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Blockchain

Blockchain and the holy real-time settlement grail

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By: **Izabella Kaminska**

Not since Prometheus bequeathed the gift of fire upon humanity — prompting stone-age entrepreneurialism of the highest order (me make fire, me then make register of value-added products made with fire, me then make trade offering to my heathen cave dwelling neighbour in hope to secure peace or value in return, me get clubbed on the head regardless) — has a technology captured the imagination of a people so.

We're referring of course to blockchain — or as we're campaigning for it to be called, batchlink, matchmerkle, infocartel, or tradeballandchain.

If the hype is to be believed, blockchain equates to a Promethean (*Satoshean surely? – Ed*) gift to humanity, which stands to eliminate all risk from the settlement process by taking society to a real-time operations framework. (Me make value-added product, me make trade offering to my neighbour, me get instant value-added product back without risk of being clubbed on the head ever.)

But as they say, be careful what you wish for. Blockchain fanaticism, and the perception that a real-time operations can eliminate all risk, opens the door to risk in and of itself.

It's for this reason we've been skeptical of blockchain hype for a while. But it's a hard message to communicate to an industry by and large blinded by love for the notion that a riskless system is just around the corner. Blockchain has become a siren song.

Luckily, there are some who seem immune to the enchantment and offering a more realistic take on the potential of the technology.

One such fellow is [Larry Tabb \(https://research.tabbgroup.com/report/v14-009-blockchain-clearing-and-settlement-crossing-chasm\)](https://research.tabbgroup.com/report/v14-009-blockchain-clearing-and-settlement-crossing-chasm), with 20 years of experience building financial markets clearing, settlement, cash management and accounting software.

Tabb recently put out a report identifying some of [the core challenges \(https://research](https://research).

tabbgroup.com/report/v14-009-blockchain-clearing-and-settlement-crossing-chasm) facing the roll out of blockchain.

One of the core issues being:

- Ownership and identification, and why real-time settlement poses major hurdles for a financial system that depends on anonymity and obscurity for liquidity and efficiency, but also a broker network which can identify parties on a need to know basis when necessary.

As Tabb states:

If we have a brokered market but have securities registered to their owners, then we either need back-to-back trades, and risk having brokers perceived as front-running, or move into an ID market, which impacts liquidity and hurts firms that would prefer to stage anonymous. And if we get rid of brokers, then it becomes virtually impossible to hide anything, unless we go to completely anonymous; while there may be brokers and clients listed on the blockchain, no one sees anything when using the public blockchain (which regulators surely won't like), and if we use a private blockchain, the owner of the private blockchain would be in complete control, as they would be the only one with any information.

Other issues then include:

- Securities lending and information leakage — the inability of investors to sell securities quickly on news events even if they are lent out, because they have to be repatriated first (discouraging stock lending in the first place). And information leakage that they are planning to sell because securities are being recalled.
- Foreign exchange — time-zone differences which impede real-time settlement in general.
- Allocations/confirmations/block process — you can't easily fragment large purchases for liquidity reasons if your name is attached to every trade, opening the door to information leakage. Then there's the issue of aggregating small trades into larger blocks, because an immutable, immediate ledger would prevent cost-averaging for group transactions.
- Physicals — All physical certificates would have to be banned, especially if they still carried legal rights to ownership, because it would be impossible to physically keep up with the settlement process.
- Netting — moving to blockchain would prevent netting and thus require the processing of up to 2.9m more settlement records a day. Not efficient. Especially if you require consensus for everyone of those trades.

- Technology infrastructure — record keeping isn't everything and blockchain doesn't solve or improve on the ability to manage accounts, drive P&L, calculate risk etc.

Conclusion?

While bankers would love to eliminate settlement risk in the system, the idea of adding literally tens of millions of additional settlements would arguably bring us back to the paperwork crises of the mid 70s, which was the driving force to create clearing houses in the first place, says Tabb.

So, once again, be careful what you wish for. Blockchain is not a panacea. Much more likely, the pursuit of a risk-free settlement system remains equivalent to a quest for a mythical thing which in our physical reality cannot really exist.

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OCTOBER 21, 2017 By: FT Alphaville

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mmortal03

Mar 2, 2016

"And if we get rid of brokers, then it becomes virtually impossible to hide anything, unless we go to completely anonymous; while there may be brokers and clients listed on the blockchain, no one sees anything when using the public blockchain (which regulators surely won't like), and if we use a private blockchain, the owner of the private blockchain would be in complete control, as they would be the only one with any information."

Sounds like they should check out Monero, where everything is anonymous, unless one chooses to share the view keys.

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Mar 1, 2016

I think it was more like, "Me make fire, give to woman, Me get night of pleasure ", or something like that. Although, mark me down as a sceptic, the IT industry has a record of churning out ideas - some good many bad, for the sake of justifying its budget to the board.

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See: Ripple. Keep the trusted parties (banks, brokers, etc) with all the benefits; use blockchain to settle transactions quickly, verifiably, in a system extremely robust to individual server failure or data loss.

Have pie; eat pie.

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Feb 26, 2016

Perhaps pairing blockchain with existing processes isn't realistic, but that is missing the point because the current setup is going to be flipped on its head. Manage accounts? Calculate risk? That is all going to be automated and distributed ledger will just be one more advancement that will support the automation drive.

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What about Blake Masters and Australian stock exchange moving fully to block chain. Didn't they think of these issues

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Feb 26, 2016

@**PEguy** ASX is planning to spend 6-12 months trying to develop something, starting work in 2017. Let's see what comes of it. <http://goo.gl/VEn2BI>

Right now it's vapourware.

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Feb 27, 2016

@**Paul Murphy** @**PEguy** I wonder if this includes the way DMA terminals interact with the exchange. I suspect not and it will be the processes pre and post trading settlement.

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No reference of JP Morgan's recent effort?

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