RESEARCH ABSTRACT

How to make sense and position on the emerging Debt Tokenization Market?

Crypto-assets have been heavily criticized in the past few years following the "crypto-debacle" that started with the demise of crypto-exchange FTX. But to say the least, the crypto-currency and digital assets landscape is fuzzy and super-fragmented across players and along the Wholesale Banking value chain, with different forms of **"new cash" aka. digital currencies** (e.g. Central Bank Digital Currencies, stable coins, deposit tokens) and **"new securities" aka. investment tokens.**

The main advantages of blockchain-based tokenization rely on a) **fractionalization** giving room to democratization, b) **blockchain based features including smart contracts** that beyond giving transparency, reduce the cost to serve (e.g. no "reconciliations" across players, lower posted collateral) and increase responsiveness (e.g. instant immutable replications).

As any security, a digital security exists across assets classes (e.g. Equities, Debt / Fixed Income, Real Assets and others) and is supposed to grow in triple digits over the 5 forthcoming years (e.g. illiquid assets from USD 0.3T to USD 10.2T).

One can observe in fact two kinds of digital security markets: a) the **"legacy players digital market"** that gathers traditional finance (TradFi) players of wholesale banking (e.g. investors and issuers, market infrastructures, CIB / Securities Servicers) on often "classic asset classes (cf. "digital bonds" growing from USD 0.5B to USD115B) and b) the **"digital native token players"** including some centralized (CeFi) or decentralized finance (DeFi) players (e.g. equity trading exchanges). These two worlds meet across the Wholesale value chain with different "use cases" and experiments:

- **Pre-trading / Primary markets** (e.g. Simplified onboarding of asset holders and traceability, Securities and Real Assets Token issuance, Fractionalization democratization offerings, NFT issuance).
- **Trading / Secondary markets** (e.g. Traditional asset type driven platforms across assets, New digital asset types trading, Funding / Liquidity arbitrage across DeFi, Automated Market Making, Trade matching work process optimization).
- **Post-Trading** (e.g. Elimination of the central counterparty clearing house (CCP), Significant reduction of settlement times and posted collateral).

Regarding the primary market, many experiments have been run by TradFi players regarding debt issuance, yet with limited size, with 2 different models:

1. Bond is tokenized but listing and bond storage on **TradFi infrastructure** (i.e. GS DAP, HSBC Orion). Example: EIB used HSBC Orion in January 2023 for USD60 m, Duration 3 years
2. Bond is listed and stored on the digital exchange (i.e. SDX, D7). Example: City of Lugano used Six **Digital Exchange** in January 2023 for USD106 m, Duration 6 years

We believe that several influencing factors remain to be looked at to identify a predictable future for this market:

- **The willingness of stakeholders to settle in digital currencies** (e.g. stable coins and deposit tokens vs. CDBCs).
- The potential **conflict of interest / threat to TradFI players** (cf. disappearance of CCPs and other revenues@risk).
- The **regulatory level playing field across regions** and restrictions on **token volumes might be restrained** (e.g. quota by issuer).
- The **technological choices such as the mix between Public and Private infrastructure** (e.g. permissioned services on top of public infrastructure emergence).

In this framework we still recommend building a two-legged strategy based on:

- **"No regret" moves** (e.g. de-risk dependance on digital currency "conundrum" with for intra-group initiatives for In-House coins, capitalize on digital asset custody experimentation as securities tokens land there).
- **Tactical moves** (onboarding current exploratory initiatives and scouting active FinTechs, Create / Onboard venture fund).

Let's get in touch to start the adventure