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What does Prime Brokerage look like for Digital Assets ?

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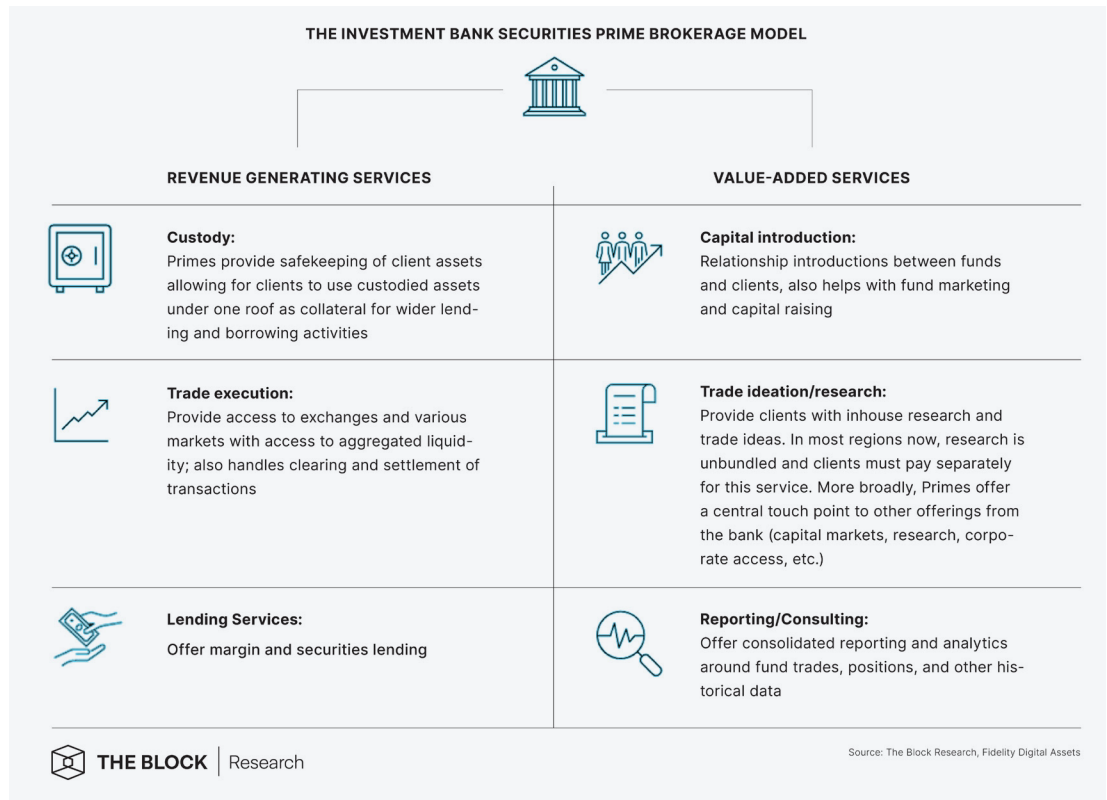
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What is a Prime Broker?

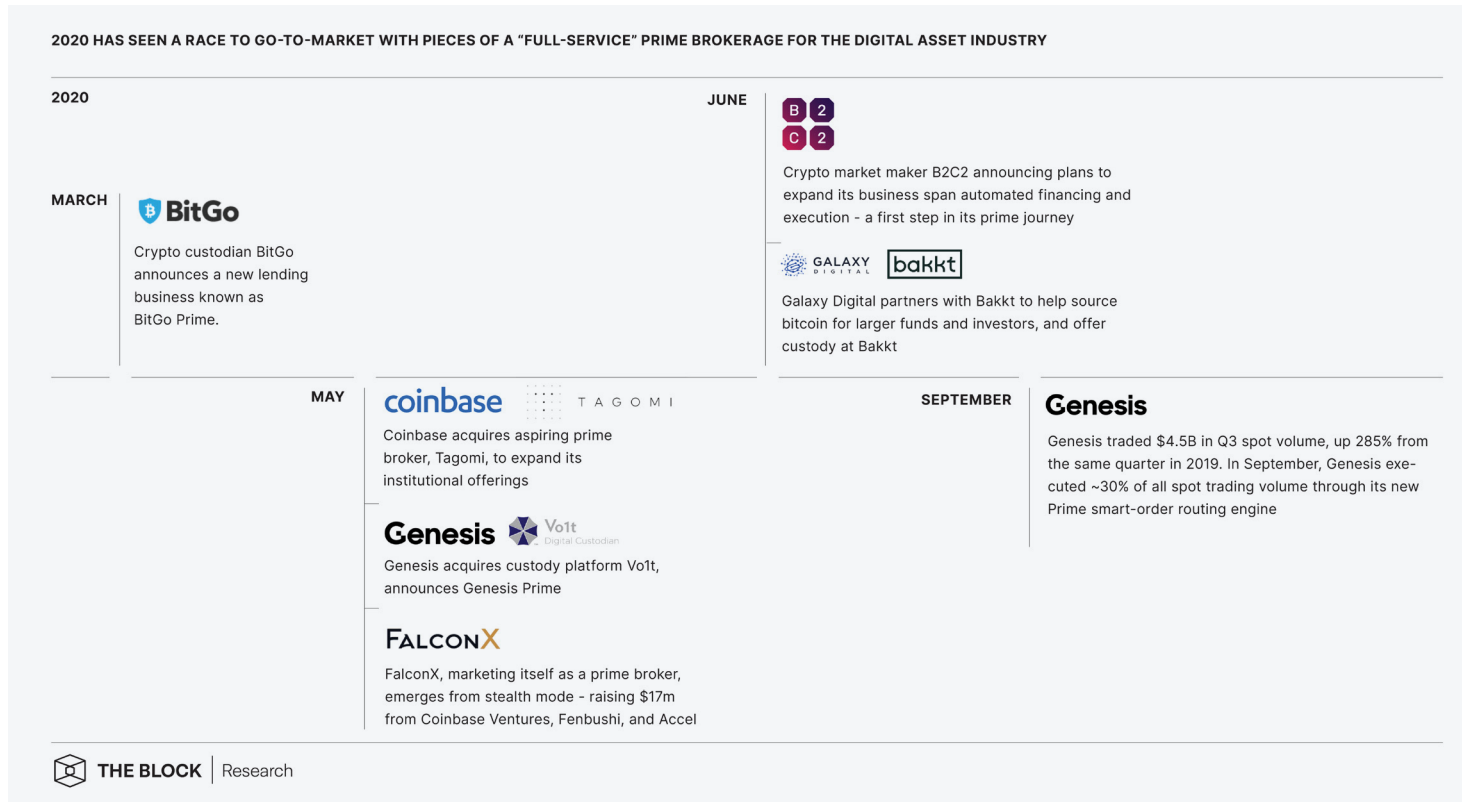
Prime brokerage services are a staple of large investment banks, assisting funds and asset allocators as they navigate markets, manage risk, build capital, among other value-added services. More recently, it has become a sort of buzzword in the digital asset space.

The buzz makes sense. In traditional finance, prime brokers sit between institutional investors and the market and offer an array of services, including custody, trade execution, risk management, lending services, capital introduction, and consulting. Crypto traders have long predicted that the addition of prime brokerage services to the market could lure institutional investors from the sidelines who expect the kind of streamlined end-to-end service model already available in traditional markets.

Companies ranging from Fidelity Digital Assets to crypto custodians such as BitGo to over-the-counter trading firms like B2C2 are aiming to break into the potential market for prime brokerage services, eyeing the same kinds of customers and business lines that, according to [Global Custodian](#), will help traditional banks generate \$30 billion this year.



Already in 2020, we've seen a handful of companies make strategic acquisitions or launch new lines of business in order to build a full one-stop-shop prime offering. Some of the larger events highlighted are below:



What does Prime Brokerage look like for Digital Assets?

A recent study entitled [The Institutional Adoption of Digital Asset Trading](#) by [Acuiti](#), an analytics platform for the global derivatives market, surveyed senior executives from the buy-side, sell-side, and proprietary trading groups specialized in traditional derivatives trading to better understand what is holding back institutional adoption of digital asset trading.

The common concerns expressed in the results varied. Some highlighted counterparty risks, while others raised questions about trading institutions and service providers. Other respondents brought up career risks. Ultimately, the magnitude of concern varied depending on the type of institution surveyed (sell-side firms, service providers, and trading institutions).

What does Prime Brokerage look like for Digital Assets?

The survey found that, in the short-to-medium term, the institutional market for digital assets is expected to “grow in-line with the expansion of offerings by existing institutional exchanges.”

In a separate institutional investor survey conducted this year, [Fidelity Digital Assets](#) found that nearly 40% of institutional investors surveyed in the U.S. and Europe said they were currently investing in digital assets, and 60% believe digital assets have a place in institutional investor portfolios.

To make digital assets more accessible to institutional clients, firms within the sector have focused on building out various niche service offerings across OTC desks, liquidity providers/aggregators, custody solutions, settlement solutions, smart order routing, execution businesses, clearing solutions, trade messengers, and algorithmic trading platforms. However, unlike more mature markets, digital asset market structure continues to be highly fragmented with liquidity and services split unevenly across various offerings around the globe.

While a handful of players have recently moved to bundle some of these offerings under one roof, there are still [at least 115 firms building out institutional infrastructures for digital assets](#).

Mapping the Institutional Digital Asset Infrastructure



In May, The Block Research [spoke to over 40 different firms](#) that operate across digital asset infrastructure to get a better sense of what participants view as the biggest risks and structural pieces still missing within this market.

One of the common themes that emerged from these conversations was the clear need for a “full prime services” offering — that is, a player that sits in the middle of the market and offers a one-stop-shop for spot and derivatives trading aggregation, margin extension, custody services, capital introduction, and even trade ideation (similar to a role equity and trading research plays for traditional banking prime services).

Recognizing the need to provide these services under one house, several players emerged in 2020 on a journey to do just that, albeit approaching the full suite of offerings from different core starting points that range from:

Custody: Institutional-grade custody for digital assets. In some cases, custody supports settlement requirements for trade executions, transaction processing, and same-day settlements.

Market Making/OTC: Providing two-sided liquidity for buyers and sellers.

Borrow/Lending: Offering access to borrow/lending digital asset credit markets where the provider acts as the trusted counterparty.





Derivatives: Providing liquidity across crypto derivative markets, whether that’s OTC or providing clearing services for derivatives markets (options and futures) and bilateral OTC derivatives. Can include pricing and structuring more exotic derivative contracts for clients.

Clearing/Settlement: Offering settlement assurances, or the act of transferring ownership (settling) in-line with the underlying agreement between parties. For digital assets, serving as a trusted escrow agent or sitting in between two trading parties is still an area that isn’t as robust as in traditional markets.

Execution: Trade messengers and execution platforms that can offer smart order routing and improve algorithmic systems for cryptocurrency trading. Execution can be either principal-based (where the other side is the dealer) or agency-based (where the intermediary is only a middleman).



Full-Service digital asset prime offerings are coming, but firms are approaching from different starting points

Firm	Custody	Market Maker	OTC Desk	Lending	Derivatives	Clearing/Settlement	Execution
 B2C2		+	+	+	+		+
 BitGo	+			+		+	+
 coinbase	+		+	+		+	+
 Fidelity DIGITAL ASSETS.	+						+
 FALCONX						+	+
 GALAXY DIGITAL	+	+	+	+	+		+
 Genesis	+	+	+	+	+		+

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One unique secondary effect of digital asset infrastructure fragmentation is an underlying market structure that is more entangled than traditional markets, one that sees crypto exchanges and OTC desks as some of the main companies looking to build prime offerings. That stands out when considering Nasdaq, NYSE, and market makers such as Virtu don't offer full prime services in traditional markets.

Looking ahead, the consensus view among market participants is that many institutional digital asset providers will look to expand their offerings across these verticals in a bid to look more like a traditional prime offering.

The challenge for contenders will be figuring out how to do every service really well while also navigating an uneasy regulatory environment that differs across jurisdictions and states (there really isn't a one legal entity structure like a broker-dealer license in traditional equities that allows you to accomplish this bilaterally across the U.S.).

Given the pace of digital asset market-structure maturation, the answers to these two considerations will continue to force providers to evaluate whether it's more prudent to build new offerings in-house or attempt to consolidate with other established niche services in the market.

While still early — and public data from different providers is sparse — companies such as Genesis Trading are beginning to demonstrate the power of a unified bundled prime model with offerings that span custody, OTC and derivative trading, lending, and other execution services.

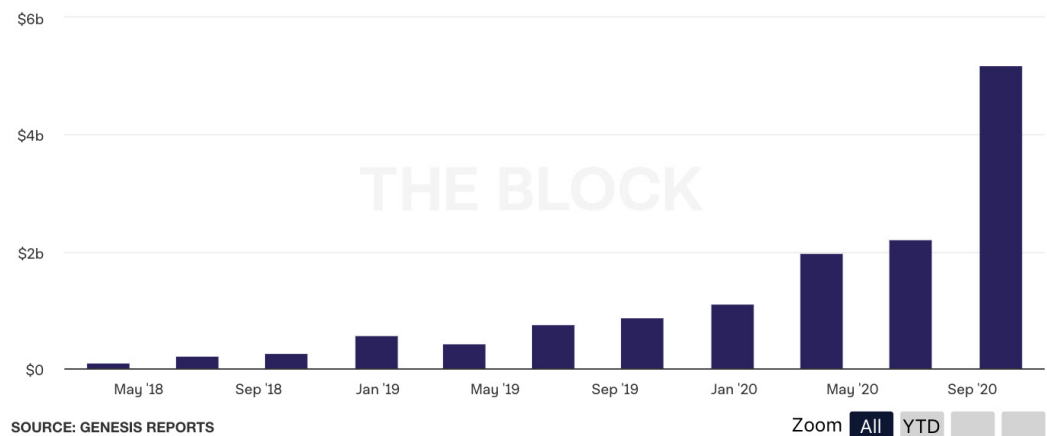


In its latest [3Q Digital Asset Market Report](#), the first full quarter of offering Genesis Custody (and with it a full bundle of prime offerings), Genesis reported spot trading volume of \$4.5 billion (up 285% Y/Y), \$1 billion worth of derivatives volume traded, and ~\$5.2 billion in loan originations (62% Q/Q) with \$2.1 billion outstanding loans (50% Q/Q).

Meanwhile, Genesis executed nearly 30% of all spot trading volume in the quarter (~\$4.5 billion) through its new Prime smart-order routing engine, with the expectation for the system to soon allow access to an upcoming agency trading launch (a way to aggregate liquidity across exchanges with pass through execution).



Loan Originations of Genesis Global Trading (Quarterly)



Perspectives from the industry: The opportunity in digital asset prime brokerage

The Block Research asked industry participants to share their views on the opportunities for prime services in digital assets, illustrate what gaps remain across these offerings, and offer perspectives how to best compete across the service suite.

The full responses are aggregated below, but a few consistent threads emerged from these conversations:

- **There still isn't a full-prime offering for digital assets, at least not like the kind that exists in typical financial markets.** This is partly due



to the size and maturation of the market, leading various providers to specialize within specific segments.

- **A commonly stated differentiator among responses on how to best compete across digital asset prime offerings was access to a robust balance sheet.** Many digital asset PM solutions come from an entity that is relatively small, venture-funded, and with a balance sheet that can't support large institutional accounts nor withstand various wider market shocks. This has pushed exchanges and large lending desks to support more digital asset prime-like functions, given their access to larger balance sheets.
- **Perceived opportunities for digital asset prime brokers were varied across responses:** institutional derivative offerings (options, cross margin products, etc.), more automated execution specifically around financing, better reporting/tooling capabilities, deeper capital efficiency/more robust credit markets, other value-added services (research, cap intro, distribution, etc.).
- **Gaps that remain in the market were largely perceived to be around clearing/settlement and deeper bank/capital market support.**



Q: How do digital asset prime brokers look and act differently than traditional PB models?



Greg Tusar

Head of Institutional Product
Coinbase

“Prime brokerage in traditional financial markets began when clients wanted to be able to buy/sell securities potentially with many brokers and wanted to maintain all of those positions in one place to more easily facilitate the provision of margin financing and borrow for shorting purposes. Traditional firms that have PB units always wanted to bundle services, but at its core, traditional PB is primarily about financing. In the digital asset space, traditional clients entering the space are driving more immediately to bundled services to mitigate the operational frictions of executing and custodial in different places. Having best in class execution capabilities including algorithms and smart order routing, together with a best class Custody product with financing/margin capabilities, together with a robust OTC trading offering are the pillars to success in digital asset PB.”



Nick Carmi

CEO
BitGo Prime

“Traditional Prime Brokerage is a mature market, where leading service providers offer a comprehensive bundle of services—cap intro, research, stock borrow/loan, trading on margin, accounting. The opportunity in crypto markets is for larger service providers with a sterling reputation and access to deep, broad liquidity and credit to build a similar one-stop shop to service larger institutional clients. At minimum, crypto prime should be the same as traditional prime services. Crypto markets are relatively small, so the indicators for a mature PB market will be white glove client service, deep inventory, multi-Prime and Prime of Prime.”



Christine Sandler

Head of Sales and Marketing
Fidelity Digital Assets

“Today, no single provider meets the standard of a typical non-crypto prime. Prime brokers in traditional markets, lend, custody assets, and offer trading both on a facilitated basis and direct market access with a full suite of algorithmic products across multiple asset classes. Prime Brokers enable clients to implement diverse investment strategies and reduce the costs of deploying more sophisticated strategies.”

Q: How do digital asset prime brokers look and act differently than traditional PB models?



Shiliang Tang

Chief Investment Officer
LedgerPrime

“A distinct feature I think in digital asset markets and PB in the space is that the exchanges and OTC counterparties (trading/borrowing/lending) currently control most of the risk and risk calculations/margin/collateral, and these calculations also differ by exchange/OTC often for even the same product, especially in derivatives or margined products. As a result, there hasn't been a fully comprehensive PB in crypto yet given they would largely be behooven to exchanges/OTC and their methodologies, which kind of defeats then the purpose of a PB.”



Max Boonen

Director & Founder
B2C2

“There is less bundling in crypto PB. The traditional functions of PB - financing, execution, custody, etc. - can sometimes be performed efficiently by different providers on a standalone basis, reducing the cross-selling efficiencies that favour one-stop shops. In any one function though, the economies of scale represent a barrier to entry, leading to a small number of large specialists in each segment.”

Q: What opportunities remain for digital asset PB?

**Greg Tusar**Head of Institutional Product
Coinbase

“There are many opportunities remaining for the digital asset Prime Broker as it is still early days in the space. The entrance of traditional institutions and funds is in its infancy, product offerings such as cross-margining derivatives and cash, and the development of a larger base of long/short strategies that demand borrow for tokens is in its infancy as well.”

**Nick Carmi**CEO
BitGo Prime

“There is a tremendous market opportunity for a trusted intermediary, like BitGo, to provide a holistic service approach to clients through ease of trading, settlement, extension of credit & lending, high-touch service among other things.

The opportunity lies in building a comprehensive PB solution to attract those traditional market participants. They want to bring their business to a PB that understands their needs and can provide the service level they are accustomed to.”

**Christine Sandler**Head of Sales and Marketing
Fidelity Digital Assets

“Quite a bit of fragmentation still exists in spot trading along with a lack of transparency, including tools to measure execution quality on either a pre- or post-trade basis. Lack of capital efficiency is also a gap – for example, there are few institutional lenders and an inability for clients to net collateral. Additionally, common value-added services are lacking, such as a strong market data construct and services like capital introduction and distribution.”

**Max Boonen**Director & Founder
B2C2

“Two things. First, the market is ripe for more automation. For instance, execution is very electronic since the rise of e-dealing in 2019, but the services around it such as financing are not. Second, practices around the extension of credit remain lackluster. In part, this is due to a volatile industry where dominant players can disappear (MtGox, KNC, Circle,...) in favour of new entrants who don't have a long history.”

Q: What gaps remain in the market?

**Greg Tusar**Head of Institutional Product
Coinbase

"There are several key gaps to consider. While banking support for the crypto space has improved dramatically in the past several years, bank support for a wholesale funding or 'repo-like' market for digital assets would greatly accelerate the financing abilities of Prime Brokers."

**Nick Carmi**CEO
BitGo Prime

"The primary gap is fungibility of assets via a central clearing counterparty. The market needs true institutional grade providers with full stack capabilities to offer the type of service required by large institutional players."

The speed of execution is also a critical component -- the size and performance of crypto pipes needs to match the speed of execution and settlement of traditional assets. Crypto has no DTCC, CREST, or Fedwire equivalent - many believe this is a good thing - but it leaves institutional counterparties beholden to the performance and risks of the blockchain. Settling a 1000 BTC transaction can take minutes while a .01 BTC settlement can take hours; processes need to be predictable and performant."

**Christine Sandler**Head of Sales and Marketing
Fidelity Digital Assets

"Robust risk management, true capital efficiency (full scale lending and collateral management) and an institutional options market."

**Alan Lane**CEO
Silvergate

"The ability to offer settlement services is a service that our customers have asked us for. Cryptocurrency markets still are not as mature as traditional financial markets, typically on the digital asset side. Somebody has to go first in these transactions. There isn't an escrow agent in the middle of most of these trades. But what if we have both transacting parties on SEN? Then we can represent to both sides of a transaction that the funds are there and process accordingly. Essentially helping our customers as that trust intermediary on both sides of a digital currency transaction is something we are interested in providing."

*On an episode of The Scoop, April 2020

Q: How do digital asset primer brokers best compete?**Greg Tusar**Head of Institutional Product
Coinbase

"There are 4 primary ways that a prime broker can set themselves apart from the competition. First and foremost is the strength of their financial condition and regulatory approach. A strong balance sheet and creditworthy status allows the PB to weather any financial condition and engenders the trust of its clients. A strong financial condition is also key to access to capital markets which is the only way a PB will be able to grow its financing business. Institutions will insist that their counterparties are regulated and have strong AML/KYC processes, well audited financials, and a high degree of operational excellence. Next is a best in class offering in each of the pillars mentioned before.

Digital asset-native customers will be ok with an unbundled offering, so each of Custod Execution, OTC and Financing need to stand on their own to compete with point solutions from others. However, new entrants from traditional markets will look at the efficacy of the entire bundle, so a complete offering for them is absolutely key. Third is service -- particularly in the digital asset space, white glove service is critical for clients who may be new and in need of education along the journey of gaining exposure to a new asset class. And lastly, of course, fees."

**Nick Carmi**CEO
BitGo Prime

"Currently, it's primarily fee based and which provider offers best-in-class security. As the business matures, the best PBs will win on the basis of credit, depth of market reach, broad range of services provided, and client service and support.

It's a mix of all three, but availability of credit is key. Also risk appetite/risk management and inventory depth. Borrowers want access to inventory at the lowest rate but need to be able to trust their PBs have the maturity, patience, and capitalization to withstand market events without broad loan terminations that impact investment strategies."

**Christine Sandler**Head of Sales and Marketing
Fidelity Digital Assets

"An effective prime broker needs to tick all the boxes. Important characteristics include creditworthiness, the provision of capital and acc balance sheet, technology (e.g., upgradeable tech for lending and trading, risk management, connectivity to clients and markets), and access to derivatives and synthetic instruments. Digital asset prime brokers will also compete on trust, reputation, and product offering. Service is a given."

Q: How do digital asset primer brokers best compete?



Michael Moro

CEO
Genesis Trading

“While there’s no doubt that fees and trust/service matter, I don’t think anything matters as much as balance sheet and the ability to lend. Capital is often scarce in crypto, and the ability to offer leverage in institutional size is the key differentiator for prime brokers.”



Max Boonen

Director & Founder
B2C2

“This depends on the function. Custody is about trust first. Execution is about cost. Financing is around service and flexibility.”

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We have a proven track record driving results for some of the world's largest digital asset focused hedge funds, family offices and market makers. [Click here](#) to learn more about Genesis. [Click here](#) for details about Genesis Prime, our digital asset prime brokerage. [Click here](#) for our Q3 results, including \$4.5 billion in spot volume traded, \$1 billion in derivatives volume traded, and \$5.2 billion in new loan originations.



