

# Digital Assets Post-Trade

The Building Blocks of Tokenization

## Key points we will cover

1. How will the post trade solutions for digital assets meet the norms for institutional capital?
2. How will this impact trading strategies and capital formation?
3. What are the custody solutions for existing assets?

# Asset Allocator and Fund Manager norms:

## Requirement

- No change in governance models
- No change in codes of conduct
- No change in compliance models
- No change in fund mandates

Changes to existing best practice model would require lengthy (3+ yrs) evaluation by asset allocators

## What this means in Practice

- Segregation of duties model
- No trading with bearer instruments
- Continuous ownership of assets throughout the trade process
- Insolvency protection
- Relevant insurance on value-at-risk
- Strong information model that supports all reporting and filing requirements
- Operational throughput to support high volume of trades

# ／ The current model is highly fragmented and weak

## Custody

- Digital asset custodians (independents and exchange tied)
  - Cold store security models subject to collusion risk
  - Manual process and slow and costly
- Fiat custody though
  - Banks held in deposit format (e.g. Signature, Silvergate)
  - Exchanges as deposits (unregulated)
  - Trust structures in USA (Kingdom, Prime)

## Settlement

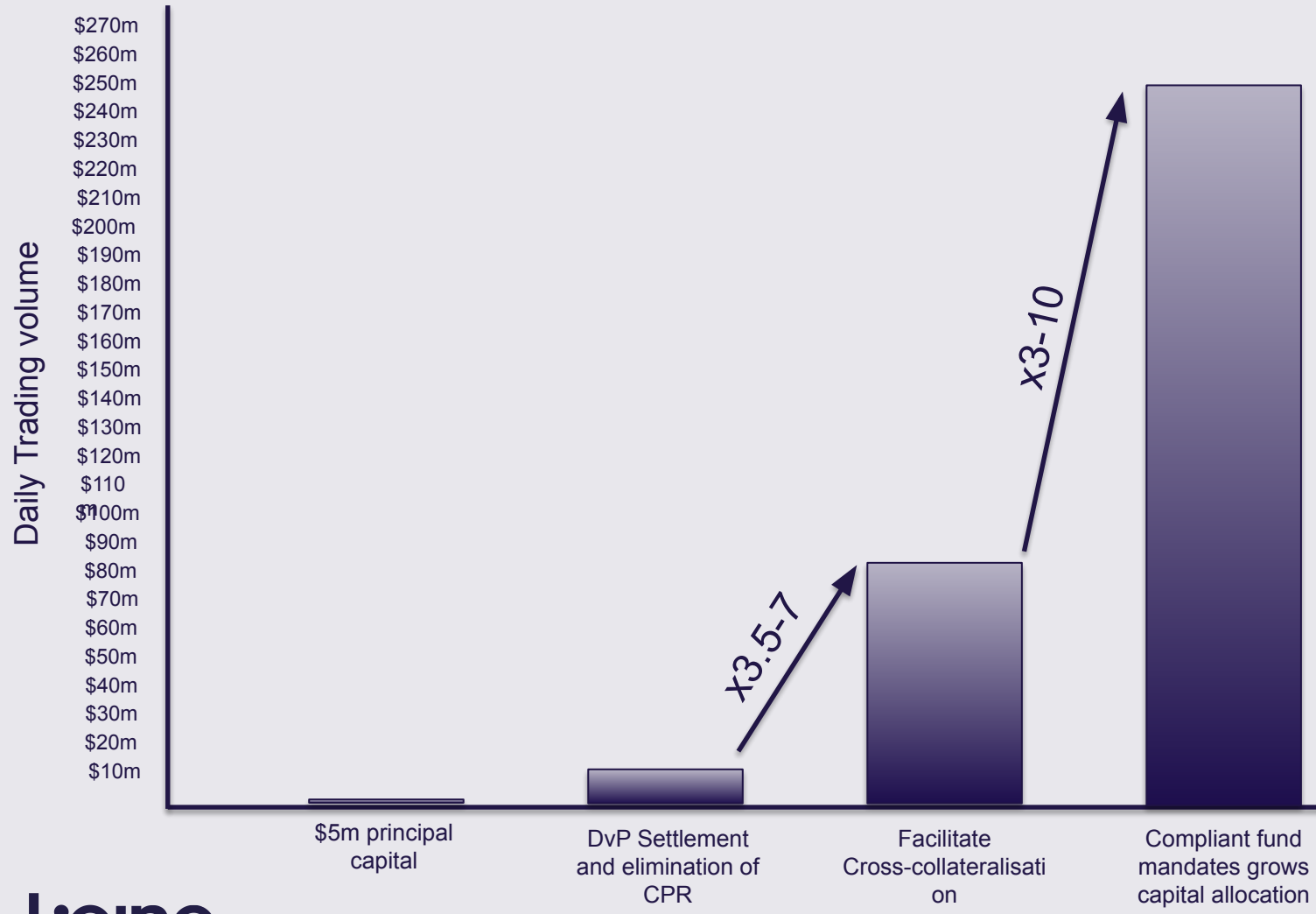
- Exchange settlement:
  - Electronic book cross
  - Unregulated, no transparency, no standards, no audit, no independent oversight
  - Considerable Counterparty risk
- OTC Settlement
  - Semi manual and slow (up to 10 hours?)
  - Free of Payment
  - Counterparty and credit risks
- Independent Settlement
  - Counterparty risk on custodians with manual processes

# ／ The Crypto-Asset Opportunity

## Our Analysis

- Family Offices entered the market in 2019:
  - used traditional capital markets OTC desks in 2019 displacing crypto-focused OTC desks and exchanges
  - Driven by security concerns
  - Amongst exchanges, those with a more institutional flavour gained relative market share (except in Asia).
- Small amounts of institutional flow into highly passive funds.
- Most Institutional capital unable to assign capital to funds due to market structure
- HFT's started to shift principal capital in small amounts mainly supporting market making opportunities.
  - Exploring trading & risk strategies using their principal capital
- Trading strategies for HFT's constrained in executing their algorithmic trading (high volume) due to
  - slow settlement times on OTC,
  - high counterparty risk on all venues and
  - absence of cross-collateralisation.

# The HFT Crypto Opportunity



Doubling the Market?

And lastly, what about digital securities...

# ／ The Digital Securities Opportunity

Liquidity

- Capital formation in digital assets currently negligible
- Retail markets in Asia, family offices and hedge funds offer initial possibilities
- Products need to be aligned to the liquidity provider profiles

Post-Trade

- Moving towards matched riskless principal trading with real-time collateral assignment
- Asset servicing and Digital CSD capabilities need to evolve
- Interim solutions around secondary “digital” issuances will emerge

Distribution

- Established investment banks will likely dominate marketing & distribution
- Financial institutions may lead with their own securities e.g. digital CDO's
- High quality Issuers need education and will be slow to adapt – expect 5+ years

Issuance Platform

- Intensively competitive space with unproven business models
- Helping to build awareness of tokenisation
- In-house investment bank platforms linked to post-trade likely to be the winners.

Crypto-asset trading will start to go institutional in 2020  
but meaningful digital securities trading is some time away

# Thank you

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Regulated by FCA in London, coming soon to USA, Luxembourg and UAE

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