coinbase ASSET MANAGEMENT

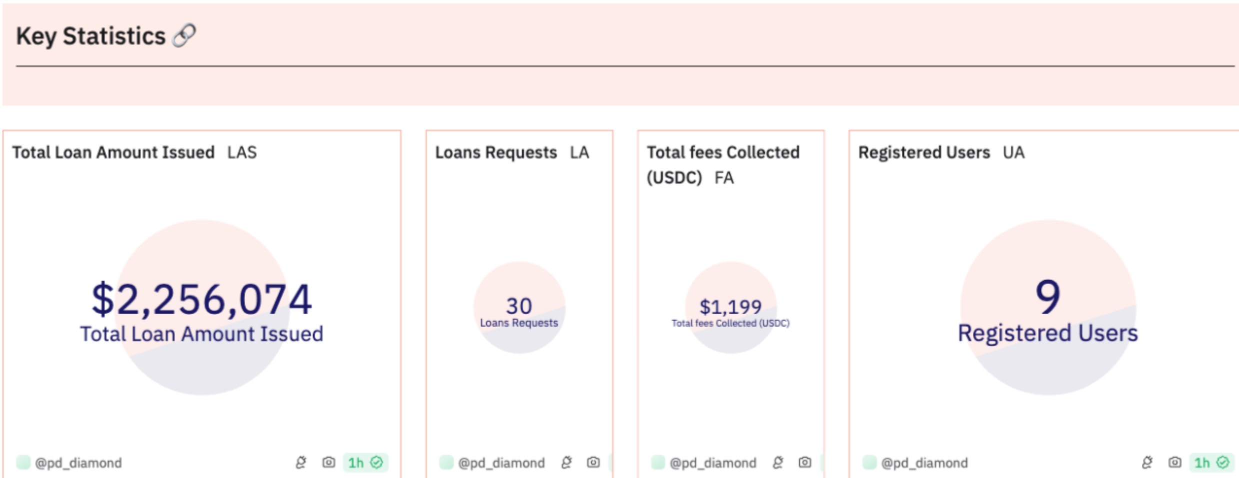
market notes: It's Alive! Experiences > Experiments

Onchain finance is gaining traction. Project Diamond aims to achieve long-term scale over short-term growth by integrating into the regulatory mainstream. It's live.

29 July 2024
Marcel Kasumovich
Coinbase Asset Management

Onchain finance is gaining traction. Project Diamond aims to achieve long-term scale over short-term growth by integrating into the regulatory mainstream. It's live.

Figure 1: Project Diamond—It's Alive!



Source: Dune Analytics. CBAM Calculations.

market notes: It's Alive! Experiences > Experiments
7/29/24 – Marcel Kasumovich, Shaun Martinak, and Oputa Ezediaro
Coinbase Asset Management

1. A new era in finance dawns with the advent of Project Diamond—an innovative infrastructure that seamlessly integrates financial activities with blockchain technologies. It is reminiscent of the iconic cry from Frankenstein, "It's alive!" By uniting blockchain technology, principles of finance, and regulatory compliance, Project Diamond aims to breathe new life into a stagnant financial landscape. It's alive, and Diamond's onchain experiences offer far more value than experiments.

2. Traditional finance players are taking notice of the explosive growth of "real-world assets" on blockchains. Their total value leapt to $178 billion from $136 billion at the start of the year. Outside of stablecoins, onchain assets have surged 64% to over $13 billion, led by private credit. The migration of private assets to onchain finance is more experimental at this stage, exploring if the infrastructure can mature to meet institutional needs.

3. Design choices are driving the uncertainty surrounding onchain finance in its experimental phase. Well-structured decentralized finance (DeFi) applications have demonstrated remarkable resilience during crypto downturns. However, scaling limitations are also evident,

with regulatory bodies observing the lack of control over how users in DeFi protocols deploy assets. Enter Project Diamond, integrated into regulatory norms—prioritizing long-term scale over short-term growth.

4. Achieving institutional scale is a matter of design. Anonymity is not an option—but privacy is paramount. Global regulatory bodies accept that rules are agnostic to technology. But technologists must also accept that the same assets meet the same rules. Digital, electronic or paper—if it walks like a bond and talks like a bond…it's a bond. Project Diamond adjusts to integrate regulatory rules into onchain finance with the objective of institutional trust and scale.

5. Abu Dhabi Global Markets (ADGM) admitted Project Diamond into its RegLab in May. This marked the start of live transactions, a first step in demonstrating onchain experience. ADGM is the hub with spokes to other global financial centers—emphasizing regulatory cooperation, not arbitrage. Transactions are reported to provide transparency at each step of the Diamond process, drawn from public blockchain data with high-level summaries available on Dune (Figure 1).

6. Who cares? Fragmented markets, where inefficiencies are most pronounced, are also where blockchain technologies showcase their value. The proposition is twofold—delivering pools of capital to smaller financial players and public records at remarkably low infrastructure costs that allow a handful of lines of code to run everything from accounting to inventory. User demand ranges from simple short-term borrowing to structured credit and complex space finance.

7. The first external transactions are set to launch, with short-term debt instruments for a small-and-medium sized enterprise. It is a step towards the future goal to bring collateral onchain, delivering unique private credit to investors at a much cheaper cost of capital for small business. With roughly 400 million small and medium sized companies around the world covering 65% of total employment and a $5.7 trillion financing gap, this is a clear bridge to demonstrate value.

8. But what's the value to regulators? Transparency. The design features limiting institutional adoption of onchain finance are key. Permissioned DeFi is not static. Just as regulatory bodies responded to the 1987 stock market crash with circuit breaker rules, guidance for onchain finance is dynamic and far more efficient. Real-time transaction surveillance, for instance, is a practical reality of Diamond, a feature unmatched by traditional tools.

9. Naturally, there are areas of caution for new players. Systemic risks are foremost. Regulators want to know what to do if the public blockchain or smart contracts fail. The solution is similar to traditional finance—disaster recovery plans. A private blockchain can run in parallel to the public chain, serving as a fallback for smart contracts if the public chain were disrupted.

Additionally, the modular approach to Diamond also mitigates contagion risk, as smart contract failure is contained.

10. There are also unique market risks associated with onchain finance. There are liquidity mismatches between a token and its underlying assets, run risks tied to an issuer of tokenized assets, and volatility transfer from 24/7 crypto to underlying assets. However, these are also design choices. Investors have gravitated to exchange-traded products for reasons related to regulatory comfort, despite taking more liquidity risk. It is a design choice.

11. The pathway forward involves incremental steps. Live transactions transform the conversation from theoretical possibilities to practical realities, showcasing Diamond's transformative potential. Today, the imbalance lies on the supply side, with robust demand for broader pools of capital. Addressing regulatory and capital limitations will be crucial to meet this demand. Project Diamond is alive, and it will thrive with the power of its network—that's you…join the experience.

Disclaimer

This communication, including any attachments, is intended only for the use of the addressee and may contain information that is confidential or otherwise protected from disclosure. Any unauthorized use, distribution, modification, forwarding, copying or disclosure is strictly prohibited. If you have received this communication in error, please delete this message, including any attachments, and notify the sender immediately. The information and any disclosures provided herein do not constitute a solicitation or offer to purchase any security or other financial product or investment and is not intended as investment, tax, or legal advice. Unless otherwise noted, all information is estimated, unaudited and may be subject to revision without notice. Past results are not indicative of future results.

This communication may contain statements of opinion, including but not limited to, the author's analysis and views with respect to: digital assets, projected inflation, macroeconomic policy, and the market in general. Statements of opinion herein have been formulated using the author's experience, research, and/or analysis, however, such statements also contain elements of subjectivity and are often subjective in nature. In addition, when conducting the analyses on which it bases statements of opinion, the author(s) will incorporate assumptions, which in some cases may be shown to be inaccurate in the future, including in certain material respects. Nothing in this presentation represents a guarantee of any future outcome. The author(s) are under no obligation to update this document, notify any recipients, or re-publish the content contained herein in the event that any factual assertions, assumptions, forward-looking statements, or opinions are subsequently shown to be inaccurate.

Bitcoin mining poses unique risks that could lead to loss of capital investment. Risk factors include the inability to grow hash rate as a function of limited computing power, the cost of acquiring new miners as affected by global supply chain issues, the value of bitcoin mined not exceeding associated mining costs, market volatility of the asset, and the reduced generation of revenue due to bitcoin "halving". Bitcoin mining may also be impacted by increasing compliance and legal costs as the industry is subject to emerging regulation.

This Presentation may contain statements of opinion, including but not limited to, Coinbase AM's analysis and views with respect to: digital assets, projected inflation, macroeconomic policy, the market adoption of digital assets, and the market in general. Statements of opinion herein have been formulated using Coinbase AM's experience, research, and/or analysis, however, such statements also contain elements of subjectivity and are often subjective in nature. In addition, when conducting the analyses on which it bases statements of opinion, Coinbase AM will incorporate assumptions, which in some cases may be shown to be inaccurate in the future, including in certain material respects. Nothing in this video presentation represents a guarantee of any future outcome. Information provided reflects Coinbase AM's views as of the date of this video presentation and are subject to change without notice. Coinbase AM is under no obligation to update this Video Presentation, notify any recipients, or re-publish the content contained herein in the event that any factual assertions, assumptions, forward-looking statements, or opinions are subsequently shown to be inaccurate.

Certain information contained in this Communication constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may", "will", "should", "expect", "anticipate", "target", "project", "estimate", "intend", "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology. Forward-looking statements made in this communication are based on current expectations, speak only as of the date of this communication, as the case may be, and are susceptible to a number of risks, uncertainties and other factors. Assumptions relating to the foregoing involve judgments with respect to, among other things, projected inflation, the regulation of digital assets and macroeconomic policy, all of which are difficult or impossible to predict accurately and many of which are beyond our control. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation to future results or that the objectives and plans expressed or implied by such forward-looking statements will be achieved.

Certain information contained herein may have been obtained from third party sources and such information has not been independently verified by the author(s). References herein to third parties are for illustrative purposes and are not an endorsement or recommendation for products or services. No representation, warranty, or undertaking, expressed or implied, is given to the accuracy or completeness of such information. While such sources are believed to be reliable, the author(s) do not assume any responsibility for the accuracy or completeness of such information.

Project Diamond is a smart contract platform developed by Coinbase Asset Management, LLC ("Coinbase AM"), and is for institutional application only. Features described within this presentation may be conceptual in nature or under development and are subject to change. In November 2023 Project Diamond completed a live discount note transaction. Project Diamond has received in-principle approval from the Financial Services Regulated Activity ("FSRA") of Abu Dhabi Global Market ("ADGM") to conduct the regulated activity of Developing Financial Technology Services within the RegLab.

Coinbase AM is a wholly owned subsidiary of Coinbase Global, Inc. Base is a permissionless L2 scaling solution built on the OPStack/Powered by Optimism. Coinbase and related logos are trademarks of Coinbase, Inc., or its Affiliates.

The preceding presentation should not be construed as any tax, accounting, legal or regulatory advice to you and you should satisfy yourself in this regard and ensure that you consult with appropriate advisors to assist in understanding the transactions contemplated by this document. Information provided reflects our views as of a particular time and are subject to change without notice. Prospective investors should not make investment decisions on the basis of any forward-looking statements contained herein.

This Presentation contains statements of opinion, including but not limited to, our analysis and views with respect to: digital assets, projected inflation, macroeconomic policy, the market adoption of digital assets, and the market in general. Statements of opinion herein have been formulated using Coinbase AM's experience, research, and/or analysis, however, such statements also contain elements of subjectivity and are often subjective in nature. In addition, when conducting the analyses on which it bases statements of opinion, we will incorporate assumptions, which in some cases may be shown to be inaccurate in the future, including in certain material respects. Nothing in this presentation represents a guarantee of any future outcome. Information provided reflects our views as of the date of this document and are subject to change without notice. We are under no obligation to update this document, notify any recipients, or republish the content contained herein in the evented by the use of forward-looking terminology such as "may", "will", "should", "expect", "anticipate", "target", "project", "estimate", "intend", "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology. For that any factual assertions, assumptions, forward-looking statements, or opinions are subsequently shown to be inaccurate.

Certain information contained herein may have been obtained from third party sources and such information has not been independently verified. No representation, warranty, or undertaking, expressed or implied, is given to the accuracy or completeness of such information by us or any other person. While such sources are believed to be reliable, we do not assume any responsibility for the accuracy or completeness of such information.

There is no guarantee that the investment objectives will be achieved. Moreover, **PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.**