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Embracing the DLT (r?)evolution

Over the past years, DLT has emerged as an important piece of technology that promises to transform capital markets by delivering a real-time, transparent, Peer-to-Peer (P2P) and inclusive experience. It enables a real-time view of activity and positions across a business network. Making it possible to detect, assess and react faster to threats and opportunities. Participants can share and trust in a single source of truth, increasing transparency and reducing reconciliation. Because of its distributed nature, participants can directly hold and transfer value in a P2P manner, but still retain the possibility to be serviced by a third party without mediation of information or network. This allows for greater direct inclusion to capital markets.

Inspired by this promise, a number of the DLT based PoCs have now moved to a project phase and aim to go live soon. Post Trade FMIs & intermediaries also fully acknowledge this transformative potential. Hence, they have not been a passive observer and have already launched dozens of projects with DLT or invested in FinTechs for use cases related to issuance, settlement, asset servicing, funds distribution, collateral management etc.

The journey for most industry initiatives, however has been a very long and arduous one and the path to mass adoption is not yet obvious. It is clear that the mere use of DLT is no longer a sufficient condition to expect success.

“Will DLT introduce additional risks and costs?” or “Will it deliver benefits materially beyond what we have today?” are questions that often get asked, but the answers are not obvious. For example, DLT instant settlement does reduce counterparty risks but also increases liquidity costs with no netting and pre-funding before trade-execution. Similarly, decentralization brings with it significant governance and legal risks. And participating on a DLT network isn’t cheap. Not everyone can afford the node setup, licensing fees, upskilling efforts etc.

So when seen in context of EU capital markets that have gone through an era of transformation to deliver market-wide efficiencies, lower risks, greater legal certainty and interoperability, the material benefits in return for undertaking such costs and risks are not always apparent.

Meanwhile market actors assess whether such goals of efficiency, transparency etc. could be more easily achieved using other new technologies such as AI, Robotics, API and Cloud.

While such questions will possibly get ironed out over time by lowering costs,

skilling more staff, etc. what certainly is required at this stage is greater legal and regulatory certainty. An EU-wide legal classification and a technology neutral regulatory framework is thus an important first step to support market adoption. Moreover, it is important that regulators take a “substance over form” approach leveraging existing safe & robust regulatory and risk frameworks, but applying them proportionally to allow innovation to thrive.

Such logical supportive steps from both public authorities & market actors will help the markets embrace the DLT evolution rather than impede its radical revolution. FMIs, given their decades experience in driving safety and efficiency and their committed experimentation will certainly be key enablers in this journey. ●