

# BLOCKCHAIN IN PRIVATE EQUITY

## A game-changer for funds

The fund administration space, especially for alternative assets, is ripe for change due to the typically manual nature of many processes. Certain types of fast-developing financial technology are being applied to the alternative asset markets. One such example is distributed ledger technology (DLT) or blockchain technology.

The excitement around DLT comes from its seamless, simultaneous integration of transactions, settlements and ledger updates directly between multiple parties. It creates a secure way to share information and conduct transactions without the need for a single, central party to approve them. In a private ledger, only authorized network members have the ability to see details of their own transactions, which provides confidentiality and privacy. All updates to the shared ledger are validated and recorded on all participants' shared ledgers, which drives accuracy and transparency. Because all updates to the ledger are unchangeable and auditable, network members can accurately trace their past activity.

Several firms, including Northern Trust, are actively engaged in DLT projects. In 2017, Northern Trust launched its DLT solution for private equity, which represented the first commercial deployment of blockchain technology for this market.

Northern Trust considered DLT to be the right technology for this development as it brings a range of positive improvements, such as:

- Improved transactional efficiency, reduced reconciliations, shortened settlement cycles and easier management of liquidity requirements;
- Creation of standard business processes, contract execution and electronic documentation when combined with smart contracts (self-executing computer programs that only run if certain conditions have been met);
- Another line of defence to combat fraudulent activity through transaction encryption and improved identity validation (e.g. 'know your customer'/anti-money laundering) on top of the existing security measures;
- More accurate and timely reporting for business and regulatory purposes through a shared ledger containing commonly validated, unalterable records;
- Storing encrypted data securely in the 'cloud', while maintaining the integrity of the host jurisdiction by using locally stored 'keys' required to decrypt the data.

Since its launch, Northern Trust has been enhancing the product to fully automate different private equity lifecycle events.



## ANTHONY STEVENS

Northern Trust

The end-to-end automation of capital calls is a good example of the way Northern Trust has put the right information in the hands of the user. As the diagram on the following page shows:

- The investment advisor recommends and issues the call.
- The call is passed to the administrator for checking.
- A set of messages are sent to the general partner (GP) board members and, if required, a board meeting is automatically set up and its outcomes are tracked. Options are available for the GP to approve the call either at the time or at a later date. The approval to allow this to happen is captured on the ledger.
- After board approval, an anti-money-laundering check and other relevant compliance checks are carried out on each limited partner (LP).
- On capturing the correct compliance responses, the call notice is issued to the LP.
- The LP's bank accounts are linked to the application to automate the payment process.

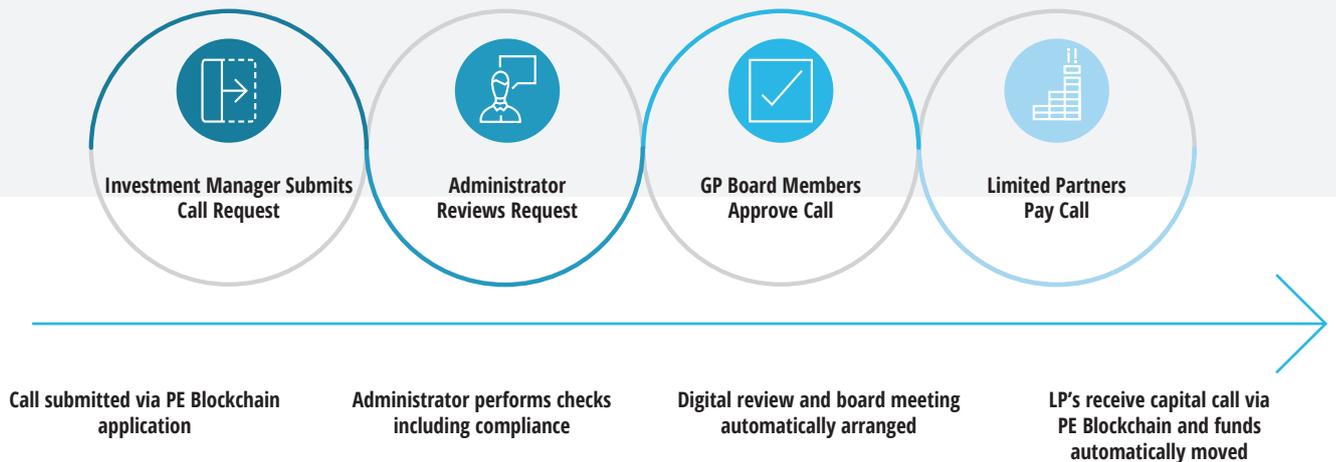
The use of workflow, digitalization and DLT speeds up the call process, provides the investment advisor with full transparency and allows the audit firms to audit in real time, directly from data nodes residing within their own offices.

From an administration perspective this may improve operational efficiency by as much as 50%.<sup>1</sup> Equally important is the clarity that DLT brings at every stage: all the participants that have the permission have a real-time view of the call to see:

- Where it is in the process;
- How long it has been at a particular point;
- Who is required to provide an approval; and
- Which investors have paid the call and which are outstanding.

<sup>1</sup>Source: Northern Trust July 2018.

Fully Automated End-to-End Capital Call Lifecycle Management



Many leading financial services firms now recognize that DLT has evolved to the stage where it could help overhaul and reshape traditional industry structures and operating models. The industry sees value in the unique combination of distributed shared ledgers, permissioned trusted networks, immutable encrypted records, data privacy, confidentiality and real-time transaction settlement.

Because many of its benefits and opportunities can only be realized through collaboration, DLT has triggered an unprecedented level of financial services industry cooperation

involving investment banks, global custodians, asset managers, exchanges, clearing houses, central banks and regulators. These institutions – together with industry bodies, consortia and trade associations – are actively studying how to leverage DLT.

Over time, we expect that as a result of these collaborations, blockchain and other technologies will evolve and will lead to increased efficiencies and improvements in the fund's total expense ratios, thereby improving the returns that the investors in this asset class may be able to generate.

## ANTHONY STEVENS, HEAD OF ASSET SERVICING PRODUCT INNOVATION, NORTHERN TRUST

Anthony has worked in the financial services industry for 17 years and joined Northern Trust in October 2007. He manages the Product Innovation Group, which is responsible for developing new products, keeping the business up to date with technology changes in both the financial and non-financial markets, as well as looking to access new external technologies and services that will enhance our clients' investment management processes. Anthony is also the product owner for the Private Equity Blockchain product and responsible for the ongoing development of that ecosystem.

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