

Digital Asset Forum | Briefing Note

Assessing Risk to Determine the Business Model

February 2023

The Digital Asset Forum is a senior-level global network of financial institutions that meets periodically to discuss developments in digital assets and perspectives on enterprise-level implications for technology, business, and strategy. The IIF convenes the Digital Asset Forum with our knowledge partner, the Oliver Wyman Forum. This briefing note summarizes the discussion held on February 1, 2023, respecting that the forum is conducted under the Chatham House Rule and does not represent the official position of the IIF or its membership.

Firms' views still vary on what 2022 means for the future of digital assets.

While all continue to see positive opportunities for their firms in digital assets, there is lack of agreement on what those opportunities are. Broadly speaking, market sentiment on speculative types of activity was viewed as negative. Firms will look to define and clarify their business models for digital assets in 2023, which will determine their investments in coming months. Integrating the technology successfully will depend on the business model it will support, which has yet to solidify for the industry. Perceived takeaways from 2022 volatility and failures vary and legislation remains uncertain. Strong regulatory sentiment against DeFi seems short-sighted and requires nuance as firms believe institutional DeFi has value.

The type of risks that a firm seeks to manage, which may vary from firm to firm, will determine its digital asset business model.

Risk management is at the core of regulated financial institutions' services. Managing risk for digital asset services appropriately requires a clear view on the sources of risk in digital assets. Disagreement exists on whether poor business practices and human failings are entirely to blame for 2022 turbulence, or to what extent certain digital assets may be inherently risky. If so, in what respect and relative to which asset? Risks frequently entail a combination of factors. How firms view the structure of the combination of these risks will determine how business models themselves are structured to capture the value of investments in digital asset opportunities. Participants are still evaluating the source and magnitude of the risks.

Fundamental questions about the value of DLT in relation to the assets themselves add to the challenge of integrating the technology into existing services.

Advancing tokenization efforts are being slowed by consideration of the appropriate technological underpinning, as some explore whether the value of blockchains can be separated from the assets traded on them. Settlement and clearing delays, despite improvements, still present a problem for many institutions, though they continue to make progress with integration. Greater transparency eases reporting burdens and strengthens trust. However, some are not convinced blockchains are value additive in excess of other technological approaches without the asset layer being present.

The regulatory perimeter around digital assets will continue to be built in 2023, perhaps with more nuance.

2022 made clear the case for extending the regulatory perimeter. Conversations with regulators and policymakers are increasingly nuanced. Regulators seem eager to define different perimeters for different activities, but may need to further define the functions of different digital assets as treatment varies across jurisdictions. Within this context, regulated institutions have an opportunity to demonstrate the ability to appropriately manage risks related to client funds while incorporating digital assets into their service offerings.