coinbase ASSET MANAGEMENT

market notes: RWA? Try DNA

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10/6/23 – Shaun Martinak & Marcel Kasumovich, Coinbase Asset Management

1. Real World Assets – RWAs – have become the beacon of warmth in a long crypto winter. They provide the opportunity to expand blockchain efficiency beyond native crypto assets and upgrade traditional finance. How? Take current assets, put them in a custodial lock-box, and print a token with a legal connection to property rights. Then ride the rails.

2. How can market participants benefit from mass tokenization of assets on a blockchain? Unlike the transitional system, you don't need to move assets to move ownership, just the tokens. It enables fractional ownership, near-instant global settlement for asset transfer, and, with enough activity, the liquidity to run programmable portfolios even in private markets. Impressive.

3. But tokenization has a cost, too. Rolling out token-based infrastructure to financial institutions takes education, infrastructure, and time. The industry needs time to build a practical, safe experience for its users. And while it does, old costs remain, and new ones are added. Transitions demand a high level of investment with conviction that the returns will be worth it.

4. We need a bridge from old to new infrastructure. It'll be clunky to start. Proof-of-concept is never profitable. But it's a necessary step, laying groundwork that unlocks efficiency. The end state where most assets ride on digital financial rails offers vast improvements to financing, liquidity, and portfolio management. There's too much potential to ignore.

5. Proof? Bitcoin and Ethereum will do – native digital assets that derive their efficiency from the blockchain. Property rights are enforced by math, transfer and settlement are bundled as a single service. They can be split, sold, and managed programmatically. So, how do we accelerate those benefits for traditional markets and eliminate the frictions from our outdated operating model?

6. Payments are the natural starting point. It is a use-case that takes the transaction cost from 50-75 basis points to near-zero. And its working – USD stablecoin volumes are now equivalent to Visa's network. Next stop, ACH. PayPal, Venmo, Visa, and Mastercard are all committed. The natural advantages of blockchain infrastructure are taking market share for the world's most used asset. Properties of instant settlement and programmability will be the benchmark.

Next step?

7. Produce digitally-native assets ("DNAs"). This creates an automated financial life-cycle that leverages onchain technologies. DNAs are issued, managed, and retired on the blockchain. But to serve traditional markets beyond payments, enforceable legal status, regulatory clarity, and investor comfort are also required.

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8. Again, patience is required. All of this will take time. Assets like private credit or real estate that have long life-cycles must live on both systems as they migrate safely to new infrastructure. Turnover is slow. But there is a way to accelerate the transition – follow the flows. Today, it is all about short-term yield – rapid money-market tokenization being an unintended benefit of the Fed tightening cycle.

9. Short duration assets are also a perfect place to start. Their life-cycle is short, allowing for a faster migration to digital rails. Like fruit flies used to experiment with evolution, their short lives offer iteration, experience. They speed up time. As we integrate short-term credit onchain, the infrastructure for more complex financial operations will be laid, and leveraged. Bit by bit.

This is our focus.

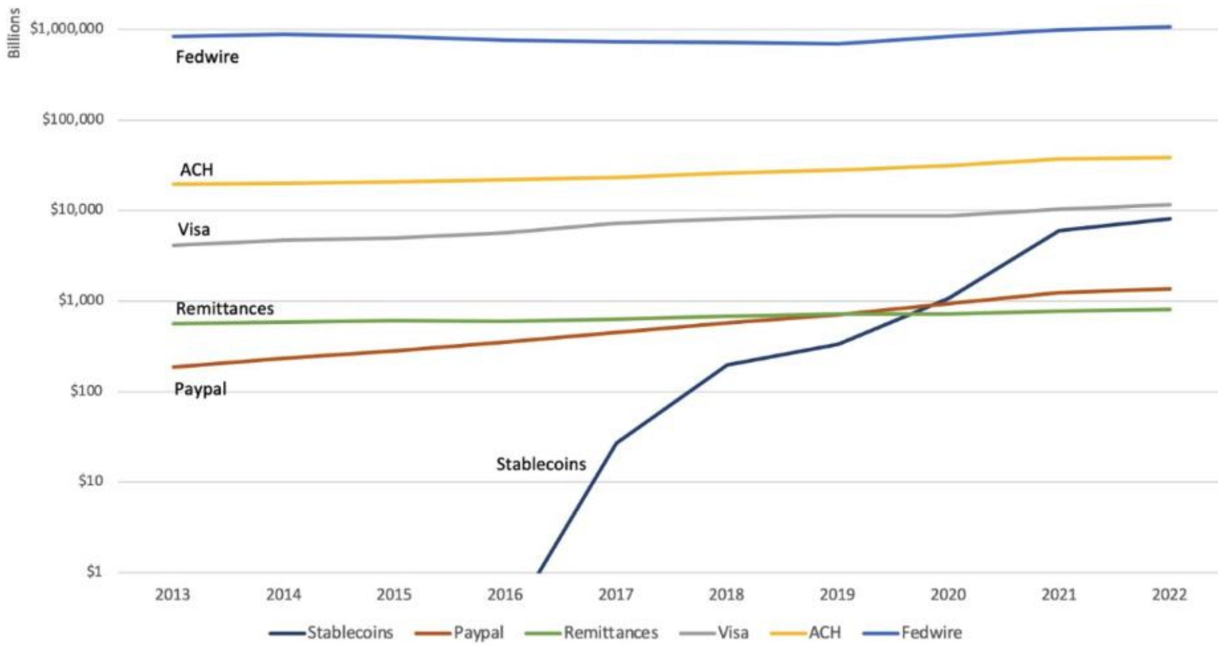
10. Project Diamond.[1] It's our smart contract platform for institutional capital markets. We begin with short-term debt for strategic partners, proving the advantages of regulated, onchain finance. We will quickly expand to other use cases in automated capital structures that solve market problems. It's a digitally-native approach that makes finance scale like software.

11. Tokenization is a leap forward from today's fragmented ownership. But it does very little to address the complexity of operations. Programmability of financial instruments is the efficiency unlock. It allows for the entire lifecycle of an asset – from investor identification to legal covenants – to live in programmable form. That's the value proposition of digitally-native assets. It is tokenization v2.0.

12. The lineup of strategic partners for Project Diamond is growing. Early movers will build the capabilities necessary to take market share from lagging competitors. Innovation in capital markets has been slowed by incumbency and regulatory complexity for decades. But we are at a turning point – one that enhances regulatory compliance and unlocks institutional capital.

[1]Recently rebranded from its former name, "Onebridge."

Figure 1 – Annual Volume of Stablecoins vs. Other Financial Systems (through '22)



Source: Castle Island Ventures – "Regime Change in Stablecoins".

Figure 2 – H1 '23 Weekly Volume for Stablecoin. (Annualized total ~$10.5T USD.)

	USDT	USDC	BUSD	TUSD	TOTAL
Ethereum	$30,224,420,033	$63,941,183,280	$4,753,494,547	$304,727,934	$99,223,825,794
Tron	$66,709,346,266	$1,564,517,928	-	$937,698,853	$69,211,563,047
BSC	$8,422,655,961	$1,341,955,058	$2,911,315,637	-	$12,675,926,656
Polygon	$1,335,538,953	$2,131,923,837	-	-	$3,467,462,790
Optimism	$345,586,721	$4,719,456,370	-	-	$5,065,043,091
Arbitrum	$1,915,821,916	$4,048,643,291	-	-	$5,964,465,207
Fantom	$109,208,291	$329,255,418	-	-	$438,463,709
Avalanche	$668,283,596	$1,132,753,279	-	-	$1,801,036,875
TOTAL	$109,730,861,737	$79,209,688,461	$7,664,810,184	$1,242,426,787	$197,847,787,169

Source: Brevan Howard Digital – "The Relentless Rise of Stablecoins"

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