

The institutional crypto backers:

How endowments are allocating to cryptocurrency investments



Executive summary

The degree of involvement of institutional investors with cryptocurrencies has been widely discussed since the appearance of digital assets on the radar of financial markets over the past two to three years. The stance of asset managers, pension funds and hedge funds has been assessed, but the appetite and activity of endowments and their investments in crypto-assets and related funds has remained unquantified and sparsely researched, until now.

Results from a survey conducted in the fourth quarter of 2018 by *Global Custodian* and its sister publication *The Trade Crypto*, in partnership with *BitGo*, show that this set of investors has turned out to be among the more active participants in cryptocurrency investing.

Our survey of 150 endowments has shown that 94% took part in crypto-related investment initiatives in 2018, with

only 7% saying they expect their allocation to decrease in 2019. Feedback from respondents showed that they find the space “exciting” and “interesting” as they appear cautiously optimistic about the long-term future of their crypto-related investment allocations.

Many still see discouraging factors in the relatively new marketplace that need to be resolved – a lack of regulation and robust market infrastructure prominent among them – but interest and activity is undoubtedly there, as proved in this study.

The research shows how endowments view the crypto landscape, what they are looking for in potential funds and how they rate their whole experience of the cryptocurrency market during 2018.

Key findings

94%

of endowments have taken part in crypto-related investment initiatives in the past 12 months



94% believe the endowment sector's allocation to crypto-related investments will either increase or stay the same in 2019



54% of these investments were direct, while **46%** were through a fund

Only **7%** believe their allocation will drop during 2019

“We are in the beginning stages of looking at this as a new asset class for the endowment.”



Introduction

The evolution of cryptocurrencies has been remarkable considering their relatively short lifespan. Whether you measure the infamy of the concept, the promise of its underlying technology or the meteoric price rise of the flagship currency, Bitcoin, the emergence of digital assets and subsequent interest from investors of all shapes and sizes throughout the world, has been undeniable.

A decentralised digital currency, in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, has become a phenomenon like no other in the context of modern day investments.

At their best, crypto-assets have been ground-breaking. In the face of adversity, they have remained, if nothing else, thought-provoking. Bitcoin was the first implementation of the concept with its specification and proof of concept

“An investment that is breaking the ups and downs in the current market.”

published in late 2008 in a paper authored by Satoshi Nakamoto. Although an air of mystery has surrounded his real identity, the paper itself is fairly straightforward. Nakamoto released the first Bitcoin software in early 2009. Since then, countless cryptocurrencies have emerged, capturing the imaginations of retail investors, entrepreneurs and capital market professionals alike.

Futures contracts, initial coin offerings (ICO's) and numerous fund launches have further whetted the appetites of investors, but the one lingering question has been around the interest and activity of institutional investors in these digital assets.

In their early years, the uptake of investment and trading of digital assets came from retail investors, but this inevitably broadened in line with the hockey stick price

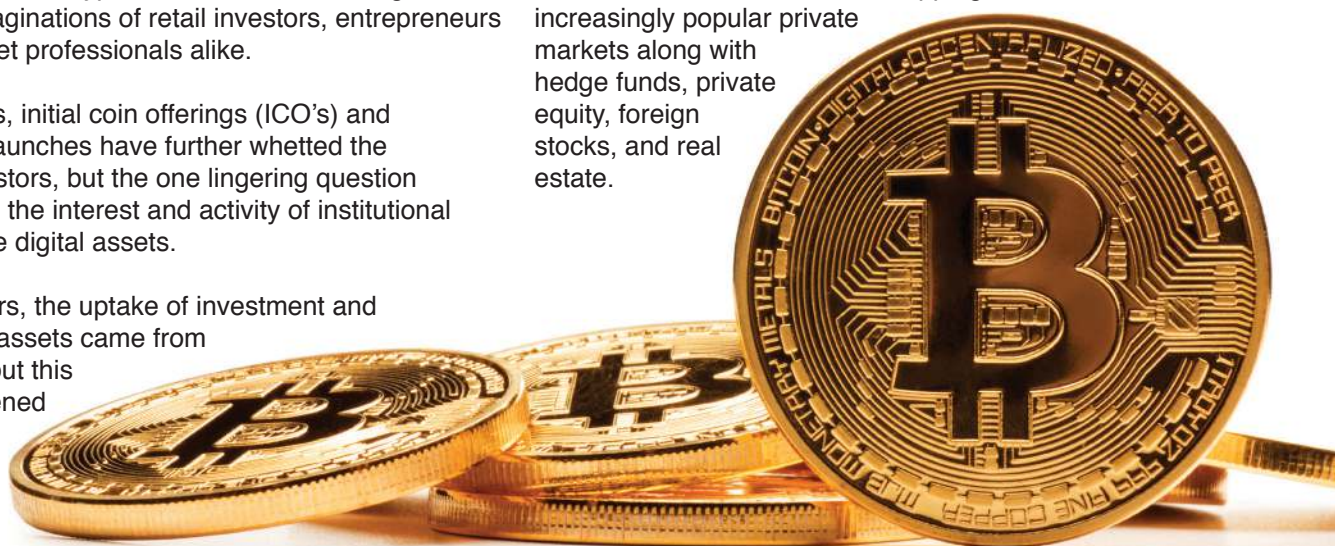
rise of Bitcoin and other cryptocurrencies throughout 2017. Crypto-dedicated hedge funds began emerging at a rapid pace – with numbers doubling from October 2017 to February 2018¹ - while family offices gradually began dipping their toes into digital assets, as have a handful of pension funds in the early months of 2019².

Traditional asset managers – the likes of BlackRock, Vanguard and Pimco – remain on the sidelines due to a lack of regulatory clarity across the world's major markets. This is not to say their interest has not been piqued, but volatility, liquidity concerns and an unfamiliar market infrastructure render the new asset class relatively untouchable, while regulatory uncertainty also persists.

But what of endowments? The multi-billion dollar US university funds, valued according to their donations and financial assets, collectively amount to a huge institutional asset pool – where returns and strategies are heavily scrutinised, and chief investment officers and decision-makers can make a real name for themselves.

A study from the National Association of College and University Business Officers and financial services company TIAA, showed that endowment returns fell by about a third to 8.2% - net of fees - for the year ending in June 2018. This was however, higher than returns in 2015 and 2016.

Given their longer-time views on investing and wider-ranging allocations, endowments were always likely to have a different approach to cryptocurrencies and crypto-funds than their institutional peers. They invest in more alternative assets than others, dipping their toes into the increasingly popular private markets along with hedge funds, private equity, foreign stocks, and real estate.



Each endowment has a different split of allocations, with Yale and Harvard the two largest and most closely-watched by those monitoring the space. In October 2018, CNBC reported that Yale's chief investment officer, David Swensen, had invested in two funds dedicated to cryptocurrencies. This news marked one of the first public backings of a cryptocurrency fund from such an institution.

In March 2019, it emerged in a board meeting agenda that the \$11.9 billion University of Michigan endowment fund had invested \$3 million in crypto-network fund CNK Fund I.

Despite these initial reports, an assessment of the entire endowment landscape and their involvement in cryptocurrency assets and funds has been unquantified.

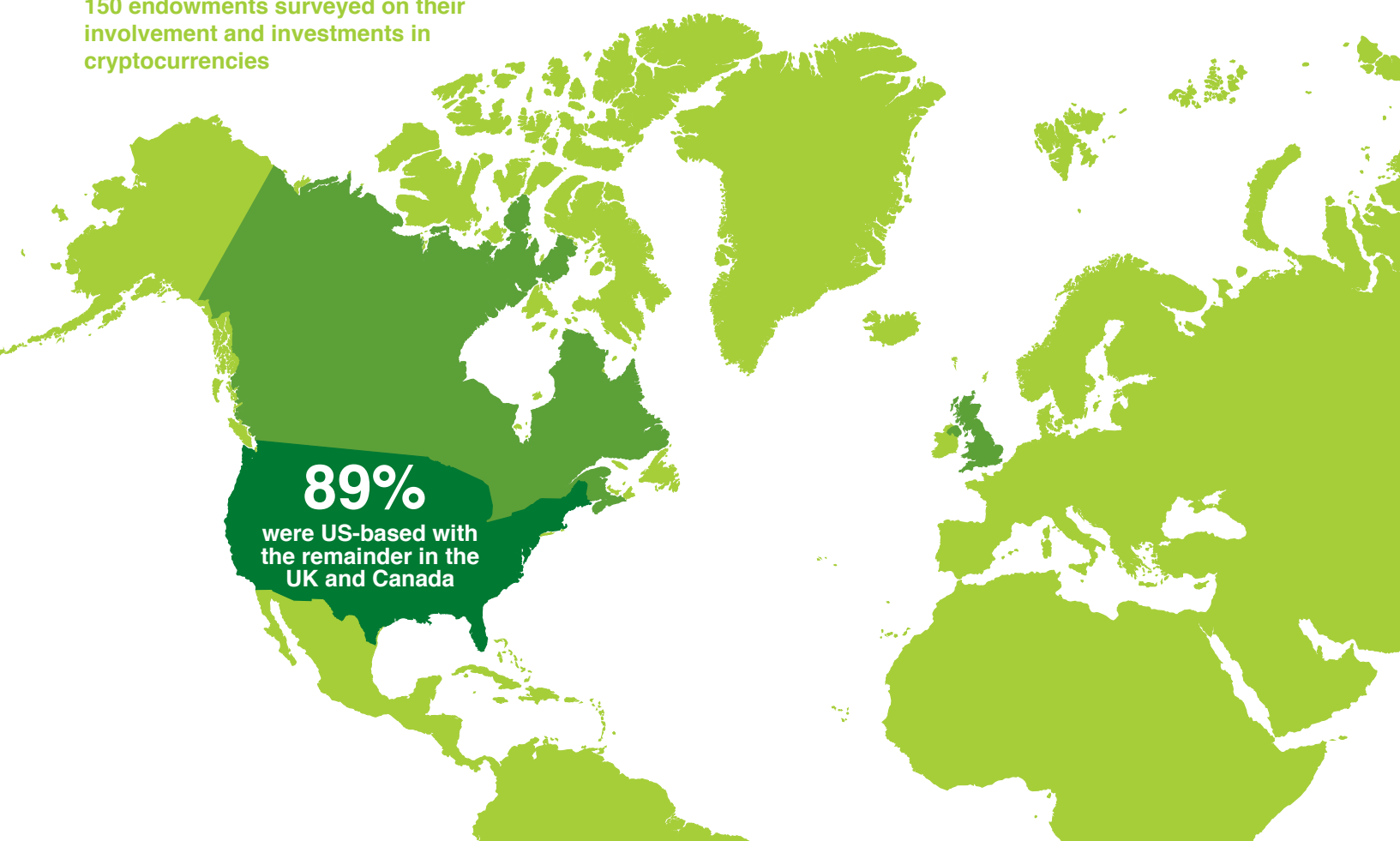
Survey overview

In the fourth quarter of 2018, Global Custodian, in partnership with BitGo, surveyed 150 endowments on their involvement and investments in cryptocurrencies, and their intentions for the next 12 months. The vast majority of these (89%) were US-based, with the remainder in the UK and Canada. Respondents were primarily decision-makers within their endowment, with others playing an advisory or Board role.

We asked of their experiences in the new asset class and the criteria that a crypto-asset fund needs to incorporate to be investible by an endowment, and finally what factors are discouraging them from investing (see Methodology for the full list of questions).

The results show the sentiment of these endowments towards this new asset class, which has supposedly been shunned by the financial market's more sophisticated institutional investors and hamstrung by its humble beginnings and infancy in comparison with the more established asset classes and their infrastructure. Our findings confirm some of the lingering worries about the burgeoning asset class, but show a more receptive and inquisitive attitude than might have been expected.

150 endowments surveyed on their involvement and investments in cryptocurrencies



Endowment asset pools test crypto-asset investments

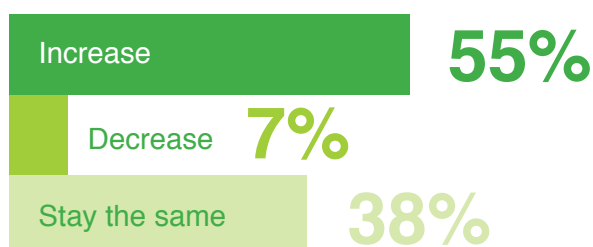
Endowments were active in crypto-related investments in 2018

Cryptocurrencies and crypto-related investments would have caught the attention of every kind of institutional investor over the past two-to-three years, but whether they actually engaged is another story. At the time of writing this report, Bitcoin's market capitalisation was around \$83 billion, up from \$15 billion in January 2017, proving that the market has been growing, despite its peaks and troughs. However, 2018 was a year where Bitcoin fell from its highs of over \$320 billion in market capitalisation to under \$60 billion, suggesting these volatile and turbulent times could have dissuaded institutional investment. According to our results though, endowments were not swayed by the market downturn and 94% said they had taken on crypto-related investment initiatives in the past 12 months. Of these active participants, 54% said they invested directly, while 46% did so through a fund.

Looking for familiarity, stability and security in crypto funds

Of the 46% which said they had invested in a crypto fund in the past 12 months, we asked what criteria these crypto-asset funds would need to incorporate to be investible by an endowment. The most common answers were around stability, reliability, trustworthiness and security, showing clearly that despite their resounding interest, the short-term priority for these funds is more to do with having the familiarity of a traditional fund than a return on investment. Of course, liquidity and good returns in

Based on your experience to date, do you expect your allocation to crypto investments over the next 12 months to:



“They would need to be stable, secure and trustworthy.”

Has your endowment taken any crypto-related investment initiatives in the past 12 months?

94% Yes

6% No

Direct 54%

If yes, what form did that investment take?

Funds 46%

the long-term came but their frequency paled in comparison to responses focusing on stability, along with safe encryption and password management. Many respondents wanted their funds to be regulated, while others called for wider regulation to be put in place. On the personnel side of the funds, respondents highlighted the need for good management, experience and leadership skills from those running the funds.

Endowment interest shows no signs of letting up

While the activity from endowments was surprisingly high, given the widespread concerns in the capital markets about regulatory, volatility and liquidity issues, what was perhaps even less expected from our findings was the intentions of our respondents in the coming 12 months. Only 7% said they expected their allocation to crypto investments to drop in 2019, with 49% saying it would increase, and 45% believing it will stay the same. While concerns around digital assets undoubtedly linger, cryptocurrencies are evidently becoming more synonymous with other established asset classes in the capital markets as infrastructure and providers continue to grow. When asked how they believed the endowment industry as a whole would approach crypto assets and crypto funds in the next 12 months, the results were similar, with 6% saying allocations would drop, and 49% deeming them to increase, while 45% said investments within the community would stay the same. Given consistency in both sets of results, it seems these decision makers are in unison on

“The market is way too volatile and the long-term structure is not in place yet to help stabilise pricing swings in the sector.”

the topic which has undoubtedly come up in networking discussions and conferences throughout the year.

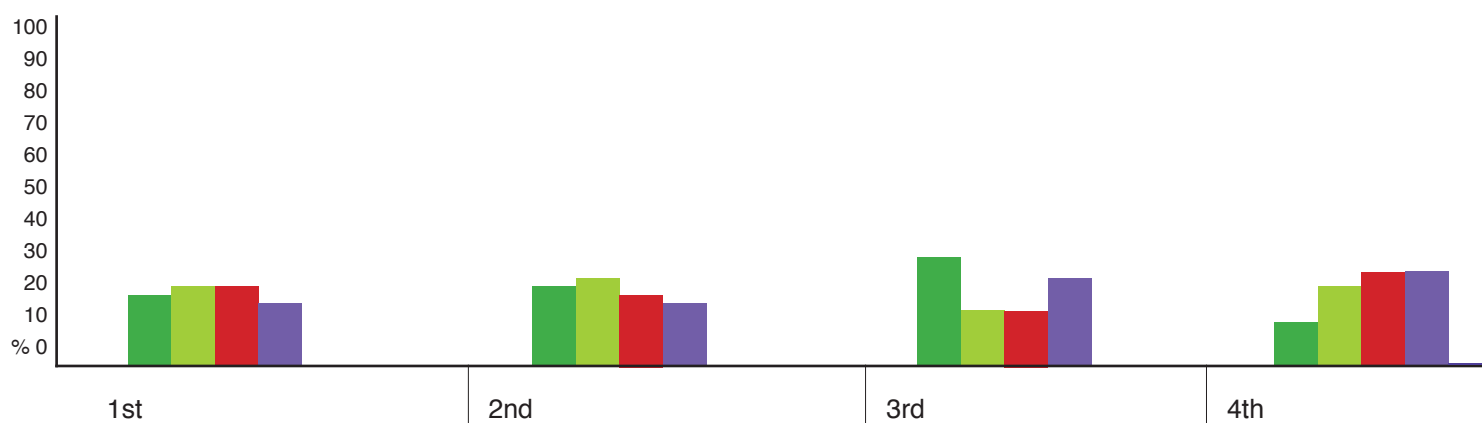
A range of potential concerns, as opposed to one decisive obstacle

Cryptocurrencies have not been without their scandals and controversies in recent years. With such a quick uptake and subsequent surge in platforms and exchanges, the pace of interest and investment exceeded the development of accompanying security and regulation in many cases. This has meant that market infrastructure has largely been playing catch-up due to the resounding and sudden interest.

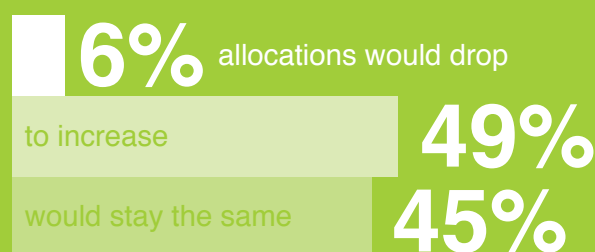
In 2018, the cryptocurrency market begun scrambling to set up access to exchanges, new derivatives products, technology, custody, administration, prime brokerage, AML/KYC checks, auditing services, data services and much more to make cryptocurrency feel like any other traditional asset class. However, volatility, regulatory concerns, liquidity worries and an evolving market infrastructure can all be deterrents to institutional investors. We asked respondents to rank the above factors, along with ‘other’, from 1-5 in order of what is discouraging them from further investment in crypto-assets (1 being the most discouraging, 5 being the least). The results showed that all the factors were

Please rank the following factors in order of importance in terms of their impact on discouraging institutional investment in crypto-assets:

Regulatory concerns Lack of infrastructure Volatility Lack of liquidity



Beyond your own experience to date, do you expect the allocation to crypto investments over the next 12 months by endowments in general to:



almost equally weighing on the minds of endowments, with a lack of robust market infrastructure and regulatory concerns the most highly ranked by mean score (2.40 and 2.43, respectively). Volatility was also cited as the number 1 discouraging factor more than the others; however its mean score was slightly lower at 2.50. Scores were quite consistent across the rankings, suggesting that each endowment has its own unique priorities when it comes to crypto investment, though most seem concerned with infrastructure, regulation and security. The biggest takeaways were that regulation featured in the top 3 concerns in 75% of the responses, while lack of liquidity seemed the least concerning factor, most often placed at number 4.

Given their long standing in the financial markets and history with long-established asset classes, endowments are used to using traditional custodians, often with decades of experience in safeguarding. In the early stages of cryptocurrency’s breakout in the capital markets, there were major concerns about the lack of safeguarding and custody, which many providers are now looking to address. For many institutional investors however, the emergence of custody offerings proven to have consistently high safeguarding standards will be essential.

⁴ www.cnbc.com/2018/10/05/yale-investment-chief-david-swensen-jumps-into-crypto-with-bets-on-two-silicon-valley-funds.html

⁵ www.ai-cio.com/news/michigan-endowment-dips-toe-crypto-pool/

Summing up the experience

When asked to sum up their experience to-date with cryptocurrency/crypto-asset investment, in just a few words, the responses gave a great insight into the excitement and cautious optimism from endowments. “Hair-raising” said one survey participant, while another described their experience as a “very wild ride” elaborating to add that while it may “swing up and down” there has been an “excellent pay off”. The words “interesting” and “exciting” appeared multiple times, with a running theme of positivity, patience and confidence in the digital asset class, throughout the majority of the answers. “I think the currency is growing and will maintain value,” said another.

There was, however, evidence of fallout from the 2018 cryptocurrency rollercoaster. Some who had clearly dabbled in the asset class were set to move on, such as one participant who said “Not a good place right now. Market is way too volatile and the long-term structure is not in place yet to help stabilise pricing swings in the sector.” Two others referenced instability within the market and another said they were “too scared” to go near it at present. Given the large sample of responses, those who had invested and moved away from digital assets, and those

“I think it is the future of investing.”

who remain uninvolved make up the minority. Overall there is a degree of caution mitigated by feelings that this exciting new asset class could be the future of investing, or at least a concept worth exploring in the current environment.

While traditional asset managers and investment banks have largely stayed away from crypto assets due to pricing issues and short-term volatility, it seems endowments are keen to give this new asset class a long-term chance. Given the nature of their investments and the long-term view to keep universities financial viable, cryptocurrencies and funds seem to fit their modus operandi, which will give confidence to those platforms hoping the asset class will be around and grow in the years to come.

Methodology

Global Custodian and sister title, The TRADE Crypto, created the survey questionnaire in collaboration with Qualtrics, the online survey platform that sourced respondents according to strict parameters of engagement with endowment policy and decision-making.

A total of 118 responses were validated by Qualtrics with a further 32 ‘late entries’ being accepted by Global Custodian, making a total of 150 responses as a basis for the aggregated results presented herein. Responses were aggregated on an unweighted basis as the purpose was to establish the breadth rather than depth of engagement of endowments with crypto-investing.

The questionnaire gathered the following information:

- Which country do you reside in?
- Job title or function
- Has your endowment taken any crypto-related investment initiatives in the past 12 months?
- If yes, what form did that investment take?
- Based on your experience to date, do you expect your allocation to crypto investments over the next 12 months to:
 - Increase
 - Decrease
 - Remain the same
- Beyond your own experience to date, do you expect the allocation to crypto investments over the next 12 months by endowments in general to:
 - Increase
 - Decrease
 - Remain the same
- From your perspective, what are the top three criteria that a crypto-asset fund needs to incorporate to be investible by an endowment?
- Please rank the following factors in order of importance in terms of their impact on discouraging institutional investment in crypto-assets:
 - Regulatory concerns
 - Lack of robust market infrastructure
 - Volatility
 - Lack of liquidity
 - Other (please specify)