Panel Discussion Takeaways

Blockchain’s Potential in the Financial Sector

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Morningstar Perspective

There’s no disputing that blockchain offers enormous potential to transform the financial services industry, but to date, adoption of the technology has been slower than initially hyped. While those on the blockchain panel at Opal Group’s Marketplace Lending and Alternative Financing Summit on Nov. 30 in Dana Point, California, noted headwinds to widespread adoption of blockchain, they also pointed out extensive benefits, including decentralization, reliability, simplification, transparency, traceability, enhanced security, potential cost savings, and improved data quality.

Stephanie Mah, vice president at Morningstar Credit Ratings, LLC, served as moderator and opened the panel with a simple graphic and description of blockchain. Blockchain is a shared database, either public or private, that contains encrypted entries that need to be validated by all participants on the network before being added. A permissioned, or private, blockchain may be the more likely choice in the capital markets because it has an authorized set of participants. This differs from an open, or permissionless, public distributed ledger like the one that bitcoin operates on. Each transaction is considered a block that gets added to the previous entry, resulting in a chain of record and one source of truth.

Ted Mlynar, partner at Hogan Lovells U.S. LLP, discussed how smart contracts on a blockchain execute automatically, essentially creating a barter system by transferring money or ownership of an asset. Blockchain creates efficiencies by cutting out the need for extraneous third parties, such as banks and clearing houses. Industries such as healthcare, insurance, and trade finance are ripe for realizing the benefits. These efficiencies, however, can introduce other issues, including potentially higher transactions costs and long processing times.

Alexandra Damsker, an advisor and former SEC attorney, noted that numerous challenges must be overcome before the market begins to see more widespread adoption. The uncertain regulatory environment, scalability, interoperability, and liquidity issues are the greatest headwinds. These hurdles are likely the reasons we have yet to see many revenue generators from blockchain.

In actual practice though, Kurt Watkins, of counsel at MG Miller, noted how blockchain has helped remittance companies facilitate payments. In emerging market economies, where banking infrastructure is less developed or in some cases nonexistent, blockchain has provided a platform for vendors to offer a basic financial payments system to consumers of varying economic status who might have otherwise been shut out of a traditional banking relationship. Watkins cited Rebit, a Philippine-based holding company for bitcoin-related ventures that provides international payment exchanges with money denominated in local currencies by using the underpinnings of bitcoin internally. Mlynar followed up with an example of how the state of Ohio will begin allowing taxes to be paid in bitcoin. He further clarified, however, that the state will not hold or invest in the cryptocurrency at any time as the bitcoin payment will be immediately exchanged into U.S. dollars.

The panelists closed out the session offering their outlook on blockchain in the financial sector. In theory, blockchain is very promising, but many financial industry market participants have yet to implement successful use cases. Payments and remittance companies, especially in emerging markets where existing banking systems are less developed, appear to have made the most strides. Meanwhile, some pioneers are already originating assets on a blockchain and looking to do a securitization on one sometime soon. The firms that can tackle blockchain issues such as scalability and interoperability will likely be the most successful--and transformative--down the road.

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