

PODCAST SERIES

Episode 3: Migration to Digital Assets Accelerates

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Anders Reinertsen

Hi, I'm Anders Reinertsen, and I lead the Asset Owner business in the Americas at BNY Mellon.

BNY Mellon Rapid Insights is a series of short podcasts aimed at providing exclusive industry views and perspectives on the most pressing topics impacting asset owners to help you turn insights into opportunity and prepare for the future.

Today, I'm joined by Caroline Butler, CEO of Custody Services at BNY Mellon, and we'll be discussing how we're reimagining financial markets through digital assets and Blockchain technology, and what we aim to deliver with our Digital Asset Platform and custody services.

Welcome, Caroline.

Caroline Butler

Thanks, Anders. Glad to be here.

Anders Reinertsen

First and foremost, congratulations on the recent launch of the Digital Asset Platform. How exciting!

Caroline Butler

I know, it's quite thrilling actually. It's nice, we're used to innovating and we're used to providing trusted services, but it's really nice to be at the cutting edge of what I think is going to be a real revolution in our financial services system.

Anders Reinertsen

Exciting times indeed. I think it's phenomenal for a bank of our age to be innovating at the pace at which we are. Can you share a bit more about the launch of our digital asset custody offering, and the vision, and what it took to get here? And more specifically, what asset owners, including endowments, could expect to see in the future?

Caroline Butler

Sure. So, what we've actually built is a digital asset platform to serve a wide variety of evolving digital assets from crypto right through tokenized assets, and across the full capability of services that are pertaining to the lifecycle of that investment.

The first capability we've gone live with is custody. It is very specifically digital custody for Bitcoin and Ether for select U.S. institutional clients. And effectively, what custody means in this context is safekeeping of the private keys, which really enables the ability to control the assets, and then managing the transactions which are enabled by signing those keys.

When you think about digital assets in this space, it's probably worth taking a step back and defining that. Because Anders, I do find depending on where a client is coming from, whether they'll think digital assets are synonymous with cryptocurrencies only, or whether it is wider in the sense of tokenized assets. And this is very important for us because, again, our platform – albeit that the first capability is digital custody for crypto assets – the foundation of how we've built it is... it's set up to be able to service across all different assets.

So, the way I define digital assets in very simple terms is three categories. One is cryptocurrencies, so think Bitcoin and Ether as two big examples in that bucket. Tokenized native assets which, again, would be, for example, if you were to issue a bond natively on the Blockchain and/or, for example, stablecoins, NFTs would fall into that category. And the third category, which I think is a very interesting category is where we start to see tokenized traditional assets. So, again, take a traditional bond and the ability to digitally represent that bond on a DLT (distributed ledger technology).

And I think when we divide it up into those three capabilities and three different types of sub-assets, I think it becomes really interesting, albeit the cryptocurrency space is probably the more matured and where we see the most demand. And we've just recently conducted an institutional survey where we actually learned through that survey – and it was close on 300 global institutions – almost 41% of those institutions already have investments in cryptocurrency. So, you can see, from our perspective, the demand was already there for crypto. So, you're seeing a little more maturity in that market, but you're seeing a lot of different projects starting to pop up in the tokenized space.

And I think that's where, personally, I see this asset class become a lot more interesting as it starts to mature over the next coming years. It's anyone's guess how much of the traditional space will be tokenized, but I think it's safe to say we're starting to see that journey take off in earnest now. And I think that becomes quite exciting.

Just one key feature for us, though, on our platform. In addition to ensuring the platform can service across the different assets, it's also very important for us and for our clients, particularly for asset owners to have that platform, our new Digital Asset Platform interoperable with the traditional space. Very, very important for our clients because, obviously, first and foremost, they're coming to us as a regulated and trusted provider to protect their assets and apply the same standards that we apply to traditional assets to this new and more unique asset type. But they also need us to do that across the diversity of their asset portfolio.

So, particular asset owners are going to allocate a percent of their investment portfolio to digital assets. So, they need a provider like ourselves to provide a consistent experience across the different asset types, ensuring that things like regulatory reporting, compliance reporting, tax reporting can be done with one provider, and doesn't have to be bifurcated, effectively putting that operational burden on the client. So, our goal is to continue to take operational burden off our clients, and providing that consistent client experience was very important.

Definitely a harder build, Anders, to do it that way. Building the bridge across the traditional and the digital platforms was the hardest and most complex part of what we've done in the last year, but we felt it was very important for our clients to be able to offer that service and that experience.

Anders Reinertsen

And Caroline, I would agree. I've talked to many clients recently about digital assets, and I think that changing investment priorities and the introduction and the valuation of digital assets, and the impact on the operating model is absolutely part of the consideration. So, being able to bridge the traditional and digital assets is important. And I think there's a lot of value in that.

So, also in those conversations with asset owners, I see different stages of their journey around digital assets. Some are still analyzing the opportunities and educating stakeholders. Some are adopting and integrating digital assets into their investment strategies.

What do you see as some of their top challenges and needs when it comes to digital assets? And secondly, when considering service providers to support their digital asset strategy, what are some of their main considerations?

Caroline Butler

So, again, I go back to trust first and foremost. The most important thing that we're hearing from clients of all types, and particularly asset owners, is the ability to have a trusted provider who is regulated and whom they know will apply the highest-grade standards to this asset. The asset itself does have some unique risk, particularly around increased cyber risk in the space, collusion. The most important thing to remember is that, unlike a traditional asset, if you lose, in this case, the private keys for a crypto asset, you effectively lose the asset. And it's very, very difficult. There are some cases where you can get the asset back, but it's very, very difficult to get the asset back if you lose the private keys. So, that's a heightened risk to what you would see in the traditional space. So, it's even more important to have the right level of standards to protect the private keys.

For us, very importantly, for custody as a capability in particular, we protect and control all the private keys behind BNY Mellon firewalls. We do not outsource that to a third party. And we feel like this is a very important safety and security feature of our offering.

Again, those private keys are what give you control of the asset and enable you to actually transfer and sign that asset. And it is really, really important to make sure that those are very well protected. So, we do all of that behind BNY Mellon firewalls.

We do leverage technology partners and FinTechs across the ecosystem for various different specialties, for example, wallet infrastructure. But again, it's fully integrated into BNY Mellon as a software provider versus as a custodian. And we feel like that's an important safety feature.

The other thing, particularly for asset owners, a lot of the asset owners that we're talking to – particularly, for example, in the non-profit space, so such as universities – we're hearing more and more that they need a provider who can receive their digital asset donations and quickly sell them in the market. So, this starts to speak to a different type of capability. It's very highly correlated to custody, but it's really around the execution capabilities. So, we're actually building those capabilities at the moment, and that's how we hope to evolve the platform that we've built is to start to add on ancillary offerings on top of our foundation of custody. Not too dissimilar, by the way, to how we look at the traditional asset space where we provide a holistic set of capabilities across the investment lifecycle. We'll do the same for digital assets, pending demand and pending the regulatory approvals

across the various jurisdictions and the various capability types. So, we feel like that's very important for clients as well.

And then finally, I would say it really is around education. A lot of our asset owner clients do rely on the expertise of our team to be able to educate them on the nuances of the different types of assets, but also the different types of technology and underpinning platforms for those assets. We're very, very fortunate at BNY Mellon to have a very diverse team. We've invested a lot into building what we believe to be an industry-best team. We've hired a number of people from digital-native firms. We obviously have a lot of deep expertise on the traditional finance side. And we've really worked hard over the past year to two years of fusing that different diversity of talent together, really cross-training the team and cross-educating the team. And I think that's really starting to show the fruits of our labor in how we are able to consult our clients, and really co-create with our clients as we continue to see more and more advanced solutions in this space.

And that's what really excites us is partnering with the various different clients out there. Making sure that we understand their needs deeply, and that we have the right expert team to work with them to co-create solutions that gives the best outcome for our clients.

So, we're very excited about that, Anders. I think we're going to see more and more different projects start to come to bear in the next, call it, year to five years if you were to take an over/under on it, particularly in the tokenized space. I think there's a lot more operational efficiencies that we could start to apply to the ecosystem for our clients as we look to tokenize traditional assets in particular.

Anders Reinertsen

I guess, Caroline, if you can maybe expand on that a bit further. How do you think tokenization will revolutionize asset management, and maybe some additional areas in which you think this space will evolve?

Caroline Butler

So, I'm going to go back to the institutional survey that we did. I was actually quite surprised with this stat. So, 97% of the institutions that we surveyed agree that tokenization will revolutionize asset management and will be good for the industry.

So, I think that's quite an endorsement for this new technology that can – it's obvious that institutions are really starting to see the benefits that can be applied to, again, ensure that assets can move more freely, that there can be more transparency, and we can see a lot more operational efficiencies come into the ecosystem.

From my perspective, the friction that happens in the traditional space today when we're transferring assets, particularly securities versus cash, it is quite laborious, and there's a lot of risk across that lifecycle. So, I think being able to tokenize assets will really, hopefully, start to de-risk, particularly, the settlement risk that clients have today across the different markets. It will start to, hopefully, decrease that.

And we're seeing that happen more and more with the different projects that are coming to bear in the market, whether it's across the bond space in particular. A number of different players across the ecosystem are looking at either issuing bonds natively and/or settling bonds in digital form. So, I think the most important thing there is how do we introduce tokenization into traditional assets, and not create too much bifurcation of the platforms, and actually create too much extra risk on clients where we don't have interoperability.

So, even if you take a digitalized bond as an example. Being able to introduce that in a very measured and disciplined way where you're still able to rely on the traditional rails for settlements to reduce that operational burden of having, what could be perceived, as a new asset type coming into the market, I think, will also be really important. And I think that will be the trick to solve over the next year, couple years as we start to look at increased tokenization of traditional assets, in particular, how do you introduce them in a way where, again, you can be very measured in bridging the traditional and digital spaces together, and not creating a whole separate world and a whole separate infrastructure that creates operational burden.

Anders Reinertsen

That's a really forward-thinking view on some of the art-of-the-possible and the opportunities that exist within tokenization. And it's exciting. So, as we think about and continue our journey on innovation as a firm, what can asset owners expect to see next? And more importantly, how can they get involved?

Caroline Butler

Yes, look, I think there's a lot of – again, we're at the start of our journey here. So, for me, I'm hoping that we're going to start to see a lot more regulatory certainty. There's a lot of hope in the market that we will. We're having very positive and proactive conversations with our regulators across the globe. So, I'm hoping that we start to see a maturing of the regulations in this space, which will be really important to provide the safety guardrails consistently across the ecosystem, to protect investors and protect clients. I think that's going to be really, really important. And it will inevitably allow the right playing field for innovation across the digital players, and the banks as well. I think that's going to be very important to mature this asset class in a very safe and measured way.

I think the second thing for us, in particular, is we build – our philosophy for how we design and build products is working directly with our clients to solve their needs first and foremost and doing so through a risk management framework. That's how we design our products, it's how we deploy our products.

So, very important for us is to continue the deep and rich dialogue that we have with our asset owner clients to ensure that we are solving their needs. We will continue to increase the capabilities on our platform based on the needs of clients. So, again, for example, looking at execution capabilities on the foundation of our custody.

We'll also look at increasing the jurisdictions that we offer our service through, based on demand, but also based on regulatory approvals, which will be very important. We're very, very excited about taking the technology, in particular, and seeing how distributed ledger technology can apply to the traditional space.

If you think about areas that are very, very operationally intensive, and often quite manual in nature. So, loans could be a good example there, corporate actions – how do you apply distributed ledger technology to enable more efficiencies in that space, and is it the right technology solution.

So, I think looking at problem areas that we have in the traditional space and seeing if DLTs are the right answer to solve for those problems, I think, is also another really interesting area. Which again, the ecosystem has started to look at this, but I think we'll see some maturing of the application of the technologies in the coming years.

Anders Reinertsen

Well, Caroline, these are indeed exciting times for our firm as we build the next generation of solutions for our clients, and develop the financial infrastructure of the future, and this Digital Asset Platform is at the heart of that.

So, thank you for sharing your insights, Caroline.

Caroline Butler

Appreciate it. Thank you for having me.

Anders Reinertsen

Thank you all for joining. I hope you enjoyed the conversation. Until next time.

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