

What Blockchain means to the Financial Services Sector

Benefits, Drawbacks and Use-cases of a technology that promises to re-define the financial services industry.

Blockchain technology is set to compete if not fully replace the centralized financial services infrastructure, especially in the B2B world.

Hence it is important to take a deeper look into the nuances of Blockchain technology and in ways it can impact the future of fintech.

Blockchain is essentially a distributed ledger database. With cryptography built into its network, Blockchain connects untrusting parties sharing a common interest. Participants of a Blockchain co-create a permanent, unchangeable, and transparent record of exchange that's publicly visible to all participants.

In contrast to traditional payment model where a central clearing house is required to transfer money between the sender and the recipient, Blockchain's distributed ledger drives consensus based transactions. Since each block in the chain records the entire transaction history, double payment (or spend) problem is averted.

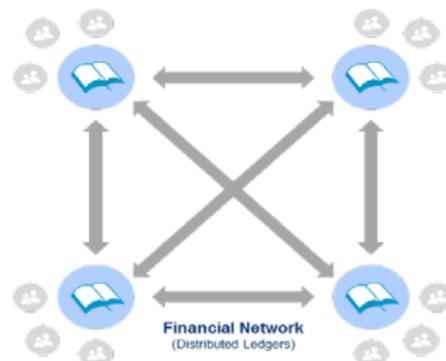
Financial Intermediaries (Today)

- + Requires trusted, centralized intermediaries
- + Batch clearing and settlement
- + Higher fees and costly infrastructure



Financial Protocol (Emerging)

- + No (or fewer) intermediaries required
- + Near real-time processing and management
- + Lower fees and reduced infrastructure cost



Source: Citi Research

Blockchain is still “bleeding edge”. It lacks the robustness of banking systems like Visa or SWIFT. However its core tenets can potentially transform traditional financial systems by reducing steps, time and cost from financial workflows.

Let’s discuss four such tenets and how they can influence financial transactions.

Decentralization: Direct transfer of digital assets based on a distributed ledger. It removes the need for an intermediary or middle man.

Automation: Smart contracts in insurance and hedging can be pre-programmed to execute after the agreed conditions are met.

Immutability: Maintain an irrefutable audit trail that tracks the ownership of the asset as it gets transferred. This is crucial from a business and regulatory standpoint.

Cost/Capital Efficiency: By removing central authorities and intermediaries, transactions are made faster with low cost of settlement.

The combined effect of decentralization, automation, cost and capital efficiency can boost both profits and performance. Immutability, in addition to bolstering trust, can find useful application in many verticals within financial services.

Blockchain: Use Cases in FinTech.

International Remittances

Although Blockchain adoption today is mainly seen with crypto-currencies, its applicability can be far-reaching in the financial sector. Many new ventures are betting big in the international remittance market. According to World Bank, cross border C2C remittances are expected to grow to \$700 billion by 2020.

Abra, founded in 2014 aims to digitalize cash and enable P2P money transfer through Abra's Blockchain network. American Express is a key investor in Abra. The rationale behind investing in Abra is explained by Harshul Sanghi, Managing Partner, American Express Ventures: "As people and businesses transact more globally, there's a need for more convenient and affordable ways to move money, and we think Blockchain could play an important role in the evolution of money transfer and commerce, especially in emerging markets."

Citigroup's FinTech Report published earlier this year cites many other Blockchain use cases in securities and settlement such as: syndicated loans, commodities trading, cash settlement, and also derivatives trading.

Investment Banks: A Key Blockchain Beneficiary

Blockchain's main benefit is reduced friction in the multi-gear financial market.

Removing intermediaries from the trading process, and their associated fees and complex infrastructure allows investment banks to significantly reduce cost in the long run.

By settling trades faster banks can reduce the liquidity they need to hold and hence the size of balance sheet. [Citigroup's Fintech report](#) estimates this in itself could amount to tens of billions of dollars in savings for large banks.

With blockchain banks can settle a transaction without having to go through exchanges or CCPs. This can potentially reduce brokerage, clearance and exchange fees (BC&E).

Faster settlement also implies reduced operational risk (due to trade fails). Reduced counterparty risk from shorter exposure can decrease clearing capital requirements, reduce pro-cyclical margin and liquidity demands, and increase global settlement harmonization.

To realize these benefits blockchain technology must evolve to industrial grade reliability and robustness and that's the road we need to chart ahead.