ROSENBLATT SECURITIES

Investment Banking – FinTech Viewpoint

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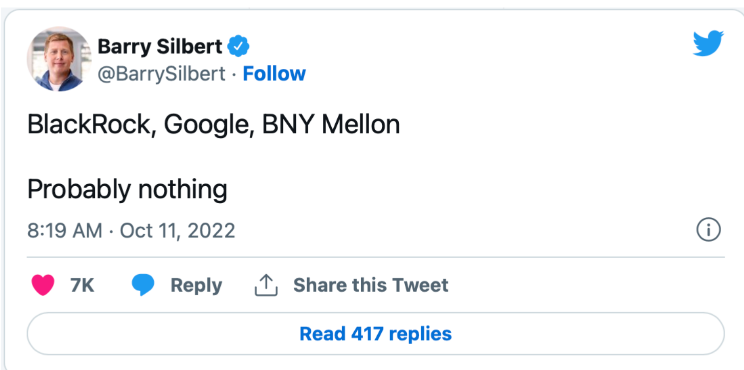
Despite the Crypto Price Slump, Institutional/Corporate Interest and Service Provision are Growing

Easier Inclusion of Crypto into Portfolios, Back-office Services like Custody, Secure and Safe Access to Digital Assets



Amidst the severe contraction in cryptocurrencies and the near or actual insolvency of prominent crypto companies and Stablecoins (BlockFi, Celsius, Voyager, and Terra Luna, among others), there is a legitimate investor concerns about the structural problem with this sector and whether institutional investors should take this asset class seriously. Our analysis of the data based on various announcements from several high-quality institutions recently paints a different picture. The real takeaway is that institutional and corporate interest in digital assets is growing despite crypto prices declining precipitously. A greater number and a wider variety of service providers are expanding access to digital assets including exchanges, custodians, institutional prime brokers, retail brokerage platforms, asset managers, payment providers, and retailers. Separately, a large number of non-financial S&P500 corporate companies are marching into adjacent but related space of issuing non-fungible tokens (NFTs) including Nike, Tiffany, Dolce & Gabbana, Gucci, Adidas, and Budweiser. By some accounts, Nike has already generated a whopping $184Mill from NFT-based projects and investments and other retailers are quickly following.

The overwhelming assumption seems to be that institutional demand for Crypto and other Digital Assets (NFTs, and forthcoming tokenized assets) should grow in the next few years once the equity and Crypto markets turn around as the Crypto has become an asset class of its own, albeit with a small market cap of under a $1 trillion (from $3 trillion a year ago), relative to large established asset classes of equities and FICC. To deliver the inherent promise, this will require a robust and comprehensive set of services and market structures to support a higher level of corporate and institutional adoption. So while retail investors have withdrawn from the Crypto market amidst a 70% decline in Crypto prices (which is consistent with the earlier crypto winters), institutional demand this time seems to be quietly growing and could break out further in the next few years. This is a dramatic shift from a few years ago when institutional involvement in Crypto and Digital Assets was practically non-existent and any CEOs that were early adopters had to valiantly defend their decisions to their boards. There is significant activity in the space and the institutional involvement is growing assuredly.

Look Beyond the Decline in Crypto Prices, Because Institutions Are Coming

For many years, there has been chatter that "the institutions are coming" and they will be stepping up their involvement in Crypto, digital assets, DeFi, and other use cases for Blockchain. Finally, we are witnessing significant interest from large financial services players to offer crypto-related services to their institutional clients. While investing in crypto appears to be the main focus of these announcements, a signficant amount of efforts and resources are being expended to expand the utilization of Blockchain in solving real-world challenges, especially in the areas of real-time payments/remittances, supply-chain and trade finance, and in tokenizing real-world assets including FX, private securities, mortgages, and fund administration,.

One of the big reasons for the slow pace of adoption among the institutions with Crypto and Digital Assets has been the lack of institutional-gradeinfrastructure providers that perform critical functions like custody, prime broking, lending, . While many of these functions were being offered by several crypto-native firms, some even the large ones like the publicly-listed Coinbase, large institutional investors were simply not going trade unless the traditional custodians like BNY Mellon or State Street started offering this as a service. Large institutions also need strong clearing, margining (including cross-margining capabilities), and collateral management functionalities from their prime brokers and custodians.

A BNY Mellon/Celent survey about Digital Asset adoption just released says that 70% of institutions they interviewed would significantly increase their digital asset activity if such services were offered by recognized, trusted service providers. That is happening now as this Viewpoint describes with Blackrock, BNY Mellon, Fidelity Investments, Nasdaq, State Street and so many others beginning to replicate an equity-like market structure in the Crypto and Digital Assets space.

It is helpful to categorize all these institutional offerings and broader involvement in Crypto and Digital Assets to have a clear picture of what is happening. These are three broad categories of activity:

- **Providing Better Execution, Prime Brokerage, and Back-office Services to Support Crypto and Digital Assets:** There is a clear movement toward replicating the comprehensive set of services and market structure that supports traditional equities in the Crypto and Digital Assets space. This includes fast and efficient execution to narrow spreads and lower fees, custody and institutional-grade prime brokerage, tax, accounting, and reporting activities. There are a number of prime brokers that have emerged including BitGo, Coinbase Prime, FalconX and NYDig but the market needs a lot more players to serve growing needs. Incumbent providers who offer these services in traditional assets like equities or fixed income are expanding into Crypto and Digital assets, the perfect example being traditional custodians extending safekeeping to these newer assets. Exchanges, broker/dealers, and market makers are coming together to create new Crypto execution platforms to address the fragmentation and rampant market manipulation that exists currently.
- **Improving and Expanding the Inclusion of Crypto/Digital Assets in Retail and Institutional Portfolios:** When the three biggest and best-recognized asset managers - Blackrock, Fidelity Investments, and State Street, start making it easier for investors to invest in Crypto and Digital Assets and even expand

access to them in 401K retirement accounts, there is no question where they believe investor demand is headed. The Blackrock/Coinbase partnership is a landmark deal allowing significantly easier institutional access to Crypto and marks a sharp reversal of the firm's skepticism about Crypto a few years ago. This is an example of a powerful, emerging trend where traditional financial services firms are partnering with Crypto specialists to improve access to these new, tokenized assets. Such partnerships turbocharge Crypto service provision because not only does it combine the deep knowledge and experience of traditional firms with the domain expertise of Crypto specialists who deeply understand this space but also offers the much-required buffer between institutional investors and the crypto-native firms. We are in the early innings of this trend so you can expect many such traditional/Crypto partnerships to be inked over the next few years.

- **Corporates Expand Crypto Acceptance, Payments, and Remittance:** While paying for goods and services with Crypto has been much slower than was expected a few years ago, corporates are continuing to expand this: accepting payments in Crypto, earnings and paying rewards in Crypto, and enabling cross-border remittances using Blockchain technology. Several large, established financial providers are expanding the use and acceptance of Crypto including Mastercard which has partnered with Bakkt (NYSE: BKKT) allowing customers to buy/sell/hold Crypto in digital wallets, and to reward them for loyalty programs with digital currencies. Visa has an alliance with Crypto.com to accept BTC to settle transactions on its payment network. Coca-Cola accepts Crypto payments through Centrapay platforms, as do Tesla, AXA Insurance, Microsoft, and Paypal through different partnerships and arrangements. The truly disruptive innovation of Blockchain and Stablecoin-based payments bypassing the traditional payments infrastructure is causing traditional providers like credit card networks and other payment facilitators to wake up and test out Blockchain-based technology.

All these instances of greater institutional involvement mark an inflection point for the Crypto market moving the action away from pure speculation (the bulk of crypto transaction volume today) to a shift towards corporates and institutions using tokenized assets for real-world, non-speculative use cases like payments, real estate, equities, and gaming.

Select Institutional and Corporate Partnerships Involving Crypto/Digital Assets Announced Recently

Here are some select partnerships and initiatives announced in just the last few months involving Crypto, Blockchain, and DeFi and why they are notable. We have focused mainly on financial-services-related activities, otherwise, the list would quickly become unmanageable. These deals indicate a broadening of use cases beyond pure speculation to a much larger range of real-world use cases that include augmenting (or sometimes replacing) traditional infrastructure, new kinds of digital and tokenized assets like NFTs, crypto-based payments, etc.

- **Blackrock partners with Coinbase:** This partnership confirms that the biggest asset manager in the world is taking Crypto mainstream and signing up with the biggest player in the crypto space - Coinbase. The deal is about creating new access points for institutional crypto adoption by connecting Coinbase Prime to Blackrock's portfolio management product suite Aladdin. Coinbase Prime will provide crypto trading, custody, prime brokerage, and reporting to Aladdin's institutional clients which are some of the largest asset managers in the world. Coinbase Prime is a major institutional prime broker platform for Crypto assets with 13,000 customers.
- **BNY Mellon enables Crypto custody:** BNY – the largest custodian in the world has begun offering Crypto custody after receiving approval from the Federal Reserve. Powered by the cryto-native custody firms,Fireblocks, BNY will store Crypto keys for thousands of fund managers (that are clients) so they can access and transfer BTC and ETH. Other essential bookkeeping, reporting, and compliance services

will also be offered. This is a landmark development because BNY is a powerhouse in custody, it is an example that traditional, incumbent firms are coming to Crypto, and this will catalyze more offerings from other custodians.

- **Block-owned TBD partners with Circle:** TBD, the open platform for Decentralized Bitcoin exchanges owned by Block has partnered with Circle Internet Finance (issuer of the USDC stablecoin) to enable cross-border, dollar-linked Stablecoin saving and remittance for investors worldwide. The goal is to improve access to dollar-linked Stablecoins, especially in countries with devaluing currencies like Argentina, Pakistan, Turkey, and Ukraine. Investors in these countries can park savings in US dollar-linked Stablecoins to avoid local capital controls or inflation-driven currency devaluation. This is a big endorsement of Crypto and Stablecoins involving one of the biggest payment facilitators and the second-largest Stablecoin issuer. It is a powerful example of the onramps and offramps being built between fiat currencies and digital assets for the future.
- **Google partners with Coinbase to accept Crypto Payments for Cloud Services:** Google will use Coinbase Prime to accept Crypto payments from customers with Coinbase earning a percentage on each of these transactions. This is part of Google's larger goal to make building applications in Web3 faster and easier for all types of customers using its Cloud platform. This partnership is part of the firm's major push this year to help Blockchain-based businesses build tools that third-party developers can use to run decentralized applications.
- **Nasdaq enters Crypto Custody:** The Nasdaq Digital Assets division is launching crypto custody for institutional clients as part of its bigger plan to become a full-service provider to institutions involved in Crypto and Digital Assets. The exchange also offers security and crime prevention for Crypto trades, as well as Crypto-related index solutions. But Nasdaq is entering a very crowded field of Crypto-custody providers that includes traditional custodians like BNY Mellon, asset managers like Fidelity Investments, and Crypto specialists like Fireblocks, Anchorage Digital, BitGo, and Coinbase.
- **New Institutional Crypto Exchange Launched, Backed By Traditional Firms:** A consortium of the largest Broker/Dealers, market makers, and VCs have launched EDX Markets, an institutional Crypto exchange hoping to narrow spreads by aggregating liquidity, improve transparency and reduce market manipulation and providing the same ease of access and connectivity as their backers already do for other asset classes. The backers are huge incumbents: Charles Schwab, Citadel Securities, Fidelity Investments, Paradigm, Sequoia Capital, and Virtu Financial, with more investors expected to join. EDX will go live by Q1 2023 and aggregate liquidity from retail firms, brokers, payment facilitators, retailers, and other Crypto market participants.
- **Fidelity Investments makes Crypto available in retirement accounts:** Fidelity Investments, one of the largest 401(k) providers in the US, announced this Summer that it will launch a new workplace Digital Assets Account (DAA) enabling employers to give workers access to Bitcoin in 401(k) accounts. The bitcoin held in these Digital Asset Accounts will be custodied by Fidelity Digital Assets. This is the first instance of a major 401(k) provider enabling investors to own a position in digital assets and a monumental move towards allowing investors broad access to Crypto. MicroStrategy was the first customer of this service with more clients lining up. We must mention that The Labor Department and many lawmakers have expressed serious concern and urged caution for 401k accounts to be allowed to hold Crypto investments.
- **Strike and Shopify partner to enable Payments using the Lightning Network:** Strike has partnered with Shopify to increase bitcoin acceptance among merchants and vendors using the Lightning Network. This is notable because Shopify has two million merchants on its platform across 175 countries, and implementing the Lightning Network will provide crucial onramps to the Crypto and Digital Asset worlds for all these customers. About 100,000 users currently have access to Lightning payments with another 80 million people who may be able to access payments on the Network. The partnership

between Strike, Shopify, and the Lightning Network means that transactions will be settled faster (instant settlement on Lightning Network instead of 3-5 day settlement for traditional payments) and with significantly lowerfees than on-chain transactions.

Future Course for Crypto: Where Do We Go From Here

It is easy to be distracted by the 70% decline in Crypto prices and the demise of once-prominent companies in this space like Celsius. But problems in the Crypto market this year are overwhelmingly related to CeFi companies that had weak business models, bad governance, and poor risk management, or were over-leveraged. It is not a reflection or an indication of the health of the Crypto and Digital Assets ecosystem nor of long-term demand. This year's events don't even cast a shadow on core DeFi infrastructure which performed well, and just as expected. For a deeper analysis of this issue, read our Viewpoint "Claims That DeFi Is Unraveling Or Structurally Flawed Are Unfounded". Having said that, the collateral damage and loss in investor confidence could stymie Crypto and Digital Asset growth for sure. We are already seeing that with significantly lower retail participation in Crypto, a 65% drop in spot BTC daily trading volumes this Summer though they have recovered recently, and a 72% decline in Total Value Locked (TVL) in DeFi since December 2021. All this could further erode customer confidence and delay institutional acceptance, involvement, and adoption of these models. It may also hinder or delay much-needed investment in Crypto infrastructure.

But in the long term, we see continued demand for Crypto and Digital Assets and a broad range of tokenized assets. The most profound and disruptive implementation of this technology – DeFi, is bound to grow over time. It is built on sound technology and infrastructure and addresses key drawbacks of TradFi and CeFi, including opacity, decentralization, and human folly/greed. Regulatory concerns about AML/KYC and other risks remain. But broader interest in using Crypto and Digital Assets, enabling the use of Crypto for payments, and inclusion in retail and institutional investment portfolios, seems to be continuing. The triumvirate of smart capital, institutional interest, and the best programming talent moving toward tokenized assets, will keep the momentum going for sure.

As further proof of this, the smartest private investors are continuing to support portfolio holdings in this space, especially companies that build infrastructure for institutions to be able to utilize Crypto. There are 10 Unicorns in this sector including firms like Fireblocks, FalconX, and NYDIG, and another 20-25 firms that could surpass a $1Bill valuation in the next few months. The real momentum in the Crypto and Blockchain spaces is in the technology being quietly built behind the scenes. So instead of focusing on Crypto/token prices and trading volumes, let's focus on the consistent growth of institutional infrastructure, interesting partnerships between TradFi/Crypto companies, and greater institutional adoption of Crypto, which may not always capture headlines, but is a more meaningful indication of where things are headed in the long-term.

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