The Future of Cryptocurrencies

Introduction:

Cryptocurrency was born in 2009 with the initial launch of Bitcoin. Ever since then, the digital innovation has grown to become a major piece of the economy, but not without its share of issues. Essentially, cryptocurrency is a digital asset that functions as a store of value and a medium of exchange. It employs a blockchain, allowing all participants to transact without a central organization. This blockchain not only houses records of all validated financial transactions, but also has power over creation of new currency. In comparison, sovereign fiat currencies, like the USD, are managed by central banks and distributed via financial banks[1].

Commonly, supporters of crypto technology highlight the benefits of its decentralized nature. Without centralized organizations presiding over such currencies, there are lower associated transaction costs and no risk of government confiscations or control. Additionally, the technology aids the underbanked and unbanked, who now can access financial services. Finally, the digital nature allows quick transactions and a decrease in counterparty risk[1].

However, crypto is not without its failures. In 2022, the enormous crypto exchange FTX went bankrupt after it was revealed for fraud. Despite cases like these, investors are as optimistic in crypto as ever, evidenced by Bitcoin doubling in 2023[2]. Naturally, this calls for strong regulations on crypto, though applying current regulations of assets like stocks to the technology prove to be difficult. Cryptocurrency is a novel asset that continues to evolve by the second, requiring regulations, and regulators that establish them, to continually be adapting. Finally, the digital aspect means big efforts must be put into acquiring data[3].

Thus, crypto lacks proper regulation. This white paper addresses the three main issues of crypto: fraud and volatility, the issue of resounding international consensus, the question of which asset class it falls in and who should regulate it in the US. It is directed to crypto interest groups like the Blockchain Association, in addition to entities that should be regulating crypto like the Securities and Exchanges Commission, Commodities Futures Trading Commision, and International Monetary Fund.

Problems:

Asset Class:

Additionally, a big cause for the mix of crypto regulation is from the ongoing question of which asset class it lies in. On one hand, crypto could be labeled a commodity because of its similarities to gold and silver, which would lead to it being regulated by the Commodity Futures Trading Commission (CFTC). On the other hand, it could be classified as a security because of its expectation of profit, which would put it at the hands of the Securities and Exchange Commision (SEC). All these US regulators are fundamentally different, with some prioritizing consumer protection, while others security or integrity. And there are many entities involved in crypto, such as miners, validators, and protocol developers, that are not protected by conventional financial regulation[3].

There also have been problems regarding crypto being put in one category or another. With the SEC, the argument is that they might too closely regulate it, letting the technology die out. For the CFTC, it is almost the opposite. The recent FTX disaster, as it happens, discredited the idea of instating the CFTC as the main regulator for crypto because FTX CEO Sam

Bank-Fried and the company donated a lot of money and effort into getting the commission to take the charge[4].

International Consensus:

Finally, it is difficult for crypto to be properly regulated without international agreement. Because crypto is entirely contained online, it can easily cross borders and travel far distances which causes complications. Some countries jumped the gun and placed heavy regulations, some even banning, while others warmly welcomed crypto as a way of boosting economic growth. For example, the Bahamas' lax regulatory climate brought in FTX, the company that went bankrupt from fraud. This fragmented reaction does nothing to prevent companies from moving to the most welcoming countries with the least stringent regulations, where fraud could occur under the radar[3].

Fraud and Volatility:

To start, one of the fundamental issues with crypto lies with its susceptibility to fraud and the resulting volatility. The digital nature of the currency puts it at risk to many technology-related threats that regulators have yet to control. These risks have culminated in cyber attacks and loss of credentials[3]. Moreover, the difficult to regulate facet of the technology has led it to be exploited by evil entities. For one, crypto has been used to buy illegal drugs, such as on online black market Silk Road, and in 2017, it was revealed crypto allowed criminal organizations to easily move their illegal funds across borders. The group of Russians that was charged with unlawfully interfering in the 2016 US elections was alleged to have used almost

$100,000 in Bitcoins in their illicit activities[1]. Finally, there have been emergences of bad cryptos stemming from initial coin offerings (ICOs) that offer deceiving or insufficient information[1].

As a result of fraud and speculation, asset values will always swing. However, crypto is known for its extreme volatility, with variations that can result in wide scale gains or losses in a short period. Irrational selloffs are caused by the market's speculative character and lack of fundamental value, which all accentuate fluctuations and threaten stability. Although this volatility draws speculative investors looking for large profits, it discourages the large herd of risk averse institutional investors and traditional businesses[5].

Solutions:

Asset Class:

Crypto's special nature requires a hybrid approach to how it should be regulated by government entities.

International Consensus:

Countries must come together for international consensus on crypto. So far, the International Monetary Fund (IMF) has called for a coordinated and complete response that will address the pressing issues of crypto's ability to move long distances easily[3].

Additionally, the Financial Stability Board (FSB), an international group of major countries, issued a report showing that, while the volume of crypto assets is still small compared to government currencies, the FSB "will identify metrics for enhanced monitoring of the financial stability risks posed by crypto assets and update the G20 as appropriate" [1]. The group also released a guide on the treatment of stablecoins and is advising on other crypto assets like the unbacked. Other influential entities are also issuing guidance, ranging from the application of current financial principles to stablecoin regulations and "prudential treatment of banks' exposures to crypto assets" [3].

The International Organization of Securities Commissions (IOSCO) has also highlighted the increased use of ICOs as an area of concern and issued a statement discussing the associated risks and the various approaches taken by the regulatory bodies of member states" [1].

Although much has been done by the international community, there are ways to go in terms of international consensus. So far, only guidance has been issued by organizations that do not have influence over all governing bodies, so an important step that must be reached is consistent regulation that spans the globe.

Fraud and Volatility:

It becomes clear that crypto needs specialized regulations protecting investors from fraud, as well as stable currencies to combat volatility.

Conclusion

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