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Rising Momentum for Blockchain's Decentralized Finance Applications

Background

Blockchain technology's potential for disintermediation in the financial sphere has evolved in the decade since distributed ledger technology was introduced. Early challenges to cryptocurrency's usability have been slowly overcome by developers through updates to existing blockchains, such as by hard forks, and the creation of new, specialized platforms, such as Monero.

The problems of climbing processing fees and extremely limited scalability are being addressed by applications like Bitcoin's Lightning Network, which recently reached new highs for user numbers and payment capacity.^[1] Although user interface and ease of access issues remain as significant bars to entry and widespread adoption of decentralized payment networks, a host of new apps – targeted at laypeople – are developing around the continually improving cryptocurrency ecosystem.^[2]

Development in the decentralized finance space has accelerated in recent months. As blockchain's potential for payment processing and international finance draws more attention in light of increasingly destabilized national currencies in countries like Venezuela, several big-name institutions, including Visa, J.P. Morgan Chase, and Facebook have taken steps to capitalize on or offer their own "decentralized" financial technologies based on blockchains.

What's New in Crypto?

Here are a few notable recent developments in the decentralized finance space:

Coinbase and Visa announce a cryptocurrency debit card.

The greatest roadblock between cryptocurrency and widespread adoption may be usability. Critics and proponents of blockchain technology alike tend to agree that a blockchain application must improve on the existing ecosystem it seeks to inhabit in order to

attract adoption. And cryptocurrency, which banks generally either cannot or will not store, and which is frequently held in private, cryptographically protected wallets or exchange accounts, can be difficult to use in the context of day-to-day transaction payments. Some attempts to increase the usability of cryptocurrency already exist – Bitcoin ATMs have proliferated, for example,^[3] and cryptocurrency exchanges have simplified their users' ability to exchange cryptocurrency for fiat currency.^[4] But the recent move by cryptocurrency exchange industry leader Coinbase and payments giant Visa to offer a debit card that allows users to “spend [their] crypto as effortlessly as money in their bank” may help catalyze a wider use of cryptocurrency.^[5]

The card, which is currently only available in the UK and the EU, will enable users to spend several of the most prevalent digital coins at any point-of-sale location where Visa cards are accepted. The payment company exchanges cryptocurrency for its corresponding value in fiat money at the moment of sale, such that the cardholder pays in their digital asset of choice and the merchant receives a traditional fiat currency payment.^[6] The card and app will even enable cardholders to withdraw cash from traditional ATMs. In order to use the debit card, however, users will be forced to hold their cryptocurrency in Coinbase-hosted wallets, a prospect that critics note leaves digital assets less secure than storage in private wallets generated by and for individuals.

Indeed, although Coinbase is not a bank, it is a central party, an intermediary for a technology whose value many believe to be its ability to exist apart from any. But the tradeoff between usability and security may be mitigated by Visa's extensive security features and Coinbase's already-developed app designed to improve user experience and account management.^[7] If users with extensive crypto holdings and no convenient method for using those assets in day-to-day purchase contexts are willing to store at least a portion of their cryptocurrency in centralized exchange accounts, the card could significantly increase the use-value of cryptocurrencies.

JPMorgan Chase launches the first bank-backed cryptocurrency.

In February 2019, J.P. Morgan Chase (JPM) announced that it was creating the first-ever cryptocurrency from a major bank.^[8] Called “JPM Coin,” JPM plans to use its new token for at least three real-world applications, according to its head of blockchain initiatives. These include: (i) facilitating international payments on behalf of large institutional clients, which currently face both high fees for using wire transfers and lengthy delays; (ii) hosting securities transactions, such as debt issuances (JPM tested a simulated \$150 million transaction on behalf of a Canadian Bank) and leveraging the blockchain to enable instant settlements; and (iii) replacing the actual transfer of cash between a customer’s various subsidiaries, thereby cutting down on wire transfer fees and accounting costs.^[9] JPM’s decision to run with the cryptocurrency came as a surprise to many, particularly after the company’s CEO called cryptocurrency “a fraud” and threatened to fire any employee who traded Bitcoin for being “stupid.”^[10] The coin, which is exchangeable with the U.S. Dollar at a 1/1 ratio, is usable only by JPM-permissioned participants and functions more as a digital representation of a company’s cash reserves than as an independent cryptocurrency like Bitcoin or Ether.^[11]

Facebook announces details of its cryptocurrency Libra.

Facebook finally revealed the details of its cryptocurrency, Libra, which is set to launch in the first half of next year.^[12] The social network site partnered with a number of financial firms, online merchants, and credit card companies to establish a stable cryptocurrency which it hopes will drive down transaction costs.^[13]

Like JPM Coin, Facebook’s cryptocurrency’s value will be tied to a government-backed fiat currency, such as the dollar or yen. But unlike JPM Coin, Facebook’s coin would likely be available to all 2.3 billion users with an account, facilitating fee-free or low-fee international fund transfers to large markets such as India.^[14]

Industry reactions to the forthcoming coin have been predictably mixed; opinions range from viewing Facebook’s initiative as “the biggest boon for crypto ever”^[15] to a poorly-veiled attempt to join “centrally controlled entities and despotic governments on the crypto bandwagon.”^[16]

Though these initiatives and other similar developments may mark increased momentum on the decentralized finance front, they face their own hurdles. All three of the above projects come from highly established institutions in the tech and banking industries – spaces that the crypto sphere has traditionally seen as needing disruption. One blockchain industry wrote that for a major bank to build using decentralized technology would be “a project reveling in its own irony.”[\[17\]](#)

But as national and international regulations surrounding cryptocurrency tighten, few organizations or groups are as well-equipped to hasten widespread adoption of blockchain technology as the highly-regulated financial institutions that have worked within complex legal frameworks for decades. Similarly, the adoption of blockchain technology applications by major corporations with virtually universal user reach may be exactly what an industry that continues to struggle with mainstream recognition and adoption needs.

Evolving Blockchain Applications

Perhaps this is why adoption of blockchain technology in the financial sector has hastened in recent months. Banks of all sizes, as well as other financial service providers, are investing in this new and emerging technology. Below is a sampling of recent developments:

Bank of America

Bank of America’s Chief Technology Officer Catherine Bessant recently stated that Bank of America is experimenting heavily with blockchain technology despite general skepticism.[\[18\]](#) Bank of America currently holds more blockchain-related patents than any other financial firm,[\[19\]](#) and its patents cover private keys, multiple digital signatures, data storage, and a cryptocurrency exchange system.[\[20\]](#) Its high number of patents indicate that Bank of America is prepared for blockchain’s mainstream emergence.[\[21\]](#)

Wells Fargo

Wells Fargo rolled out a pilot program with the Commonwealth Bank in Australia in October 2016, but the program was not as successful

as anticipated.[\[22\]](#) Nevertheless, recent statements made by Wells Fargo's CEO indicate that it believes long-term potential exists.[\[23\]](#) Wells Fargo has applied for a number of blockchain-related patents, notably a patent for a tokenization system for sensitive data.[\[24\]](#) This system could be used to control access and maintain data integrity, even when that data is stored in a public network.[\[25\]](#)

PNC Bank

PNC Bank has partnered with Ripple to use RippleNet to expedite cross-border transactions.[\[26\]](#) Ripple's software uses an inter-ledger protocol instead of distributed ledger technology, but this approach is seen as a first step that might precede usage of Ripple's digital token.[\[27\]](#)

Square

Square recently received a patent for a system that allows merchants to accept cryptocurrencies and then convert those payments out into the currency of the merchant's choice.[\[28\]](#) In June 2019, it hired former Google director Steve Lee as the first member of its new crypto team,[\[29\]](#) and in the first quarter of 2019 has generated \$65.5 million in Bitcoin-related revenue.[\[30\]](#)

TD Bank

TD Bank appears cautious about cryptocurrency investment[\[31\]](#) but recently partnered with Hydrogen to allow customers to use Hydrogen's blockchain-based authentication for web-based investing.[\[32\]](#) It also applied for a patent to protect a blockchain-powered point-of-sale system.[\[33\]](#) This system could be used to create a public distributed ledger to track transactions.[\[34\]](#)

BNY Mellon

In June 2019, BNY Mellon signaled an intent to become a digital-assets custodian when it took the step to partner with a firm that plans to establish a bitcoin futures exchange.[\[35\]](#) Despite earlier comments cautioning direct investment in cryptocurrencies, BNY Mellon noted that blockchain technology could be used to eliminate transaction and foreign exchange costs, accelerate growth in peer-to-peer transactions, and change the way investors view

opportunities worldwide.^[36] It also joined a group of banks to form a company called Fidelity in a bid to fulfill the vision of a utility settlement coin.^[37]

Takeaways

The examples set forth above are some of the many ways in which banks and financial institutions are experimenting with blockchain technology. This technology, despite its disruptive ambitions, has a bright future in the financial services industry as it can help banks not only reduce the cost of processing payments, but also create new products and services that can generate important revenue streams. Importantly, some FinTech companies are developing blockchain-based solutions that allow them to compete for revenue streams traditionally dominated by banks. Banks and financial institutions that choose not to play in the blockchain space may find themselves playing catch up, or worse, left behind.

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