CLIENT ALERT

BLOCKCHAIN AND CRYPTOCURRENCIES – THE JURY IS IN: THEY *ARE* COMPETITIVE ADVANTAGES.

For some time, there has been a debate about whether digital assets, based on blockchain technology, are a passing fad or a fundamental game changer. A recent survey and report by Deloitte seems to put that question to rest. As the report reads: "Participation in the age of digital assets is not an option – it is inevitable." Thus, key changes to banking and finance must be embraced as the world goes digital. In gathering the data to prepare its report, Deloitte polled a sample of 1,280 senior executives and practitioners in 10 international locations who had at least a general understanding of blockchain, digital currencies, and digital assets. Within that larger group, Deloitte defined two subgroups, Financial Services Industry respondents ("FSI overall") and Financial Services Industry Pioneers ("FSI Pioneers"). It defined FSI Pioneers as those respondents whose organizations have already deployed blockchain solutions into production and/or integrated digital assets into their core business activities. The highlights of the report are below.

- **It has become imperative for businesses to adopt blockchain and digital assets, and this need continues to increase.** For example, more than three-quarters of executives surveyed stated that their business believes there is a compelling business case for the use of blockchain, digital assets, etc. within their organization. And close to three-quarters stated that their organization would lose an opportunity for competitive advantage if they do not adopt blockchain and digital assets.
- **The end of physical money as we know it represents an overdue – and now inevitable – upgrade.** There is a consensus that digital assets will replace fiat currencies in the next 5 to 10 years. More than three-quarters of overall respondents and FSI respondents believe the changeover will occur. This number jumps to 94% for FSI Pioneers. With all the current interest from institutions as well as individuals, funds continue to flow into digital assets. Clearly this will have an impact on deposit accounts, but it also provides opportunity for financial services providers. However, with change comes operational risks. Banks must bring new and continually evolving technology into its own "technology stack," which may have evolved in a different direction.

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- **Blockchain is driving change in the holistic financial ecosystem, from deposit taking to payments, lending, investing, and trading anything of value.** This leads to many, currently unanswerable questions: Will these changes in the financial services infrastructure lead to new opportunities for economic growth and activity more generally? Will it lay the groundwork to disintermediate banks, investment managers, payment companies, and insurance companies? Is the financial services regulatory structure ready for change? One thing that is clear is that digital assets will be the driving force behind the next phase of the financial service industry's evolution.
- **As one result of the change from physical money to digital, safe custody services for digital assets are likely to become very important.** Custody services can take a variety of forms, but because the assets themselves are new, they present new risks. This will require new processes and procedures as well as a new technical infrastructure. Custody services and new payment channels were voted the two most prominent use cases for digital assets for organizations in the future; each received a vote of over 60% of FI Pioneers.
- **Banks aren't standing still – they remain some of the largest patent filers around digital assets and blockchain technologies.** This reflects the major shift in the field. For example, cross-border payments and global money movement are rapidly changing, and financial institutions will need to change accordingly. They will need to completely rethink their business models with respect to payments and will need to find new ways to add value as the industry transforms. Financial institutions may innovate to offer new services so that businesses do not adopt a self-banking model but continue to profit from using banks.
- **The cross-border movement of money will likely become much more efficient for corporations.** It is believed that in 2020 there were approximately $2 trillion dollars in global payments revenue (defined as involving currency transfers with no risk). But this industry is likely to drastically shrink for financial services providers as corporations become able to conduct these transactions themselves for free or for a minimal cost.
- **Seventy percent of FSI Pioneers say that access to funding sources will serve as the largest area of digital asset impact to their respective organizations.** Disruption in capital formation and finance will continue as there is a growing need for more efficient funding. Decentralized finance is rapidly evolving as a supermajority of FSI respondents and Pioneers believe that digital assets will play an important role in how funding gets done. One way of raising funding also relies upon blockchain technology and involves token issuances through smart contract-based governance models. Capital formation and funding, executing corporate actions, and value exchange all are expected to become far more dynamic, and these shifts are likely to be transformative for financial services. As trust in these methods increases, the velocity of the changes will tend to increase as well. This will lead to changes in the wider marketplace that are still coming into focus.
- **One of the biggest obstacles to the acceptability of digital assets is regulatory barriers.** Two other major related areas which greatly concern survey respondents are privacy and cybersecurity. Regulation of cryptocurrency and blockchain technology has been patchwork and

piecemeal. The United States' current regulatory framework is extremely uncertain. The SEC, CFTC, and federal and state banking regulators all have provided different guidance. It is unclear whether this will continue or whether they will join forces and coordinate. Near term, however, the report predicts that US federal regulators will issue additional guidance focused on specific issues which are associated with digital currencies: cybersecurity, AML, securities registration, antifraud, tax, and transaction reporting risks.

Murphy & McGonigle's attorneys are on the forefront of the digital currency space. Members of our Blockchain Practice Group and our Banking and Financial Services Practice Group have decades of experience responding to and anticipating regulatory challenges and helping clients create innovative solutions to change. You can track the most recent developments in this space by going to blockchainlawcenter.com where you will find news on the latest insights and innovations.

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