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Regulation and use cases for cryptocurrencies

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Lack of regulation in the field could see cryptocurrencies restage the Great Financial Crisis. Blockchain technology can serve a greater good beyond financial speculation

Rehypothecation. It is the practice of lenders taking collateral that borrowers had pledged for a loan, and promising the right to that collateral in exchange for further funds from another lender or financial institution.

It lays at the heart of Lehman Brothers' collapse in 2007: over half of the US$40 billion held by the firm's European prime brokerage held been rehypothecated. In theory, one default in a long chain on rehypothecated assets can set off a domino effect if it was big enough; it was, setting off the Great Financial Crisis.

While finance and banking laws have been updated to prevent a repeat, the relative lack of regulation on the cryptocurrency front could yet yield something similar.

"The dangerous thing in crypto being unregulated [with regard to] lending means there's no oversight on rehypothecation," explains **Joshua Ho**, Managing Partner of digital asset traders QCP Capital. "Let's say you have to put down collateral, they typically ask for 200 to 300 percent of the loan. What happens is the broker in between takes that on, then he lends that out again, so someone with a $20 million balance sheet in this space can have a $1 billion loan bill. This is how we got into the financial crisis."

"That's happening right now. This is very worrying to us because it takes just one default and the whole system collapse. This is not something we need after everything that's happened in the last year or so." He adds:

> *"The worst part of all this is the guys who are lending have no idea what credit risk means. You have a lot of Silicon Valley engineers who have no capital markets understanding and you tell them, 'Look, I can give you this transparent deal, and you know exactly who you're borrowing from.' And they say, 'But this guy pays me 17 percent!' Why do you think they're paying 17 percent? They don't understand the implications. This is some education that you need to do."*

THE USE CASE FOR BLOCKCHAIN

Ho made those remarks in a panel discussion titled *Digital Assets in Asia* at the recent SMU SKBI event, *Digital Assets Working Group (DAWG): APAC Readout 2019* where he brought up the topic of stablecoins (see Perspectives@SMU artcle *Stablecoins: The cryptocurrency Holy Grail?*). While this latest flavour of cryptocurrency has generated its fair share of controversy, other panellists see real-life use for it.

"Stablecoins [are] something that's gaining traction across our industry," says **Bridie Ohlsson**, Founder and CEO of Geora, an Ethereum based commercial blockchain protocol designed for agriculture. "We've run pilots previously with private banks and other big agribusinesses where we create our own representation of Australian Dollars or whatever other currency we're looking at, within our network.

"There's an enormous amount of efficiency we can create just by automating deductions of royalties, pay it all back to state coffers or levies paying back to government and having that all programmed into the exchange of the asset and the currency, but that's not very valuable until we can actually bring currency in and out of that system.

“That's where stablecoin comes in, so I think that's valuable. But that has to be regulated, it has to interface into traditional banking sectors as well for agriculture to adopt this.”

On top of that, Ohlsson also highlighted blockchain technology’s to capture verifiable information about animal assets’ history: “RFID tag in the ear of the pig and a mobile application to capture really important information about that pig asset whether it's been fed sweet potatoes, which is very important information for the value of that asset.”

“[We can also see] whether it's been vaccinated,” Ohlsson continues. “We create this history of that commodity which can then be shared when that asset goes to market and used as a way of collateral for accessing finance for those small farmers.”

That traceability also extends to a physical asset’s ownership and financial history, which was at the heart of the 2014 Qingdao metal warehousing scandal. When viewed in combination with the occasional scares about food safety that rock the region from time to time, Ohlsson believes blockchain and distributed ledger technology could make a big difference in the farming and agriculture sector.

“It's not just the end consumer who feels this stress of not knowing if this asset is real and the state of it, but it's everyone along the supply chain,” Ohlsson elaborates. “How are we ensuring that farmers are paid for what they're selling and [what] we're eating? And we often don't know if the farmer has actually been paid.

“Once you create this entire chain of custody, chain of ownership, and this record of this asset, it's a fantastic way to get extra liquidity into the supply chain. Because you have a proof point, you can actually have finance, and you can have liquidity off the back of this asset itself.

“The asset might be a plot of land and it's something that you can put up as collateral for getting access to finance which is critical for farmers throughout Asia.”

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