Exploring Blockchain's Real Impact on Securities Finance, Collateral Management and the Repo Market

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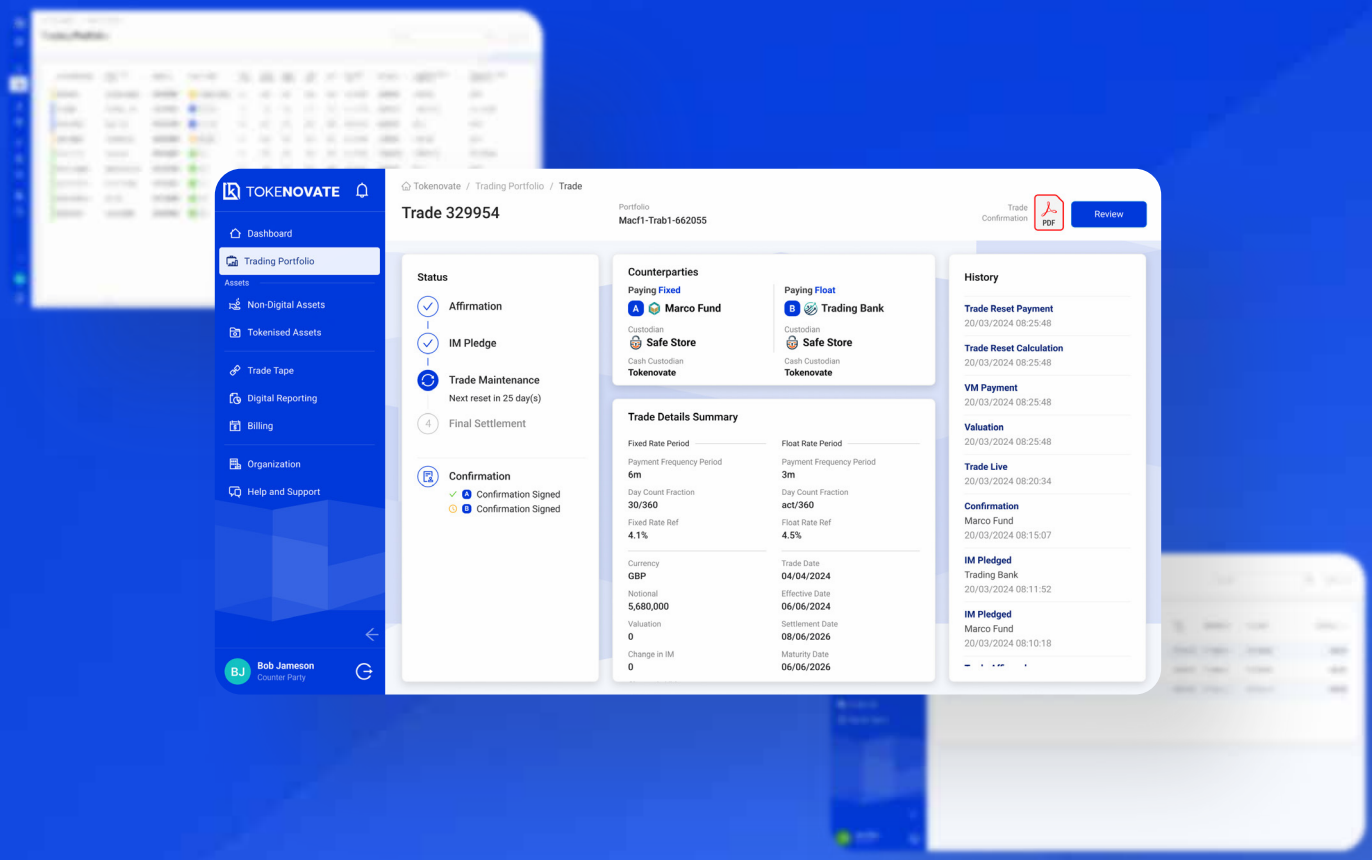

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On June 04, 2025, Tokenovate and Future of Finance co-hosted a half-day event at the City of London Club, titled Exploring Blockchain's Real Impact on Securities Finance, Collateral Management and the Repo Market. The event attracted more than 120 attendees from banks, asset management companies, market infrastructure, law firms, industry associations, Fin-Techs and consultants. This is an edited summary of the discussions that took place.

Introduction

These discussions will assess how the application of distributed ledger technology (DLT) and use of tokenised collateral will impact the securities lending and financing markets.

Proponents have claimed that this innovation may extend access for market participants to a wider range of counterparties and enable firms to mobilise a wider range of collateral drawing on traditional and digital asset inventory.

In this half-day event, we intend to road test these arguments. If this does enable market participants to employ new types of collateral in secured financing transactions, how will this be treated by counterparties from a collateral eligibility perspective?

- How effectively will it meet their requirements in terms of credit quality and liquidity? And in terms of legal enforceability?
- What will be the implications for collateral re-use or rehypothecation?
- What advantages will this provide in terms of timely and accurate pricing data ensuring that, as settlement moves intraday and closer to real-time, margin management and mark-to-market keep pace with this real-time world to ensure exposures are fully collateralised to the minute or second.

In the four panels, we examine the potential operational benefits and complexities coming out of this roadmap, recognising that in current TradFi frameworks we are often dealing with a chain of transactions where non-delivery for an upstream settlement may trigger a sequence of failures down the chain.

Intuitively, it seems that use of smart contracts and atomic settlements can help us to ease these bottlenecks. But what will this mean in practical terms – for managing returns and recalls in securities lending trades for example?

For the sell-side – and for bank intermediaries more widely – what potential do these innovations offer for squeezing greater capital efficiency from their lending and financing strategies? How far will these enable securities lending or funding mechanisms that improve on their TradFi equivalents in terms of balance sheet usage, in terms of collateral mobility and in terms of delivering end-to-end automation across the transaction lifecycle?

Keynote

Ciarán McGonagle's, Chief Legal and Product Officer at Tokenovate, Opening Remarks at Exploring Blockchain's Real Impact on Securities Finance, Collateral Management and the Repo Market

Good afternoon. I am Ciaràn McGonagle, Chief Legal and Product Officer at Tokenovate. Prior to joining my current role, I worked for six years at the International Swaps and Derivatives Association (ISDA), focusing on contractual and legal standards and their application to new technology in the derivatives market. More broadly, over the past 16 or 17 years I have held a range of different positions working in derivatives and capital markets in global banks and law firms.

Reflecting on the title of this event, Exploring Blockchain's Real Impact on Securities Financing and Collateral Management, there has been a high level of expectation over the past 10 years regarding the potential that blockchain offers in bringing higher levels of efficiency to financial markets, reducing reconciliation errors and providing the accuracy and convenience of a centralised digital record.

While there has been much enthusiasm and publicity around blockchain and its application to financial markets, many observers might have anticipated greater adoption by this stage in its evolution.

In a recent industry discussion, a contributor noted that blockchain is yet to have its ChatGPT moment. Since its launch, ChatGPT has been intuitive almost from day one, users have been able to deploy it relatively simply to their business and personal needs and it has had a defined impact very quickly on people's lives.

In contrast, with blockchain and tokenisation, we have not yet seen this fast and simple passage towards mass adoption. Many projects are still at a sandbox phase, with firms developing proof of concepts and testing out new proposals. While this development work is ongoing, the traditional financial infrastructure continues to operate largely as it has done. This seems to paint a negative picture – but one that captures the current reality.

However, I would like to present a more optimistic view of the potential offered by tokenisation and distributed ledger technology. In one of my favourite literary works, Ernest Hemingway's The Sun Also Rises, Mike is asked about the circumstances leading to his declaration of bankruptcy. "Bankruptcy came in two ways," he replied. "Gradually, then suddenly".

This logic also applies to the application of blockchain to financial markets. There has not yet been a sudden transformation, leading to mass implementation and transition to scale – and it was probably unrealistic to assume that would ever happen. However, we are now starting to see a gradual and powerful transformation regarding how the financial markets operate.

As a legal specialist, I would highlight several areas. One is the emergence of legal standards around the digital asset industry. If a case went to court 10 years ago involving cryptocurrencies, judges commonly found it hard to evaluate the claims from a legal perspective. Does a cryptocurrency constitute property? If it is property, what sets of rights does the digital asset afford? If it is not, how should the digital asset be represented legally and what are the practical implications for financial markets?

Although these questions have not been fully resolved, there has been significant progress in addressing problems of classification. There is now greater certainty from a legal perspective in terms how digital assets and smart contracts operate and the rights and obligations these engender. In turn, there has been detailed thought given to which types of tokenisation structures provide users with the legal certainty, and legal enforceability, that they expect.

From a regulatory perspective, the Markets in Cryptoassets Act (MiCA) in the European Union, and the HM Treasury proposals advanced in the UK in April, Regulatory Regime for Cryptoassets (Regulated Activities), provide a major step forwards in delivering greater certainty to providers in this market. The technology continues to mature and we see more innovation in tokenisation and artificial intelligence.

These advances are combining to create an inflexion point that offers the commercial drivers for greater adoption. One important feature is the push for standardisation built around the industry's growing application of the common domain model (CDM).

A second is the important advances in digital regulatory reporting (DRR) that have grown out of projects led by key trade associations and which are finding rising adoption by global banks and other market participants active in securities financing and derivatives trading. ISDA, for example, has run a comprehensive DRR project in collaboration with its members, providing a golden-source interpretation of each regulatory reporting rule set and using CDM to translate this mutualised version into machine-readable code.

At Tokenovate, we are building a post-trade transaction lifecycle automation platform for derivatives and SFTs. We are keen to ensure that everything that we are building is embedded within common standards. We use the common domain model, created by ISDA approximately 10 years ago and more recently made available to the industry via the FINOS open source community. We embed that model within our platform.

These are live implementations that are being implemented now. They may not appear to be eye-catching innovations from a revenue growth perspective, but they represent the hard yards that the leading foundations are putting in to establish robust solutions that will support the growth of their securities financing activities. This is key to support an industry that can – where appropriate – deploy real-world assets and digital assets as collateral and support its SFT and derivatives recordkeeping on a blend of TradFi, permissioned and permissionless blockchain infrastructure.

Panel 1

How is blockchain reshaping liquidity and collateral flows in securities lending and repo?

Panellists: Doug Bambrick, Head of the UK Custody Product for the UK and Middle East, BNP Paribas Securities Services; Basu Choudhury, Head of Partnerships and Alliances, OSTTRA; Yalini Isweran, Executive Director, Product Management at DTCC Digital Assets; Martin O'Connell, Solutions Architect, HQLA[x]

What problems does blockchain solve in the securities finance sector for lenders, borrowers and intermediaries?

One of the brightest opportunities lies in its potential to bring more assets as collateral into the securities finance markets. This will include assets sitting on permissioned networks – as natively-issued positions or as tokenised real-world assets issued off blockchain – potentially alongside assets held on public permissionless chains. This collateral set, as in the TradFi securities finance world, will be shaped by the collateral eligibility preferences of the collateral taker and the funding and financing needs of the collateral provider. It will not be purely a technology-driven decision.

In applying blockchain technology, its primary value lies as part of an ecosystem of interoperating DLT-based networks supporting a broad range of assets and providing efficient linkages between issuer, intermediary and investor. The objective, noted a panellist, is not to apply blockchain as a series of isolated and disconnected digital ledgers, but to harness the network benefits that such an ecosystem can deliver. Through this ecosystem of interoperating blockchain networks, participants may have access to a wider range of counterparties than they do in a traditional sec finance environment, and have opportunities to trade in markets and timezones that may be inaccessible to them today.

As one example, DTCC announced the release in April 2025 of a new blockchain-based digital collateral platform. This represents one of the core pillars of its digital ecosystem and is key to the organisation's ambitions to improve collateral mobility and to reduce collateral fragmentation. It proposes that the combination of distributed ledger technology, tokenised movements of collateral on either a delivery-versus-delivery (DvD) or a delivery-versus-payment (DvP) basis, and the use of smart contracts, provides a powerful opportunity to drive new efficiencies to collateral management.

As traditional and digital assets converge, the need to handle these asset types together in a hybrid collateral management environment will force intermediaries to reassess their business models, evaluating how they generate revenue in this new environment and how they adapt their product sets.

Is blockchain necessary to deliver these benefits?

This depends on the business case, but invariably the answer is no. However, blockchain provides a good technology foundation when building a platform to address some of the pressing business problems discussed at this conference.

A panellist noted that, over the past 5-6 years, firms have already confirmed that they can deliver robust, scalable platforms using DLT that bring greater efficiency to collateral transformation trades and to DvP financing of securities tokens against digital liquidity.

So, blockchain is not a requirement. But, for certain securities finance use cases, it is a useful tool to have in the toolbox.

Will the transition journey create a digital mirror of the model traditionally employed in the TradFi funding and financing world? Or follow a new path that bypasses the old mistakes and inefficiencies?

The transition will follow a new path when it can, learning lessons from the past and eliminating inefficiencies and mis-steps that have been taken in this TradFi evolution. But the securities finance industry has developed well-formed risk management practices, operational standards and means of doing business that have become established for good reason. Participants active in securities finance markets will wish to retain many of these elements that provide a sound foundation for sourcing liquidity, financing assets held in inventory and delivering an attractive additional source of risk-adjusted return on portfolio assets.

The transition is likely to be evolutionary rather than a big bang. Important advances may start in the post-trade area. Until there is certainty around settlement and full visibility around asset inventory and funding positions, it is difficult to establish a full securities financing ecosystem. Consequently, unlike some other transaction segments where innovation has been driven initially by the execution layer and has filtered downstream to post-trade processes, settlement finality, efficiency of collateral movement, management of recalls and returns and other post-trade considerations will be key in shaping this transition journey for securities finance.

Will this trigger disintermediation? Or 're-intermediation', with the entrance of new intermediaries while others are prompted to reconfigure or exit?

A panellist noted that these developments will present attractive opportunities for market intermediaries. For agent lenders, for example, this may enable them to deliver better value trades, matching the needs of lender and borrower more efficiently and at lower cost.

Triparty agents bring significant scale and efficiency to the securities financing marketplace currently, being major aggregators of collateral, offering access for lender and borrower to a wide range of counterparties, and providing powerful collateral optimisation capacity.

Consequently, it is important not to lose the value offered by the existing TradFi securities finance ecosystem – intermediated by a mature network of triparty collateral managers, agent lenders, custodians and other service vendors – simply to move growth over to digital.

As a custodian, the ability to support interoperability across blockchain networks and TradFi infrastructure is important since it will be supporting traditional real-world assets and digital assets simultaneously. A custodian will be required to provide a one-stop shop where clients can have a single consolidated view of their digital and traditional assets, with these holdings serviced through an integrated process.

As the market advances towards 24/7 collateral movements in a digital ecosystem, custodians will play a key role in supporting interoperability across triparty agents, central securities depositories and in connecting providers and takers of collateral and liquidity. They will continue to be a requirement for core asset servicing and safekeeping functions across real-world asset (RWA) and digital asset inventory, servicing assets across chains of collateral re-use, and potentially helping clients to meet liquidity requirements in tighter settlement timeframes.

By operating through a digital centralised book of record, panellists suggested that blockchain networks may offer greater flexibility for central counterparties (CCPs) to provide cross-product margining, and to deliver offset margining across CCPs. Offset margining can be complex to deliver in a TradFi environment for CCPs that operate as different legal entities, with different margin calculation methodologies and collateralisation practices, and with their own operational set ups. By centralising data and removing reconciliation errors, this will provide greater flexibility to support cross margining across clearing houses.

In this respect, the path to broader adoption lies in working with other market infrastructure to bring greater flexibility to the market for digital assets. Firms can start to tokenise, bringing RWAs into a digital ecosystem, ensuring common standards around how they tokenise and encouraging cross-jurisdiction acceptance of these assets.

“With this digital transition, we are unlikely to remain as the plumbers of the financial services industry,” says a panellist. “Those functions, at least in part, will be taken over by the technology. However, there is great value through collaboration between financial infrastructure providers and intermediaries in shaping this digital future, ensuring that we can work through common standards, maximising end-to-end automation across the transaction lifecycle and applying the benefits of this new environment to develop new business opportunities.”

Panel 2

How can Tokenisation Unlock New Opportunities in Traditional Financing? What will the Future Look Like?

Panellists: Adrian Dale, Head of Regulation & Market Practice at the International Securities Lending Association (ISLA); Marcus van Abbé, Head of Digital Market Infrastructure at R3; Steve Whyman, European Commercial Head of Digital Asset Funds and Business at Apex; Roy Zimmerhansl, Partner and Head of Capital Markets, WTS Hansuke

Securities finance has confronted longstanding problems of collateral mobility and collateral fragmentation. What can tokenisation deliver to address these constraints?

An attractive feature of tokenised settlement is that it may provide access to the inaccessible – enabling real-world assets to be used for collateralisation that are currently hard to mobilise in a traditional finance environment. A number of solutions have been released, enabling use of tokenised money-market funds (MMFs) as collateral to source digital liquidity. Industry working groups have discussed potential for use of tokenised commercial real estate and a range of other real-world assets for collateral purposes.

More broadly, atomic settlement offers the potential to reduce counterparty risk and to improve collateral mobility and collateral velocity – accelerating collateral transfers and reducing the time that collateral is tied up between one location and another. As we have noted, this is likely to drive changes in how triparty, CSDs and CCPs work together within a collateral ecosystem supporting movement of real-world assets and digital assets as collateral.

The availability of new types of collateral will solve a problem in cases where there is a potential shortage of collateral. But this is contingent on collateral takers being willing to accept digital assets as eligible collateral.

To do so, the collateral taker should be confident that it can sell the collateral without loss of value, or be willing to retain the collateral, should the collateral giver fail to repay. Inter alia, this will be contingent on asset type and credit quality, liquidity, price volatility and the availability of timely mark-to-market pricing. The asset should be enforceable as collateral under relevant legal frameworks and it should meet the standards set for eligible collateral under relevant financial regulations.

A panellist referred to a paper he had written 12 years ago addressing potential for wider use of exchange-traded funds (ETFs) as eligible collateral. But, despite being relatively liquid and priced intraday, many collateral takers remain unwilling to accept ETFs within their collateral eligibility criteria.

Tokenisation of relatively illiquid real-world assets may provide the technical and operational means to deploy these hard-to-mobilise assets as collateral. But these assets will need to fulfil a wider set of eligibility criteria applied by the collateral receiver if they are to be used more widely in secured transactions. This is not a technology issue, it is a human choice issue. It is about business culture and the standards enforced by an organisation's credit department, risk committee and trading teams in terms of what quality of collateral it will accept.

Significantly, attendees at the conference noted in discussion that counterparties were currently posting cryptocurrencies and stablecoins as part of their margin requirements in some bilateral relationships. One participating firm indicated that digital assets already form a small but noteworthy component of customers' eligible collateral sets deployed in its bilateral OTC collateral and margin service.

Progress from proof of concept to launch to building scale has been relatively slow for some blockchain-based product releases we have seen. Are potential buyers currently focused on other priorities?

While the opportunities presented by tokenisation are widely discussed in digital asset working groups and conferences, the focus of a firm's development strategy – and its related budgeting decisions – are typically much more immediate. A consultant to the securities finance industry, with many decades of experience, noted that it is rare for clients to be paying for consultancy advice to solve problems five or seven years from now. Rather, clients are focused on today's problems that they need to solve here and now.

So, in sum, resource prioritisation tends to be relatively short-term in nature. Firms are committed to solving today's problems, seeking solutions that are easy to implement and to adopt into ongoing business processes. In many cases – but not all – firms are agnostic to whether a solution employs DLT or other technologies. They want a solution that works, that is cost-effective and, typically, one that has an established track record of reliability.

Notwithstanding, the securities finance industry must continue to innovate and to evolve in line with the changing needs of its user communities. If it fails to do so, reducing costs and speeding up its processing, then it will lose its market to other alternatives. Swaps and synthetic routes to market already offer advantages in terms of capital efficiency. If it is operationally expensive, the securities finance industry in its current form will be consigned to history.

What will be the impact of accelerated settlement in the EU and UK?

The challenges of managing intraday liquidity – and of moving transaction settlement progressively closer to real-time – typically lie in questions of data accuracy and reconciliation.

In fundamental terms, blockchain is a means to manage data across networks. In exploring competing drivers for blockchain adoption, one has been the drive for accelerated settlement and the potential benefits that blockchain can deliver in providing a centralised record of ownership. A second driver is a broad suite of regulatory changes, including the Securities Financing Transactions Regulation and the Settlement Discipline Regime provisions in the Central Securities Depositories Regulation, imposing a requirement for improved settlement efficiency and accuracy in settlement reporting.

As the EU and the UK move to T+1 settlement, scheduled for migration on 11 October 2027, demand for intraday liquidity is expected to rise in parallel with this transition. Trades that were previously batch settled in a T+2 environment, with the benefit of netting to reduce liquidity needs, may no longer pass through a netting cycle in a T+1 regime – and this will generate demand for additional intraday liquidity to ensure timely and efficient settlement.

In this context, intraday repo is likely to play an important role in easing these liquidity pressures. While SFTs do not fall directly into scope of the T+1 transition, given the exemption granted by the European Council in May 2025, they will play a role in making T+1 effective – for example through intraday liquidity support and fails coverage.

In meeting this demand, a number of banks and service vendors have demonstrated their ability to deliver DvP transfer of tokenised collateral against digital liquidity.

Does this offer new opportunities for buy-side firms ?

Asset management firms have been challenged for many years with how to grow their assets under management, to extend their distribution reach and to reduce the cost of distribution. These are integral to the buy-side's fight to enhance profitability against a background of fee compression.

DLT networks have been advanced for at least a decade as a potential solution, enabling buy-side firms to issue fund products 'natively' on chain, or to tokenise real-world assets issued off chain, and then to distribute cheaply and efficiently to a large pool of potential customers. However, we are not there yet and there is still much work to be done to apply blockchain effectively for achieving these objectives.

Panel 3

How are public blockchains and smart contracts revolutionising financial processes?

Panellists: Ciarán McGonagle, Chief Legal and Product Officer, Tokenovate; Steve Whyman, European Commercial Head of Digital Asset Funds and Business, Apex

In simple terms, financial products may be viewed as bundles of rights and obligations governed by conditional logic. What are the challenges in capturing these rights and obligations digitally in a smart contract and using this to deliver event-driven automation?

A transaction – whether a securities lending trade, a repurchase agreement or a derivatives contract – is conducted on the basis of agreed contractual obligations between counterparties. These involve an obligation to pay or deliver a specified asset at a given time and a corresponding right to receive that asset. Pre- and post-trade arrangements exist to manage the ongoing risks associated with fulfilling those legal rights and obligations, including legal and regulatory risk associated with characterisation of the asset, along with market risk, settlement risk, credit and credit valuation adjustment (CVA) risks.

Conditional logic statements define a chain of action where if one event happens, a specified action or chain of actions will follow. Financial products can be distilled down into such a set of conditional logic statements. As a technology, DLT and smart contracts are typically well suited to managing this type of sequential logic.

Settlement failures in a TradFi environment often result from the failure of an upstream delivery in a chain of transactions. Can DLT and smart contracts help to address this?

This simplification comes with a caveat. If financial processes were linear and always followed conditional logic statements, the argument would stand up well. However, experience tells us that there are regular exceptions. In securities financing transactions, trade settlement may be delayed by non-delivery of the required securities. In current TradFi frameworks we are often dealing with a chain of transactions where non-delivery for an upstream settlement may trigger a sequence of failures down the chain.

Reflecting on his earlier career as a repo and bond trader, a panellist recounts how the delivering party is typically required to make a "reasonable effort to source". This could result in a significant delay in delivery of the required securities, sometimes up to 90 days. This good-faith effort to fulfil the obligation does not align well with use of smart contracts.

Do additional complexities present themselves when managing collateral re-use of tokenised securities?

This will depend on the implementation, but in most cases it does not present significant issues. Tokenised settlement will involve transfer of ownership of a tokenised securities against payment, in a DvP settlement, or against another security, in case of DvD settlement. The key point is that tokenisation does not change fundamental characteristics of the underlying asset. A government bond remains a government bond when a token has been created that references that asset. If this bond is eligible for collateral purposes, it is likely to continue to be classified as eligible in its tokenised form.

What refinements need to be made to model legal agreements such as the GMRA and GMSLA to support lending and financing of digital assets?

Referring to the discussion above, we started with a deliberately simplified analysis based on conditional logic statements. This is a simplification because, as we have established, there is an overlay to this logic – there are considerations of reasonableness and broader and more complex considerations within contracts agreed between counterparties. So there is still work to be done to create better digital models for those agreements.

The trade associations have done important work in preparing model legal agreements and in coordinating dialogue with key industry stakeholders. The International Swaps and Derivatives Association (ISDA) has created data taxonomies for all their contracts and the International Capital Markets Association (ICMA) has coordinated the creation of the General Master Repo Agreement (GMRA) for repo contracts. ISLA has driven work to deliver the General Master Securities Lending Agreement (GMSLA) and its twin, the GMSLA Securities Interest, for pledge transactions.

Industry working groups, including the Common Domain Model (CDM) Tokenised Assets Working Group, have begun remodelling those provisions within the CDM such that, as trade lifecycle events are automated within smart contracts, there is a high level of assurance that these do represent faithful reproductions of the obligations sitting within the legal agreements. This is powerful since it can serve as the domain language model for all of this innovation across the market.

Change will come in this area, but it will take time. There is a commitment to homogenising data and data fields. But, in keeping with a long-established trope, firms are often willing to support standardisation initiatives when this involves standardisation on their own terms and in accordance with their existing modes of operation. When the standardisation process involves major changes to their existing operational models and business practices, firms invariably take longer to align.

For DLT to be successful in securities finance, it is important to have a domain–specific language model that describes trade events in a standardised way. CDM largely fulfills this requirement and adoption is now accelerating. The CDM code was integrated into the FINOS open-source repository in 2023, enabling users to deploy CDM in their own applications on an open-source basis.

What challenges are involved in building connections between private blockchain networks and connecting these to the large public DeFI ecosystem?

There are a lot of opportunities available. Although blockchain pioneers probably envisaged operating via a single centralised blockchain, that will probably never happen. The industry will be working with a multi-chain world for the foreseeable future, involving a mix of permissioned and permissionless blockchains, and that will require having bridging mechanisms to make these networks interoperable.

With regard to the challenges of locking and minting coins, and of transferring those assets from one blockchain to another, the Law Commission paper, Digital Assets, raises questions around the characterisation of those assets. If you create a token on one blockchain and you wish to bridge it into another blockchain, then in practice it is likely that you would lock the asset on Blockchain A through some kind of smart contract. You would then create a new asset on Blockchain B which would link back cryptographically. This creates dual assets which purport to represent the same interest. The smart contract is effectively holding an asset in custody, permitting a token referencing that asset to be traded on another blockchain.

Panel 4

How are regulators adapting to accommodate blockchain-based solutions in securities financing and collateral management?

Panellists: John Allan, Head of the Innovation and Operations Unit at the Investment Association; Romin Dabir, Partner, Financial Services and Regulation, Reed Smith; Anna Matson, EMEA Head of Digital Assets and Innovation, Northern Trust

Is there a challenge in making digital asset regulation fit within, or alongside, the existing TradFi rulebook?

In the European Union and the UK, that question has been pretty much settled. Digital assets are firmly regarded within the scope of financial services regulation, although there can sometimes be difficulties in clarifying whether an instrument is a financial instrument or a specified investment.

In the UK, a financial instrument is a portmanteau term embracing a wide range of assets and contracts with financial value. A specified investment is a more specific category of financial instrument that is subject to regulatory requirements under the Financial Services and Markets Act 2000 (Regulated Activities) Order (RAO). Amendments to the RAO under 'Part 2' creates new categories of specified investment and related specified activities for cryptoassets.

In the EU, the Markets in CryptoAssets Regulation (MICAR) regulates assets that are not already in scope of existing EU financial services legislation. This includes asset-referenced tokens, e-money tokens and a wider family of "other cryptoassets". Some categories of cryptoasset are exempt, including assets that are not transferable or those that are only accepted by the issuer.

In which areas do industry working groups and trade associations need to liaise most actively with regulators to deliver safety and efficiency alongside flexibility to innovate?

This is an important balance. For industry associations, the aim is to provide a safe space and convening power such that regulators can get the information that they require from the industry. This is important to ensure that their interventions have maximum impact and can be applied by the majority of industry participants.

There are multiple examples of how this has worked successfully in the past. For example, the Investment Association has worked with HM Treasury and the Financial Conduct Authority to prepare the conditions for investment management companies to utilise blockchain in their investment administration and operations.

There is considerably more than can be done. The areas of anti-money laundering (AML) and know-your-customer (KYC) are constantly in focus, whether for onboarding of funds, custody and collateral use cases. Digital ID has been highly topical with policy makers across the world.

Industry associations play a key role in bringing together the industry and policy makers across their areas of expertise. But there is a requirement to provide greater coordination at supranational level to ensure that work is happening globally to enable firms to innovate with confidence, knowing that the regulators are on board with the direction in which this innovation is moving.

Which areas are most pertinent currently in this work with policymakers?

Discussions are currently ongoing about the potential use of public permissioned blockchains. Currently DLT-based activities in the investment funds industry are hosted principally on private permissioned blockchains. Some buy-side firms would welcome a wider range of options in this area. Discussions are also ongoing across jurisdictions on AML and KYC. There is likely to be more news around this issue in the coming months.

In the EU, the regulators have released a significant body of guidance on where the perimeter between TradFi and DeFi lies and how a cryptoasset should be characterised. However, the digital asset industry is still at a relatively early stage in its development and this does not make it easy for policymakers and financial regulators that are trying, as far as possible, to future proof at the drafting stage. The technology is advancing quickly, such that within a few years rules that are introduced now may not be fit for purpose. Regulators are doing their best, through consultation with industry participants, to anticipate these changes and to minimise the requirement for constant rewrites.

The UK's approach is to draft changes into the existing regulatory regime. This is important in expanding the rulebook to cover the transaction lifecycle for cryptoassets. It also has wider implications for regulated activity for non-cryptoassets in cases where there is equivalent activity.

How should digital innovation be applied to make banks more capital efficient and to reduce the regulatory capital cost associated with SFTs?

The potential here is enormous. As regulators gain greater transparency regarding which institutions are holding which assets, this will enable them to regulate for regulatory capital in real-time, rather than having a blunt set of rules that are not sufficiently agile to align with the real-time risks that an organisation is actually facing.

This is a case of moving from just-in-case regulatory provisions to just-in-time. The more accuracy you have in your models or data, the more this provides a strong foundation for trust.

For some categories of cryptoassets (Group 2b cryptoassets under the Basel framework), risk weights are applied at 1250% on the absolute value of aggregate long or short positions. Consequently, banks have strong incentive to apply trading strategies and business practices that squeeze maximum efficiency out of their balance sheet usage, including that tied up in funding and financing activities.

Financial regulators, and multilateral agencies such as the Bank of International Settlements, have created innovation hubs designed to nurture digital innovation projects. Where are these delivering benefits in the securities finance area?

These innovation hubs have in many cases provided a supportive environment in enabling participants to experiment with technology in a digital sandbox. This enables project owners to explore what is possible with the latest technology and standards, while allowing them to modify or disapply elements of live legislation for the purposes of testing their innovations under different regulatory conditions.

The UK's Digital Securities Sandbox was established in January 2024 under powers granted to HM Treasury under the Financial Services and Markets Act 2023, forming part of a package designed to promote the UK as a global hub for cryptoassets and investments. The Digital Gilt Instrument project (DIGIT) – perhaps its flagship project to date – was announced on 14 November 2024 and has attracted significant interest in laying the foundations for government debt

issuance on chain, potential applications of digital gilts for collateralisation purposes, and as a stimulus for wider adoption of DLT-infrastructure in UK capital markets.

The EU DLT Pilot was launched in March 2023 and provides a legal framework for trading and settling transactions in cryptoassets that qualify as financial instruments under the Second Markets in Financial Instruments Directive (MiFID II). This sets out the rule book for forming DLT-based multilateral facilities (MTFs), trading and settlement systems.

The interaction between industry and regulators is clearly hugely important on both sides. Regulators can only interact with the industry effectively when they know where the core problems lie and the issues that are most urgent. This provides reassurance for the industry that they are able to research their innovation ideas in a supportive environment, to test these inside or outside of a regulatory sandbox, and then to deploy with confidence.

What take-home messages do you have for our audience that emerge from this discussion?

Firms must be constantly adapting today's business models to the proposals that will be taking effect tomorrow. When this throws up problems, they must make their views known to the industry associations and the regulator. By the time that rule changes hit the statute book, it will already be too late to complain that these are inappropriate or ill-designed. So stay engaged. Organisations must not do this in a siloed way, but by having representatives from different areas of the business. It is insufficient just to leave this to the General Counsel or to the Compliance Officer.

In parallel with engagement, the other key priority is education. Engagement and education provide the foundation for advocacy – and firms should be embracing advocacy as an integral part of their daily business.

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