HL Influencers: Digital Transformation

Transcript

Behind the scenes at the Digital Assets Summit - Featuring Lawrence Wintermeyer

Sharon Lewis	Hello and welcome to another episode of The Influencers. It's a special episode today. We are here live in London for our Digital Asset Summit, where we are going to be looking at the roadmap to the mass adoption of digital assets in financial services. I'm Sharon Lewis, I co-chair our Digital Asset and Blockchain practice alongside my fellow partner John Salmon. I'm also here with Lawrence Wintermeyer co CEO of Global Digital Finance.
John Salmon	Thanks Sharon, as you mentioned the topic of the Digital Asset Summit is institutional adoption by financial services of digital asset technology and it is very exciting. We've got an amazing line up of speakers right across buy side, sell side and some of the infrastructure players and importantly the regulators and policy makers that can hopefully make this all happen. Lawrence, what are you most looking forward to in today's global Digital Assets Summit?
Lawrence Wintermeyer	Well, it's always great to bring together the community and we've been working at this for seven years. We've had five Summits - I've been trying to do the math. I think we must have had to leave one out over Covid, because we should be at a run rate of somewhere around six, and then of course we've all worked together in the fintech ecosystem with Innovate Finance back a decade. The importance of that is that really we've been working with fintechs and institutions for near a decade focused on this topic of adoption and it has moved pretty slow. Well, why has it? There's been confusion about what digital assets are, from native cryptographic assets to tokenizing real world assets; there's been quite a bit of regulatory friction; clearly payment rails are sorting themselves out, digital custodians, which you and I coined the Gordian knot of digital assets back in 2017. Those solutions are coming through, so I think what we're seeing as we go into this year's conference is all of the building blocks from the supply chain end space. And then, of course, we've got the great success on the buy side of things like the Bitcoin ETP and the BlackRock case study of the fastest growing ETF in history really making a case for digital assets. So I'm really looking forward to hearing what all of our fintech

	and institutional partners have to say about what they're focused on in 2025. GDF responds to its members from survey-based content in their priorities, and so we are at the time of the year where we're trying to get a handle on what the agenda looks like going into 2025. I think with macro-economic uncertainty, you know, its not entirely clear where those big mass adoption drivers are going to be. Hopefully we'll get some more context on that today.
John Salmon	Yes, and I think the regulatory and policy making environment that you mentioned earlier on is looking more positive. You know, we've got MiCA coming in force next year, we've got the UK Regulatory Regime coming in place, you know, and some exciting developments like the Digital Securities Sandbox. I think you also did a survey, didn't you Lawrence, on institutional adoption and what members were saying. What were the key takeaways from that?
Lawrence Wintermeyer	Well on the back of the BCG ADDX Survey EY Parthenon data kicking around the community and in particular Larry Fink talking about tokenization of real world assets being a sixteen trillion opportunity by 2030. We independently surveyed a hundred, you know, particularly asset managers, both buy side and sell side, and folks on the supply chain. And that was conducted earlier in the year and overwhelmingly four out of five are scaling up their own innovation teams and infrastructure teams for digital assets. Almost 100% of them claim to be engaged in the digital eco assets system to some extent with, I think, 97 or 98% of them claiming to handle Bitcoin in some capacity, which really surprised us. And then maybe not as surprising, in terms of the tokenization of real world assets, debt seems to be the first taxi off the rank most folks are voting for. And so I tie that in, Sharon, to discussions we've had and then again looking at the work you've done on fixed income and bonds, and the tokenization of the fixed income community which we know is probably moving fast, probably the fastest moving asset class on the sell side. We don't see as many regulatory barriers in that space, but there are some nuances, I think in major jurisdictions, that you've pointed out on the work that you've done.
Sharon Lewis	Yes, and I'm really excited this afternoon to be chairing the session looking at the comparisons between different jurisdictions, it's quite exciting. And it is amazing to see how things are progressing in these different jurisdictions. In Europe for example, Germany has made a very big step with the issue by KfW of its bonds. You need that leading institution to step forward and create that path. And the interesting thing for me, however, is that a lot of this is happening outside the regulatory markers. So, outside MiCA, outside using the traditional

	regulatory space to advance, because quite frankly one can't wait for regulation.
John Salmon	Yes, and I think that is the challenge that in adoption, I think the biggest challenge that the banks still find is that regulatory uncertainty, and I think they would rather stick with what we currently have, right, and keep it very safe. And I think to see the real innovation coming through, I think we could do with more support from some of the regulators. I'm very encouraged by the Digital Securities Sandbox and the direction of travel. And Sharon, you and I have had some great dinners with some of the banks and others looking at the opportunities there are. But, you know, we're waiting to hear from the Bank of England on the direction of travel but, you know, it's by no means certain that that's going to be what the institutions want, because they want the ability to go in and go in quite big and the current proposed limits may stop that, right?
Sharon Lewis	Yes, and there is lack of scalability within these sandboxes. So I think that this is something that will have to develop over a relatively quick period of time.
Lawrence Wintermeyer	There are a number of good points here. If you focus on the US market, and look at the proposed SEC staff accounting bulletin (SAB) No. 121, most institutions would say well, boy, its not a very level playing field when unregulated firms in the digital assets space can do what they want, but we're going to be punitively charged with a blockchain tax for holding these assets on our balance sheets. I think that's an important part of what's emerging in 2025 on this regulatory narrative. From my personal perspective in speaking to institutions and coming back down to securities, and then again as a securities and securities derivative guy, most of the players I know say, look, securities are regulated, we know securities so we're happy to develop infrastructure. Where there's a gap or a rub or a conflict is that securities from brokers to settlement don't happen "atomic-ly" in real time. And you know, you don't need blockchain or digital assets to do that, technology can do that, but it's that intersection of how this new enabling technology can, you know, compress time, get cost down, improve liquidity, and improve collateralization, but it's still stuck in a regulatory framework that was developed when we had, you know, carrier pigeons and wires so that really needs to be sorted. So I think folks, Sharon's point about the restrictions on sandbox, particularly around securities, is an important one, but hopefully we are at a point where with the UK Digital Securities Sandbox it will react to constraints in a productive way, particularly where we need to see legislation change as a result of significant barriers that are preventing

	assets to work correctly in this new environment. So I think that's pretty encouraging.
John Salmon	Yes I think that's a good point, Lawrence, and I think we are all pretty optimistic and positive on where we are. I think the institutions are very keen to adopt this technology, they see it saving costs and being better for customers. I think there are lots of good points and I think from a policy maker, regulatory side, I think they're beginning to understand that this is not crypto criminals that are operating outside the system and there are really important use cases for this. So it feels like everything is going in the right direction. It's just a question of timing and making sure that we can best move this forward together.
Sharon Lewis	You mentioned, Lawrence, the fintech space. Now ten years ago when we talked about fintech people rolled their eyes and thought, well you know, what is this to do with me? And yet today fintech in the retail banking space has become very much business as usual. There are still fintechs bringing new products, but globally the banks themselves have become fintechs, and we all bank online. And all that happened really quickly without people really thinking about it, largely driven by Covid. I truly believe that fintech is going to go into the wholesale banking space. And there is no better illustration of where that will happen in the digital asset space particularly bonds, securities, derivatives and the tokenization of real world assets.

Lawrence Wintermeyer	You raised so many great points there, Sharon, that I think are at the heart of what will help further scale digital assets into 2025. And so, ten years ago, when I was chairing the industry sandbox consultation at Innovative Finance for the FCA, and Hogan Lovells were on the Steering Committee, most of the financial institutions didn't want to participate with fintech. There was a real issue in the ecosystem getting them to work, and I kind of likened the relationship with fintechs and banks to that of carriers, national air carriers, and low cost airlines. Ten or fifteen years on, all of the national carriers use all of the same tools that the low cost airlines do. I mean, the experience has been transformed by lower cost airlines, but the national carriers are still there. It's not as if they've gone out of business, they've adapted and they've almost become low cost airlines themselves. Other than inflation and fuel costs that we've seen post Covid, and so I think that your point is absolutely right, as long as that innovation continues and we've seen certainly the growth in cap markets-fintechs in the past five years. The biggest issue with innovation is that with inflation and no free money, fintech investment is down and innovation theater is struggling a bit, so I think from a macro prospective most of us, certainly in the West, are hoping that we can get interest rates down and certainly get back to a more reasonable level of funding innovation, a lot of which is destructive capital. And so, you know, we used to think, boy, it take ten years to develop an eco-system. Well, we're fifteen, sixteen years into DLT thanks to bitcoin. It probably takes closer to thirty to really transform the plumbing of the infrastructure and then the benefits that do flow through to consumers and society are ultimately great and they've not borne the cost of all that disruptive capital, that happens in the eco system and you know, consumers hopefully just get the benefits of that sort of stuff. But long may that sort of disruptive innovation continue to drive adoption.
Sharon Lewis	Yes, and I think in addition to inflation, interest rates, and the like, I do think that there has been this other sexy little thing that has come along in the form of Gen AI. And that has also made people think about where they're putting their money other than investment. And that's diluted a little bit the focus, but I don't think that even though that has happened that it changes ultimately what needs to happen in the Financial Services area in relation to digital assets. Not just Gen AI which will take out these costs.
John Salmon	Yes. It will be very interesting to hear what the Bank of International Settlements (the BIS) are talking about with the Finternet.. You know we have a great keynote from Francesca today and it will be very interesting to hear from some of the regulators and policy makers on

	how they see this moving through as well. I think there is a lot to look forward to today, right guys?
Lawrence Wintermeyer	Well indeed and just to pick up that point on Gen AI, that's an important one. And again too, there are too many interesting things to speak about, sort of try and keep it really pithy, it's not a fintech space. You really need to have deep pockets in that Gen AI large language model space, but for most folks that have been involved in machine learning right through to AI and heuristics, regulated financial services and we were talking about the compliance challenges earlier in the digital asset space. Regulated financial services I liken more to like a sigma control environment, you know, its pretty difficult to get things into production for clients without having gone through a lot of production testing product committees etc. And so, you know the whole idea of large language models is not suited for highly regulated environments when just smaller language models and, you know, I think the domains that folks like us in reg FS are comfortable in dealing with. So there is a bit of a storm in a teacup, we're certainly impressed by some of the language characteristics and I think certainly law firms have a lot to learn from LLMs and what's going on in that space. I think most of the institutions that I hear speaking about things are reasonably tempered. The interesting thing about Gen AI is how it transforms either consumers or investors in the access of the choice of the data that they're looking at before they even go to providers, so I think that's something that you know, bigger asset managers and investment managers are focused on.
John Salmon	I think that's a great point, Lawrence, and I think the financial institutions on the one hand are very keen, because they see this as another digital infrastructure that saves costs and creates better products, but at the same time very concerned about governance and risk, to have inherent bias and discrimination built into the system. And it's, you know, you have to be really careful on this, right, and as you say there are a lot of committees to go through etc etc, I think its again encouraging technology, but lots to think about.
Sharon Lewis	But then again they'll come back to retail banking space, they were worried about all those things in relation to adopting fintech and yet we all now bank online. Who has a cheque book? And that has happened is such a short space of time.

John Salmon	If you think back to the days when the internet first came on board, I remember speaking to banks and they said well this internet stuff is great, really good but we're never going to transmit money, right we're never going do payments via the internet. So there's a lot of "we will never do", right? But guess what we figured a way out. As you see, Sharon, its figuring out a way to do this without risk, and actually getting the best of it.
Sharon Lewis	I actually did the first green bond, probably more than 20 years ago and then, nobody thought that was very interesting, you know, who's going to do that? And actually again, today, it's business as usual.
Lawrence Wintermeyer	Oh well, it does argue for handing off all of these competencies to your children because there is only so much you can do in one inning in your career, over twenty or thirty years, you think gosh we've not really moved the dial as much as we thought we would, we need to hand off to the next generation. But John, I'd like to pick up on this point that you make about you know, payments, because for me a very big part of mass adoption in fintech started in remittances.
John Salmon	Yes
Lawrence Wintermeyer	And I loved it because it was almost a highjacked play on institutions in that you signed up online with a remittance firm but you needed to have a bank account so your KYC was done and they were actually using the benefit of a fixed cost infrastructure to take a spread quite often of the currency exchange you get it to the destination, but there was no infrastructural change it was an innovation play on top of the current banking rails. And to your point, Sharon, now all of these years later banks aren't charging you £40 or you know, eight or nine percent for a foreign transfer so you can see the impact of those things. But I think it was when Clear Bank launched here in the UK and we started to see the greater introduction of DLT that we started to see the infrastructural change. And so I only note that in, you know, the three of us do work now in Westminster with the all party Parliamentary Group for Digital Finance and the message that keeps coming back is you need to make this more compelling. And we keep saying gosh, changing the plumbing is pretty unexciting. And then you know, John, the discussions we have it's a bit more like the Japanese kaizen of hundreds of performance improvements or it's business as usual now, there isn't a big lightning bolt and a big change that's going to move society when you're replumbing the infrastructure. So I think that's the thing that we really

	had to learn to become a bit patient with, you know because again I get back to the stuff you and I have been doing on Codes of Conduct for seven years. It just takes quite a bit of time to get people used to these.
John Salmon	But one of my biggest, earliest fintech projects was a plumbing project which you and I talked about before, which was for a wealth management industry in the UK. At the time if you had an independent financial advisor, you wanted to know how much your pension was worth, you'd phone your IFA, your IFA would then have to phone a call center at, you know, Aviva or whoever and they would have to fax it or telex the number. And guess what, right, a lot of the time they got it wrong or they couldn't find your account or whatever. So what we did was create a legal framework to ensure that data could be sent between IFA's and product providers in a secure way where the liability was very clear if someone messed up, right. And that seems totally obvious now, right, we can go into a portal and get that, but that infrastructure, that legal infrastructure and tech infrastructure is still the same as it was 25 years ago it was all XML messaging, it was all very straightforward, but actually until you did that, right, everyone was saying, because at the time it was done with third party web portals as well, at the time people were like, how are we going to do this, right?
Sharon Lewis	Yes, and I think the European Commission has published its report on the capital markets and one of the focuses has been on securitization.
Lawrence Wintermeyer	Yes
Sharon Lewis	Well, twenty years in the weeds, securitization very much has been limited to those well known originators, well known products, and many have left the securitization market and many have never adopted it. And quite frankly it will be very expensive to do securitization for new entrance without mass adoption of technology, and blockchain to me, particularly for the tracking of receivables and the like, is one of the keys to unlocking the securitization market.
Lawrence Wintermeyer	Absolutely
Sharon Lewis	I think its also one of the keys to scaling ESG. Again, lots of different rules, lots of different regulations, different jurisdictions, but ultimately what it means is a huge burden of reporting transparency and the like. And I think these type of things will drive, have to drive, this market.
Lawrence Wintermeyer	You raise such a good point, and it is the benefit of, you know, network technology, distributed ledger and web3 and most of the things that this community here are focused on. Franklin Templeton's numbers, particularly around blockchain and mutual funds, and I can't remember them actually because the numbers and the cost savings are so big,

	you know, the cost of a very large number of transactions launching is the equivalent to the cost of one transaction now in the de-materialized world where we still have Post-It notes and spreadsheets and XML or that sort of interface you've described, John. And that's quantum and that's just the cost-perspective of something that is actually a reasonable low cost asset class or product anyway. But I think these are the important things that, you know, it's the plumbers in the community that get excited about this, because in particular, capital efficiency, whether its your balance sheet, whether its liquidity or whether its collateralization. You know, for governments and larger institutions focused on creating capital and generating wealth for society, which is certainly a big government agenda here now in the UK, with a new government, it's through that plumbing and through that enablement that you've just spoken about Sharon, that will make that happen and unlocking those smaller franchises and making it safe for larger pools of capital issuers to securitize what they're doing. So it bores a lot of folks at a cocktail party when the three of us are standing there and
Sharon Lewis	Ideally [laughs]
Lawrence Wintermeyer Lawrence Wintermeyer	Don't go speak to those three, they're talking about securitization or blockchain again, it's so boring. But it's actually important and it is, you know, again interesting, to hear today how that's moving along from all the folks that you mentioned who are speaking earlier today, John.
Sharon Lewis	70 percent of ESG reporting is done on Excel. Which is remarkable, there must be something better than Excel.
John Salmon	As Lawrence said, a lot of these big financial services organizations and with their products are very expensive. And there's probably a lot of Excel and a lot of other pretty clunky technology that doesn't always necessarily fit together. Anyway Lawrence, thank you very much once again for helping us with this podcast, and importantly, hosting the excellent Digital Asset Summit. We're all very much looking forward to it.