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Guest speaker spotlight: Heath Behncke



Heath Behncke was an ANU alumni who graduated with First Class Honours in 1998. Heath has been an analyst and portfolio manager with AMP Capital, Magellan Financial Group, Credit Suisse Asset Management and Sigma Investments. In 2018, Heath co-founded Holon, a next generation fund manager, venture capital firm and Web 3.0 infrastructure and decentralised data custody/storage provider powered by the Filecoin ecosystem. Holon believes innovation drives wealth creation, and everyone should have access to investing in the best companies and technologies globally that are driving innovation today, tomorrow and in the future. Heath shared his insights on digital disruption with the SMF, which are summarised below alongside the Q&A session.

Digital finance

Evolution of the internet

The 1990s saw an increasing pace of change with the invention of the World Wide Web, which ushered in various new industries with vastly improved economic propositions. This period amounts to web 1 – the ‘internet of information.’ After 2004 to around 2016/2017, web 1 transitioned into web 2 – the ‘internet of communication.’ Web 2 was enabled by smartphone and cloud computing, driven by the iPhone and Amazon web services. The result was a paradigmatic shift, the power of which has consistently been underestimated. Much of the value generated in the global equity market over this period stemmed from companies harnessing web 2.

In 2016/2017, solutions began to emerge that dissolve issues around data verification, initiating the evolution of the internet into web 3. Today’s platforms that are based around ‘read/write’ (e.g. Zoom) will transition into ‘read/write/verify.’ One of the key implications is that transactions will become automated without the need for an intermediary, such as traditional banks. This will enable a shift from the ‘internet of communication’ to the ‘internet of value,’ under which financial services will change markedly over the next 20 years. When the fiat-based financial system is contrasted against the current uptake of decentralised services globally, it is clear a major shift is underway.

Bitcoin’s influence on digital scarcity and governance of money

The transition to web 3 was set into motion by Bitcoin, a key feature of which was to resolve the issue of digital scarcity. This will go down in history as a very significant event. Disregarding its volatility, the main feature is creation of a monetary network based on digital scarcity that supports automating transactions without the use of

financial intermediaries. Following on from Bitcoin, operators in the web 3 space have been seeking further methods to automate and scale functionality in similar ways. This will take us from an information age into an age of autonomy, with many exciting prospects for innovation and efficiency improvements. As an investor, it is important to pay attention to these trends, and understand the directions the world may be taken in by web 3.

Evolution of fiat money: Central bank digital currencies & stablecoins (Meta's Diem)

The shift to the internet of value will have implications for fiat currencies and central banks (CBs). In 2015/2016, Swedish Riksbank prompted CBs globally to evolve their definition of money and to consider the use of digital currencies and stablecoins. The Riksbank saw the need to evolve fiat money and observed the diminishing role of cash in the economy. Meta (previously called Facebook) escalated the shift to digital currencies in 2019 by introducing Libra, now known as Diem, which is established as a global currency that allows free and instant payments across currencies. There are potentially profound benefits for the 3 billion users of Facebook, especially those in areas with a lack of accessibility to financial services, essentially enabling financial inclusion through the use of pseudo ledger technology. The largest network in the world creating their own global currency naturally attracted the attention of CBs, including concerns over Meta's history of data controversies. This set the scene for policy makers and people around the world to educate themselves about the potential benefits of pseudo ledger technology, with 80 CBs now looking into how to evolve money.

Additionally, Meta has plans to launch various stablecoins as simplified versions of Diem, so far launching a USD version that is presently in the cryptospace. Stablecoins are simple to use, transact globally and offer clarity and transparency over their operation. Such benefits explain why there has been a rapid movement of money into that ecosystem. Over the last two years, the total value of stablecoins has grown from less than US\$10 billion to over US\$100 billion, driven by the fast integration of technology. A global discussion has commenced about how to regulate stablecoins, and will continue to evolve in coming years. The rate of development in the web 3 sphere is vastly faster than what occurred in web 2.

Global digitalisation of financial services and impact on traditional local banking

Programmable money enables data granulation, with the potential benefit that the financial system can be operated with lower risks. Currently, there is limited visibility on how the financial system operates. For example, the RBA collects information that is still fairly opaque. In the digital sphere, everyone views the ledger so that both information and system operations become transparent. Information can be easily verified, and this transparency brings some great benefits to regulators.

Further, a move to a CB digital currency would be like a replumbing of the banking system, i.e. a very big structural change. CB digital currencies will have longer lead times and require experimentation, similar to the delay in implementation under the NBN. Banking systems globally are homogenous but disconnected. Digitisation can connect them, and engender competition.

Asset allocation in a world where "cash" does not lose purchasing power

A potential shift towards a new monetary system implies that people will gravitate out of the current localised financial system, to which existing financial companies are tethered for various reasons (e.g. laws, protections). The reorientation around

blockchain technology creates the potential for globally scalable financial service companies to emerge in this environment. An example is Coinbase, the leading listed cryptocurrency exchange. Noting that deposit collection is at the heart of banking, Coinbase holds a cost advantage over traditional banks in this area. It has the ability to conduct business over a software platform and information system, which can be accentuated by the rapid growth within a blockchain environment. A globalised transition towards decentralised finance (DeFi) will accelerate the pace of domestic disruption.

A further impetus is that CBs are consistently manipulating the printing of money, raising questions over the implications for fiat money as a store of value. By contrast, although it has a volatile price, the 'monetary policy' of Bitcoin is fixed and known. This solves this governance issue around money within an alternative monetary system. A large change in the global regulatory landscape has been signalled by the US Office of Comptroller of the Currency stating that there are no issues with engaging with digital assets. Many companies have since started subscribing to Bitcoin infrastructure, including Visa, Mastercard, Paypal, and various insurance and wealth companies. This is serving to accelerate the development of web 3, as people are coming to understand that sound money can be accessed via their mobile phones.

Banking: what was historically safe is becoming risky; and what looks risky is becoming safe

Post GFC in 2008, a regime was entered into to guarantee the entire financial system. Government guarantees underpinning the system explicitly led to a crunch on banking returns by requiring more capital to be held. The status quo is tenuous, and there is a need to de-risk the system by transitioning it to become more utility-like in nature. However, the traditional banking outlook is a lot tougher compared to the previous 15 years, partly due to the fishbowl effect in how we are dealing with our money. Not having guarantees may look risky, but might actually end up the safest option.

As a way of escaping this conundrum, it is projected that fractional reserve banking supported by implicit guarantees may not prevail. Society could opt for a different operating model, where automated financial services infrastructure replaces intermediaries like traditional banks. The key underpinning idea is a shift to cash where purchasing power is maintained. In a Bitcoin world, there is no disconnect between the amount of money and the amount of goods and services over the longer run, as purchasing power is maintained (putting aside volatility). This idea introduces a different starting point for asset allocation.

Q&A session

- 1. What does the adoption of this technology look like in developing countries with unbanked populations and increased capital controls? How does it translate to developed countries like Australia with effective regulatory regimes to protect domestic banking?**

Cost savings are substantial on global remittances. The El Salvadoran president mandated a Bitcoin network, realising that it would enable remittance from overseas for 70% of the unbanked population. Africa and Tonga are other examples of developing countries with communities that always send money back home. Financial inclusion via lowering remittance costs is very important. This is the reason why awareness of Bitcoin emerges in these nations, as they realise it is a great way to save money. This will

become prevalent across more countries. Another example is Latin America, where people have had poor experiences with their governments and governance around money. This experience leads them to understand the significance of cryptocurrency.

In terms of developed economies, companies will likely start to carry Bitcoin as a store of value, to use stablecoins, and develop various processes around it. The issue for smaller developed countries is that they are unlikely to understand how quickly they should adapt to the shift, which will be momentous. People and regulators should eventually become better educated. With this turning point, they will start to understand the benefits of the technology.

2. Since Bitcoin does not have a proprietary claim on blockchain technology, where does its intrinsic value come from?

Understanding Bitcoin's source of value is key. With gold, many cite its tangibility as its main source of value. This is inaccurate: the value arises from scarcity. For digital currencies, value is underpinned by digital scarcity and network effects. In the case of Bitcoin, it is valuable because it is hard to break the stable network effect. For instance, it is possible to replicate the code of Bitcoin (e.g. Litecoin), but it still lacks the network effect of Bitcoin. Taking a code and modifying it is one thing, but convincing people to utilise it is another. Bitcoin had the first mover advantage and this is difficult to replicate. When examining currency, it is imperative to understand its value proposition, governance and also surrounding network effects.

3. Coinbase is a centralised exchange platform for different moving cryptocurrencies. What is the business model, and how does it convert into cash flow generation?

Trust is a huge part of the business model of a cryptocurrency exchange. Coinbase solves access in a trusted way. When people delve into cryptocurrency for the first time, they will choose Coinbase as it is listed and regulated. The technology Coinbase utilises is not the best, but what they possess is the brand name and trust. The legal and compliance team is enormous, a necessity in order to innovate and prosper within financial services. Coinbase is also shifting to providing custodial services to large institutions and charging a fee for service. The fees are likely to compress over time as competition comes into the space and the ecosystem grows. However, Coinbase will look to other products as they move forward, to diversify their income stream over time.

Prepared by Julie Lin (Relationship Officer)