Disrupting Financial Markets (1) - The Issuer

Graham Rodford

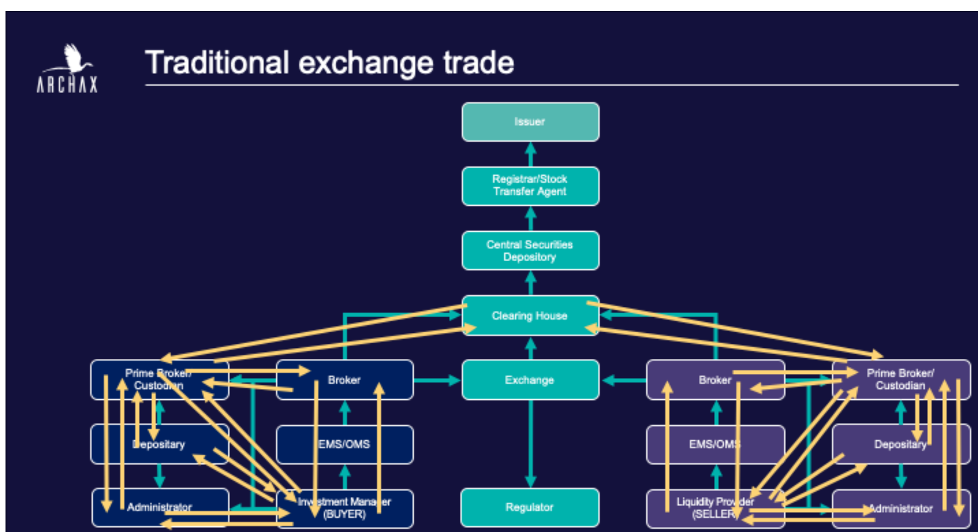
There has and continues to be much talk around digital securities or security tokens, which are securities represented digitally on a blockchain. Many advantages are talked about on how they will disrupt financial services and democratise capital markets for everyone. But to what extent are the advantages down to the technology, a renewed way of thinking or only possible if you disregard regulation? In this first article in our series "Disrupting Financial Markets", we look at what digital securities are and the benefits they can bring to the issuer.

The old versus the new

Before delving into the detail, it is important to understand the difference between traditional securities and their purely digital counterparts.

	Traditional Securities	Existing Crypto/Utility Tokens	Digital Securities
Hours/Days	9/5	24/7	24/7
Market	Local	Global	Global
Settlement	Slow	Fast	Fast
Workflow Integration	Integrated	Partial integration	Partial integration
Ownership Register	Maintained by 3rd party	Maintained by exchange	Maintained by 3rd party
Regulation	Regulated	Unregulated	Regulated
Compliance	Manual	Manual	Smart contract enforcement

If you look at how securities exchanges have traditionally behaved, they typically trade limited hours a day and largely focus on local markets, targeting local brokers or investors. The trading process is integrated into the platforms and workflow used by financial institutions and the instruments are regulated, but the compliance process is often manual. When it comes to post-trade, the process is complex and inefficient, involving any number of intermediaries whom all frequently are forced to reconcile information with each other.



With the advent of distributed ledger technology and cryptocurrencies, the market infrastructure providers re-imagined the way instruments could be traded. For cryptocurrency exchanges, 24x7 trading became commonplace. They were accessible globally with limited intermediaries, settlement was instantaneous, but they were generally unregulated and were not well integrated into the established financial markets' infrastructure. Whilst these differences were exciting, a lot of the changes were not caused by blockchain specifically, but rather by the way the trading was funded and the lack of a regulatory framework in place. Most crypto exchanges require all trading to be pre-funded, which allows for real-time trade settlement, and combined with the absence of regulation, meant that there were no requirements for clearing nor the post-trade intermediaries from the traditional capital markets world. The lack of regulation also meant that instruments could transfer between jurisdictions more easily and be tradeable by all, these instruments being much more freely transferable than traditional securities. However, as cryptocurrencies are bearer instruments, their safe custody is vital, and people were free to store them with the exchange operators or in a wallet of their own.

As volumes, volatility and acceptance increased, so too did regulatory scrutiny and the recognition that some of the instruments being traded should be considered as regulated securities and therefore follow the appropriate regulatory rules. These digital securities contain the transferability and potential benefits of blockchain but must operate within the rules.

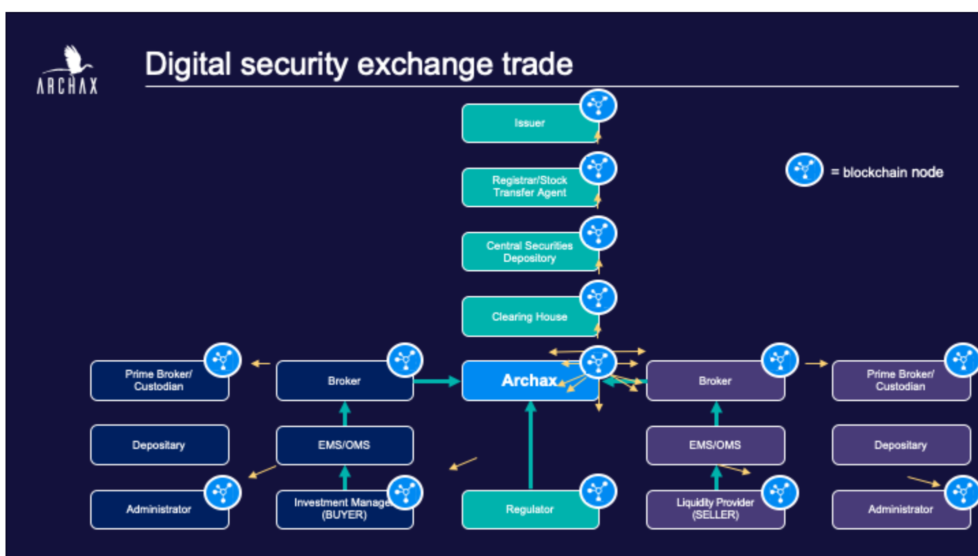
So what are the advantages?

24/7 trading is often talked about as one of the main advantages, but is that really true? Whilst cryptocurrency exchanges made it commonplace, it wasn't because of the technology — it just made the most sense for these globally demanded assets that were accessible by all. Traditional markets could open for longer and there are pockets of liquidity outside of the main markets, but for the most part, this has been resisted by market incumbents and in some circles there is even a move to reduce hours and concentrate liquidity.

Fractionalisation of assets is often cited as an advantage too, and it can certainly be achieved easily using blockchain technology, but it was really also possible before. Any asset can be put into an SPV and fractionalised into as many shares as you want, which can then be traded. Increasingly, fractional share trading is popping up as an option for retail investors too who are often not able or willing to purchase whole units.

Does it really need to be the case though that these things are only exciting because they are possible with distributed ledger technology? The idea of 24/7 trading and fractionalisation doesn't become uninteresting just because it could have been done before, it has just been reimagined and so is compelling — especially when coupled with the actual advantages which were not possible previously.

One key advantage is that with transactions captured on a blockchain, all parties are able to view their transaction immutably and in a trustless way. This has huge benefits for market infrastructure providers, which we will discuss in the next article in this series.



Blockchain also brings potential benefits to the issuer. At any point in time, all wallets that hold an issuer's token can be seen, albeit probably pseudonymously. This has advantages for cap table management as well as for monitoring activity within the issuance.

From a corporate action point of view, it is possible to process payments in positions or cash directly to the beneficial owners with little friction. This will pave the way for an increasing number of corporate actions than those we see today.

If you combine the above from an issuer point of view, the question really becomes "why would I not use a better technology for my issuance?". If regulation recognises the digital security and the market is willing to consider it a legitimate instrument, you would be left with little reason as to why not. These things are now happening, and the traditional market infrastructure providers and financial institutions are realising that there are benefits for them too.

We discuss those benefits further in our next article, but when viewed together, the case for digital securities and a digital securities ecosystem becomes compelling.