

# Bridging the gap between traditional and digital currency markets

**360T** explores how traditional solutions from the FX markets can further advance the digital currency space by diversifying its range of participants

**I**n recent years, the technology, infrastructure and overall ecosystem around digital currency trading has been evolving at close to breakneck speed, as providers rushed to fill surging demand for access to these products.

Overwhelmingly, the vast majority of this demand was coming from retail brokers, platforms and crypto-trading hedge funds, all looking to service this seemingly insatiable appetite. A natural consequence of this is that the aforementioned ecosystem – which includes trading venues – was developed to cater to the specific needs of these customer segments.

But digital currencies are an increasingly attractive proposition for many participants in the traditional FX market, such as institutional investors and corporates, and there are grounds to believe 2022 might be the year more of them begin trading and holding these assets. If this does happen, it will likely have a profound impact on the digital currency market.

There are many reasons digital currencies are either attractive or necessary for these firms. For example, they offer the potential to generate outsized returns relative to many other asset classes and are uncorrelated to the other assets in investors'

existing portfolios, helping them diversify exposures. Some firms are increasingly eyeing these products as a hedge against inflation. Corporates will increasingly be confronted by the consumer or supplier who wants to change the nature of how they make payment.

However, the current infrastructure has not been built with the traditional customer segment in mind and creates a barrier to entry for those FX market participants.

For example, when it comes to trading venues, these organisations have rigorous demands around the robustness, security and stability of the platform and have



high expectations about the level of service and support they will receive from the venue operator themselves. In addition, these are often highly regulated entities that are in turn looking for a regulated trading environment with transparent rules and processes in place to match the requirements of their own compliance frameworks.

For many buy-side firms these compliance considerations will also include a requirement to achieve and prove best execution, for which being able to connect with multiple liquidity providers on one platform to compare and contrast pricing is essential. As we've already seen in the FX markets, putting pricing into competition via a single connection leads to spread compression and drives execution efficiencies, which will benefit users more broadly in the digital currency space.

Another key consideration for these companies is the track record of the venue in question. They're looking for battle-tested infrastructure solutions that can demonstrate a history of strong performance over a long period of time. In addition, they want to be confident in what the ownership, structure and focus of the providers that they partner with will look like many years into the future – something that can be challenging when many of the providers in the crypto space have only been around for a few years.

All of which means we're more likely to see existing FX platform providers rather than crypto firms step in to effectively act as a bridge between the fiat and digital currency markets for traditional financial services firms. More specifically, it will be the FX platform providers who have long-standing relationships with a diverse client base from across the entire spectrum of capital markets – from asset managers and corporates, to hedge funds and retail brokers – that will be best positioned to achieve this.

Somewhat ironically, given blockchain is often touted as a 'trustless' mechanism for moving assets such as digital currencies, trust will be the key to the broader adoption of these assets within financial markets.



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Another crucial point is that to enable the broadest swath of the existing FX market to start participating in the digital currency space they need to be provided with different ways to gain exposure to these products.

Providing access to the digital currency spot market is the obvious starting point, but this requires an end-to-end solution that provides an agnostic execution layer seamlessly linked to custody and settlement services. This, again, needs to meet very high standards in terms of security and reliability.

Another concept gaining traction is digital currency non-deliverable forwards (NDFs), which have the potential to offer synthetic exposure to this asset class without any of the infrastructure complexities associated with utilising blockchain technology or holding digital assets. The trading technology and workflow could look very

similar to FX NDFs, enabling firms to integrate this easily into their existing trading operations, and they could potentially use traditional credit models for managing digital NDF cashflows.

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Just as this technology fuelled the growth of the FX market to the size of \$6.6 trillion per day in notional turnover at last count, it will also drive the next evolution of the digital currency space by bringing a truly diverse range of participants into this market. **A**