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Virtual Event Series

DeFi Meets TradFi

Guest Speaker:

Aya Kantorovich

Head of Institutional Coverage

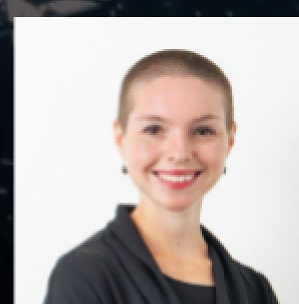
FalconX

Hosts:

Kenny Estes

CEO & Founder

Diffuse



Ayla Kremb

COO & Co-Founder

Diffuse

DiffuseTap: DeFi Meets TradFi

Last time on DiffuseTap, Aya Kantorovich, Head of Institutional Coverage at FalconX, talked to us about where the institutional appetite is during this current bear market, the U.S. opening its gates for derivatives trading, and what stands between institutions and crypto adoption.

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DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)... straight from your armchair like a boss.

Meet the Speaker

Aya Kantorovich is a founding member of FalconX, one of the fastest growing cryptocurrency and fintech companies valued at $3.75B with over 100 employees globally. Currently the youngest FalconX executive, Aya built the company's sales trading desk, ran PR and marketing, and is brand ambassador for FalconX. She leads the sales and client coverage organization supporting 700+ clients with over 30x YoY revenue growth. LinkedIn: @ayakantorovich

About Diffuse®

We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: We're here to hear from Aya. So Aya, would you please be so kind as to introduce yourself a little bit?

AYA KANTOROVICH: Sure. Thanks so much for having me today. I'm really excited to dive into this and feel very lucky to be here on the 100th episode. I've heard phenomenal things about these sessions, so I'm very excited to be here today. To give a little bit of my background, I'm the Head of Institutional Coverage at FalconX, in which I lead all of our sales, trading, and everything client-related for the firm.

FalconX is three years old. I was part of the founding team. Today, we are building a prime brokerage for institutions in crypto. That includes everything institution-based. We're looking to offer 200 different tokens for institutions, and we have over 500 institutional clients today. That includes trading, credit clearing, yield aggregation, staking, and so on, all in one place. It's all point and click. And so, I'm very excited to talk about the evolution of crypto. Previously, I was at Pantera Capital, on the venture side of the business. Pantera is one of the oldest and largest cryptocurrency hedge funds and venture funds in the U.S.

AYLA KREMB: Beautiful. I will hop right in and start asking questions. How has your customer base changed over the last couple of years at FalconX?

AYA: Sure. To no surprise, when we started three years ago, almost 100% of our clients were crypto native. Our clients were crypto native hedge funds and venture funds. Our largest persona across the desk were hedge funds, venture funds, and prop shops. Think of some of the largest OTC desks, like the Cumberlands and B2C2s of the world.

That has really changed over the last year and a half. Today, we see over 50% of our volume coming from traditional finance. That includes massive asset managers who have over 50 billion plus in AUM, family offices, financial intermediaries, regional banks, investment banks, larger banks, as well as traditional venture funds and hedge funds.

What I think has been very interesting is, we're seeing a lot of traditional venture funds enter the space in the private markets. They'll make an investment and typically this investment has the option of becoming a token at some point due to how the equity is converted. So, they evolve into a hybrid hedge fund-venture fund because they may need to sell out of the position at some point - using some hedge fund trading strategies to execute that. We do have months where our traditional volume flow is far larger than the crypto-native flow. The reason it's 50-50 is because the crypto native funds have also grown tremendously in size. We find that some of them who may have started off with 50 to 150 million in AUM are now far over 500 million to a billion in AUM. And so, you've seen the institutionalization of those crypto native funds.

KENNY: That makes a lot of sense. The big boys are coming in. You mentioned that smaller funds are now a lot bigger because crypto is pretty liquid at the moment. What are the areas that you're surprised about? Do they dig into NFT's very often? Is that too esoteric? Where's the appetite right now, especially with the bear market?

AYA: Currently, the appetite is in yield. If you look at the NASDAQ, yesterday it had its worst day since 2020. And so, institutions are looking for ways to find returns. I believe that if you look at just the first month of the quarter, a number of traditional hedge funds were already down 30% on the year.

And so, they're really looking for other ways to find returns in this type of market ecosystem. One example is DeFi yield farming, where you can potentially see returns in the double digits. For example, you could run delta neutral strategies and market neutral strategies that have a leverage on them with over 40% returns, annualized.

That is a very attractive number for an institution that may be looking at 2 to 5% return in traditional markets, and who is looking at crypto very seriously, while starting to understand smart contract risk and other risks associated with these trades, and how to put these trades on through players, like Diffuse.

AYLA: Some people sent this question in the chat. You're talking a lot about institutional products that some of these firms offer. Have you guys seen the big need to borrow against staked stable coins? Has FalconX been able to solve that issue?

AYA: Yes, we do offer liquid staking and our clients absolutely love it. You're always hearing about a number of institutions that are trying to build the prime brokerage in crypto. Crypto loves labels, so what does prime brokerage in crypto actually mean? For us, it actually means capital efficiency. In the bare bones of it, it doesn't necessarily mean off-platform lending, or to be the best lender, or to be the best trader. As margins are compressed, similar to traditional finance, it means capital efficiency.

And so, taking liquid staking for what it actually is, you look at the staked assets as collateral in order to put a position against that collateral, while you're also continuing to earn yield on the staked assets. For example, you don't need to un-stake your assets and lose that yield in order to leverage that as collateral. The reason why this is important is because on average, especially in decentralized finance, collateralization rates can be over 120%.

You may be able to get really great interest rates. Let's say you're looking to borrow assets. You may be able to find rates for BTC and ETH at around 4 to 5% annualized, but the collateralization rate is 120%. Whereas at FalconX, you can collateralize 20%, and potentially get a 10 to 15% interest rate, but you use only 20% of that collateral.

Capital efficiency is really important. Liquid staking continues to enable that, especially when you see the biggest use case of this, which is staked ETH. If you stake your ETH, you can't un-stake it until Ethereum transitions from proof-of-work to proof-of-stake, and that timeline keeps getting pushed. And so, you're earning yield on that staked ETH, but you want to apply that collateral in different ways. This enables that.

KENNY: That makes a ton of sense. I've got a bit of a softball question from the chat for you. How does your institutional offering differentiate from the other actors in the market, such as Binance? What do you feel sets you apart?

AYA: There are three different competitors in this market today. Exchanges such as Binance are one bucket. Today, we aggregate liquidity across both lit pools and dark pools, and that's really important. A majority of institutional flow actually happens in dark pools today, so they don't even touch order books. Exchanges, in general, are very retail-centric products.

You may not have heard about this, but there are certain exchanges in the space where it can take six months to onboard. There are also certain exchanges where you don't have customer service, which means you're not going to hear from a person on the other side.

And so, as you think about some of these institutions who want a human on the other side, who want a very white glove experience, or even who want very advanced types of algorithms in order to trade certain strategies, you're not necessarily going to find that with exchanges. These institutions are looking for the best execution, specific accounting and auditing. And they're looking for specific standardization of reporting that exchanges may not necessarily have, because they're retail-centric platforms that can have lower uptime.

And so, you'll see as volatility increases, some exchanges may go down. And, if that happens, you won't be able to access your account. If you can't access your account for trading, that means they also shut down custody, so you won't be able to move your assets. If you have a margin position, and you need to top up, you may not be able to do that, and you could get liquidated on those exchanges. Binance, Coinbase, and FTX have some of the deepest liquidity for tokens. However, it is very expensive to list a token on an exchange. It can cost $250,000, as well as a dedicated market maker, which you pay for out of pocket.

For a lot of these projects, they don't have that kind of capital when they launch. And so, you see that a lot of projects actually launch in DEXs where they're able to do it for free, as long as they have the tokens on their side, in order to post both sides of the trade. The second bucket is prop shops. Think about all the traditional prop shops that exist today. You have Jane Street, Citadel, B2C2, Cumberland, and the likes. These are some of the best traders in the space. But these are traders that are trading against their own book of business. So, they may be trading against you. They do have a last look on every trade. And so the uptime especially, or the ability to fill a trade, even with a prop shop is very difficult.

In the first year of its existence, FalconX spent a lot of time figuring out how to integrate some of this more unstructured liquidity into a platform where we can aggregate it. Prop shops are typically not tech-savvy institutions that don't have a lot of technology. It's all very over-the-counter and manual. But they do have really great pricing. That's where you see a lot of the dark pools happening as well. People are able to execute just over-the-counter, over-the-phone, or one-one-one without having to take it to an exchange.

Finally, the last bucket is the technology approach. This is where FalconX exists. Competitors include Talos, as well as Tagomi, which sit inside Coinbase. And the difference for us is approaching the problem with technology,, to be able to create capital efficiency. We are going to win by combining trading, prime services, and clearing in a really cohesive way, so that people can access all of them in a way that makes sense for the strategies that are running.

AYLA: One question. You mentioned favoring using technology over people. What are some of the most surprising things that institutional investors are interested in? That can include different products like NFTs, or products that provide technology enablement when it comes to security, or whatever that might be. What are some of the things that surprised you?

AYA: To the point about NFTs, what's really interesting is that currently, if you sit in an investment bank, you cannot touch crypto because the bank itself can't touch crypto. You have thousands of employees who want to engage with this ecosystem who can't. And now, we've seen that interest pushed into NFTs, because NFTs are more like art, not crypto. A number of employees in investment banks have started trading NFTs.

You see a lot of requests happen around financial instruments for NFTs. Those include borrowing against NFTs, fractionalizing them, using them as collateral, and so on. I think that's interesting just given the fact that NFTs today don't have an order book. It's highly liquid, which is very similar to traditional art. There are a lot of dark pools, and a lot of deals that happen where if you're looking to sell your NFT, you can place a bid or an offering that someone listed. On the other side, there isn't a lot of transparency around what the demand is. So that's been really interesting.

I would say another thing that's been really interesting is the mass adoption of stable coins. This is really important. Right now, there is a lot of interest around algorithmic stable coins. These are stable coins that are not pegged one-to-one. Even if you look at stable coins that are pegged one-to-one, Tether has increased 4x from last year. It is the largest stable coin. It has over $40 billion in market cap.

We also have USDC, which is one-to-one to the US dollar. That's the one that's also highly regulated by the U.S. government through Circle. It's up 10x from last year to this year, with over $50 billion in market cap. The adoption of stable coins, especially by institutions, has been tremendous. The last thing I'll say is we used to see a lot of stable coins being driven by USDT primarily. It was very much driven by Asia. At the beginning of this year, we saw that flip for the first time with a number of institutions. Even Asia-based institutions were trading USDC, because of some of the concerns with Tether earlier in the year.

KENNY: That's really exciting. And yes, with Tether, I'm not entirely sure what the collateral is. I'm glad we're starting to see that trend invert, as it were. Earlier, you mentioned that institutions are very interested in crypto. What can't they do right now? Why is it very difficult to get across the front line? And that also leads to a corollary question, which is, what's at the front of crypto that is exciting?

AYA: Institutions can't touch DeFi. I would say that one thing every institution usually asks on a call is, "how can you help me access DeFi without touching it directly?" Now, the reason for that is because of the KYC rules. You want to know your customer on the other side. The United States regulatory system takes that very seriously, primarily because of the fact that you could be trading against a blacklisted wallet, a terrorist account, and so on and so forth. The implications of that in the United States are very, very serious. Therefore, a lot of these institutions do not want to access it at all. But that is where you can potentially get double digit yields, because it's so inaccessible today. And so, we've seen institutions access that in a couple of ways. On the non-technology side, which is where you see a lot of the private capital getting raised, they'll invest in fund of funds who are able to touch DeFi directly.

I would say there's a number of companies working on tagging wallets that have associated KYC documents, which are stored in a single folder or location that the US government can access. They're tagging wallets that have been KYC'd and whitelisted. This way, you can only engage with those wallets. Fireblocks is leading that primarily.

Also, you've seen a lot of closed loop DeFi pools. One of the largest today is Avalon, or Ave. Ave has a closed loop KYC liquidity pool. That said, the incentives for market makers to post in a closed loop pool are not very high. And so, you haven't seen mass adoption there. I would say there's a number of market makers in crypto who think it goes against the ethos of crypto to have a closed loop ecosystem. And so, a number of other folks are working really on just tagging wallets that are safe to engage with directly.

KENNY: I'll pick up a question in the chat from Michael. Onshore versus offshore. With onshore institutions in the U.S. specifically, there are a lot of limits around derivatives trading. That goes even for some exchanges, like Binance versus Binance.US, or FTX versus FTX US. Do you want to talk a little bit about that schism and maybe pontificate on where you think that's heading?

AYA: Sure. I'm going to answer the question to the extent that I can speak about it. U.S. exchanges have no liquidity.. Most of the market makers are on overseas exchanges, with Binance being the largest one. You just can't compare that with Binance.US. It's the same thing with FTX and FTX US. The order books are incredibly thin. There can be mass slippage on a trade that you place in those exchanges.

The best exchanges in the United States today are Kraken and Coinbase, in terms of liquidity. Now, that said, you've seen FTX apply for the ability to offer derivatives directly to their retail clients. That was one of the primary reasons that they acquired LedgerX. We just got our swaps dealer registration approved last week. We were the first company in crypto to do that. You're seeing a lot of companies work very closely with regulators in order to push for safe and regulated derivatives trading in the U.S. because that is one of the largest markets for crypto.

As it stands, this used to not be the case. Two years ago, Asia was the largest market for crypto. But since the China ban on mining, a lot of the miners have actually moved to the United States. That makes the U.S. the largest market today. Regulators understand that. And so, the goal is how to protect consumers while making sure that we can also regulate this space in the same way it's regulated in traditional finance.

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