Baffled by Bitcoin: Asia Takes On Virtual Currencies

By Tsering Namgyal

Few innovations in financial technology have captured the public imagination with such force as digital currencies, also known as virtual or crypto currencies. Unlike traditional, or fiat, currencies that are backed by governments, these digital assets use encrypted transaction technology known as blockchain and rely on network effects, among other things, to fuel their valuations.

Asia has a particular fascination with these virtual currencies, and that has governments grappling with how to regulate them, writes Tsering Namgyal.

WITHIN A DECADE, the world’s first cryptocurrency, Bitcoin, which was launched in 2009, has amassed a cult-like following around the world — and nowhere more so than in Asia. It has also spawned dozens of other digital currencies and the creation of exchanges to trade in them. It has even led to the emergence of a class of assets for fund-raising known as initial coin offerings.

All of this has financial regulators and institutions, including the International Monetary Fund, sitting up and taking notice — not least because Bitcoin has experienced phenomenal gains that have sparked fears of a bubble. But it is in Asia where government regulators have been the most active in trying to come to terms with this financial innovation. In seeking to establish new rules to govern cryptocurrencies, they are performing a delicate balancing act, because any form of prohibition might risk sending the cryptocurrency industry underground or making it even more popular. Or worse, the potential unintended consequences might include throttling innovation surrounding blockchain technology itself, which has earned many supporters and is seen as having a potentially revolutionary impact on areas as diverse as trade finance, government procurement and public records keeping.

In short, cryptocurrencies are no longer a plaything of technology eccentrics who speak at cultish conferences filled with tattooed, thuggish-looking characters. Large-scale patrons and speculators now feed the crypto bubble, forcing both national and international regulators to pay closer attention to the phenomenon. Even finance chiefs and central bankers among the Group of 20 major economies found it fit to discuss Bitcoin and other cryptocurrencies in March, during their meeting in Argentina. They said they would continue to monitor the sector, while maintaining that the market remains small enough at this point not to pose any significant threat to global financial stability. They flagged such concerns as consumer protection, because many retail inves-
tors have become carried away by cryptocurrency mania without being fully aware of the risks. They also worry about the anonymity that Bitcoin affords its holders and how that makes it prone to illicit activities such as black money transactions and terrorist financing. They lament the challenge of tracing on Bitcoin transactions, let alone doing proper know-your-customer checks, which makes the currency particularly attractive to those who wish to circumvent capital controls and international sanctions and do not want their financial transactions monitored by governments. Christine Lagarde, the managing director of the International Monetary Fund, has offered the organization as a platform to deliberate on a cross-border framework for cryptocurrencies.

A BRIEF HISTORY OF BITCOIN

Bitcoin has its origins in a paper entitled “Bitcoin: A Peer-to-Peer Electronic Cash System,” published in 2008 by the pseudonymous author Satoshi Nakamoto. While several people have been suspected of being Nakamoto, the real identity of the person remains a mystery, which adds to Bitcoin’s romance as a stateless digital currency.

Experts hold that a form of money that can be e-mailed from one individual to another seems to be a natural step, if not the final frontier, in the evolution of the Internet. It should come as no surprise that Bitcoin had been predicted as early as 1999 by none other than one of the greatest technologists dealing with decentralized systems, notably securities laws, that were first created in the early 20th century. Many consider Bitcoin to be a response to the nature of Bitcoin and whether it is even a currency at all or should be viewed as a commodity. Some even began to look for clues in history and prehistory, even to the days before humans had an established concept of money millennia ago.

ENTER THE ICO

With the growing popularity of Bitcoin came a whole new addition to the Bitcoin ecosystem — the so-called initial coin offerings (ICOs) that were issued by blockchain companies to raise capital. With the creation of ICOs, Bitcoin and Ether — another cryptocurrency that runs on a blockchain platform known as Ethereum created by 24-year-old Canadian-Russian developer Vitalik Buterin — could be used to directly invest in startups. This has spawned thousands of ICOs, such that the mechanism now competes with traditional forms of venture capital through a new, alternative form of crowdfunding.

This added a whole new dimension to the discourse over the regulatory frameworks governing cryptocurrencies. Helping frame the debate over the nature of these ICOs was a statement published by the US Securities and Exchange Commission (SEC) on a blockchain project known as the Decentralized Autonomous Organization, or the DAO, in 2017. The SEC’s ruling that tokens issued by The DAO should be defined as securities was followed by official pronouncements in Hong Kong and Singapore. Regulators in these two Asian financial hubs maintained that ICOs that issue digital tokens that act like securities must be regulated under the relevant securities laws. They have to follow the same procedures as any other initial public offering, including the publication of a prospectus, unless they are exempted from doing so.

While regulators differ widely when it comes to their position on Bitcoin and cryptocurrencies, and most of them remain skeptical at best, they are unanimous in their support for blockchain as a technology.
ASIA’S DIVERGENT RESPONSES

The response of governments in Asia to the rise of Bitcoin remains quite diverse, ranging from a draconian approach in China to a more progressive one in Japan. Tokyo has officially recognized Bitcoin as a “means of payment that is not a legal currency.” This Japanese approach was born out of its 2014 experience of dealing with one of the first major scandals involving a Bitcoin exchange, the collapse of Mt. Gox, which at one point handled 70 percent of the world’s Bitcoin transactions. Bitcoin exchanges are now required to be registered with the Financial Services Agency.

Some countries such as Singapore have embarked on a major overhaul of financial regulations to accommodate new financial innovations centered on cryptocurrencies. While Bitcoin itself is not regulated in Singapore, the city-state is set to revise its payments bill that would subject intermediaries that deal in cryptocurrencies to a licensing regime for cryptocurrency exchanges. Such rules put the city-state far ahead of any other regime in Asia, perhaps in the world, for having a legal framework for cryptocurrency exchanges.

In Hong Kong, Bitcoin itself, as in Singapore, is not regulated, as it is considered a virtual commodity. But cryptocurrency exchanges there, particularly from mainland China after Beijing banned Bitcoin exchanges in 2017, remain unlicensed, and thus prone to huge regulatory risks.

South Korea has also emerged as a major player in the Bitcoin sector, because it caught the fancy of the country’s millennials, who went into cryptocurrencies with enthusiasm bordering on fanaticism. Such was the demand that cryptocurrencies traded at a higher price in South Korea than anywhere else in the world, in what came to be known as the “kimchi premium.” So stressful was it to manage the country’s crypto boom that one senior regulator reportedly died of a heart attack in his sleep. Bitcoin is currently unregulated in South Korea and its position on ICOs is seen by market participants as lacking clarity. But the government has said they are going to regulate Bitcoin and cryptocurrencies in the future. In the meantime, it has stepped up its policing measures, including raiding crypto exchanges and reportedly banning Bitcoin futures and derivatives.

India has yet to come out with a policy framework to govern Bitcoin, as authorities wait for a report by an ad-hoc committee entrusted with the task of drafting a formal response to Bitcoin. Finance Minister Arun Jaitley, however, told parliament that the government does not recognize Bitcoin as a legal tender and will discourage its use as a payment method. Indian Bitcoin exchanges have also challenged in court the Reserve Bank of India’s decree that asked all banks to stop dealing with the exchanges. Understandably, two less developed Asian countries, Nepal and Bangladesh, have issued a blanket ban on Bitcoin.

BLOCKCHAIN, NOT BITCOIN

While regulations differ widely when it comes to their position on Bitcoin and cryptocurrencies, and most of them remain skeptical at best, they are unanimous in their support for blockchain as a technology. They are pushing for the use of blockchain in such areas as trade finance and initiatives to enhance financial inclusion, and some central banks, somewhat prematurely, are even toying with the idea of creating their own digital currencies. Major stock exchanges and banks, meanwhile, are pouring money into the new technology. It is seen as having the potential to help solve many age-old problems for the financial sector, from making securities settlements and clearing less cumbersome to introducing cost-efficient forms of delivering banking services to the poor and the financially excluded. All of this has little or nothing to do with Bitcoin itself, they say. And they don’t want to conflate blockchain with Bitcoin. It is clear that the task of how best to support developments in blockchain technology while containing unforeseen risks from cryptocurrencies is likely to keep them busy for years to come.

Teising Namgyal is a journalist based in India who writes on financial services and regulatory issues.