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Bitcoin, the City traders' anarchic new toy

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By Naomi O'Leary

LONDON, April 2 (Reuters) - Financial traders have a new toy: Bitcoin, a digital currency variously dismissed as a Ponzi scheme or lauded as the greatest invention since the Internet.

Unlike conventional fiat money and other digital currencies, Bitcoin runs through a peer-to-peer network, independent of central control. Bitcoins are currently worth \$4.88 each on online currency exchanges, where they can be bought and sold for about 15 world currencies.

Users - an odd assortment of uber-geeks, anarchists, libertarians, scammers and forex traders - sent about \$4.3 million worth to each other in the last 24 hours.

Banking and payment expert Simon Lelieveldt believes they are living on borrowed time.

"There is always a power base underlying a currency," he said, speaking at the Digital Money Forum in London in March.

"Bitcoin is not going to fly because there is no central bank or power base. It's doomed to fail."

But its separation from power is precisely what attracts many users.

"Bitcoin is not run by people with hot sexual appetites for hotel maids. It is not run by corporations. It is not governed by people with budgets to meet. It is governed by a mathematical formula," one trader and Bitcoin enthusiast told Reuters over a pint of Guinness in London's financial district.

He also likes that there is an absolute limit of 21 million Bitcoins built into the system.

"If you try to print more than 21 million Bitcoins, you will be rejected by cold, loveless computers whirring away in nerds' garages. It is a better form of money than we have right now, or than anyone has designed so far."

The trader, who was not willing to be named, said he spent four hours a day on Bitcoin, describing it as his second job. He estimated 90 percent of traders have bought it, most "looking for a quick 2,000 percent".

He, however, is playing the long game, accumulating as much as possible in the belief that one day, he will own a small but significant percentage of a world currency with a fixed supply.

He and three other traders are currently seeking Bitcoin startups to invest in, he said, adding he was hoping to put in \$300,000 worth.

WILD WEST FINANCE

He is not alone. Workers at Morgan Stanley and Goldman Sachs in London and New York have been visiting online Bitcoin exchanges as often as 30 times a day, according to documents seen by Reuters. Neither bank wanted to comment.

Employees at almost all the major international banks and numerous trading and investment firms have shown interest.

Bitcoin has become the Wild West of finance, with a proliferation of websites offering loosely regulated replicas of the services familiar to those in the financial industry.

There is a Bitcoin stock exchange, where companies can make initial public offerings and pay dividends in Bitcoin.

One website offering Bitcoin options trading was 'listed' this month for an implied valuation of half a million dollars.

Perhaps the most notorious is Bitcoinica, a platform offering margin trading, short selling and stop orders run by 17-year-old Chinese high school student Zhou Tong.

Users can leverage their bets up to a ratio of 10:1 on Bitcoinica, meaning they can lose more than their initial investment.

Zhou Tong, who is professionally advised by a forex trader and the head of a Singapore-based algorithmic trading firm, now lends his name to international slang.

To be "Zhou Tonged" is to be wiped out financially.

The chorus of a YouTube rap laments a Bitcoin day trader rash enough to hold a position with no stop loss protection: "It's so silly, how come you just lost funds? You got Zhou Tonged!"

THE ANTI-BANK SYSTEM

Its popularity with financial professionals highlights an irony at the heart of the Bitcoin usership; suspicion of the banking

system is written into the program's DNA.

It was released in January 2009 by a developer using the probable pseudonym Satoshi Nakamoto. Embedded in the code of its first block of transaction history are the words 'The Times 03/Jan/2009 Chancellor on brink of second bailout for banks'.

This was a way of time-stamping the first Bitcoin transaction, but also a clue to the developer's motivation.

Before disappearing as an online presence in January 2010, Nakamoto made clear his disapproval of quantitative easing measures and blamed banks for creating credit bubbles.

Such sentiments are common among users.

"There are no bailouts of banks on Bitcoin," one put it.

WHAT IS IT FOR?

The Greek owner of an island bar and restaurant who accepts payment in Bitcoin alongside euros told Reuters he liked the currency because it was the opposite of a banking system.

"I don't put money in the banks," said Gerald, who did not give his surname. "I trust the euro as a note, but I don't trust banks. I don't want them making money out of my earnings."

Digital money consultant Jon Matonis, former head forex trader at Visa, said Bitcoin was a natural fit for societies that prefer cash payments.

"Try tell the Italians that they can't use cash any more. Try tell the Greeks!" he said.

Bitcoin payments are difficult to trace back to a person's identity, offering an anonymity that protects users from data-mining by advertising companies, but also facilitates illicit trade and has obvious potential for money launderers.

The currency gained notoriety alongside a website named Silk Road, where vendors offer to send heroin, LSD, or 9mm Beretta handguns in the post in exchange for Bitcoin.

Yet there are signs Bitcoin is finding a niche among ordinary people for everyday, legitimate transactions.

One British businessman in China said he regularly used it to deal with businesses in Asia, Europe and the Americas because of local restrictions on sending currency to foreign companies.

"I've been able to have cash in my bank account in a matter of hours using Bitcoin, rather than three days with traditional banking," he said.

Quietly, a growing list of businesses are starting to accept it for a wide range of goods, from legal services to food.

Matonis says it could be a perfect 'digital poker chip' for online gambling and a competitive way for immigrants to send money back home.

REGULATION LOOMS

Bitcoin poses a puzzle for regulators. It does not fit the UK Financial Services Authority's definition of e-money as it is not issued on the receipt of funds, according to an FSA response to a Bitcoin business that requested to be regulated in the UK.

But the creation of Bitcoin could amount to "issuing payment instruments" as long as Bitcoins in fact count as money, which is "if and when they become widely used", the FSA concluded.

A spokeswoman for the German Bundesbank told Reuters it was not classifying Bitcoins as e-currency.

She said EU law required only euros to be accepted as legal tender, but this was superseded by German law that allows those involved in a contract to determine its content. So Bitcoin is at least not illegal there.

The situation in the United States is even more complex, where financial regulation differs from state to state.

As Bitcoin is a huge distributed peer-to-peer system, any effort to enforce regulation would be difficult, though the exchanges, where Bitcoin is swapped for real-world currency, are potentially vulnerable.

A legal precedent could come from France, where the biggest online exchange, Mt Gox, is in dispute with Credit Mutuel's Credit Industriel et Commercial.

Mt Gox sued CIC after the bank closed its account. CIC said the company was illegally behaving as a financial intermediary and that using their account made the bank an accomplice, according to court documents.

The court told the bank to reopen the account and compensate Mt Gox, but it was unable to determine whether Bitcoin is a virtual currency under French law and thus subject to relevant regulation. It has referred the question to another court.

"If exchanges which are trying to walk the path of legality are being closed, then less law-friendly exchanges will thrive," commented Mt Gox head Mark Karpeles.

"This won't stop Bitcoin. It may just kill any chance Bitcoin has to become a clean way of paying merchants, friends and family."

Credit Mutuel declined to comment on the ongoing case.

ECONOMIC ENIGMA

The existence of Bitcoin is also an economic puzzle, raising questions about the definition of money itself.

Its value depends on users' belief that it is worth something. So does all money, but in the case of Bitcoin this faith could be more fragile.

It also runs up against standard economic theory that people will not spend money if they expect it to increase in value; the 21 million limit means once all Bitcoins are in circulation, there are no internal inflationary pressures to devalue it.

More of a threat is the tsunami of other digital forms of money that are beginning to be offered by states and companies.

The Royal Canadian Mint, for example, is exploring how to issue digital currency in the future. Its chief financial officer Marc Brule said Bitcoin's biggest problem was that it is not backed by anything.

"The system we would bring in would be backed by a fund," he told Reuters. "Bitcoin may work for the small group of people that believe in its value, but that could change very suddenly."

Without that backing or a similar power base, Bitcoin lives with the ever-present risk of failure.

"To be clear, I would say the same about the euro," said payment expert Lelieveldt.

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