Blockchain Technology and Structured Finance

Blockchain is best known as the decentralized technology behind cryptocurrencies, such as bitcoin, and is, essentially, a growing list of linked records called blocks. These blocks can be comprised of any kind of data and are generally unable to be modified. Blockchain does not run on just one computer like a regular database would, and is widely believed to be more secure, more transparent and quicker than traditional financial transactions. Many believe it will play a central role in a variety of transactions, including structured finance.

Currently, structured finance, and specifically securitizations, are cumbersome to draft, negotiate and close, requiring a high level of trust and dependence on third party intermediaries. Securitizations now require voluminous paperwork, inefficient due diligence, and opaque methods of rating and performance of the underlying assets. Blockchain provides solutions to many of these issues.

First of all, blockchain utilizes smart contracts that accelerate the transactional process. Conceptually, smart contracts can be complex, but they are essentially a digital contract between two or more parties that are enforced by cryptographic code. These contracts are designed to execute exactly as they are created. Securitizations can be streamlined by replacing paper contracts with smart contracts.

Because it utilizes a distributed ledger, blockchain also allows for a greater level of transparency. Each party involved has access to the same data simultaneously, giving them more control to monitor and audit more effectively. When one party makes a change, a digital fingerprint is created and validated. This step increases accuracy and eliminates the need for parties to store multiple copies of documents. A distributed ledger also provides for shared audit trails which can help parties to resolve any disputes in a timely manner should they arise.

Major investment banks and accounting firms are devoting substantial resources to setting up blockchain systems that will revolutionize much of structured finance. For securitizations, this will mean putting the underlying asset data (often mortgages or student loans) on the blockchain leger, which is traceable and verifiable to all. Not only will the underlying assets be transparent to the rating agencies, regulators and eventually investors, but the process of documenting and closing securitization offerings will be greatly simplified. After closing, the servicing and monitoring of the securitized assets will similarly be streamlined, and more easily verified by the secondary markets, rating agencies and regulators.

The benefits of blockchain in structured finance are numerous. Not only can it streamline a process that is notoriously slow and plagued with delays, it can also provide greater transparency for all parties involved. This technology will surely continue to transform the way companies handle financial transactions as we move into 2018 and beyond.