



# SWAPBlocks

## A Cost Saving Blockchain Protocol for Asset Issuance & Exchange

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### **Abstract**

The rise of DAPP platforms over the last few years has sparked a movement to completely decentralize computing resources. This movement has led to the creation of many irrational ecosystems where the cost and reliability of applications is determined by the market price of the ecosystem's coin. While these ecosystems may work for simple contract execution, many organizations that could benefit from the publicly verifiable nature of the ecosystem, especially those subject to complying with changing regulation, are hesitant to do so due to uncertain cost. In order for mainstream adoption organizations must have the ability to manage the cost of their own services.

In this paper, we discuss a new distributed ledger transaction verification protocol designed to enable asset managers to control the cost associated with transaction verification, data storage and transmission of their managed assets on a public ledger. This protocol allows for centralized, semi-centralized and decentralized control of assets registered on the ledger.



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# 1 Introduction

The SWAPBlocks protocol is a complement to distributed ledger technology that enables asset managing entities to register and control the transfer of assets on a distributed ledger. The SWAPBlocks network is an implementation of this protocol aimed at creating a network of clearinghouses, making automated swap transactions between all asset classes possible. Such a network would remove many of the cost associated with hiring expert facilitators, provide a publicly verifiable lineage of each asset, and eliminate the need for two parties to convert to a common currency.

SWAPBlocks node API's will enable seamless integration into existing record keeping infrastructure and encourage fast adoption. These features enable regulated and physical assets to be exchanged as quickly, cheaply and easily as cryptocurrency.

The amount of data needed for rights transfer can vary based on the asset class jurisdiction and the asset issuer. For this reason data used for additional verification is hashed and discarded by the main network, passing on the responsibility of maintaining data details to the asset issuer. This helps prevent the chain from becoming bloated with information irrelevant to the majority of the network. By checking the hash on the network against the hash of the data provided by the registering entity counterparties can easily confirm data integrity and detect tampering by the asset manager.

## 2 SWAPBlocks Protocol

### 2.1 Base Protocol

Assets are registered on the network by creating a new asset object containing a `unique_id`, a pointer to the issuer, an `asset_id` created by hashing the pointer and `unique_id`, a prepended weight associated with the number of signatures needed for transactions to be considered valid and a `valid_through_date`. Once the asset is created it is signed by the issuer and broadcast to the network as an asset genesis transaction. The issuer then runs a node supporting the network and listening for transactions containing its managed assets.

When a transaction is detected containing a managed asset the issuer processes the transaction and decides to approve or reject it. This approval



## 2.2 Consortium Extension

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can be determined by any preset or future case set by the issuer. Some examples include verifying that the address receiving the asset is legally allowed to receive the asset, verifying that an appropriate transaction fee has been included in the transaction, verifying that an encrypted form sent with the transaction contains the correct information, etc.... It is the responsibility of the issuer to provide counterparties with asset transfer instructions and the responsibility of the consumer to interpret the instructions.

To approve a transaction the issuer must sign the transaction and re-broadcast the transaction to the network. Once the transaction is signed by the issuer the transaction will be eligible for the next block. If the issuer does not approve the transaction it will time out and be cleared from all network nodes.

## 2.2 Consortium Extension

The base protocol forces all transactions pertaining to a specific asset through the issuer's node which can cause performance issues and creates a single point of failure. To solve these problems, issuers can extend the base protocol by forming consortiums that operate under consortium agreements. These consortium agreements keep track of member nodes, consortium governing rules and verification scripts. By joining a consortium the issuer agrees to process transactions of member nodes in accordance to the agreement and/or store the additional data attached to member transactions.

## 3 Consortium

Leaving an entity to verify all transactions pertaining to its managed assets can create a centralized bottleneck. To solve this problem a municipal node can join or create a consortium. Consortiums are groups of nodes that require the same transaction verification process. This can be the full transaction verification needed or a subset of the full transaction verification. Consortiums follow rules set out in a consortium agreement which includes a transaction verification script, consortium data packet storage and routing fees.

Consortiums create a semi-decentralized, semi-private transaction verification network that enables a central entity to benefit from the distributed properties of a decentralized network. Consortiums also reduce the amount of



### 3.1 Consortium Agreement

trust needed to interact with any particular central entity since the operating agreement can be read and verified on the blockchain.

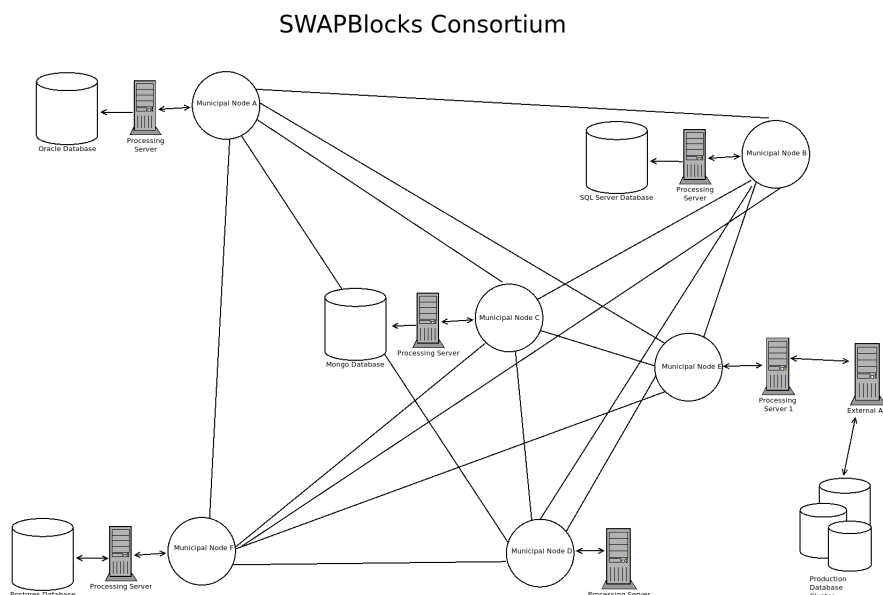


Figure 1: Consortium data storage infrastructure can vary between consortium nodes.

### 3.1 Consortium Agreement

A consortium agreement is stored on the blockchain and acts as the operating agreement for all member nodes. This agreement outlines the processing script, consortium members, number of member signature needed for amendments, routing fee prices, a list of all member nodes' static IP's, etc. . . .

### 3.2 Consortium Routing

In order to limit the impact asset transactions have on the network as a whole mining nodes receive a portion of the attached fee for sending asset transactions to the correct consortium network. Consortia can adjust the fee regularly to stay competitive for both consumers and miners or build out a network. For a miner to increase their chances of receiving a routing fee they can store a dictionary of consortiums' node addresses for quick routing.



### 3.3 Routing DAG

The routing DAG contains the information associated with the routing of asset transfer transactions. For example node X receives the transaction and performs standard verification, signs the transaction and broadcast it to the network where it is picked by node Y. Node Y looks up the consortium's address in its dictionary of consortiums, signs and sends the transaction to consortium member node A. Node A performs consortium verification, signs the transaction and routes the transaction directly to municipal node F. Node F verifies and signs the transaction. Now this transaction can be included in a block. When the transaction is included in a block the last 3 addresses to sign the transaction receive shares of the attached routing fee. Each signature in the routing DAG points to the previous one and can only contain one signature per level of verification. The first signature can be any node in the network, the second signature can be either a consortium member or the municipal node and the third can only be the municipal node. The amount of signatures needed is determined by the asset's assigned weight value.

## 4 Node States

SWAPBlocks assets view nodes in three different states. The state that the node is viewed in by the asset determines the level of verification the node is allowed to and should perform.

#### 1. Standard Node State

- Any network node that has no ownership stake in an asset
- Checks that each transaction output points to a valid UTXO and that all signatures are correct.

#### 2. Consortium Node State

- Node belongs to the same consortium as the asset issuer, thus abiding by the same consortium agreement.
- Typically responsible with processing or storing consortium data packets containing information needed for additional verification

#### 3. Municipal Node State



- Node owned by the asset issuer.
- Responsible for verifying municipal data packets.
- Responsible with updating their own outside record keeping systems with with status changes of registered assets.

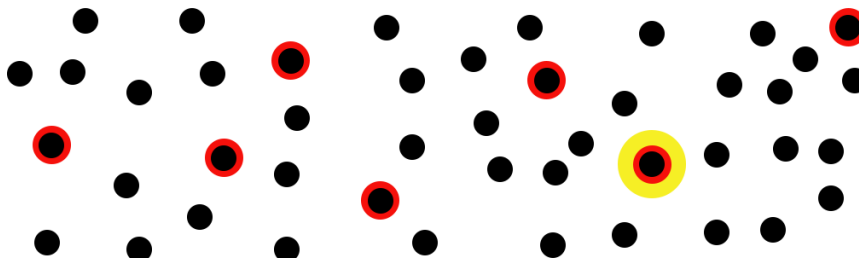


Figure 2: Node space in relation to some registered asset

Figure 2 represents the node space in relation to a registered asset. Each circle represents a node and each color represents the state that the node is in for a particular asset. The yellow circle represents the municipal node, meaning that the yellow node registered and manages the asset. The red circles represent consortium nodes, meaning that each red node is a member of the same consortium as the municipal node. The black dots represent standard network nodes that do not have any special permission or obligation to provide additional verification for this asset.

## 5 Asset Registration

Municipal nodes register assets in an asset genesis transaction. When an asset is registered there are only 4 required fields, the registering nodes pub key, the consortiums address if there is one, a UAI and a `valid_through` date. This `valid_through` date is the date that the entity guarantees the information about the asset to be correct. The asset must be verified through an asset probe transaction to update the `valid_through` date.

### 5.1 Asset ID

Assets on the SWAPBlocks network are represented by a unique asset ID (UAI). The UAI is created by hashing the consortium address with the mu-





## 5.2 Weights

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municipal address and then hashing that with the municipal ID to create the `base_id`.

Now that the base ID has been formed the municipal node assigns a weight, determining the level of verification required to transfer the asset, and prepends the weight to the beginning of the asset ID.

### 5.2 Weights

Assets are assigned weights when they are first created. These weights are used to determine the level of verification a transaction containing the asset needs before being eligible to be included in the next block. Weight is calculated based on the number of valid signatures a transaction has in its routing DAG.

- Weight 0, Standard Verification
  - Default verification requiring the transaction to include valid UTXOs and signatures.
- Weight 1, Consortium Level Verification
  - Transactions must pass weight 1 verification and contain an additional signature from a consortium node.
  - Assets with this weight may require a consortium data packet to be sent along with every transfer transaction
- Weight 2
  - Transactions must pass weight 0 verification and include a municipal signature in the routing DAG.
  - Consortium nodes can perform consortium verification on the consortium data packet, sign the DAG and send the transaction directly to the municipal node, enabling the consortium node to receive some of the routing fee. If this verification has been done and signed off by a trusted consortium node the municipal node does not need to reverify and will only need to perform municipal verification.



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## 6 Transactions

### 6.1 Transaction Types

There are 5 basic types of transactions in SWAPBlocks.

1. Currency

- Involves the transfer of SXB coins from one address to another.
- Currency transactions can be validated by checking UTXOs and the validation can be performed by every node in the network.

2. Asset Genesis

- Transaction that registers an asset on the network for the first time.

3. Asset Transfer

- Transaction used to send an asset from one account to another with no contingencies.

4. Asset Swap

- Transaction in which two parties agree to swap ownership of two assets with the contingency that each transaction clears before the swap completes.
- Contains maker and taker sections. Both sections must be complete and verified for the transaction to be eligible for the next block.
- If the bid section is blank, then the transaction is considering pending and can be filled by any bidder and rebroadcast to the network. These pending SWAP transactions will be stored in the SWAP order book, which is like a mempool for SWAP transactions.

5. Asset Probe

- Transaction completed by the asset issuer or trusted third party that validates that the assets condition is the same as the current record stored by the issuer.



## 6.2 SWAP Order book (*The SWAP DEX*)

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- These will have to be completed periodically to ensure the asset has not been discarded, destroyed or transferred off network.
- Managing entities can charge fees to complete an asset probe transaction for an asset they manage.
- Asset probe transactions can also be completed by third party networks and will be linked to the assets transaction chain but the valid\_through date will still remain the same.

## 6.2 SWAP Order book (The SWAP DEX)

The SWAP order book is a specialized mempool for storing unverified SWAP transactions. What this means is that all SWAP transactions without a taker will be stored in a separate mempool for quick lookup. Decentralized exchange portals will be able to utilize this mempool to quickly place and fulfil orders.

## 6.3 Transaction Timeout

In order to limit the number of unverified transactions in the mempool, transactions are created with a max\_verify\_time. The max\_verify\_time is the latest time a transaction may be kept in the mempool. If a node has transactions in its mempool past the max\_verify\_time the node can discard the transactions. This helps to prevent spam transactions from bloating the mempool without needing to charge a fee.

For verified transactions that have not been included in a block and that contain data packets, the max\_verify\_time acts as a data\_storage time limit. Once the max\_verify\_time has been reached all nodes can delete the data packets of non-consort assets, leaving only the hash value.

The max\_verify\_time will have a constant max time on network launch. In the future a proof of importance algorithm may be used to allow users to extend the max\_verify\_time.

To prevent users from issuing transactions with extremely long max\_verify\_time's, transactions max\_verify\_time must be less than or equal to a network constant as part of standard verification.



## 7 Permissioned Smart Contracts

SWAPBlocks enables asset transactions to include temporary encrypted data packets. These data packets are used by municipal and consortium nodes to make verification decisions. Asset transactions can include two separately encrypted data packets for multi level verification and increased privacy.

### 1. Consortium Data Packet:

- Contains information that can be verified by consortium member nodes.
- Enables entities to validate standard form data quickly.
- This data packet is typically spread across the consortium for backup and high availability.
- Data is encrypted with a randomly generated key that is then encrypted with the consortiums public key and added to the transaction.
- All consortium members have access to a shared key pair

### 2. Municipal Data Packet:

- Contains information that is either confidential or that the consortium has not agreed to process.
- Can only be verified by municipal nodes
- Only stored by municipal nodes

Once the data packet has been verified by the approved node, the node signs the transaction. This signature is added to the routing DAG and the transaction is either routed to the next required level or broadcast to the network. When a transactions DAG has reached its required weight, the transaction can be included in the next block and the data packet will be cleared from all non-member nodes.

If the data packet has not passed verification the verifying node will not sign the transaction leaving the transaction to time out and be cleared from all network nodes.

This verification process can be thought of as using permissioned smart contracts. In the case of municipal verification, registering accounts are the



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only approved account to run the verification script on the asset. With consortium verification the smart contract will be defined in the consortium agreement.

## 8 DPOS Blockchain

SWAPBlocks will utilize a Delegated Proof of Stake consensus algorithm to secure the blockchain. The native tokens (SBX) are software licenses that grant owners certain rights to utilize the SWAPBlocks protocol. These rights include but are not limited to the right to execute transactions as described in section 6.1, and the right to vote for delegates who will secure the blockchain. The purpose of this structure is to create a self-sustaining environment that does not require a central entity to sustain proper functionality. SBX is necessary for the blockchain to be secure, this means SBX license coins cannot exist without the blockchain, and the blockchain cannot be secured without freely transferable SBX. SBX must be fully transferable in order for new network nodes to quickly and easily take the place of network nodes that no longer wish to operate, without the need for a centralized intermediary to facilitate the transition. The base blockchain is based on LISK and will initially allow users to run delegate nodes if elected, vote for delegates, and transfer SBX coins between accounts. In the future users will be able to register assets, earn SBX coins for running delegate and routing nodes and trade assets registered on the SWAPBlocks blockchain.



## 9 Use Cases

### 9.1 DLT Global Asset Exchanges & Clearinghouses

Perhaps the largest opportunity for the SWAPBlocks protocol to make a deep impact is global capital markets. Today, capital markets operate with significant need for manual validation and intermediation. This inefficiency permeates almost every aspect of the market.

SWAPBlocks will not only create a marketplace for participants to operate with increased freedom and efficiency, it will enable them to form “sub-markets” that enable governance based on specific needs associated with a given asset class, geographic location or other distinguishing factors.

This use case encompasses a wide range of asset types, each with their own nuances and regulatory requirements. The SWAPBlocks consortium model allows groups of participants to take advantage of the benefits of distributed ledger technology while ensuring their assets are traded within the confines of any rules, laws or regulations applicable to that market. A key distinction of SWAPBlocks is that our approach is one that seeks to allow entities to begin to engage in the digital economy without requiring them to make unreasonable leaps away from existing systems and market needs. Some asset-specific examples of the platform’s value creation follow.

#### 9.1.1 Foreign Exchange

Entities (banks, non-bank financials, SWAPBlocks, or any other institution) could issue fiat-backed assets on the SWAPBlocks platform. This would allow for the exchange of fiat currency between parties as well as the utilization of blockchain benefits for fiat denominated payments. Any user could pay for goods and services using these fiat-backed assets as long as the seller accepts them. This provides both parties with many of the benefits of using the blockchain (immutability, auditability, trustless transfer, custodial flexibility) without subjecting themselves to the purchasing power fluctuations of an asset like Bitcoin.

Parties could also trade with the intent to profit from currency fluctuations as on traditional forex markets. Benefits of using this system are that with SWAPBlocks, there’s no intermediary required, and custody of the assets can remain with the owner until the moment of transfer.

A third use case for foreign exchange would be travel. Someone traveling



from the US to Europe could easily trade USD for EUR on SWAPBlocks, and assuming the dApp platform issuing the fiat-backed assets supports it, the user could easily convert those assets to actual fiat through a simple debit card transaction.

### 9.1.2 Bonds

Debt markets represent one of the largest opportunities for the SWAPBlocks platform to impact market efficiency. Today, bond issuers rely heavily on financial intermediary to issue debt and manage principle and interest payments or other corporate actions like the exercise of embedded options. With SWAPBlocks, much of this can be disintermediated and automated. To understand the impact the platform can have, one must consider the perspective of investors in the market and the perspective of the issuer.

Significant efficiency gains can be made by debt issuers utilizing SWAPBlocks. The existing processes for corporate actions involve archaic messaging standards like ISO 15022 which require manual processing on the part of central securities depositories who then route payments to the appropriate destination. Not only does this process require trust in the depository, but it represents significant costs. These costs are bore by the issuer and represent an increase to the cost of capital. On the SWAPBlocks platform, issuers have no need for central securities depositories because owners have custody of those assets and are easily identifiable. This means interest or principal payments can be automatically routed to the appropriate parties. Furthermore, this action can take place much faster than today. Couple this fact with the instantaneous settlement features of the blockchain, and the result is a market where buyers and sellers can trade almost up to the moment of disbursement without concern for ex-coupon dates.

Another significant advance of the platform will be derived from the fact that many assets types will coexist. In section 9.1.1 we discussed the ability for fiat-backed assets to live on SWAPBlocks. Once this is the case, bond issuers will have the ability to disburse P&I directly to bondholders in any asset type that resides within the ecosystem. This means a bond could pay interest in USD backed coins, EUR backed coins or any other fiat-backed token. Additionally, other assets types could be used as well (bitcoin-backed tokens, etc.). This functionality is important because it enables unprecedented flexibility for issuers and allows them to participate in the benefits of the ecosystem without the currency translation risk of a platform relying



solely on a native token or Ether.

From the investor's standpoint, SWAPBlocks offers transparency that is not available in today's dealer-based market. Bond trading desks have historically been extremely profitable for banks because the market is opaque. Buyers and seller do not have adequate means to find each other. To this point, dealers have maintained bond inventories and source bonds for buyers if a bond is not in their inventory. The result is a market where buyers have visibility into prices that sellers are actually requiring. Conversely, sellers have no direct path to buyers or way to understand what the market's appetite may be for bonds with similar characteristics to the one they wish to sell. The only winner in this paradigm is the bank's bond desk, who tacks on hefty fees for playing the middleman.

SWAPBlocks overcomes these inefficiencies in two ways. First, by allowing buyers and sellers to see orders in real time, market participants can not only purchase directly, without an intermediary, but they can price their debt holdings more appropriately as well. Second, potential buyer could query the blockchain and see public keys for all holders of a given bond. A simple messaging application would allow the buyer to make direct offers to bondholders even if there were no active asks in the order book. These attributes would not only transform the methods investors use to transact but also reduce information asymmetry and counterparty risk while improving liquidity. The result will be a decrease in the required rate of return, further decreasing the cost of debt capital for issuers.

The bond market is especially ripe for this technology, but small and micro-cap corporate bonds stand to gain tremendously. Today, there isn't any good way for bondholders of small corporate debt to easily exit their position in the secondary market. This leads to an illiquidity premium which represents a significant cost to the issuer and reduces the number of investors willing to hold that debt. If these corporations were to issue their bonds on SWAPBlocks, they would be providing their investors with an outlet to connect with others in the market. Doing so would unlock a massive amount of potential liquidity in the debt markets.

### 9.1.3 Equities

Many of the advantages discussed in 9.1.1 and 9.1.2 are applicable to equities and other asset types covered here. However, they do present some distinct attributes. Equities would work in a similar fashion to bonds on the SWAP-





## 9.1 DLT Global Asset Exchanges & Clearinghouses

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Blocks platform with regard to advantages the platform offers in the areas of custody and holder of record issues and cash dividend disbursement. Areas of distinction from other assets types include:

- Stock dividends
  - Stock dividends could be managed in a way similar to cash dividends with respect to the identification of owners and disbursement to those owners, but those owners would receive equity tokens instead of fiat-backed, or some other asset type.
  - If the issuing entity held existing equity tokens on account (i.e. treasury stock), they could disburse these directly.
  - If new tokens had to be created it would follow the process outlined in section 5 prior to being distributed to the appropriate asset owners.
- Stock Splits
  - Stock splits would work similarly to bullet 3 under stock dividends.
- Reverse Splits
  - Reverse splits will require asset owners to submit their existing equity assets to the issuer in return for new ones in proportion to the split ratio. Managing this process would take a few forms. One option could be to utilize the asset probe function described in section 6.1 to change the `valid_through` date. This date would then represent the asset's expiration and a deadline for asset owners to submit them in return for the new tokens. Contingencies could be made for late submissions based on the issuer's needs.
- Proxy Votes
  - Proxy voting could initially use existing voting mechanism that reference the blockchain to validate voter rights.
  - More advanced and automated voting could be implemented as the platform matures that enables direct voting by asset owners that uses a private key signature for a given public key to validate the vote.



#### 9.1.4 Crypto/Crypto & Crypto/Fiat Swaps

Many cryptocurrency exchanges are being developed today. These are classified primarily into the two broad categories of centralized and decentralized. Centralized exchanges have certain advantages when it comes to transaction speed and flexibility because they settle off-chain and simply adjust ownership entries on their own internal ledgers. Their inherent disadvantage is that their existence is in contrast to the decentralized nature of the blockchain revolution. By requiring custody of any asset being traded, owners are subject to significant counterparty risk. Furthermore, the advantages of trustless transactions on a blockchain are partly undone when one has to give away that advantage to exchange that asset.

Decentralized exchanges are the flipside to that coin, where no trust is required because custody remains in the hands of the owners until the transaction is validated. There are a few drawbacks to these current models however. One is that on-chain order books can lead to high latency and bottlenecks. Additionally, it requires fees to place orders as well as to cancel them. This is inefficient, costly, and is a disincentive to market making activities.

Hybrid functionality, where the order-book is off-chain, but transaction settlement is on-chain is a likely equilibrium. While not completely trustless (i.e. user must trust the order-book application is truthful), the counterparty risk is significantly diminished because asset custody remains with the owner. However, it enables users to place/cancel orders freely and will lead to the liquidity decentralized exchanges currently lack.

SWAPBlocks will operate in this “goldilocks” zone by implementing the specialized DEX discussed in section 6.2. The reference to decentralized exchange portals speaks to the ability for any third party to create front-end applications that facilitate the exchange of assets on the platform.

Just as SWAPBlocks or another third party will create fiat-backed tokens, other crypto-assets can be represented on the platform in a similar manner. In essence, these are proxy-assets that are redeemable for the actual asset that was deposited. For example, SWAPBlocks or another third party could implement a dApp that managed the deposits and withdrawals of Bitcoin and allowed users to perform asset swaps on SWAPBlocks using Bitcoin. The dApp would receive the user’s Bitcoin deposit and issue a SWAPBlocks-based BTC token. Users wishing to withdrawal the actual bitcoin for any reason could do so in the same manner that a user wishing to withdraw



actual USD for their USD-backed token could. The functionality of this process would be similar to the crypto-bridge application which runs on the BitShares network. The importance would be for users to ensure the party responsible for asset deposits/withdrawals is operating in a way that reduces trust and/or increases accountability (published audits, distributed gateway system, etc.), and guards against loss in the event the company creating the dApp goes out of business.

### 9.1.5 Limited Partnership Shares

LP shares serve as an excellent example of how SWAPBlocks can improve market conditions for investors and issuers alike. Whether for a hedge fund or private equity, LP investments are very illiquid because the general partner needs to operate for extended periods without worry of significant redemptions in order to ensure they can execute the investment strategy appropriately. For investors, this means very illiquid holdings, which translates to higher required returns by investors.

SWAPBlocks can offer investors and investment firms the ability to forego these hurdles by listing LP shares on the platform. They could manage those assets in two primary ways. The first would be to issue LP shares as a Weight 2, requiring any asset transfer to be validated by the issuing firm itself. This allows the firm to ensure that any buyers of the shares are whitelisted and legally able to purchase in a given jurisdiction. The second option would be to form a consortium, as outlined in section 3, with similar firms. In addition to validating each other's transactions, the consortium members would share the same rules for LP share transfers as well as whitelisted investors.

This would create a new secondary market that does not exist today and enable investors to unlock liquidity not previously available. This would also allow firms to maintain capital levels more easily because investors' liquidation of a position does not have to take the form of redemptions.

### 9.1.6 Money Market Instruments

Money market securities are typically a bit less complex than other asset classes like equities or LP shares. They primarily issue for one amount, and the holder receives a higher amount at maturity, similarly to a pure discount bond nearing maturity. Whether it is CDs, commercial paper, T-bills or repos, SWAPBlocks would enable money market participants to utilize the



instant settlement and auditability, trustless transfer, and disintermediation of the blockchain protocol.

While striking a deal with the US government to issue T-bills on the platform might be a difficult task, that wouldn't be the only way to incorporate this volume. An intermediary step could be for large institutions to utilize the platform for its efficiencies and upon maturity, disburse final payments either using SWAPBlocks-based assets or using the legacy financial system. All trading in the meantime could be housed on the platform and the issuing entity could form consortiums of similar issuers to validate transactions and reap the fees for doing so. While the former would be more decentralized, the latter approach would be a strong step in the direction of efficiency, transparency and decentralization. This concept would serve as an example of how other money market instruments could be listed and exchanged on the platform as well.

### 9.1.7 Commodities

Cash settled commodities are yet another asset type that would benefit from living on the SWAPBlocks ecosystem. Similar to the benefits reaped by other asset types, commodities would benefit by being able to automatically cash settle using any supported asset type (fiat-backed, crypto-backed, direct commodity swap). Even if issuers desired to settle upon maturity using legacy financial system means (ACH, wire transfer), there would be other benefits, like the option to develop consortiums of commodity asset issuers to govern specific market segments.

### 9.1.8 Derivatives

Derivatives represent an interesting use case as they are inherently more complex in many cases. For instance, forward rate agreements would require a clearinghouse to mark to market each day and insure agreements are kept. Some of this could be automated, but without a clearinghouse there would be no recourse for the opposing party when a counterparty defaults.

This introduced an opportunity for partnership with clearinghouse services who would benefit from the ability to easily credit accounts in a way that further reduced counterparty risk (i.e. the clearinghouse effectively diversifies the market's counterparty risk, but participants are still exposed to the risk of the clearinghouse itself not upholding its duties).



## 9.2 Automated Asset Registration and Tax Collection

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Futures contracts and other derivative types would trade in a similar fashion, with a clearinghouse, or group of clearinghouses forming a SWAPBlocks consortium and validating transactions on the platform, marking to market based on consortium rules, and cash settling based on consortium rules or the issuing municipal node's rules.

The major advantages would be twofold. First, the market would receive price transparency, because trade history and bids/asks would be visible to all participants in real time, effectively removing the intermediary's moral hazard. Second, many settlements could be automated. For example, a call or put option could exercise automatically as long as the underlying asset lived on the SWAPBlocks platform.

### 9.1.9 Automated Corp to Corp Asset Swaps

Corporations that transact with each other in “paper” assets or real assets that cash settle could be directly swapped on the platform. This would provide parties with the ability to settle and audit quickly and easily with reduced risk of user error. Tokens representing these assets would only be tradable between the associated parties by simply issuing the asset validation rules so that only whitelisted counterparties can hold them. In this way, attempted transactions involving anyone else will fail to validate at either the consortium level (if the parties create one), or more likely for low volume transaction types, at the municipal level.

## 9.2 Automated Asset Registration and Tax Collection

While tradable financial assets may represent a large portion of the opportunity, numerous other types of assets can be represented on the SWAPBlocks platform. The levelled approach to transaction validation creates a flexible framework for asset governance that does not exist on other platforms. An entity desiring to issue a token representing ownership of an asset can do so with any level of verification. Consortium nodes can hand of verification data to record keeping systems of their choosing, enabling integration with future and legacy systems. This allows governments to take advantage of the SWAPBlocks ecosystem without being forced to hire niche specialist for everyday task, retrain all employees or upgrade existing infrastructure.



### 9.2.1 Motor Vehicle Registrations & Titles

Vehicle registrations and titles in the US are managed at the state level, however paper records are easily lost or damaged. Each state could issue these documents as tokenized assets that allow vehicle owners to more securely maintain their records and transfer ownership in a trustless manner. Ownership lineage would be easily identified by motor vehicle departments. Transactions of an asset would have to be validated by the municipal node (the DMV) before the transaction was completed. Additionally, the issuing agency could elect to accept tax payments in any asset type supported by the SWAPBlocks platform.

### 9.2.2 Real Estate Registration & Lineage

Real estate use cases are similar with regard to ownership lineage and taxation. Many functionalities currently done manually in the real estate market could be improved by utilizing the blockchain. A prime reason why SWAPBlocks is the best platform to do this on is the unique validation governance model.

### 9.2.3 Insurance Policies

Insurers could trade policies between themselves to source liquidity without concern of unsanctioned buyers participating.

## 9.3 Back Office Automation

Today's back office functions are comprised of three primary functions. Those functions are settlement, compliance, and data governance. The SWAPBlocks protocol will allow organizations to streamline these functions through the integration of their existing systems.

Settlement of asset transfers is immediate, immutable, and instantaneously auditable on the blockchain. These attributes enable organizations to do away with costly labor capital associated with manual and semi-manual labor processes in use today. It also removes the duplication of work. In the current environment, both parties to a transaction will have their own back office settlement processes, and each party is responsible for performing those tasks and reporting on them. Using the blockchain, both parties reference the same transaction on the public ledger. By integrating their



### 9.3 *Back Office Automation*

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back-office systems with the SWAPBlocks blockchain, users track and report on transaction settlement with ease.

Compliance is the second function of an organization's back office, and it represents a significant cost for most industries, particularly financials. Compliance processes are improved using the SWAPBlocks platform for asset issuers and investors. Issuers benefit by being able to quickly reference the municipal and/or consortium rules that govern a given asset. This ensures that the asset was not bought or sold by anyone without the appropriate permissions to do so. For example, consider a hedge fund that issued LP share tokens as a weight 1 asset. If a compliance audit was required, the hedge fund could reference the consortium agreement which would show that appropriate measures were in place for transaction validation. Additionally, they could reference the consortium data packets (see sections 3 and 7) to review a specific transactions or group of transactions. Keep in mind that some markets will be large, with standardized consortium rules. In our hedge fund example, rules regulating the transfer of LP shares would be standardized in most cases, so the issuer isn't necessarily responsible for compiling transaction rules themselves.

For the investor, recordkeeping is drastically simplified because their transactions are stored on the blockchain and easily referenced. While this isn't specific to SWAPBlocks, our platform will provide value compared to permissioned blockchains from a cost perspective. For an institutional investor to create their own permissioned blockchain would require a large initial outlay. Utilizing SWAPBlocks' blockchain history is free. As the ecosystem matures, and more markets come online with more volume, this ease of compliance and reporting will incentivize deeper relationships with the protocol.

From a governance perspective, public blockchains ensure that records are accurate and cannot be changed ex-post facto. This is vital because it provides assurance that your transaction data is accurate and tampering, whether purposeful or by accident, has not occurred. SWAPBlocks offers additional convenience for users transacting in multiple asset classes. By eliminating the needs for intermediaries and counterparties specific to each asset class, investors can go from compiling statements from multiple departments at multiple banks and other institutions, to obtaining reporting on all transactions across asset classes in a few clicks.



## 9.4 Enhanced Public Trust

Public trust lends legitimacy to many governing bodies, regulatory organizations and many other types of entities. Without the public's confidence, the usefulness of the work those organizations do is greatly diminished. SWAP-Blocks offers these entities a new way to build trust by providing a mechanism for public verification of the underlying data used to derive their outputs.

What does a real-world example of a relationship between the SWAP-Blocks platform and an entity as described above? Consider a contested topic like climate science. This topic is hotly debated and there have been numerous claims of bias and data manipulation for even the most respected organizations such as NOAA<sup>1</sup>. SWAPBlocks could offer a solution, because consortium and municipal data packets are hashed prior to being discarded there is a digital fingerprint of the raw input data. In this example, the climate research entity would publish the underlying data used for their reporting, allowing the public to hash it and verify it matches the hash from the original data.

This process could extend to numerous organizations and data types including:

- Census surveys
- Voting
- Economic Surveys

Because the organization operates as a sole municipal node, or as part of a consortium, they can ensure information within the data packets is not made available to inappropriate parties on the front end. Only the hash is public. This would be important for instances where public availability of the raw data prior to publishing results would be sub-optimal. For instance, for sampling purposes, if the public could see survey responses it could taint the sampling window, but because the SWAPBlocks platform only reveals this the data packet to consortium and/or municipal nodes, that data is managed privately while leaving a unique hash behind on the blockchain.

## 9.5 Other

There is significant potential for other industries to utilize this functionality. As the market develops and society begins to understand the vast benefits





a platform like SWAPBlocks can provide, we believe new use cases will continuously evolve and develop.

## 10 The SBX Token

### 10.1 Structure & Functionality

SBX is the native token on the SWAPBlocks blockchain. As briefly mentioned in section 8, SBX tokens are software licenses that grant users rights to transact and govern the SWAPBlocks ecosystem. Unlike traditional software licenses in use today, by tokenizing the licenses SWAPBlocks can ensure that the public will have the ability to use, operate and upgrade the network regardless of the existence of any centralized business entity.

This is accomplished in a few ways. As part of the licensing rights, licensees (i.e. those who own SBX) are authorized to vote for delegate nodes who will validate transaction and keep the platform operational. This means that if a delegate fails to perform their duties they can easily be voted out and replaced by another party, ensuring sustainability. Additionally, SBX authorizes users to perform any transaction type described in section 6.1.

In contrast to traditional software licenses, as users perform transactions SBX is expended in the form of a fee paid to the validating node(s). SBX is also different from traditional licenses because it acts as a mechanism to enable the licensees to maintain and improve the network without reliance on a central business entity. This business model greatly reduces informational asymmetry and the principle/agent conflicts of interest that plague traditional business models. This is because management responsibility is decentralized and directly controlled by the users.

### 10.2 Tokenomics

From a token economics perspective, this model creates an ecosystem that is sustainable and balanced. In the previous section we touched on the presence of conflicts of interest when management rights are separated from use rights. This is solved by licensing all rights through a single vehicle. This does not change the conflicting nature of the interests of users and managers, but by utilizing a single vehicle to accomplish both tasks, an equilibrium of these opposing forces is reached.



In essence, this is true because it creates an environment of mutual benefit when users and managers work together, and mutually assured loss when one side acts in a manner that is detrimental to the ecosystem. Consider the platform manager perspective first. Managers in this sense are network nodes that perform transaction validation (all nodes) or vote on changes to the protocol (delegate nodes). If these actors vote to raise fees too high or change the protocol in a way that harms the users, the demand for licensing may decrease and reduce the value of the managers' stake in the platform. SBX licensees also have the ability to vote for delegate nodes who will in turn vote on proposed changes to the protocol. Consider if these users refuse to allow reasonable transaction fees, or necessary protocol improvements, by voting out any delegate that supported those actions. In that case there would be no incentive to maintain the network and the users' licenses will likely become worthless because the network would not function. Another scenario would revolve around transaction fees for specific assets charged by consortiums. If the consortium's fees are not competitive, another consortium will form to challenge them in the market and users will abandon the uncompetitive consortium and the assets associated with it.



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## 11 Roadmap

Spring 2018	•	SWAPBlocks DPOS Blockchain (Lisk Clone)
Winter 2018	•	SWAPBlocks Asset Management Protocol
Spring 2019	•	SWAPBlocks in House DEX Portal
Sprint 2019	•	Developer Documentation and Tutorials
Summer 2019	•	Partnership Development (Trading Shops and Brokerages)
Fall 2019	•	Create Fiat Consortium Managing Registered Fiat-backed Assets on SWAPBlocks
Winter 2019	•	Strategic Expansion Into New Asset Classes
2020 and Beyond	•	Contracting With Asset Managers and Governments