

THE HUB

MARKET INSIGHTS

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

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The blockchain is on the verge of revolutionising fund distribution in asset management

Key Takeaways:

- The blockchain will disrupt the way in which transactions are made, much as Internet has revolutionised communication with the TCP/IP protocol.
- There are three types of stakes involved in the blockchain for fund distribution: better investor knowledge, greater efficiency, and accelerated innovation.
- Institutional investors could naturally benefit from the blockchain in placing orders directly in open-ended funds, and also into dedicated funds through their asset managers.
- Ostrum AM has decided to be a leader in the blockchain rather than a follower, with a global first in 2017, and is actively contributing to the activities conducted in this area by the authorities and regulators¹.

The blockchain is anything except a passing fad. It will disrupt the way in which transactions are made, much as Internet has revolutionised communication via the TCP/IP protocol.

But, first, let's recall in a few words what the blockchain is. It is a database – or a large book of accounts – shared by several users that guarantees both proper user identification (transparency) of the integrity of inserted data (inalterability), and permanent access to records of all updates (traceability).

The blockchain is a technology in which any new, validated transaction is immediately distributed throughout the network without the intervention of a central authority.

It is also a formidable tool of disintermediation for trusted third-parties in financial services, including paying agents, transfer agents, centralisers, account-keepers and others. This reduction in the number of technical intermediaries between the end-investor and the investment management company should ultimately lead to reduced costs and shorter transaction processing times.

In asset management, there several uses, such as registration and transfers of assets between participants, keeping of registers and investor or lender positions, and the automated execution of business rules.



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These applications can involve both portfolio assets and liabilities:

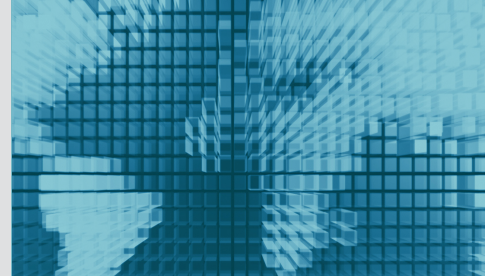
- Portfolio assets via order trading and execution activities, transaction reconciliation and settlement/delivery between the middle offices of transaction counterparties, managing votes at AGMs, managing corporate actions (e.g., merger/absorptions and dividend payments), and managing OTC contracts.
- Portfolio liabilities via the compiling of client identity information, managing anti-money laundering procedures, receiving investor orders, and keeping their positions.

There are still few applications in portfolio assets (but more and more projects are being launched). The same is not true of liabilities, where investment management firms are leading the charge in innovation – understandably so, given the stakes involved.

1. ESMA (European Securities and Markets Authority), FCA (Financial Conduct Authority) and AMF (Autorité des Marchés Financiers).

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The stakes involved: efficiency, lower costs, customer knowledge, and innovation

There are three types of stakes involved in the blockchain for fund distribution: better investor knowledge, greater efficiency, and accelerated innovation.

First of all, investor knowledge will be enhanced throughout the mutual fund distribution chain. Order-marking currently provides only a very partial vision of a fund's liabilities.

Second, the blockchain should lead to greater overall efficiency, with better management of liquidity risk by investment firms and lower operating costs borne by funds, distributors and investors. These declines will result from the disintermediation of fund centralisers and transfer agents, the dematerialisation of distributor back offices, and lower custody fees and transaction fees charged to investors by distributors.

And, third, blockchain is accelerating innovations by promoting the sharing of investor knowledge between distributors and investment firms. Enhanced user interfaces and new, personalised consulting services will allow distributor teams to better respond to distributors by better addressing their clients' savings needs.

So the blockchain can be seen as a great opportunity for distributors, which, with the help of investment management firms, will be better armed to meet their clients' needs through an enhanced offer of services.

Institutional investors can, of course, benefit from the blockchain when placing their fund orders. They would no longer have to worry about identifying the fund depository(ies) of the funds concerned. The number of units that they hold in funds should also be

certified directly by the blockchain on which they hold an "account", along with all of their positions. For those who hold only fund units, it should no longer be necessary to have a securities account at a bank.

Lastly, institutional investors who delegate management of dedicated funds to asset managers will now be able to place their unit subscription and redemption orders directly via the extranet tools or apps made available, and their features will be enhanced to become transactional.

Ostrum AM: an early adopter of the blockchain

Given the stakes involved for asset management, Ostrum Asset Management has decided to be a leader in the blockchain rather than a follower, with a global first in July 2017 – for the first time, investors were able to place their orders for selected Ostrum Asset Management funds via the FundsDLT blockchain platform, the result of a partnership between KPMG Luxembourg, FundSquare and InTech. This is designed to test the operating efficiency of a blockchain platform solution.

Meanwhile, the number of cross-border funds referenced by Fundsquare – an investment fund distribution platform – could also cause many distributors to join the crowd and use FundsDLT.

In 2018, the first fund distribution offers via the blockchain are scheduled to be launched. This would be a significant milestone of the last few decades in this area.

What next?

Ostrum Asset Management is actively contributing to the activities conducted in this area by the European authorities and regulators who are closely monitoring blockchain developments, while seeking to supervise them.

The Paris market intends to spearhead blockchain apps in finance and is encouraging the development of fintechs. The French government, for example, released a ministerial order authorising direct management of registration of non-listed securities and ownership transfers via the blockchain in a simpler and more secured manner. Meanwhile, the blockchain allows distributors to comply with MIFID2 by monitoring matches between funds and client's level of knowledge and risk profiles, thus attempting to mitigate the risk of misselling.

Through its other businesses, the Natixis Bank is also participating closely in several initiatives and in blockchain consortiums, including we.trade and R3 which involve about 40 other major international financial establishments².

Major institutional investors and issuers, as well, seem to have an interest in directing these changes towards more direct and less costly transactions. This should take a little more time, as it will also require a revolution in mind-sets, but for asset management professionals, the blockchain is part of the march of history.

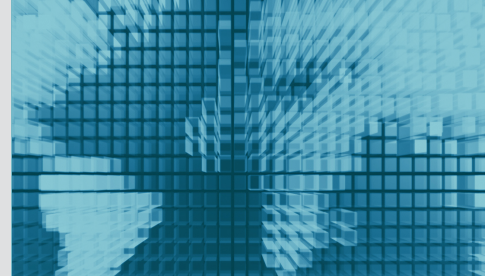
16 April 2018

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2. The we.trade platform regroups seven banks (Rabobank, Deutsche Bank, HSBC, KBC, Natixis, Société Générale and UniCredit) and IBM. This ground-breaking shared platform aims at making domestic and cross-border commerce easier for European companies by harnessing the power of distributed ledger technology. With a global network of partners, R3 develops innovative apps for finance and commerce on a blockchain enabled platform using corda protocol.

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