
Emily: Hello and welcome to a DerivSource podcast. I'm Julia Schieffer, the founder and editor of DerivSource.com.

Blockchain remains one of the top trends in 2017, but how does this technology fit into the post-trade space?

In a recent report, entitled 'Is Blockchain A Good Fit? A Disciplined Approach in Post-Trade', Aite Group's senior analyst, Javier Paz explores the insight and information that financial institutions require to best evaluate the opportunities in blockchain technology or 'chaintech' which can deliver the increase in automation and reduced operational base that this technology promises.

Welcome to the podcast Javier.

Javier: Thank you very much, happy to be here.

Emily: We have covered blockchain, or distributed ledger, as a concept in the past on DerivSource, but Javier can you give us a little bit of a quick refresher in the definitions of blockchain and what you call chaintech?

Javier: Chaintech is the more expansive term, and it is one that we use to indicate that the notion of blockchain is transforming, moving beyond what it was explained to us early in 2016 or before, what we knew then were the network nodes from public chains like Bitcoin or Ethereum, where all nodes communicate with each other and synchronise to each other, and chaintech allows us to accommodate for other types of distributive networks being part of the mix.

Emily: Thank you Javier for that clarification. So, as you pointed out in your research paper, many of the larger sized financial institutions are investing heavily in chaintech proof of concepts or select vendors in this space while the smaller firms, such as mid-tier banks or brokers, for instance, are not investing as heavily. Why the difference in interest levels? Do larger banks see more of the potential in this area compared to smaller firms?

Javier: The difference is in the economies of scale for each type of firm. So transacting a few thousand trades a year, or a few million trades a year, determines the value of blockchain-led efficiencies in the post-trade space.

It makes little sense for smaller financial institutions to lead the charge in this transformation if the current system is good enough for them to settle the amount of trading that they do.

It is incumbent upon the larger firms, providing the brokers or smaller buy-side firms some kind of servers or auxiliary work to be the first adopters of blockchain technology, simply because they have much more to gain from it.

The larger firms are definitely busy doing something with blockchain in the settlement space, but what is less clear is whether they are close to common standards or common chaintech protocols.

The R3 Consortium has under its banner the largest number of banks, something like 80+ members, of which 65 or more are banks. But there are other chaintech platforms that banks are seriously evaluating, such as Hyperledger Fabric, a Digital Asset platform, Axoni's AxCore, and more recently (and gaining quite a bit of momentum) is also JP Morgan's Quorum, which is an Ethereum-inspired open source code.

Emily: **Your paper focuses on the post-trade space, so let's look at this in a post-trade lens. How do you see blockchain or chaintech impacting the post-trade space?**

Javier: Certainly. One of the hottest areas right now seems to be e-proxy voting, with several hats on each distributed ring. Nasdaq was the first to the line with a project they launched in Estonia late last year. This was followed by Broadridge and EMX Group this year, also coming forth with their own advanced versions and plans of providing this service and using blockchain technology.

Blockchain seems to be causing greater initial impact for securities that are not traded very frequently, and this is evidenced by the DTCC's plans to roll out technology in credit services and in the repo market.

A big test of the technology on a major scale is coming up in Australia later this year, as the ASX Group which is in the process of using the technology to replace its clearing and settlement system for all-cash equity trades, will decide whether this platform they've been working on for two years, alongside with Digital Asset, will effectively replace what they have during 2018.

So this big test will usher either more credibility in the technology that's being used outside of the United States, because as we all know it's the biggest market in cash equities, but certainly a lot is riding there and we should know how that is proceeding later this year.

One thing to consider though is that Australia's daily volume of stocks is much different than that of the US, so this questions whether chaintech throughput is ready for prime time in the US, and that's a very valid question. So I think all of these events going on in the US happening outside of cash equities, and outside of the US in cash equities, are really exciting and important to watch, and it gives time for the technology to grow into what everybody hopes that it will be, giving

them more throughput and flexibility to meet the demands of real high-volume securities trading.

Emily: **You mentioned some of the benefits, but are there operational benefits blockchain or chaintech can potentially deliver to financial institutions that is really driving the interest in investment behind this new technology?**

Javier: Well, the main benefits... there are some \$2 billion dollars or more in inefficient middle and back office operations across the cash equities industry, according to Goldman Sachs, that blockchain could help eliminate. And that's serious money, supporting operational redundancy and manual reconciliation in some 10% of all trades, so something like 800 million trades in 2015 that had to go to manual reconciliation—that's a lot of inefficiency right there.

So the price tag for this inefficiency impacts all firms—on the sell side, the buy side and those providing services in between.

Emily: **Focusing on the C-level executives, what are the main questions they should be asking themselves when evaluating the applicability and the value of blockchain to the post-trade space? What kind of information or data do they require to make decisions?**

Javier: The C-suite should mine blockchain impact from a defense and offense perspective. From a defensive perspective, they should ask themselves, what are manual-heavy and error-prone parts of their businesses that could become obsolete through blockchain? What are duplicative processes within the firm, or across the supply chain, in which they operate?

From an offensive perspective, they should try to quantify these inefficiencies, and see if the potential blockchain use could give them, as a potential pioneer in its application, a competitive edge, and those are some of the considerations. They need to put themselves through some education what they are able to assess this highly technical information, and I believe in that regard, blockchain is different than, say, big data or moving operations to the cloud, where it is required for management to understand the key concepts of blockchain architecture, and that will allow them to better seize opportunities, and deal with extensibility issues, which means learning how to let blockchain adoption grow with them into the future, and open up new opportunities to interact with their clients and with partners, rather than just have it built to specifications based on today's needs.

Emily: **Finally, looking ahead, Javier, how do you see investment in blockchain for post-trade developing in 2017 and beyond?**

Javier: Investment in blockchain platforms is becoming larger and more selective, going to firms that are generating serious traction from large corporate end users in the post-trade space.

So there is a bit of uncertainty today in terms of who will prevail. There's multiple firms that have a credible background and attractive technology or features that are attractive, such as speed of processing and know-how in terms of the post-trade space, or they have the right membership in terms of, they could make a new protocol, a new technology, become the norm because of *who* backs the technology.

However, the final decision, the final word, the success achieving scale has yet to be determined. We just need to patiently wait for those winners to emerge and see how the adoption dynamics favour one side or the other and that, much like the TC/IP model (of the internet), came to be through consensus and certain tipping points in terms of scale. We expect the same kind of dynamics for blockchain.

If you are an entrepreneur or you are an investor there's still plenty of opportunities to take advantage of this wave of interest in blockchain technology in the settlement space. One has to be patient and continue to watch closely which of the ten or so platforms are likely to be the top three, and at that point provide a service that is more utility-like, that helps interoperability between the various prevailing networks, or in some way augments the power or the capabilities of the various networks to achieve more services within the post-trade space.

Emily: Thank you Javier for sharing your views with us today.

Javier: Happy to be here, and thank you for inviting me.

Emily: Listeners we will share the link to the research report on the shows notes page on DerivSource.com. You will also find the transcript for this podcast there, as well.

Thank you for listening. Join us next time.

Copyright for this document is retained by DerivSource and this document or any excerpts should not be republished or distributed without written notice of Emily Fraser Voigt, of DerivSource.com. For further information please contact Julia Schieffer at Julia@derivsource.com