



Blockchain technology holds the key to transforming the asset management industry.

The key to transforming the asset management industry

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Technology-regulated and -operated investment funds promise lower fees, higher transparency, more choice and better security. These funds could transform the asset management industry, forecast the Multichain Asset Managers Association (MAMA).

Technology-regulated and -operated investment funds (TROIFs) are a type of investment fund which is entirely created, operated, audited and regulated by blockchain technology, in a fully automated way. They are investment vehicles for which all parameters relating to risk, benchmarking, liquidity, the universe of investment assets, fee scheduling, legal requirements and so on are coded into «smart contracts» or «smart protocols», and all transactions are stored on a blockchain. In the future, all financial assets and investment products – such as equities, gold, real estate and diamonds – will be tokenized and when that happens, blockchain-based asset management will provide the best investment vehicles for both crypto and traditional, real-world assets. In what follows, we outline

some of the benefits of TROIFs and highlight a number of challenges going forward.

A more secure and transparent trading environment
TROIFs, and crypto traders more generally, benefit from vastly improved trading conditions in terms of speed, security and transparency. Peer-to-peer transfer of crypto-assets is now possible using nothing but a precoded smart contract or protocol. In contrast to traditional trading, there is no need for clearing or settlement and no need for custodians to transfer physical ownership titles from selling parties' custodians to buyers' custodians. With crypto trading, everything happens in a matter of seconds. Apart from significantly lowering costs, this also

has an impact on risk management; since transactions are settled (almost) instantaneously, it is possible to manage risks on a real-time basis rather than after the fact (ex post).

Secure automation of fund operations

Using blockchain technology, TROIFs can securely automate the vast majority of fund operations and risk management using smart contracts. For example, the calculation and distribution of management and performance fees can be coded into a smart contract and take place automatically. Smart contracts could also help automate both tax assessment and collection. Blockchain accounting through a user's wallet or fund address can be used to accurately determine financial gains or losses, and solutions like bear.tax exist to help users customize calculations according to their jurisdictions. In addition, a by-product of running an investment fund entirely on a blockchain is that users will benefit from blockchain accounting and be able to reliably account for all trades and track records fully and transparently.

Investors maintain control and custody of their wallets

Many countries require investment funds to employ custodians and fund administrators. While this makes sense for traditional asset management, it creates complex issues for crypto managers since holding assets or private keys

with qualified custodians and centralized exchanges offers little to no security for investors and simply creates a counterparty risk instead. TROIFs allow investors to maintain control and custody of their own wallets thereby making the requirement for a fund custodian obsolete.

One example is the Melon protocol. When a client subscribes to a fund using Melon, a fund contract creates new tokens in that fund and automatically sends them back to the investor's wallet address. These tokens are redeemable at any time for the underlying assets in the fund. The blockchain only ever recognizes the original investor as the owner of the underlying assets. So, by subscribing to the fund, the investor has simply given their permission to someone to manage their funds within a set of clearly defined parameters while retaining custody themselves. As such, the need for a third party custodian is eliminated.

Issues for TROIFs

One of the greatest challenges for TROIFs, and for crypto investors generally, is regulatory uncertainty. The tax and regulatory treatment of cryptocurrency investments is often unclear, and this presents problems in terms of maintaining fund compliance. Some tokens have governance or voting rights like traditional equity, others simply replace or track traditional financial assets, and others can be redeemed for services or products. As a result, a cryptocurrency might be

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a commodity, a security or a currency. This creates uncertainty for investors since each of these asset classes is treated differently for tax purposes, falls under different regulatory bodies and agencies, and usually requires separate measures for compliance. Another issue is the fragmented trading infrastructure for best-price execution. Best-price execution is a legal mandate that requires brokers to provide the most advantageous order execution for their customers. Brokers typically need to consider, track and document issues such as volatility, total volume available, price, liquidity, the number of markets examined, transaction type and size of order. While crypto trading is increasingly competitive, it remains a highly fragmented market. For example, there are currently 400 exchanges trading Bitcoin, and none of them have a leading market share. To truly achieve best-price execution, brokers need to aggregate prices from all the exchanges (both centralized and decentralized) in order to get a combined order book, which is not currently possible. However, teams like DEXY, Oasis Dex (with Oasis Direct) and Melonport are currently working on this issue and amalgamating the order books of decentralized exchanges to allow for dark pools (hidden orders) in order to encourage liquidity and help more accurate pricing. As liquidity improves, quality of execution will improve, and the ability to manipulate assets by bringing prices in from the outside via an oracle will diminish.

Conclusion

Blockchain technology, and TROIFs in particular, hold the key to transforming the asset management industry. Real-time auditing, investor reporting, portfolio transparency and other benefits of the blockchain directly address regulators' concerns about fraud, money laundering and even tax compliance. In addition, some of the largest barriers to entry for aspiring fund managers, such as start-up costs, administrator fees and other compliance costs, auditing and investor reporting services, could be mitigated or eliminated, allowing greater competition in the space and lower fees and charges to the investors themselves. For investors, TROIFs promise lower fees, higher transparency, more choice and better security. As such, the potential prize for investors, fund managers and regulators is significant.

Multichain Asset Managers Association (MAMA) is a non-profit trade body which represents asset management companies, investors, technology providers, service providers and ecosystem players interested in working towards a new vision for asset management using blockchain and other supporting decentralized technologies. <https://mama.global>



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