Bitcoin
The new gold rush?

Bitcoin basics

Bitcoin is a cryptocurrency, a digital alternative to traditional money relying on cryptography for its operation. The Bitcoin protocol, a system of open source processes, governs the currency and is primarily supported by a peer-to-peer network. This design also makes Bitcoin a payment network, one that exists outside the traditional payments system.

Pros

- Low transaction costs
- International transferability and convertibility
- Protection from some political risk and inflation
- Basic alternative digital currency problems of supply growth and double payment/verification solved
- Operation is outside the banking system — immune to bank failures, but not protected by deposit insurance

Cons

- Currently volatile value
- Limited adoption by retailers
- Combined with other software, anonymity can be used for illegal purposes
- Lack of trusted intermediaries to challenge fraud
- Potential to expose users' transaction history to the public
- Uncertainty about security and operational resiliency
- Inadequate mass-market understanding

Conditions for mainstream adoption

Stability

- Bitcoin's volatility needs to moderate in order to enter the mainstream
- Bitcoin's utility as a medium of exchange, unit of account, and store of value will be limited until stability is reached

Trust

- Trust may be a challenge given Bitcoin's complexity, decentralized system, operational issues, volatility, and association with illicit uses
- Lack of consumer protection may further inhibit trust

Acceptance

- An increasing number of businesses accept bitcoins, but the currency still remains a niche phenomenon
- The lack of acceptance by traditional financial institutions limits Bitcoin's use
- Without price stability, widespread adoption appears unlikely

Business and institutional implications for financial services companies

Business implications

Hedging and investment services
Firms may consider creating new investment offerings focused on Bitcoin, such as index funds and exchange-traded funds.

Payments
Transfers between individuals via Bitcoin are faster, simpler, and less expensive than those offered by many financial services companies. Companies may need to innovate to retain their dominance in this space.

Retail and investment banking
These firms may begin looking at the acceptance of bitcoins as deposits, the use of bitcoins as collateral, the pursuit of business with Bitcoin-related companies, and Bitcoin trading.

Institutional implications

Risk and compliance
Bitcoin raises many concerns from a compliance and risk perspective. Risk governance and internal controls may need to be developed or adjusted to account for Bitcoin and other cryptocurrencies.

Operations and technology
Software and other IT investments may be needed to integrate alternative digital currency platforms into infrastructure and product offerings.

Tax and accounting
The adoption of Bitcoin may carry numerous tax and accounting implications, among them revenue recognition, mark-to-market valuation, the characterization of profits and losses for tax purposes, the applicability of barter transaction rules, basis tracking, and hedging considerations.

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