Digital Assets in 2023

Regulation and the rise of institutional players

A refocus on the blockchain technology and the emergence of Hong Kong as an alternative jurisdiction.

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Contents

Introduction

The world of digital assets has seen a spectacular rise (and fall) in the last few years, with cryptocurrencies and other digital assets now widely recognised as an alternative investment class.

Several factors combined between the autumn of 2020 to winter of 2021 to capture the zeitgeist partly fuelled by stimulus cheques, non-spend on the services sector, astronomic increase in **media mentions** plus sheer greed. The benefactors of this rapid growth were the incumbents at that time, many of whom were leveraged to the hilt and lacked sound corporate structures and governance, none more seminal than FTX – whose implosion was reckoned to be the digital assets 'Lehman Bros' moment.

Two months into 2023, as the glass pieces begin to settle in the wrought kaleidoscope, a few themes are emerging more clearly out of the FUD (fear, uncertainty, and doubt). In this paper, we will explore the key trends that are shaping the digital asset landscape, including the critical role of regulation, the importance of corporate governance, the emergence of a new jurisdiction, and the continued evolution of blockchain technology.

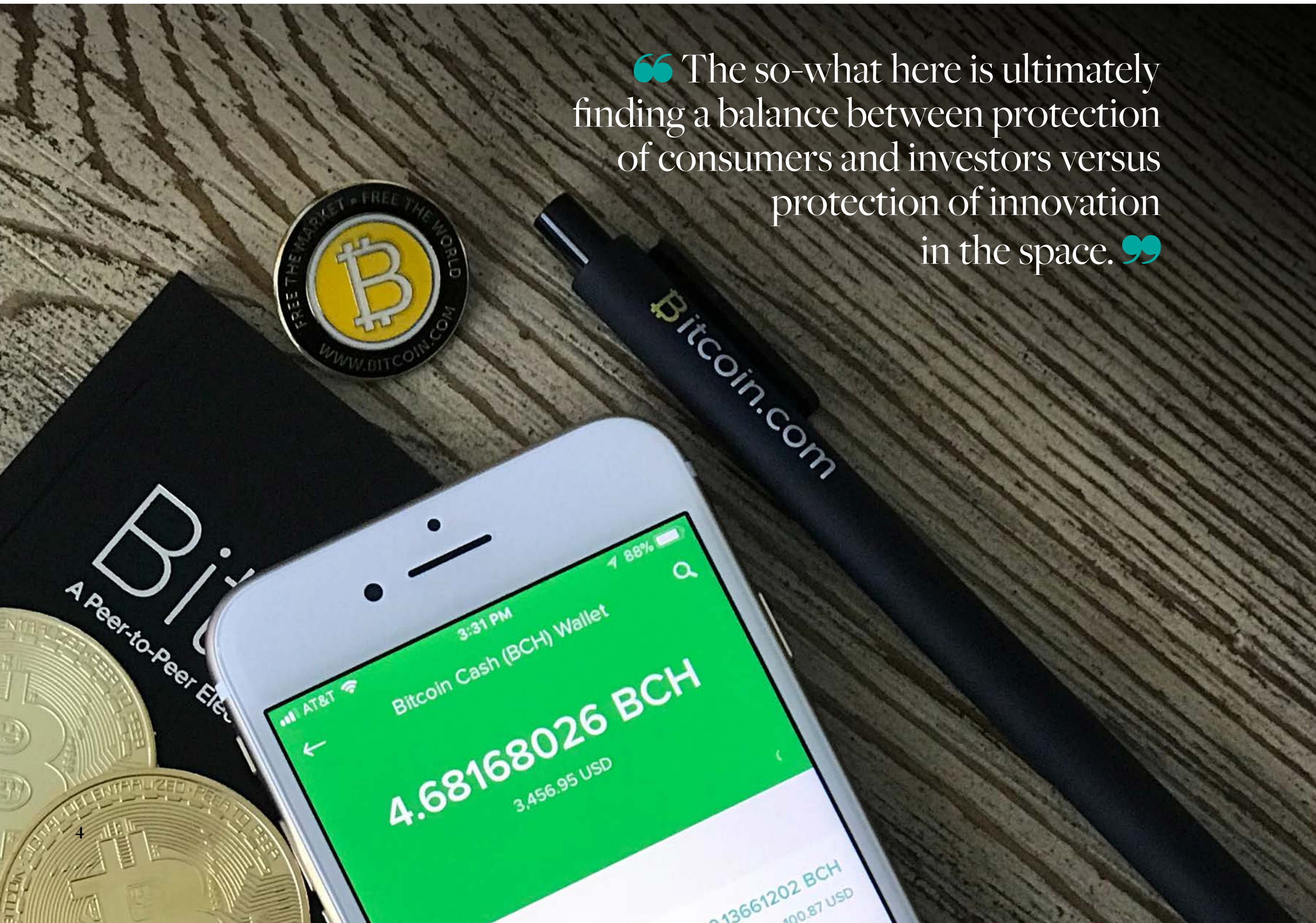
Fidenza #313 by the artist Tyler Hobbs. This artwork was purchased as a non-fungible token (NFT) for ETH 1,000 which was the equivalent of USD3mn at the time.

Regulation

Regulation has been a contentious issue in the digital asset space, with many investors and industry players calling for increased oversight to protect consumers and promote wider adoption, whilst OGs and purists viewed this as the antithesis of *the* blockchain.

The events in November 2022 as FTX filed for bankruptcy – the largest of its kind in the industry – brought consensus across most parties. Regulators worldwide scrambled to close the gaps and loopholes and most importantly increased collaboration among themselves. What is expected is a more definitive outline and approach to a regulatory regime/framework in 2023. In the European Union, the proposal to regulate crypto-assets and the activities – MiCA (**Markets in Crypto-Assets**) Regulation is due a final vote in **April 2023**. In the US, the SEC and CFTC have taken a cautious and proactive approach respectively with the former most recently clamping down on Ethereum staking – which in the simplest of description is akin to a commercial bond. In the UAE, the Abu Dhabi global market is regarded as more advanced with a detailed view on most aspects of digital assets regulation including DeFi (decentralised finance).

The 'so-what' here is ultimately finding a balance between protection of consumers and investors versus protection of innovation in the space. It is generally expected that added oversight will in due course attract more institutional players bringing in increased liquidity, stability, and growth. Custody and staking will be prime services in this space with first movers looking to gain an advantage over the rest.



"The so-what here is ultimately finding a balance between protection of consumers and investors versus protection of innovation in the space."

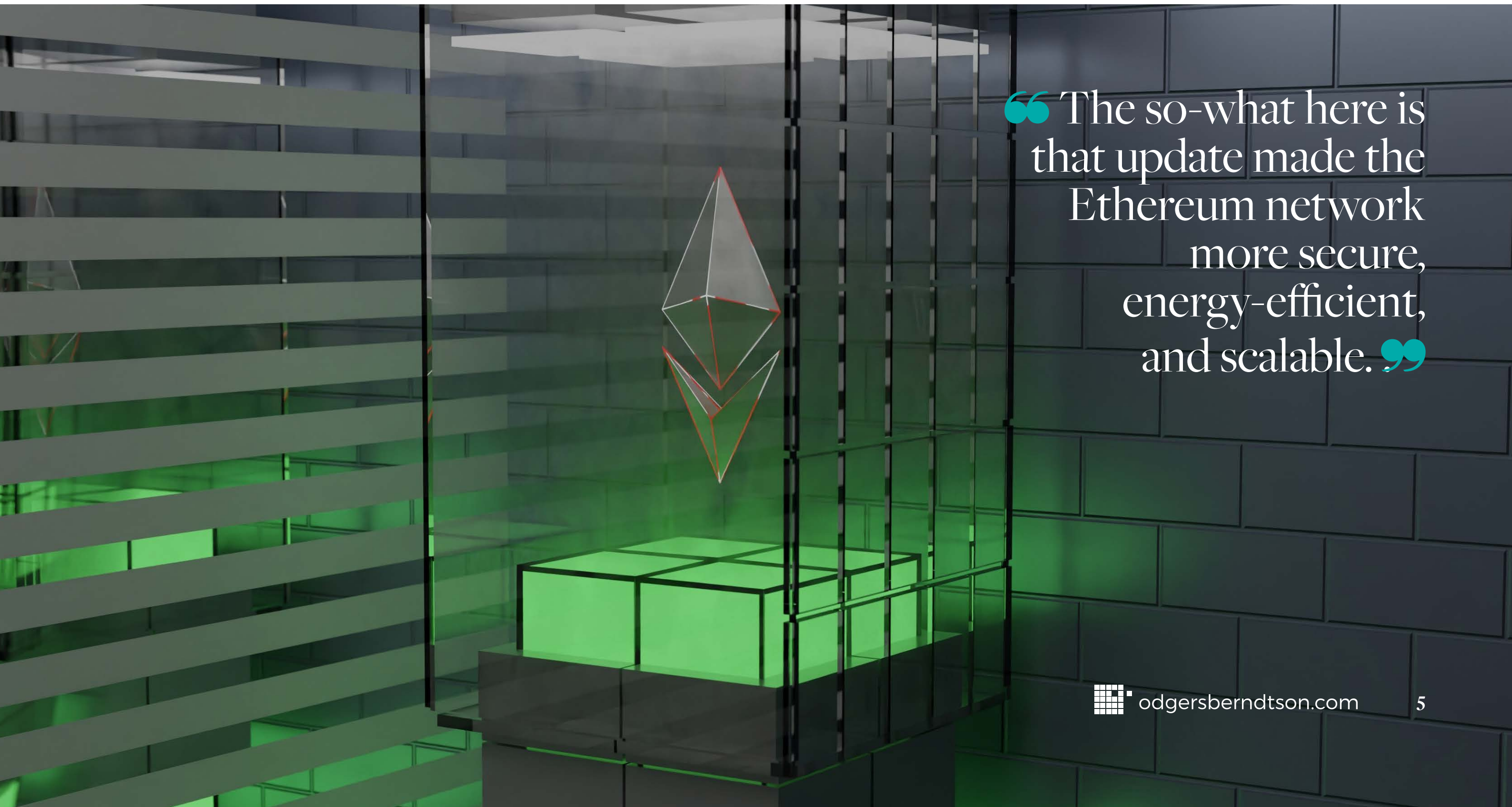
Blockchain Technology

The silver-lining in the dark FTX, LUNA, Celsius, 3 Arrows Capital clouds has been the robustness of the blockchain technology. Blockchain is at the core of the digital assets, providing the foundation for secure, transparent, and decentralised transactions.

One particular event in 2022 that did not garner the recognition it deserved was the update to Ethereum. A simplistic view is to liken Ethereum to a decentralised global computing system i.e. 'cloud servers' operating in unison and independently. These 'servers' are not owned by one company like you have in Amazon, Microsoft or Google but are owned by thousands (possibly tens of thousands) of people running computers simultaneously. The incentive to run these computers is the opportunity to earn the token native to Ethereum – ETH – which has a real-world monetary value. Anyone can run a program on the Ethereum network but to do so one must pay a service fee that is commonly referred to 'gas fee' and is that is denominated in ETH (the token native to the Ethereum network). This Ethereum computing system underwent an upgrade from a proof-of-work (where all the 'computers' would process each transaction on the network) to a proof-of-stake (where 'computers' with at least 32 ETH would run transactions). This upgrade code named 'the merge' happened overnight across millions of computers running the Ethereum software and went off without a hitch – this was an impressive feat with very few superlatives.

The 'so-what' here is that update made the Ethereum network more secure, energy efficient, and scalable. The economics to this move incentivises the pooling together of ETH at 32 increments to be given access to run transactions in the new proof-of-stake set up. Every time a transaction is run, a payment is received. It is this payment that is behind the staking (commercial bond equivalent).

The Ethereum network has a number of updates and improvements for 2023 that are expected to significantly enhance its performance and capabilities. These updates will be rolled out in phases, each of which is expected to bring new features and improvements to the network. For now, the next upgrade is codenamed Shanghai. The name of which bodes well for a new digital assets jurisdiction that is on the ascendency – Hong Kong.



Hong Kong, the alternative Jurisdiction

While Dubai and Singapore have been popular destinations for digital asset companies in recent past, we believe that Hong Kong will emerge as a new alternative.

The Hong Kong government issued a **policy statement** on the development of virtual assets that highlighted its commitment to developing a vibrant sector and ecosystem for virtual assets (digital assets) in the region. Given that Hong Kong has an existing world-class financial infrastructure and legal and regulatory regime, this pivot and focus on the digital assets industry will make it a favourable jurisdiction among service providers and investors at large.

At a state level, Hong Kong will be piloting two projects that will provide credentials to their cause. The first is a green bond tokenisation – tokenising government green bond issuance for subscription by institutional investors. The second is a e-HKD – a digital version of the Hong Dollar. What will set Hong Kong apart from the other jurisdictions will be access to an abundance of talent, capital, and the weight of the political will from the Hong Kong government.

King Leung, Head of Fintech at InvestHK commented that as the Web3 world is growing at a breakneck pace, Hong Kong government officials and regulators have taken a stance on virtual assets emphasising the need to create a robust legal and regulatory framework to support the sector. Since 2018, Hong Kong Securities and Futures Commission has been consistent in its position that accentuates investor protection as a bedrock of the regulatory principle where 100% of customers' virtual assets are ringfenced. The 'same activity, same risks, same regulation' approach shows the city is actively striking a balance between investor protection and granting further access such as the tokenised green bonds, virtual asset futures ETFs, and even highly liquid assets for retail participation.

The ongoing optimisation of regulation with consistency in policies and willingness to listen and act reiterated our favourable position and paced the wave for Hong Kong to become the 'Asia virtual asset hub'. Our recent policy statement on the development of virtual assets and the active follow-up by the Securities and Futures Commission has reassured companies considering Hong Kong as their hub to restore investors' confidence and grow their business.

> "The 'same activity, same risks, same regulation' approach shows the city is actively striking a balance between investor protection and granting further access such as the tokenised green bonds, virtual asset futures ETFs, and even highly liquid assets for retail participation."

King Leung, Head of Fintech at InvestHK

Importance of Corporate Governance and Leadership

Finally, as the digital asset industry matures, we believe that corporate governance and implementing a combination of conventional and new leadership models will become increasingly important.

Leadership teams in digital asset industry must develop the ability to anticipate and navigate the complex landscape of regulation, technology, and wider market dynamics. This strategic foresight involves understanding the potential impacts of emerging trends and proactively devising strategies to capitalise on opportunities and mitigate risks. Compliance and risk management will be integral to the success and adoption of digital assets.

The digital asset industry sits at the intersection of finance, technology and regulation. A cultivation of cross-disciplinary expertise will be required to address the unique challenges and opportunities that arise from these diverse fields. This includes developing a deep understanding of blockchain technology, regulatory frameworks and financial markets, as well as fostering a culture of continuous learning within their organisations.

In light of the collapses of FTX, Terra Form Labs, Genesis and a host of firms in the digital assets space, it's crucial for leaders to prioritise effective crisis management. Seeing as these firms unravelled over the course of days, establishing a dedicated 'war room' will prove to be crucial in enabling swift and decisive responses to emerging threats and crises in real time. This includes developing robust contingency plans, setting up rapid response teams and maintenance of transparent communication channels to facilitate prompt decision-making during critical situations. As this paper goes to press, the collapse of traditional finance institutions in the US and Switzerland further underscores the necessity of sound crisis management teams within the digital asset landscape.

We anticipate the growing importance of diverse and inclusive leadership teams in the digital asset industry to be brought at the forefront of corporate governance. By incorporating varied perspectives, backgrounds and skill sets, these leadership teams can generate more innovative ideas, identify blind spots and build more resilient digital asset firms. This diversity should extend to factors such as professional experience, gender, race and last but not least, age, in order to create an environment where everyone's contributions are valued and respected.

Conclusion

In conclusion, the digital asset industry has undergone a remarkable journey in the last decade, experiencing events that typically span across multiple decades in traditional industries.

With increased regulation, robust corporate governance, effective leadership, technological innovation and an increasing adoption of blockchain technology, the digital asset is now regarded as a genuine alternative to traditional investment vehicles.

As we look ahead, and governments and regulators around the world increase their scrutiny of digital assets, investors may seek out high-quality assets that are less likely to be affected by regulations or enforcement actions. We anticipate that the kaleidoscope of digital assets will continue to create mesmerising patterns, reflecting the ever-changing landscape and hashes of this exciting and dynamic industry.

Will established jurisdictions like Singapore, UAE and the UK maintain their competitive advantage amidst Hong Kong's emergence as an attractive alternative?

In our upcoming whitepaper, we will delve into the ongoing initiatives and progress from a jurisdictional perspective. For now, here's a brief overview of Singapore, UAE, and the UK:

The Financial Conduct Authority in the UK is consulting on focusing its regulatory efforts on activity generated by and around digital assets rather than descriptively targeting the tokens (assets) and/or the inherent technology and provides definition of the asset classes clearly. The emergence of institutional investment in establishing infrastructure around access to and custody of the digital assets along with regulatory policies to support this is gaining.

Singapore, a global fintech hub with over 1,500 registered firms, hosts a thriving ecosystem with payment companies forming the majority share. Recently digital asset firms and virtual asset service providers (VASPs) are increasingly comprising an important constitution of this ecosystem and the innovation plans for the Lion City. The Monetary Authority of Singapore (MAS) is carefully balancing the desire for innovation brought by digital assets technology whilst instituting stringent licensing requirements and setting up guard rails to protect consumers and investors. MAS aims to maintain an attractive, forward-thinking jurisdiction while enhancing risk and regulatory oversight.

The tripartite of Abu Dhabi, Dubai and Ras Al Khaimah have taken significant and distinctive strides in building an offering for digital assets industry. Abu Dhabi Global Market has been a pioneer in developing a forward looking and pragmatic regulatory framework around digital assets. Being the 'capital of capital', this has drawn in several key players, most notably Binance. Dubai is championing a digital economy and recognises digital assets as one of the core pillars in this strategy. The Virtual Assets Regulatory Authority has been established to drive the establishment and activity in the open world's first free zone for digital and virtual asset companies.

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Michael heads the Financial Services and Technology practice in the Middle East. He is passionate about succession planning and aligning talent and culture with corporate/organisation strategy and innovation. Michael helps clients address their corporate and digital transformation and ESG goals. He also works with early-stage SWF/VC backed companies to recruit and structure their organisation to deliver on strategy.

Michael joined Odgers Berndtson after serving as the Head of Talent Acquisition Operations in Public Investment Fund, the sovereign wealth fund of Saudi Arabia with AUM of $620bn. Prior to PIF, Michael worked in one of the leading global organisational consulting firms for six years where he was a member of the Global Financial Services and Professional Services practices. He has lived in both Dubai and Riyadh, providing clients with a well-rounded view of the gulf region.

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Sejal leads the payments, market infrastructure and digital assets vertical at Odgers.

Prior to joining Odgers in April 2022, she worked across Financial Services for 20 years in strategy consulting, analytics, digital innovation, and business transformation. Sejal spent 12 years in management consulting, starting at McKinsey & Co as an analyst subsequently moving to FS and strategy consulting at PA Consulting working across UK, Europe, Middle East and Asia.

More recently as a Director at HSBC and then Fluidly, Sejal focused on digital innovation through establishing partnerships between Banks, FinTechs and wider digital ecosystem.

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Jessica Torres Underwood leads the Financial Services practice at Odgers Berndtson's Singapore office. She also leads the growing fintech and digital assets vertical in Singapore and Hong Kong. Jessica specialises in helping clients grow and scale their Asia operations, as well as advising them on succession planning issues and talent strategy early on. She is a strong advocate for the APAC region and its evolution across all areas of financial services.

Prior to joining Odgers Berndtson, Jessica worked at JP Morgan for nearly seven years, leading front recruitment for them in the Southeast Asia region, and delivering key strategic hires to the bank. Before that, she worked at another executive search firm for over eight years in London and Singapore, focused on the private banking, asset management and family office segment, helping firms to build and grow their wealth management operations.

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Barry's capability spans the UK and Ireland markets within the technology and IT services sectors. He specialises in software & cloud services, data analytics & AI and has a particular affinity for fintech.

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Prior to Odgers, Barry spent over 20 years operating in international markets across EMEA, APAC and the US. His early career was spent with Microsoft before leading a number of early-stage and scaling tech companies in the cloud computing and data analytics arenas.

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Earlier in his career, Richard worked at Ernst & Young in London and was then a Partner at Rockpools, a London-based search boutique, where he helped build the Technology & Professional Services Practice.

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