Nick's Corner

Embrace this Digital Future or Die

This is the summary of a panel discussion hosted by Dominic Hobson, co-founder of Future of Finance in London on the 20 September on a presentation by Dr Ian Hunt on his recently published paper, Digital Issuance – An Optimal Model for Digital Assets and Transactions,

- **Margin pressure exerted by institutional investors and passive investing means Asset Managers must cut costs but the methods used over the last 30 years – computerisation, outsourcing and offshoring – are no longer sufficient. The asset management industry needs to move on to a new operating model.**
- If the asset management industry fails to adopt a new operating model, it risks being displaced by the Decentralised Finance (DeFi) industry.
- A further challenge facing the asset management industry is set by unavoidable generational change. Baby Boomers which saved via pensions, funds and housing are being replaced by Millennials and Gen Z, which are not only digitally native but alienated from all existing financial services providers, as their enthusiasm for tokenised forms of finance proves.
- **Tokenisation offers a new operating model**. Instead of assets (such as securities) and cash (as payment) being moved between buyers and sellers by a complex eco-system of exchanges, brokers, clearing houses (CCPs), custodians, central securities depositories (CSDs), registrars and paying agents and their computer systems, tokens move between nodes on a network.
- Ultimately, **finance is about the transfer of value through time**. Its essence can be reduced to flows of value in which an asset is a purchase of future flows of value (an investment by investors) and a liability is a sale of future flows of value (an issue of equity or debt by an issuer). Financial services exist to facilitate exchanges between investors and issuers.
- It follows that intermediaries that facilitate exchanges of futures of flows of value between issuers and investors must add value or they will become vulnerable as forms of transactions costs only. In principle, tokenisation can dispense with intermediaries altogether, with issuers and investors holding self-servicing tokens on their nodes only.
- Tokens differ from conventional financial assets. A conventional equity offers an uncertain promise of capital appreciation and dividend income. A fixed rate bond offers a certain income and a promise of redemption. Mutual funds are more like bonds than equities. What tokens offer is something simpler: a pledge to deliver a particular flow of value in the future.
- Fulfilment of pledges of future flows of value can be automated by building intelligence into a token, making it a "smart token". For example, when the date arrives to make a transfer of value such as a dividend or interest payment or rights issue or redemption, it triggers the token to deliver other tokens of the requisite value to the node of the holder of the pledge.
- Tokens can also be fractionalised (broken into ever smaller pieces for sale to investors with smaller needs or less wealth to invest) and clustered (simulations of future flows on conventional assets such as bond coupons and redemption payments or bespoke groups of tokens designed to achieve a particular set of exposures that suit a particular investor).
- The ability to combine smart tokens in any way means they can be used to create the equivalent of any conventional financial instrument – equities, bonds, money market instruments, options, loans, mortgages, margin calls, complex derivatives and structured products, and so on – at much lower cost than existing forms of issuance. It creates a single operating model.
- Smart tokens can replace not only the process by which conventional financial assets are issued but the processes by which they are traded.
- Smart tokens also alter the process by which conventional assets are serviced. Payments of dividends or interest or other forms of value can be made by the transfer of payment tokens between issuers and investors. Other corporate actions (such the issue of rights) can also be fulfilled by the transfer of tokens between nodes.
- Tokenisation of issuance, properly conceived and implemented, will not make existing processes more efficient. **It will replace them**, because the existing, duplicated and reconciled data flows between exchanges, brokers, custodians, CCPs, CSDs, trade repositories, SWIFT, CLS, Omgeo and computerised databases are needlessly complicated and risky.
- The optimum model of digital issuance is drastically simplified.
- The matching process is also simplified and automated.
- One consequence of a simplified issuance model is a reduction in the burden and cost of regulation. This is partly because smart tokens can incorporate compliance with regulatory obligations (for example, avoiding mis-selling of products) and partly because there will be a reduction in the number of entities involved in issuance, trading and token servicing.
- **But the major benefits of a simpler system are a reduction in the costs of issuance and liability servicing for issuers; more choice and tighter asset/liability matching for end-investors; lower execution, systems and operational costs and faster product development for asset managers; and elimination for all three parties of the costs of third-party service providers.**

Client Services

The new platform will be available for a month of client testing in ***June 2023***. Date to be finalised and advised.

Some of the new features on the Chain:

Easy Access and Filtering of Data
- All unique records are displayed on the UI, this applies to all file types i.e. trades, confirmations, prices, holding balances, accounts, etc. These screens are coupled with **powerful filtering** options, making searching for data quick and easy.
- Holding balance statement records will be available.

Uploads
- Auto submission of files will be available **across all file types**.
- Errors, failures and files not authorised can quickly be identified and resolved with the enhanced upload and authorisation workflow.

Future Dated Trades
- Clients will have the ability to **upload trades for a future date**.

Fund Cut Offs
- Cut off times can be assigned to all fund types (not only MM as is the case on the current FinSwitch application). Cut offs can also be configured on a company & fund level e.g. on a company level MM funds could be set at 11am however on the fund level some of those MM funds could be set for a different time.

Fund Validations
- Fund categories (i.e. UT, MM, Hedge, Life) will have specific validations.
- ***Funds must be categorised correctly.***

Custom Built Process for Fund Migrations/Amalgamations

Feature Access Functionality
- The ability to segregate user and company roles at a granular level.

API
- Atomised trading.
- Greater data access.

In addition to the above features, other benefits include:
- Adoption of ISO 20022 standards.
- Introduction of 2 Factor Authentication (2FA).
- Stricter compliance to POPIA requirements.
- Enhanced flow reporting

We have an upcoming training session scheduled over the 7-8 March 2023, that will introduce clients to the upload functionality. Keep an eye out for the invite that has been sent by Noorun-Nissa Martin.

We look forward to introducing you to this new functionality!

Best Wishes
Tasneem Gydien
Manager: Client Relations