



How Financial Futures Are Changing

Description

Web3 is an umbrella term for the vision of a new version of the internet, in which services are decentralised and users control their own data and identity.

In the past few years, Web3 has come to mainstream attention due to bitcoin's price volatility, the recent popularity of non-fungible tokens and the rebrand of Facebook to 'Meta'. This vision, if widely adopted, could drastically change many industries, including financial services.

DeFi

Decentralised finance (DeFi) is a component of Web3 that aims to reimagine financial services. In this vision, there is no requirement for centralised entities such as banks, insurers and ultimately central banks.

Although in its infancy, DeFi is already creating a parallel financial services world with a total value locked (TVL) of \$239.44bn (as of January 2022). TVL is the overall value of crypto assets deposited in a DeFi protocol, or in DeFi protocols generally. In DeFi, users are already making payments, lending and trading without relying on a central third party. Instead, peer-to-peer exchanges are done using decentralised applications, or 'Dapps'.

This new vision has the potential to open up access to the estimated 1.7 billion underbanked and unbanked, since anyone can open an account as long as they have an e-wallet. However, to reach its full potential, the DeFi community needs to bridge the gap between traditional financial services and the new DeFi experience. User interfaces and experience must be improved and the risks associated with 'being your own bank' must be mitigated.

Some financial services companies have taken note of this gap and are moving to fill it by creating the bridge between DeFi and traditional financial services. For example, in February 2021, Mastercard announced that it would support certain cryptocurrencies.

Decentralised Identity

One of the innovations of Web3 is that each user will have a unique digital identity. Currently, users access online services by using a username and password. Users have a separate account per service provider,



leaving them with a multitude of passwords and a fragmented identity experience. Additionally, users lose ownership of their identity as each service provider controls their data.

In the decentralised model, users store their verified credentials — a passport or driving license — in a digital wallet. Then, when they register to a new service, the user shares only the relevant information with the third party, which verifies the identity via a blockchain-based ledger. For example, if the user's age needs to be verified, instead of providing their driving license, the user only shows the age information.

The decentralised model goes further if we consider the cryptographic concept of zero-knowledge proof, in which two parties can validate data items without ever disclosing the data itself. In this new world, the user's personal information is fully protected and controlled by them.

In financial services, decentralised identity can have an immediate impact on compliance. Financial services companies would be able to reduce the amount of data they have access to, reducing costs and decreasing the risk of cyber-attacks.

In the long term, if the decentralised concept gains momentum, existing onboarding, know-your-customer requirements and other compliance processes may change drastically. Note that in decentralised service there is no third party — such as a bank — to perform those checks, but there is still a need to ensure privacy and identity safeguards. This is a space that will require regulator attention, and a decision on who will own the risk and how it should be mitigated.

Creator Economy

Web3 has reignited the creator economy by returning ownership. According to the US business magazine *Fast Company*, “more than 50 million people globally consider themselves content creators, and the market size has grown to well over \$104bn”. Creators can now own the platforms, products and communities they create. They also have voting rights and can fully monetise their services.

While currently neither incumbents nor fintech companies seem to have tapped into the creator economy, the market growth potential may grab the attention of financial services players.

The opportunity for financial services companies lies in bridging the gap between cryptocurrencies and traditional banking, while tailoring it to the creators' needs, such as providing loans based on predictable future income.

Visa is taking this approach; in October 2021, it announced a programme to help creators navigate the world of both crypto and traditional payment infrastructure.

Additionally, in the Web3 creator economy, any activity performed would be documented and part of the decentralised user identity. Like the physical world, a person's identity would include interests, accomplishments, actions to date and so on. This could open up a stream of data that could be leveraged by financial services companies for credit, loans and other decisions.

While Web3 is still in its infancy, it is evident that it has the potential to democratise finance and change business models. Many suggest that we will coexist and interoperate between two worlds: the digital world, powered by a decentralised economy, and the physical world, powered by a more traditional economy.

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Date Created

January 2021