

WHAT IS A DIGITAL SECURITY?

To keep it simple, it's any traditional financial instrument or security, loan or share, issued over a digital format. Most digital securities contain a piece of code called a "smart contract" or a "DAPP". These operate somewhat like an excel Macro and contain all of the legal documents and functionality of the financial instrument; for example, a digital loan would contain a digitised version of all of the terms and conditions and regular payments.

TOP 10 WAYS TECHNOLOGY AND DIGITAL SECURITIES WILL CHANGE FINANCE

A financial system that has taken centuries to evolve will change dramatically in the next few years.

BY LISA WADE



The way we move, store and access money is about to change forever.

FUNDAMENTALLY, OUR FINANCIAL system has been built and governed by various forms of banks and financial institutions, whether they be merchant banks, retail banks, central banks, investment firms and everything in between.

One of the key themes in finance over the past year has been the emergence of a new type of security, broadly called “digital assets” or “digital securities”. These new securities will simplify the financial infrastructure through automation and provide a range of benefits.

So how do digital securities change this complex system? Whether you run a multibillion dollar corporation or want to buy an ice cream when you are not carrying any cash – the way we move, store and access money is about to change forever.

Here are the top 10 ways:

1. **Access** – the first aspect is access to “credit” and money will be different. Currently there is a complex “credit” process around accessing money; even if you have it, you have to go through multiple layers of identity verification and anti-money laundering processes, and if you need to borrow, extensive credit checks. Digitisation will mean a lot of these processes are automated and it will change the way “credit” checks are done in terms of the underlying data used to assess borrower suitability. This will be the most powerful for the unbanked and we believe will also transform corporate finance in many ways. The second aspect is access for investors, who will be able to tap into new and previously inaccessible asset classes. Real assets are currently hard to invest in and fractionalize, whereas digital securities that are asset backed can be infinitely fractionalized. This will create the ability to unlock vast amounts of capital invested in real assets and will help with portfolio diversification.
2. **Better** – accessing credit and moving money will be more focused on the user experience so it will be better for everyone. We will shift from connectivity to interactivity.
3. **Cheaper** – the repetitive processes outlined above are expensive and time consuming. These savings will mean smaller margins, so that fees will fall as will “risk” premiums.
4. **Faster** – currently it can take weeks or months for credit checks, even for large corporates. Once you have your digital identity up and running, access to credit and moving money will be faster. We will move into a world of straight-through processing of complex transactions and “atomic” (or instant) settlement.
5. **Liquidity** – digital assets will be tradeable in secondary markets – in many asset classes these secondary markets do not currently exist. The creation of these new secondary markets will unlock liquidity in an unprecedented fashion and play its own role in re-pricing risk as currently real assets trade with a “liquidity” premium due to lack of liquidity.

6. **Transparency** – we will be able to verify and prove the origin of all digital assets and financial transactions embedded in the instruments. The implications of this are profoundly positive – no more cooking the books and deception. Financial instruments will be what they say on the box.
7. **Trust** – transparency will build trust in the entire marketplace.
8. **Blurring of the lines between public and private markets** – this will be a radical change. There will be little delineation between what are currently two distinct private and public capital markets. This has regulatory implications, and until regulation adapts, we need to regulate all digital securities to the highest standard for credibility.
9. **Frictionless trading and funding** – all of the above issuance will be done on open source ecosystems and market places and be frictionless. We will have access to real time price and liquidity discovery and instant access to what we need.
10. **Operational risk** – this is a real and pressing issue for many large financial institutions and places costs into the financial system. Digitising the process will allow many aspects subject to human error to be removed from the value chain of financial instruments. This will represent a dramatic reduction in operational risk – and therefore also costs.

BLOCKCHAIN FACTS AND FIGURES

Since mid-2015 global financial institutions have committed significant resources to research, experimentation and product development with blockchain technology across a wide range of use cases such as cross-border payments, trade finance, identity management and Know Your Customer (KYC) and securities settlement. According to recent reports from Gartner, IDC and CB Insights:^{1,2,3,4,5}

- 100+ global financial institutions have joined blockchain consortia since 2016
- 90+ central banks have explored blockchain potential since 2016
- US\$8 billion-plus has been invested in blockchain projects from 2014-2018
- 2500+ blockchain-related patents have been filed between 2014-2017
- In 2019, global financial institutions investments in blockchain initiatives will reach US\$2.9 billion

1. http://www3.weforum.org/docs/WEF_The_future_of_financial_infrastructure.pdf
2. <https://www.cbinsights.com/research/blockchain-disrupting-banking/>
3. <https://www.idc.com/getdoc.jsp?containerId=prUS45429719>
4. <https://www.idc.com/getdoc.jsp?containerId=prUS44898819>
5. <https://www.gartner.com/smarterwithgartner/the-cio-s-guide-to-blockchain/>