Blog

"I don't touch Bitcoin, I only do Blockchain"

You can hear these words in almost every bank in the world. WRONG. Ironically the the Bitcoin blockchain is the blockchain that financial institutions touch the most. Every day banks clear millions of dollars in transactions to and from Bitcoin exchanges and merchant processors. Some banks have put in place controls and processes to onboard these businesses, others simply have retail customers buying and selling Bitcoin directly from their bank account...

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Published May 16, 2016

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The year is 1766 and Sweden has just passed the world's first law enabling the public to access information related to the government. Since then, transparency has been instilled in Swedish culture. Today in the EU, the Swedish commissioner Cecilia Malmström is the only Commissioner that publishes her external correspondence in a publicly accessible register. Bold acts of transparency undoubtedly help democracy and protect society...

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You can hear these words in almost every bank in the world. WRONG. Ironically the the Bitcoin blockchain is the blockchain that financial institutions touch the most. Every day banks clear millions of dollars in transactions to and from Bitcoin exchanges and merchant processors. Some banks have put in place controls and processes to onboard these businesses, others simply have retail customers buying and selling Bitcoin directly from their bank account.

The bank might already have customers that they cannot investigate because they are unable to understand the activity that their customers are performing. This is actually a great learning experience on how the blockchain can be purposed as a Regtech solution.

Regtech is sexier than Fintech these days

Regtech describes the process of leveraging technical solutions to meet regulatory requirements. For the financial industry that is so highly regulated, having new technical solutions to offset the increasing cost of compliance is essential. And it not only effects the big banks that you see in the news receiving multi-billion dollar fines. The Federal Reserve of St Louis estimates that the compliance costs community banks 22% of net income on average or $4.5 billion. This has led to consolidation in that market and the removal of certain financial products.

The intersection of blockchain and regtech is defined by a combination of transparency, enforceability and strict accountability. The way that a Blockchain can give strong guarantees of consistency across multiple untrusted parties is a way to change the organizational structure of an industry. Will cover more of this in future posts.

Bitcoin Regtech

Using Bitcoin as an example, we will quickly see how the public blockchain serves as a method of building trust among participants and introduces new possibilities of regulatory design and implementation. Bitcoin is designed so that every transaction is made public through a shared ledger. The identifiers within each transaction are usually only known to the participants in the transaction. The sender knows the recipients identifier and the recipients can see from where the Bitcoin came from.

However the public nature of the transaction ledger allows third parties to receive the information that this transaction occurred. With the analytics that Chainalysis provides the risk of the specific transaction can also be assessed.

This means that every stakeholder in the ecosystem has access to a canonical version of the settlement layer between every player on the Bitcoin network.

The Bitcoin businesses that allow consumers to buy and sell Bitcoin have full view over their customers and are still required to keep records and have KYC and AML controls. The bank now has a better way to have an ongoing monitoring program of the Bitcoin business that they have onboarded due to visibility of the overall settlement activity of their customer. But note that they only see the activity of their customers' customer on an aggregate basis as they don't have a map of which of their customers' customer made any particular Bitcoin transaction. The regulator can also have access to the same information and can ask questions about the level of activity on an ongoing basis. Finally law enforcement does not have to wait to be notified about suspicious activity and can be proactive in sending requests for information.

This opens the possibility for different arrangements between all the players in the ecosystem that are still being negotiated and understood. This takes time because the Blockchain is arguably more an innovation about how to arrange organizations and humans than about technology.

Banks, regtech and blockchains

People need analogies and experience in order to implement new ideas. Today, banks could improve its compliance posture by understanding their retail customers who are active in digital currencies better. This will allow them to gain experience in understanding how the future of information sharing on a blockchain could change their business as well as more accurately assessing the risk of their existing customer base.

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Bitcoin,   Blockchain,   Fintech

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