

Is Asia Pacific Poised to Lead the Growth of Digital Assets?

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While historically Asia Pacific (APAC) has trailed North America and Europe in establishing markets for new asset classes, when it comes to digital assets, the region's FinTech industry is setting the pace.

Many of its exchanges and regulators are moving swiftly to put new supporting infrastructure in place, and regional investors are expressing a growing interest in digital assets.

The growth of digital assets

Just over a decade ago, digital assets came to widespread public attention with the release of a whitepaper written under the pseudonym of Bitcoin's anonymous creator, Satoshi Nakamoto. The paper proposed a peer-to-peer electronic cash system that bypassed the need for third-party involvement by established financial institutions such as banks.¹

The proposed system would operate on cryptocurrencies, of which today's Bitcoin and Ether are the most widely known. However, cryptocurrencies represent only a small fraction of how digital assets are changing the financial services landscape.

Cryptocurrencies are just one application of what's known as 'tokenization': the process of converting proprietary asset rights into digital tokens, which are then stored on a distributed ledger such as blockchain.

There are currently three main types of digital tokens:

- Exchange or payment tokens designed to be traded, spent and received, such as cryptocurrencies
- Utility tokens, which provide future access rights to a specified product or service such as Basic Attention Tokens (BAT) used in digital advertising
- Security tokens which represent real-world assets, and as such are comparable to conventional financial instruments

Tokenization has major implications for capital markets, from both an investment and an operational perspective.

For investors, it creates new types of assets to invest in — such as cryptocurrencies and utility tokens — as well as new ways to invest in real assets. Tokenization also opens up illiquid assets such as art and real estate to a larger pool of investors, as distributed ledgers enable new market models.

From an operational perspective, tokenization enables automation of parts of the exchange process, making transactions cheaper and quicker, as well as improving transparency of security ownership.

As tokenization becomes more commonplace in capital markets, the opportunities for investors and service providers will accelerate globally. But the speed at which this value is realized will depend on multiple stakeholders — from regulators and stock exchanges to FinTechs and investment institutions. Across APAC, many of these organizations are pushing hard to take a global lead.

¹ <https://bitcoin.org/bitcoin.pdf>

APAC institutions lay the groundwork

There are a growing number of opportunities to gain exposure to digital assets across APAC. Some Asia-based funds are providing institutional-grade, diversified crypto-investment opportunities, together with the ability to invest in blockchain-oriented companies.

Asian exchanges are proactively laying the groundwork for this new digital asset marketplace. One example is the Stock Exchange of Thailand (SET), which has a three-year strategic plan focused on developing a digital infrastructure platform and a “one-stop” digital capital market. The SET has announced that by the end of this year, the bourse’s infrastructure will be fully digitized, including a paperless account opening process, electronic payment of stamp duty and direct-debit registration processes. SET’s digital assets’ platform is forecast to go live in 2020.²

In addition, several other regional exchanges are in the process of integrating distributed ledger technology (DLT) into their systems to aid post-trade processes. This is an area of particular interest given the heightened regulatory requirements in the wake of the financial crisis.

In May, the Australian Securities Exchange (ASX) announced the opening of a new DLT-based customer development environment to replace the exchange’s current system for equities clearing and settlement.³

The Hong Kong Stock Exchange (HKEX) is partnering with DLT start-up Digital Asset to develop the use of blockchain for post-trade processing and to reduce settlement risk. While the Singapore Exchange (SGX) is collaborating with the Monetary Authority of Singapore (MAS) on a series of industry-level projects to explore the use of blockchain for digital money in the clearing and settlement process.

Optimizing post-trade processes is the first stage in deploying DLTs across capital markets. The next step will be using the technology for issuing and trading tokens. Given the integration of DLT into their existing infrastructure, APAC’s exchanges will have the first-mover advantage.

Innovation fueling the growth of digital assets in APAC

Along with keen interest and an early start with digital assets, APAC’s advantage is further strengthened by factors such as funding availability, regional regulator engagement, and new pockets of FinTech innovation.

In 2018, APAC overtook North America to become the leading destination for FinTech fundraising, attracting a total of US\$29.8 billion.⁴ Mainland China and India took the bulk of the inflows, but Hong Kong also received a large proportion, owing to its role as an international financial center and a key facilitator of China’s trade flows.

Several countries — Australia, Hong Kong, Indonesia, Malaysia, Philippines, Singapore,

² <https://www.set.or.th/set/newsdetails.do?newsId=15524345124140>

³ <https://finance.yahoo.com/news/australian-securities-exchange-opens-dlt-154640437.html>

⁴ https://www.accenture.com/_acnmedia/pdf-97/accenture-the-win-win-proposition-apacfintech-momentum.pdf

Taiwan and Thailand — have introduced regulatory sandbox regimes.⁵ These sandboxes serve as the foundation for FinTech development, with digital asset initiatives as a key focus. For example, security token platforms in the Singaporean sandbox are already onboarding issuers and investors. Some are targeting 2020 to exit the sandbox and become a fully-regulated capital markets platform to help companies raise funds through tokenized securities.

Some APAC countries have already moved beyond sandboxing to implement progressive regulatory oversight. In early 2017, the Japanese Financial Services Agency introduced a regulatory framework for digital assets, and Bitcoin has been recognized as legal tender in Japan since April 2017.⁶

23%

of APAC investors expect the market to mature and become a mainstream alternative asset class

Addressing real and perceived barriers to digital investment

A 2018 State Street survey of institutional investors found that APAC-based respondents are slightly more optimistic about the opportunities offered by cryptocurrencies than their peers in Europe and North America.⁷

There is less short-term appetite for investment in APAC (23 percent) compared to North America (34 percent), but 62 percent say they are monitoring developments with a view to investing in more than one year — 10 percent higher than global peers.

Understandably, some concerns remain among APAC's more established institutional investors. To date, interest in crypto funds has mainly stemmed from smaller, less risk-averse clients such as family offices and high-net worth individuals, as well as from the alternative fund space. One notable exception is the National Pension Service (NPS) of Korea, the world's third-largest pension scheme. In January last year, NPS invested 2.6 billion won into four companies operating cryptocurrency exchanges in Korea, which may encourage other institutional investors to begin dipping their toes into the water.⁸

⁵ https://www.bakermckenzie.com/en/-/media/files/insight/publications/2018/12/guide_intlguideregulatorysandboxes_dec2018.pdf

⁶ <https://atozmarkets.com/news/2-2top-6-blockchain-friendly-countries-in-the-asia-pacific-region>

⁷ State Street Growth Readiness Study 2018. <http://www.statestreet.com/ideas/articles/routes-to-growth.html>

⁸ <https://news.bitcoin.com/south-korean-national-pension-fund-invests-crypto-exchanges/>

APAC respondents to our survey cited the primary barriers to investing in digital currencies as volatility (34 percent), unreliable pricing (34 percent) and negative regulatory responses to digital currency investment (31 percent). However, many of these concerns are already being addressed.

The introduction of stablecoins, backed by a 'stable' asset such as a fiat currency or other asset types, aims to reduce volatility and increase the chance of using such coins for payments. Additionally, many issuers are trying to align their Security Token Offerings (STO) with existing securities laws to offset the shortcomings seen with initial coin offerings (ICOs). Their aim is to attract institutional investors into the digital asset space for investing and, eventually, secondary trading of such tokens.

Only time will tell what will drive institutional flows into the new territory of digital assets. What seems certain is that digital assets have the potential to fundamentally change the financial landscape. Moreover, the speed and enthusiasm with which jurisdictions react to and embrace this change is likely to impact the competitiveness of their local market and, potentially, their economic wellbeing.

As the market for digital assets evolves, APAC's FinTech strength, combined with forward-thinking exchanges and regulators, should position it well to be a global leader in the digital assets arena.

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