FINTECH ONE-ON-ONE PODCAST – LEX SOKOLIN

Welcome to the Fintech One-on-One Podcast. This is Peter Renton, Chairman & Co-Founder of Fintech Nexus.

I've been doing these shows since 2013 which makes this the longest-running one-on-one interview show in all of fintech, thank you for joining me on this journey. If you like this podcast, you should check out our sister shows, PitchIt, the Fintech Startups Podcast with Todd Anderson and Fintech Coffee Break with Isabelle Castro or you can listen to everything we produce by subscribing to the Fintech Nexus podcast channel.

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Peter Renton: So, we are continuing our series of podcasts that were recorded at Fintech Nexus USA in New York City in May and this time it is Lex Sokolin who is the Founder of Fintech Blueprint, he also works at ConsenSys. We cover a lot of territory in this discussion. We talk about the acquisition of Fintech Nexus - acquired Fintech Blueprint recently, we talk about a lot of different fintech topics, we talk about DeFi, we talk about AI, we talk about payments, self-driving money, really cover some of the hottest topics of the day. Lex is one of the great thinkers in all of fintech so I think you're going to really enjoy this episode.

Welcome, Lex, back to the Fintech One-on-One podcast recorded live here at Fintech Nexus USA. How are you doing today?

Lex Sokolin: I'm doing fantastic, thank you so much for having me.

Peter: Okay. So, I want to kick it off by sharing a little bit about our partnership, we announced it on stage yesterday that Fintech Nexus has acquired Fintech Blueprint, the newsletter, so maybe I guess describe the newsletter a little bit and tell us about what led to this partnership.

Lex: Absolutely. So, the Fintech Blueprint is a newsletter that covers the core of fintech topics, started looking at things like Robo-Advisors, neobanks, digital lending, payments technology, things of that nature and then we started coverage of the large platform shifts. And so, you know, back in 2017/2018 it wasn't obvious, but things like Artificial Intelligence, blockchain and digital assets augmented in virtual reality, we started asking questions for how do these emerging themes interact with financial services not on their own, you know, like how great is it that Facebook has the Oculus or, you know, how Chinese tech is going to take over Western tech, but, in particular, how all this affects financial services. And we've really built out a data-driven, analytical-focused newsletter that's really resonated

with a number of audiences, so one audience that has really enjoyed the newsletter are entrepreneurs and builders.

So, we see a lot of people who are building companies, whether they are fintech projects, whether they are Decentralized Finance projects or if they're operators and doing digital transformation at large banks, the kind of thinking about strategy to play in the world and so that's one audience. Another audience is investors so how do you make a decision within a strategic context of the macro economy and the technology evolution, how do you make it a decision on what to bet on because it's fuzzy and ridiculous and there's weird capital markets interactions.

And so, we've had a lot of success in attracting attention and engagement with our material and, you know, the Fintech Nexus community we've been friendly with for quite a while for many years and loved the footprint of both the events and the engagement as well as the digital footprint and the type of engagement that you have with your readers and your community. And so, one of the things that really attracted me to this partnership is figuring out, you know, how can we do more for Blueprint, how can we deepen what we do for people, how can we open up their abilities to build companies or to invest better in a live tangible way and that for me is a big driver of what we're trying to do together.

Peter: Right. We are so excited about what this partnership can bring, but I don't want to dwell on that, I really want to get into some of the most interesting topics of the day and maybe we can start with, I mean, you talked about platform shifts in a lot of the content that you do, that you put out is focusing on this movement away from the traditional way of doing finance into a more digital, more real-time way so maybe just start with what are some of the broader themes that you're seeing in that shift.

Lex: Yeah. So, yesterday in our conversation on stage, you know, I kind of started talking about the current situation which is obviously very challenging for companies and for people all over the world. And so, it can be a little bit difficult to tell the science fiction story of what will happen in the future when so many companies are struggling for cash flow when valuations, fintech valuations, are down, you know, from 20 or 50 times revenue to two times revenue even when fundamentals are still good and so it's a tough place from which to tell the story.

But at the same time, I think that a lot of that challenge is quite mechanical in the sense that you have the macro economy, you have the challenges to it, you have the response to those challenges through interest rate policy, you know, inflation is finally turning down, there's a chance of recession and investors are still preparing for that. So, it's a difficult environment, but it's sort of, there's nothing fundamental to me about being at the bottom of a cycle, cycles are always part of the journey.

But on the fundamental side there are things that are happening that are, I mean, just profoundly amazing and whether that is the economic architecture of decentralized networks, you know, the ability to run software at scale on open source rails for any asset class, now seeing things like layer 2's attached to blockchains so we have throughput that was promised years ago we can execute real software or whether that's the impact of generative AI on knowledge labor and the ability to automate human judgment and integrate that into large language models. I think these things are profoundly changing what a person is able to produce and how that can happen.

And so, those are the types of platform shifts I'm talking about, but it's not going to take away from the fact that finance is necessary and that, you know, it's kind of an emergent pattern of the economy where people always need to pay, they'll always need to bank and to lend and underwrite and take on risk, insure things and then form capital through the capital markets and invest through investment and asset management. And so, for me, the question is how do you stay grounded in the realities of actual financial services demand, but then pay close and respectful attention to what the very innovative edge of technology is bringing.

Peter: Right. I want to dig into a couple of those things there. So, maybe we can start with Decentralized Finance. You know, in the fintech space there's been sort of a moving away from embracing anything that has sort of a crypto-type component to it and you know, this could be short-term, hopefully it is as far as from the fintech space. But I'd love to get your perspective on, you know, clearly nothing's changed in the underlying technology, in fact, it keeps developing, right, it keeps getting more fully featured and more things that you can do with it. But I'm curious about what.....so when you look the Decentralized Finance area itself so maybe we can start there and say what is different, or what is better and how are you thinking about this space now compared to, you know, over a year ago before the any of the crypto blowups happened?

Lex: Yeah. So, I think the first is to say that the crypto blowups, to me they're not crypto blowups, they are a pretty interconnected financial crisis across everything. So, it's absolutely true that there are things in crypto that became exposed as a result of going from a risk-on environment where money is very cheap and there's a lot of it, you know, where valuations for tech companies are at sky high and where the expectations of the future are very optimistic, you know, because interest rates are low, you're not discounting those expectations, you're treating them as if they're as valuable almost as what you have today.

Going from that environment to a risk-off environment where you have a 5% bank account interest rate essentially, you know, on every person's iPhone where it's trivial to earn 5% interest and in that transition a number of things became exposed and broke. Exposed in a sense that cheap money chasing opportunities receded, it left and without the next financing or without the next set of investors some of the sort of pyramid structures that we have, both in the crypto ecosystem as well as in the American banking system, became apparent, fragile and fell apart. So, you know, if you look specifically at crypto, you have a set of events that created a liquidation cascade starting with the collapse of Terra Luna then spilling over into Celsius and Three Arrows Capital, you know, companies and asset managers that were levered up and exposed to that event.

Those companies couldn't have raised capital, they couldn't cover, right, because again it was a risk-off environment and that continued to open up the malfeasance of FTX. FTX wouldn't be in the situation that they were in if they could have fundraised, or they could plug the hole but they did not and so that exposed again sort of the poor behavior and risk management of their custodial activities and so on and so forth. I mean, a very similar story can be told about the collapse in American banking, you know, resulting from a very quick rise in interest rates and creating a bank run because the banks owned treasuries and mortgage-backed securities, like the most secure things the American government prints. The American government prints dollars which go into consumer accounts, which go into the banks which the banks invest in American treasuries and then the banks are seized by the US government so, you know, these pyramids are everywhere.

Anyway, I'm going on and on, but I think the point is that a lot of speculation in the crypto ecosystem was washed out and now what remains is a lot of focus on infrastructure. And as I had mentioned, the promise of what Ethereum and Web3 and adjacent networks, that promise that was made back in 2015/2017 with proof of stake so an ESG-friendly network that doesn't use Bitcoin mining type operations, the promise that was made about a transaction throughput so processing, being able to process as many transactions as a large card network like a Visa or a Mastercard, these things are in place. I mean, Ethereum has staking, staking both withdraw and deposit, Ethereum has many roll ups, the roll ups are processing millions of transactions, and so I think the infrastructure is ready for kind of the next generation of applications.

Peter: Okay. So then, it's ready but it's not being adopted now by mainstream finance, what needs to bring it into that forefront, what needs to be done to.....everything has been built, what you've described, obviously that's a lot of work that has been done over the last, I mean, several years, but obviously the US government is just making it very difficult for any US fintech or bank or crypto company to really operate. So, how are we going to.....I mean, obviously, it could happen offshore, I guess, but how are we going to bring what has been built into traditional finance, how are we going to bring those two systems together?

Lex: So, these are my personal views, just to start off.

Peter: For sure, yeah.

Lex: So, the first thing is that there are two strategies, there are two ways that financial companies have tried to engage with blockchain themes, the first is to save costs. I have a portfolio management system or a core banking system or, you know, a payment network and if I only I replaced this thing with a blockchain, or with a DLT then I will save 30% on my cost because I am mutualizing infrastructure industry costs and, you know, we'll have a better business as a result. And so, you have enterprise blockchains, you have private consortia, you now have digital assets launched a chain with a bunch of banks and R3 in a prior generation had done the same and so that's one direction. I think CBDCs can be kind of lumped into that as well because they're enterprise infrastructure.

Then the other direction is revenue, right, so I want to offer.....there's demand from consumers and perhaps some businesses for the crypto asset class, and I want to offer the asset class as a broker or a distributor or a lender to people who want to own it, who want to engage with it, right. And so, before all the recent collapse, like if you looked at things like PayPal or Square, CashApp and so on, SoFi, you'll see them integrating crypto trading and crypto access into their core offerings using Paxos or other companies. So, these two directions are very different in their nature and I think they're also cyclical so when crypto is popular, you know, when Bitcoin was popular everybody's there to trade Bitcoin and then when that collapsed is, of course, nobody wants that, we just want blockchain, blockchain enterprise, and then when you realize actually nobody wants to buy your security token offerings of whatever it is, laundromats in Malaysia, that you can't sell to your high net worth clients then it pivots back out.

And then you have DeFis and NFTS and on-chain and OpenSea and celebrities talking about Bored Apes and when that crashes we're back into the enterprise world, right. So, now it's government

chains and KYCs, Layer 2's and so on and so forth so I think it's a pendulum swing back and forth. It is particularly egregious in the United States in the moment in terms of the regulatory climate, both in the banking regulators as well as the securities regulators seem to have flipped their prior positions very explicitly, like in literal terms contradicting their prior positions and that's resulting in good companies finding pathways to leave the United Sates which I think is absolutely insane.

I mean, Web3 is denominated in the dollar, the USD is the currency of Web3 and, you know, the US is under attack on most technology fronts by other global actors, you know, the AI war with China, same thing with semi-conductors and so on. So, it's absurd to me that you would throw the baby out with the bath water when the gift of an open-source decentralized web denominated in the dollar has been given to you, but I think it's a political moment and political moments pass, and so we'll just have to continue to see how it plays out.

Peter: Right, right. I don't know it you caught Caitlin Long this morning on the keynote stage, she was talking about…… she was in London just earlier this month talking with one of the Big Four accounting firms, or consulting firms, that she spoke with at an internal event for them and they built a Layer 2, Ethereum Layer 2 that they wanted to help promote and open public blockchain, and they want to basically get the US involved with it as well.

But it seems like, this is obviously the Big Four accounting firms are all US-based, but this is a UK subsidiary or branch of that that has really wanted to do this and they're wanting to build it in the UK. I mean, you live in London, what's it like there now compared to what it's like here, it feels like the UK is much more open than the US today.

Lex: I think it's a fair statement for all of Europe and the recent regulation coming out of Europe, MiCA, which is focused on digital assets and focused on digital assets by taking the architecture of the technology at face value, you know, like not attempting to shoehorn prior regulation onto things that simply don't have that shape. You know, it's as if we said you can't settle equities electronically because we don't see where the papyrus is, you know, the scribe at the temple seems to not be present. And so, because we have not said the holy words and signed the thing with our quills, we can't settle it on this fancy computers that are made by criminals and hacksters because why would you need a computer when you can just talk to a person live.

It is absurd insanity, I mean, it has no sense at all in a position of refusing to understand how a thing works when you try to make rules about it and I think that's how the US is coming off. While the protections and the outcomes that you want to regulate against which is, you know, negative experiences for consumers, capital loss, fraud, those outcomes on a principle's basis are absolutely important and should be protected against. But you have to do it in such a way as to understand like the invention of blockchain, how it works, what its purpose is before you try to, again, kind of shoehorn legacy on top of it.

So, I think in the UK, the banking sector is a lot more cooperative with startups because, you know, it's not as large as the American economy and so there's more incentive to cooperate, there's more incentive to do things together in a smaller market, but the UK also has a lean towards enterprise. I think it's a long path and the only way through is going to be negotiating regulations through the various political processes that we have, you know, including Coinbase going to court. I think that's a

positive development because we have three branches of government and all of them need to be invoked to get to a good outcome here.

Peter: Right. Before we move on from Decentralized Finance, I want to talk specifically about payments because that is an area that there's a huge amount of innovation happening right now, both in, you know, the blockchain space and outside the blockchain space, but I'm curious about it. There's so much waste and expense built into traditional payments, it feels like it's inevitable that it's going to go away. What's your vision for how a payment system will operate when Decentralized Finance takes kind of center stage in that realm?

Lex: Yeah. I think it's a very hard question and people have various levels of expertise around payments. I think from my perspective, it's important to see that there are many payment systems operating all the time so when you get into an Uber, you don't expect to give the Uber driver cash, you can't, your cash is without value to the Uber driver, you will be kicked out of the car, your cash has no good here, it is the wrong payment rail. Similarly, if you're sitting in front of your computer and trying to swipe your plastic card in your monitor, you're a crazy person (Peter laughs) and so let's bring the same logic to decentralized rails, like if you want a payment processor that works in DeFi, you need to use a technology that is built on the same rails as the financial services with which you're interacting.

And so, I think the good news is that blockchain networks are payments rails themselves, their core capability is to move value around for a fee that clears in the market. The more difficult question is to say, you know, how do you get things into that particular venue, what are the on-ramps, what are the off-ramps, how do you get things on, how do you get things off. And by the way, this is a global payment rail so every country has the same opportunity to use it and of course, no country has the same payment regulations or expectations, you know, so you have endless number of different on-ramps and off-ramps.

I think Stripe just recently launched an on-ramp into crypto so you can go from Stripe directly into Web3, I don't remember if it's through buying Ethereum or buying USDC, but, you know, I think the connectors between the Internet payment processors and gateways and Web3 are the first ones to be built because these are, at least, digital nations that speak similar languages, not the same languages. I think the next challenge is going to be around big tech companies so looking at Apple and Samsung and Google and so on that all have a strategic interest in their digital wallet that is not a crypto wallet, right, and it's not a neobank but it is wrapper for traditional financial services.

And so, I think there's also a tension, we've talked about attention about finance and crypto, but there's a tension between big tech as it exists today in its Web2 format of large, centralized companies with huge advertising revenue bases, there's a tension between that and the vision that Web3 brings which is much more person focused. So, for each person, it's their data, they custody their data, it's their money, they custody their money and companies don't get to access it, companies don't get to hold it on your behalf, it's non-custodial.

And so, I think it'll be also a challenge to see how Web3-based payments interact with, you know, the large distributors, the big tech companies. As for Mastercard and Visa and the other card networks, their positioning is that they're the network of networks and so to plug-in yet another network is very, very natural. So, for anybody that is API first or technological first, Visa, Mastercard, Plaid, Stripe,

companies of that nature, not that it's trivial, but I think it's very adjacent to their strategy to include yet another rail which is how they would look at computational blockchains.

Peter: Right, right, okay. I want to switch gears a little bit and talk about AI. I want to go back to something you said on your panel yesterday, you were talking about self-driving money and I'd love to kind of get how you think AI, and there's been a lot of talk at this event about AI and also including our opening keynote, Marco Argenti from Goldman Sachs had some really interesting things to say, but when it comes to finance and, you know, you were one of the panelists there yesterday, we don't make very good decisions with our money, we're not very smart about it and having an AI assistant for this could end up being very beneficial. Tell us a little bit about your vision there when it comes to automated help with our money.

Lex: Yeah. This is also a really difficult question because AI can be applied in any part of financial services, whether it's distribution in the front which is kind of what we're talking about when we talk about, you know, financial advisors or bank branches or interactions or talking to Amazon Echo in natural language, that's the distribution of financial services or whether we're talking about AI in the manufacturing part. So, we're all familiar over the last decade with machine learning and side up underwriting, right, and so figuring out risks is very cyclistical and there's lots of machine learning that's been applied to that and in the capital markets around trading or market making.

There's tons of machine learning applications there and, of course, in the middle and between the back and the front office there are things like giant fraud systems, like catching malfeasance and there's lots of interesting companies that have a machine intelligence footprint to deal at scale with sort of onboarding and KYC and things of that nature. But what's going on that's interesting now, in my view, is that we've had a profound breakthrough in essentially the Turing test so the ability of a machine intelligence to appear human to the average person. This has happened in other parts of AI where machine vision, for example, five years ago became better than human vision in recognizing objects as people would, right.

So, you have a hundred people look at pictures of cats, 96 people get all the cats right, four people get it wrong, that's kind of the, you know, some cat might be fluffy in a particular way that looks like a Corgi, I don't know. And then machine vision got good enough that it's as good as 97 people getting the cats right, you know, and that was amazing but it wasn't obvious to some people that that's really scary, you know, that a human sense is better performed by a math algorithm or a math algorithm is able to fit mathematically around a human sense to generate the same outcome as an organ or as a brain function.

And so, large language models which we have now, LLMs, are doing the same thing but for speech generation that appears to us to carry some sort of human rational pattern, right, and that pattern is derived from the data set of the entire Internet. So, the billions of words of the Internet that we're constantly adding to are feeding the mathematics which are being fit around what looks to us like thinking, it's not actual thinking but it appears to think, you know. So, the way LLMs work is they just predict the next word in a string based on the probabilities of all the words in the English language relating to each other based on this corpus of the Internet.

So, it's not like an individual human brain, it's like the brains of all humanity with a math algorithm on top that's trying to replicate what the average case would be and then you can play with the different parameters to make it more creative, less creative and so on. So, bringing that back to financial services, I think, you know, the first point is there's just going to be raw economic impact so in the way that industrial robots displaced a lot of physical work, machine intelligence robots will displace a lot of intellectual work. Creativity and empathy aren't going to, it doesn't matter, we have a math equation that does creativity and empathy now and so that's going to cause severe economic challenge.

I mean, right now, we have IBM firing 8,000 people saying we're just going to replace this with the math algorithm that does what you do. I think robotic process automation companies like UiPath once they've integrated and plugged in this capability will annihilate the back offices of many, many companies. You know, if your job is to figure out how to take the facts and input it into the core banking system and make a decision on whether it's real or not, like it's not going to happen.

So, dealing with that economic hit is one thing that finance could think about, right, what are the solutions for universal income, what are the solutions for lending for people who are out of work. I mean, these are financial problems and they're going to, for sure, integrate with government solutions in the way that you had during COVID, lots of payments to small businesses to protect the small businesses from disappearing, you know, governments are going to be forced to deal with the economic impact of LLMs.

The other sort of more narrow answer is sort of the role of the human-to-human interaction in the delivery of financial services. About 10 years ago, maybe 15, we started to see Robo-Advisors and neobanks and those companies took the mechanistic part of what banks and investment managers do, you know, make an asset allocation, make an underwriting decision, put it into a software and made it self-service. Those interfaces are, you know, they're computer interfaces, they're not like talking to an empathetic person that cares about you, they're just buttons. Well, now, instead of buttons you have empathy on demand, you have creativity on demand, and it can be hyper personalized to every single individual based on their search intent, based on their Internet footprint, whatever you like.

And so, I think for a lot of the distribution part of the industry, in my view, we're just going to see the large language models become the place where people buy financial services from, they are just going to get advice from it, we're going to have all these AI friends that give us all sorts of advice and financial advice will just be one of the features that they have.

Peter: Okay. So, maybe we can close with, you know, you've painted some interesting pictures here today, maybe give us your kind of, like your optimistic view or maybe just your view, it doesn't have to be optimistic, I guess, of what are the most sort of impactful technologies happening right now that are going to really ...you can see in two to three years things are going to be very different. What are you looking at most closely?

Lex: I feel like the stuff that I gave you is kind of it, you know, I think the large language models are one, it's hard to tell exactly the impact but I expect they will have an outsize impact in the way that the mobile phone had created the mobile Internet. I think the AI interfaces will create a completely new sort of substrate in terms of how we interact with things. And then on the Web3 side, I think we're going to need to counteract some of this large-scale machine intelligence stuff, like I think we're going

to need things to give us back the ability to own digital assets and digital objects, right, because AI is kind of the extreme end point of social media and endless Internet content.

If you start at a point where you want everything to be free and funded by advertising, you end up with AI because you have created all this content and then you feed it into a content creator that then infinitely can create free content, right, and if we let that run, you're going to have some very weird outcomes. So, I think that what Web3 offers which is to say okay, in this digital world there are actually some things I own, you know, like these robots that I'm training, I don't want Microsoft to host them on their servers, it's icky for Microsoft to have a digital twin of me that has all my log-ins, that is managing my money and that can speak using my voice, I don't like that.

I don't want Microsoft or certainly, you know, Zuckerberg, I don't want him to have it or TikTok, right, and if you think I'm being silly, again, open up your iPhone and invest through Goldman Sachs through your Apple account. So, if we don't want that to be the case, you've got to take control of your own robots and the only way that that exists today is through blockchain architecture where you have an account, you have your wallet, you have maybe some NFT that is representing your AI agent and so I think this stuff will will start to interact. You know, it's hard to be precise with it because it's so science fiction but at the same time, these technologies are here today and that's where the venture investment is going.

Peter: Okay. We'll have to leave it there, Lex, that's fascinating, you brought up some very thought-provoking things there. Thanks for joining me here at Fintech Nexus today.

Lex: Thank you for having me.

Peter: Okay, see you.

Well I hope you enjoyed the show, thank you so much for listening. Please go ahead and give the show a review on the podcast platform of your choice and go tell your friends and colleagues about it.

Anyway, on that note, I will sign off. I very much appreciate you listening. Bye.

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