

FINTECH TRENDS 2018 CRYPTOCURRENCIES WILL EXPLODE (ONE WAY OR ANOTHER)

The global virtual currency market has fallen to around US\$250 billion from a high of more than US\$830 billion in early January 2018, while Initial Coin Offerings (ICOs) have raised over US\$3 billion so far this year. Cryptocurrencies, neither issued nor backed by any national government, promise to reduce institutional intervention, offering a means of borderless, anonymous international transfers and the opportunity for investment in a new asset class.

But they are also complex, volatile, prone to fraud, potentially high-risk and at the same time, a mass market phenomenon – a fact that hasn't escaped the attention of regulators across the globe. Whether they are captured by existing rules, or if the blockchain technology on which they are based demands entirely new ones, is a pressing question. Regulators are taking a number of different approaches:

- In China, domestic cryptocurrency exchanges have been shut down, financial institutions banned from dealing in Bitcoin and websites of overseas cryptocurrency exchanges blocked. The authorities have also banned ICOs.
- South Korea's authorities raided three cryptocurrency exchanges in March over suspicions that staff may have embezzled customer funds. Anonymous cryptocurrency trading has been banned and the country banned ICOs in 2017.
- In the US cryptocurrencies are typically classified as spot commodities or currencies and market trading is regulated by the U.S. Commodity Futures Trading Commission.
- Hong Kong regulators are taking a technology-neutral approach and fitting cryptocurrencies within existing regulatory schemes for commodities and securities. Early signs suggest that the UK is following suit.
- In Germany Bitcoin constitutes a "unit of account" and is therefore a financial instrument.
- Singapore and France seem to be seeking a middle ground. Singapore's Monetary Authority is gently encouraging activity and French regulators are adopting an ad hoc approach.

"Expect to see regulators forced out of sheer necessity to take a more active role in shaping cryptocurrency markets."

Rocky Mui,
Senior Associate

- In Gibraltar, legislation provides for a new licensing regime for Distributed Ledger Technology Providers, which will apply to certain virtual currencies.
- Japan has designated both ICO tokens and cryptocurrencies as “virtual currencies,” a new legal classification that will be subject to its own specific regulatory regime. In 2017, the Japanese Financial Services Agency granted a number of licenses for exchanges but following the US\$500 million Coincheck hack, it has taken a harder line. Two cryptocurrency exchanges have been shut down and on site inspections are being carried out.

Ultimately, regulation may be multilateral. Germany’s Finance Ministry recently announced its support for a French-led initiative to introduce the idea of joint regulation of Bitcoin at the G-20 level. Bank of England governor Mark Carney, also head of the G-20’s Financial Stability Board, says that tightening regulation of Bitcoin is necessary. And South Korean, Chinese and Japanese financial authorities have discussed joint oversight of cryptocurrency investment. Whether the right multilateral channel turns out to be at the G-20, regional (EU, ASEAN, OAS, African Union), or a series of informal frameworks between individual countries, remains to be determined, but watch this space – we believe much more is to come in 2018.

What’s next?

- 2018 will be the year of (global) regulation. Expect to see regulators forced to take a more active role in shaping cryptocurrency markets. Regulators will need to strike the right balance between innovation and consumer protection.
- Going mainstream: After several years on the periphery of financial markets – and often linked to activities on the dark net – cryptocurrencies have captured widespread interest and credibility. This will continue, particularly as geopolitical uncertainty fuels demand for alternative currencies.
- As gatekeepers for large sections of the investor population, exchanges such as Coinbase, Etoro and Bitfinex will expand and become critical infrastructure providers. Lawsuits against exchanges for hacks, service outages or for failing to prevent misconduct by traders will rise.
- Concerns have been raised about systemic risk in the context of Bitcoin futures, though many central bankers have rejected this as a near-term possibility. We believe such anxieties are to be expected and, to a degree, encouraged, as they will allow crypto markets to mature and become more efficient. The key will be to not lose sight of the underlying value of the technology, in amongst the chaos.

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