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The Declining Governmental and Legal Risks to Bitcoin & Cryptocurrencies (July 2017)

Bitcoin is the first non-dilutable, fixed-supply currency in human history. The inherent demand for such a store of value must be at least as large – if one considers that for a moment – as the value of world-wide money supply and savings upon which the owners do not wish to earn a negative real return after the impact of the dilution of their money supply. In our era, such dilution, through the power to print money, has been a coordinated policy of the world's central banks for the past decade. The concept of such an instrument, a non-fiat, non-inflationary currency, is not new; it's just that there did not previously exist the technology to enable it.

The survival risk for any new financial instrument, particularly as radical a one as bitcoin, is obviously great, success requiring its acceptance broadly across the populations of individual buyers, private commercial interests and institutions, let alone by public institutions, regulatory bodies and sovereign authorities. That risk has diminished markedly in just the last several months and weeks.

As of July 1st, three months after declaring bitcoin to be legal tender, Japan removed the 8% consumption tax on cryptocurrencies – that is not merely allowance, it is encouragement.

On the same date, Australia recognized bitcoin as legal tender and removed the 10% consumption tax on such transactions.

The Japanese retailer, Meganesuper Co. Ltd. (3318 JP), which operates 334 stores, started accepting bitcoin for payment in July. Megane sells eyeglasses, sunglasses, contact lenses, and hearing aids. Other Japanese companies accepting bitcoin for payment include a mobile payment app called AirREGI, and a budget airline called Peach Aviation. The latter plans to install bitcoin teller machines in airports to facilitate exchanging yen for bitcoin, presumably so the customer can use the cryptocurrency to pay the airline. The three largest banks in Japan, MUFJ, Mizuho, and SMBC, are backing bitFlyer, an existing cryptocurrency exchange that is the largest one in Japan.

On July 11th, Switzerland's Financial Market Supervisory Authority approved the first Swiss private bank for bitcoin asset management. This Zurich bank, known as Falcon Private Bank, holds CHF 14.6 billion in client assets. It has offices in Zurich, Abu Dhabi, Dubai, and London.

In February, in response to dramatically rising bitcoin use by its citizenry, the Philippine central bank issued a circular describing guidelines for virtual currency exchanges, including regulations governing registration, reporting requirements and annual fees. Mainstream adoption of bitcoin in the Philippines is occurring well in advance of developed markets, due to much more obvious practical needs (the term "adoption" does not apply to the U.S., since most people know nothing of it, and those who do have merely heard drastically conflicting headlines and rumors). The Philippines is the third largest remittance market in the world, at over $30 billion received per year, behind China and India. Much of the Philippine bitcoin volume is related to expatriate Filipino employees who use bitcoin to send earnings home, sidestepping the usurious, confiscatory fees charged by banks and wire transfer companies such as Western Union. Another major source of demand is from local employees, who settle utility bills and other common payments in bitcoin, escaping a notoriously inefficient banking system.

As of August 1st, Singapore's central bank issued its first regulatory memorandum for cryptocurrencies, which will begin under the auspices of its Securities and Futures Act. Regulation, though some view it through a negative or suppressive interpretation, is, in reality, tacit acceptance.

South Korea is considering the modification of its Electronic Financial Transactions Act to regulate bitcoin. It is asserted that 8% of the world's bitcoin now trades in South Korea on a daily basis.

These are large economies and major central banks. Moreover, these actions relate only to bitcoin or other cryptocurrencies in their use as a medium of exchange. Not mentioned here are as great a set of efforts being undertaken with respect to using the blockchain technology *(see further discussion below)* that underlies cryptocurrencies, to replace central bank money transfer systems and entire classes of securities and transactions recordkeeping – the province of the world's financial sector companies .

In the U.S., effective August 1, 2017, it will be legal in the State of Delaware to maintain corporate records on a blockchain. That is such a significant development that its implications can hardly be overstated. Since most U.S. corporations are chartered in Delaware, they can now have blockchain-based records. It is but one of the rapidly proliferating signs of how rapidly this technology is advancing.

We will discuss this further in future letters, but the seriousness of this effort is illustrated by the Bank of Japan's approving the development of plans to shift its money transfer system to the Ripple blockchain. As of March of this year, a consortium of 47 Japanese banks began to use the Ripple system following a multi-month pilot program. They are reported to account for 30% of Japan's banking system.

In March, Singapore's central bank, the Monetary Authority of Singapore, completed a proof-of-concept project to conduct domestic inter-bank payments using distributed ledger technology in partnership with a consortium of financial institutions. The consortium includes, among others, Bank of America Merrill Lynch, Credit Suisse, DBS Bank Ltd, The Hong Kong and Shanghai Banking Corporation, J.P. Morgan, and the Singapore Exchange. The next phases of the project will address instantaneous-settlement cross-border payments and securities trading and settlement.

As well, the rise of bitcoin and other cryptocurrencies does not merely occur in isolation. In fact, it cannot occur in isolation; it will come at a cost, and in some areas, a terrible cost. It is a technological and disruptive threat to the profitability of the incumbent financial services sector. This means not only displacing the aforementioned wire transfer activity; it includes the disintermediation or cannibalization of custody services and fees, deposit balances, credit card fees and transaction volumes, and more. Financial services is the largest sector in most global indexes, although it is only 14% of the S&P 500.

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