swisscom Blockchain
Digital Asset Custody
Secure digital asset storage from a trusted global brand
Swisscom Blockchain AG, a joint venture between ex Ernst & Young executives and Swisscom, the Swiss communications giant, have launched their new Digital Asset Custody solution into the global Financial Institution market place.

Mark Lally, Principal Advisor with Swisscom Blockchain, explains: “We offer key products and services across three specific areas: Firstly, the Enterprise Blockchain business unit delivers consulting services and project implementation expertise to existing businesses.

“Secondly, our Tokenisation Services unit focuses on asset tokenisation where real world assets get tokenised on the blockchain. This also includes fund raising ICO’s for established or start-up businesses where we act as the technology and expertise provider to help execute a successful ICO.

“Thirdly, our Blockchain as a Service business unit focuses primarily on the development and delivery of our Digital Asset Custody solution which is aimed at financial institutions of all sizes who wish to offer digital asset custodial services to their clients.”

Lally explains: “We started off understanding the business needs and concerns of financial institutions from big global retail banks down to small private banks or family offices that want to enter into the digital asset custody space. Right now, our prime target clients are those who have done the research into blockchain based digital assets and have arrived at the point where they want to gain exposure to this new asset class. On top of securely holding the assets they also want the ability to move/trade these assets at any given moment.

“We offer an off-the-shelf solution that allows these financial institutions to achieve exactly that. The solution consists of three core components. A vaulting hardware which securely stores the digital asset private keys, a web based UI dashboard and a backend Relay Service to facilitate safe and secure movement of the stored assets when required. It can be fully integrated into existing core banking infrastructure if required.

“Clients vary and range from start-up crypto funds, Wealth Managers, Family Offices, Private Banks all the way up to multinational retail banks. What we are witnessing on the market right now is savvy end clients of these financial institutions have done their research over the past number of years and have arrived at the point where they want a percentage of their investable portfolio to have blockchain digital asset exposure.

“However, they want their trusted bank to take care of this for them. They want a percentage of their portfolios invested in this space but don’t want the hassle of learning how to do this safely themselves.

“We have invested heavily in the development of our Digital Asset Custody solution and expect to see exponential global growth from early 2019 onwards,” Lally says. “The digital asset custody market is currently in its infancy. Interested clients are currently investigating potential market offerings which matches their respective needs and are waiting for the regulatory landscape to become clearer before they ‘pull the trigger’ on a custody storage solution for their business operations.

“Every single financial institution that manages portfolios on behalf of clients will have digital assets exposure to some degree in the near future. We predict that it will form a core offering of all financial institutions within the next 5-10 years. Swisscom Blockchain is here now to help such institutions compete for this new business revenue.”
Investors embrace crypto assets

By Nicholas Cooper & Dr Hartmut Neff

The addition of crypto assets to the investment portfolio is on the rise among professional and institutional investors. What makes this move increasingly interesting for institutional investors? Swiss-based Crypto Fund AG, a subsidiary of Crypto Finance AG, explores the market with the advent of regulated business partners and crypto asset technology breakthroughs.

**Opportunity in the crypto asset market**
The crypto asset market saw its first major influx of investment, resulting in a price surge through December 2017, followed by the recent period of substantial public interest in crypto assets and blockchain. The recent drop in prices has not deterred the financial industry from investing, as seen in the growth in crypto fund assets under management. Last year’s inflow of financing is now being harvested to develop the innovative and disruptive technology. Three factors appear to be playing a role: positive regulatory signals, the arrival of institutional providers, and expected technological advancements – all significant for institutional players to enter the market.

The decreasing price volatility against the US dollar over the last six months indicates possible maturation in the industry. Lower volatilities during a period of stable prices can indicate an expectation of a positive turn in the market.

The positive long-term prospects for the crypto ecosystem continue. This presents the opportunity to invest at the currently deflated price points. Prices should reflect the long-term positive expectations and upcoming technological advancements.

**Positive regulatory environment**
Regulators around the world are taking crypto seriously, issuing guidelines and laws (such as Liechtenstein’s Blockchain Act and Japan’s crypto exchange regulatory announcements). Increasingly, the crypto world is open to regulation: it improves legal certainty and speeds up adoption.

As the crypto market evolves, so do industry best practises and standards. Fewer operational issues will occur on crypto exchanges with increased regulatory oversight, more professional custodian practices, and highly secure crypto asset storage. Insurance products are being released to cover risks in the event of compromises, as is necessary in traditional banking.

Regulators of asset management companies are increasingly embracing the crypto industry. Crypto ETFs and other similar collective investment schemes are edging closer to approval with the biggest regulators, such as the SEC. Crypto Fund AG is the first, and presently the only, Swiss crypto asset manager authorised by the Swiss Financial Authority FINMA under the Swiss Collective Investment Schemes Act.

---

**Crypto funds – assets under management (in USD millions)**

<table>
<thead>
<tr>
<th>Date</th>
<th>AuM</th>
<th>CMI10 Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 17</td>
<td>675</td>
<td>1,000</td>
</tr>
<tr>
<td>Jul 17</td>
<td>2,200</td>
<td>2,268</td>
</tr>
<tr>
<td>Jan 18</td>
<td>5,860</td>
<td>10,622</td>
</tr>
<tr>
<td>Apr 18</td>
<td>5,580</td>
<td>6,097</td>
</tr>
<tr>
<td>Jul 18</td>
<td>7,110</td>
<td>5,040</td>
</tr>
</tbody>
</table>

Comparison: Crypto funds assets under management and crypto asset prices.
Sources: Bloomberg, Crypto Fund Research
**Institutionalisation of the crypto industry**

Institutionalisation has arrived. Crypto Finance AG, launched in 2017, has worked closely with FINMA in building a bridge between the traditional financial world and the emerging crypto asset market. Financial services professionals, including former UBS and Credit Suisse employees, and technology specialists back up CEO and co-founder Jan Brzezek’s team.

With recent institutional announcements, the larger players are now entering the market. The crypto fund assets under management increased significantly this year, counter to the substantial fall in crypto market capitalisation (as crypto prices fell). The indication: vast crypto fund inflows during 2018.

**Technology as a market catalyst**

Looking further afield, the potential for widespread crypto adoption is visible in financial services, healthcare, insurance, supply chain management, internet of things (IoT), wealth storage, and global settlement.

Crypto technology breakthroughs are expected in one to three years. The highest potential projects have achievable and impressive ambitions with professional development teams. Extensive manpower is being dedicated to finding solutions to current challenges, including effective decentralised governance protocols, faster transaction speeds and scaling systems, lower energy mining consumption, denial of service resistance, geographical disbursement solutions, and mining pool concentration safeguards.

**Allocating crypto assets into portfolios**

The broad crypto asset market exhibits low correlations with traditional asset classes such as equities, fixed income, currencies, and gold. The addition of crypto investments brings diversification and strengthens a portfolio, based on the long-term potential of this new industry. Crypto assets added to a portfolio as an allocation in an alternative investment quota can ensure an investor does not miss potential bull runs. This position could be considered as similar to an equity option without maturity.

Adding crypto to a portfolio should be considered as a long-term investment. Investors should review specific tax and legal advice in their jurisdiction.

**Crypto investment fund vehicles**

Using collective investment vehicles to gain crypto asset exposure brings the benefit of crypto experts and financial services professionals managing the products without the difficulties of direct investment. Crypto funds can also offer favourable liquidity terms, such as weekly Net Asset Values (NAVs).

Passive funds track indices, such as the Crypto Market Index 10, calculated by SIX Swiss Exchange AG, are constructed to represent the broad crypto market. Active fund products differ in investment style and objectives, such as a systematic approach using algorithmic filter analysis, to name but one example. Unregulated crypto funds often lack basic corporate governance, controls, and processes expected of asset managers. Most hold their crypto assets in self-custody. Third-party crypto storage providers with top-tier institutional storage infrastructure solutions are an essential requirement for any professional investor.

**The crypto industry is moving towards institutional professionalism**

According to Bloomberg: “Institutional investors are becoming more involved in the USD220 billion cryptocurrency market than many observers may realise”. The drivers of this increased investment include the growth of institutional partners available, expected technological breakthroughs, and supportive regulatory advancements.

As the importance of crypto assets grows and matures across many markets, the Swiss authorisation from FINMA for Crypto Fund AG is an important acknowledgement for crypto assets around the world. It allows professional investors a pathway to invest easily and transparently in the crypto industry.