

First Securities Lending Transaction Using Blockchain Technology Completed

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It was reported this month that ING Groep NV and a major international bank recently completed the first live securities lending transaction settled using distributed ledger technology ("DLT"). The transaction involved the banks swapping baskets of government securities through a collateral lending application from financial technology company HQLAx built using bank consortium R3's Corda DLT. Securities lending transactions involve the temporary exchange of securities (including legal title), usually for other securities or cash of an equivalent value, with an obligation to redeliver a like quantity of the same securities at a future date.

Currently, securities lending transactions require the transfer of underlying securities between party accounts. For this transaction, the banks agreed to transfer legal title to baskets of government securities on the DLT platform by transferring ownership of HQLAx Digital Collateral Records ("DCRs"), while the underlying securities were held at a third-party custodian. According to HQLAx, DCRs created using Corda allow market participants to exchange legal title ownership of and/or pledge baskets of securities in real-time using standardized legal documentation and "haircuts". Each DCR is intended to be backed by pre-defined baskets of eligible collateral which are stored for safekeeping in a segregated custody account at a trusted third-party custodian. The creator of each DCR has an obligation to maintain securities in the DCR custody account equal to or greater than the notional value of the DCR.

The lynchpin of the transaction is reliance on DCRs to effect legal title transfer of the underlying securities that comprise the DCRs, thereby facilitating liquidity transfers without the requirement to actually move the underlying securities through the custodian infrastructure. The importance of the transfer of legal title is twofold. First, it allows the borrower to deliver the securities onward, for example to settle a short trade. Second, it means that the lender generally receives value in exchange for the disposition of legal title (whether in cash or securities), which ensures that the loan is collateralized.

While HQLAx noted that this was only a pilot transaction, it represents an important milestone and HQLAx is targeting the end of 2018 for rollout of a production-ready securities lending platform.