

Topic 6.1: The Convergence Thesis

FinTech and DeFi Coming Together

Joerg Osterrieder

Digital Finance

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By the End of This Topic, You Will Be Able To:

1. **Explain** the Convergence Thesis and why the FinTech/DeFi divide is dissolving
2. **Identify** key drivers pushing FinTech toward DeFi and DeFi toward FinTech
3. **Analyze** real-world convergence examples: institutional DeFi, tokenized deposits, embedded finance, hybrid protocols
4. **Evaluate** the trade-offs inherent in convergence (what is gained vs. what is lost)
5. **Apply** a framework for assessing which innovations are most likely to achieve mainstream adoption

Key Insight

The future of finance is neither purely centralized nor purely decentralized—it is **hybrid**.

FinTech (Financial Technology)

- Technology applied to **traditional finance**
- Centralized platforms (Revolut, Stripe, PayPal)
- Licensed, regulated entities
- Trust in **institutions**
- Fiat-centric, bank partnerships

DeFi (Decentralized Finance)

- Finance rebuilt on **blockchain**
- Decentralized protocols (Uniswap, Aave)
- Permissionless, pseudonymous (identities hidden behind addresses, but transactions visible)
- Trust in **code** (smart contracts)
- Crypto-native, no intermediaries

Quick refresher from earlier days (don't worry if you don't remember everything—we will revisit key ideas as we go): Day 1 introduced *what money is* and the FinTech vs. DeFi distinction shown above. Day 2 covered *digital payments, APIs, and platform economics*. Day 3 explained *blockchain cryptography, wallets, and Bitcoin vs. Ethereum*. Day 4 explored *smart contracts, DeFi lending/trading, stablecoins, and tokenization*. Day 5 examined *risks, regulation, DAOs, and privacy*.

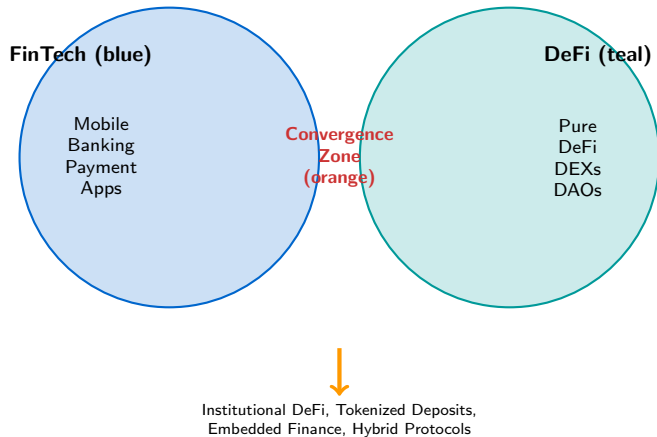
This framing served us well throughout the course...
But it is dissolving in practice.



Key Question: Are these philosophies incompatible, or are they converging toward common ground?

- **2017–2020:** Clear separation
 - ICO boom (2017)
 - Crypto winter (2018)
 - DeFi Summer begins (2020)
- **2021–2024:** Boundaries blur
 - PayPal adds crypto buying (2021)
 - Visa settles in USDC (2021)
 - Aave Arc launches permissioned DeFi (2022)
 - BlackRock files Bitcoin ETF (2023)
 - Spot Bitcoin ETFs approved in the US (Jan 2024)
- **2025+:** Convergence accelerates—hybrid models dominate new product launches

The Convergence Thesis



What Is the Convergence Thesis?

Definition

The **Convergence Thesis** states that the traditional divide between FinTech (centralized, regulated, institution-based) and DeFi (decentralized, permissionless, code-based) is **dissolving in practice**.

Evidence of Convergence:

- FinTech companies adopting crypto features for efficiency and customer demand
- DeFi protocols adding compliance layers to access institutional capital
- Traditional banks experimenting with blockchain settlement
- Hybrid products that blend the best of both worlds

Key Insight

Convergence is driven by **pragmatism**—both sides recognize that pure approaches face scalability, adoption, or regulatory barriers.

FinTech → DeFi:

- Cost efficiency (24/7 settlement)
- Yield opportunities (staking, lending)
- Programmable money features
- Customer demand for crypto
- Competitive pressure

Examples:

- PayPal integrating crypto
- Robinhood listing tokens
- Visa settling in USDC

DeFi → FinTech:

- Regulatory survival
- Institutional capital access
- User experience expectations
- Fiat (government-issued money like USD or EUR) on-ramp/off-ramp (converting between traditional money and crypto)
- Compliance requirements

Examples:

- Aave Arc (permissioned pools)
- Circle (regulated stablecoin)
- Coinbase (public company, licensed)

The Efficiency Argument

Blockchain settlement offers measurable improvements over traditional rails:

Metric	Traditional	Blockchain
Settlement time	T+2 days	Minutes to seconds
Operating hours	Business hours	24/7/365
Cross-border cost	3-7%	~1%
Intermediaries	3-5 parties	0-1 parties
Programmability	Limited	Smart contracts

Why FinTech cares: Lower costs, better margins, competitive advantage

Why banks care: Operational efficiency, reduced counterparty risk (the danger that the other side of a deal defaults)

Regulators Pushing Toward Convergence:

- MiCA (EU) requires licensing for crypto
- SEC enforcement against unregistered offerings
- FATF travel rule for crypto transfers
- Bank regulators exploring tokenized deposits

Result:

- Pure DeFi faces legal challenges
- Compliant crypto gains legitimacy
- “Regulate to innovate” mindset
- Hybrid approaches become necessary

Regulatory Reality

The choice is increasingly binary: add compliance and survive, or remain pure and face enforcement. Most choose survival.

Trillions in Capital Waiting

Global assets under management exceeded \$120 trillion in 2024 (BCG Global Asset Management Report). A growing share of these institutional investors want blockchain exposure but require:

- **Regulatory clarity:** Clear legal status of assets
- **Custody solutions:** Qualified custodians (firms licensed to hold assets on behalf of clients) with insurance
- **Counterparty verification:** KYC/AML (Know Your Customer / Anti-Money Laundering—identity checks required by law) compliance
- **Risk management:** Understood, quantifiable risks
- **Familiar structures:** Funds, ETFs (Exchange-Traded Funds—investment products traded on stock exchanges like shares), and other regulated vehicles

Institutional DeFi emerges to serve this demand:

- Same smart contracts, restricted access
- Whitelisted wallet addresses (pre-approved cryptocurrency wallet addresses that have passed identity verification)
- Compliance layer on-chain or off-chain

Definition

DeFi protocols or pools designed for institutions with KYC/AML (Know Your Customer / Anti-Money Laundering regulations), permissioned (requiring approval to join) access, and regulatory compliance.

How it works:

- Whitelisted wallet addresses
- Identity verification required
- Compliance layer on-chain or off-chain
- Same smart contracts, restricted access

Key examples:

- **Aave Arc**: Permissioned Aave for institutions (launched 2022; saw limited adoption—institutional DeFi access has since shifted to platforms like Fireblocks and Copper)
- **Compound Treasury**: Institutional lending product
- **Maple Finance**: Institutional credit pools
- **Centrifuge**: Real-world asset financing

Key Insight

Same DeFi rails, different access model. The technology does not change; the *governance layer* does.

Key Features:

- Fireblocks provides identity verification and custody
- Only whitelisted addresses can interact with Arc pools
- Smart contracts identical to permissionless Aave
- Institutions get DeFi yields with compliance

Translation for Beginners

Think of Aave Arc like a **members-only club version** of an open marketplace. The marketplace (Aave) is the same, but Arc adds a bouncer at the door who checks your ID. Only verified members can enter and trade. The goods and prices inside are identical—only the entry rules differ.

Note: Aave Arc launched in 2022 but saw limited uptake. The institutional DeFi market has since moved toward custody-first platforms such as Fireblocks and Copper, though the concept of permissioned DeFi pools remains influential.

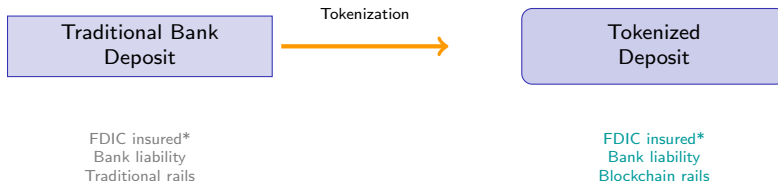
Key Takeaway

The *concept* of permissioned DeFi pools—where identity-verified users access decentralized protocols—remains influential even as specific products come and go.

Convergence Example 2: Tokenized Deposits

Definition

Bank deposits represented as tokens on a blockchain, combining bank liability with blockchain programmability.



*FDIC = Federal Deposit Insurance Corporation, the US government agency that insures bank deposits up to \$250,000. Most countries have equivalent schemes (e.g., FSCS in the UK, Einlagensicherung in Germany/EU).

Key players: JPMorgan (JPM Coin), Citi, Wells Fargo, Societe Generale

Difference from stablecoins: Tokenized deposits are *bank liabilities*, not claims on reserves held by a separate issuer.

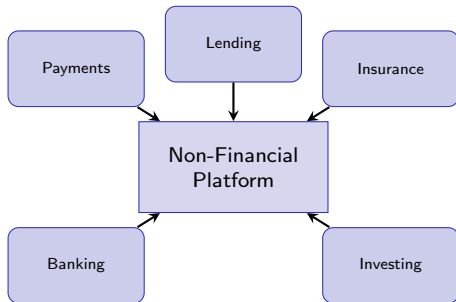
Feature	Tokenized Deposit	Stablecoin (e.g., USDC)
Liability type	Bank liability	Issuer liability
Deposit insurance	Yes (in jurisdictions with schemes, e.g. FDIC in the US, FSCS in the UK)	No
Issuer	Commercial bank	Crypto company
Backing	Bank balance sheet	Reserve assets
Regulation	Banking regulation	Varies by jurisdiction
Redemption	Direct with bank	Through issuer

Why It Matters

Tokenized deposits bring **banking-grade safety** (deposit insurance, bank oversight) to blockchain rails. This could enable institutional adoption at scale.

Definition

Financial services seamlessly integrated into non-financial platforms and workflows.



Examples:

- Shopify Capital (e-commerce lending)
- Uber driver instant pay
- Klarna Buy Now Pay Later
- Amazon lending to sellers
- Tesla insurance

Crypto angle:

- Crypto payouts in apps
- DeFi yields embedded in wallets
- NFT financing at checkout

Why Embedded Finance Accelerates Convergence:

1. **Invisible infrastructure:** Users do not see “DeFi” or “FinTech”—just seamless service
2. **Best tool for the job:** Platforms choose blockchain or traditional rails based on efficiency
3. **API-driven:** Both DeFi protocols and banks offer API access
4. **User experience trumps ideology:** What works, wins

Example: Shopify + Crypto

Shopify integrates:

- Traditional payment processing (Stripe)
- Cryptocurrency payments (BitPay)
- Seller financing (Shopify Capital)
- Potential: DeFi lending pools for merchant financing

The merchant sees one platform; underneath, multiple financial rails.

What makes them hybrid?

- On-chain execution + off-chain compliance
- Decentralized protocol + centralized governance
- Crypto assets + real-world assets
- Permissionless base + permissioned layers

Examples:

- **MakerDAO** (rebranded to **Sky** in 2024, with DAI transitioning to USDS): DAI/USDS backed by RWA vaults
- **Ondo Finance**: Tokenized treasuries
- **Backed Finance**: Tokenized ETFs
- **Goldfinch**: Credit to emerging markets

MakerDAO's RWA Strategy (now Sky)

MakerDAO (rebranded to Sky in 2024) allocated \$2B+ to real-world assets (US Treasuries, corporate bonds) as of mid-2024. A “DeFi” protocol holding TradFi assets—convergence in action. The rebrand also transitioned DAI to a new token called USDS.

Implications:

- DeFi protocol now depends on TradFi counterparties
- Diversifies collateral risk beyond crypto volatility
- Requires trust in off-chain asset custodians
- Blurs the line between DeFi and traditional finance

Key terms: PSM = Peg Stability Module (a mechanism that lets users swap stablecoins 1:1 to keep DAI/USDS close to \$1). RWA = Real-World Assets (traditional financial assets like bonds, loans, or real estate tokenized on a blockchain).

What Happened

In 2021, Visa began settling transactions with partners using USDC stablecoin on Ethereum, later expanding to Solana.

Why This Matters:

1. **Validation:** World's largest payment network using crypto rails
2. **Efficiency:** 24/7 settlement, reduced counterparty risk
3. **Programmability:** Smart contract-enabled payments
4. **Hybrid model:** Traditional Visa network + blockchain settlement

Convergence in Action

Visa did not become a “crypto company.” It integrated blockchain where it made business sense while maintaining its core regulated infrastructure.

Hybrid Custody: Blending Self-Custody and Institutional

There is a spectrum between full self-custody (you hold all the keys) and full bank custody (the bank holds everything for you). Most real-world solutions now sit somewhere in between.

Pure Self-Custody:

- User controls private keys
- No recovery if keys lost
- Maximum sovereignty
- Requires technical knowledge

Analogy: Keeping cash in a home safe—only you have access, but if you lose the combination, no one can help.

Pure Institutional Custody:

- Institution holds keys
- Recovery possible
- Counterparty risk
- Familiar to traditional users

Analogy: A bank safe-deposit box—the bank secures it for you, but you must trust the bank to stay solvent.

Hybrid Custody Solutions

- **Multi-sig wallets:** 2-of-3 keys (user, institution, backup). *Like a safe that needs two of three keyholders to open.*
- **Social recovery:** Designated guardians can restore access. *Like naming trusted friends who can vouch for you if you lose your key.*
- **Tiered access:** Small amounts self-custody, large amounts require verification. *Like using a debit card for small purchases but needing extra approval for big ones.*
- **MPC (Multi-Party Computation—splitting a secret key among multiple parties):** Key shares distributed, no single point of failure. *Like splitting a treasure map into pieces held by different people.*

Framework for Evaluating Convergence Likelihood

Factor	High Likelihood	Low Likelihood
Regulatory clarity	Clear path	Fundamental conflict
Institutional demand	Strong	Weak/retail-only
User experience	Comparable to TradFi	Significantly worse
Risk profile	Understood, manageable	Novel, unquantifiable
Value proposition	Clear efficiency gain	Ideological appeal only

Most likely to converge: Payments, lending, asset tokenization

Least likely: Privacy coins, fully anonymous DeFi, unregistered securities

Definition

Building systems that use **both** traditional technology and blockchain, picking the best tool for each job—rather than forcing everything onto one platform.

Examples:

- **Hybrid databases:** Use a normal database for everyday records, but record final settlements (confirmed transactions) on a blockchain for tamper-proof proof
- **Layer 2 solutions:** A fast centralized processor handles transactions quickly, then a decentralized blockchain double-checks the results (as covered in Day 3)
- **Private + Public chains:** A company runs its own private blockchain internally, then periodically anchors a summary to a public blockchain for transparency
- **API gateways:** A traditional web interface (API) that lets apps connect to decentralized protocols without users needing to understand blockchain directly

Design Principle

Not everything needs to be on a blockchain. The best systems combine technologies based on what each does best.

Cross-Chain Interoperability: The Connector

Key terms: *Interoperability* = different blockchains being able to communicate and transfer assets, like being able to send email between Gmail and Outlook. *Cross-chain* means moving assets or data between different blockchains (e.g., Ethereum to Solana). A *bridge* is software that locks an asset on one chain and issues an equivalent on another.

Why Interoperability Matters for Convergence:

- Enables value transfer between different blockchains
- Connects blockchain and traditional systems
- Breaks down liquidity silos (pools of money trapped on a single platform)
- Improves user experience (no manual bridging)

Solutions:

- **Bridges:** Cross-chain asset transfers (but with security challenges—bridge hacks have caused billions in losses)
- **Chain abstraction:** Hide blockchain complexity from users so they do not need to know which chain they are on
- **Standardized protocols:** Common messaging formats so different chains can “speak the same language”
- **SWIFT integration:** Traditional banking networks connecting to blockchain

SWIFT + Chainlink

SWIFT (the messaging network used by 11,000+ banks worldwide for cross-border transfers) partnered with Chainlink to enable blockchain interoperability—a direct FinTech-DeFi bridge.

What Slows Convergence Down?

Technical Barriers:

- Legacy system integration complexity
- Blockchain scalability limits
- Security risks (bridge vulnerabilities)
- Interoperability challenges

Non-Technical Barriers:

- Regulatory uncertainty
- Cultural resistance (both sides)
- Conflicting incentives
- Talent shortage

Overcoming Barriers Requires:

- Time and regulatory evolution
- Successful case studies demonstrating value
- Technical maturation of blockchain infrastructure
- Aligned incentives across stakeholder groups

Background

In March 2024, BlackRock (world's largest asset manager, \$10T+ AUM) launched BUIDL—a tokenized fund for US Treasury exposure on Ethereum. Within months BUIDL attracted over \$500M in assets, making it the largest tokenized Treasury fund.

Key Features:

- Tokenized shares representing US Treasury holdings
- 24/7 transferability on blockchain
- Institutional-grade compliance (KYC required)
- Integration with DeFi protocols as collateral

Convergence Significance:

- TradFi giant embracing blockchain infrastructure
- “Safe” asset (Treasuries) in DeFi ecosystem
- Signals institutional acceptance of tokenization

Background

Project Guardian is a collaborative initiative by the Monetary Authority of Singapore (MAS) with major banks to test asset tokenization.

Participants: DBS Bank, JPMorgan, Standard Chartered, HSBC, and others

Tested Use Cases:

- Tokenized bonds trading and settlement
- Foreign exchange transactions on blockchain
- Asset-backed securities tokenization
- Cross-border payments

Key Finding: Tokenization can improve efficiency by 30-50% in trade settlement while maintaining regulatory compliance.

Coinbase's Evolution:

- 2012: Bitcoin exchange
- 2018: Custody for institutions
- 2021: Public company (NASDAQ)
- 2023: Licensed in multiple jurisdictions
- 2024: Banking partnerships, Base L2

Convergence Features:

- SEC-regulated entity
- Institutional custody (Coinbase Prime)
- Fiat banking integration
- Layer 2 blockchain (Base)
- Stablecoin partnership (USDC)

The Transformation

Coinbase demonstrates how a crypto-native company becomes a regulated financial institution while maintaining blockchain infrastructure.

Circle's Strategy

Build a “digital dollar” that is fully compliant, transparent, and integrated with traditional finance.

Compliance Features:

- Monthly attestations by Grant Thornton
- US state money transmitter licenses
- Reserves in US Treasuries and cash
- Partnerships with major banks (BNY Mellon)

Integration with TradFi:

- Visa settlement partnership
- Mastercard integration
- Apple Pay compatibility
- Cross-border remittances

Result: USDC is accepted by both DeFi protocols AND traditional financial institutions.

What Is Lost in Convergence?

- Permissionlessness
- Censorship resistance
- Privacy/pseudonymity
- Trustlessness
- Decentralization purity

What Is Gained?

- Regulatory acceptance
- Institutional capital
- Consumer protection
- Mainstream adoption
- Integration with existing systems

Discussion Questions

1. Is “permissioned DeFi” still DeFi?
2. Will the permissionless layer survive alongside the permissioned one?
3. Who benefits most from convergence?

Framework Application

For a proposed convergence initiative, evaluate:

1. **Regulatory clarity:** Is there a clear legal path?
2. **Institutional demand:** Do institutions actually want this?
3. **User experience:** Can mainstream users understand it?
4. **Risk profile:** Are the risks quantifiable?
5. **Value proposition:** What is the clear efficiency gain?

Exercise: Apply this framework to:

- Tokenized real estate
- Decentralized identity for banking
- Algorithmic stablecoins
- NFTs as collateral for loans

Which has the highest convergence likelihood? Why?

Step-by-step hints: (1) Pick one innovation above. (2) Score each of the five factors as “high” or “low.” (3) Count your “high” scores—more highs = higher convergence likelihood. (4) Compare with a classmate’s choice and discuss where you disagree.

Key Takeaways

1. **Convergence is real:** The FinTech/DeFi divide is dissolving as each adopts features from the other
2. **Drivers are pragmatic:** Efficiency, regulation, institutional demand, and user experience push convergence
3. **Hybrid models dominate:** Institutional DeFi, tokenized deposits, embedded finance, and hybrid protocols represent the future
4. **Trade-offs exist:** Convergence sacrifices some crypto-native properties (permissionlessness, privacy) for mainstream adoption
5. **Framework matters:** Regulatory clarity, institutional demand, UX, risk profile, and value proposition determine convergence likelihood

Bottom Line

The future of finance is neither purely centralized nor purely decentralized—it is **hybrid**, blending the best of both worlds.

Convergence Thesis The idea that FinTech and DeFi are adopting each other's features, dissolving the traditional divide

Institutional DeFi DeFi protocols with KYC/AML, permissioned access, designed for institutional participants

Tokenized Deposits Bank deposits represented as blockchain tokens, maintaining bank liability status

Embedded Finance Financial services integrated seamlessly into non-financial platforms

Hybrid Protocol Systems combining on-chain execution with off-chain compliance or real-world assets

Permissioned DeFi DeFi protocols that restrict access to verified participants

Real-World Assets (RWA) Traditional financial assets (bonds, loans, real estate) tokenized on blockchain

Hybrid Custody Custody solutions blending self-custody with institutional safeguards

Technology Stack Blending Architectures combining traditional and blockchain infrastructure

Compliance-Friendly DeFi Protocols designed with regulatory requirements from inception

Cross-Chain Interoperability Ability to transfer value and data between different blockchains

Chain Abstraction Hiding blockchain complexity from end users

Misconception 1: “Convergence means DeFi is dead”

Reality: Permissionless DeFi will likely coexist with permissioned versions. Different use cases require different access models.

Misconception 2: “All FinTech will move to blockchain”

Reality: Blockchain adoption is selective. Traditional rails remain superior for many use cases. Convergence is about adding options, not replacing everything.

Misconception 3: “Tokenized deposits = stablecoins”

Reality: Critical difference—tokenized deposits are direct bank liabilities with deposit insurance; stablecoins are claims on separate issuers.

Misconception 4: “Compliance kills innovation”

Reality: Compliance enables institutional capital and mainstream adoption, which can fund more innovation.

Question 1

What is the fundamental concept of the Convergence Thesis?

- A. All cryptocurrencies will eventually merge into a single blockchain
- B. The traditional divide between FinTech and DeFi is dissolving as both adopt features from the other
- C. Banks will completely replace blockchain technology
- D. Cryptocurrency will become illegal worldwide

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Answer: B. The Convergence Thesis describes how FinTech and DeFi are adopting each other's features—FinTech adopts crypto for efficiency, DeFi adds compliance for institutional access.

Question 2

Visa's strategy of settling transactions in USDC stablecoin represents:

- A. Visa abandoning traditional payment rails entirely
- B. A convergence move where a traditional payment network integrates blockchain for settlement efficiency
- C. A marketing gimmick with no practical implementation
- D. Visa becoming a cryptocurrency exchange

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Answer: B. Visa remains a traditional, regulated network but integrated blockchain settlement for efficiency.

Question 3

What are the primary trade-offs LOST in the convergence process?

- A. Transaction speed and security
- B. Permissionlessness, censorship resistance, privacy, trustlessness
- C. User interface quality and customer support
- D. Profitability and market share

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- C. User interface quality and customer support
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Answer: B. Convergence sacrifices key crypto-native properties for mainstream adoption.

Coming Up:

- AI applications in finance
- Machine learning for risk management
- Algorithmic trading strategies
- AI + blockchain convergence
- Regulatory implications of AI in finance

Connection to Convergence:

- AI enables smarter hybrid systems
- Automated compliance (RegTech)
- AI-driven risk assessment for DeFi
- Natural language interfaces
- Predictive analytics for both FinTech and DeFi

Preview Question

How might AI accelerate or change the convergence between FinTech and DeFi? Consider both opportunities and risks.

Academic Papers:

- “Tokenization of Financial Assets” – Bank for International Settlements
- “DeFi: Decentralized Finance” – Federal Reserve Bank of St. Louis

Industry Reports:

- Project Guardian reports (Monetary Authority of Singapore)
- Chainalysis “State of Crypto” annual reports
- World Economic Forum blockchain reports

Websites and Tools:

- DeFi Llama (defillama.com) – DeFi protocol tracking
- The Block Research – Industry analysis
- CoinDesk – News and analysis

Course Materials:

- Review Day 1-5 materials for foundational concepts
- Quiz 6.1 for self-assessment

Questions?

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