

First Movers: Understanding Decentralized Finance for Institutions

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Introduction

Institutions and retail investors alike are continuing to add cryptocurrencies to their portfolios, spurring the not-so-gradual reckoning that blockchains are here to stay. KPMG in 2022 [reported](#) that nearly one-third of institutional investors surveyed already have direct or indirect exposure to digital assets. Decentralized finance—DeFi—is the next phase of the fintech revolution, capable of supporting a range of uses and applications that extend far beyond cryptocurrency.

Traditional financial institutions are increasingly investing in cryptocurrency and offering crypto products to their customers. A 2021 [survey](#) by American Banker found that only around 10% of financial advisors were already managing cryptocurrencies within their client accounts, but nearly 40% expected to begin offering crypto products to retail customers in 2022. As crypto allocations in institutional portfolios similarly increase, new sources of liquidity are being created that can lower the volatility of the asset class.

Financial institutions can offer crypto to their investors in the form of a diversified portfolio of products. Crypto derivatives can be used for hedging and leverage, deflationary cryptocurrencies can provide much-needed protection against inflation, and yield generation products can offer compelling alternatives to traditional fixed-income securities. A proliferation of financial products is set to increase trading volumes in the sector, further boosting liquidity and driving volatility down below historic levels for the asset class.

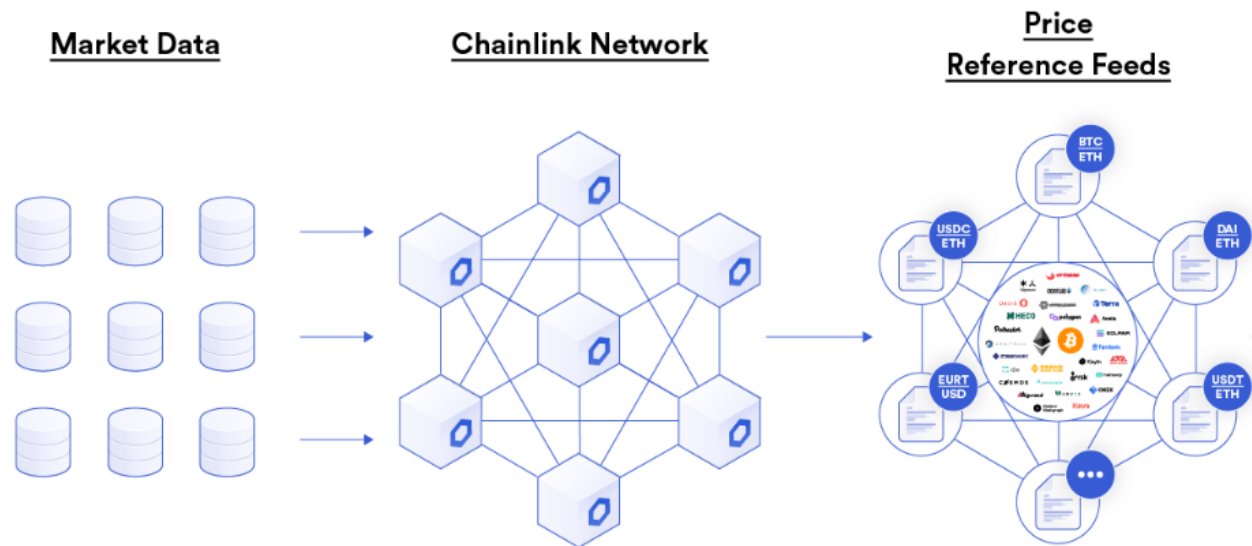
With portfolio exposure to crypto already commonplace among many institutional investors, legacy financial institutions can further enhance their exposure to blockchain technology to gain competitive advantages and create new income streams. Institutions can use blockchain technology to efficiently receive data from a blockchain, and can simultaneously be paid for providing proprietary data to an on-chain network. Deutsche Telekom's T-Systems and Swisscom are examples of two major technology companies that operate blockchain oracle nodes to send and receive data, while The Associated Press uses blockchain technology to provide trusted datasets to multiple blockchains.

Organizations like Swisscom and The Associated Press use Layer-2 scaling solutions to connect with one or more blockchains, which by design are autonomous “digital islands.” Layer-2 solutions, which are crucial for legacy organizations to connect with any blockchain or decentralized app, enable efficient and secure interactions among traditional institutions and the blockchain. Layer-2 scaling protocols can boost the usability of blockchains by enabling them to process transactions more quickly and cheaply, in addition to supporting the interoperability of data from on-chain and off-chain sources.

Financial institutions using Layer-2 scaling protocols to share or receive data are using smart contracts to connect with blockchains. Smart contracts—electronic contracts that can be programmed to execute automatically when certain conditions are met—can boost the efficiency of data exchange and ensure that only verified information is sent or received. The decentralized nature of blockchain technology supports data transfers that are transparent, cost effective, and secure.

Chainlink is an example of a leading Layer-2 scaling solution that is enabling legacy financial institutions to integrate with one or more blockchains. Institutions can use Chainlink’s oracle technology to receive cryptocurrency price feeds or other real-time data, thereby enabling many different financial market participants to offer retail crypto products. Bank of America in a 2022 research report posits that Chainlink could drive mass integration with the blockchain across sectors as diverse as finance, insurance, gaming, and gambling.

Financial institutions wishing to receive data from a blockchain to support a new crypto offering require institutional-grade assurance about the credibility of the data. Using Chainlink, data such as a price feed for a cryptocurrency is verified by multiple authenticated sources that collectively and continuously maintain consensus about the validity of the data. The decentralization that’s core to blockchain technology eliminates the possibility of any single point of corruption or failure.



As institutions continue to adopt blockchain technology through the use of Layer-2 protocols, blockchain applications designed for institutional investors are proliferating. Developing an understanding of Layer-2 solutions can surface new investment opportunities for institutions, and enable a clear early-mover advantage for organizations that choose to harness the power of decentralized technology.

Blockchain integration is not without risks for financial institutions, which must remain vigilant about regulatory compliance, insurance coverage, security, and market integrity—among other concerns. With the long-term risk of non-participation in decentralized finance increasingly outweighing the short-term risks of crypto integration, Layer-2 solutions like Chainlink can provide the needed bridge between legacy institutions and on-chain environments.


Decision-makers at financial institutions can begin to integrate cryptocurrency into their client offerings by first understanding decentralized finance. Read the full report—[First Movers: Understanding Decentralized Finance for Institutions](#)—to understand:

- DeFi and its adoption by legacy institutions
- Current and future use cases for DeFi protocols and applications
- How blockchain technology integration can drive competitive advantage
- Benefits of blockchain technology for organizational security, transparency, and efficiency

Regardless of the degree of involvement by traditional institutions, financial innovation will continue. With the on-chain environment increasingly coming into focus for the financial sector, establishing interoperability between blockchains and legacy data sources is rapidly gaining importance for established institutions.

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Legacy financial institutions can't ignore the rise of DeFi—and many aren't. The dividing line between on-chain and off-chain data environments is fading fast.

Learn what DeFi is and understand how legacy players are getting connected to the blockchain. Understand the many applications of DeFi and how early institutional movers are already gaining competitive advantage. 
[link to report]