

RegTech Issues in Cryptomarkets and Digital Assets

Ensuring Security, Trust, and Compliance in Tomorrow’s Markets



On May 19-20th, Rosenblatt’s FinTech Investment Banking group hosts its [13th FinTech Summit](#) with the theme “*Building Tomorrow’s Marketplaces*.” The Summit is about how modern technology, ambitious entrepreneurs, and investor demand for new assets are causing traditional assets (real estate, art) and new assets (digital assets, cryptocurrencies) to get traded on emerging marketplaces. 15 leading FinTech CEOs will join three panel discussions at our event to describe how they are building marketplaces or providing the infrastructure to support new assets. [Nasdaq’s](#) CEO Adena Friedman will kick off our Summit with a fireside chat sharing her vision of how the exchange is utilizing its knowledge and expertise in operating securities markets to facilitate the operation of new markets in industries worldwide. Please read our two previous Viewpoints about the Summit [“Building Tomorrow’s Marketplaces”](#) and [“Building Institutional-Grade Services to Support New Assets”](#) published in February and March, which introduce the overall theme and describe the infrastructure being built to support these assets.

For new assets like cryptocurrencies and other digital assets to come fully online, get traded on new marketplaces, and for greater investor adoption, a whole new market infrastructure needs to be developed. Long-term sustainable growth of such assets heavily depends on institutional-grade infrastructure for pre-trade functions like research and investment decision-making, execution support, and post-trade services like clearing/settlement or regulatory compliance. This Viewpoint describes the regulatory and compliance challenges that must be addressed for both retail and institutional investors to make sustainable, meaningful allocations to new assets and digital reincarnations of traditional assets. The CEOs of five leading RegTech companies – [Elliptic](#), [Eventus Systems](#), [Looking Glass](#), [Onfido](#), and [ThetaRay](#), will give attendees at our FinTech Summit a masterclass in addressing RegTech challenges for all types of assets.

Regulatory, Cyber Security, Privacy Challenges for Traditional and New Assets

Covid-19 and the dramatic shift to online transactions for all types of services have caused cyber threats to explode over the last year. Phishing and ransom attacks, malware, identity theft, and cyber-hacking reached record highs, and the trend will continue. Google estimates there were 2.14 million phishing sites in Jan 2021,

up 27% year over year. Our RegTech panel will be a masterclass in addressing these issues using the latest technology provided by firms like [LookingGlass](#), which uses advanced AI and cyber tools to monitor global threats, changes in cybercrime tactics, and identifies nefarious threat behavior. Their CEO will describe LookingGlass's three-pronged strategy of detecting threats quickly and comprehensively, launching an advanced threat response, and ensuring protection against emerging threats.

Regulatory, compliance, and security issues are challenging enough to address for standard financial instruments like equities. They are even more complex and compounded for digital reincarnations of traditional assets and newly emerging digital assets. The challenges for such assets are multiplied due to a lack of adequate regulatory guidance and protection, limited investor education, and weak infrastructure to protect investors from bad actors. The lack of clarity in the regulatory jurisdiction of digital assets is the most fundamental challenge. For example, the CFTC defines Bitcoin and other cryptocurrencies as commodities, but many tokenized assets fall between the jurisdiction of multiple regulators. It took the SEC several years to grapple with how to handle initial coin offerings (ICOs) before eventually deeming them to be securities. If that's not bad enough, the IRS treats digital assets as currency sometimes but as investments at other times. Such regulatory uncertainty around digital assets curtails institutional adoption of new assets, slows down product development plans of compliance vendors, and creates risk in trading these assets.

Beyond regulation, there are challenges around marketing new assets to customers appropriately based on their risk appetite, suitability, and sophistication, to proper customer onboarding, account setup, and AML/KYC. These are complex challenges to address for alternate assets like real estate, cryptocurrencies, and all the digital assets in the pipeline. Fortunately, there are leading RegTechs like [Eventus Systems](#) that provide multi-asset trade surveillance, transaction monitoring, and risk management solutions for traditional and new types of assets. At our Summit, Eventus's CEO will describe how the firm is taking its RegTech experience from plain vanilla assets like equities and extending that to crypto assets, and why four of the top six crypto exchanges use its Valdis software for trade surveillance of crypto assets.

Another aspect of digital assets is that, unlike real assets, they are borderless, which means security threats can more easily emanate across national borders. But the ability of businesses to protect investors from bad actors operating in digital assets is several years behind the ability of nefarious people to target investors holding such assets in their portfolios. Phishing attacks and scams are still the biggest way most people lose money, and weak security infrastructure for new assets is to blame. Our Summit will showcase [Onfido](#), a leader in identity management whose solutions are used by leading online marketplaces (e.g., the Salesforce AppExchange) to authenticate 1500 institutional customers across 195 countries. Current, Drivy, DraftKings, Europcar, Indiegogo, Remitly, and Zipcar are sample Onfido clients who selected it for its scalability, speed of onboarding, and the ability to stop fraud using advanced biometrics.

Specific Regulatory Challenges in Cryptomarkets

As with any emerging asset class, the crypto market is rife with challenges, including lack of investor education, inadequate regulatory guidance and supervision, and nascent infrastructure. These issues cause high degrees of fraud, market manipulation, money laundering, high transaction costs, and risk. Unless these issues are addressed, institutional adoption of crypto assets will remain subdued and anemic. There are three major types of RegTech challenges in crypto markets:

- **Custody and Security:** Safe custody and security remain top challenges in a market riddled with bad actors, sophisticated hackers, and extortionists located across the world. Despite operating on the Blockchain, which has natural advantages, cryptocurrencies are bearer assets whose ownership is determined solely by who possesses them and could therefore be more vulnerable than physical assets. Fiat currency is also a bearer instrument, but a 10 dollar bill can be safeguarded better than a private key to a Bitcoin wallet. That's where firms like [Elliptic](#) come in, helping detect high-risk transactions, suspect

customers, tracing the source and destination of funds, and providing suspicious activity reports (SARs) to financial institutions, business entities, and governmental agencies.

- **Market manipulation:** Manipulation is the largest and most consistent issue in the crypto market and a top concern for regulators worldwide. At the start of 2021, an estimated 35% of crypto transactions worldwide were fraudulent, with the problem significantly more outside the US. Manipulative traders leverage large crypto positions across exchanges to manipulate spot prices while taking advantage of this in the Derivatives market. Another common tactic is to trade large quantities of Bitcoin on execution venues with thin liquidity to inflate/deflate prices artificially. Again, firms like [Elliptic](#) and [CipherTrace](#) provide advanced Blockchain analytics to address these issues.
- **AML and KYC issues:** The anonymity of Bitcoin and other cryptocurrencies attracts money laundering, human trafficking, sanction avoidance, and other illegal activities. RegTech leaders such as UK-based [Elliptic](#) provide blockchain analytics for 100+ crypto assets and 10 billion+ data points that service providers can use to mitigate risk and comply with AML rules. Israel-based cybersecurity company [ThetaRay](#) is bringing its significant AI capability to address cyber threats, money laundering, and fraud in the crypto space as well. It addresses regulatory issues like the Travel Rule, which requires Virtual Asset Service Providers (VASPs) such as crypto exchanges to share counterparty information on transactions of more than \$1000 to mitigate counterparty risk and establish the source of customer funds.

Concluding Thoughts

Rosenblatt's 13th FinTech Summit to be held on May 19-20th will focus on the concept of bringing new assets to get traded on emerging marketplaces, democratizing access to a whole slew of investors who couldn't invest in these assets until now. While the keynote speech and the first two panels will introduce the concept, analyze the issues involved, and showcase 10 cutting edge FinTechs that operate marketplaces or provide the infrastructure to support new assets, the third panel will be a masterclass in handling regulatory, compliance, privacy, and security issues for new assets. The CEOs of Elliptic, Eventus, Looking Glass, Onfido, and ThetaRay will describe how they address the challenges of traditional assets and new assets like cryptocurrencies or emerging digital assets. You don't want to miss an opportunity to hear from them. Full Summit details and registration instructions are available at www.rblt.com/fts2021.



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