# Investing in Digital Assets

**Family office and high-net worth investor perspectives on digital asset allocation**

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# Contents

# Foreword

Digital assets have exploded in recent years and are now a trillion-dollar alternative asset class. Well-established cryptocurrencies like Bitcoin and Ethereum have been joined by other options including non-fungible tokens (NFTs) and decentralised finance (DeFi) tokens, while the associated infrastructure has also developed, creating a wide variety of new investment choices. The huge growth has attracted mainstream attention, with institutional investors entering the space. However, volatility in the market has been a feature, with some digital assets experiencing significant swings in value.

Family offices (FOs) and high-net worth individuals (HNWIs) have also moved into the digital asset sphere. However, while the digital assets ecosystem presents plenty of growth opportunities, it is still a new, complex and fast-moving market, with a wide range of cryptocurrencies and other digital assets available, as well as a huge array of service providers. With the global regulatory landscape still catching up with the rapid development of the sector, there remains uncertainty around how digital assets will be treated.

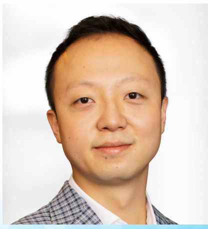
To better understand the opportunities and challenges that FOs and HNWIs are seeing in the digital assets ecosystem, KPMG China and Aspen Digital have joined forces to gain insights into their current activity in the market and plans for future investment.

*Investing in Digital Assets - Family office and high-net worth investor perspectives on digital asset allocation* is a report based on a survey of FOs and HNWIs in Hong Kong and Singapore, as well as interviews with industry stakeholders. It takes an in-depth look at where and how FOs and HNWIs are investing, the key drivers behind their choices, as well as the main challenges they see to investing in the sector.

The report found that the vast majority of respondents are interested in the sector, with particular interest in cryptocurrencies. Many respondents were also investing in service providers, so they can benefit from exposure to growth in the overall market. The report also explores the key concerns of investors around regulation of digital assets and their treatment for tax purposes.

We would like to thank all survey respondents and interviewees for their contributions to this report, and for sharing their insights into the digital assets investment environment in Hong Kong and Singapore. We hope that this report provides you with greater understanding of the digital assets investment landscape from the perspective of HNWIs and FOs, and we welcome the opportunity to discuss these findings further.

**Paul McSheaffrey**
Partner, Financial Services
KPMG China



**Yang He**
CEO/Co-founder
Aspen Digital

# Executive summary

Digital assets have evolved to an alternative asset class in recent years, with a market capitalization of more than USD 1 trillion. Family offices and high-net worth individuals in Hong Kong and Singapore have embraced this new asset class, with more than 90 percent of our survey respondents already investing in the space or planning to do so. The prospects of high returns and portfolio diversification have driven the growth in interest, while the increased participation by mainstream institutional investors has helped to spur confidence in digital assets.

## Widespread interest in digital assets

The inaugural Investing in Digital Assets report, jointly authored by Aspen Digital and KPMG China, provides an in-depth insight into the current perspectives of family offices (FOs) and high-net-worth individuals (HNWIs) on investing in digital assets. The report also looks at investors' portfolio allocation, the types of assets they favour, and the key challenges they perceive in the digital asset space.

The report is largely based on a survey of 30 FOs and HNWIs in Hong Kong and Singapore carried out in the second quarter of this year, as well as in-depth discussions with survey respondents and other stakeholders.

Despite the volatility in the digital asset market in the past two years, FOs and HNWIs are keen to invest in the sector. The survey found that 92 percent of respondents were interested in digital assets, with 58 percent of FOs and HNWIs already investing and 34 percent planning to do so.

The main reason for the growing interest is the huge upside potential. Since digital assets emerged around a decade ago, investors have seen outsized returns, although recent volatility may have an impact on expectations. Another factor is the increase in mainstream institutional investors who are now investing in digital assets, which has given FOs and HNWIs more confidence about the sector.

The industry has also seen a huge amount of development in terms of infrastructure and talent acquisition. The demand for high quality talent from service providers is expected to continue.

In terms of hurdles to investing in digital assets, respondents to the survey noted the evolving global regulatory environment and difficulties in accurate valuation. They also shared concerns about the volatility in the market.

## Portfolio allocation

Although many FOs and HNWIs are now investing in digital assets, the allocation typically remains relatively small, with most of them allocating less than 5 percent of their portfolios. While more than half of respondents would like to increase this proportion, others plan to keep it at 5 percent or less.

Among the digital assets that FOs and HNWIs are investing in, cryptocurrencies dominate. All of the respondents who are investing in digital assets own Bitcoin, and 87 percent Ethereum. Those who have not yet invested in the digital space are also most interested in cryptocurrencies and stablecoins.

The survey also shows growing interest in non-fungible tokens (NFTs) and decentralised finance (DeFi), reflecting the huge global growth in both these segments in the past two years.

In terms of how to invest, the landscape for digital asset investment is highly fragmented, with around 500 centralised and decentralised exchanges globally. FOs and HNWIs currently favour cryptocurrency exchanges, which tend to be user-friendly with good customer service, followed by cryptocurrency-focused hedge funds. Some survey respondents said that security was more important than product offerings when choosing cryptocurrency exchanges.

FOs and HNWIs are also investing in digital asset service providers, especially cryptocurrency exchanges and software developers, with 58 percent of survey respondents already investing in such providers, and 21 percent interested in doing so. Investment is either through direct equity, or a hybrid of equity and tokens. The key reasons given for investing in service providers include portfolio diversification benefits and exposure to ecosystem growth.

## Hurdles to investment

As digital assets are fairly new, there is still some uncertainty among FOs and HNWIs about investing in the sector, particularly regarding regulation and valuation. Diverging regulatory approaches to digital assets in different jurisdictions is a key concern according to the survey, and investors are looking for a clear regulatory regime that enables the trading of digital assets.

However, the global environment is evolving as regulators are creating specific regimes to deal with digital assets. Asian regulators are seeking to balance investor protection and the growth of the digital asset market. For example, all virtual asset service providers (VASPs) in Hong Kong will have to apply for a license by March 2024. Singapore is also planning to broaden its cryptocurrency regulations.

Valuing digital assets can be challenging due to the lack of publicly available information, and half of respondents said that this was one of their main concerns. However, there is a lot of real-time data available on the performance of digital assets, so a new methodology could be developed to value digital assets. The limited research methodology and valuation approach on digital assets also hinder investment in service providers.

Some investors also noted a lack of clarity on how digital assets are treated for tax purposes.  In Hong Kong, there are no specific tax regulations dealing with cryptocurrency, for example, leading to some concern about the potential for disputes with the tax authorities. Cryptocurrencies may be less attractive as they do not currently enjoy the tax exemptions that apply to traditional assets.

Another concern of investors is the financial reporting requirements for digital assets that are held for investment purposes. The key issue is not so much a lack of clarity over the accounting that is required, but rather that the required accounting treatment does not meet investors' needs.

The market volatility seen in the past two years has had an impact on investment approaches. Respondents have addressed volatility concerns by adopting market-neutral strategies and investing in stablecoins. Investing in service providers can also help FOs and HNMIs to access the sector's expected growth in the next few years while protecting them from swings in the value of digital assets.

# Chapter 1:

# Interest in digital asset investment among FOs and HNWIs

## Summary of key findings

**Digital assets: an emerging asset class**

58% of FOs and HNWIs interviewed are currently investing in digital assets, while 34% are not yet investing but interested in doing so

**Growing institutional interest**

Increased mainstream institutional attention is cited as one of the top motivators to invest in digital assets

Institutions now have more accessibility to digital asset financial products, including regulated products

**Further regulatory clarity needed**

A current lack of regulatory clarity in areas such as taxation and financial reporting have hindered larger allocations to digital assets in investment portfolios

## Digital assets present huge upside potential, compared to traditional financial assets

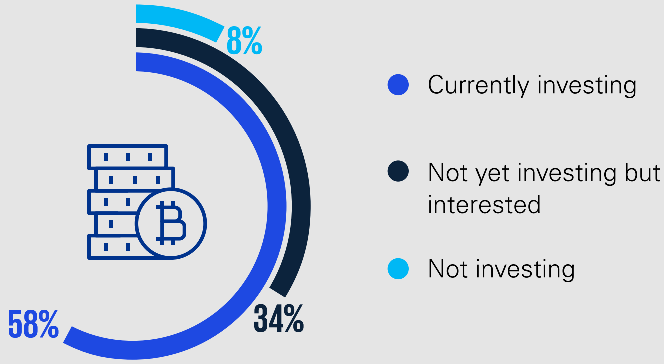
The digital asset industry first emerged in 2009 with Bitcoin, a peer-to-peer electronic currency powered by blockchain technology. The industry then evolved as the digital asset community realised the usefulness of blockchain technology in building decentralised applications. Ethereum is the first public blockchain that brought the smart contract to the mainstream and empowered the birth of key sectors such as decentralised finance and non-fungible tokens. Although there has been volatility in the past two years, the digital asset sector has grown rapidly overall since its inception and is currently a USD 1 trillion industry, as of September 2022.[1]

For the Asian private wealth management industry, the digital assets sector is emerging as an alternative asset class for both clients and wealth managers. This is reflected through our questionnaire, where we found that 92 percent of FOs and HNWIs are currently investing in digital assets or are interested in investing in the future. Currently, 58 percent of respondents are already investing while 34 percent plan to do so [Figure 1].

[1] Global Cryptocurrency Charts - Total Cryptocurrency Market Cap, CoinMarketCap, Sep 2022; https://coinmarketcap.com/charts/

**Figure 1: Investment appetite for digital assets**

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

Since Bitcoin's inception in 2009, digital assets have achieved outsized cumulative returns compared to gold and stocks.[2] In our study, 64 percent of respondents invest in digital assets to capture upside potential, whereas 35 percent do so because of the comparatively low returns of traditional financial instruments such as equities and bonds. However, market volatility in 2022 may have an impact on clients' investment outlook and priorities going forward. As such, clients and private wealth management (PWM) institutions will need to carefully assess the current market conditions with regards to digital asset portfolio management.

*Over the last 18 months, we have seen a huge increase of institutional investor interest in digital assets. For the Asian private wealth management industry, digital assets represent an emerging asset class with opportunities that are unrivalled within other financial products.*

***Yang He***
*CEO/Co-founder, Aspen Digital*

[2] Historical BTC Performance, SmartValor, March 2022; https://smartvalor.com/en/news/bitcoin-performance

## Digital assets are attracting mainstream institutional attention

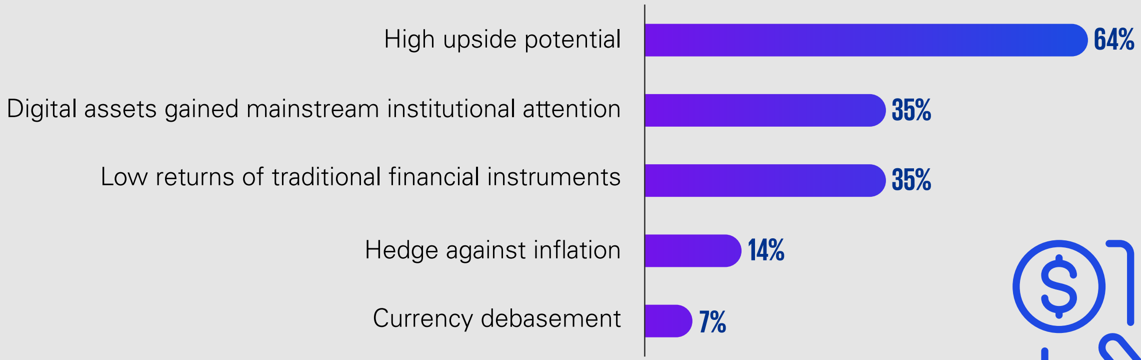
The past year has also seen increasing interest from institutions in investing in digital assets, partly driven by the widening access. For example, the United States Securities and Exchange Commission approved the Bitcoin Futures Exchange Traded Fund in October 2021.[3] Some mainstream institutions are also using blockchain technology to streamline their businesses. This is reflected in our study, with 35 percent of respondents citing the rise in mainstream institutional attention as a key reason they have invested or would like to invest in digital assets [Figure 2].

### Investor insight

*A high-net worth investor we interviewed for this study highlighted that various publicly listed companies have announced their purchases of Bitcoin and Ethereum, showing signs of confidence in the growing asset class. He noted that Bitcoin and Ethereum combined account for 70 percent of his digital asset portfolio.*

### Figure 2: Key reasons to invest in digital assets

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

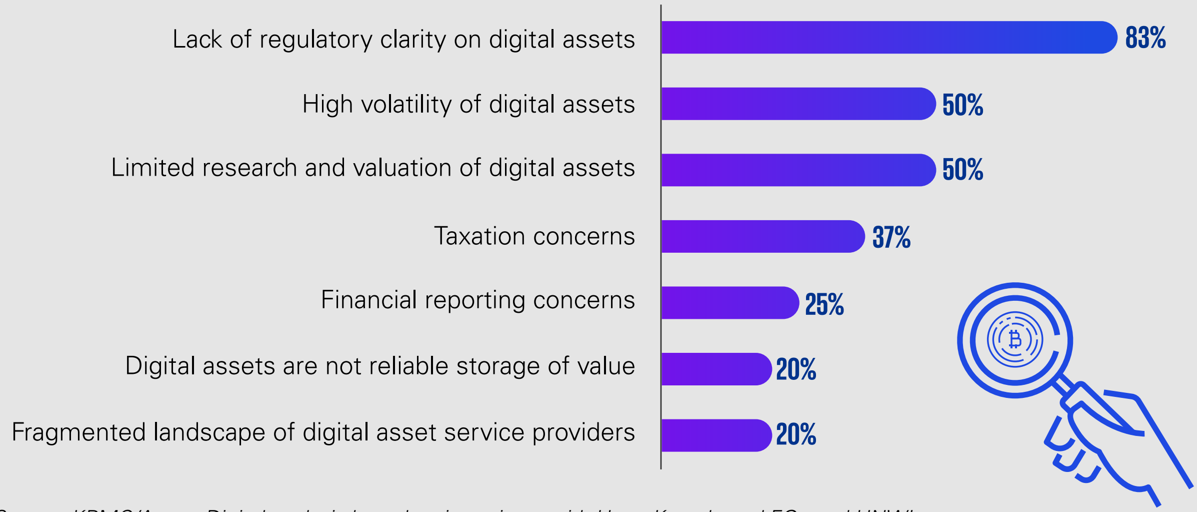

[3] Form N-1A Registration Statement - ProShares Trust, U.S. Securities and Exchange Commission, Oct 2021; https://www.sec.gov/Archives/edgar/data/1174610/000168386321006052/f10028d1.htm

## Regulatory clarity, volatility and limited research on valuation seen as main obstacles to digital asset adoption

According to interviewed respondents, the top three obstacles to digital asset investments are lack of regulatory clarity, high volatility and limited research and valuation [Figure 3]. The results are in line with the 2021 *Hong Kong Private Wealth Management Report*, from the Private Wealth Management Association supported by KPMG China, in which a vast majority of surveyed PWM institutions viewed a lack of regulation and transparency as barriers to greater investment in virtual assets.[4] In terms of areas that lack regulatory clarity, 37 percent and 25 percent of respondents cite taxation and financial reporting as key concerns, respectively.

### Figure 3: Key concerns related to digital asset investment

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

> *Institutional investors are looking for a clear regulatory regime that enables the trading of digital assets. Many jurisdictions are starting to license exchanges and brokers that deal in digital assets, providing more regulatory certainty and therefore comfort to institutional investors. However, we can still expect further developments as regulators start to consider specific regimes that cater for the specifics of digital assets.*

***Paul McSheaffrey***
*Partner, Financial Services, KPMG China*

[4] KPMG China: Hong Kong private Wealth Management Report 2021; https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2021/10/hong-kong-private-wealth-management-report-2021.pdf

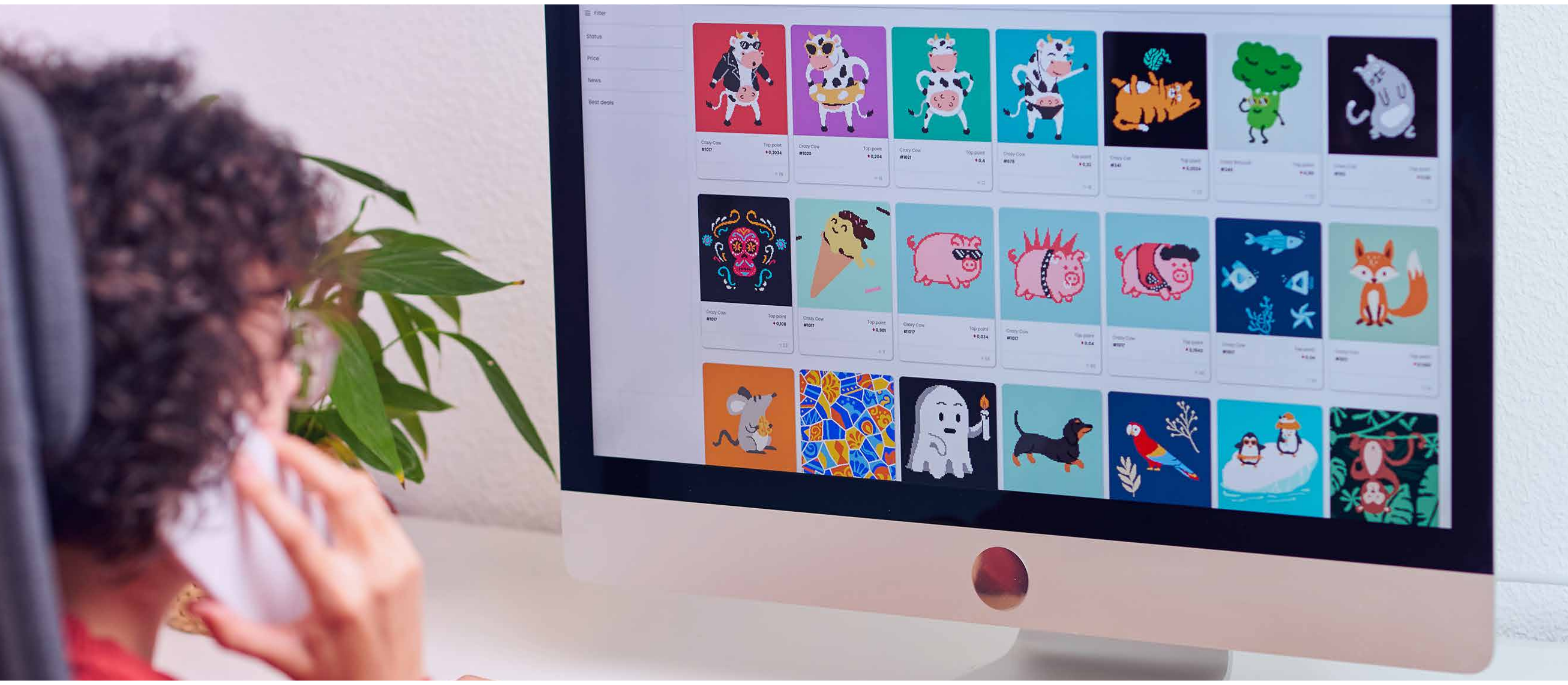
## The digital asset industry is generating huge demand for talent

As the digital asset sector continues to generate high returns, it is increasingly attracting top talent. Likewise, asset management institutions are also increasingly seeking to attract talent with specialised skills and experience in digital assets. According to LinkedIn research, digital asset industry-related job postings grew by almost 400 percent in 2021.[5]

In our study, a chief investment officer from a multi-family office agreed that the digital asset sector is attracting a broad array of talent, including entrepreneurs, engineers and support staff, who are founding and building companies that are creating and capturing immense value. To help grow the industry, their approach is to work with experienced managers with proven ability to join and support founders early on their journey.

*Despite the recent market volatility, the industry has seen a huge amount of development in terms of infrastructure and acquisition of talent. With digital asset service providers critical to expedite mainstream adoption, we are likely to continue to see a high demand for quality talent among these providers.*

***Elliot Andrews***
*Head of Business Development, Aspen Digital*



[5] LinkedIn analysis, LinkedIn News, Jan 2022; https://www.linkedin.com/posts/linkedin-news_theworkshift-economy-labormarket-activity-6887062336839016450-67iT/

# Chapter 2:

# Portfolio allocation and diversification of digital asset investment

## Summary of key findings

**Current portfolio allocations to digital assets are below stated targets**

Most FOs and HNWIs (60 percent) interviewed are presently allocating less than 5 percent of their portfolios to digital assets, while more than half (54 percent) say they want to allocate between 5 and 30 percent

**Present dominance of Bitcoin and Ethereum**

All of respondents who are investing in digital assets own Bitcoin, while 87 percent own Ethereum

**Rise of non-fungible tokens (NFTs) and decentralised finance (DeFi)**

60 percent of respondents who currently own digital assets are investing in NFTs

DeFi tokens were still emerging, with 47 percent of respondents owning digital assets investing in them

## Current vs desired allocation of digital assets

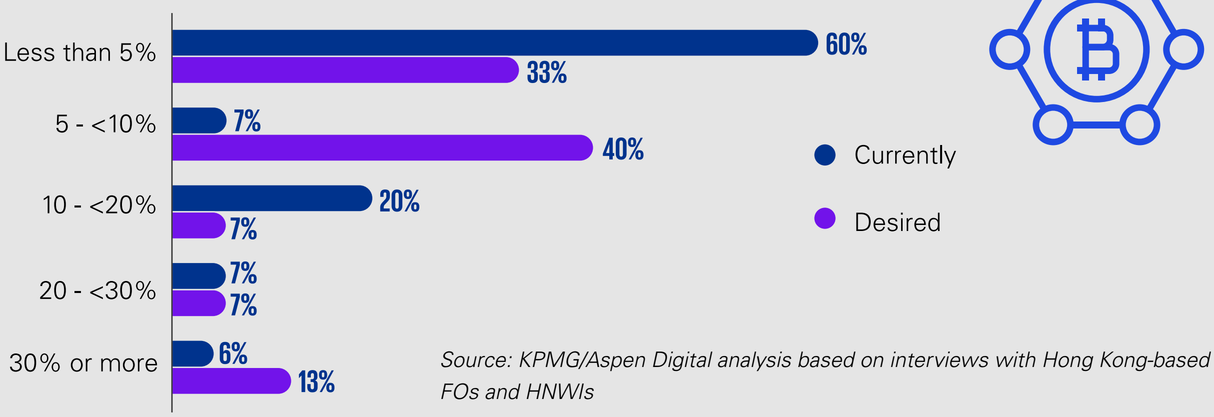
While the interest in digital assets is increasing, PWM clients and institutions alike are adopting a cautious approach to this emerging asset class. A significant proportion (20 percent) of respondents are allocating 10 – 20 percent of their portfolio to digital assets, but for the majority (60 percent), digital assets make up less than 5 percent of their portfolio.

The proportion is likely to remain relatively small, with 40 percent of respondents reporting that they intend to invest 5 to 10 percent of their portfolio in digital assets, while 33 percent say they want the proportion to remain below 5 percent.

For those with more conservatively planned allocations, market volatility was a key reason cited. A Financial Officer from a Hong Kong-based family office currently allocates less than 5 percent of their portfolio in digital assets and plans to remain within this band. Another Head of Investments from a Hong Kong-based hedge fund agrees, highlighting that while digital assets present innovation potential, an exposure of less than 5 percent is currently desirable given recent volatility in the pricing of digital assets.

### Figure 4: Current vs desired portfolio allocation for digital assets

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

### A majority of respondents own Bitcoin and Ethereum in their digital asset portfolios, and they are open to exploring investments in decentralised finance (DeFi) and metaverse-related tokens

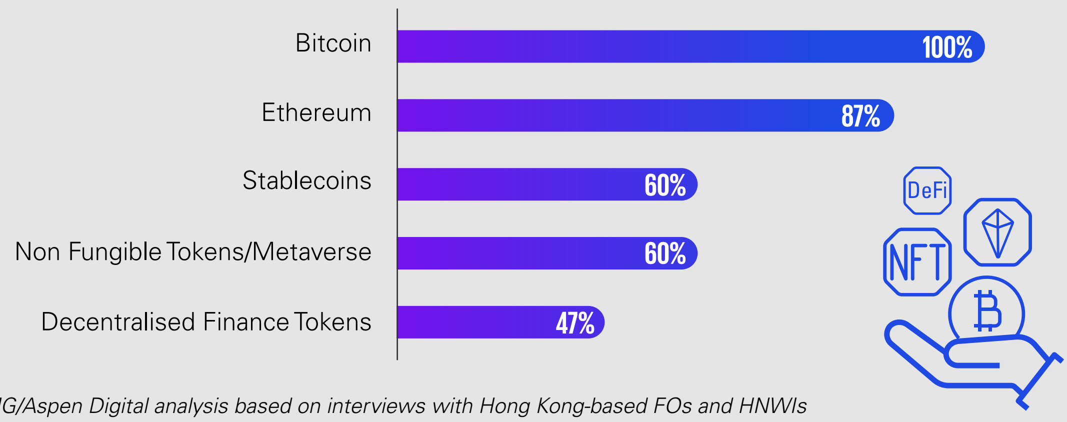
All respondents who are currently investing in digital assets own Bitcoin and 87 percent currently hold Ethereum – comprising 19 percent and 20 percent of their digital asset holdings respectively [Figure 5]. The top three areas of interest for them with regards to digital assets are store of wealth, decentralised finance and non-fungible tokens/metaverse. Respondents that are not currently investing in digital assets also tend to be more interested in cryptocurrencies such as Bitcoin, Ethereum and stablecoins [Figure 6 on next page].

Several interviewees expressed their interests in investing in decentralised finance and metaverse, as both sectors had gained mainstream attention and presented huge growth potential. One high-net worth investor said he does not currently invest in digital assets but is open to gaining digital asset exposure in the future. In particular, he said he was bullish on Ethereum's scalability and ecosystem development following the upgrade to its blockchain technology, which took place as expected in September.

> *To increase allocation to digital assets requires related hedging and derivative products to allow investors to manage risk effectively. The development of such products outside of popular tokens such as Bitcoin and Ethereum will help to drive allocation to a wider range of digital assets.*
>
> ***Paul McSheaffrey***
> *Partner, Financial Services, KPMG China*

**Figure 5: Digital asset allocation and types in portfolio**

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed who are currently investing in digital assets*



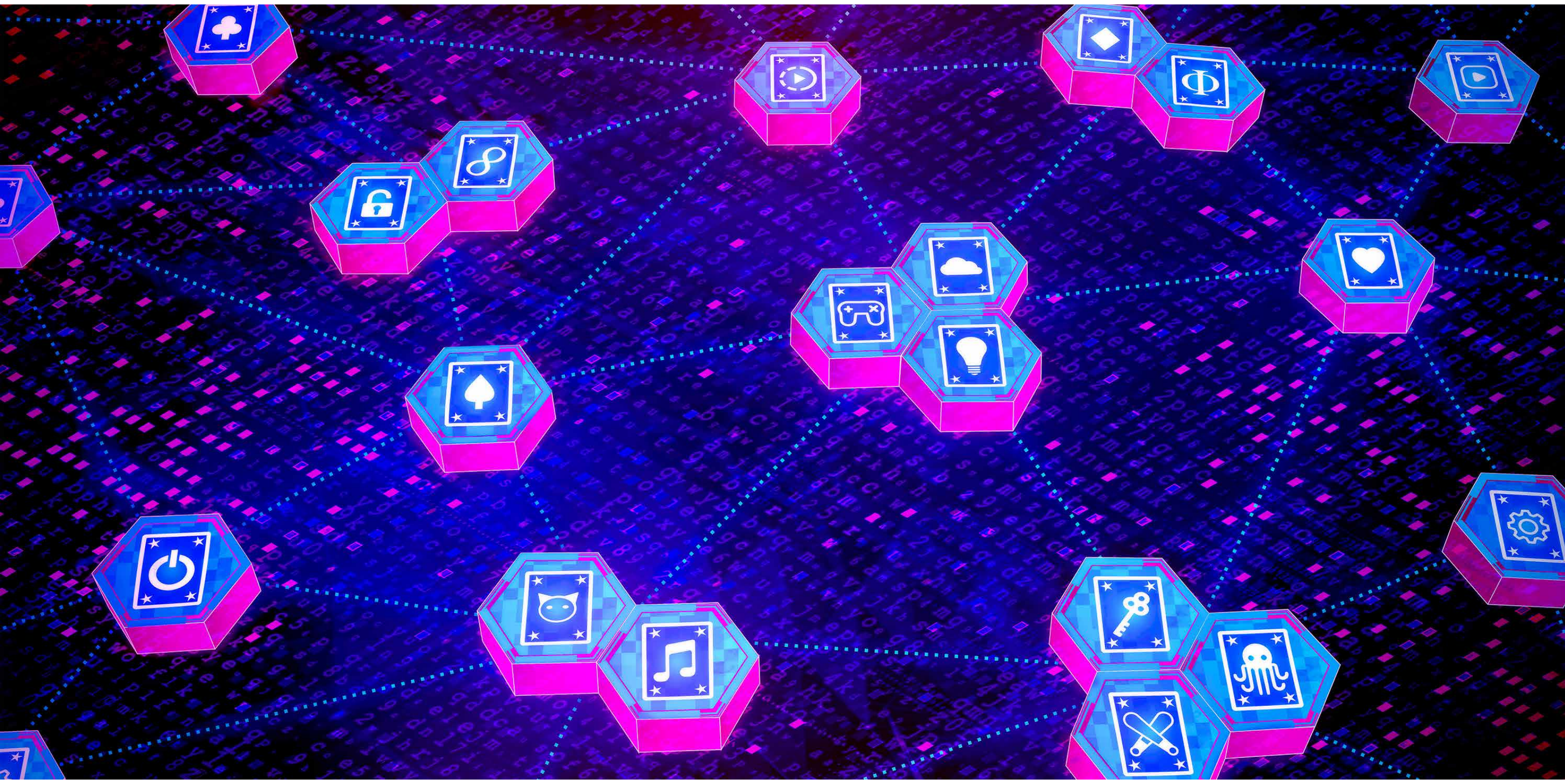

*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

## Decentralised finance is attracting institutional attention with its potential to disrupt the financial services industry

Decentralised finance (DeFi) consists of financial services enabled by public blockchains and smart contracts, with no ability for a central party to intervene or manipulate users' assets.[6] The DeFi market size is measured by total value locked, meaning the total value of assets deposited in smart contracts. Since 2020, the DeFi market has evolved into a billion-dollar market, with a total value locked of approximately USD 55.4 billion as of September 2022.[7] The innovation appeal of DeFi has led to a growing user base. The number of unique addresses transacting DeFi assets has grown 4.8x since 2021 – and this figure has remained stable despite recent market volatility.[8] DeFi is listed as one of the top areas of interest among current digital asset investors [Figure 6].

In our study, 60 percent of respondents that invest in digital assets are currently investing in DeFi tokens, and interviewees also acknowledged DeFi's potential to disrupt financial markets. One Asian hedge fund manager pointed out that DeFi can be a 'game changer' for financial markets, given blockchain's ability to facilitate seamless transactions and enhance security. However, the interviewee added that DeFi is far from mass adoption, and still has a relatively low user base.

Another interviewee, the Head of Investments from a Singapore-based external asset manager (EAM), noted that their clients are increasingly interested in DeFi applications, from yield farming on decentralised exchanges to using asset swaps to transfer their assets across multiple blockchains.



6 Crypto Insights #1. An introduction to decentralised finance, KPMG China, Oct 2021; https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2021/10/crypto-insights-part-1-an-introduction-to-decentralised-finance.pdf
7 DeFi Llama, Overview, accessed September 2022, https://defillama.com/
8 Number of unique addresses that bought or sold a DeFi asset worldwide from Dec 2017 to July 4 2022, Statista, July 2022; https://www.statista.com/statistics/1297745/defi-user-number/

## Non-fungible tokens and the metaverse gain institutional interest

The metaverse and non-fungible tokens (NFT) represent the next generation of the internet and could reshape the way businesses and consumers engage, transact, socialise and work. The metaverse is an estimated $13 trillion market opportunity that could boast as many as 5 billion users by 2030, according to Citibank estimations.[9]

According to our study, 60 percent of respondents are currently investing in NFTs or metaverse-related tokens, with the median allocation of 8 percent of their digital asset portfolio. This sentiment is also echoed in our in-depth conversations with family offices: in one of our discussions, a Head of Research from a Hong Kong-based single family office identified enhanced token utility and price transparency of NFTs as future catalysts for mass adoption. He added that regulation of NFTs could mitigate speculative activities and pave the way for a healthy development of the emerging sector.

### Figure 6: Key areas of interest within digital assets

| Rank | Among FOs/HNWIs who are currently investing in digital assets | Among FOs/HNWIs who are not currently investing but plan to invest in digital assets |
|---|---|---|
| 1st | Store of Wealth | Stablecoins |
| 2nd | Decentralised Finance | Bitcoin |
| 3rd | Metaverse/Non-Fungible Tokens | Ethereum |
| 4th | Smart Contract Platforms | Central Bank Digital Currencies |

*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

### Investor insight

*The current state of the metaverse at present is similar to the first internet boom in the late 1990s. The future of the metaverse may be led by companies that are not founded yet, with some current providers becoming obsolete as new leading players emerge.*

*CEO, Hong Kong-based hedge fund*

9 Metaverse and Money: Decrypting the Future, Citi, March 2022; https://ir.citi.com/gps/x5%2BFQJT3BoHXVu9MsqVRoMdiws3RhL4yhF6Fr8us8oHaOe1W9smOy1%2B8aaAgT3SPuQVtwC5B2%2Fc%3D

# Chapter 3:

# Methods of digital asset investment

## Summary of key findings

**FOs and HNWIs are utilising cryptocurrency exchanges for digital asset investment**

Cryptocurrency exchanges and crypto-focused hedge funds are the most common ways that FOs and HNWIs interviewed for our study are investing in digital assets

**Security is a key consideration in choosing cryptocurrency exchanges**

Respondents consider security to be a top consideration when choosing a cryptocurrency exchange

**Team and track record are crucial in selecting a digital asset service provider**

FOs and HNWIs consider the team and past track record as important factors when choosing a digital asset service provider

### Family offices and HNWIs primarily invest in digital assets through cryptocurrency exchanges and crypto-focused hedge funds

When the digital asset industry was in its infancy, peer-to-peer trading platforms and cryptocurrency exchanges were the main avenues to buy and sell digital assets. As the industry develops and attracts institutional interest, investors can gain digital asset exposure through multiple avenues, such as hedge funds, cryptocurrency exchange-traded products and direct investment in digital asset service providers.

According to our study, the top three ways for family offices and HNWIs to gain digital asset exposure are centralised or decentralised cryptocurrency exchanges, cryptocurrency-focused hedge funds and direct investment in digital asset service providers. A family office executive we interviewed said that they are preferring to take a diversified approach to gain broad exposure to all major growth drivers behind the digital asset economy and defer to their general partner relationships in making thematic, sector-specific bets.

### Figure 7: Most popular methods for digital asset investment

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed who are currently investing in digital assets*

- CBDC — Centralised or decentralise cryptocurrency exchanges — 1st
- Cryptocurrency-focused hedge funds — 2nd
- NFT — Direct investment in digital asset service providers — 3rd

*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

### Market-neutral strategies gain popularity in light of recent market volatility

As a result of the recent market volatility, family offices and HNWIs have adopted a more rigorous risk management approach to convert their digital asset holdings to stablecoins or market-neutral strategies. One interviewee from an external asset manager highlighted the importance of protecting the principal value of digital asset investment, in particular during times of volatility.

FOs and HNWIs are also adopting market-neutral strategies, which aim to take advantage of inefficient pricing between various digital assets. This strategy emerged as a common alternative investment among several of our respondents, as it gives them exposure to digital assets and returns without having to forecast the direction of the market.

### Team and past track record are crucial in choosing digital asset service providers

The digital asset industry landscape is highly fragmented – family offices and HNWIs have multiple avenues to gain digital asset exposure. The decision of choosing digital asset service providers is based on multiple factors, such as the team's track record, industry reputation, business model, compliance standards, and more.

Our study indicates that the team behind the service provider (68 percent) and past track record (58 percent) are crucial for family offices and HNWIs in choosing their digital asset service providers [Figure 8]. This is followed by matching investment mandates and industry reputation.

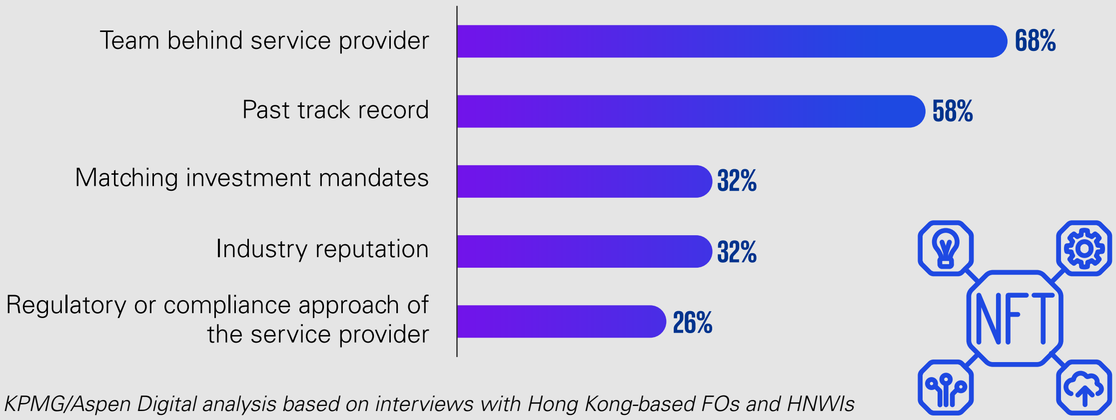
**Investor insight**

*"In times of market volatility, our organisation has deployed market-neutral strategies, such as basis trade and statistical arbitrage, to set a cushion against market decline. However, market-neutral strategies are not risk-free as there are execution risks and price filling risks to deploy the strategy."*

*Chief Investment Officer, Hong Kong-based hedge fund*

**Figure 8: Leading reasons for choosing a digital asset service provider**

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed who are currently investing in digital assets*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

In light of recent market volatility, robust risk management controls and operational transparency are also important for FOs and HNWIs when choosing their digital asset service providers. One family office interviewee noted that the financial transparency of a digital asset service provider, including the source of yield in the yield-generating products offered, is a crucial factor, particularly with the recent market volatility.

> *While many platforms offer attractive returns and yields, gaining an understanding of the risks and strategies the platform uses to generate these yields is critical. Security and risk management are the two key areas that digital asset service providers need to have strong policies around.*
>
> ***Yang He***
> *CEO/Co-founder, Aspen Digital*

## Family offices/HNWIs value user experience and data security over liquidity when choosing cryptocurrency exchanges

Cryptocurrency exchanges are a highly fragmented landscape – there are around 300 centralised exchanges and more than 200 decentralised exchanges as of September 30 2022.[10]

The considerations when choosing a cryptocurrency exchange are multi-fold, including the exchange's trading volume, product offerings, liquidity, security, user experience and more. According to our study, 74 percent of respondents favoured cryptocurrency exchanges that are easy to use and provide a good user experience.

Other popular reasons in choosing cryptocurrency exchanges include proven security record and regulatory status. In choosing cryptocurrency exchanges, one high-net worth investor said that security is more important than the number of coin offerings. He said he believes cryptocurrency exchanges that offer security are more likely to attract professional traders, as the exchanges are less vulnerable to hacks.

Leading cryptocurrency exchanges have a wide variety of customer segments ranging across the wealth spectrum and with various levels of maturity, sophistication and experience in dealing with these types of digital platforms. A good experience in cryptocurrency platforms often goes beyond just ease-of-use – many platforms are in fact industry leaders in providing innovative propositions.

For less sophisticated users, an introductory cryptocurrency experience should focus on ease-of-use. However, as users become more mature in this space, they will be looking to experience new and unique propositions. As a result, an extensive education system for such propositions is commonly provided by cryptocurrency platforms to ensure a high-level experience. For example, it is very common for cryptocurrency exchanges to accompany new and sophisticated propositions with videos to guide users as well as providing the right risk management disclaimers in place.

[10] Top Cryptocurrency Spot Exchanges, CoinmarketCap Sep 2022; https://coinmarketcap.com/rankings/exchanges/

Many cryptocurrency platforms have excellent customer service teams and communities have been built up through continuous engagement and feedback with their users. As the market continues to innovate and evolve, users are expected to become more sophisticated and redefine what a great experience is.

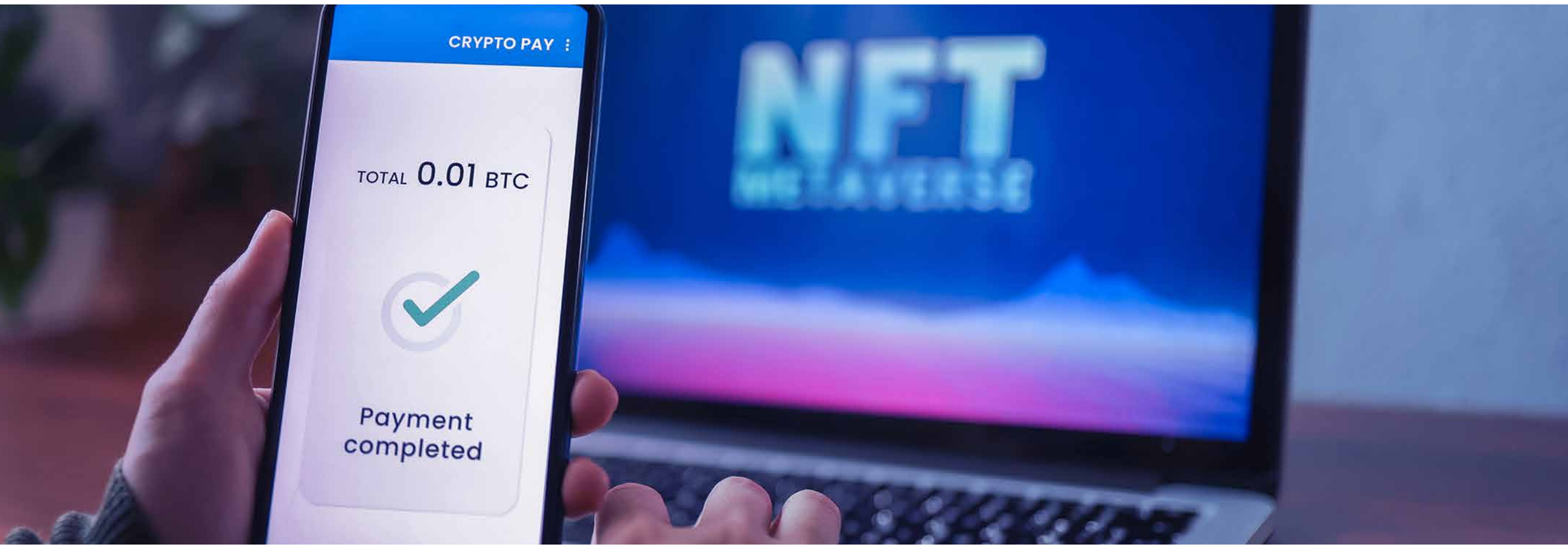
### Figure 9: Leading factors in choosing a cryptocurrency exchange platform

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed who are currently investing in digital assets*

- The platform is easy to use and provides good user interface/experience — 1st
- Proven security record — 2nd
- The service provider is regulated — 3rd

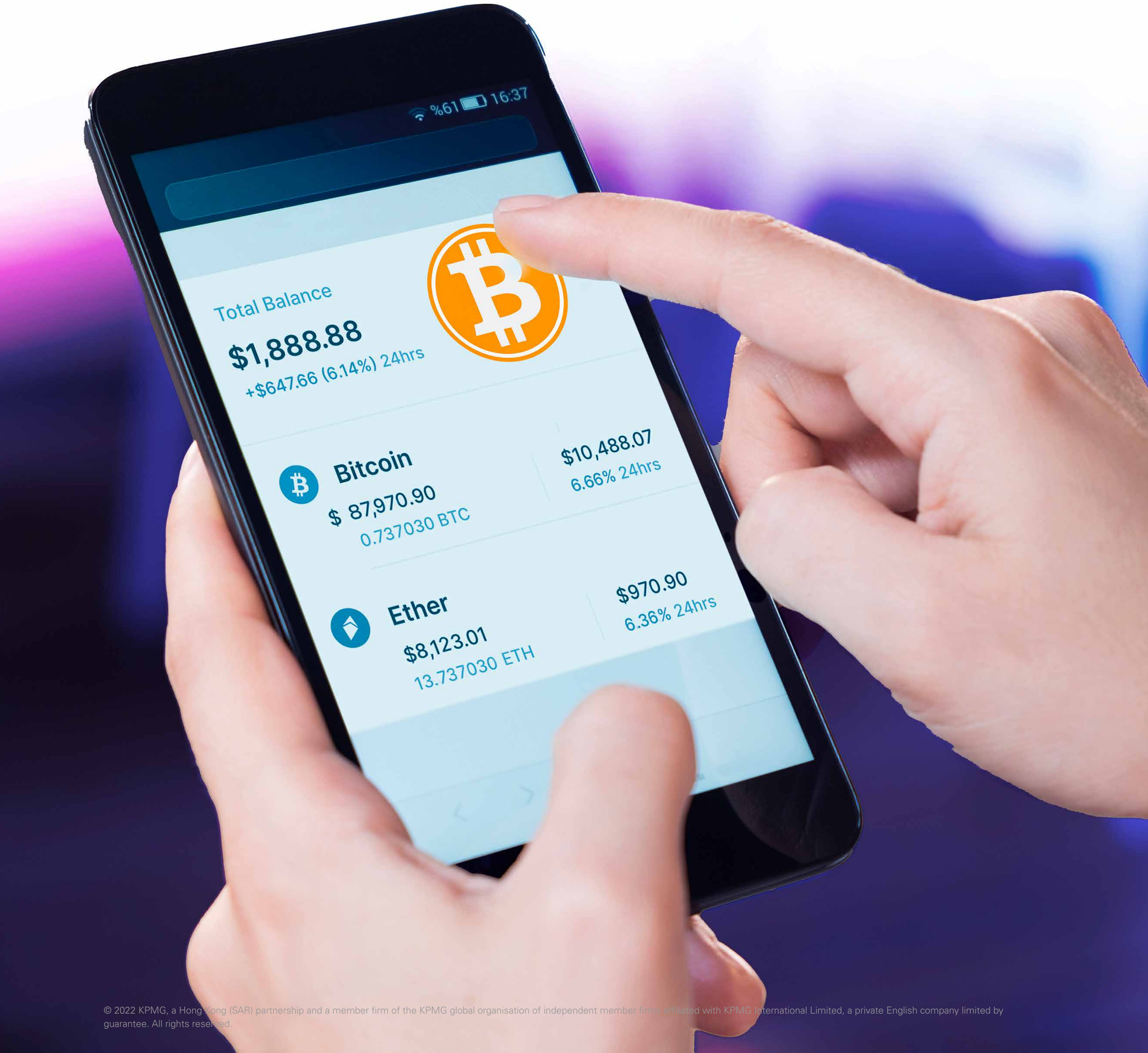
*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

> *From our experience, the biggest point of friction for clients looking to invest is the complexity of the space in general. They are looking for a simple and secure solution combined with exceptional client service to help limit the risks that are inherent in trying to navigate the asset class.*
>
> ***Elliot Andrews***
> *Head of Business Development, Aspen Digital*



# Chapter 4:

# Investing in digital asset service providers



## Summary of key findings

**A majority of FOs and HNWIs interviewed are investing in digital asset service providers**

- 58 percent of respondents currently invest in digital asset service providers, while 21 percent say they plan to do so in the future
- Direct equity is the most common method of investment, while other forms include public tokens or a combination of equity and tokens

**Investments based on business model, execution capabilities**

- Having a solid business model and strong operational capabilities are leading factors in decisions to invest in digital asset service providers, given the current market volatility

**Cryptocurrency exchanges and software developers have high appeal**

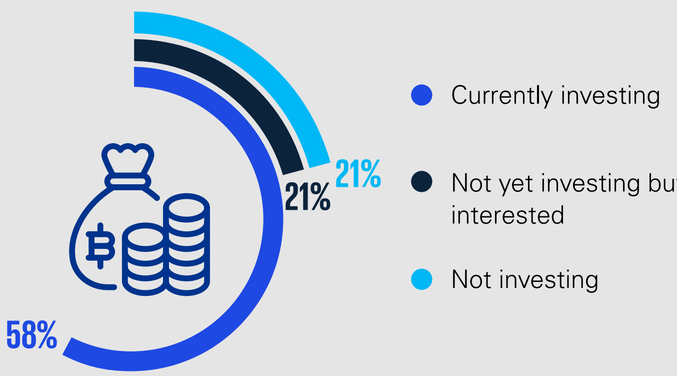
- The most common types of providers receiving investment dollars from FOs and HNWIs are cryptocurrency exchanges and cryptocurrency software developers

Venture capitalists have been investing in Bitcoin and blockchain technology start-ups since 2012.[11] As the digital asset industry has developed, venture capitalists have diversified their blockchain portfolios into emerging sectors such as blockchain infrastructure, decentralised finance, and the metaverse, among others. According to market research firm CB Insights, global venture funding to blockchain start-ups reached USD 24.8 Billion in 2021, an 800 percent year-over-year increase.[12]

Our study indicates that 58 percent of respondents have invested in digital asset service providers. Meanwhile, 21 percent of respondents have not yet invested in such companies but are interested in doing so [Figure 10].

### Figure 10: Appetite to invest in digital asset service providers

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

[11] 10 VC Firms Betting Big on Bitcoin and the Blockchain, Coindesk, Sep 2021; https://www.coindesk.com/markets/2015/07/19/10-vc-firms-betting-big-on-bitcoin-and-the-blockchain/

[12] State of Blockchain 2021 Report, CB Insights, Feb 2022; https://www.cbinsights.com/research/report/blockchain-trends-2021/

*It is still early in the evolution of cryptocurrencies and the wider crypto economy. However, many investors are of the view that the attributes of blockchain technology mean that the overall industry will grow significantly in the coming years. As such, rather than investing in specific cryptocurrencies or tokens, they are investing in infrastructure providers which should benefit from overall industry growth.*

***Barnaby Robson***
*Partner, Deal Advisory, KPMG China*

## Cryptocurrency exchanges and software developers gain investment appeal among family offices/HNWIs

In general, there are two key categories of digital asset service-related providers – infrastructure and applications. Infrastructure-related companies, such as software developers and mining companies, empower innovation in public blockchain infrastructure. Application-related companies focus on innovation in key sectors in the digital asset industry, such as decentralised finance, non-fungible tokens and metaverse. Cryptocurrency exchanges are platforms that facilitate the trading of digital assets and often serve as the gateway for institutions to gain digital asset exposure.

Our study found that 57 percent of respondents have invested in cryptocurrency exchanges or cryptocurrency software developers. This is followed by cryptocurrency custodians and cryptocurrency data service providers at 28 percent each [Figure 11].

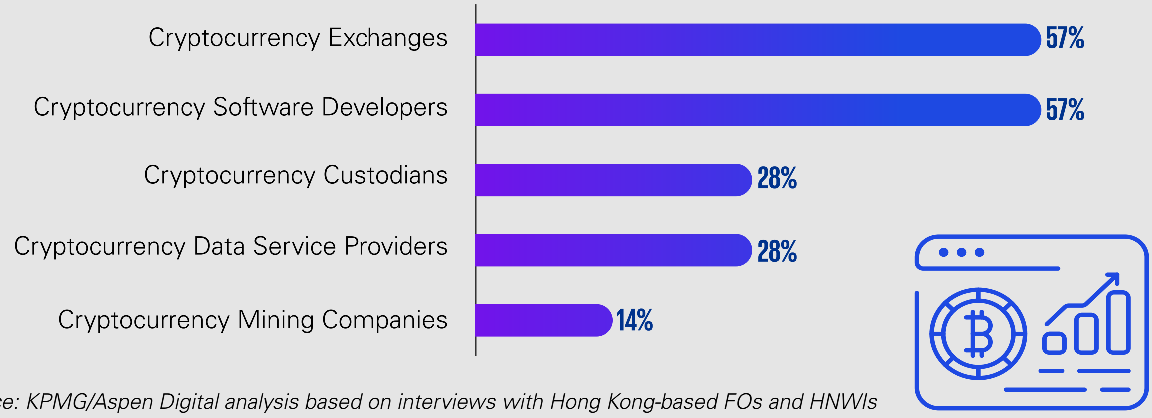
A Chief Investment Officer from a Hong Kong-based single family office we interviewed highlights that cryptocurrency exchanges present huge growth potential, as they are the core liquidity aggregator of digital assets.

When FOs and HNWIs invest in cryptocurrency exchanges, their considerations include:

- Regulatory certainty, i.e. if exchanges have the right licenses
- Quality of anti-money laundering (AML) and know your customer (KYC) controls
- The competitive landscape. As with traditional finance exchanges, typically the key determinant of success is the depth of liquidity on the exchange. Larger cryptocurrency exchanges are expected to grow market share and the industry may trend towards an oligopoly.
- Traditional financial considerations, including growth rates, margins and customer acquisition costs
- Quality of the technology stack and operations, including scalability considerations

### Figure 11: Types of digital asset service providers commonly invested in

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed who are currently investing in digital assets*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

## Direct equity investment most frequently cited as the primary source of funding for digital asset service providers

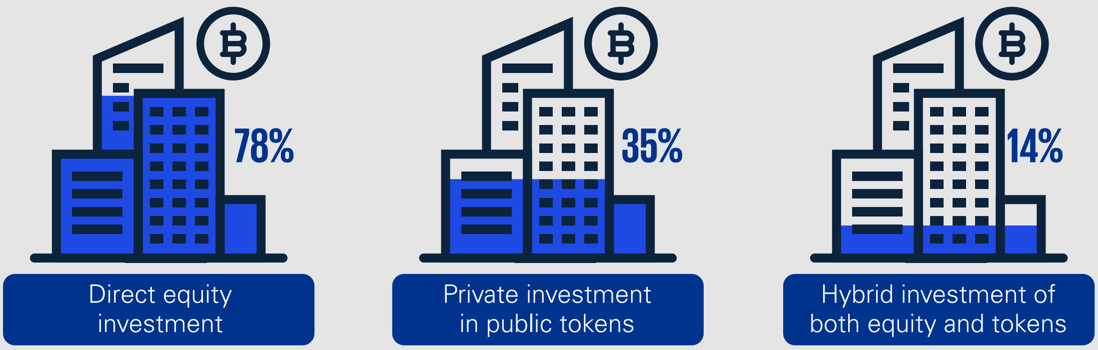
In traditional venture capital investment, investors typically receive equity to represent their investment stake. For blockchain start-ups, investors may receive both equity and tokens for their returns. According to our study, 78 percent of respondents gain their equity ownership of digital asset service providers through direct equity investments. This is followed by private investment in public tokens (35 percent) [Figure 12].

Private investment in public tokens takes place when the blockchain protocol team offers an opportunity to invest in cryptocurrencies during the private venture rounds. This allows investors to acquire the token at a lower price, compared to the token's initial listing price on centralised or decentralised cryptocurrency exchanges.

14 percent of respondents invested in digital asset service providers through a hybrid investment of equity and tokens. Equity plus token warrants is the most common approach for hybrid investment to digital asset service companies. For this approach, investors are entitled to equity ownership of the company, and have a right, but not the obligation, to receive or purchase project tokens that are launched in the future. The holder of tokens can participate in of governance of a blockchain protocol.

### Figure 12: Forms of participation for digital asset service-related company investments

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed who are currently investing in digital asset service providers*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

One HNWI interviewee shared her experience in investing in a decentralised exchange operator through private investment in public tokens. She commented that tokens allow her to participate in the governance of the decentralised exchange, such as voting on proposals to add new cryptocurrency trading pairs.

*"We have observed that family offices/HNWIs prefer direct equity investments, while crypto-focused venture capital firms favour equity plus token warrant approach to invest in digital asset service providers."*

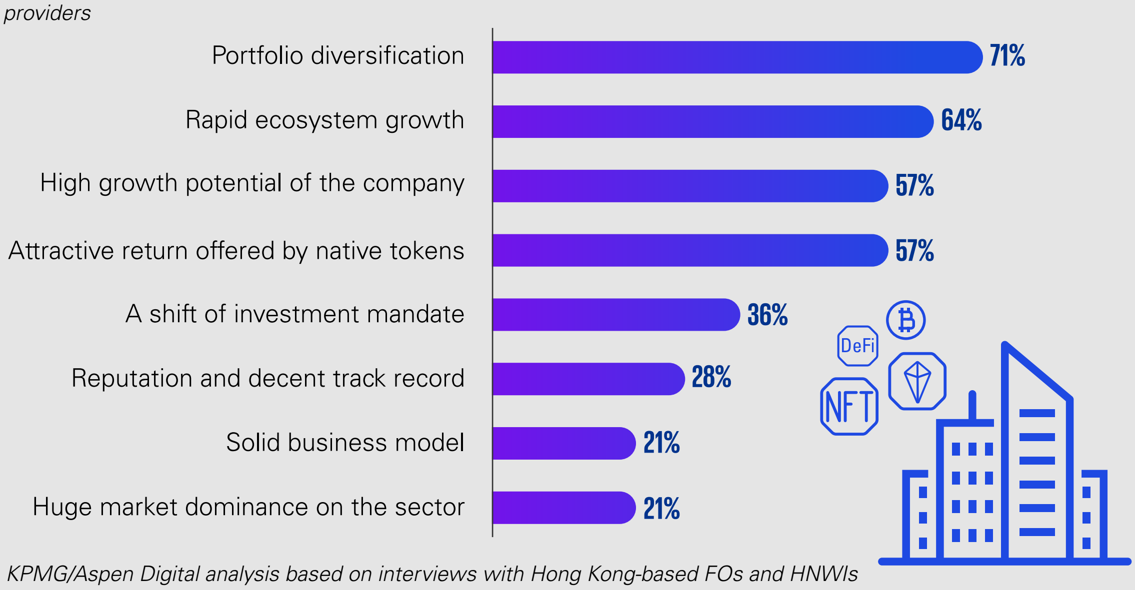
***Matthew Lam***
*Head of Research, Aspen Digital*

## Investment in digital asset service providers allows portfolio diversification and benefits from ecosystem growth

Family offices and HNWIs interviewed for this study have various reasons for investing in digital asset service providers. A main reason is portfolio diversification, which was mentioned by 71 percent of respondents. Others include the ecosystem's rapid growth (64 percent), a belief in the high growth potential of the companies they invested in (57 percent), and attractive return offered by native tokens (57 percent) [Figure 13].

### Figure 13: Leading reasons to invest in digital asset service-related companies

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed who are currently investing in digital asset service providers*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

Non-fungible tokens (NFTs) are a sub-sector of the digital asset industry that has developed rapidly in the last two years. Following the popularity of Bored Ape Yacht Club and other NFT collections, the marketplace of NFTs has seen tremendous volume growth. According to The Block Research, NFT marketplaces generated a total volume of USD 46.2 billion in the first half of 2022, tripling the amount during the same period of 2021.[13] The volume of NFTs being traded has dropped in the third quarter of 2022, but remains much higher than a year earlier. One HNWI we interviewed noted that he has invested in NFT marketplace operators, betting on NFT's potential for mass adoption in the long term.

[13] NFT Marketplace Monthly Volume, The Block Research, Sep2022; https://www.theblock.co/data/nft-non-fungible-tokens/marketplaces/nft-marketplace-monthly-volume

# Chapter 5:

# Regulatory and tax considerations for FO/HNWI investors

## Summary of key findings

**Regulators' attitudes a key guidepost for digital asset investment**

72 percent of respondents say that they consider the current regulatory environment a key factor when considering investment in digital assets

**Clarity needed in taxation and financial reporting**

Taxation and financial reporting guidelines need to be clearer to encourage FOs/HNWIs to make greater allocations in digital assets

**More mature methodology needed to value digital assets**

Half of respondents (50 percent) say difficulties related to the valuation of digital assets is one of their main concerns in digital asset investment

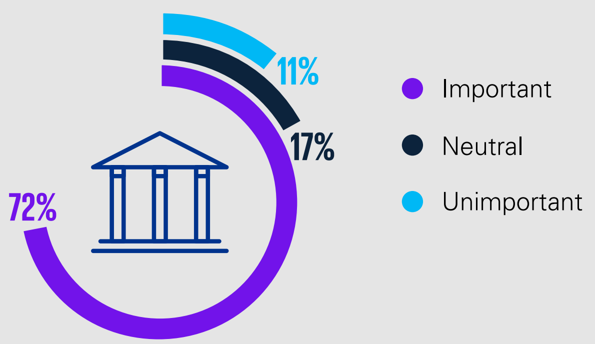
### A lack of regulatory clarity on digital assets appears to be a main obstacle to digital asset adoption across Asia's PWM industry, with financial reporting and taxation key pain points

Regulatory challenges, such as diverging approaches to digital assets by global regulators, present the biggest constraint for digital asset adoption in Asia. According to our study, 83 percent of respondents viewed a lack of regulatory clarity on digital assets as their main concern regarding investing.

Meanwhile, 72 percent of respondents agreed that the regulator's attitude towards digital assets is an important consideration for digital asset investments [Figure 14]. One interviewee of a Hong Kong-based family office said that the government should offer more clarity in the regulation of digital assets, to protect the interests of professional investors.

**Figure 14: Importance of regulator attitudes towards digital assets in FO/HNWI investment decisions**

*Percentage of family offices (FOs) and high-net worth individuals (HNWIs) interviewed who agree regulator attitudes are important*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

On June 24, 2022, the Hong Kong SAR government gazetted the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022.[14] The bill will introduce a licensing regime for virtual asset service providers (VASPs) and will impose statutory anti-money laundering and counter-terrorist financing obligations on VASPs in Hong Kong.

As noted by the Hong Kong Legislative Council brief, the Amendment Bill will likely offer a more comprehensive and rigorous regime than existing regulations in Singapore, the United Kingdom and Japan. This includes the assessment of the applicant's company and management structure, and a requirement for the applicant's business model to be sound, with detailed risk management policies and other listing and counter-market manipulation measures. For additional investor protection, the bill will at the initial stage stipulate that VASPs can only provide services to professional investors, although in a positive move regulators are planning on consulting with stakeholders about widening this to include retail investors.[15]

The existing regime in Hong Kong only applies to Virtual Asset Trading Platforms (VATP) that trade at least one security token. It is voluntary in nature, and VATPs opt-in by trading a security token in order to bring themselves into the scope of SFC's supervision. The changes to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO) grant additional supervisory powers to the SFC to bring all VASPs within scope of the regulations.[16]

*VASPs operating exchanges in Hong Kong, or located outside Hong Kong but actively marketing their services to customers in Hong Kong, need to study the new requirements carefully. If they decide not to apply for the new licence, or are unsuccessful in their application, then they will need to cease operations or cease actively marketing to customers in Hong Kong by 1 March 2024.*

***Tom Jenkins***
*Partner, Head of Financial Risk Management, KPMG China*


[14] Gazettal of Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022, The Government of the Hong Kong Special Administrative Region, June 2022; https://www.info.gov.hk/gia/general/202206/24/P2022062300509.htm

[15] Legislative Council Brief - Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022, Financial Services and the Treasury Bureau, June 2022; https://www.legco.gov.hk/yr2022/english/brief/bm4141c_20220622-e.pdf

[16] Virtual Asset Service Providers: Hong Kong formalises regime, KPMG China, August 2022; https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2022/08/virtual-asset-service-providers-hong-kong-formalises-regime.pdf

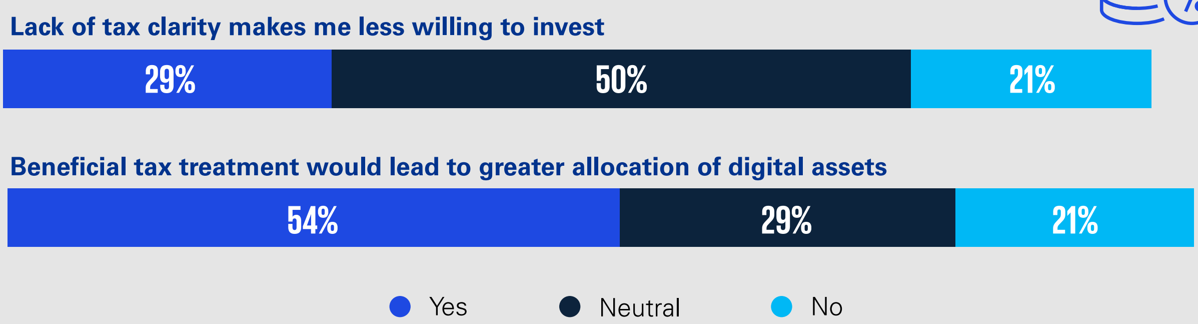
Apart from Hong Kong, the Monetary Authority of Singapore (MAS) will broaden cryptocurrency regulations and plans to consult on the proposed steps in October 2022. Ravi Menon, managing director of MAS, noted in a July 2022 speech that the MAS will "set out how their developmental and regulatory approaches will work in harmony to achieve the vision of Singapore as an innovative and responsible digital asset hub."[17] In response to this, a Singapore-based HNWI interviewed for our study welcomed the MAS's proposed actions to offer regulatory clarity, given the recent market volatility.

## Taxation clarity on digital assets is crucial for family offices/HNWIs to make investment decisions

The tax treatment of digital assets is a growing area of focus for the industry. Figure 15 below shows how the lack of tax clarity affects family offices/HNWIs in digital asset investment decisions. Nearly one in three respondents (29 percent) say that lack of tax clarity makes them less willing to invest in digital assets, whereas 50 percent are neutral. Meanwhile, 54 percent of our respondents agree that they would be more willing to invest in digital assets if they could receive beneficial tax treatment. One family office interviewee said that the lack of clear definitions on the nature of digital assets is a main obstacle to report taxation obligations.

**Figure 15: Impact of taxation treatment on digital investment attitudes**

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

Hong Kong's tax legislation does not contain any specific provisions to deal with cryptocurrency. For tokens which do not comprise securities as defined under the Securities and Futures Ordinance, taxation of gains requires application of general principles around source of profits and whether gains may be regarded as being 'capital gains' or as ordinary 'revenue gains'.

For individual investors who do not carry on a trade or business in their own names, profits from trading in cryptocurrency should not be subject to profits tax. However, for investment groups these principles are often difficult to apply in practice.

[17] Remarks by Ravi Menon, Managing Director MAS, at the MAS Annual Report 2021/22 Media Conference,19 July 2022; https://www.mas.gov.sg/news/speeches/2022/remarks-by-mr-ravi-menon-managing-director-mas-at-the-mas-annual-report-2021-2022-media-conference-on-19-july-2022

The Inland Revenue Department (IRD) has provided only very general guidance on how these principles should apply to cryptocurrencies.  Where it has provided further guidance in public statements, it has taken a very narrow interpretation – for instance, looking to the location of an exchange to determine source of cryptocurrency profits may only be done where the cryptocurrency is traded through traditional exchanges. Pure cryptocurrency exchanges generally may not be considered for this purpose, notwithstanding the possible technical merits of such a position.

Given that disputes with the IRD on tax matters generally can be protracted, the lack of certainty regarding the taxation of cryptocurrency means that investors who are solely Hong Kong-based may prefer not to use Hong Kong structures. However, if investment groups have little 'substance' outside Hong Kong, this may increase the risk of challenge by the IRD for their use of 'offshore' cryptocurrency investment holding structures.

Investing in security tokens that are securities under the SFC, on the other hand, may fall within certain tax exemption provisions, such as the fund and family office tax exemption provisions.  However, given that nearly all token issuances are structured so as not to be classified as security tokens, in the present environment these exemptions will be of little benefit.

Until the Inland Revenue Ordinance is updated to expand the scope of the exemption provisions for all forms of cryptocurrency, for instance by allowing cryptocurrencies to be taxed in a way similar to traditional securities or commodities, investors will need to take care how they structure such investments.

## Relevant accounting standards are critical for family offices to make digital asset investment decisions

Recognition and measurement of digital assets will be a major factor in financial reporting. According to our study, 75 percent of respondents think that the accounting treatments under the existing accounting standards may not provide relevant information for their investment decision making.

Cryptocurrency is defined by the International Financial Reporting Interpretations Committee (IFRIC) as digital or virtual currencies that are recorded on a distributed ledger, but are not issued by a jurisdictional authority or other party, nor do they give rise to a contract between the holder and another party.[18] For International Financial Reporting Standards (IFRSs), cryptocurrencies are not financial assets but assets in the scope of IAS 2 *Inventories* or IAS 38 *Intangible Assets*. For the United States Generally Accepted Accounting Principles (US GAAP), digital assets are accounted for as intangible assets.

The challenge with the financial reporting requirements for digital assets that are held for investment purposes is not so much a lack of clarity over the accounting that is required, but rather that the required accounting does not meet investors' needs. When held for investment purposes, digital assets fall under the intangible asset accounting model. That accounting model is in essence the equivalent of the accounting for property, plant and equipment. This may work for items such as software that get amortised over their useful life, but does not work well for assets held as investments. This is because the accounting model is asymmetrical, recognising declines in value below the purchase price as 'impairment losses', whereas increases in value are not recognised until they are realised (usually when the asset is sold).

While IAS 38 allows using a revaluation model, the eligibility of that model is limited to assets with an active market; and if applied, the revaluation gains are never recognised in profit or loss, but instead in other comprehensive income. Even when eventually realised through a sale of the asset, the gain would still not be 'recycled' to profit or loss (but remain in equity).

What would be needed to provide relevant information about investments in digital assets is a neutral or symmetrical accounting model that measures those assets at a current value (such as fair value) and recognises the resulting gain or loss in profit or loss irrespective of whether it has been realised. To get there, IFRSs would need to be changed.

> *There are multiple categories of digital assets, including governance tokens, cashflow/utility tokens, vote escrow tokens and NFTs. The underlying value of these assets depends on a number of factors, including specific rights attaching to them. While it is fair to say there is no consensus on how to value these assets, often there is more real-time information regarding the performance of the underlying protocol than would otherwise be seen in traditional investments such as equities.*
>
> ***Barnaby Robson***
> *Partner, Deal Advisory, KPMG China*

[18] Holdings of Cryptocurrencies – June 2019, The International Financial Reporting Standards Foundation; https://www.ifrs.org/content/dam/ifrs/supporting-implementation/agenda-decisions/2019/holdings-of-cryptocurrencies-june-2019.pdf

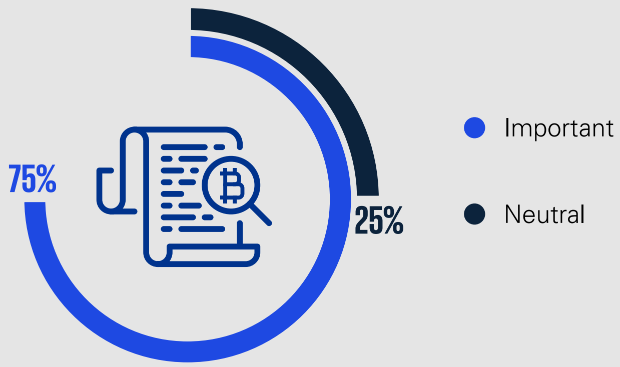
## The valuation of digital asset investments requires a new approach

For equity investments in publicly listed companies, investors make their investment decisions based on publicly available information, such as the company's annual reports and valuation models. On the contrary, there are limited public information and historical trading data on some digital assets – making the evaluation of digital assets investment opportunities more challenging than other assets.

According to our study, 50 percent of respondents identify limited research on the valuation of digital assets as one of the main concerns in digital asset investment. To understand the value of the self-minted/created tokens that a company puts into circulation, investors must understand the 'project' that is behind it, which is complex. SAFTs (simple agreements for future tokens) are popular, as these types of contracts avoid the need to value the token at the time of the investment. However, even SAFTs are difficult to value. Legal uncertainly, such as the status of 'white papers', is another factor that makes valuation difficult. Meanwhile, 75 percent agree that clarity on financial reporting impacts their investment decisions (Figure 16).

### Figure 16: Impact of financial reporting clarity towards digital asset investment decisions

*Among family offices (FOs) and high-net worth individuals (HNWIs) interviewed*




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

One external asset manager we interviewed for this study commented that traditional valuation approaches such as discounted cash flow model have limited applicability in valuing digital assets, because of the different nature between companies and digital assets.

> *Compared to traditional equities, digital assets require a new fundamental analysis framework for screening investment opportunities. For instance, on-chain data is a new metric to measure the network robustness of digital assets. As more institutions are expressing their interests to explore on digital assets, we will expect a more mature research methodology to evaluate the emerging asset class.*

**Yang He**
*CEO/Co-founder, Aspen Digital*

# About the study

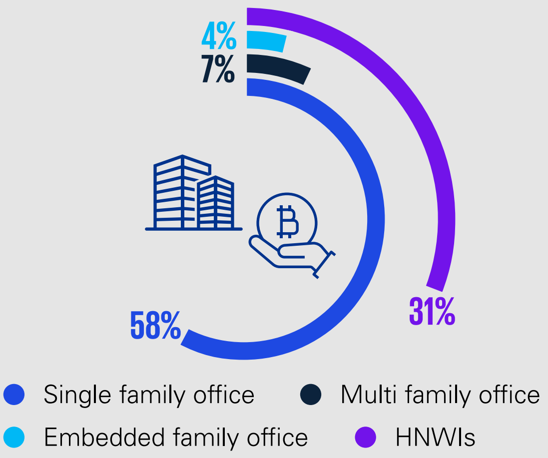
The findings of this report are based on a questionnaire distributed to 30 family offices (FOs) and high-net-worth individuals (HNWIs) based in Hong Kong and Singapore in the second quarter of 2022. In-depth follow-up interviews were also conducted with leading funds, FOs, external asset managers and HNWIs to gain additional perspectives on investor sentiment. Due to sensitivities surrounding disclosing the financial positions and strategies of specific institutions, institution and investor names have been kept confidential.

More than half of respondents were single family offices (58 percent), while multi-family offices and embedded family offices were also represented. Roughly 61 percent of institutions/investors represented have assets under management between US$10 to 500 million, while 12 percent are managing $500 million or more.

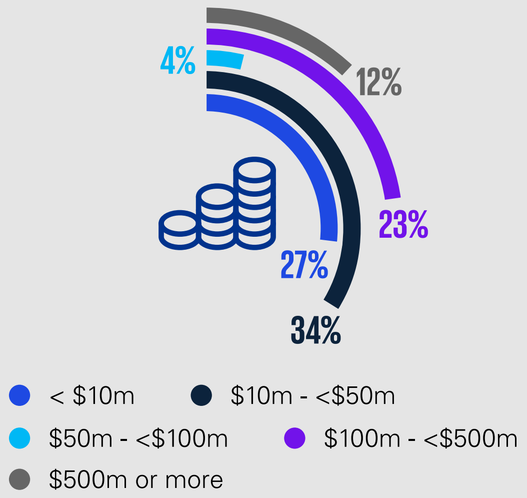
In terms of overall investment objectives, a majority (62 percent) of FOs and HNWIs interviewed view wealth preservation as their core investment mandate, while diversification and capital generation for multigenerational wealth transfer are also key goals [please see full respondent profile below].

## Profile of interviewees for this study

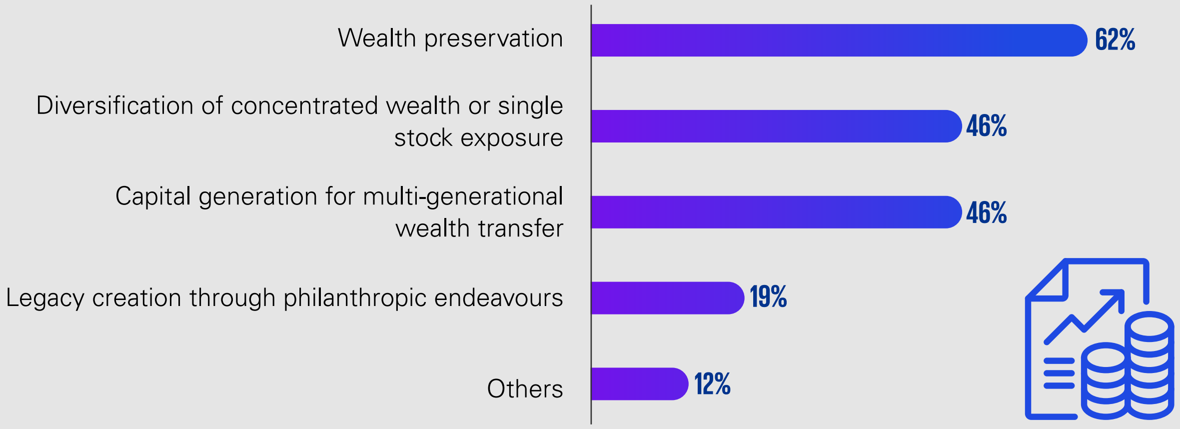
### Institution/Investor type




### Total assets under management




### Main investment goals




*Source: KPMG/Aspen Digital analysis based on interviews with Hong Kong-based FOs and HNWIs*

# About KPMG China

KPMG China has offices located in 30 cities with over 14,000 partners and staff, in Beijing, Changchun, Chongqing, Dalian, Dongguan, Foshan, Fuzhou, Guangzhou, Haikou, Hangzhou, Hefei, Jinan, Nanjing, Nantong, Ningbo, Qingdao, Shanghai, Shenyang, Shenzhen, Suzhou, Taiyuan, Tianjin, Wuhan, Xiamen, Xi'an, Zhengzhou, Hong Kong SAR and Macau SAR. Working collaboratively across all these offices, KPMG China can deploy experienced professionals efficiently, wherever our client is located.

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In 1992, KPMG became the first international accounting network to be granted a joint venture licence in mainland China. KPMG was also the first among the Big Four in mainland China to convert from a joint venture to a special general partnership, as of 1 August 2012. Additionally, the Hong Kong firm can trace its origins to 1945. This early commitment to this market, together with an unwavering focus on quality, has been the foundation for accumulated industry experience, and is reflected in KPMG's appointment for multi-disciplinary services (including audit, tax and advisory) by some of China's most prestigious companies.

For more information, please visit kpmg.com/cn.

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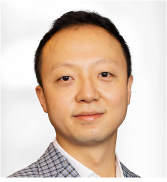
# About Aspen Digital

Aspen Digital is a leading technology and financial services company with a mission to accelerate the mass adoption of digital assets. The company provides a digital asset management solution for asset managers, institutions, and sophisticated investors. Aspen Digital was co-founded by digital assets innovators and asset management veterans at Everest Ventures Group ("EVG") and TT Bond Partners ("TTB") in 2021.

For more information, please visit https://www.aspendigital.co/.

## Key contacts

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