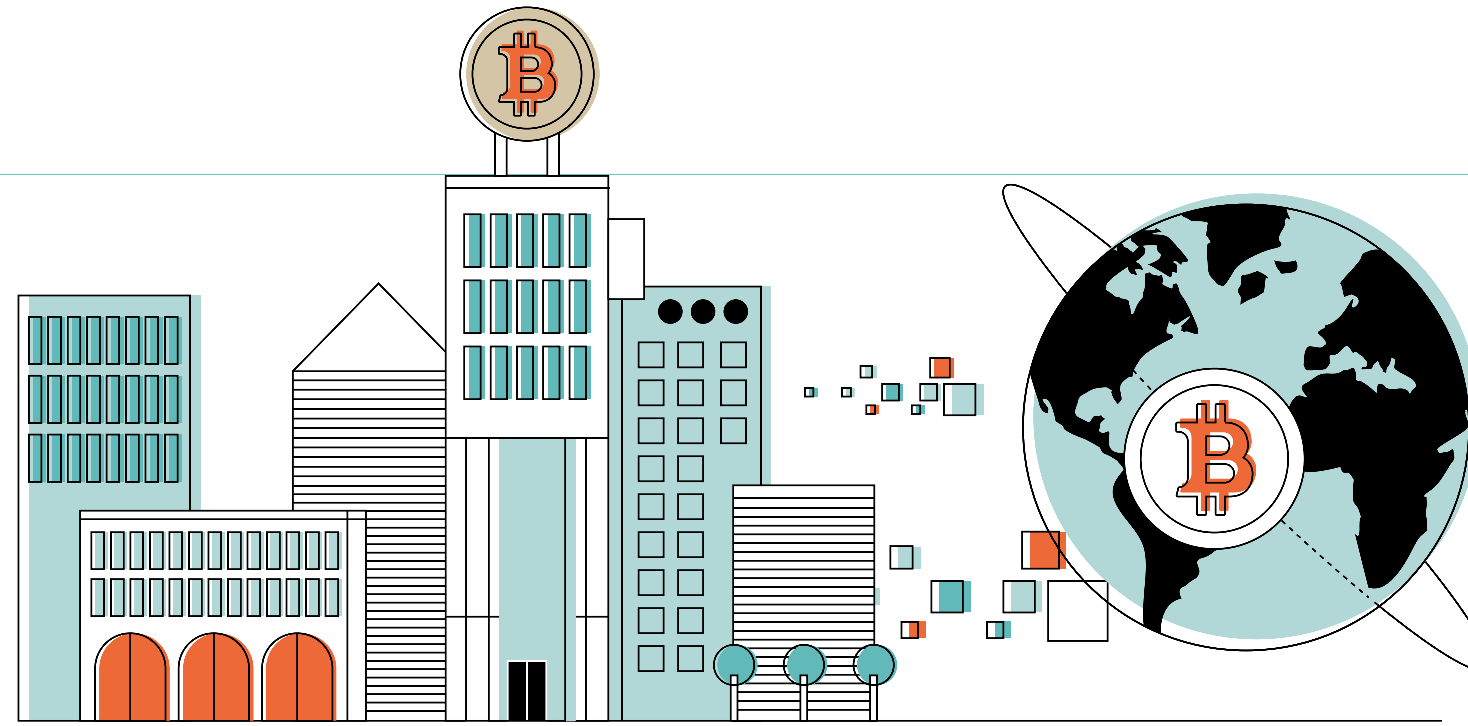
Beyond the Blockchain Hype

A number of barriers must be overcome before commercial digital ledger services are launched, writes Jennifer L. Schenker



What a difference a year makes.

When over 8,000 banks from around the world gathered for Sibos 2014 in Boston last autumn most bankers had never heard of blockchain, the distributed ledger technology underpinning Bitcoin that could be as revolutionary as the Internet.

Now the technology is taking center stage – not just at Sibos 2015 in Singapore but around the globe. A growing number of banks are convinced it's the Next Big Thing, rushing to open blockchain labs and embracing blockchain start-ups.

Barclays has even created a position called vice-president of blockchain research and development; Simon Taylor, a scheduled speaker at Sibos 2015, holds that title.

However, some in the tech community have questioned this new-found love affair, suggesting that it is fear of missing out, rather than solid business cases, driving the agenda. They cite a number of barriers that will need to be overcome before blockchain becomes a commercial reality.

In September some 22 top banks, including Citi, BBVA, Deutsche Bank, Credit Suisse, J.P. Morgan, Goldman Sachs and Bank of America, joined a consortium led by financial tech firm R3 that is working on a framework for using blockchain technology in markets. The group's stated goals are to: develop a platform that can efficiently transfer the billions of dollars worth of transactions handled by the financial industry; build a sandbox for experimenting with these new tools; and learn from these experiments what works and where the technology can best be used in financial services.

Banks interviewed by Informilo say commercial distributed ledger services are still two to three years off and are likely to first be applied to trade finance, a sector that has long cried out for digitization and transparency. "The ability to encrypt and verify the addition of records into a database is a far more auditable, transparent way of doing data entry and brings huge efficiencies," says Barclays' Taylor.

Eventually blockchain's open source distributed financial exchange mechanism could be used to trade everything of value, including payment processing, deposits, withdrawals/overdrafts, foreign exchange, float, transfer/wire services, title insurance collections and notary services.

"We clearly see the focus shifting away from bitcoin currency to the distributed ledger and that is opening up constructive disruption," says Sibos 2015 speaker Mark Buitenhek, global head of transaction services at ING in Amsterdam. "The jury is still out, of course, but the potential seems to be huge and if it really can be applied as we hope, it will become huge."

A June Fintech 2.0 report backed by Santander InnoVentures, the Spanish bank's fintech investment fund, Oliver Wyman and Anthemis Group, estimates blockchain could save up to $20 billion annually in settlement, regulatory, and cross-border payment costs.

"Blockchain is a lot more than a technology; it's a strategy," says Adam Ludwin, CEO of Chain, a San Francisco-based start-up working with banks and other institutions to develop ways to trade and transfer financial assets using blockchain technology. "Market structures don't change that often and blockchain is that once in a very long time market-structure-shifting opportunity."

Maybe so, but some in the financial services sector remain skeptical. "A lot of bankers still don't understand blockchain; they are jumping on the bandwagon out of fear of missing out," says Nektarios Liolios, co-founder and CEO of the Startupbootcamp FinTech and Insurance accelerator in London.

"Usually bankers try to understand first and then get involved but there is so much buzz that banks are joining groups like the one in New York just to be part of it and they are not really sure why."

"There are naïve assumptions that this will solve problems overnight and if [the banks] put their names out there start-ups will flock to them," says Liolios, who previously worked as an innovation leader at Innotribe, the innovation arm of SWIFT. "A lot of expectations are being built on the bank side but there are not enough quality developers globally to develop these things and I have little faith in the ability of banks to develop the capability on their own."

Since January some 200 out of 700 start-ups that have applied to the Startupbootcamp Fintech and Insurance accelerator are building products around the blockchain, says Liolos. "That is way more than we would ever have imagined. But not all solutions to existing problems need to be on the blockchain. And when we go into the next stage – evaluating the applications – the quality is not very high. The banks are coming to them and saying, 'we have this problem; come and solve it with blockchain,' but the people building on the blockchain have no business background and no understanding of financial services. There is an element of translation needed between the two worlds. maybe the R3 consortium can actually build that bridge, but it is still to be seen.

"My big bugbear is the big gap between banks' appetite and their capacity to deal with start-ups," says Liolios. "Very few banks have grassroots hands-on experience with the entrepreneurs. It is great that a bank can say, 'we have a blockchain officer,' but do they actually have the infrastructure to experiment with an entrepreneur that has a great technology or a great idea? A lot of the banks don't."

The fault doesn't necessarily lie with the banks. Technologies do not always live up to their promise, says Neal Cross, Chief Innovation Officer at Singapore's DBS bank.

"I have been in tech for a while now," says Cross, a scheduled Sibos 2015 speaker. "As an observation I have noticed that every time a new technology comes along an instant set of gurus rides in ready to tell you that this tech will fix everything and try to retrofit it into existing problems. My role is to cut through the hype and to ascertain what this technology can enable that was unachievable before and how it could potentially change the cost model of our technology or operations. One way to do this is by organizing hackathons and getting start-ups to innovate on this platform. But in fairness the results for blockchain have been less than spectacular to date."

There are other reasons to be skeptical about blockchain's impact on the industry as a whole.

Things move slowly in the banking world, notes Cross. "Even though we are very excited about the future possibilities of blockchain, the reality is that the Next Big Thing for us in Singapore is cloud computing as historically the regulators have been behind in this regard. Thankfully this is changing now."

Banks are expecting to have difficulty reconciling their compliance requirements with digital ledger technology as well. "Everyone is excited in the industry about [distributed ledger] technology but institutions have had a hard time actually going live because regulators have been largely silent," says scheduled Sibos 2015 speaker Dan Markovitz, CEO of Earthport Europe, a London-based company that has built an alternative to correspondent banking.

Earthport and San Francisco start-up Ripple are teaming on a service that allows banks to maintain their current technology and compliance regimes while also benefitting from blockchain technology. "Our approach is pragmatic. Let's just assume that all current screening, monitoring regimes have to stay as they are – and we need to find a way to make this technology work with today's compliance requirements – not some future state which will arrive – who knows when," he says. "We have cracked the code."

But the issue of interoperability still needs to be cracked and standards agreed. "We need organizing bodies, we need coalitions, we need everyone talking to each other," says Chain's Ludwin, another scheduled Sibos 2015 speaker. "We also need leadership – we need certain institutions to say, 'we are going to invest in building something and you are going to come along with us.' From my perspective it is better to work in coalitions than to invest deeply one at a time. But we have to do both. It is going to be lumpy and zig-zaggy because there is no way a standards body is going to be driving revolutionary things."

"Once these networks take off it is going to feel like in one day the world changed overnight but in practice before that happens a lot of people will have to be working on this diligently building partnerships," says Ludwin. "A lot of ground work will be necessary."

Blockchain Offerings

Earthport
www.earthport.com
London, UK
Earthport acts as a central clearing agency to which all payments go — so that any bank or big corporate with a single connection to Earthport can send payments around the world. It is teaming with San Francisco-based Ripple Labs to allow banks to maintain their current technology and compliance regimes while also benefitting from blockchain technology.

Digital Asset Holdings
www.digitalasset.com
New York, NY, U.S.
Digital Asset Holdings is able to build both Bitcoin blockchain networks, which are permission-less, as well as off-the-shelf private networks like Hyperledger. Hyperledger enables financial institutions to create private blockchain networks for different asset classes and record the data and positions of the participating banks.

Chain
www.chain.com
San Francisco, CA, U.S.
Chain claims it enables institutions to build and operate blockchain networks that can power any type of asset in any market. Investors include Visa, NASDAQ, Citi Ventures, Capital One Financial and Fiserv. NASDAQ has announced it will use Chain's technology to facilitate the trading of stakes in unlisted companies on its private market.