Block to the Future II: Finance, Transformed

In the second of three anticipated columns in *Corporate Counsel*, Jones Day partners Stephen J. Obie and Harriet Territt explain how financial institutions' practices—from syndicated lending to capital markets administration—are being radically transformed by blockchain technology.

Invoking the virtue of creative destruction can be an empty cliché or a rhetorical misdirection. When it comes to blockchain technology, however, the phrase would appear to be most appropriate. As noted in this space before, blockchains can be powerfully deployed in the area of supply chain management. But a host of other applications are on offer. Among the many transformations that the technology presages, perhaps none is as potentially powerful as the prospect that it will reduce friction in financial markets.

Financial institutions were among the first wave of commercial businesses to explore how blockchain technology can be applied to different aspects of financial markets, including syndicated lending, payment systems, and administration of capital markets. This might prove especially salient in the realm of fundraising through, for example, token offerings or clearance and settlement systems. Leaders in finance also believe that blockchain technology can help make traditional infrastructure more efficient, promising significant advantages.

Despite the technology being in its infancy, its fundaments suggest the potential to transform current financial systems in the following ways:

- Reducing costs, especially overhead and cost compliance;

- Increasing transparency;

- Mitigating risk of errors, fraud, and corruption;

- Creating new business opportunities;

- Improving security, speed, transparency, and cost of payments; and

- Expanding access to capital markets, especially for new or non-traditional market entrants.

At its heart, blockchain is a crowd-maintained database. The technology is used for storing, tracking and processing information. Each transaction is stored on a "block" of data that is securely linked to the blocks containing previous transactions (hence "blockchain"). The secure link between blocks makes it simple to track and audit the validity of entries, yielding platforms that are much more difficult to hack or falsify than existing databases.

The technology is also capable of running a "smart contract"—a piece of computer code using standard prewritten logic (e.g., if x happens, then y is the outcome). When a smart contract is stored on the blockchain, it can be made self-executing and self-enforcing. In other words, when the "if" condition in the smart contract is fulfilled, the "then" outcome is automatically put

into place, without the need for any human intervention or approval.

Proof of concept can be found in recent applications—from loans and payment systems to the administration of capital markets.

In the realm of syndicated loans, one large Spanish bank recently used a private blockchain network to lend $150 million to an electric grid operator, with co-lenders from Japan and France. Blockchain technology simplified and expedited the process of completing the arrangements, resulting in a "huge reduction in internal costs," according to the bank's head of global finance. Going forward, another provider aims to dramatically transform and streamline the syndicated loans market with a platform that went live in November 2018. As for payment systems, one multinational investment bank created a "settlement coin" to make markets more efficient by allowing financial institutions to pay each other without waiting for traditional money transfers to be completed.

When it comes to capital markets, several global stock exchanges are using blockchain to reduce the cost and increase the speed of settlement processes. Last year the digital retail giant Overstock's portfolio company tZERO announced a joint venture with BOX Digital Markets LLC to develop a U.S. national securities exchange with regulatory approvals that would enable the exchange to trade digital securities. Once it obtains approval from the Securities and Exchange Commission, the joint venture will operate as a facility of the BOX Options Exchange. (More recently, tZERO won a patent designed to use blockchain technology to integrate legacy banking systems with cryptocurrencies and digital asset technology.)

Again, we don't want to get ahead of ourselves. The most prominent examples of blockchain's ability to transform financial markets are in the early phases of implementation. However, significant interest exists, especially among large financial institutions looking to use blockchain technology to improve current infrastructure and coordinate efforts to launch new blockchain-based systems. Moreover, in the spaces where blockchain is being already being used, for example among payments, it has received a lot of attention and is gaining popularity among financial institutions.

Blockchain is here to stay. It is here to transform. Here's to helping it do so creatively.

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