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# Blockchain Transferred Funds (BTFs): The new frontier for investment funds

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Innovative technologies have impacted and advanced many industries, yet their integration into financial services products, processes, and infrastructure has been less frequent. The global institutional asset management industry is a US\$100 trillion behemoth that has traditionally been impervious to new technology adoption mainly due to the significant advantage of legacy technology and strict regulation. Securities markets, in particular, are vast and complex ecosystems of interconnected participants, regulators, and service providers. Because the parties depend on each other to maintain a harmonious balance, the evolution of investment structures and funds is often sluggish, and it is challenging to effect substantive change.

## A changing of the guard

Blockchain technology introduces a compelling value proposition that gives the industry the tools and the impetus to improve upon traditional, often antiquated methods. Blockchain's decentralised and distributed technology offers peer-to-peer transferability, traceability, immutability, and enhanced security features that have the potential to transform the investment experience with greater accessibility, increased liquidity, near real time settlement, and fractional ownership. Therefore, we believe the next iteration of our financial system should combine the best of traditional finance and the transformative power of blockchain to achieve optimal performance, issuance, and investment processes.

Accordingly, Arca developed a solution to incorporate blockchain technology into the traditional pooled investment fund structure, regulated under The Investment Company Act of 1940 ('40 Act). Developed over 2 years in conjunction with financial institutions, service and technology providers, and market participants, Arca Labs—Arca's innovation division—created a blockchain transferred fund (BTF), the first registered '40 Act fund to issue shares as digital asset securities. It represents the next generation of investment vehicles that we believe will revolutionise the global financial system.

## The evolution of investment vehicles

On the occasions that financial innovations have emerged, notable paradigm shifts have propelled the industry forward, shaping the investment landscape for decades to come. One such shift was the early 20th century idea of pooling capital for investment, which led to the advent of mutual funds. This relatively simple concept transformed the way the world invested. The traditional mutual fund

reigned supreme until the late 1980s, when the need for greater liquidity and the ability to track indexes with computer technology gave rise to exchange-traded funds (ETFs), sparking another dramatic evolution in investing.

The progression of pooled investment vehicles demonstrates how advancements in technology enabled the development of more efficient investment products. However, while ETFs have become the financial product of choice, integrating blockchain technology into a pooled investment structure offers the potential to create a financial product that combines the benefits of an ETF with the advantages of blockchain technology. This fusion creates a new framework to solve some of the industry's most salient challenges: transferability and time.

In 2018, Arca Labs analysed the existing financial landscape and considered the products and processes that could be improved with blockchain technology. The result was a solution incorporating blockchain technology into the traditional pooled investment fund structure, regulated under the '40 Act. Widely recognised and well-understood, the '40 Act fund provided an opportunity to innovate and improve operational efficiencies while reducing risk. After two years of research, product development, regulatory review, service team assembly, and new workflow creation using blockchain, Arca Labs launched the BTF—the first registered '40 Act fund to issue its shares on the blockchain. These shares represent ownership in the fund's portfolio and are digital asset securities that can be issued, transferred, and redeemed entirely via a blockchain.

ETFs and BTFs are links of the same evolutionary chain—the BTF integrates blockchain technology into the structure that underpins ETFs and enhances the preceding framework to offer, in our opinion, a more operationally efficient product with increased time and cost savings. The combination of public blockchains, permissioned blockchains, and distributed ledger technology (DLT) creates a new technological framework that we believe serves as a blueprint and demonstrates a pathway for registered investment vehicles to be tokenised and issued on a blockchain.

### **What are digital asset securities?**

Digital asset securities represent an ownership stake in real world assets that already have value (like real estate, a car, or corporate stock), where ownership is recorded on a blockchain. Initially known as security tokens, they are digital representations of fractional ownership interests in an underlying asset or company that can move freely among KYC/AML-approved investors at the asset owner's discretion. Digital asset securities must follow prescribed purchase and transfer guidelines and are subject to jurisdictional securities law and applicable regulation.

According to [The Future of Securities: A Digital Asset Securities Study](#) conducted by Coalition Greenwich on behalf of Arca Labs in 2021, 77% of respondents across all global regions agreed that most securities would be digitised and settled on a blockchain in 5-10 years. One of the most highly anticipated use cases for the convergence of blockchain and financial products is the investment fund. The survey revealed that 61% of participants wanted to see investment funds transferred on the blockchain.

Like traditional securities, the BTF abides by the conventional regulatory oversight, reporting requirements, and strong compliance mandates prescribed by the '40 Act that investors are accustomed to, encouraging further investment confidence in the BTF structure. Additionally, the BTF delivers the enhanced benefits that blockchain enables:

### **'40 Act traditional regulatory requirements**

- Assets held in a regulated trust
- An independent auditor, administrator, and board of trustees
- Mandatory reporting of annual audited financials, semi-annual reports, trade confirmations, monthly account statements, daily NAV, and SEC filings on material events

### **BTF added benefits**

- Immutable record-keeping
- Programmable security/fund registration requirements
- Ability to freeze, cancel, or replace lost or compromised tokens
- Lower fees due to the elimination of unnecessary intermediaries
- Asset ownership and history transparency
- Faster settlement
- Automated execution

- Peer-to-peer transference
- Fractionalisation

### **The BTF is revolutionary – Future use cases**

Following the trajectory of how ETFs built upon the mutual fund structure, we believe the next iteration of '40 Act products will similarly transform the investment landscape. Blockchain and distributed ledgers can build on previous financial instruments to offer new efficiencies and unique functionalities. For example, blockchain's peer-to-peer functionality enables the BTF's digital asset security to be held by the investor rather than a third-party intermediary. This unique quality radically shifts industry perspectives on asset ownership and has the potential to change investment behaviour and market strategies.

Beyond providing utility as an investment vehicle, BTFs offer the additional benefit of being a means of value transfer. The utility integrated into the BTF structure has the potential to enable advancements in industries like insurance, real estate, and entertainment, and can impact financial sectors that would benefit from a reduction in settlement time, elimination of laborious processes, and risk mitigation.

For example, collateral management—the pledging of assets from one party to another to mitigate credit risk and potential default—is widely used in banking and financial services. However, the current methods for collateralising are manual, expensive, and time consuming, exhibiting a prime area for innovation. US Treasuries are among the most common assets pledged for collateral management because of their stability, liquidity, and high investment grade ranking. Therefore, a BTF with a portfolio of US Treasuries that issue its shares as digital asset securities has a clear use case for institutional collateralisation. BTFs utilise the core benefit of digital asset securities—peer-to-peer transference—to reduce costs associated with cross collateralisation, abate the time required to trade reserves using traditional trading platforms, and decrease risk and error by eliminating intermediaries.

Additionally, payments is a massive financial sector that represents the mechanisms allowing individuals and entities to exchange goods and services. However, the existing structural make-up of payment networks is encumbered by layers of intermediaries between assets and owners, presenting an industry ripe for modernisation. The introduction of an instantly settled asset, such as digital asset securities, provides a means to carry out payment exchange without the need for intermediaries. This change could collapse the space between payments and investments, enabling investors to more efficiently access and deploy all of their capital. In addition, the frictionless feature of digital asset securities grants investors greater authority and earning power over their assets. BTFs add this capability to single assets represented by digital asset securities and commingled investment vehicles.

### **The framework of the future**

Technology has consistently been a catalyst for the transformation and growth of financial products, often resulting in redefining moments. Truly innovative technologies profoundly challenge our concept of utility and stimulate previously unimagined possibilities. Presently, blockchain technology is the stimulus for pooled investment vehicles, addressing shortcomings from archaic architecture and antiquated processes. The novel BTF structure introduces an opportunity for the industry to shepherd in a revolutionary new era and blazes a trail for other registered investment vehicles to be launched and tokenised on-chain. We believe blockchain technology will revolutionise the global financial system and will ultimately underpin all industries in the future.

[Read the full white paper](#) to discover more about the next iteration of pooled investment vehicles for professional investors.

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