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Playback of Project Guardian: Unlocking TradFi with DeFi

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Summary

The roundtable “Playback of Project Guardian – Unlocking TradFi with DeFi” was held at the Point Zero Forum on Monday 26th June 2023 in Zurich, Switzerland. The roundtable marks the first-year anniversary of Project Guardian. Members of the Project Guardian working group and financial industry leaders explored several topics related to the initiative and discussed key findings from the related industry pilots and case studies.

The session was moderated by Alan Lim, Head, FinTech Infrastructure Office, Monetary Authority of Singapore.

Members of the Project Guardian working group and financial industry leaders will continue to test the feasibility of applications in asset tokenisation and DeFi while managing risks to financial stability and integrity. Taking the outcomes of this roundtable as input, a follow-up discussion will be planned at the upcoming Singapore FinTech Festival.

Key themes that emerged during the discussion are outlined below:

1. **Harmonisation of regulations and standards:** regulations and standards need to be applied consistently across global jurisdictions to unlock the potential benefits of digital assets and decentralised technologies for financial markets, by enabling open and interoperable networks, and achieving scalability.

2. **Tech neutrality, same rules, same risks:** regulations should apply tech neutrality principles to ensure the same objectives and outcomes are achieved irrespective of the underlying technical implementation.

3. **Servicing clients is key to commercialisation:** to move from proof of concepts to commercialisation, more emphasis needs to be placed on servicing client needs and pain points across the full value chain, especially on the buyside. To date, most efforts have focused on the sell-side, token issuance and distribution.

4. **Trusted parties are essential:** centralised trusted entities still have a role to play within decentralised institutional ecosystems, where trusted parties and verifiable identities will be important for supporting confidence and integrity within the markets.

5. **Legacy infrastructure shouldn't be a constraint:** potential benefits of digital assets for clients and investors should not be constrained by existing legacy market infrastructure. Paradigm shifts have occurred in the past and will occur again in the future.

In relation to the topics above, some of the calls to action highlighted are:

- **Fostering international collaboration:** there is a strong view that the financial industry must collectively inspire a well-regulated ecosystem and encourage alignment between regulators and standards bodies across all major global jurisdictions. To focus on the need for global interoperability, not regional.

- **Promoting responsible innovation:** further collaboration between the public and private sectors is required to better understand the potential benefits and risks associated with any new technology from multiple angles. Project Guardian is a great example, having started as an isolated set of pilot use cases last year, the progress and expansion of initiatives has raised the bar significantly, generating positive interest to the benefit of all.

- **Focus more on outcomes, less on tech:** we should move beyond the current debate around decentralised technical implementations such as private vs public, permissioned vs permissionless ledgers as a driver for solutions. The conversation needs to focus more on the core principles of protecting investors and better servicing clients.

- **More focus is required on the buy-side:** most initiatives to date have focused on the benefits decentralised technology offers to the sell-side participants, with the issuance and distribution of digital asset products. Additional effort is required to explore the benefits that can be offered to the buy-side, in areas such as asset servicing.

- **Re-evaluating the roles and responsibilities of intermediaries:** Whilst the principles of financial market intermediaries (PFMI) remain the same irrespective of the technology used, adjustments are required to account for changing roles and responsibilities which are enabled by these latest technologies.

- **Standardized controls:** Project Guardian should continue to explore the concepts and potential use cases for digital/decentralised identities, trust anchors and verifiable credentials, and seek to establish standards and best practices aligned with the efforts of traditional technical bodies such as W3C, the Open ID foundation.

Harmonization of regulations and standards

The emergence of blockchain and decentralised ledger technologies has triggered the need for regulators to respond to the changing market conditions and activities, to protect investors and ensure the stability of their financial systems. Much of the initial response to the rise of cryptocurrencies, initial coin offerings, crypto exchanges, digital payments, and other crypto native activities was focused on the challenges they presented to traditional anti-money laundering, counter-terrorism financing measures and retail investor protections, with that focus now broadening towards the wider financial ecosystem and institutional investors. Examples include Markets in Crypto-Assets (MiCA) regulations in Europe, crypto-asset regulations and Stablecoin Act in Japan, and the Payment Services Act (PSA) in Singapore.

“Harmonisation globally is important for scalability.”

The idea of a global digital asset ecosystem is very important with many advocating the benefits of decentralised technologies, to reduce the dependence on intermediaries, and more efficiently facilitate transactions, especially cross-border transactions. Harmonisation of regulations is now required to help facilitate cross-border transactions by reducing legal and regulatory barriers, supporting regulatory certainty by removing regulatory gaps, and to encourage innovation.

“Global fungibility is the goal, not local fungibility, and the technology needs to be fully aligned.”

Tech neutrality, same rules, same risks

A lot of emphasis has been placed on discussing the merits of public vs private, permissioned vs permissionless networks, but irrespective of the underlying technology, we fundamentally need the same regulatory safeguards applied.

> *"In simple terms, we are talking about the exchange of payments for financial assets. We need to peel back the layers, and it doesn't matter if we talk about private or public, permissioned or permissionless. Same rules, same risk."*

Regulations and market infrastructure need to retain focus on the safety of financial assets for investors, whereas the technology should be implemented to achieve cheaper, quicker and faster investment options to benefit all investors. The legal and regulatory frameworks should take precedence based on their core objectives, rather than applying a bottom-up approach based on technological capabilities, as this is the approach that Swiss law chose.

Servicing clients is key to commercialisation

Two key points became apparent during the roundtable discussions, in that (a) past industry focus and many pilot case studies have focused specifically on sell-side activities, and (b) achieving successful commercial adoption of digital assets ultimately requires delivering tangible benefits to end investors and clients.

> *"Digital assets should focus on solving pain points of the buy-sides, such as a lack of secondary market liquidity and transparency, especially because there is no lack of product supply. Token forms can potentially provide new options to service buy-sides and address their problem statements."*

The consensus is that we must think beyond the current emphasis of asset tokenisation and the issuance of new products, to ensure that these digital assets provide ongoing utility and benefits to the investors that purchase them, in areas such as improved asset servicing capabilities and corporate action processing, accurate price discovery and sufficient liquidity supported by the availability and access to secondary markets.

> *"Ultimately the aim for buy-side firms is the breadth of investment options packaged in a way that allows the investor more choice, interoperability, and facilitates personalised asset allocation. Bringing new types of products to market must be about servicing clients."*

Trusted parties are essential

Trusted agents are essential to enabling the widespread adoption of digital assets within the institutional financial system and to unlock the full potential of the technology. Trusted agents underpin secure, reliable, and regulated environments for financial transactions, and support confidence in the markets. Whilst decentralised technologies can potentially alter the landscape for FMIs, with changing roles and responsibilities, it was recognised and agreed that trusted parties will remain a critical component of any institutional-grade digital asset ecosystem.

> *"A full scale of decentralisation is not realistic in the tokenised security market. Unlike crypto markets, tokenised security transactions require almost instant connection and communication with the underlying asset to be serviced in the off-chain environment. This still requires a centralised trusted party, to oversee and ensure the underlying assets are real, unique, not misused, or double spending/lending. This is going to require effort from a centralised trusted party."*

This conversation extended to the public vs private ledger debate, and it was highlighted that these implementations shouldn't be viewed as black or white. There is a need to establish a spectrum with multiple dimensions, where participation could be open or closed, combined with identity overlays – in the form of trust anchors and verifiable credentials – that can be applied to achieve varying degrees of trust and controls.

> *"In future, the trust anchor concept discussed under Project Guardian, could include expanded responsibilities to cover some of these needs. Could be assumed in future by wallet providers, tokenisation platforms, and custodian roles."*

Legacy infrastructure shouldn't be a constraint

The digital asset journey is only just commencing and there is a steep learning curve ahead for the financial industry but what is clear is that digital assets and decentralized technologies pose significant challenges to existing market infrastructure and frameworks that have evolved over time to become fit for purpose.

The primary concerns that surfaced during the roundtable were two-fold and in opposing directions: (i) industry attempts to retrofit digital assets into existing processes, negating the benefits and opportunities presented by the new technology, or (ii) efficient, effective systems and processes that have evolved over time are butchered and/or disrupted in the pursuit of achieving new digital asset forms, especially when the legacy infrastructure is doing its job.

Neither of these outcomes is desirable. *"What we don't need is a Ferrari on the front end, with a horse cart on the back end"* nor a *"Ferrari with the handbrake on"*

The reality is the journey will take time and require significant investment, ultimately with a focus on providing better and more secure services to investors. And with it, market infrastructure and systems will need to adapt or evolve.

"We need to focus on new services and economic outcomes. We always tend to look backwards to the past and draw references to existing efficiencies, but this is about acting on the opportunities to look forward and build new capabilities."

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