Nick's Corner

FinChain

Our new distributed ledger platform is now ready to go-live. I would like to take this opportunity to thank the FinSwitch team for their extraordinary effort over the duration of the project, to FNZ for producing a quality product and for all our clients who did their testing. Thank you.

The request from the industry for an additional round of Market testing, means that the go-live will be postponed until the 1st quarter of 2025 due to the festive season and industry code freezes. While frustrating, it is beneficial in ensuring that all clients do test, reducing the risk to the industry and their counterparties. The go-live signals the opportunity for the industry and our clients to leverage the value-add benefits that a distributed ledger provides especially given that the entire industry will be operating on a single platform, and I would encourage all clients to start thinking, how and where, they can leverage the opportunity it provides. This surely is a world first. The following is an edited extract from a Mckinsey article, which talks to the growing trend and opportunities associated with the platform FinSwitch has created in partnership with FNZ.

From ripples to waves: The transformational power of tokenizing assets

Edited from an article by Mckinsey and Company. June 20, 2024 By Anutosh Banerjee, Julian Sevillano, and Matt Higginson with Donat Rigo and Garry Spanz

Tokenized financial assets are moving from pilot to at-scale deployment. Adoption is not yet widespread, but financial institutions with blockchain capabilities in place will have a strategic advantage.

Tokenization, the process of creating a unique digital representation of an asset on a blockchain network, has reached a tipping point after many years of promise and experimentation. The benefits—including programmability, composability, and enhanced transparency—can empower financial institutions to capture operational efficiencies, increase liquidity, and create new revenue opportunities through innovative use cases. As infrastructure players pivot away from proofs of concept to robust scaled solutions, many opportunities and challenges remain to reimagine how the future of financial services will work.

What is tokenization? If we were to design the future of financial services, we would arguably include many of the features of tokenized digital assets: **24/7 availability; instant global collateral mobility; equitable access; composability,** thanks to a common technology stack; and managed transparency. More and more institutions are rolling out and scaling tokenized products, from tokenized bonds and funds to private equity and cash. The digitization of assets seems even more inevitable now as the technology matures and demonstrates measurable economic benefits.

Tokenization in waves. The appetite for investing in tokenization likely scales inversely to the richness of fees earned from today's less efficient processes, depending on whether the functions sit in-house or are outsourced, and how concentrated the main players and their fees are. Outsourced activities often reach economies of scale, reducing the incentives for disruption. Time to impact—that is, how quickly returns on tokenized-related investments can be achieved—can augment the business case and thus the appetite to pursue tokenization.

Asset classes with the fastest paths to adoption. We expect the most prominent front-runners will include cash and deposits, bonds and ETNs, mutual funds and exchange-traded funds (ETFs), as well as loans and securitization. For many of these, adoption rates are already material, underpinned by greater efficiency and value gains from blockchain along with higher technical and regulatory feasibility.

Mutual funds. Tokenized money market funds have attracted over $1 billion in assets under management, signalling demand from investors with on-chain capital in a high-interest-rate environment. Other types of mutual funds and ETFs could offer on-chain capital diversification to conventional financial instruments.

The transition to on-chain funds can substantially increase utility, including instant 24/7 settlement and the ability to use tokenized funds as payment vehicles. For instance, highly tailored investment strategies would become possible through composability across hundreds of tokenized assets. Having data on a shared ledger reduces errors associated with manual reconciliation, and increases transparency, leading to lower operational and technology costs.

Subsequent waves of assets. One class of assets for which tokenization holds great potential, in the eyes of many market participants, is alternative funds, potentially sparking growth in assets under management and streamlining fund accounting. Smart contracts and interoperable networks can make managing discretionary portfolios at scale more efficient through automated portfolio rebalancing. They may also enable new sources of capital for private assets. Fractionalization and secondary market liquidity may help private funds access new capital from smaller retail and high-net-worth individuals. Additionally, transparent data and automation on a unified master ledger may create operational efficiencies for middle- and back-office activities.

Overcoming the cold start problem. A cold start problem is a common challenge to adopting innovation, in which products and their users need to grow at a healthy pace but neither succeeds alone. In the world of tokenized financial assets, issuance is relatively easy and reproducible, yet true scale can be achieved only when network effects are achieved: when users (typically, investors on the demand side) capture real value, whether from cost savings, higher liquidity, or enhanced compliance.

A path forward. Although it is fair to expect tokenization to spur such a multidecadal transformation of the financial industry, there may be particular benefits for early movers who are able to "catch the wave." Pioneers can capture oversized market share (especially in markets benefiting from economies of scale), enhance their own efficiency, and set the agenda for formats and standards, as well as benefit from the reputational halo of embracing emerging innovation. Early movers in tokenized cash payments and on-chain repos have demonstrated this.

Our thesis that the case for tokenization is at a tipping point suggests that this mode may be too slow once we see some important signposts, including the following:

- **Infrastructure:** blockchain technology able to support trillions of dollars of transaction volume.
- **Integration:** blockchains for different applications demonstrating seamless interconnectivity.
- **Enablers:** widespread availability of tokenized cash (for example, CBDCs, stablecoins, tokenized deposits) for instant settlement of transactions.
- **Demand:** appetite from buy-side participants to invest at scale in on-chain capital products.
- **Regulation:** actions that provide certainty and support a fairer, more transparent, and more efficient financial system across jurisdictions, with clarity on data access and security.

In the near term, institutions, including banks, asset managers, and market infrastructure players, should assess their product suites and identify which assets would most benefit from transitioning to tokenized products. We suggest questioning whether tokenization can accelerate strategic priorities, such as entering new markets, launching new products, and/or attracting new customers?

By aligning pain points (on the buy- and sell-sides) with buyers and market conditions, stakeholders can assess where tokenization creates the greatest risk to their market shares.

Client Services

Chain Market testing took place over a 5-week period during August and September! The testing went extremely well with very few clients encountering any issues. Client participation was good, where 113 of our 180-client base tested. The problems experienced were mostly around what to do and how to log in as clients had not read and followed the extensive instructions sent.

There have been many requests for additional testing time, and we are happy to advise that another testing window will be available between the 20th January – 14th February 2025.

This will impact our go live date, which will be confirmed at a later stage.

Further details pertaining to testing will be confirmed closer to the time.

We urge all clients who have not tested thus far, as well as those who have requested additional testing to utilise the additional window.

We want to thank each client who has participated, engaged with us, and provided valuable feedback during the previous testing period.

Best Wishes
Tasneem Gydien
Manager: Client Relations