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Commercial Lenders Brace for Consumer-Style Disclosures in California and Beyond

By Clinton R. Rockwell, Kathryn L. Ryan, Moorari K. Shah and Frida Alim

One year ago, California became the first state to require consumer-style disclosures similar to those required for consumer loans under federal laws. The requirements of Senate Bill 1235 signal a sea change likely to affect other states as well. This article, the first of two, explains the implications for the equipment leasing and finance industry.

Privacy Puzzle — Grappling with the Patchwork of New State-Specific Data Privacy Laws

By Andrew Baer and Matthew Klahre

Lessors conducting business in California must pay attention to the evolving and sometimes puzzling amendments to the California Consumer Protection Act. The act affects both business-to-business and business-to-consumer transactions. Several other states also are enacting laws that signify compliance challenges for national and international businesses.

Blockchain: Transforming Public Data for Improved Financial Success

By Raja Sengupta

Blockchain has the potential to help states establish and demonstrate transparency, speed up processing times, and cut operational costs related to commercial lending. That augers well for states vying to attract new businesses. Advances such as "smart UCCs" will benefit lenders, too. Where they can conduct due diligence easily, they will be more apt to do business.



Blockchain: Transforming Public Data for Improved Financial Success

By Raja Sengupta

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Blockchain is set to revolutionize recordkeeping and securitization across the private sector in the United States and abroad, including commercial lending and the equipment finance space. The potential benefits in efficiency, cost reduction, and convenience are enormous and are rapidly being implemented in the private sector. However, for a variety of reasons, the public and private sectors are often out of step when it comes to implementing new technology. Are the two sides able to find common ground?

State governments at all jurisdiction levels have struggled to meet the sometimes unrealistically high standards of citizens and businesses around their concerns for security, access, and high-quality maintenance of public and private information. Modern technology

has created the expectation of immediate feedback and results, but that is not always reality.

For instance, it can take several days for a bank to determine via state and local governments if a business that has applied for a loan has already mortgaged the same collateral with another lender. An individual trying to rectify a faulty land record will sometimes need to navigate several touchpoints to get the information corrected.

States also face enormous challenges in establishing transparency in governance processes, given the realities of public budgets and sometimes incompatible technology platforms. The side effects can include manual work processes, duplication of effort, errors in data entry due to manual recordation, handoffs in processes,

and specialized resources to handle critical data.

This, in turn, drives higher costs, longer cycle times for servicing citizens and businesses, and poor service levels. Further, like every other individual and entity connected to the internet, state and local jurisdictions are increasingly under attack by hackers, raising concerns over the security of these systems.

Accordingly, commercial lenders and businesses must work together with state and local governments for the benefit of all their respective constituents. These constituents are very similar to those constituencies in for-profit institutions. In business we know that increased employee satisfaction leads to greater customer satisfaction — which leads to shareholder value in the public sector.

These constituents include all of the employees that work for the public jurisdiction, the “customers” that use the system, and all of the public entities and their taxpayers that use their systems. It is imperative that all implementations of new systems serve the interests of all these constituencies.

Public records are the cornerstone of UCC filing in the equipment finance sector and, by extension, profitability for equipment financiers. For governments, improving the current state with existing systems and technology is a challenge due to complex in-place purchasing policies and constrained budgets.

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commercial lending. In this light, it is encouraging to see some states accepting, experimenting with, and adopting blockchain for public recordkeeping at this early stage in the blockchain technology life cycle. But what does that mean for equipment finance?

BLOCKCHAIN AS A TECHNOLOGY FOR GOVERNMENTS CAN TRANSFORM THE FINANCIAL SECTOR

Blockchain is a distributed ledger database with multiple stakeholders on its network. It digitally records data for every transaction in chronological order in the form of “blocks” and creates a “chain” of blocks linking subsequent transactions to the previous ones. Each block is immutable, contains details of

transactions and descriptions, and provides transparency to users that can view the digital block.

The technology promises to be highly secure and almost impossible to tamper with because the blockchain ledger is replicated on servers on a global scale and is easily accessible by users. Moreover, it allows for provenance, allows tracking of chain of custody, and ensures accuracy.

Specifically, blockchain can establish security around recordation, access, and authentication for maintaining personal, public, and corporate data; asset ownerships; trading and exchange of assets; cross border business regulations; enforcement of smart contracts; and digital signature authentication.

Blockchain can also make the due-diligence and risk assessment much faster with “KYC” (know your customer) due diligence requirements. As the information about businesses and their corporate information moves from paper and the web (stored in government and other corporate records) to the blockchain, it will be much faster to

conduct the search for business names and corporate profiles, including outstanding liens and any adverse records.

As a result, lenders will be able to conduct due diligence much faster than they do today. Clearly, where lenders can conduct due diligence easily, they will be more apt to do business. This benefits everyone involved with the transaction.

Blockchain can also help build “smart UCCs” that automate the entire life cycle of filings. The process may not require any manual action for the filing, as long as the business logic can be embedded in the filing itself through blockchain’s smart contract mechanism. This would automate any future actions for the filing including amendments, renewals, and terminations. The operational cost savings for both the states and lenders would, in theory, be quite significant.

STATE GOVERNMENTS ARE EXPLORING THE TECHNOLOGY FOR SEVERAL REASONS

State governments have started looking at blockchain as a way

to reduce costs and improve transparency for their regulatory filings and public data. It is only a matter of time before banks and other financial institutions will be able to leverage state-held public information like UCC and corporate charter information, land records, and motor vehicle titles to make lending decisions faster and also monitor the risk to their loans through tracking services.

Faster approvals are in everyone else’s interest as well: the customer gets faster turnaround, the workload is reduced for public employees, and costs are reduced for states and municipalities.

States are also concerned about protecting revenues, given that states act as middlemen, charging a transaction fee for recordation and access. It is conceivable that the public sector is vulnerable to private parties that might provide a more efficient blockchain-based service, thereby cutting states out of a valuable revenue stream.

Some states have been early and enthusiastic experimenters with blockchain. To date, at least 16 states are in some

stage of adopting blockchain: Arizona, California, Delaware, Florida, Hawaii, Illinois, Maine, Maryland, Michigan, Nebraska, New Jersey, New York, Ohio, Tennessee, Vermont, and Wyoming.

In addition to the benefits of reducing costs and increasing the accuracy of public records, states are looking to improve their ease of doing business in order to attract new businesses to incorporate in their state. Adopting blockchain promises transparency in governance and allows for both secure transactions and accurate recordation at reduced costs. These benefits could easily make a state more attractive to new businesses.

However, states still need to carefully consider how they legitimize, regulate, pilot, adopt, and scale the technology. There are five stages of this adoption journey, outlined as follows:

1. Exploration – where states form a task force; carefully consider their specific needs; assess the impact, benefits and risks; publish findings; invite opinions from industry players, technology partners, and citizens; and make recommendations to the appro-

In the medium term, competition among states to attract new businesses and a fear of losing existing revenue are pushing states to act.

appropriate elected officials and relevant regulatory agencies.

2. Legislation – where states enact laws to recognize use of blockchain technology for a specific purpose, legitimize the records held on blockchain in a court of law, create safeguards against misuse, and incentivize innovation.
3. Pilot – where a state engages with technology partners to build prototypes, pilot the use for specific use cases, and learn from feedback.
4. Early Adoption – where states adopt the use of blockchain with use cases with specific objectives. Delaware and Ohio are moving toward early adoption. Delaware had its first milestone in 2016 when the state authorized tracking of

share issuances and transfers on blockchain and smart contracts. In 2017, the state initiated a pilot for “Smart UCC filing,” exploring automated release or renewal of UCC filings and faster and efficient searching of UCC records. Delaware is now piloting blockchain-based business filing. In Ohio, Franklin County is working with a real estate blockchain startup and plans to move all its land parcels onto a digital ledger in the next three years (2019–2022). Earlier in 2018, Franklin County also auctioned off 36 forfeiture properties by transferring the deeds via the Ethereum blockchain.

5. Transformation – where states adopt the technology across multiple areas of governance such as individual and property records, titles, liens, real estate records, supply chain tracking, electronic records, contract execution, business and asset registrations, and digital signatures.

Government adoption will accelerate once a state has success in scaling a blockchain initiative, and there is movement toward a light touch and

progressive regulatory environment. This will enable blockchain-based innovation, possibly leading to an open market for applications built for states.

BARRIERS TO BLOCKCHAIN ADOPTION BY STATES

On the technology front, lack of agreed-upon standards, interoperability across blockchain platforms, and maturing the technology in terms of scalability and processing power will need to be dealt with and overcome. Having enough experienced talent to deliver blockchain solutions is another issue — a challenge of varying degrees depending on the state in question. Recent advances in ledger-agnostic (non-ledger-specific) blockchain technology and common standards across blockchain consortia will help address some of these key technological challenges.

There are other, nontechnical barriers to the wide implementation of blockchain in government bodies. These include the different processes and purchasing procedures at each level of government to create requests for

proposals, “hidden stakeholders” that can introduce delays and complexity in the bidding and specification process, complications from public employee employment contracts, and the need for public hearings and comments that may emerge from these.

In the short term, governments are likely to continue to explore the potential of blockchain technology. In the medium term, competition among states to attract new businesses and a fear of losing existing revenue are pushing states to act. Successful pilots across a range of use cases nationwide should establish the viability of the technology.

Movement by an early adopter state will likely trigger a wave of adoption from other states. However, this situation poses the significant challenge of different vendors selling incompatible systems to various states. Any of these could compromise the efficiency of blockchain for all users.

KEY TAKEAWAYS

Lack of knowledge about blockchain among lawmakers,

resistance to change, lack of standards across blockchains, and lack of interoperability are key barriers to blockchain adoption by states.

Given the transformative benefits for states and local government, and the challenges to adoption, strong sponsorship by elected officials and excellent implementation team leadership will be crucial to the first successful implementation at scale.

Once one state crosses the threshold beyond the pilot phase and into the early adoption phase, competition among states to attract new businesses will create the necessary snowball effect. The state that executes the early adoption phase and plans for broad adoption of blockchain technology as part of a transformation phase will draw investors and attract new businesses and investments to that state.

Regardless, financial organizations and states are continuing their long journey toward collectively adopting blockchain. At the end of the day, governance will be transformed.



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