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JP Morgan, Apollo use fund tokenization for personalized portfolios

10 hours ago • by Ledger Insights

JP Morgan and Apollo Global partnered on a blockchain proof of concept (PoC), as part of the Monetary Authority of Singapore's (MAS) Project Guardian tokenization trials. By tokenizing funds, including alternatives, its possible to automate and personalize the discretionary portfolios of wealthy clients, a $5.5 trillion space.

included the Cosmos based Provenance Blockchain and an Ethereum compatible subnet on the Avalanche blockchain.

To date much of the emphasis in fund tokenization has been on the ability to expand the client base, improving liquidity. This PoC covers that because tokenization enables alternative assets to be included in portfolios more easily alongside publicly traded assets. JP Morgan and Apollo estimate this could be a $400 billion revenue opportunity for alternative fund managers (such as Apollo) as well as distributors.

Today wealth managers typically offer a limited list of approved alternative funds on an advisory basis. However, the client has to complete the paperwork and make payment themselves. Hence, tokenization can enable better distribution of alternative funds via wealth managers.

But there's another equally, if not more important, potential for blockchain. Asset managers can use blockchain to automate and transform asset management, by tokenizing the assets in a portfolio. This will not only enables efficiencies but also the potential for personalization. Until now, it's mainly fund distributor Calastone, owned by Carlyle, that has been pushing this vision for years. Another Project Guardian initiative with Schroders and Calastone also explores this.

Key tokenization findings

For a wealth manager with 100,000 portfolios, monthly rebalancing typically involves 3,000 steps. With the JP Morgan Crescendo prototype, that becomes a few clicks.

One of the more surprising findings was the benefit of real time settlement. JP Morgan estimates that typically 3% of portfolios are held in cash, losing a potential 8% return over cash. That percentage could be reduced to zero with real time settlement, yielding a benefit of 24 basis points. However, zero cash assumes all assets are perfectly liquid. Anyway, the 0.24% represents 20% of costs.

And there's the $400 billion revenue opportunity if alternative funds are distributed more efficiently.

How the fund tokenization PoC worked

For the PoC, Onyx developed a portfolio management prototype, Crescendo, to automate a significant amount of the portfolio management. Wealth managers generally have model portfolios for wealthy clients. Some clients might be more interested in capital appreciation versus income. Others want a greater emphasis on ESG. One might think of a model portfolio as a template.

Alternative asset managers JP Morgan Private Bank, Apollo and WisdomTree tokenized their funds on three blockchains: Onyx Digital Assets (private, Ethereum-based), Provenance blockchain (public, permissioned zone, Cosmos-based) and a permissioned Avalanche subnet (Ethereum-compatible).

Axelar was used for interoperability between the Provenance blockchain and Onyx. And LayerZero was used to connect Avalanche with the Onyx ledger. As an aside, Biconomy's account abstraction was used on Avalanche so that an asset manager doesn't need to use crypto to pay for gas fees.

Next up was to make changes in a model, replacing one fund asset with another. The smart contracts automatically redeemed fund assets and subscribed to others, despite the funds living on separate blockchains. Likewise the discretionary portfolios were automatically updated when a client added more capital.

A couple of existing relationships underpinned this PoC. Christine Moy was formerly with Onyx by JP Morgan and is now Strategy partner at Apollo responsible for Digital Asset. And Apollo has a relationship with Figure Technologies to explore fund tokenization. Figure is the founder of the Provenance blockchain. Apollo and JP Morgan published a report on that PoC.

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As part of Singapore's Project Guardian tokenization trials, UBS, SBI and DBS Bank executed a repurchase transaction (repo) of a natively issued digital bond on a public blockchain. The transactions spanned three jurisdictions, Japan, Singapore and Switzerland.

Regulators are still wary about the institutional use of public blockchain. One of the aims of Project Guardian is to show what's possible. Additionally, this transaction demonstrated real-time atomic settlement and capital efficiencies.

"With this pioneering transaction, we proved the feasibility of executing a fully automated and instantly settled transaction across several jurisdictions by leveraging a public DLT network under a strict compliance framework," said Mike Dargan, UBS Group's Chief Operations and Technology Officer.

Repo is widely used by banks for short term finance in which they sell a bond and agree to repurchase it a day or week later. In this transaction, a JPY bond was natively issued on a public blockchain using the UBS Tokenize platform. The settlement was instant using a JPY stablecoin issued by SBI's Shinsei Trust & Banking. The repo transaction involved borrowing Japanese yen against the bond, with the proceeds used to buy more bonds.

Eventually, it was unwound and the bond was redeemed. That part of the process – paying the principal and interest at maturity were all executed on chain. Hence the entire lifecycle

Fernando Luis Vázquez Cao, CEO of SBI Digital Asset Holdings (SBI DAH) said the transactions were "an example of the strength of partnerships SBI DAH has with large global institutions and across the SBI group, with SBI SECURITIES as counterparty to the repo transaction and Shinsei Trust & Banking as the issuer of JPY stablecoin."

As an aside, Japan supports different types of stablecoins, including those directly issued by a bank or ones issued by a trust bank on behalf of an issuer holding the reserve assets in trust.

UBS and SBI tokenization activities

UBS Asset Management conducted another pilot under Project Guardian for a tokenized money market fund as previously reported. This involved a collaboration with SBI Digital Markets.

Meanwhile, SBI has a wide array of blockchain activities. One of the features of blockchain is they are global and linking jurisdictions is part of SBI's goals. Hence this Project Guardian use case's international dimension is typical.

SBI recently invested in Standard Chartered's Zodia Custody. Plus, Zodia formed a digital asset custody joint venture with SBI DAH in Japan, SBI Zodia Custody. SBI Digital Markets provides advisory, tokenization and custody services. And AsiaNext is a joint venture with Switzerland's SIX. With an institutional focus, it aims to create cross broder secondary markets for crypto and digital securities.

You will note there was little mention of DBS Bank. Because of several banking outages, the Monetary Authority of Singapore has banned DBS from participating in certain activities for six months, including innovation.

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