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PROFIT&LOSS
IN THE CURRENCY & DERIVATIVE MARKETS

September 9th, 2015 *Author: Galen Stops*

Does Bitcoin Have a Future in Financial Services?

With financial services firms currently tripping over each other to highlight the potential applications of blockchain technology, Galen Stops looks at what this means for Bitcoin's chances of entering the financial mainstream.

There are very few topics within the financial services industry that have the ability to polarise an audience like Bitcoin.

Since capturing the attention of both finance executives and the public at large two years ago, Bitcoin has been at the centre of scandals, bankruptcies and a burst price bubble. Yet despite this, not only has Bitcoin not gone away, but investment into the space continues to grow exponentially. Venture capital (VC) investment into Bitcoin is projected to more than double to $786 million in 2015. But while the VCs still appear to be excited about bitcoin, the cryptocurrency, there has been a notable shift amongst financial institutions towards instead focusing on ways to utilise the blockchain technology that underpins Bitcoin.

"Sexy" Topic

"They're now looking at blockchain as a sexy topic that they can promote to try to solve these problems that were solvable a long time ago," Paul Chou, CEO LedgerX

Increasingly, the concept of a private blockchain is being touted by financial institutions as a means of circumnavigating some of these issues. Where they have aligned incentives, such as in the settlement of financial products, firms could agree to form a private blockchain to which they would each agree to contribute computing power in order to keep adding blocks to the chain.

But Paul Chou, CEO of bitcoin derivatives exchange, LedgerX, maintains that even this idea that the blockchain can be effectively separated from bitcoins and used as an infrastructure tool is "extremely misguided" and that attempts to retrofit the blockchain to work within the bank's existing centralised ledger and centralised operating model will most likely fail.

He points out that once the parties that would be on such a hypothetical blockchain have come together to agree to participate in a private ledger then they might as well use a regular open source database, which he says is faster, more efficient, can easily be duplicated and has a proven track record of effectiveness.

Paul Chou, co-founder and CEO, LedgerX

"There are many alarming misconceptions about Bitcoin," says Chou. "It is often said that the blockchain is fast and efficient. In reality, it is slow to process transactions, but this disadvantage is tolerated because it allows open access participation in the ledger. Once you decide to restrict access to known, trusted parties, the blockchain design becomes unnecessary, and in fact, strictly suboptimal.

"What we've seen is financial institutions looking at blockchain as a sexy topic that they can promote to try to solve problems that were solvable a long time ago."

Interestingly, Chou says that he has observed a schism in the attitude towards Bitcoin from US West Coast and East Coast firms that might help explain why the cryptocurrency versus technology debate has become so complex.

"Ironically, the West Coast understands the technology very well and they're much more excited about the financial applications of bitcoin as a legitimate currency. But here on the East Coast, they are looking at it as a technology issue and care less about the currency aspect. So we see this weird dichotomy where the West Coast cares more about the financial applications and the East Coast cares more about the technological applications," he says.

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