A Practical View of Digital Assets for Bond Traders

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I wouldn't call myself a crypto skeptic. I fully appreciate the opportunities presented by distributed ledgers, smart contracts, Ethereum, and even some cryptocurrencies. Further, creating new infrastructures that allow institutions to trade cryptocurrencies safely or a new market structure that provides liquidity and transparency to private markets is smart. But I believe some of the ideas being thrown around to "transform" and "revolutionize" existing parts of the capital markets are solutions in search of a problem.

More Liquid and Transparent Markets

Nevertheless, traditional capital markets professionals trading and working around centuries-old products like stocks and bonds shouldn't completely write off the impact these innovations can have over time. We don't need to scrap hundreds of years of market evolution to create something brand new, nor should the potential of digital assets and the ecosystems that support them be thought of that way.

I'd suggest we think of distributed ledgers, smart contracts and all of their cousins not as innovations poised to take over capital markets, but as new technologies that, over time, will play a role in helping markets to become more liquid and more transparent—just as cloud computing and unstructured-data databases have already done.

DLT-Enabled Issuance

For instance, I was intrigued by the recent issuance of bonds in Europe on the Ethereum blockchain (one of the biggest distributed ledgers). It was interesting because it wasn't just some tiny company doing a tiny offering because it makes for a good press release. Instead, it was a real firm (European Investment Bank) borrowing real money (€100 million)—they just happened to record the deal on Ethereum.

A solution in search of a problem? Maybe. Relational databases have gotten us this far, after all. But one of the biggest challenges facing global bond market investors and liquidity providers is knowing where to find the bonds you want to sell or who holds them when you want to buy.

Billions of dollars have been poured into AI and all manners of analytics to provide informed suggestions to traders looking to buy or sell bonds. Ethereum, at least in theory, could eliminate most if not all of that, acting as a golden source repository of bond issuance and ownership. Furthermore, a host of lending solutions have been introduced that come with intriguing business models and technology underpinnings (albeit mostly retail-focused). And if global regulators can put guardrails around stablecoins – digital representations of real US Dollars and other hard assets – lending and borrowing in this decentralized world could start to look more interesting.

I know what you're thinking. Moving all issuance and trading of corporate bonds or U.S. Treasuries onto Ethereum is nuts and will never happen. While the last 20 years have taught me never to say never, you're probably right. Even so, if this new form of issuance proves cheaper and easier, regulators approve (which is no small assumption), and more issuers borrow this way, there is no reason DLT-enabled bond issuances can't grow.

These bonds could still trade on the traditional bond-trading platforms. All that would be needed is a different settlement workflow that sends the transaction to Ethereum rather than traditional settlement mechanisms (again, no small assumption). Heck, the traditional settlement systems could even take on the task of routing to Ethereum themselves.

A Better Way or Just Buzz?

What I and the market still need to better understand is whether this new way is a better way or simply a new way that is appealing because it's based on buzz-worthy technology. Despite the valuations of digital-asset-related companies worldwide, I don't think anyone really knows the answer yet. But the existence of SEC approved 40 Act bond funds launched via Ethereum show the rubber is starting to meet the road.

What we do know for sure is that completely ignoring these technological advancements isn't a good idea. Markets don't tend to evolve quickly, but they most certainly do evolve. And history has shown that some of the biggest winners of the past 20 years started their journey being told, "It's never going to work."

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