

## **Banking a Blockchain, AI and Cryptocurrency Future**

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*New Malta Bankers Association chairperson Marcel Cassar speaks to Helena Grech about the many hurdles and opportunities facing the banking industry, not least of which is the advent of blockchain, artificial intelligence and crypto currencies*

**As the newly appointed chairman, what will your focus be and how will it differ from that of the previous chairperson?**

These are interesting and exciting times for banks as strong economies and new technologies present us with opportunities to grow and transform. There are also many challenges, not least a changing risk landscape, more demanding regulation, and retaining talent for an increasingly dynamic and complex banking industry. But our business is founded on trust and reputation and these are also critical times as Malta faces some important tests. The fifth round of Moneyval is underway and the IMF's Financial Sector Assessment Programme, the first in Malta since 2003, has also started. Malta's financial services industry and its supervisory framework are also under increased scrutiny by EU and international institutions, not to mention governments.

The MBA must play its part by setting the tone, requiring all its members to uphold onerous standards of conduct. Against this background, I also want to see how we can continue developing the Association to be better equipped and increasingly relevant to meet the expectations of its members.

**In the objectives of the MBA, the first one is to identify and discuss matters of common interest to its members. One area which must be top of the agenda is the new technologies rocking the banking sector – Blockchain, AI, and Crypto currencies. As a banker, what are your views on the three separate technologies?**

Let's start with Blockchain. It sounds like a banker's dream: having records of all transactions, documents and contracts that are always authentic and reliable. Identities, signatures, authorities, etc. that can be validated, stored, verified and shared, with no risk that they are tampered or deleted, without using intermediaries; safety and security without the heavy and costly hierarchies, bureaucracies and controls as we know them. I read recently that the present environment in which the digital world is evolving is like a rush-hour gridlock trapping a Formula 1 car! Therefore, blockchain sounds wonderful – it can be a total game-changer. But going by our experience of technological innovation, a blockchain revolution of business and government could still be years away because many barriers would need to fall in the meantime. Turning to artificial intelligence (AI), it is a fact that the leading global banking firms have prioritized investment in AI to enhance service, revenue and performance. Emerging fintech and AI applications will heavily influence the future of finance and we see companies like Amazon, Google and Apple entering the arena – with a more alluring reputation for innovation,

setting the stage for increasing competitiveness. It's no different to the appearance of the first ATM 50 years ago – it was revolutionary technology then, whereas today we speak of AI and robotics as the future of banking. So will those players with the most progressive use of AI have the upper hand? The traditional bank business model, unlike that of many modern tech giants, sees armies of employees performing mundane paperwork and 'legacy' processes, many of which may be eliminated once the AI revolution takes over. That does not necessarily make AI a redundant force over employees, more an augmenting or transformational one.

Cryptocurrencies are another story. Money, whether conventional or crypto, needs payment systems to flow. The currency is the 'what' while the payment technology is the 'how' – but they are not one and the same. Take what happened with mobile payments in developing countries, where not everyone has access to a bank account. In East Africa, for example, mobile phone companies leapfrogged banks as payment intermediaries because they made it possible for people to transfer cash-convertible phone credits to each other. That meant that phone credits could be used as a digital medium of exchange and the payment infrastructure became the mobile network. So cryptocurrencies are like those phone credits, a medium of exchange for those willing to offer and accept it. But there are still some fundamental questions. Will they be accepted as a store of value? How will they be regulated? Will they become legal tender? At this point, there is little evidence to suggest that cryptocurrencies, for all the hype, can be a threat to the fiat currencies in the short or medium term. But what it means for banks is that their traditional role as main payment intermediary for funds and currency transmission will become challenged, if not obsolete.

**It is undeniable that cryptocurrency threatens the functionality of banks as we understand them today – could such innovation somehow be turned into an opportunity for the banking sector? Do you think that crypto is here to stay, and in practise, what would that mean for banks in your opinion?**

Many banks have been steering clear of cryptocurrencies because of the novelty they present, not being conventional legal tender nor backed by a central bank. They also present risks of money laundering because of the inherent anonymity of the assets while the volatility in their prices makes the average retail investor nervous, to say the least. Some banks have also taken a hard-line approach by, say, blocking cryptocurrency purchases on credit cards or refusing deposits from clients funded by selling cryptocurrencies. But more and more bankers, typically from smaller Swiss and European institutions, are beginning to seize on what they see as opportunities. These include advising companies on initial coin offerings, promoting crypto-tracker funds to investors, providing custody services and generally taking a more open stance to cryptocurrency related activities. My view is that cryptocurrencies are here to stay and, just like the early days of the internet which created a furore because of lack of regulation, once regulation and education improve and banks gain more confidence, some may reap first mover advantages. But there are still many unknowns and it may be a risky road until then.

**DLT could be used to make the banking sector more efficient and transparent especially through closed systems that are used for internal banking operations, as well as open networks to effect payments and transactions. Government is pushing for DLT and banks seem more ready to accept it – what are the areas of concern for the MBA at present?**

As I have already outlined, we should see blockchain, or DLT, not as a disruptive technology that attacks the traditional business model with lower cost solutions – but as a foundational technology that can create new platforms for our economic and social infrastructure. The benefits are undisputed and recent examples of IBM announcing the successful completion of a proof-of-concept of its Corporate Know Your Customer (KYC) solution, and the Italian Banking Association announcing its testing of blockchain for interbank and correspondent reconciliations, are only indications of the potential. So we welcome the initiatives of the government as it moves to pilot legislation and look forward to the creation of a sound, robust regulatory framework. Right now, we are seeing the first exchange platforms seeking to establish banking relationships in Malta and we acknowledge that this is an area of unknown and unprecedented compliance risk for our banks. So we need to be sure of what enhanced risk management and compliance capabilities the banks are putting in place because there are also other important linkages that need to be protected, among others our correspondent banking networks which still see these technologies as new and susceptible to risk of criminal abuse. We look at the competent authorities, notably the MFSA, to set the appropriate risk tone and regulatory parameters in this regard.

**In addition to the technologies mentioned above, new services such as Revolut which are gaining massive popularity overseas have also dealt a huge blow to the banking sector. Do you think it is high time for banks to innovate and alter their core services in order to keep in line with this fast-paced world?**

The tagline of Revolut is ‘Welcome to a world beyond banking!’ For a company launched barely three years ago it has been one big success ride – and still revving. I like to quote Citigroup CEO Michael Corbat who said: "we are a technology company with a banking licence". This sums up an intriguing picture which questions the conventional definition of a bank. It was Corbat's predecessor Walter B. Wriston who in 1981 famously said: "The belief that a market is yours by some divine right is an old dream. Companies that fail to change become tombstones in the corporate graveyard." We see this phenomenon daily, as digital is no longer a channel but is becoming mainstream. Banks have no option but to innovate and accept that the traditional demarcation lines of business are long gone. But the lustre of banking innovation is no longer special. For example, global fintech investment reached \$20 billion in 2016 while banks spent \$241 billion in IT worldwide. But just think of the bigger impact which fintech is making because it is so highly targeted. So bank innovation, which is also costly and comes with no guarantees or exclusivity, is making way for fintechs to lead innovation, with less regulatory burdens and actually driving the new business model. These are particularly important challenges especially for our member banks where scale is not to their advantage.

**People often complain about the local banking system, especially recently when fees were imposed for consumers who withdraw funds from ATMs of other banks. Others complain that they get a better service in general overseas. As somebody on the inside, how do you think the banking sector compares with the service given to clients overseas?**

An initial statement I will make is that the Maltese banking sector is subject to an increasing load of EU and international regulations that are meant to make our business more secure, more transparent but which also add costs to the process. These measures may make banks appear to be overly bureaucratic in the way they offer their services. De-risking strategies and more onerous customer acceptance policies may also come across as unfriendly practices. Our retail banks are also still heavily involved in extensive handling and clearing of cash, cheques and identification procedures that tie up service channels. There is more to say but I guess you get the point that it is a complex topic. Comparisons with the service that clients overseas receive from their banks are difficult to make and we get to hear of compliments as well as complaints in that regard! But in a survey commissioned by the MBA late in 2016, on a 1 to 5 rating scale (5 being best), level of service received a mean score of 3.9, with 69 per cent of respondents rating 4 or higher. On the other hand, low interest rates on deposits, long queues and excessive charges came tops in the list of complaints. Where things are within our control to manage better, there is certainly room for improvement.

**The infamous Pilatus Bank: Many have questioned how it is possible that the MFSA was not aware that Pilatus Bank owner was under investigation when it granted the licence. The whole experience, together with that of Nemea Bank risks reputational damage to Malta's financial services sector including the banking sector. The MBA was one of the few associations who took action when faced with the news of Pilatus Bank's disturbing activities. As an association, when the allegations were surfacing about the bank's chairman Ali Sadr and the entity in general, were investigation proceedings launched? Did you lobby for official investigations to take place?**

Pilatus Bank became a member of the MBA shortly after it was licensed since, in terms of our rules, membership is open to all banks authorised under the Banking Act. The Association does not have the power or the means to investigate its members; however our statute contemplates circumstances that can lead to termination of membership. In the case of Nemea Bank, that happened automatically when the ECB withdrew its licence on 23 March 2017. In the case of Pilatus Bank, we followed closely all developments as these unfolded in 2017 and our position was that the authorities should resolutely uphold and defend the integrity of our financial services industry at all times, the growth of which was always underpinned by strong values and high standards. Some days after the MFSA announced its regulatory actions on 21 and 22 March 2018, the Association's Board met specifically to consider these announcements. It was determined that in the circumstances, Pilatus Bank's membership of the Malta Bankers' Association was to be terminated with immediate effect. Our decision, however dramatic it

might appear, was necessary because safeguarding Malta's name and the reputation of our industry are paramount. There can be no room for compromise and there are no second chances.

**From the way the Pilatus events unfolded, do you feel that the media jumped the gun in its reporting of the allegations? Do you feel that it is reasonable for MFSA investigations to be taking as long as they are? What are your thoughts on the comments being made about the situation in general, and whether simply speculating on the facts available in the public sphere is doing any more harm?**

Having been involved in bank regulation and supervision at various stages of my career, I know that investigations can take long even in the simplest of cases. From what I read, the Pilatus Bank events appear complex and there are also multiple, cross-border regulatory, supervisory and enforcement considerations at play. I think that the media are doing their job when they investigate and report responsibly and it is nothing different to how other stories overseas have been reported in the past. Remember Banco Ambrosiano, BCCI, Barings and, more recently, the Latvian banks at the centre of large-scale money laundering allegations, to name just a few? It is inevitable that journalists investigate; what is essential is that the supervisory authorities carry out their job seriously, efficiently and serenely, free from any pressures. It must also be said that the regulatory actions taken by MFSA against Pilatus Bank, including the appointment of a competent person in terms of the Banking Act and the significant restrictions imposed on its activities, should further limit the scope for speculation until investigations are concluded.

Source: Ms Helena Grech on The Malta Independent published on the 17<sup>th</sup> June 2018.

(Link: <http://www.independent.com.mt/articles/2018-06-17/local-news/Banking-a-blockchain-AI-and-cryptocurrency-future-6736191857> )