31st Asian Shadow Financial Regulatory Committee Statement

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Cryptocurrencies: *Quo Vadis?*

Cryptocurrencies in general, and bitcoin, in particular, have been receiving considerable press of late, driven mainly by wide swings in value in the cryptocurrency exchanges. There are now in excess of 2,500 products considered to be cryptocurrencies and in the last three weeks alone their combined market value has plummeted from USD 830 billion to USD 545 billion as of today, of which USD 215 billion is attributed to Bitcoin and Bitcoin cash (source: coinranking.com). To keep this in perspective, however, Apple Inc. has a market value of USD 880 billion as of today. Market value measures the equity value of a business- or what investors are willing to pay for its future profits. Unlike enterprises, however, Bitcoin has no business, no intrinsic value, no cash flows, no profit and loss statement, and no balance sheet. It is a speculative instrument. Cryptocurrencies, including Bitcoin, are not considered currency today because they are not a universal means of payment, nor a stable store of value, nor a reliable unit of account. Buyers purchase on the basis that these cryptocurrencies would rise in value. While market value has been the main focus of the current interest, the more important issues are around the role of cryptocurrencies both as financial assets, and the role they can play in transaction settlements, and their implications, if any, on financial stability.

While there is much interest in cryptocurrencies, especially Bitcoin, the volume of transactions remains very small currently. For example, total US dollars in circulation amount to USD 1.6 trillion as of today. M3 (broad money) is valued by the Federal Reserve at USD 14 trillion. Total US economy assets in 2016 were valued at USD 220 trillion. So why the fascination with cryptocurrencies?

Supporters of bitcoin claim it to be a superior store of value to fiat money issued by central banks because its supply is limited by design and therefore cannot be debased. In addition, the technology behind Bitcoin, called the Blockchain, provides anonymity to its players. That is why it is a favourite with money launderers, tax evaders, terrorists, drug smugglers, hackers, and anyone who wants to evade the rule of law. Many people who use cryptocurrencies assert that they pay minimal transaction costs mainly because it avoids the cost of financial intermediation.

Still, there is large potential for capital gains because of the wide volatility of its price movement. This is the main driving force behind the popularity of cryptocurrencies like Bitcoin. However, there are high risks involved including extreme volatility and opaque, unregulated exchanges that are prone to cyberattacks.

Authorities and regulators worry about Bitcoin because they fear it is a bubble. In the event of a bust, investors in Bitcoin-they are many, spread over various continents and countries-will be hurt, and they exert pressure on governments to regulate this business in order to protect investors. In addition, they worry about the impact-in the event that cryptocurrency trading becomes a significant element in maintaining financial stability-in terms of the impact of the transmission of monetary policy and its effects on the banking system, and most of all, on systemic risk, if any.

Authorities have responded in different ways. In South Korea, new regulations today require banks and exchanges to identify who their customers are, imposing greater transparency in the conduct of the cryptocurrency business. On the other hand, Japanese authorities are more liberal. They only require the registration of companies engaged in this business at this time.

Many other authorities, including those in the US, are adopting a wait-and-see attitude while studying the issues, recognizing that there may be a role for them to introduce some regulatory measures in the event that the volume and price volatility of cryptocurrency transactions become more and more significant.

In the meantime, government and tax authorities feel uneasy about the impact on revenue collection. Other regulators are worried about crowd funding through ICOs (Initial Coin Offers). Authorities in a number of countries, including the US, have introduced measures to regulate the issue of new ICOs to ensure that investors are provided with the necessary information before making such investments. At the same time, central banks in many countries are looking into the desirability and possibility of issuing their own digital currencies, including to counter privately-issued cryptocurrencies.

Recommendations:

1. Bitcoin came into prominence because of an apparent lack of confidence in fiat currency. It is imperative that governments and central banks continue to give priority to (i) protecting the integrity of their currencies; (ii) designing policies to contain inflation to prevent it from debasing the currency; and (iii) strengthening their mandate to promote financial stability over financial development, if needed (including ensuring Fintech development does not undermine confidence). Also, in cases where authorities do not have the power to regulate the cryptocurrency business, they should actively seek such authority where appropriate.

2. Monetary authorities should be open to creating digital currencies rather than confining their money supply to notes, coins and deposits. But they should do so in a transparent manner and only after careful consultation and study.

3. It is the role of government to warn their citizens and investors about the high risk involved, and ensure transparency in Bitcoin activity, and not to unduly introduce more and more regulations that will stifle innovative initiatives. Blockchain technology, for example, does have other useful applications apart from the issue of its use in the creation of digital currency.

Investor Protection

As we see today, Bitcoin and the other cryptocurrencies are not currencies. Mostly, they reflect speculative activity. Hence, investing and transacting in them involve high risks. It is imperative that investors realize this and approach investing in cryptocurrencies with caution and with as much information as is available to help them manage these risks. Investors must fully understand that cryptocurrency prices need not necessarily always rise, particularly because they have no intrinsic value; they could just as easily fall. So investors beware: *Caveat emptor.*