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While it is now digitised, the insurance industry’s basic infrastructure has remained substantially unchanged for the past century – and the same is true of other parts of the financial system: banks, brokers, and exchanges, as well as central monetary authorities.

Yet the current system is arguably failing. Why does it cost 3% every time a credit card is swiped? Why are savings rates zero or negative? Why are borrowing rates so high? Why is transferring money...
These persistent financial frictions take a toll on economic growth. Suppose an entrepreneur has a great idea with a target rate of return of 24% a year. They go to their bank and ask for a loan. The bank agrees that the idea is a good one, but the client is too small; it would prefer to deal with one larger commercial customer than 100 small ones. Instead, it offers to significantly increase the credit limit on the entrepreneur’s credit card—and we all know what the interest rate is on credit card debt.

The project is never pursued, but it is exactly the type of project that boosts economic growth. For the past decade the US economy has been stuck in a 2% annual growth mode, while government debt has piled up. There are three ways to pay off that debt: increasing taxes,
In DeFi, peers interact with peers via algorithms or smart contracts. It is not hard to imagine a future in which we deal with algorithms in many industries. In DeFi, these algorithms do not carry the baggage of traditional finance – there are no layers of bureaucracy or back-office staff. When peers interact, no middle person is making a large spread or commission.

Furthermore, decentralised apps are interoperable. In centralised finance, it might take days to send money from your broker to your bank or vice versa. No such delay exists in DeFi.

Finally, the current system is opaque. We rely on government regulators to spot trouble, and history suggests a dubious track record in monitoring. In DeFi, this is not possible.
One risk is smart contract risk – a flaw in one of the algorithms. Unlike our current system, all code is open source, so the exploiter does not need to ‘hack in’ to see the code.

The fact that DeFi is decentralised opens up the possibility of governance risk, in which a small group takes control of an algorithm.

DeFi uses blockchain technology, which is a closed system. It is important to get information from outside the blockchain into the blockchain. The link to the outside world is called an oracle. The source of the oracle’s information can be manipulated, which introduces oracle risk.

Current DeFi technology, which processes 15 transactions per second, cannot
contrast, popular cryptocurrency exchanges, such as Coinbase and Binance, are centralised exchanges. With DEX, the investor interacts with an algorithm, not a broker, which leads to its own set of risks: DEX risk.

A cryptocurrency is identified by a private key – a long number that cannot be guessed. If the owner loses the key, they lose their cryptocurrency. This characteristic introduces custodial risk. Several solutions have been put forward to mitigate this risk, such as the use of a professional custodian.

Most current cryptocurrencies use a very energy-intensive method to add to their blockchains, introducing environmental risk. Many experts estimate that cryptocurrencies’ energy use is equal to a country’s energy use.
only now trying to develop a framework for them. The regulators need to be careful. If regulations are too harsh, innovation is squashed or moves offshore. There is currently considerable regulatory uncertainty, and the DeFi space will benefit once this is resolved.

Again, any large-scale technological change involves risk – and there is certainly plenty of risk in this space today.

**Where next?**

It’s early days for DeFi. Fintech companies largely still use the current centralised financial architecture, and we are just now seeing the scaffolding of a new city.

For those who choose to ignore the DeFi future, beware. I have heard many say, “I am not interested in this space and do not
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Request for buoyant 2022 higher COVID-19 mortality