Self-regulation of Bitcoin & derivatives

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“Digital currencies will create peace, reduce poverty and will make transacting business more affordable for the masses” - Dr. Ruja Ignatova

Recently, the world's first Bitcoin Exchange-Traded Fund (ETF) was officially rejected after seeking SEC approval. This can be seen as a major set-back for anyone else wishing to implement Bitcoin in modern financial markets. Others, can view this opportunity to re-evaluate the current situation, all factors involved, and create something better suited for modern times.

The commission ultimately concluded that the price of Bitcoin is still too vulnerable to manipulation for it to be certified. “Regulated markets related to the underlying asset provide a ‘necessary deterrent to manipulation,’” the commission wrote in its analysis. “To the extent there is some question as to the degree to which Bitcoin is subject to manipulation... regulated markets relating to Bitcoin would help answer that question and address instances of such manipulation. Two other ETF proposals pending before the SEC, and there are significant differences that might allow either one to succeed. [1]

Those whom been involved with Bitcoin for quite a few years: can all agree on one thing. Bitcoin has been like the "wild-west" on steroids. Most of us can vividly remember exchanges going bankrupt after thieves broke into their servers and stole all the coins, investment funds that became ponzi schemes, price manipulations by malicious miners, and robotic traders. This wild ride has shaken, stirred, and affected investor confidence that could have supported a positive SEC assessment to begin approving many ETFs.

“Bitcoin is a relatively successful application of block-chain technology, Digital currency, block-chain, and other technologies will have an unpredictable impact. In the development process, the problems encountered needs to be regulated.” - Wu Xiaolin 2017-03-09 (Chinese Congresswoman)

Truth be known: the SEC and other financial regulators are desperately trying to keep up with the ever changing crypto-currency economy. This complex, independent peer to peer economic model conflicts with their own ideologies; focusing more on centralized oversight, rather than consensus among those involved within the industry. Most bankers and governments are only beginning to understand Bitcoin, the block-chain, peer to peer networks, and how these concepts can transform finances for many generations to come.

“According to the World Bank, the total U.S. stock market is now valued at more than 150% of annual gross domestic product. That is way above historic norms, and about the same as it was at the market extreme of 2000.” [2]

Pioneering Bitcoin users, realize the risks involved and already understand that any oversight from regulating agencies won't affect their own confidence in protecting themselves with market risks. Some enthusiasts actually fear industry regulation due to a threat of negative interference in what most consider a true free-market. The concept of a free-market having regulation is viewed as somewhat of a contradiction by some people, although nearly everyone can agree that some kind of “government” oversight is required for mass-adoption and integration into the current financial system.

According to Wu Xiaolin, the PBOC should be in charge of regulating bitcoin exchanges because the businesses involve certain aspects of anti-money laundering (AML), foreign currency management, and payment settlement. Wu explains the recent inspections were needed, so bitcoin is not a tool used for money laundering purposes. The congresswoman also states she hopes the bitcoin exchanges within the country are compliant with the new regulatory policies. However, she expressed bitcoin exchanges have so far been very cooperative and have carried out self-examinations. [3]

Controlling money laundering, fraud and terrorism activities has been the general mission for current regulating agencies, their focus has been directed towards the large exchange platforms and services. Yes, they should be a priority, although the effectiveness can be argued; since the very foundation of fiat money: is unlimited untraceable units of wealth, this undermines the transparent and limited supply ideology of Bitcoin. Simply asking for and verifying passport and identification documents will never fully stop criminal activities using Bitcoin nor using bank accounts. The problem is not born from a "new age" payment method; Digital currencies using very advanced cryptographic encryption along with algorithms for controlling inflation, payment processing, and transaction fees... The problem is the current financial system. New politics must evolve alongside free-markets.

“The transparency of economic activities in every corner in the country will significantly improve," "The central bank will have unprecedented knowledge of how the economy runs." - Duan Xinxing, vice president of Beijing-based OKCoin Co. [4]

Self-regulation and education regarding digital commodities/currencies and their derivatives is the only way to move new concepts forward by minimizing risks involved. Also, clearly stating: “they're only experimental”.

Beginning at the protocol level for crypto-currencies: implementing a user-based voting system should become priority in the future. Account addresses should be rated by users of the network to publicly display reputations and potential risks involved in dealing with certain merchants, exchanges, or individuals. This could allow for simple due diligence to be performed and prevent some levels of fraud. Decreasing the resources used for regulating and enforcement by centralized third-party oversight; formed as "regulating agencies". Alternatively: a simple self-regulating protocol with transparent integrity checking will automatically assist legal proceedings of criminal activities warranting investigation or prosecution.

Regulating ETF and other crypto-currency derivatives & investment assets is a very difficult task to accomplish. If this can be achieved; it would most certainly be a positive thing for Bitcoin. In most humble opinions: Bitcoin and related investments should not be traded on the major markets alongside Exchange Traded Funds or considerably safe hedge funds or labeled as such. A new "side-market" should be designed and implemented with caution, one that embraces the fundamental transparency of block-chain technology and decentralized networks. As described above: a user-based voting system for accounts should also be implemented, along with a proprietary method for pricing shares based on real performance of companies or hedge funds. Backing their "real-worth" using digital commodities like Bitcoin. This can be achieved using a peer to peer network separate from crypto-currency block-chains, or integrated within the existing networks. A side-chain protocol is highly recommended for security measures. Separating the derivative from the commodity backing its true market value creates an added layer of security and transparency.

There's considerable reason to believe that regulating a decentralized free-market is nearly impossible using centralized politics. Seeking regulating agencies full approval should not become a priority to further advance Bitcoin and crypto-currency technology. Mass adoption can happen very quickly if governments carefully approve financial instruments from these industries. Yes, this can be positive but could also be devastating.

One also has to evaluate the key negative effects this could have on the underlaying technologies and theories. Without fully educating new investors and users into the fundamentals of Bitcoin and these EXPERIMENTAL technologies, large financial loses can be incurred by those unprepared or misinformed about the risks. Profit incentive can be a driving force in breading corruption and that's the last thing Bitcoin needs at this point in time. Developers are busy experimenting with new improvements to the Bitcoin protocol, creating “Code Forks” (clones) with very creative features and building new concepts like smart-contracts or ways to use the existing Bitcoin network more efficiently. None of these, nor Bitcoin itself is in any technical condition at this point; to merit unbelievable growth. Everyone must slow down and realize this technology is still very new. Programmers are only beginning to show crypto's full potential uses based on theories that have yet to be proven fully.

"Getting to know more precisely how much banks lend, where the money goes and the pace of credit creation is key to curbing money laundering and making monetary policy more effective," said Duan Xinxing, vice president of Beijing-based OKCoin Co., one of the country’s biggest bitcoin exchanges.

Some may argue, due to Bitcoin's apparent unstable nature, it should be ignored or forbidden. At this point in time; that might be a good idea for most conventional investors, merchants and customers. Those who educate themselves, and fully understand the risks, should not be deterred or prevented from using these new financial concepts. Global entrepreneurs can see they provide long-term and large profit potential for solutions that reach success. Most Block-chain technology is transparent and public. Anyone can view the transactions on the networks in real-time, where they come and go, how much volume is transferred, and new coins created by “miners”.

The modern mainstream financial system is a mess! Wall-Street has become a casino, banks are more secretive, corrupt, and powerful than ever before in history. Governments are losing control of their own system… Citizens are being robbed blind and it feels like nobody can stop it!

Corporations issue shares which are offered for sale to raise share capital. The owner of shares in the corporation is a shareholder (or stockholder) of the corporation. A share is an indivisible unit of capital, expressing the ownership relationship between the company and the shareholder. The denominated value of a share is its face value, and the total of the face value of issued shares represent the capital of a company, which may not reflect the market value of those shares. [5]

How many predominantly intelligent “experts” among the finance industry have actually paused to consider the implications of the above definition of shares? How many have considered this to be a very risky way to raise capital? Considering a public corporation's reputation is often reflected upon their share's market price, but the market price of the share is not directly calculated based on performance of that business or its true reputation with customers.

Their worth is valued on what the 'debt buyers or sellers' wish to pay or accept! How many have actually stopped to think about this method of lending capital with the intention of earning profits based upon the reputation of the business? Seriously, pause... Think!

“SunEdison was, after all, a red-hot company in a red-hot space — renewable energy. Its market capitalization reached nearly $10 billion, putting it on a par with the likes of Wynn Resorts of Las Vegas. Among the believers betting on its stock was the hedge-fund heavyweight David Einhorn of Greenlight Capital. With plans to buy Vivint Solar for $2.2 billion, SunEdison appeared unstoppable. And then the company went supernova. Its shares fell from around $32 last summer to 34 cents this week. On Thursday, to the surprise of no one, SunEdison filed for bankruptcy — one of the largest in a series of recent green-energy failures.” [6]

Consider all the factors involved here, and how vulnerable what most considered a “safe-investment”. Malicious investors with sufficient capital can reduce public market reputation to virtually nothing with compounding effects, even if the hedge fund or business issuing the shares are doing quite well in terms of sales or profits with an outstanding reputation among customers. Corporations can be destroyed in a very short time-frame.

Shares are valued according to various principles in different markets, but a basic premise is that a share is worth the price at which a transaction would be likely to occur were the shares to be sold. The liquidity of markets is a major consideration as to whether a share is able to be sold at any given time. An actual sale transaction of shares between buyer and seller is usually considered to provide the best prima facie market indicator as to the "true value" of shares at that particular time. [5]

Considering this method for valuation; how can a share guarantee a profitable return unless demand continues to rise or supply falls? It simply can't. This “true value” of shares becomes unintentionally the “supply and demand value” of a capital loan agreement. How does the “investor demand” of a loan liability influences its “true market value” in terms of how

that share represents the available capital held by that company and how much it can afford to pay dividens? In reality: it doesn't. This fatal flaw amongst major money markets is very concerning, if the true-value of “something valuable” is in reality, nothing.

Profit sharing refers to various incentive plans introduced by businesses that provide direct or indirect payments to employees that depend on company's profitability in addition to employees' regular salary and bonuses. In publicly traded companies these plans typically amount to allocation of shares to employees. The profit sharing plans are based on predetermined economic sharing rules that define the split of gains between the company as a principal and the employee as an agent. For example, suppose the profits are x, which might be a random variable. Before knowing the profits, the principal and agent might agree on a sharing rule s(x). Here, the agent will receive s(x) and the principal will receive the residual gain x-s(x). [7]

An entirely new approach must be developped in the form of a stable platform that allows small or large businesses, hedge funds and even governments to seek capital investments, and provide them at a low rate of external risk to global investors. The same basic principals used in employee profit sharing plans can be applied to external share-holders; using a secure peer to peer network, backing the “true market value” of each share by liquid capital in the form of digital commodities such as crypto-currencies, gold or silver bullion, or verified deposited capital at a banking institution.

The DAO (Ethereum) was an extreme case of what could happen if smart contacts aren’t vetted properly. However, there are also many other risks when you get into cryptocurrency as you are in a sense becoming your own bank which means you’re in charge of how secure your funds are. In addition to being very familiar with how blockchain works, one also needs a strong “BS detector” to be safe online and especially while transacting coins. [8]

Ethereum began to develp a new area of Bitcoin that was not included originally in Satoshi Nakomoto's original source code. This theoretical feature was not mentioned in the Bitcoin Whitepaper but contained within a reference [9]. Connecting a smart contract directly to the commodity backing it, developers had very good intentions, and this protocol has proven to be very effective for limited peer to peer financial operations. These experimental, complex, digitaly signed, automated enforcement agreements have also proven to be very risky during development stages. Blockchain technology also allowed for most “stolen” funds to be recovered when a malicous user exploited a vulnerability in the source code.

“Ethereum is a decentralized platform that runs smart contracts: applications that run exactly as programmed without any possibility of downtime, censorship, fraud or third party interference.” [10]

A new approach to digital smart-contracts has been conceptualized for quite some time, prior to the launch of Ethereum and Bitcoin itself. Innovative companies are struggling to acquire new investment capital for experimental markets and technologies. Renewable energy industries are a very good example where massive growth potential exists and can be achieved only if the foundation exist for sufficient capital market support. Without a stable platform technology will never be able to solve urgent environmental and economic problems.

Razzouk got the ball rolling by saying that capital markets, collectively worth $250 trillion in investments, are not taking sustainability seriously at all. “As long as that amount of capital doesn’t actually care about climate, clean energy, sustainability and science-based emissions targets, then the world as we know it is not going to change at the speed that we need it to change to survive as a species. [11]

- As of early 2017, the Swiss National Bank owned MORE shares of Facebook than the social media company’s founder, Mark Zuckerberg.
- According to *Bloomberg*, The Bank of Japan is on track to be the #1 buyer of Japanese stocks. And if their buying binge continues – within a few years, they’ll own the ENTIRE market!
- China’s Central bank is now a Top 10 shareholder in the biggest, most well-known stocks in Shanghai.
- The U.S. Federal Reserve has cracked open the door. Federal Reserve Chairman, Janet Yellen says, “There could be benefits to allowing the central bank to buy stocks.”

[12]

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