What does the integration of blockchain mean for mutual funds?

As fund managers look to enhance networks already in place, it is important to remember everyone is in their blockchain research and development phase

By Pete Cherecwich, President of Global Funds Services at Northern Trust

An analogy: 40 years ago, everyone recognized that video cassettes were a transformational innovation – but no one who bought a Betamax player in 1976 knew that VHS would own 90% of the market just 10 years later. Is blockchain Betamax or VHS? Did we jump straight to DVD or even streaming technology? Only time will tell, but in either event we will be working with our clients and the industry to prepare for the inevitable changes to come.

Blockchain is not a new topic for the financial services industry, as many banks and financial institutions have been exploring both bitcoin and blockchain for years. It is, however, an evolving technology that may help the mutual fund industry streamline its operational procedures in the near future.

As fund managers look to enhance networks already in place, it is important to remember everyone is in their blockchain research and development phase. While many agree there is a lot of potential for the technology, the industry doesn't quite understand yet what specific problems blockchain might ultimately solve. Collaboration is therefore imperative at this stage.

According to news reports, mutual fund operators Schroders Investment Management and Aberdeen Asset Management have set up a new program that will test blockchain in a trading environment, with the intention of reducing operating costs. It is the first time asset managers have come together to experiment with blockchain.

At Northern Trust, we started investigating how we might use blockchain technology 18 months ago while completing a proof-of-concept as part of the R3 CEV Banking Consortium. We have since been working to understand how the technology may effect cash and securities transactional movements, asset servicing and ledger distribution.

Private equity serves as a good use case. For example, an investor may have invested in a private equity infrastructure fund. In order to facilitate the private equity investment, many parties are involved in passing manual documentation back and forth. Blockchain has the potential to automate the sharing of documentation and reduce operating costs for the fund. But in order for the technology to be transformative, multiple people must be connected to a single transaction at one time.

This kind of collaborative technology will also allow multiple parties to add information without altering the record or requiring a central authority. Thanks to blockchain's built-in encryption, the information can be shared instantly and securely, which will increase trust between counterparties as well as reduce the need for a central ledger. This is important to regulators as they continue to look for client protections around investment transparency.

When it comes to transactional movements, a blockchain-based system may allow for better tracking when both cash and securities change hands. In addition to simplification, it will also reduce the possibility for human error or tampering. Ultimately, it may allow mutual funds to reduce their operational costs.

According to one report, blockchain might not only streamline the clearing and settlement of cash securities, but also save the financial services industry $6 billion a year globally, including $2bn in the US alone.

We are cautiously optimistic about blockchain's potential to change the mutual fund industry for the better over the next five to 10 years. At the same time, it's important to recognize that while blockchain is a promising technology – Deloitte has called it "game-changing" – we know that the industry must coalesce around one standard and that means both the technology and the underlying data to support it.

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