

T

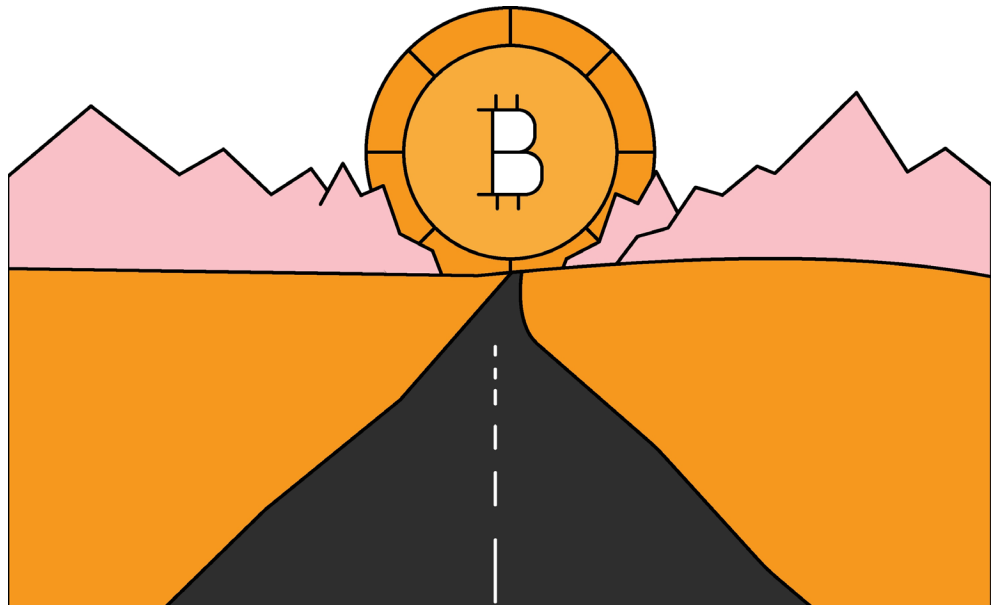
From

THE PULSE

SPRING 2024

Bitcoin: Finance on the Modern Frontier

By John Arvanitis and Richard Lee



Since it became a teenager in 2022, Bitcoin has drawn a lot of attention with its Wild West appeal and pioneering potential. Yet, like any new arrival on the frontier, its bright promise doesn't guarantee it'll strike gold. That bright promise lies in an alternate path to financial freedom—a shift away from traditional, centralized systems of wealth creation and management. This revolutionary approach has captivated a myriad of individuals, from those in the traditional finance space looking to capitalize on a popular and growing asset class, to innovators in adjacent services, to first-time investors taking their shot at generational wealth.

However, as this nascent crypto industry evolves with Bitcoin as its crown jewel, it faces many challenges, including an uncertain regulatory landscape, concerns over its use in illicit activities, and debates about its legitimacy. These factors collectively paint a picture of a sector at a crossroads, grappling with growing pains while striving to prove itself as a legitimate component of the global financial system.

(continued on next page)



(CONTINUED)

Bitcoin: Finance on the Modern Frontier

The Crypto Draw

At its core, the cryptocurrency movement is driven by a desire for decentralization—a departure from traditional, centralized financial systems and regulatory frameworks. Bitcoin represents not just a technological innovation but a radical rethinking of financial sovereignty and the democratization of wealth creation. It has attracted a broad community of enthusiasts, investors, technologists, and detractors, all invested in exploring the potential and risks of Bitcoin as an alternative form of investment or payment.

For example, leaders in the U.S. financial services business have touted the importance of the underlying blockchain technology as well as the potential for the asset class to promote wealth generation and enable faster forms of payment. This opportunity is illustrated by the Securities and Exchange Commission's (SEC's) approval of various exchange-traded funds (ETFs) fueling the recent bull run, as well as by the creation of adjacent services and solutions specifically for digital assets that, for many, symbolize the next great path to riches.

The Regulatory Landscape

The swift expansion and growing acceptance of Bitcoin by the financial services industry and mainstream retail investors have unsurprisingly caught the attention of regulators, presenting challenges for market participants and lawmakers worldwide.

For market participants, the challenge presented is an uneven playing field and lack of regulatory clarity, particularly in the U.S. where there is no single regulator responsible for industry oversight. Also, there is no regulatory harmonization at the federal level since the regulatory landscape for cryptocurrency in the United States is still in its early stages. In contrast, jurisdictions such as Singapore and the United Kingdom have done more to mature their regulatory frameworks, while the United Arab Emirates is welcoming the industry and providing government support to build the necessary infrastructure.

For their part, regulators face multiple challenges as well. Primarily, lawmakers in the U.S. have yet to develop a regulatory roadmap for issuing a cohesive set of industry guardrails that protect consumers, counterparties, and financial markets alike. These guardrails should address fraud and market manipulation as well as prevent the financial system from becoming a conduit for illegal activities, including money laundering and terrorist financing (ML/TF).

Lawmakers must also contend with any potential risks to financial stability posed by this new asset class and growing market. For example, the collapse of the FTX cryptocurrency exchange not only affected its own customers, employees, and investors, but also had a ripple effect on other crypto businesses and traditional banks, contributing to the failure of several institutions. This underscores the importance of

For market participants, the challenge presented is an uneven playing field and lack of regulatory clarity, particularly in the U.S.

(continued on next page)



Regulators are caught in a delicate balancing act.

(CONTINUED)

Bitcoin: Finance on the Modern Frontier

financial stability considerations in the development of new laws, as seen after the 2008 global financial crisis, leading to the introduction of [the Dodd-Frank Act and strict prudential requirements](#). It also shows the increasing interconnectedness of Bitcoin, crypto institutions, and traditional finance.

Regulators are caught in a delicate balancing act: How to facilitate the innovative potential of Bitcoin for market growth and wealth generation, while mitigating the potential risks it poses to the financial system at large? An example of this balancing act is the recent [SEC approval of 11 Bitcoin ETFs](#), including offerings from financial market leaders such as BlackRock, Fidelity, and ARK Invest, marking a milestone in integrating Bitcoin into mainstream financial markets. This decision, seen as a major boost for the cryptocurrency sector, opens the floodgates for billions in investments, simplifying Bitcoin ownership for mainstream investors by allowing them to have skin in the game without the complexities of direct ownership.

The sector's growth has drawn both skepticism and support from members of the regulatory and legislative community. SEC Chair Gary Gensler has emphasized the [association of cryptocurrency with illicit activities](#) and its [Wild West ethos](#). In contrast, SEC Commissioner and "Crypto Mom" Hester Peirce has championed [a more frontier-spirited approach to Bitcoin](#).

The Dark Side

The same decentralization that drives the value of virtual currency in today's market has also made it appealing for cyber outlaws and other bad actors. From transnational global syndicates covertly cleaning their money away from the public eye to headline-stealing stories, like FTX, as well as TerraUSD and Luna, the vulnerabilities within the cryptocurrency ecosystem, due to the lack of effective guardrails, are compellingly evident. These incidents serve as stark reminders of the potential for illicit activity shrouded within the dark underbelly of a largely unregulated U.S. market.

[Guidance from the Financial Crimes Enforcement Network \(FinCEN\)](#) and enforcement actions by the Office of Foreign Assets Control (OFAC, including [its largest to date](#), surrounding Bitcoin's use in ML/TF) highlight the urgent need for comprehensive regulations to address crypto risks. One potential guardrail could be expanding the [mandate](#) requiring that senior executives possess certain qualifications to run a financial institution to the virtual currency space.

The Case for Legitimacy

Despite the illicit activity, Bitcoin's journey marches on, marked by significant price fluctuations. These highs and lows embody the quintessential dilemma of cryptocurrency: Is it a revolutionary investment or a speculative bubble? [The legal recognition of Bitcoin](#) lends credence to the former, highlighting its unique, non-replicable nature and potential as a legitimate asset class despite the broader market's

(continued on next page)



(CONTINUED)

Bitcoin: Finance on the Modern Frontier

volatility. Conversely, this volatility underscores the risks associated with Bitcoin, reflecting the push and pull between regulatory enforcement actions and growing mainstream interest shaping the Bitcoin ecosystem. Thus, the narrative surrounding Bitcoin's viability as a long-term investment continues to evolve, balancing between its potential to redefine financial paradigms and the inherent uncertainties of a rapidly changing market that Bitcoin itself lends a hand in altering.

The Tension Going Forward

As Bitcoin continues to grow, so too does the tension between groundbreaking financial innovation and the imperative for regulatory oversight. This digital currency, which once attracted only a cult following, has gained considerable mainstream acceptance. But with growth comes growing pains, including regulatory ambiguities, concerns over illicit use, and volatility. Bitcoin's journey, with groundbreaking achievements and high-profile setbacks, epitomizes the dual-edged sword of the cryptocurrency space— unlimited potential for financial liberation (should it mature as an independent financial asset in the marketplace) marred by limitless potential for unmitigated loss. Just as early American pioneers steered through the challenges of leading their loved ones through uncharted territory, Bitcoin too holds a pivotal role at the new frontier of a financial revolution, facing both the cheers of prospectors and the skepticism of naysayers doubting its ability to strike it rich in the big bonanza.

As Bitcoin continues to grow, so too does the tension between groundbreaking financial innovation and the imperative for regulatory oversight.

John Arvanitis

John Arvanitis serves as Senior Managing Director, Financial Crimes and Fraud Solutions at Treliant. John advises clients globally on anti-money laundering matters, bringing impactful and valuable insight to their regulatory challenges via his extensive international and domestic investigative experience. He has significant experience across a broad range of compliance-related programs including know your customer and anti-money laundering processes, policy, and program formulation. JArvanitis@treliant.com

Richard Lee

Richard Lee is an Analyst at Treliant. He is an adept and experienced BSA/AML specialist with a passion for preventing financial crime. At Treliant, Richard brings his expertise in transaction monitoring and client due diligence to bear in helping financial institutions comply with regulatory requirements and prevent financial crime. RLee@treliant.com

Treliant, an essential partner to financial services companies globally, brings to you *The Pulse*, a quarterly newsletter offering insights and information regarding pertinent issues affecting the industry. This article appeared in its entirety in the Spring 2024 issue. Other articles that appeared in this issue include:

- Operational Risk: A Deciding Factor in Financial Services M&A
- The First Line of Defense Is Having Its Moment
- SEC Introduces Climate Disclosure Requirements, Litigation Intensifies

To subscribe to our quarterly newsletter, *The Pulse*, visit [Join Our Newsletter - Treliant](#).

Treliant®