diffusetap
Virtual Event Series

Why Real World Assets Are Not on Chain Yet

Guest Speakers:

Kumar Ujjwal
Founder and CEO
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DiffuseTap: Why Real World Assets Are Not on Chain Yet

Last time on DiffuseTap, **Kumar Ujjwal and Nathan Paitchel of DwellFi** talked to us about how asset tokenization is solving the biggest gap in investing, why not all assets are going on-chain, and why asset tokenization has not taken off as much as everyone said it was going to.

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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 Speakers

KUMAR UJJWAL is Founder/CEO of DwellFi, a venture-backed, blockchain-based fund administration platform. An expert in SaaS, machine learning, and blockchain, Kumar founded companies such as Revni, a fintech that provides financing opportunities for home buyers.

Linkedin: @kumarujjwal1

NATHAN PAITCHEL is a business development veteran with almost 10 years of experience across multiple industries. He led development at Lightstone, a real estate investing and management firm, Digital Currency Group, a digital assets-focused VC fund, and currently, DwellFi.

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About Diffuse

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KENNY ESTES: Here are the speakers for today, Kumar and Nathan. Kumar, maybe you want to tell the good folks a little bit about you, your background, and what you're up to over at DwellFi?

KUMAR UJJWAL: I'm Kumar, founder and CEO of DwellFi. A little bit about my background. I started my career as a software engineer in 2008. A couple of years later, I started my first company. I ran it for a couple of years, sold it, and then mostly moved into the machine learning area. I worked for large corporations working with machine learning, and I have a couple of patents in machine learning.

Most recently, I was the head of product at Punchh. After that exit, I started DwellFi. That's why we're here. To talk a little bit more about DwellFi, what we are doing is we will have a tokenization platform. We do asset tokenization. But at the same time, we also built a fund data platform, which is the concept we took from my previous company, where we were building a Customer Data Platform, or CDP, which is the largest segment now. We took the concept from there and realized that there is nothing similar to this, and that there is actually a massive need for that. That's where we started this, and that's what my goal is.

KENNY: Awesome. Great stuff, thank you very much. Nathan, do you want to give the folks a bit about your background, too?

NATHAN PAITCHEL: Yeah, absolutely. Pleasure to meet you all, I originally come from New York City real estate development. I worked for a private developer for about nine years, and then across a wide range of multifamily hotel portfolios. I went pretty far down the crypto rabbit hole, like I'm sure many others too here, in 2015. I was super interested in the technology.

And that was amplified by Digital Currency Group, or DCG. In 2021, I worked alongside the venture capital team and led their NFT strategy for a while. I heard a lot of pitches about real world asset tokenization. I heard a ton about DeFi fractionalization, where everyone can trade it and own a piece of the Eiffel Tower.

Everything sounded great, but I just didn't see how it was going to be regulatory compliant or scalable in most instances. And then, I actually had the pleasure of meeting Kumar through Lou Kerner, who runs Crypto Mondays. I was just really impressed with Kumar. He was building more of a fund administration platform. I think it solved a lot of the issues that I saw during my time at DCG. Again, I'm super excited to be here. Happy to get more into the conversation.

KENNY: All right. Well, we'll start there. Kumar, a question for you. Circa 2018, I had a terrible interim executive role at one of the then three ATSs that could do security tokens in the States. And among the funds at the time, real estate was all the rage for real world assets. Those things had no liquidity. They did not trade at all. My understanding is that the gold asset market has not moved

that far in terms of liquidity since then. So, is that a fair assessment? And are you trying to help with that a little bit?

KUMAR: Yeah, that's a very, very good question. This is actually one of the big problems in the space. Everyone was saying "get ready for the tsunami of RWA space" and all these things, which has never happened so far. And so, one of the big problems as to why it never happened is that mostly, the way that people have done organizations so far is through tokenization. You take an asset, you create a new SBC out of that, and then you tokenize that SBC.

When you do the tokenization of the SBC, you are basically tokenizing the LP interest in the SBC, which is good. It solved one of the problems. You have the LP interest tokenized. So, what you can do is, you can do a proxy voting and all those things. But ideally, it would be an equity management on-chain versus equity management off-chain. That's what it is.

But now, if you want to do any action of the tokenization of assets, like for example, you want to do a trade, you want to create liquidity, borrow against those assets, and all those things. When you want to do it, what happens is you need to have that asset data. Also, you have to do all these things frictionlessly. But the problem is, when you tokenize that and you don't have that data along with that tokenized asset, then it's not a frictionless experience. Because now, you have to go off-chain, pull that data, and then do the transaction on-chain.

So, what is the whole purpose of doing it on-chain? You can do it off-chain too, right? That is one of the fundamental problems which people have not solved yet. And this is how we started. We started building it. We started from the ground up in solving the problem of why this thing has not yet taken off. So now, when we tokenize these assets, we tokenize the asset as data. The way we do it is a dynamic NFT format.

What is the use of a dynamic NFT? With a dynamic NFT, when you have a tokenized asset, it has two parts in it. One is fungible, and the other is non-fungible. Your non-fungible is the proof of ownership. Your fungible part is all the metadata associated with that part. For example, your nav, what is the unit of that form in that particular transaction, pictures, and anything leveraging all those things. What are the documents, were they signed, etc. Every single thing. All the metadata along with that.

So now, you package that. That's where you have the dynamic NFT representing the real word asset as a token. Now, when you do any kind of transactions on that, when the transaction is happening, you will have the real time information about that asset. For example, one of the use cases which we're trying to solve is how you can borrow against those assets, which are tokenized. Real world assets. So, if you have these two dynamic NFTs which are representing all the metadata, a lender can go and see your dynamic NFT.

And then, you can collateralize that asset and borrow their source assets. That's how we are solving this liquidity problem in this space. It's by bringing the data and assets on-chain together.

KENNY: Awesome, great answer. Nathan, anything you want to add to that before we jump to the next question?

NATHAN: I think that was a pretty good answer. Why don't we jump to the next one? I think I have a good idea of where you're going.

KENNY: All right. Well, maybe we'll stick to you, Nathan, just to mix it up a little bit. Giving the information into a smart contract is not easy. In my experience, the buyers and the owners who own the assets already have more context. They have financial statements and things along those lines. Getting someone who is accountable to actually put that information into the NFT itself is not necessarily the easiest thing. So, how do you overcome that person problem?

NATHAN: It's actually pretty cool. It's a feature that we are going to release on Monday. One example of an asset that we tokenize, for instance, is real estate funds. What we do is, just like how a normal real estate fund operates, we take every single data source, whether it be in Excel or any other possible data source, even PDFs, where their asset data, their fund performance data, all their GPs, LPs, etc. are included. We can take all those data sources and drop them into what we call the Dropbox. And then, that is what we coin as our fund data platform.

The fund data platform will actually spit out structured data, which we can then use services on top of. We've done it with real estate. We're looking into private equity right now. We're actually even doing it with fund administrators' existing funds, so we can do open and close. That's basically how it works. We take all the data piled into one central source, and then we can structure it and then spit out services on the back end.

KUMAR: Somebody asked in the chat. This data is huge, how do you manage it? That's right. You need a trusted party. We work with the trusted parties involved in that. You have an admin. You have a CPA. We work with them. Where we bring efficiency is in the tech. That includes how fast you can pull this data, how you can sanitize this data when you pull it out, how you can verify that data on-chain, etc.. That is what we do. But the reports and everything is encrypted by our admin, who is regulated by law. That's how you verify the data.

KENNY: It makes sense. You always have to have those third party trusted intermediaries, no matter how you call it, especially on top of financial services. It makes sense. A question from the chat, cutting right to it. What's your poster child? What is something you've actually tokenized thus far?

KUMAR: So far we have tokenized a $120 million point today, which is already on the Celo blockchain. We decided to use Celo because Celo's Merrick was one of our early advisors. And it's an L1 chain, so we can move it to any EVM compatible chain. It doesn't matter if it's on Polygon, or Celo, or anyone else. As long as you're EVM compatible we can do that.

Today, this one is live. You can see $120 million on-chain. There are a total of 620 wallets that are holding these assets and every transaction which has happened so far, like your payments, your subscriptions are described, and everything is recorded on-chain today.

KENNY: I recognize it's early, but do you have liquidity? Do you have actual trading volume on there? Or were you working on getting more of the transactions?

KUMAR: In the first part, we did that. Now we're bringing the liquidity part. We're working with different vendors to bring liquidity in.

KENNY: Okay. Maybe we'll go back to you Nathan, if this is your forte. George Clayton has a question about the legal piece. You mentioned a fund. So, are you replacing the actual PPM and subject to docs, and doing it all on-chain? Or is this a layer that you put over the top of it to update the cap table?

NATHAN: No, we take the exact standard way as you do in the real world. We actually host all the PPM agreements. Everything is stored on the platform. The GPs can populate it all in, and then as LPs sign and make new investments, they will get a copy of those agreements. Everything is just seamless on the platform. We are not reinventing the wheel here. We're just doing a portal and making sure it all gets audited on-chain.

KUMAR: Yeah. The only thing is the signature. That digital signature goes on-chain to verify that you've done that transaction.

KENNY: Okay. Back to you Kumar. If I wasn't in crypto, this would seem pretty hard to interact with. I'm assuming I need a MetaMask wallet, or some form of wallet. What are those barriers of entry to get more retail to flow in? And how are you trying to address that?

KUMAR: Yeah, that's a very good question. This was one of the things that we were building, because all our investors and LPs on the platform, I have never seen interact with a wallet and all these things. So, we took the same Coinbase approach, where we tried to make it simple with a user interface. Where, when you come to the platform, you don't see a wallet. The way it works is, when we onboard a fund, each LP will have a login in what looks like a traditional portal.

And when they go there, they see certificates. These are called digital certificates, which are basically just a piece of certificate, but it's on-chain. In the backend, there is already a wallet. We provision our enterprise wallet for everyone, in which this is stored. And your wallet permissions are very simple. In the backend, it's complex. It takes care of all the policies and everything. But on the front end, you are ordinary members. It's that kind of provision. They don't even know this is a wallet, but they are the owner of their investment.

If you want to do a trade, you can just click redeem, or you can click borrow. Those are the trades, but in a very traditional way. You don't even interact with the blockchain in the UI. All of that happens in the bank. That's how we overcome that friction. That's how you can bring crypto to non-crypto native people.

KENNY: That kind of feels obfuscated, which I'm not using in a derogatory sense. It's built that way to save them from the complexity that they don't need to know anything about. But Nathan, were you going to add something?

NATHAN: Just the other component that we're all excited about. I saw someone in the chat posted something about, "how do you see all assets trading together?" I think it's very easy to effectively do liquid assets on-chain right now. I shouldn't say "very easy", but it's much more possible. We see a world in the future where real estate funds, hedge funds, crypto funds, and everything else will trade seamlessly on platforms. But it's just going to take a really long time to get there.

And especially on my side, on the business side of having to deal with sales, if you go in and you're talking to a giant asset manager or private equity fund and you start throwing these words like blockchain and everything, especially with all the sentiment right now, you are not going to get the customers unless they have some some person that is super entrenched in this and in crypto.

So, what we're really trying to do is doing this very slow two-step approach, where it's more of an educational phase, and really putting blockchain on the back end, but having everything run seamlessly through the blockchain.

KENNY: I'm going to put you up there. You said you can see that in the future, everything is going to be on-chain. I was a high frequency trader for about a decade, and I'll tell you right now. Doing anything on-chain is about 1,000 times more expensive than trading Microsoft. So, do we actually see that future state where everything is on-chain? Or is that only for specific assets?

NATHAN: I think private funds will be the last to come on-chain. But if you look at what Binance and a few others like Sologenic have tried to do, they threw stocks on-chain. And why not? Why should the S&P and the Nasdaq have all the control, and collect all the fees from these brokerage houses? Why can't these stocks just trade and be fractionalized, just like everything else?

I think it's just the inevitable future of how markets will operate. I think it runs faster. I think there is less friction. People will fight to make sure they can continue to carry their fees, but I do see a world in the future where all these assets will eventually be unchained as opposed to just siloed at these homes right now.

KENNY: Kumar, anything you want to add? Because I know this is really the big "why" for DwellFi, right?

KUMAR: Here's what I think. The tokenization of real world assets will start from a lot of illiquid assets coming into the RW space. The liquid asset high frequency trading and all these things are not going to come. I don't think there is a need for that because it's already liquid. You can do all these things, so why would you want to bring them on-chain? With regards to the transaction costs, those are going to reduce no matter what. You will see a lot of different element chains, and all these new technologies are coming, which will reduce the cost.

If they end up the way they're working, you will see that you can do a lot of Ethereum transactions with a very low gas cost in the next three to four years. But that is not a problem. The problem is, what is the value add of bringing anything on-chain? Is it just for the purpose of "okay it's on-chain"? That does not make any sense. I think you will see all the illiquid assets first, because those are the things that take forever to transact, and to create liquidity from.

If you bring them on-chain, the friction of doing all these things often reduces, and you can do more frequently, and do a lot more different types of transactions on that one financial instrument. You can bet that's where the value is. So you will see all those illiquid assets coming on-chain. And then, who knows? I can just envision up to that.

KENNY: Start with the illiquid, and then we'll deal with the liquid on a much future date. Probably not on Ethereum, given the gas fees.

KUMAR: Yeah. There are a lot of different chains out there, so...

KENNY: Yeah, exactly. Question from the chat, AML KYC. You mentioned that obfuscation, where the people don't even necessarily know they're involved with smart contracts. I'm assuming then you're doing that AML KYC. Is it one market that you control? Are these white labels on a per fund basis? How do you work on a technical perspective?

KUMAR: We do white label solutions for existing firms. For anyone who comes to our platform, the white label, the whole tech stack, and then the platform is available for them. The KYC and everything is integrated in that also. It's one single platform where you do all this seamlessly with the digital onboarding of the client. Every client has a KYC, and that is also digitized.

Once you tokenize a KYC on the platform, you can do other transactions also, because it can verify those things. You don't have to do it twice or three times. All these things are white labeled.

KENNY: Gotcha. All right. And Nathan, I think you answered that in the chat, so thank you for being on top of that. Anything you want to add before we pop into the breakout rooms?

NATHAN: No, I think that's a good place to leave it. Excited to get more into the nitty gritty in the side rooms.

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