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Blockchain Gets Real: Loans, derivatives and repo… connected through equity

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In my first blog post on the evolving blockchain technology landscape I wrote about how, following the hype of 2015, this year would see technology companies and financial services firms explore different ways to use the blockchain technology in capital markets. Since then the ecosystem continues to develop in 2016 with many companies announcing blockchain initiatives and proofs-of-concept (POCs), including RBC, Japan Exchange Group, Mizuho and Bank of America among others. However, three announcements in particular caught my eye.

Ipreo and Symbiont announced a joint venture to focus on using blockchain to overhaul the syndicated loans market. A syndicated loan is a loan extended to a corporate customer by multiple financial institutions forming the syndicate. There is an active secondary market for these loans with investors including all major banks and hundreds of loan funds transacting around $600 billion per year. However settlement times can take as long as 25 days following the trade. It is for this reason that people have pointed to syndicated loans as a market ripe for blockchain disruption – one of the advantages of blockchain and distributed ledger technology being seamless transaction settlement (for example, bitcoin transactions settle in about 10 minutes).

However, a closer analysis of this deal shows that it is driven at least as much by smart contracts as by blockchain technology. While the average settlement time in the syndicated loans market is high, some trades settle in 3 days or less. This suggests that technology is not necessarily the gating factor. Indeed, workflow and process are often the reason loan settlements get dragged out, and the expectation here is that smart contracts will shorten settlement time by streamlining workflow from one step to the next throughout the settlement process.

ICAP and Axoni announced they had completed a successful test of blockchain technology to settle FX forward contracts. Part of what is interesting here is that no-one had heard of Axoni before the announcement – the company is a new affiliate of existing bitcoin company Tradeblock whose launch was announced on the same day. In this proof of concept, the distributed ledger technology was introduced downstream in the settlement process after the trades had been matched and again used smart contracts to streamline the settlement process. This is important as it demonstrates there are post-trade applications of blockchain technology that do not require the asset to be digitized and recorded on the blockchain.

And last but not least was the big news yesterday (3/29/2016) that the DTCC and Digital Asset Holdings would be collaborating to implement distributed ledger technology for the US repo market. When the DTCC invested in Digital Asset Holdings in January, it seemed unlikely that they would seek to implement blockchain technology in the US equities market – it is too broad and interconnected and already has a relatively transparent and efficient settlement process, which makes it a bad candidate for a pilot/POC of a new, untested technology. A repo, or repurchase agreement, is a form of short term borrowing where a dealer raises cash by selling securities (usually government bonds and munis) to an investor with the intent to repurchase them at a future date. The repo market makes a lot more sense as it is an OTC, dealer based market with no central counterparty, and there are significant potential benefits to the market in terms of counterparty risk and cost of capital reduction. It is also a market currently in a state of flux as stricter capital requirements, are reducing the borrowing requirements of large banks and impacting downstream liquidity in the bond market. Although likely many months away, a blockchain solution increasing efficiency could potentially help prevent future squeezes in the market.

So blockchain continues to get real with three new asset classes being added to the list of use cases being worked on: syndicated loans, derivatives and repurchase agreements. But another thing that links these three initiatives together is equity: Ipreo and Symbiont are combining equity into a newco joint venture; Axoni is connected to ICAP through an equity investment from Euclid Opportunities, ICAP's venture capital subsidiary; and the DTCC is an equity investor and board member (via its CEO) in Digital Asset Holdings. When it comes to this burgeoning blockchain technology, the power of the network is important in more ways than one.

[i] Smart contracts are self-executing computer programs that can carry out the terms of a contract – for example, automatically triggering the transfer of a coupon payment from a borrower to a lender.

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