Author **S. Matthew English**

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Blockchain Land Registry May Lead to New Global Financial Crisis

A Blockchain-based land registry may help create new toxic assets and lead to a new financial meltdown.

Across the Third World, from Honduras (http://www.coindesk.com/debate-factom-land-title-honduras/) to the Republic of Georgia (http://www.coindesk.com/bitfury-working-with-georgian-government-on-blockchain-land-registry/), efforts are underway to establish land titles via the Blockchain. Proponents of this system advocate it as a mechanism to enable marginalized residents of the world's slums to take out loans using this newly recognized property as collateral.

The commodification of people's homes for use as financial instruments was at the heart of the financial crisis of 2008. The correlation between those toxic assets and the Blockchain-based property schemes which are now in the early phases of implementation warrant close scrutiny. Failing to learn the lessons of the last financial meltdown may precipitate another massive disenfranchisement of the world's most vulnerable citizens.

Land Grab Mania

The financial crisis of 2008 is considered by many economists to have been the worst since the Great Depression of the 1930s. The impetus of this man-made disaster was the securitization of home mortgages which were subsequently arranged into tranches and partitioned on the basis of repayment expectation.

Predatory lenders issued mortgages to unsuspecting victims in the form of NINJA loans (No Income No Job or Assets). These financial instruments were thrust upon people with no real hope of paying them back and the result was countless families losing their homes when the system imploded in 2008.

Hernando de Soto is President of the Institute for Liberty and Democracy. De Soto espouses the notion that residents of Third World shanties such as the Juhu slums of Mumbai, depicted in the film Slumdog Millionaire, are essentially locked out of global capital markets by their inability to secure credit.

Slum property rights

Officially such people are homeless, lacking governmental title to their domicile. However, the facts on the ground tell a different story. Typically members of these local communities are conscious of one another's de facto property rights, which are acknowledged and respected.

Prior efforts to establish title to such slum properties have resulted in failure as corrupt officials allocated land rights on the basis of favoritism or influence. The Semantic Blockchain presents an appealing alternative as the consensus mechanism might ensure that a majority of residents would act in good faith and correctly assign addresses.

"Of the 7.3 billion people in the world, only 2 billion have a title that is legal, effective and public regarding their control over an asset." remarked De Soto in a public statement. "When something is not legally on record as being owned, it can therefore not be used ... as collateral to get credit, as a credential that you can be able to transfer part of your property to invite investment in. Things are owned, but when they're not adequately paperized or recorded, they cannot fill the functions of creating capital and credit."

Toxic Assets in the Making

A collateralized debt obligation (CDO) is a type of structured asset-backed security (ABS). Originally developed for the corporate debt markets, over time CDOs evolved to encompass the mortgage and mortgage-backed security (MBS) markets. In the years leading up to the crash of 2008 some MBS issuers, such as Fannie Mae and Freddie Mac, guaranteed against homeowner default risk while requiring private mortgage insurance on loans in which the borrower provided a down payment of less than 20% of the property value.

Decentralized insurance

Together these financial instruments comprised the toxic assets that necessitated the infamous government bailouts which may have been a motivation behind the creation of the world's first digital currency.

In fact the genesis block of Bitcoin time-stamped itself with the text 'The Times 03/Jan/2009 Chancellor on brink of second bailout for banks.'

Peer-to-peer, decentralized, and even autonomous insurance is a concept which is recently gaining traction in the Blockchain community. The London Fintech Week Blockchain Hackathon generated a smart contract insurance system (http://www.coindesk.com/ipo-and-insurance-projects-win-2000-at-blockchain-hackathon/) which would provide instant compensation on a variety of claims.

In light of pilot projects taking aim at a Blockchain-based land registry currently under way (https://bitcoinmagazine.com/articles/bitfury-announces-blockchain-land-titling-project-with-the-republic-of-georgia-and-economist-hernando-de-soto-1461769012) it appears as if a network of mortgage-backed securities generated by first-time borrowers in the Third World might be a near term reality.

It is conceivable that these insurance contracts could, in the foreseeable future, be combined with autonomous smart contract mechanisms to create a DAO (decentralized autonomous organization) of MBS. This has the potential to usher in a new wave of financialization of people's homes.

Learn the lesson of DAO disaster

Under such a regime repayment tranches could be configured and rated automatically providing more transparency in an industry notoriously opaque to customers and regulators alike.

Lest we fall prey to an epidemic of irrational exuberance we might do well to remember the recent disaster of the DAO and temper our excitement. A system such as the one herein described could unlock vast economic potential, or, to paraphrase Michael Lewis, it could be the making of a new doomsday machine.

Karl Marx noted that "History repeats itself. First as tragedy, second as farce." Let us hope that the DAO of the MBS doesn't prove this adage correct.

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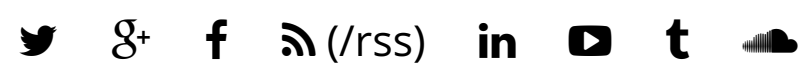Email Address **Subscribe**

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