

Regulating Bitcoin: how new frameworks could be a catalyst for cryptocurrencies

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Computer geeks packing away hard drives was never going to be quite as dramatic as sharp-suited bankers carrying boxes of their possessions and pieces of office art down Wall Street, but the collapse of the Bitcoin currency exchange Mt Gox in 2014 was widely seen as the alternative digital currency's Lehman Brothers moment.

The Tokyo-based exchange, which was handling 70pc of all Bitcoin transactions a year earlier, suspended trading and was eventually liquidated, with approximately \$450m disappearing. Earlier this month, Japan introduced legislation to protect users from being ever stung by a collapse again, while also making Bitcoin exchanges comply with anti-money laundering regulations and officially authorising it as a normal payment method.

In the UK, cryptocurrencies, as payment methods such as Bitcoin are known, still have a confusing legal status. But Japan's move could act as a framework and catalyst for widespread adoption.

Dr Cathy Mulligan, co-director of Imperial College London's Centre for Cryptocurrency Research and Engineering, who believes that insufficient regulation could be holding back startups and the growth of financial technology, rather than creating opportunities through lack of regulatory constraints, says: "We have the situation in the UK where many startups are chasing the regulator to say, 'How are we going to be regulated?' rather than the other way round.

"Bitcoin in the UK is really treated as private money. If you tried to exchange Bitcoin for sterling you don't get charged VAT on the value of the Bitcoin but it is charged on, for example, the commission instead.

"From the UK perspective, we haven't seen huge amounts of regulation. They aren't being forced to have AML [anti-money laundering regulations] or 'know your customer' regulation just yet. I think what will happen in Japan is, there will be an influx in startups, because the business environment is stable and you'll know how you're going to regulate it."

A study released last week by the Cambridge Centre for Alternative Finance, which gathered data from more than 100 cryptocurrency companies, estimated that there were up to 5.8 million active users of cryptocurrencies in the world, with Bitcoin taking a 72pc share of the market.

Working out how large the market is in the UK is difficult, given the secretive nature of Bitcoin, but a Bank of England report released in 2014 said that only 1.2pc of Bitcoin trading was against sterling. However, the Bitcoin exchange platform Coinbase said it had recently seen a fivefold year-on-year increase in the number of UK users.

Eitan Jankelewitz, a lawyer at the law firm Sheridans who specialises in blockchain and e-commerce, said: "At Europol [the EU's law enforcement agency] they don't like the anonymity of Bitcoin, which I think perhaps is a bit of a misunderstanding, because it is not truly anonymous.

"You can trace every transaction and follow it all the way through. You can see the life of a penny and see exactly where it's been. The problem is that you don't know exactly who controls those wallets."

Currency or commodity regulating Bitcoin is, in part, held back by governments' inability to define what it actually is.

Dr Mulligan says: "Some countries are taking it as a commodity like we are, other places are treating it like money and others are treating it as unknown, which changes the way you tax things."

The cryptocurrency seems to straddle the boundary between commodity and currency. It can be spent in hipster food stalls in Camden Market and pubs in East London but also is finite and traded like a commodity. Its volatility (Bitcoin has seen its price range from \$776 to \$1,291 just this year) also hampers its use as an everyday currency.

Mr Jankelewitz, whose law firm has started to accept Bitcoin as a payment method, said: "The brutal truth is that as a currency in the UK, and perhaps globally, it hasn't taken off. People generally buy it because they think it's going to increase in value in the long term or they just like the volatility and they decide they are going to trade it the same way you trade gold. It's another currency, but there's no burning need for it."

Bob Swarup, author of *Money Mania* and a principal at Camdor Global Advisors, says: "If Bitcoin was going to become any kind of valid currency with widespread appeal, then it really needed to grow up and growing up in the currency world means accepting the influence of the state and regulation in some way. People are pretty messianic about Bitcoin, it's like it's the second coming of the currency Christ. They're like Trekkies."

Dr Swarup says Brexit offers an opportunity for the UK to become a hub for cryptocurrencies if it tries to reposition itself as an innovation economy. Bitcoin's appeal, however, is possibly stronger in emerging markets.

For example, it has become a safe haven in Venezuela as the country struggles to deal with the downturn in the oil industry, which represents around 90pc of all export revenue. The country's opposition-controlled National Assembly estimates that inflation in Venezuela has already hit 741pc and the International Monetary Fund believes that it will reach over 1600pc this year. Bitcoin means that Venezuelans only need an internet connection to accept a more reliable form of currency.

According to the largest Venezuelan Bitcoin exchange, Surbitcoin, the cryptocurrency's user base has soared from triple-figure digits in 2014 to more than 85,000 by the end of last year, with some companies in Venezuela now only taking payments in Bitcoin.

Rising demand Swarup draws the comparison between Bitcoin's search for legitimacy and tally sticks in the 12th century. In 1100, King Henry I decided that pieces of wood, known as tally sticks, could be used as currency to pay for taxes, with a notch in the wood representing a payment. Demand for tally sticks rocketed because of the legitimacy they had been given, he says.

Dr Swarup believes if Japan's adoption of Bitcoin spreads across the world, the same would happen.

"The moment a government sanctions it, a much wider population, who would only be looking at this in a vague sense, would suddenly find it interesting," he argues.

Already, Bitcoin's widespread adoption in Japan is beginning. AirRegi, a tablet-based payment method covering 260,000 food outlets and retailers in the country, said it would now accept the cryptocurrency, and the big Japanese retailers Bic Camera and Recruit Lifestyle have outlined similar plans.

Despite the breakthrough in Japan, Bitcoin still faces challenges elsewhere. Last month, the US Securities and Exchange Commission rejected a proposal by the Winklevoss twins, Cameron and Tyler, to create an exchange-traded fund based on Bitcoin. There is a

disagreement within the community over the cryptocurrency's future, and continuing problems with security and theft.

However, Dr Swarup says: "You have a lot of people at the Bank of England and other policymakers talking about whether currency should become all-digital anyway, so a digital pound would immediately have competition online from Bitcoin or other digital currencies as well. "If a government in general doesn't stay ahead of the curve, they might find themselves swamped by it. Japan [has] in effect created a framework for every digital currency out there."

FAQ | Bitcoin



What is it?

A digital currency, used to make payments of any value without fees. It runs on the blockchain, a decentralised ledger kept running by "miners" whose powerful computers crunch transactions and are rewarded in bitcoins

Who invented it?

Satoshi Nakamoto, a secretive internet user, invented bitcoin in 2008 before it went online in 2009. Many attempts to identify Satoshi have been made without conclusive proof

What's it for?

People see value in money free from government control and the fees banks charge; as well as the blockchain, to verify transactions. Bitcoin has been seen as a tool for private, anonymous transactions, and it's the payment of choice for drug deals and other illegal purchases

Is it worth anything?

Yes. As of December 2016, there were around 16m bitcoins in circulation. In March 2017, the value of a Bitcoin, at \$1,268, exceeded that of an ounce of gold (\$1,233) for the first time.