Growing pains?

Blockchain and digitisation are increasingly being incorporated into the securitisation process. **Claudia Lewis** explores the benefits and challenges that these new technologies represent.

Blockchain and digitisation are increasingly being incorporated into the securitisation process, with the aim of facilitating market efficiency. It is hoped that these new technologies will also help overcome some of the issues highlighted by the financial crisis and address new ones potentially still to come.

Traditional methods of conducting transactions are reliant on outdated technologies – such as email, excel and standard telephone calls – which throw up several challenges throughout the securitisation process. On top of this, the US CLO market, for instance, has more than doubled in size since the financial crisis and such growth demands either larger teams of people to conduct existing structures of business or fundamental changes in workflows to improve inefficiencies.

Octaura's digital CLO trading platform, for one, seeks to enhance the workflows of existing trading platforms *(SCI 14 June 2022)*. A principal aim of the platform is to reduce the BWIC auction process to 10-15 minutes by eliminating

John Pellew, Arrow Global

the telephone relay and providing users with integrated abilities to offer and receive instant feedback on a transaction.

Blockchain technology is also being adopted to address inefficiencies in the securitisation market. John Pellew, principal of distribution and securitisation at Arrow Global, argues that the use of digital technologies – including blockchain – can be a fundamental tool for addressing issues brought to light in 2008-2009.

"I would argue that difficult times like we saw in the financial crisis are actually the driver of changes like this and the introduction of new technologies like this too. Alongside this current blockchain movement, we are also seeing another potential economic crisis and while it's not for the same reasons as seen in 2008-2009, it could have the same impact on the macro environment," he says.

He continues: "When considering buying securitisations – or any other products that involve pools of underlying assets – you want to be sure that what you're buying is what you expect. Blockchain definitely gives you the ability to look into the data and be able to rely on the fact that data has not been manipulated once it has been put into the system."

The integration of data analytics is key for most digitisation strategies, as it helps to address matters of transparency and efficiency. Brightvine and Liquid Mortgage are examples of fintechs working to bring those benefits to securitisations through the use of blockchain – in their case, beginning with the mortgage space.

"We are currently focused on data and compliance – so we create underlying digital assets for every single loan we onboard," explains Ian Ferreira, Liquid Mortgage's founder and ceo.

At present, investors typically wait 55 days for loan-level reporting to be released for a given month, to check whether a borrower makes a payment. However, Liquid Mortgage can offer investors insight into payments on a daily basis, so investors can make more informed decisions.

By onboarding single loans and creating a digital asset replica that sits on the blockchain, contributors can add data and documentation to the asset while maintaining anonymity for the borrower, property and loan attributes. Further, Liquid Mortgage ingests servicer data on a daily basis and then replicates any payments from the previous day on-chain.

Ferreira states: "When you ingest information from multiple sources, all of the data is structured differently. What we are doing by putting it on the blockchain is creating structured data – meaning we, or other companies, can come in and build AI/ML or other analytical tools that sit on top of the blockchain."

Ian Ferreira, Liquid Mortgage

information directly to investors on a daily basis," comments Ferreira.

The firm perceives its role in the market as an intermediary between the 'real' world and the blockchain universe. "We post information on-chain and we also pull that information off of the blockchain for reporting purposes, so we really see ourselves as that intermediary where a traditional bank or asset manager doesn't want to have to deal with direct interaction," Ferreira adds.

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Thus far, Liquid Mortgage has been involved in eight different securitisations, six of which were prime jumbo and the other two single-family rental. "Because we are written into the securitisation itself as distributed ledger agent, we create all of the digital assets and capture payment data on the loan level, then report that

Meanwhile, Brightvine perceives itself as an instigator for fundamental structural changes. "It is going to take some time to get the entire traditional financial industry to move on to the blockchain, and anyone who is in this space is going to experience that whenever they are innovating. I think the main challenge right

Joe Vellanikaran, Brightvine

now is that we are dealing with the convergence of traditional finance with blockchain and distributed ledger technology – so there is just this inertia," says Joe Vellanikaran, ceo and founder of Brightvine.

Infrastructure is high on the list in terms of what the securitisation market needs, in order to support further digitisation. "In our industry, a lot of companies are focused on the origination side and not focused enough on post-close infrastructure. And that is the piece that is really broken and needs to be fixed," Ferreira observes.

Pellew agrees that there are many moving parts within the blockchain ecosystem. "A lot of it has to do with regulatory aspects," he explains. "But other parts of it have to do with the ecosystem and whether your counterparties are ready to deal with the complexities of holding digital assets."

He argues that the primary challenge facing the blockchain space remains the issue of interoperability. "The reality is that there are thousands of blockchains and thousands of permutations of blockchains, and at some point you have to accept that the ecosystem will not make a singular technology choice. From my experience, this misunderstanding is one of the biggest barriers I've encountered in the market – and is the thing stopping people from investing in blockchain. As a business, we should essentially be able to do a transaction into an interoperability network layer that would be able to connect to anybody that wants to do business with us, and we should be able to deliver our own digital assets, data, cash, origination across the network from anyone to anyone, and from anywhere to anywhere."

Another issue is resistance from both regulators and issuers. On the regulatory side, Ferreira suggests that it is not a question of regulators' openness to learning more, but rather the lack of regulatory clarity that exists for the blockchain market at present.

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He explains: "There is a hesitation from firms right now who are waiting for clarity from regulators on how digital assets should be treated. For example, are digital assets securities if they are backed by loans? Or if you fractionalise a loan-backed digital asset, does that mean you are creating a security? The large banks we have spoken with are open to tests and pilots right now, but full integration requires further clarity."

Meanwhile, some issuers believe they don't need to provide transparency, as bond investors currently don't require it. "Our theory is that once you get a critical mass of investors asking for the data or for processes to work a certain way, then everybody will be more open to change," Ferreira says.

Looking ahead, Liquid Mortgage is focused on onboarding loans earlier in their lifecycle – whether at origination, warehouse financing or diligence. "We have structured the business model to reduce risk from boom-and-bust origination cycles and to focus on solving problems at any point during the lifecycle of the loan," explains Ferreira. "We are having conversations with both new origination channels and firms invested in non-performing loans and reperforming loans because we can provide solutions to both."

He continues: "We believe a key point in the loan lifecycle sits with warehouse providers and therefore have focused conversations on these institutions to onboard loans at the point of financing. While warehouse providers play a key role in the non-agency market, our current focus, we believe this is also a way for us to move our technology into the agencies."

Vellanikaran is optimistic about growth in the use of blockchain in the structured finance market in the future. "I think everyone in structured finance is now aware of all the benefits of blockchain, so I think you're going to see over the next few years a movement with large institutions using blockchain systems that allows for the sharing of information like what we do at Brightvine. Our goal is to continue working with Angel Oak and other large issuers to put tokenised assets on Brightvine and work with getting all the stakeholders involved in the structured finance market to be using our platform," he concludes.

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