FCAM

Decentralised Digital Investing

With Innovation Brings Regulation

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"All truth passes through three stages. First, it is ridiculed. Second, it is violently opposed. Third, it is accepted as being self-evident"

Arthur Schopenhauer, Philosopher.

Recent actions from US regulators and legislative bodies are sending a clear message that the Western World is moving quickly towards the next phase of adoption of digital assets. It's always been our stance that regulation and the adoption of central banks digital currencies (CBDC's) were key events that would precipitate the next wave of innovation and growth in the DeFi sector. Moving from the speculative crypto casino culture and focussing on the application of the technology for mainstream adoption is something we very much welcome and will spend this month's research note discussing in detail.

We start with an overview of blockchain technology as it applies to its adoption via a different political ideology. In 2014 China's central bank, the Peoples Bank of China began work on developing a fully backed digital fiat currency. In 2019, Chinese President Xi Jinping declared his support and encouragement of the development of blockchain technology. The Chinese government has emphasized the distinction it sees between cryptocurrency and blockchains. Industry participants were warned not to conflate the two and reminded that the development of blockchain applications, as opposed to cryptocurrency, is widely encouraged. The recent banning of Bitcoin mining in China clearly reiterates this stance. The launch of China's CBDC, e-CNY, is speculated to take place in February 2022 as part of the Beijing Winter Olympics. A bold statement to a global audience that there is a potential new player at the global monetary table.

The capitalist United States has chosen a very different path when approaching the new world of digital assets.

Being the incumbent global monetary power it is not surprising it has been slow to act. Blockchains and “crypto-currency” are joined at the hip in the US. The crypto currency industry has morphed into Wall Street on steroids. A winner takes all race for entrepreneurs, making the most noise to gather the most followers and promote the latest narrative. This has led to eye watering valuations for the middleman (the crypto exchanges) getting rich cheering from the sidelines. You could be as confused as we are as to why technology that promotes the removal of intermediaries is financially rewarding those that keep the centralized intermediary status quo. The power and resources of the incumbent financial institutions remains very important in the west.

The dramatic wealth created from the latest crypto bull market run has attracted the attention of US regulators, legislators, and the IRS. The crypto exchanges have had their wings clipped, with excessive leverage (100x) removed from their product offering along with offerings of tokenized securities, a direct violation of SEC regulations.

The crypto industry found itself in the unenviable position of being used in the horse trading as the senate sought to pass the latest US Infrastructure Bill. The amendments proposed clarification on which industry participants should be taxed and how that would be enforced. US regulation remains focused on forming and enforcing views on whether a digital asset fits into a predefined bucket of security, commodity or currency. The inability of US regulators and others to focus on the merits of the technology illustrate the violent opposition stage that the technology currently faces from incumbent institutions.

Not to be forgotten from the growing list of parties circling the US monetary hegemony is the private sector.

Whether it is the legion of Bitcoin maximalists calling for global adoption, the evolution of stablecoins, or the invention of private sector currencies such as Facebook's Diem, there is a growing list of private challenges for the USD standard. It is our opinion stablecoins are not the threat that regulators believe them to be, but they do represent for the first time USD in a digitally native format i.e. they can be self custodied with no bank account required. This is not a threat to financial stability, but to power and control.

The US Federal Reserve is owned by a select group of unnamed US Banks. Having money in a format that does not require a bank account is a seismic change that will certainly lead to violent opposition. The Federal Reserve is issuing a discussion paper on the merits of a US CBDC in September, seven years later than their Chinese counterparts. Facebook's Diem project brings with it huge global network effect of 2.8billion registered users and digitally native money. A frightening proposition for any central banker is an understatement.

This month's note is hopefully a reminder to focus on blockchain technology and what is the end game – peer to peer financial transactions at zero cost. Certain countries have embraced the technology, some are looking at how it fits into the existing regulatory framework while others are still shunning it. The technology is highly disruptive and is being applied directly at an industry that has experienced limited technological innovation – banking and finance. We understand the disruption that this technology will bring, and it is important to take stock of where we stand in the evolution of this technology into our everyday lives. Opposition has just started and expect it to continue in the coming weeks, months and years until digital assets are accepted as being an obvious monetary evolution. As we know however there are two certainties in life, death, and taxes. The death of the old financial system will not be fast and likely not violent, more just a slow reorienting of precursors until today's industry is unrecognisable. Regulation and taxes are inevitable, the desire to tax success is a strong force, but equally is one that implies acceptance of a desire for industries to succeed.