

# GT34 – 38<sup>th</sup> ALCO Round Table - 04.06.2018

## When a compliance officer tries to make up his mind about crypto-currencies and blockchains

### **Blockchains**

When hearing for the first time about the blockchain technology and the creation of crypto-currencies several years ago, I was quite attracted by the concept.

As a compliance officer, I saw the block-chain as a way to increase the traceability of the crypto-assets. As from the original mining process up to the actual holder, everything is traced in a way that cannot be contested, hacked for, nor destroyed, at least for the time being. Moreover, traceability files are supposed to be accessible worldwide in an easy way. What could a Compliance Officer object to this?

*I now understand however that certain technologies based on blockchains enable transactions in several crypto currencies (Monero, Zcash...) not to be traced.*

Moreover, the blockchain offers the possibility to confine the use of trusted third parties<sup>1</sup> such as a notary public, a public administration, a custodian... This might reduce the cost of a lot of transactions or contracts.

### **Crypto-currencies**

#### *Democracy*

As a firm believer in democracy, I understood that crypto-currencies could be alternative means of payments within dictatorships, for opponents of a corrupted regime. I imagined the people living in the fear of being prosecuted because of their political, religious or philosophical beliefs, gaining access to something like a safe haven currency avoiding the spoliation or seizure of all their financial assets by corrupted police forces.

*I now have the impression that owners of crypto assets invest in it rather for speculating than for sheltering their savings. Or, even worse, they use it through the dark web in transactions fearing the daylight for criminal reasons. Even democratic countries, respectful of Human rights are now trying to limit as far as possible the use of crypto-currencies.*

#### *Security & Integrity*

Being attracted by security, I am reassured to hear that hack the system today is almost impossible.

As a supporter of integrity, I expected that manipulation of the interest and exchange rates crypto-assets/currencies would be almost impossible. This is because crypto-currencies are not supposed to be issued by anybody. Moreover the algorithms behind the creation, transfer and ownership mechanism are expected to be totally invariable. Indeed, for the first time in the history of mankind, a currency is not linked to a person, an issuer, a state having the (physical) power or the (religious, political...) authority to tell to others what currency they have to trust or not.

*Unfortunately, I recently read on CNBC that "Bitcoin's epic rise last year may have been more than investor fervor. A study published Wednesday says at least half of the jump in bitcoin was due to coordinated price manipulation."*

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<sup>1</sup> « tiers de confiance »

## *Value*

Currencies (and even precious metals or seashells) are only worth what people believe they are worth. The price is what the fool accepts to pay for it. When their trust in the issuer increases, the value increases. When the trust disappears, the worth disappears as well. That works for currencies, for gold and, in some contexts even for seashells. Tulip bulbs, (rare old) postage stamps and diamonds follow other (speculative) patterns, probably because of both, their scarcity and their not (fully) fungible character.

Nobody is expected to encourage people to believe that a cryptocurrency is worth something. Authorities are usually acting in the opposite direction. They warn the public that the cryptocurrencies are not granted nor protected by anybody, that speculation on these currencies is strongly discouraged. Of course, because it is in their own interest to maintain their own currencies and avoiding competing currencies to gain in interest among the population. But not only.

## *Aristotle*

A lot of religions, philosophers and laws are warning against some types of speculation. Aristotle (384-322 B.C.) is known also for having determined limits beyond which speculation becomes reprehensible. Same ideas are widely present in the Koran and the Christian and Jewish religions.

One might speculate that the exchange rate €/€ will evolve in favour of the € because of political, economic, sociological reasons. One might speculate that the interest rate of a currency of a well organised country who shows its ability to improve its economical balance will decrease. But what about a crypto-asset. What can influence the willingness of people to buy or to sell it? Nothing but beliefs that, for some personal (psychological? Philosophical?) reasons, the appetite for the asset will remain stable, increase or decrease. Quite disconcerting, isn't it? Is this acceptable from an ethical point of view that work, economic risk taking and even knowledge or analytical skills are excluded from the process? In such a context, I feel speculation is closer to a Ponzi scheme or to an on-line casino mechanism.

Speculation and greed combined together often attract criminals who try to benefit from (potential) investors naivety or lack of experience. Authorities try to warn and increase awareness by different ways. E.g. by updating frequently lists of crypto-assets, or firms or individuals who are suspected from fraud or abuse of confidence. So did recently the FSMA, after having received a significant number of complaints. Even Facebook refuses nowadays any advertisement related to crypto-currencies, in order to protect its clients.

## *Environment*

Another highly questionable issue is the environmental impact of the mining process and the ancillary processes. Crypto assets are requiring lots of energy: electricity to run and maintain the processes and including the huge amount of electricity to cool down the processors and other device that are used for mining and registering the currencies. New technologies are trying to find alternatives to this excessive energy consumption. Let's hope a solution will be found soon.

## *Financial sector*

Do financial institutions have advantage in participating, enabling or encouraging investments in cryptocurrencies? Aren't they cutting off the branch they are sitting on? The creation of cryptocurrencies might have been motivated by the willingness to get rid of the banks or, at least, to reduce people's dependence on them. However, now they are created, financial institution cannot ignore them. They have to position themselves. Only a few will conclude the crypto-currencies / assets do not suit their business conduct policy.

"The Bitcoin is a fraud that will ultimately blow up", according to JP Morgan boss Jamie Dimon speaking at a conference in New York "I will fire in a second anyone found to be trading in Bitcoin. For two reasons: it's against our rules, and they're stupid. And both are dangerous."

Some will probably see opportunities in making extra money, in gaining new clients. Most of them will bet that the future will oblige banks and crypto-currencies to co-exist and to depend on each other. All of them want to improve their understanding, of the phenomenon. Building knowledge, skills and experience requires as from a certain stage to participate, to try and test the process.

### ***Conclusion***

But let us be careful not to lose our trustworthiness through inappropriate actions and decisions. Banks need to have a sober and realistic view on what society is expecting from them. Banks are not expected to accept whatever the clients want them to do. The Compliance Officer, thanks to his independent and permanent advisory role, might be one of the key staff members to help them to take well-informed and intelligent decisions.

*11.06.2018*

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