The Future of Crypto Markets

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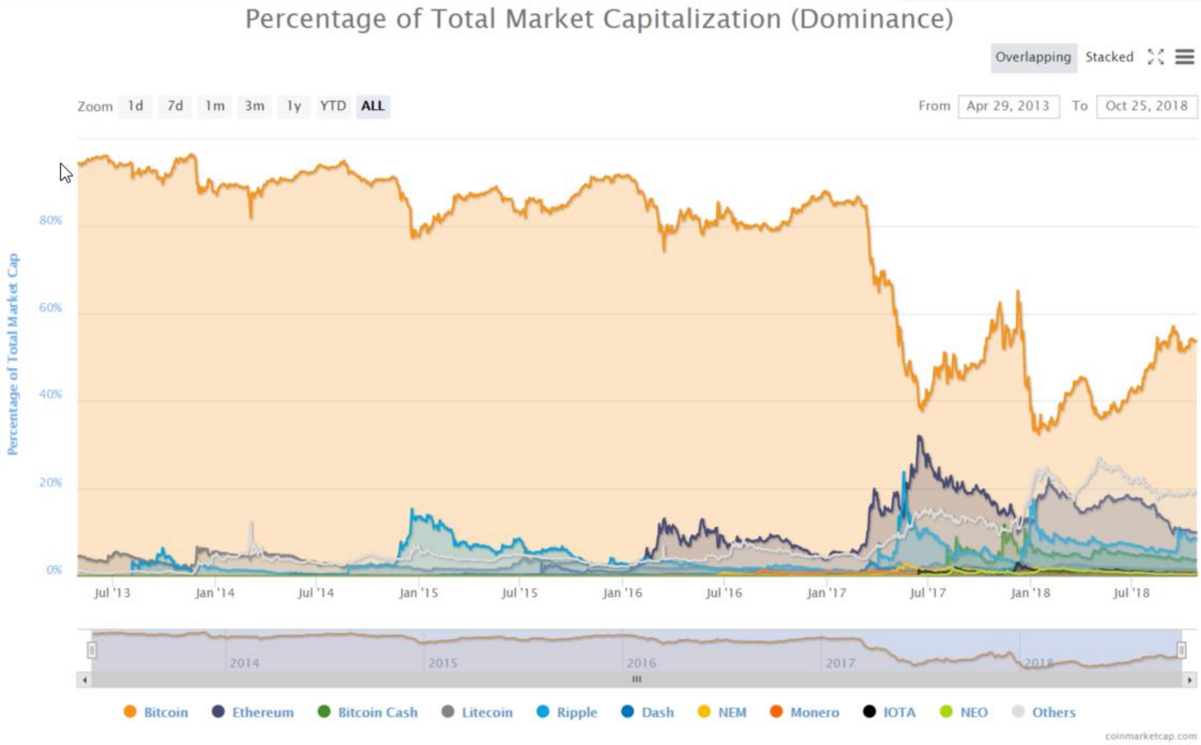
This issue is focused on Crypto ecosystem, marking its 10th Anniversary since bitcoin creator **Satoshi Nakamoto** published his white paper on bitcoin and latest developments in regulation of cryptocurrencies. The global economy was taken by storm of new and exciting transformative potential of digital currencies. Some of us still trying to make sense of the concept of new ways to transact and invest, figuring out what exactly is involved and how we are going to be impacted by the "crypto revolution". The development of the crypto market is emphasized by its growing market capitalization. As shown in the chart below, in Jan 2017, the market capitalization was $17bln and grew significantly during 2017, reaching its peak in Jan 2018 at $830bln, falling and fluctuating thereafter.[1] As of this publication, 24th Oct 2018, total market cap is $211bln, with Bitcoin still leading the market capitalization percentage at more than 53%.[2], losing its popularity due to increasing transaction cost.



[1] Kate Rooney, 27.03.2018, CNBC
[2] CoinMarketCap.com

Every seemingly small regulation announcement has driven the price of bitcoin and other cryptocurrencies in 2018.

Japan being the major global player in cryptocurrency investment market, accounts for 56.2% of BTC (in Bitcoin), owning it's no 1 position to a solid legal system supporting the industry to build credibility among individual investors, legalizing cryptocurrency trading in May 2016.

Similarly, other regulators and Central banks have accepted the inevitable crypto world' transformative mainstream and value. The bitcoin is already treated as a legal tender, however not everywhere, varying by the country.

Switzerland' FINMA and **Israeli** Securities Agency have agreed to classify cryptocurrency into payment tokens, utility tokens, and security tokens. Similarly, here in **Singapore**, Mr Menon of MAS views the crypto space entering into its "second generation", with emerging new terminology of "crypto tokens" rather than "crypto currencies". The efforts are to aid clarity, allowing entrepreneurs and investors a much firmer ground to build projects and governments to develop an effective regulatory guidance. **G20 members states** and **Financial Stability Board** (FSB) already working on these issues, led by Japan, requiring licenses and working with self-regulated organisations (SROs) to help mainstream and police the space.

At G-20 meeting in Buenos Aires, March 20th, 2018, Mr Luis Caputo, Argentina's former central bank governor, outlined a necessity of a deadline for members to have "specific recommendations on what to do" with subsequent submitted proposals in August this year to de-risk cryptocurrency markets and craft regulation that will not "stifle" the innovative potential of blockchain.[3]

MAS monitors closely the nature and scale of crypto token activities in Singapore, assessing it's posing risk to financial stability as "not significant", in line with the FSB' 2018 assessment, addressing some of the challenges related to network congestion, energy costs, money laundering risks and, importantly, price stability. In his speech at Money 20/20 on 15th March 2018, Mr Ravi Menon, managing director of MAS, have highlighted global trend of regulators preparation towards introduction of cryptocurrency regulations with prioritizing investor protection and market functioning. [4]

Most recent and eagerly anticipated **FATF** announcement came on 19th October, reinforcing its position on virtual assets progressing AML concerns, and imposing global cryptocurrency licensing and regulations by July 2019. Main outcomes include new definitions of "virtual assets"[5] and "virtual asset service providers", widening the definition of who is subject to these requirements, regulating the infrastructure around the currencies and not the currencies themselves. The entities serving the new asset class in now called Virtual Asset Service Providers (VASPs) and include exchanges, certain types of wallet providers, and providers of financial services for ICOs. The regulations are not ground breaking and follow risk based approach, in line with current FATF standard recommendations. Meanwhile, the spirit of the AML/CFT compliance would be achieved if the FATF's 2015 Guidance on virtual currencies is followed.

As we know, it would take any jurisdiction years to make a relatively minor regulatory changes to the financial regulatory regime. We are already familiar with regulators methodology of first assessing related activities, draft proposals for consultation, set implementation date and subsequently publish changes – a lengthy process prioritized with bigger issues, depending which jurisdiction implements the change. For example, **HM Treasury** is currently greatly preoccupied with the Brexit issues. According to RPC' legal director, James Kaufmann, UK regulation of the cryptocurrency market would take two years to introduce based on comparable extensions of the **FCA**'s remit.[6]

Notably, recently published The UK Treasury Committee's Report, have outlined regulatory concerns in implementation a workable regulatory regime for cryptocurrencies, with an international approach to cryptocurrency regulation in US, Asia and Europe - quite invaluable material for any risk and compliance professionals specializing in support of fintech organisations anywhere in the world. In the report, many market players gave interesting and somewhat new insights on issues and additional risks some of us might not be aware of, like storing and access to passwords of crypto-asset platforms. Blockchain, a non-custodial software

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[3] Francesco Canepa, G20 leaders to hold fire on cryptocurrencies amid discord: sources, Reuters, march 20th, 2018
[4] Mr Ravi Menon, Straits Times, Mar 2018
[5] http://www.fatf-gafi.org/publications/fatfrecommendations/documents/regulation-virtual-assets.html
[6] https://www.rpc.co.uk/, 11 Oct 2018

platform that provides wallets to customers, states that "your recovery phrase is the only way to restore access to your wallet if you forget your password".[7] Thus customers that have lost their passwords (and consequently access to their accounts) have no support in this matter from the firm that runs their account locking out the customers permanently, causing additional risk of losing the investment.

The report outlines some examples of cyber risk mitigation already put in place, for example when asked how crypto-asset exchanges can mitigate the risk of hacking, Iqbal Gandham, chair of Crypto UK and managing director of eToro, explained that by keeping customers' details offline, greater security can be achieved. He said that "Crypto UK have created a self-regulatory code of conduct, one aspect of which is keeping 90% of customer assets in cold storage on a devise that is not connected to internet". Interestingly, in the same report, Izabella Kaminska, editor of the Financial Times Alphaville, argued that the use of cold storage highlights the inefficiencies of the crypto-asset exchanges, and creates market liquidity issues. Mr Nwosu, CEO of Coinfloor, stated that most exchanges did not have any mechanisms for compensation in the event of a hack and subsequent loss of crypto-assets.

Failed ICOs are also of concern, a new way for companies to raise money via crowdfunding using blockchain technology. The track record of ICOs has been tainted by considerable financial losses for initial ICO investors. A crowdsourcing website that helps tracking of coins that have gone out of existence, www.deadcoins.com, has identified over 900 failed ICOs. Coindesk' study reviled that more than half of ICOs failing within 4 months. It doesn't mean that lessons won't be learned with potential more advantageous ways to participate in ICOs in future. The research, conducted by a small team at Boston College in Massachusetts, found that a mere 44.2 percent of token projects are active into the fifth month or beyond, using their social footprint via Twitter as a barometer of health.

Looking forward, Nigel Green, founder and CEO of financial advisory firm deVere Group, predicts that Bitcoin's influence and dominance will be drastically reduced in its second decade. "This is because as mass adoption of cryptocurrency grows, more and more digital assets will be launched – by organisations in both the private and the public sectors. This will increase competition for Bitcoin and dent its market share. Even if bitcoin's dominance fades, Green says there is a clear shift among retail and institutional investors away from fiat money and into crypto, believing that crypto's momentum will only intensify in the coming decade. As a result, he expects "the market will have grown beyond recognition when Bitcoin celebrates its 20th anniversary."

On the institutional investment front, hedge fund managers, derivatives brokers everywhere are racing to get into the crypto game. There are already specialized aggressive players out there like crypto funds allowing investors to put their wealth into a pool of existing and new crypto assets. Such funds are still a work in progress, majority being set up by amateur traders who are making it big. There is a new wave of cryptocurrency traders taking the investment world by storm with highest appeal being current lack of regulations. Recently, Singapore Business Insider reported on one would-be fund manager who apologized for his new found wealth turning $600k into $8mln.[8]

Some bigger and already established trading brokers offer crypto trading on their platforms – Markets.com, Plus500, eToro, AvaTrade, CoinBase (for US traders) each competitive in various categories – best platforms and tools, low deposits, leverage, cost. The above companies are pioneering the digital investment world while majority of established brokers, investment banks and custodians taking a more cautious approach, hesitant to try the new technologies when existing systems still work and profitable, opting to observe how others do before committing themselves into major investments. In our opinion it's a matter of time when bigger banks and financial institutions do so, supported by upcoming clear regulatory guidance.

The race to establish a workable and regulated regime for crypto-tokens or crypto-assets is surely worth the time and effort of global regulators, who already have proven their acknowledgement of positive effects for business servicing cryptocurrency markets, as well as potential increase in tax revenues for the authorities. As we know though ICOs are banned in China, however the ban proved to be ineffective, ICO activity continuing to intensify. China-based Shenzhen Puyin Blockchain Group reportedly have generated over $60 mln from its three ICOs,

[7] Extract from Blockchain's Facebook page, accessed on 12 June 2018, House of Commons Treasury Committee, Crypto-assets, 22nd report of session 2017-19, 12 Set 2018

[8] Oscar Williams-Grut, Business Insider US, Business insider, Singapore, June 6th, 2018

ACChain, BioLifeChain and Puyin. In recognition, in May 2018 The Chinese Ministry of Industry and Information Technology released its first Rating of Public Crypto to aid its citizens to make informed investment decisions, evaluating 28 cryptocurrencies, committed to fostering the technology for China. Which makes sense due to China's status of being the host of most cryptocurrency mining facilities in the world, using the highest level of power consumption of all countries, with it's access to low-cost electricity to run the operation profitably.[9]

A major organizational restructuring of South Korea' financial regulator, FSG, establishing an exclusive department for policymaking initiatives in the nation' blockchain industry, Financial Innovation Bureau is another example of firm trend towards embracing crypto ecosystem by global regulators and governments.

In **CONCLUSION,** it is of our opinion that that crypto regulations would not really mean the end of crypto. We believe that current ambiguity behind the legitimacy of digital currencies will be soon cleared providing an invaluable opportunity to market players to diversifying the businesses with a sustainable and manageable risk models, ultimately boosting investors' confidence in new investment class. Blockchain and other evolving new technologies are set to transform the payment systems and trading offering a sustainable alternative to current systems - in our estimate, as early as within 2 to 4 years of the next decade.

[9] Dr Garrick Hileman & Michel Rauchs, Global Cryptocurrency benchmarking study, Cambridge University, 2017