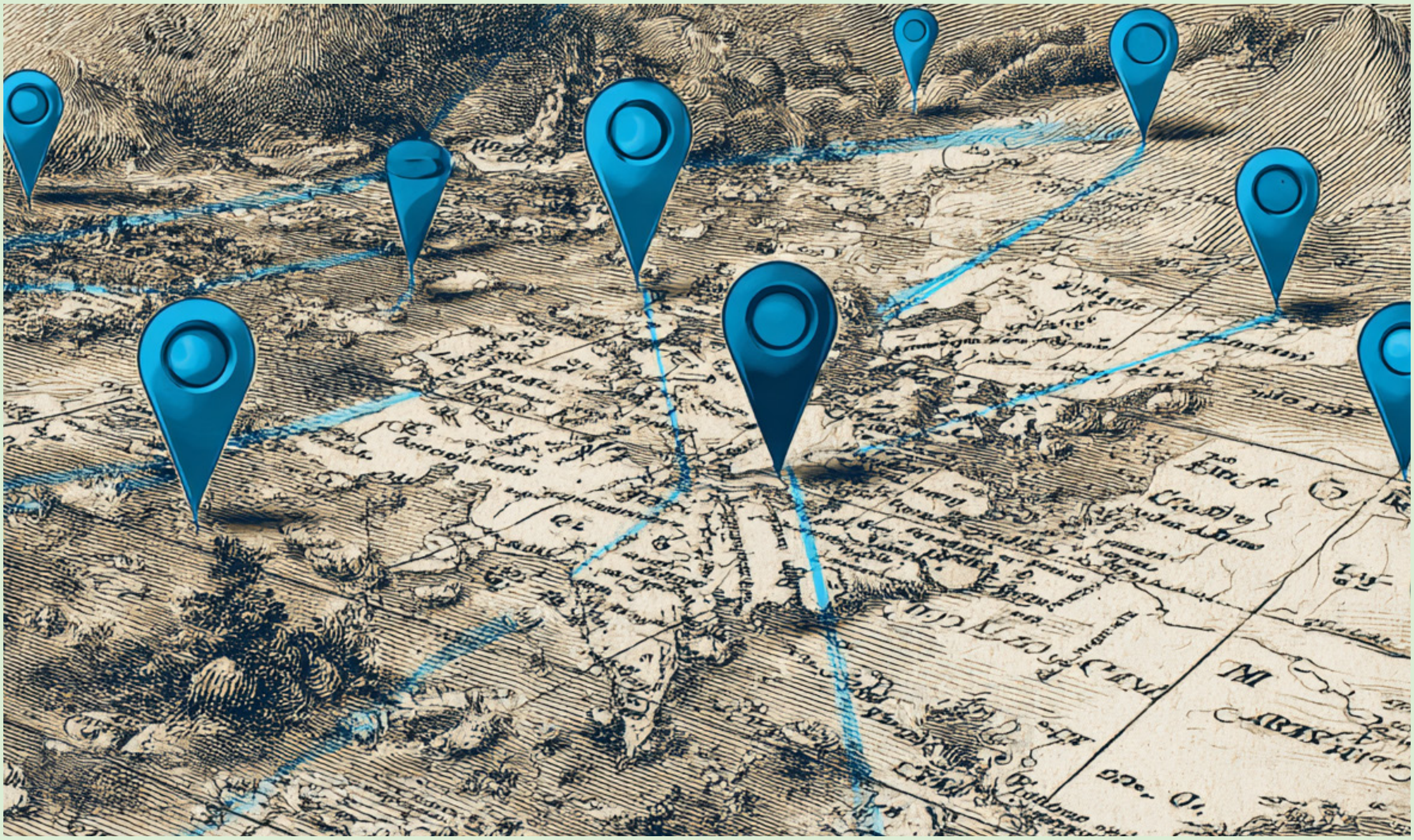
Digital Assets: The New Frontier for Asset Managers



Future of Finance

BX Digital

On 14 May 2025 BX Digital hosted a roundtable discussion that explored Digital Assets: The New Frontier for Asset Managers. On that frontier, the asset management industry is encountering a new opportunity: digital assets. The tokenisation of securities and funds on blockchain-based networks has the potential to solve the major challenge the industry currently confronts: revenue and profits under downward pressure as investor behaviour changes and technological and compliance costs increase. Digital assets can reduce costs, widen distribution and restore growth in the asset management industry. Yet few asset managers have embraced tokenisation enthusiastically as yet. Even those that have issued tokenised funds have preferred a conservative approach in which tokenised funds are not “native” but merely twins of traditional funds and so minimise disturbance of the status quo. Many reasons are advanced for the caution. They include an absence of early returns, regulatory uncertainty and lack of resources to finance an expensive transition to an entirely new system, especially while maintaining legacy systems alongside it. But there is also evidence of managerial inertia and a bias to investments which retain existing clients and revenues instead of seizing the opportunity to build an eco-system that can be scaled. A consequence is that responsibility for effecting change in the asset management industry must be assumed by others, including digital asset exchanges.

The roundtable discussion explored the incentives and constraints that asset managers face, and what exchanges can do to encourage progress in building a prosperous future for the asset management industry. Moderated by Future of Finance Co-Founder Dominic Hobson, it was attended by Rana Bhugoowan, Head of Global Supplier Services and Strategic Partnerships at Northern Trust; Shruti Deb, Policy Adviser, Technology and Innovation, at the Investment Association; Hansjorg Hettich, Executive Director and Board Member at Multichain Asset Managers Association; Justin King, a Quantitative Portfolio Manager at SCRYPT Digital Investments; Laurent Kssis, Managing Director at Issuance Swiss; Dr Ian Hunt, an independent fund adviser; John Wallis, Managing Director and Global Head of Market Opportunities at BBH Innovation and New Ventures; Stephen Whyman, European Head of Commercialisation for Digital Assets and Finance; and Claudio Tognella, Director of Sales and Business Development at BX Digital.

This is a Summary written by Future of Finance which is fully responsible for the content. This summary reflects a range of opinions provided during the roundtable.

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Executive Summary

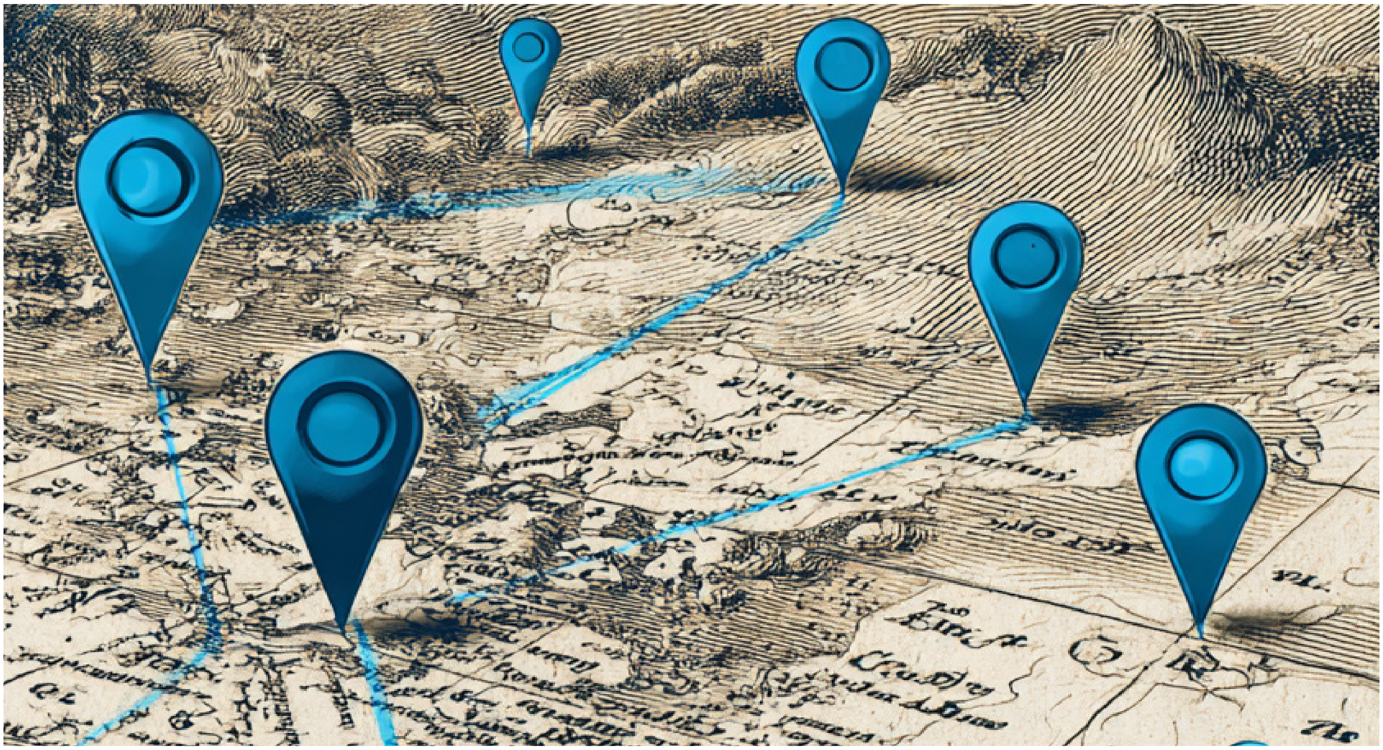
The opportunities tokenisation presents

- Tokenisation has the potential to cut distribution and servicing costs in asset management dramatically and enhance public trust in the industry by making more economical products available for purchase.
- Some asset managers are tokenising money market funds as a means of gathering assets from investors and traders active in the cryptocurrency markets.
- Stablecoins offer asset managers the opportunity to trade cryptocurrencies, recruit younger savers, cut transaction costs and track investor behaviour.
- In attracting younger savers, tokenised products will compete more effectively with technology stocks and cryptocurrencies.
- The tokenisation of services that cut the costs of holding cash on low-yield deposit, sourcing or upgrading collateral and obtaining credit for banks will have positive effects for asset managers, by reducing the cost of securities financing and increasing revenue from securities lending.
- Falling technology costs, pressure from distributors for tokenised products to sell, and the need for scale are already changing attitudes at progressive asset management firms.
- Steps progressive managers can take towards a tokenised future now include buying tokenised commodities or transition and precious metals, accepting tiny subscriptions from retail investors instead of focusing solely on institutional business and personalising investment portfolios.
- Tokenisation enables managers to replace their current product (risk-adjusted market returns) with guaranteed investment outcomes tailored to individual needs.
- "Native" tokens issued on to open platforms to common design standards can solve the systemic revenue, cost and profitability problems asset managers face.
- Exchanges can help asset managers by providing platforms on which asset managers can trade less liquid assets, by recruiting market-makers to supply liquidity and by providing clearing and derivatives services.

The challenges tokenisation can address

- Asset managers face perverse incentives: to gather assets, keep clients captive and monopolise any value created by tokenisation, when they should build a wider tokenisation eco-system to scale the token markets.
- By adding scale, tokenisation can counteract the zero-sum thinking that persuades asset managers to resist common platforms because they fear competition for assets to manage will intensify.
- Contributing to an eco-system will release asset managers from capture by third-party asset-servicing and data management platforms, which are not comparable with common token issuance and trading platforms.
- A collective approach to tokenisation will also release asset managers from internal inertia, perverse management incentives to minimise risk, lack of budget, limited experimental success and over-reliance on service providers.
- The asset management industry faces a dilemma it must overcome: it is eager to grow but hard to invest when legacy business is suffering from falling fee income and rising compliance and technology costs, which are squeezing profitability.

- Efforts to restore profitability by cutting costs through outsourcing and lifting revenue by geographic and asset class expansion are no longer sufficient and may even go into reverse.
- Doing nothing is a strategic choice, which asset managers may regret if technology-enabled competitors already active in cryptocurrency markets maintain their current momentum or entirely new digital asset competitors emerge.
- The asset management industry needs to move beyond its current enthusiasm for tokenising money market funds only because they are not traded on-exchange, or acceptable as margin, and in non-native form do not cut costs.
- Citing regulatory uncertainty as an excuse for inaction is evasive because regulation everywhere is in a perpetual state of flux and can never be settled definitively – and regulation of digital assets is currently becoming more favourable.



Is the asset management industry in trouble?

Yes. Declining inflows of capital means assets under management (AuM) are not growing as fast as they did. This is partly a function of demographics. Ageing populations spend rather than save but, counter-intuitively, so do Generation X, Millennials and Generation Z. Lower AuM is squeezing fee income but so is rising consciousness among investors of the toll management fees exact on the performance of actively managed portfolios. The broader shift from active to passive investment strategies also results in lower fees. In addition, an industry cushioned by the rising asset prices of decades of cheap money has struggled to improve efficiency. Money is no longer cheap, and the costs of technology and compliance are rising simultaneously, so margins are being compressed. Efforts to reduce costs through operational outsourcing and offshoring have reached the limits of their effectiveness. Efforts to retrieve some of the value currently captured by fund distributors, expansion into developing markets such as India, where savings ratios are increasing, and into higher margin alternative investments, such as privately managed assets and cryptocurrencies, have not developed rapidly enough to offset the cost and revenue pressures in the core business. Besides, new asset classes require investment in new technologies, compliance regimes and operating models. These are exacerbating the cost problems of the asset management industry.

Is the asset management industry offering sufficiently attractive products?

No. Younger savers are not enticed by returns of 6-7 per cent a year. The Magnificent Seven stocks – Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla – have produced returns over the last ten years that range from 491 per cent to 19,395 per cent.[1] In the same period, the price of Bitcoin has increased, albeit with considerable volatility, at a compound annual rate of 82.2 per cent. The sustained shift by asset managers to the sale of low-cost passive investment products is also reaching a natural limit, at which price discovery decays, valuations are distorted and correlation between stocks increases, leading to market instability. The natural limit is thought to occur at 29 per cent of global AuM, and passive investments already account for 25 per cent of global AuM.

Can tokenisation help the asset management industry get out of trouble?

Yes. Tokenisation offers asset managers a systemic – as opposed to tactical - solution to their cost problems. In theory, if asset managers communicated directly with investors on a blockchain platform, they could eliminate the costs of distributors, transfer agents, fund accountants, payment banks and custodians. Investment portfolios could be personalised to meet the needs of individual investors, by making exposures available in lower minimum amounts. Post-trade asset servicing tasks such as the collection and distribution of entitlements and the re-balancing of portfolios could also be automated using smart contracts. Tokenisation would facilitate expansion into new asset classes (such as private equity and debt) and demographics (such as younger savers and emerging middle classes in developing markets) too. It would release employees to focus on innovation, client service and especially renewing trust with clients. Asset managers have forfeited the trust of investors since the financial crisis of 2007-09, mainly because of a (necessary) concentration on compliance with the post-crisis regulation of the industry. The alternative future promised by tokenisation is an asset management industry with its costs (including compliance costs) under control, its revenues boosted by wider and more profitable distribution, and its reputation secured by an ability to not only personalise investment portfolios but guarantee outcomes.

Why is the asset management industry failing to invest in tokenisation?

One reason is inertia. Asset management firms have evolved to do what they do now. The industry is still profitable. Although margins are being squeezed, asset management is not yet experiencing enough pain to want to reinvent its operating model. At all but a handful of established asset management firms, senior management has exhibited a low appetite for risk. Most senior managers are coming to the end of their careers and are heavily invested in the continuity of their firms via stock options and retirement packages. They do not wish to take the risk of reinventing the firm. Indeed, most senior managers continue to believe that they can solve their problems by more energetic asset gathering, even though the value of the additional AuM needed to offset the downward pressure on fees is beyond the reach of any realistic growth scenario. As a result, the industry is spurning the opportunity to transform itself while it has the profits to fund the transition. Switching to blockchain would upgrade the infrastructure that underpins the asset management industry, creating room to address the cost and growth problems. But asset managers worry instead about the costs and complexity of the transition. Shrinking revenues and profits are creating an incentive to curb spending, including the budgets needed to invest in tokenisation. What investment budget is available is being diverted instead into artificial intelligence (AI). AI appears to address directly the need to cut costs in ways that previous economy measures - outsourcing, offshoring and robotic process automation (RPA) – have failed to do. Use cases that solve identifiable problems for asset managers have proved hard to find too. Tokenised real estate and privately managed asset funds, for example, have not taken off chiefly because tokenisation has not yet solved the valuation problem (though data oracles linked to smart contracts will eventually accomplish this). Tokenised government

1. Fidelity, *What are the Magnificent Seven stocks?*, 18 April 2025, at https://www.fidelity.com/learning-center/smart-money/magnificent-7-stocks

bonds would almost certainly be popular with asset managers but are not yet available. The lack of trustworthy money on-chain remains a problem. Lastly, asset managers have over the last 50 years acquired a habit which is hard to break. This is that they do not expect to invest in market infrastructure. They expect it to be delivered and operated by their service providers.

Is investment in tokenisation the responsibility of service providers to the asset management industry?

A circular stand-off has developed, in which the sell-side is waiting for the buy-side to commit to tokenisation, and the buy-side is waiting for the sell-side to make it possible for them to commit to tokenisation. But history suggests that the sell-side must commit first. Tokenised banking products - such as treasury, repo and collateral management, where tokenisation can reduce the burden imposed on banks by capital and liquidity constraints - are better starting points for a tokenisation revolution than asset management. If tokenisation can increase the trading capacity of investment banks, by cutting the costs of holding cash, sourcing credit and obtaining collateral, asset managers will be drawn into the token markets as lenders of cash and securities. Asset managers will benefit not only from the revenues this generates, but from obtaining credit, cash and collateral at lower cost themselves.

What happens if the asset management industry does nothing?

Tokenisation is a risk as well as an opportunity for the asset management industry. It is already threatening to democratise investment, with start-ups selling tokenised funds directly even to the unbanked. Just as the Internet allows anybody to publish anything, an Internet-based technology such as blockchain allows anybody to offer to manage money (though asset managers are increasingly required to register with the authorities, or obtain a licence to provide a service, especially if they are managing money for third parties). In the cryptocurrency markets, this opportunity is already being seized. Start-up firms from outside the asset management industry are publishing cryptocurrency investment strategies and securing investors to support them. Nickel Digital Asset Management, founded in 2019, is allocating capital to independent cryptocurrency traders, in the same way that Millennium has long allocated capital to entrepreneurial hedge funds. Some traditional asset managers are hedging their bets by forming partnerships with cryptocurrency asset managers. Others are pondering a new role as due diligence intermediaries capable of assessing the value and integrity of cryptocurrency investment strategies. Asset managers believe they can wait for now. Lack of interoperability between the different blockchain protocols which host cryptocurrencies hampers the ability of asset managers to grow by trading portfolios across networks and expanding into tokenised asset classes other than cryptocurrencies. But once the interoperability problem is solved, that growth constraint will be lifted. Traditional asset managers might then find they are ill-prepared to take advantage of a large and fast-growing market that has expanded beyond the cryptocurrency markets.

What explains tokenisation of money market funds?

Tokenised money market funds, which can be traded as cryptographic tokens on blockchains, appeal to traditional asset managers for a traditional reason: asset-gathering. The opportunity exists chiefly because the buyers find them useful in on-chain trading and investment activities. Like Stablecoins, tokenised money market funds provide convenient on-chain liquidity for cryptocurrency traders, who use the funds in lending, borrowing and staking transactions and in liquidity pools. Traditional funds cannot fulfil these roles. They are traded only when markets are open, settle after the market has closed, rely on updating of a traditional register maintained by a transfer agent to record changes of ownership and take at least 24 hours to turn into cash. Tokenised funds, by contrast, can in theory be traded round-the-clock, monitored in real-time, settled and registered instantaneously wallet-to-wallet and turned into cash in an off-chain bank account. Tokenised money market funds are also regulated securities, which broadens their appeal to institutional investors, especially those active in the cryptocurrency markets. Institutional holders can place them for safekeeping with independent custodians and exchange them with authorised investors. Investors have full transparency into the assets (mostly Treasury bills, repos and cash) that underpin the fund. They collect a dividend yield daily by payments of new tokens into their wallets. Corporate treasurers are warming to tokenised money market funds because they promise round-the-clock liquidity, operational cost savings, real-time visibility into holdings and higher yields on surplus cash.

What are the limitations of tokenised money market funds?

Round-the-clock trading remains a theoretical benefit of tokenised money market funds. It has yet to translate into practice, because the funds are not listed and traded on blockchain-based exchanges. Lack of trading limits their utility as collateral, especially as an alternative to cash in meeting margin calls, because their value is uncertain. The infrastructure to facilitate their use in margin management does not exist anyway. Even if tokenised money market funds were widely traded, there is no guarantee that any counterparty would trust prices derived from blockchain-based exchanges. They might eventually be adopted as an acceptable substitute for cash collateral in margin payments but only if cash is posted in the first instance. Finally, tokenised money market funds are not "native" funds issued on to blockchains only but remain digital "twins" of traditional funds. This means they are functionally equivalent to mere certificates of title, dependent on an off-chain register. They do not reduce costs significantly either, because the persistence of the traditional fund means all intermediaries, and their associated costs, remain intact.

If they are issuing tokenised money market funds, why don't asset managers issue Stablecoins as well?

Stablecoins, being near-identical to the tokenised money market funds already being issued, are not a major operational challenge for asset managers. In fact, asset managers are already involved in Stablecoin issuance. Managers active in the cryptocurrency markets are long familiar with Stablecoins as a trading tool. They could be useful in portfolio management more widely, especially as a technique for recruiting younger investors with instantaneous payment rather than waiting days for a subscription to be processed off-chain by a transfer agent and a bank. One global asset manager is understood to be experimenting with issuing its own US dollar-denominated Stablecoin, on grounds it will reduce the transaction fees extracted by banks and facilitate the tracking of investor behaviour.

What incentives currently govern the behaviour of asset managers?

Pondering whether to issue an in-house Stablecoin, like issuing tokenised money market funds, is characteristic of how asset managers approach the tokenisation opportunity. The intention is to gather assets and retain clients which might otherwise by captured by a competitor. In this sense, asset managers do not differ from the banks that are building their own tokenisation platforms and issuing their own Stablecoins. They do not want to build a new market or eco-system by endorsing an open, permissionless blockchain where investors can meet issuers directly and buy and sell tokens that are standardised across all asset classes. They want to capture all the value of innovation for themselves. They fear open or common platforms, and standardisation of issuance and trading, because they would make it easier for investors to move assets elsewhere. This beggar-my-neighbour, or zero-sum approach, sometimes dignified as "tokenomics," does not help asset managers overcome the systemic problems they face.

What model would enable asset managers to overcome the systemic problems they face?

Instead of replacing shares and units with digital "twin" tokens which leave the same operating models, technologies, processes, intermediaries and even regulations in place, asset managers need to embrace self-executing tokens issued on to open blockchain platforms that share a common design and operate to a common model, in "native" form only. This would allow every asset class to be tokenised in a standard way. Ties with traditional assets would be cut because the tokens would exist on-chain only. Such tokenised assets could move between different blockchain platforms seamlessly. A network of interoperating platforms could emerge, overcoming the asset class silos that divide traditional financial markets, let alone token markets. It solves the technology and compliance cost problems that asset management is suffering from by replacing multiple operating models with a single standardised operating model. This approach has been endorsed by the Bank for International Settlements BIS), the International Monetary Fund (IMF) and the Monetary Authority of Singapore (MAS) as part of its Project Guardian programme. But asset managers are reluctant to endorse it.

Aren't asset managers already supporting a common infrastructure already?

Yes, asset managers are supporting third party investment, trading, data management and asset servicing platforms such as Aladdin (provided by BlackRock), State Street Alpha and SimCorp (now owned by Deutsche Börse). But the attraction of these platforms is limited to the cost savings created by eliminating the need to integrate hundreds of proprietary applications internally. They have also proved popular with end-investors, which have found it easier to conduct due diligence on asset management firms that use industry-standard platforms. They do not represent change on the scale of a common platform design.

Why are asset managers reluctant to embrace a common operating platform?

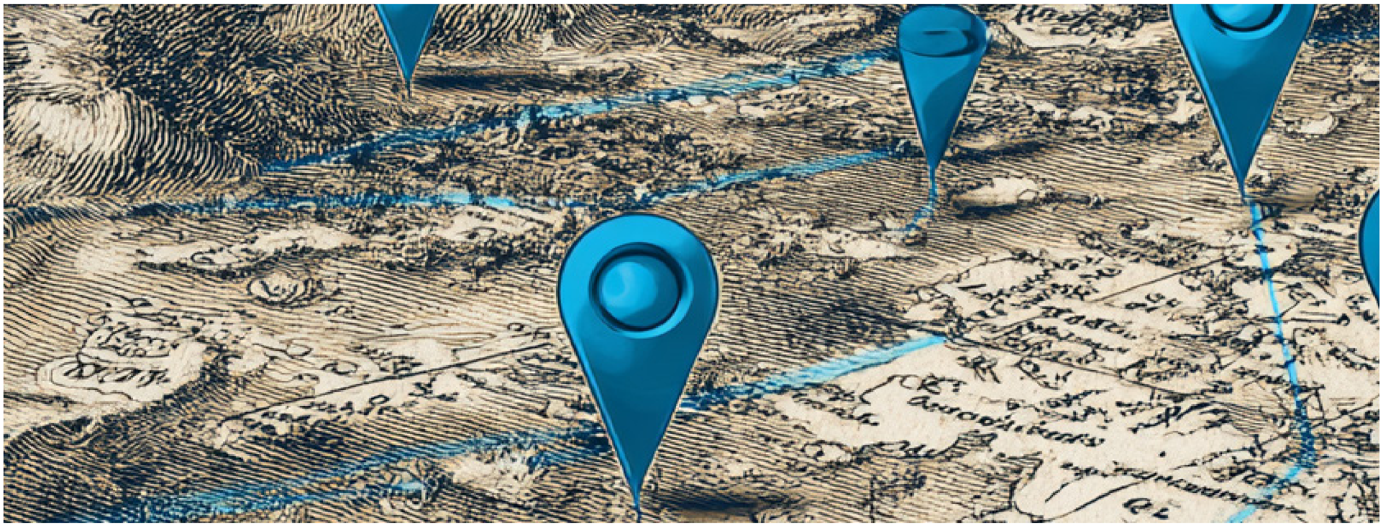
Because it would expose them to competition for AuM by lifting the protection afforded by distribution agreements, suitability constraints, investment vehicles, fund share classes, management and performance fee structures, service providers, customer due diligence procedures, regulatory regimes and other differentiators. Asset managers would be judged by solely by their ability to generate alpha. Their reluctance to embrace such a future is understandable, but the asset management industry cannot solve its problems unless it acts collectively to achieve commonality across its operating models, dispensing with asset class specificities in terms of products, technology, regulation, law and infrastructure. The risk now is that the global asset management industry adds digital assets as just another asset class rather than embracing tokenisation as a new way of doing business.

What might encourage asset managers to embrace tokenisation more wholeheartedly?

Five factors are at work. The first is that tokenisation technology is steadily becoming cheaper to adopt. The second is that fund distributors will understand that tokenisation both broadens sales opportunities and cuts the cost of seizing them, so they will pressurise asset managers to issue funds in tokenised form. The third factor is that cost pressures will persist, and they do create a need for scale. The asset management industry is consolidating already, and it will continue to consolidate, easing the fragmentation that obstructs adoption of tokenisation. The fourth factor is the likelihood that certain new asset classes will be available as digital assets only, and asset managers will not be able to access them or the investors that buy them if they can operate legacy infrastructure only. The final factor is simply the passage of time. It took 20 years for electronic trading to embed itself inside regulated institutions and achieve scale, and tokenisation is likely to follow the same timetable. Evidence from other industries, such as music, suggests that technology paradigms reaching a tipping point at which all market participants adopt the new technology quite suddenly.

Would regulatory certainty help asset managers to embrace change?

Asset managers certainly say they want regulatory certainty before committing to tokenisation. But regulatory uncertainty is chronic and can never be resolved. Jurisdictional competition for asset management business, for example, forces asset managers to choose between established regulatory jurisdictions and jurisdictions that are betting heavily on attracting digital assets. There is no way of knowing which is most likely to succeed. Regulatory change is also a constant theat. It can be precipitated anywhere at any time by an unexpected market development - such as, for example, Stablecoins undermining the funding base of the banking industry. Regulators must always adapt to changing circumstances. However, this is especially likely to happen in a jurisdiction without legacy institutions, infrastructures and regulations, such as the Gulf states, which are presently attracting business that would struggle to gain acceptance in long-established jurisdictions. Each jurisdiction will also retain its own peculiarities. In the United Kingdom, for example, asset managers are particularly sensitive to their obligation, specified in the Client Assets Sourcebook (CASS) of the Financial Conduct Authority (FCA), to protect client money and assets from loss.



What should asset managers enthusiastic about tokenisation do now?

They should experiment by buying tokenised minerals such as transition and precious metals before they are mined, distributing tokenised funds to investors with trivial amounts to invest, embracing telephone apps as a key distribution network, and partnering with FinTechs to experiment with new ways of managing money, building and maintaining portfolios and distributing funds. A more disruptive steps towards a tokenised future would be to empower retail investors to personalise their portfolios. This would encourage tokenisation (as a means of broadening asset classes) and fractionalisation (as a means of enabling even small portfolios to assume exposures). Here, integrating AI could help, in gathering the data about individual investors, and prescribing portfolios of investments that meet the financial needs of individual investors over long periods based on assumptions about careers, family sizes, investment returns and life expectancy. Such services will appeal more to the younger generation of investors.

How can tokenisation assist the personalisation of investing?

Fund distributors already have good data on the financial needs of their clients (for example, when their children go to university and when they want to retire) and their investment preferences (for example, environmental, social and governance (EG) criteria) but make poor use of it. Instead, they allocate investors to risk appetite categories and sell them poorly differentiated, high cost, packaged investments such as mutual funds. The asset management industry should stop selling what it likes to produce. It should instead be offering automatically adjusting personalised portfolios driven by algorithms that reside in the digital wallets of retail investors. More importantly, the industry should also take responsibility for the outcome of the investments, because at present all the risk of under-performance remains with the investor. Ultimately, true personalisation entails asset managers tailoring flows of value to individual investors to meet their financial needs as they arise. In other words, fully realised personalisation means replacing the sale of risk-adjusted returns by outcome-based investing. As a product with guaranteed returns, an outcome-driven investment would be more like a defined benefit pension plan or an insurance contract. It would be superior to liability-driven investments (LDIs) because a portfolio of tokenised assets with the same sensitivity to market developments as future liabilities would obviate the need for expensive interest rate swaps to mitigate the risk of adverse changes in interest rates. Such a switch to outcome-based investing, in which portfolios of assets are designed to meet specific liabilities over time, has large implications for the capitalisation of the asset management industry. Tokenisation, by extending the range of investable asset classes, lowering the cost of customising portfolios and shrinking dramatically through fractionalisation the size of the exposures that can be taken, can contribute to a successful transition.

How can exchanges help the asset management industry?

The conventional view is that exchanges will provide markets in tokenised securities and funds where there is a demand for portfolio diversification and existing issuance, trading price discovery and post-trade arrangements are inefficient, such as privately managed assets, trade finance, commodities and energy. It is true that, in these areas, exchanges can provide all the underlying tokenised assets that asset managers need to construct portfolios. Exchanges can filter the assets by setting minimum listing standards. They can also audit smart contracts embedded in tokens, and sponsor activity by encouraging banks to join and trade on behalf of underlying investors. But exchanges could also provide classical central counterparty clearing services, in which every trade would be against a central counterparty, with the risk of non-payment or non-delivery covered by a combination of initial margin payments, variation margin payments from asset managers to clearing brokers, default fund contributions from clearing broker members, proprietary capital and the ability to call for additional contributions from non-defaulting clearing broker members. In addition, exchanges could add derivative contacts for token issuers to cover the risk of adverse market movements before an investment yields a return. Exchanges can host anonymous marketplaces where issuers can publish indications of interest (IoIs) to purchase self-executing tokens, akin to cryptocurrency holders locking a percentage of their holdings into a proof-of-stake blockchain ("staking") in the hope of earning a yield by being selected to validate a block of transactions. As the dealers who established NASDAQ discovered when they set up the first exchange for securities not listed on an established exchange, superior issuance and trading platforms can grow quickly. Some of the established exchanges have embraced the idea, but others have unrealistic expectations about how quickly the market will grow and they can recoup their investment. The tokenisation opportunity is not attractive for short-term strategists. It will reward patience and commitment.

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