



# BLOCKCHAIN AND INVESTMENT SERVICES



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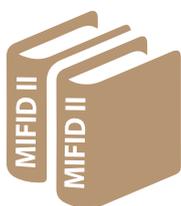
## Blockchain and Investment Services



Blockchain technology has transformed from a popular buzzword to a technology that is in the process of revamping a wide range of operational and business processes within the financial service industry. A segment of the financial industry that could benefit greatly from the implementation of the distributed ledger technology is the investment services sector.<sup>1</sup>



The implementation of blockchain technology would likely result in reduced operational expenses, elimination of redundant and time-consuming functions and more opportunities to enhance the client experience. More specifically, using blockchain technology in important areas such as the client on-boarding process, the creation of model portfolios, the settling and clearing of trades and compliance processes related to AML/KYC regulations can all be improved by implementing distributed ledger technology-based solutions in the investment services industry.<sup>2</sup>



Firstly, blockchain technology can be applied to digitize and streamline the customer on-boarding and profiling process. Strict regulatory requirements require investment managers to collect information such as proof of identification, marital status, residency, sources of wealth and political ties from new potential clients. This can be a cumbersome, long-winded and, therefore, costly process. If instead, individuals' data were to be stored on a distributed ledger to which permissioned parties could gain access with the individual's approval, then this would greatly reduce the time and cost of on-boarding a new customer. Furthermore, due to the immutability and auditability of the blockchain, an audit trail could easily be kept for each client.<sup>3</sup> This would help to comply with regulatory requirements such as MIFID II.



Another interesting solution is that blockchain could facilitate the creation of portfolios and the communication of portfolio changes to clients. Currently, investment managers use a variety of different platforms to create and maintain portfolios and most of these platforms do not enable direct communication with the client. Hence, by developing and implementing a blockchain solution that allows investment managers to create and manage portfolios according to clients' stored investment restrictions that also allows for direct communication with regarding portfolio changes, the entire investment process would be made substantially more efficient and client relationships could be deepened due to an increase in direct communication between the investment manager and its clients.

Thirdly, the use of blockchain technology can eliminate errors in reconciliation procedures and lower operational costs and associated risks.<sup>4</sup> In today's post-trade environment market participants have to maintain a whole range of interfaces and reconciliation processes. Every step of the clearing and settlement process is loaded with cost and complexity. With a ledger that publicly records the movement of every asset, along with proof of ownership and the authenticity of assets protected by a coded secure cryptographic framework and with confirmations of new trades identifiable by a unique crypto stamp, there is a significant reduction in manual processes.<sup>5</sup>

It is not hard to see how a single, trusted, ledger would reduce costs and would remove the need for duplicated reconciliation processes as well as reducing the number of interfaces that need to be maintained. Some people envision a world with no middle or back-office, and no registry, which would clearly have a major impact on costs.

Another benefit of blockchain technology for the provision of investment services is that shortening the settlement times for trading would reduce the risk that counterparties would not be paid, while also cutting the amount of collateral used to back trades. Collateral would also move around the system quicker. If properly implemented across financial services, blockchain would eliminate much of the slow and expensive post-trade and clearing ecosystem.

<sup>1</sup> <https://bitcoinmagazine.com/articles/ey-report-how-wealth-management-industry-could-benefit-blockchain/>

<sup>2</sup> <https://letstalkpayments.com/an-overview-of-blockchain-technology/>

<sup>3</sup> <https://bitcoinmagazine.com/articles/ey-report-how-wealth-management-industry-could-benefit-blockchain/>

<sup>4</sup> <https://newsroom.accenture.com/news/blockchain-technology-could-reduce-investment-banks-infrastructure-costs-by-30-percent-according-to-accenture-report.htm>

<sup>5</sup> <http://www.the-blockchain.com/docs/Seven%20ways%20the%20Blockchain%20can%20change%20the%20trade%20system.pdf>



When this happens, it would also remove the need for much of the market intermediary structure.<sup>6</sup> Some intermediaries are more at risk than others. These include the CSD, sub-custody or prime brokerage sectors. For example, since a blockchain would hold the registration details of each trade, there would no longer be a need to distinguish between the custodian, CSD and registrar. In a report issued by NASDAQ, it envisions a world where clearing houses can be by-passed. Using a concept called smart contracts intermediation between buyer and seller would be reduced.

One could expect that there are a number of challenges which blockchain technology is likely to encounter. In addition, wealth and asset management funds do not exist in a bubble and are usually interconnected with other firms.<sup>7</sup> Therefore, a wide-scale adoption would likely take a long time, considering there would have to be a consensus as to what type of blockchain solutions the whole financial industry chooses to adopt and the amount of processing power needed. Due to these factors, most firms are currently only willing to test blockchain technology on a small scale before considering a broader adoption of this technology.

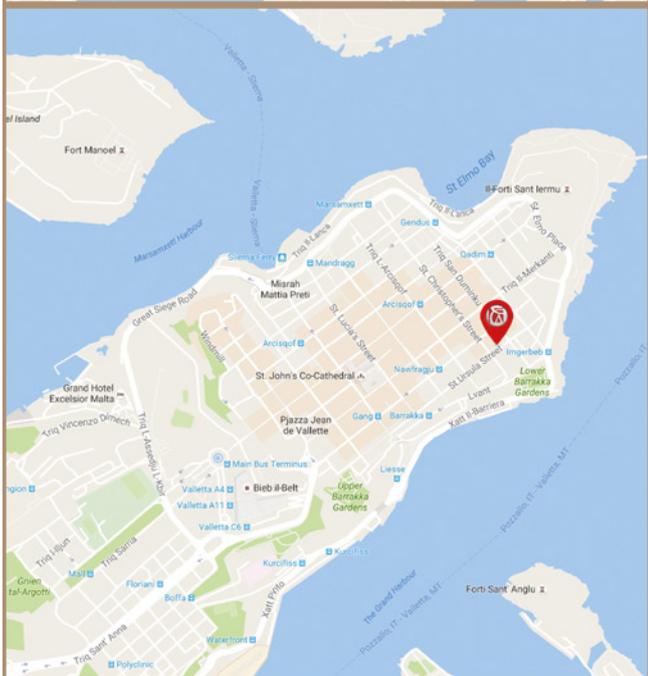
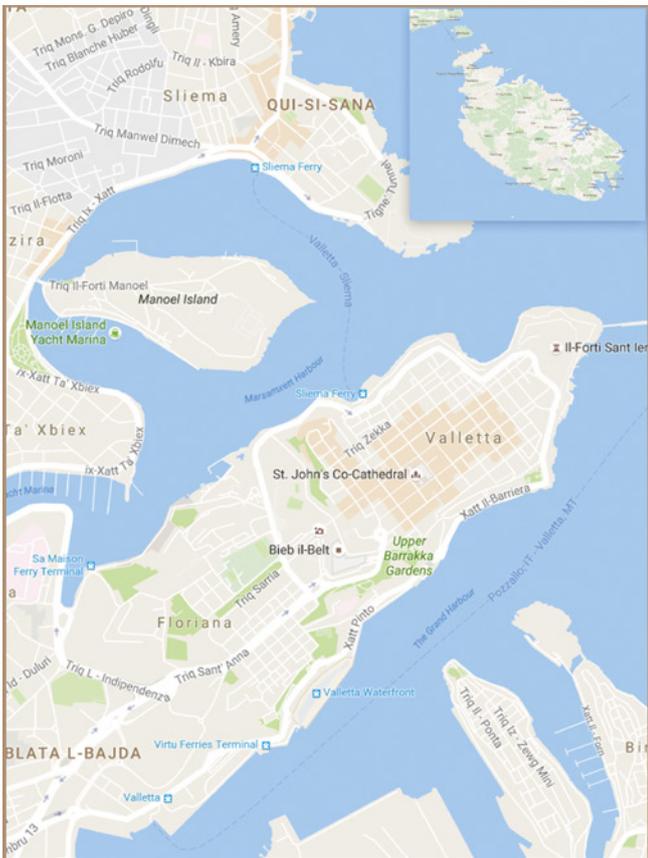
It is important to note that those investment firms that are first to adopt blockchain technology may reap the lion's share of its benefits.<sup>8</sup> As the success of blockchain solutions for the financial services industry depends on its participants, it is important that investment firms begin the innovation process early as first-movers are likely to benefit the most. Investment firms that do not take the time to understand the potential impact of the technology, and consider how it will impact their business strategy, may find themselves at risk.

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<sup>6</sup> <http://www.the-blockchain.com/docs/Seven%20ways%20the%20Blockchain%20can%20change%20the%20trade%20system.pdf>

<sup>7</sup> <http://www.nasdaq.com/article/ey-report-how-the-wealth-management-industry-could-benefit-from-the-blockchain-cm804456>

<sup>8</sup> <https://bitcoinmagazine.com/articles/ey-report-how-wealth-management-industry-could-benefit-blockchain/>



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