

Perspective from
Franklin Templeton
Industry Advisory Services

New investment options and opportunities from commingling assets in crypto wallets

Cryptographically protected wallets commingle assets in a common container, creating new investment options and opportunities

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*This is the sixth article in the Future of Investing series, drawing insights from our annual industry-wide survey, *The Future of Investing*.¹ The Overview summarizing the top 10 key findings can be found [here](#) along with a series of articles, each exploring a key finding in more depth.*

We rarely stop to think about it, but today's investor "portfolio" is a reporting and analytical construct. It refers to the collection of assets spread across different investment accounts that belong to the investor. The "portfolio" gathers together the assets held in these accounts virtually as illustrated in Exhibit 1.

The design of the financial market infrastructure has forced each organization to maintain multiple sets of accounts for each investor serviced. Each firm processes individual transactions on a bilateral basis, moving payments and securities between distinct client accounts. Clients owning the same stock at two different brokerage houses would see two distinct listings and could not aggregate their exposure.

Fund ownership requires two ledgers: the ledger recording the *fund's* holdings of securities, and the shareholder ledger that shows how much of the fund's interests each *shareholder* owns. This makes it impossible to commingle fund assets. Even if an investor were to own two equity mutual funds with the exact same strategy and investment universe, their ownership would be recorded on two separate shareholder ledgers and each fund's holdings would be administered in separate brokerage accounts.

Exhibit 1: Portfolios Composed of Multiple Accounts



Source: Franklin Templeton Industry Advisory Services. For illustrative purposes only.

“Today, we see every fund has its own custodian, its own fund administrator, its own KYC/AML responsibility. We’ve set the system up to be this way and then we complain about there being no interoperability.”

FinTech
Innovator

Owning an exchange-traded fund (ETF) eliminates one set of bookkeeping. Investor interests in these offerings are recorded only on a shareholder ledger until a shareholder redeems their ETF “in-kind” in the primary market. The growing use of separately managed accounts (SMAs) represents the opposite approach. Whereas with an ETF the holding is only of a fund (with no individual security holdings), SMA account owners only hold *securities* and there is no fund structure, and thus no shareholder ledger to administer.

Private funds add further complexity and even more accounts. Most of these offerings are recorded via a roster of limited partnership (LP) interests maintained bilaterally with each distribution partner. An investor may choose to increase their LP interests in a fund over time, but if the second allocation were done via a different bank or advisory firm, the fund would need to maintain and administer two LP records for the investor—one with each organization. Co-investments create yet another set of accounts between each alternatives manager and investor that sits on the side of the fund’s investment in that asset.

Using cryptographically protected wallets to hold digital or tokenized assets represents a very different value proposition from the loose affiliation of accounts underlying today’s portfolios. In these wallets, assets may be stored *alongside* all other holdings. At present, these assets mainly include cryptocurrency coins, fungible tokens that represent participation interests in various protocols and decentralized apps, and non-fungible tokens (NFT) representing unique assets, typically digital assets. However, these wallets could potentially hold a variety of other assets as well.

Several bonds have been issued on blockchains where ownership is reflected via a token and that token is held in a cryptographically protected wallet. Investors have been able to use central bank digital currencies (CBDCs) held in a cryptographically protected wallet to purchase such bonds. For example, earlier in 2024, the Swiss city of Lugano issued a six-year digital bond of CHF 100 million where subscribers to the offering paid with a CBDC.²

Wealth Manager
 <US\$500 billion

Physical assets have also been tokenized with digital instruments providing proof of ownership stored in wallets. For example, in early 2024, Galaxy Digital Holdings LP provided a loan to the co-founder of Animoca Brands, accepting as collateral a tokenized version of the renowned 1708 “Empress Caterina” Stradivarius violin, represented by its NFT equivalent. The physical Stradivarius violin, valued at over US\$9 million in 2023, will remain securely stored with a Hong Kong-based custodian until the loan is fully repaid. The NFT, which grants ownership rights to the Stradivarius, is held in Galaxy’s digital wallet.³ While this example highlights an innovative way to create new assets, it should be noted generally that investing in NFTs is considered speculative and involves substantial risks, as ownership rights lack legal recognition and enforceability in some jurisdictions.

All these tokenized assets—cryptocurrencies, NFTs, tokenized securities, tokenized funds, tokenized physical assets and new forms of digital “money”⁴—can coexist within the same cryptographically protected wallet, as shown in Exhibit 2.

We examine the broader future of advisory in subsequent articles, but even here one can see how this defragmentation of the portfolio and consolidation of its holdings in a wallet could reduce the frictions involved in changing advisor and increase the portability of an individual's portfolio, e.g., to another advisor. This will intensify competition to add value to the client in new and additional ways to retain clients and/or attract new ones.



Investor



From an investor perspective, beyond the obvious benefit of exchanging payments and assets in real-time, several other aspects of a portfolio's operations will likely be enhanced by traditional financial assets existing in tokenized form and held in a cryptographically protected wallet.

- **Proportional yield:** Today, many funds pay a yield, which is typically calculated and paid out to shareholders of record at the start of the trading session. Subsequent activity during the trading day is not factored into the calculation. Yield is only awarded on a calendar-day basis. With blockchain-based, tokenized funds, each NAV cycle can be broken down into minutes or even seconds. Every movement of fund shares during that window can be assessed as a unique payment. A similar approach could be used for any award of other types of payments or application of corporate actions.
- **Fractional bond and mutual fund shares:** Today, the ability to invest small amounts of money into individual stocks or ETFs allows investors to participate in the market without needing to purchase a full share. However, fractionalization is not yet available in bonds, mutual funds and many other offerings. Most bonds have a US\$1,000 minimum and most retail mutual funds require between US\$500 and US\$5,000 to purchase a share. Tokenized instruments on blockchain remove that barrier, allowing fractionalization and administration of any financial instrument down to tiny increments.
- **Continuous net asset value (NAV):** Today, the NAV on a fund is calculated once daily, after trading for the day has concluded. With tokenized fund shares and blockchain-based transactions, the exact holdings of the fund and its value can be calculated at any time. Similarly, the number of outstanding tokens and the owners of those tokens can be readily monitored. As a result, the industry would be able to move to NAV-pricing on demand.

These enhancements would make for both a far more efficient operational environment and a much better investor experience, in our view. Having tokenized versions of today's financial assets in a wallet also creates additional opportunities to wring more utility from investor portfolios.

- **Expanded payment options:** Today, the only way to pay for a security or fund transaction is with fiat currency. All the money and money-like assets discussed in [Applying the technology being explored in payments to modernize financial markets infrastructure](#) could be used in a blockchain-based environment, but perhaps more interestingly, so could an investor's other holdings. Fractional amounts of stocks, bonds, ETFs or even funds enhanced by new continuous NAV calculations, could be tendered to pay for other securities or fund transactions, and potentially, even for other types of transactions.
- **New income opportunities:** Tokenized assets held in a cryptographically protected wallet could also be used to add liquidity to automated market-making or lending protocols. Both opportunities provide a way to share in the earnings being generated in those asset pools and could allow users to deposit their tokens and share in the earnings generated.
- **More accurate investment portfolios:** Tokenizing traditional assets and holding them in a cryptographically protected wallet would allow these investments to be considered alongside crypto investments. Today, it is not possible to hold securities and tokenized assets in the same portfolio. This presents a significant obstacle to an investor's ability to capture the value protocols and decentralized projects are creating. For example,

Ethereum, the largest layer one public blockchain, launched in 2015, was reported to be on track to reach US\$1 billion in annual profit in 2024.⁵ It would be hard to have a full view on developments in the e-commerce and online platforms or the software development space without considering Ethereum's positioning. In the future, Ethereum's tokens could be held and administered side by side with stocks such as Amazon or Apple in a digital wallet, something that's not possible in today's account-based approach.

In addition to the benefits discussed already, there are deeper considerations about what the commingling of traditional and new digital assets in a cryptographically protected wallet may mean for investors and for asset and wealth management more generally. The entire concept of what constitutes an investor's wealth and the role, purpose and composition of their portfolio may expand significantly. We examine this in our next article in this Future of Investing series.

For more information or to request a presentation on the 2024/25 Future of Investing findings, please contact your Franklin Templeton representative or reach us directly at industryadvisoryservices@franklintempleton.com.

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Endnotes

1. On an annual basis, Franklin Templeton's Industry Advisory Services team conducts off-the-record, unscripted interviews of leaders across the financial services industry. This year, we were fortunate enough to hear from 85 leading thinkers controlling over US\$50.1 trillion of assets under management across the financial services industry about their views on the future of investing between March and September of 2024. Input came from a broad cross-section of the industry—asset owners, private banks, wealth managers, consultants, investment managers, crypto firms, academics, industry leaders and fintech firms. Conversations took place formally as part of free-ranging, qualitative, off-the-record, survey interviews, and informally during one-on-one sessions where the implications and plans for each organization are discussed and explored. Each of these inputs added to an emerging picture of an industry that is changing rapidly and across multiple dimensions. Interviews were conducted globally with about two-thirds of discussions held with leaders of firms based in the United States, and the other third spread between Europe and Asia.
2. Source: "Swiss city Lugano issues blockchain bond with settlement in wholesale CBDC." Global Government Fintech." February 14, 2024. There is no assurance that any estimate, forecast or projection will be realized.
3. Source: "Galaxy Digital's Innovative Loan Secured by Tokenized Stradivarius Violin." Softtix. June 14, 2024.
4. Tokenized assets may function in ways similar to a form of "money," but these assets are highly speculative and have an uncertain regulatory status.
5. Source: Bhardwaj, Shashank. "Ethereum Aims For \$1 Billion Annual Profit As DeFi Gains Momentum In Q1." Forbes India. April 19, 2024.

Curated glossary of relevant terms

Blockchain

A blockchain is a digital record or ledger of transactions, duplicated and distributed across an entire network of computer systems. Blockchains represent complete records of all transactions ever performed within that system. Every node in the blockchain network has a real-time, simultaneously updating copy of this ledger. Every node sees new blocks of transactions being appended to the existing chain of verified blocks and could re-create the entire sequential history of transactions on that chain stretching back to the very first (genesis) trade on the ledger. Blockchain is sometimes described as “distributed ledger technology” or DLT.

Cryptocurrency

Cryptocurrency is a form of digital or virtual currency that uses cryptographic techniques to ensure security, making it nearly impossible to counterfeit or double-spend. Most cryptocurrencies operate on decentralized networks powered by blockchain technology, which is a distributed ledger maintained by a network of computers. Cryptocurrencies are typically not issued by any central authority, making them theoretically resistant to government interference or manipulation.

Minting

Minting is the process of generating new coins through verification of data, creation of new blocks, and documentation of the verified information on a blockchain network via proof-of-stake consensus mechanism. These newly minted coins are circulated in the market for trading purposes.

Tokens

Tokens are used to facilitate payments, initiate services, bestow ownership, authorize voting, convey rights and transfer assets. Specialized tokens are used for each of these functions. Broadly, these specialized tokens can be broken down into two categories: cryptocurrency tokens and app-issued tokens.

Tokenization

Tokenization is the process of converting, through symbolic representation or encoded rule sets and attestations, something of value into a digital token that can be transacted on a blockchain. These tokens can represent tangible assets like gold, real estate, and art, or intangible assets like voting rights, ownership rights, or content licensing.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Companies in the **technology sector** have historically been volatile due to the rapid pace of product change and development within the sector. **Artificial Intelligence** is subject to various risks, including, potentially rapid product obsolescence, theft, loss or destruction of cryptographic keys, the possibility that digital asset technologies may never be fully implemented, cybersecurity risk, conflicting intellectual property claims, and inconsistent and changing regulations.

Blockchain and cryptocurrency investments are subject to various risks, including inability to develop digital asset applications or to capitalize on those applications, theft, loss or destruction of cryptographic keys, the possibility that digital asset technologies may never be fully implemented, cybersecurity risk, conflicting intellectual property claims, and inconsistent and changing regulations. Speculative trading in bitcoins and other forms of cryptocurrencies, many of which have exhibited extreme price volatility, carries significant risk; an investor can lose the entire amount of their investment. Blockchain technology is a new and relatively untested technology and may never be implemented to a scale that provides identifiable benefits. If a cryptocurrency is deemed a security, it may be deemed to violate federal securities laws. There may be a limited or no secondary market for cryptocurrencies.

Digital assets are subject to risks relating to immature and rapidly developing technology, security vulnerabilities of this technology (such as theft, loss, or destruction of cryptographic keys), conflicting intellectual property claims, credit risk of digital asset exchanges, regulatory uncertainty, high volatility in their value/price, unclear acceptance by users and global marketplaces, and manipulation or fraud. Portfolio managers, service providers to the portfolios and other market participants increasingly depend on complex information technology and communications systems to conduct business functions. These systems are subject to a number of different threats or risks that could adversely affect the portfolio and their investors, despite the efforts of the portfolio managers and service providers to adopt technologies, processes and practices intended to mitigate these risks and protect the security of their computer systems, software, networks and other technology assets, as well as the confidentiality, integrity and availability of information belonging to the portfolios and their investors.

ETFs trade like stocks, fluctuate in market value and may trade above or below the ETF's net asset value. Brokerage commissions and ETF expenses will reduce returns. ETF shares may be bought or sold throughout the day at their market price on the exchange on which they are listed. However, there can be no guarantee that an active trading market for ETF shares will be developed or maintained or that their listing will continue or remain unchanged. While the shares of ETFs are tradable on secondary markets, they may not readily trade in all market conditions and may trade at significant discounts in periods of market stress.

Non-fungible token (NFT) investments carry substantial risks. The market is volatile, liquidity can be challenging, and regulations are evolving. Technological risks, such as smart contract bugs, hacking, and platform failures, can result in the loss of an NFT or its value. Transactions may also involve counterparty risks, including default by the other party. Unlike stocks or bonds, NFTs lack intrinsic value, with their worth solely based on market demand and sentiment.

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