

# Cryptocurrency explained - What we as solicitors need to be aware of



**In 2021 it was estimated that approximately 9.8 million people in the UK owned crypto currency, a substantial increase on the estimated 1.5 million in the UK in 2018. Currently the UK government and legislature does not ban cryptocurrencies, but neither does it license them, although since January 2020 the Financial Conduct Authority (FCA) has been given the powers for money laundering purposes to regulate crypto currencies.**

The FCA imposed a ban on the marketing and distribution and sale to retail clients of derivatives and exchange notes referencing unregulated transferable crypto assets such as cryptocurrencies. In the UK most crypto exchanges must be registered with the FCA. While HMRC currently have no bespoke tax rules for cryptocurrency, they are keen to point out that cryptocurrencies are not exempt from Capital Gains Tax.

The independent nature of cryptocurrency made them attractive to many criminal enterprises, for example taking payments on the dark web for drugs and other illicit products, and the movement of funds around the world. The police are increasing the number of investigations into attempts by both businesses and individuals to hide the proceeds of crime through the use of crypto assets, something which we solicitors should take cognisance of.

In 2021 the London Metropolitan Police's Economic Crime command unit as part

of an international money laundering investigation seized nearly £180 million worth of crypto currency.

## **What is Cryptocurrency?**

Cryptocurrency is a difficult concept to understand and is generally explained in terms that do little to dispel the mysterious nature of the thing. Add to this the highly volatile value of these currencies, and it is something that many people avoid at all costs. However, it will undoubtedly become more prevalent in the future, so I hope the following will demystify the whole thing a little.

It may help to think for a moment what currency essentially is. Without currency, how would we obtain the things we need in life. If you go back far enough, people would swap something they had a surplus of for something they needed, say corn in exchange for cattle. However, without the internet, how do you find someone who wants to swap their cattle for your

corn? The solution was currency – an intermediate step, swapping for a medium of exchange, something with an agreed value to both parties.

The currency could be anything, so long as both parties agreed it's value or purchasing power. Pebbles, for example, wouldn't work, as they are so plentiful, and hence of no value.

The Aztecs opted for cacao beans, as they were scarce and highly sought after. Salt was another popular commodity-based currency in some parts of the world. Commodity based systems have drawbacks, however, being bulky and in some cases even perishable.

As early as 2,500 BC the Egyptians used metal rings as currency, and coins have been in use since 640 BC, initially in parts of Turkey and later adopted by the Greeks and Romans. Coins were minted by the Government and had many advantages, as they were small, durable and had an intrinsic

value, as most were originally made from gold or silver.

The use of coins, however, allowed unscrupulous Governments to become rich by reducing the amount of precious metal in the coins. This is said to have been a factor in the fall of the Roman Empire, when Roman Emperors did just this, leading to devaluation and instability in the economy. Europe became wary of coins as a result and returned to feudal methods until the Renaissance.

Paper money only became popular in Europe in the 1700's being an adaptation of the bills of receipt that goldsmiths gave customers for their gold deposits. The French government issued paper bills, which represented a real value of physical gold – essentially the gold standard.

This was the position with most major currencies until 1971, when the US left the gold standard, closely followed by just about every other major currency. The result is that there is nothing guaranteeing the value of the pound, the Euro or the dollar etc. There is no intrinsic value save by agreement of the parties including governments and banks etc., and the relationship between supply and demand. This is known as Fiat currency or Fiat money and leads to greater control over the economy by the central banks & governments, who control how much is printed.

So how is the above relevant to cryptocurrency? Many perceive cryptocurrency as having no real or intrinsic value, being essentially little more than a number stored on a computer. The truth is that cryptocurrency has, in some ways, more real value than our everyday currencies.

Bitcoin is the most well known of the cryptocurrencies, having been around since 2008, and based on an open source cryptographic technology that made available to all. It was created in order to provide a secure currency without government or central bank control, essentially a system 'without the need for trust'. Rather than relying on a central bank or server to record transactions, Bitcoin utilizes what is known as blockchain to store records on distributed servers around the world. The blockchain is the equivalent of a bank ledger in this context.

A blockchain is a series of transactions or records that are stored and grouped into 'blocks' and the blocks are connected together in a chain. All the blocks in the chain are encrypted in such a way that they cannot later be amended, as the encryption incorporates details of the previous block, the time and date etc. etc. Any changes require the creation of a new block at the end of the chain, and because every transaction is replicated across all the distributed servers, the system is highly secure. Every copy of the blockchain contains all the records of every transaction ever. The result is that for a hack into the blockchain to succeed, it would have to be replicated over more than 50% of the servers. As there are currently 13 million servers, this is unlikely.

Bitcoins are created through a process called mining. Think of this as an extremely complex mathematical puzzle, which takes a massive amount of computing to solve. The more bitcoins are 'mined' the more difficult it becomes to find new ones. The mathematics only allow a maximum of 21 million bitcoins, and there are currently over 18.9 million in circulation. That means there are only another 2.1 million that can ever be mined or created.

As previously mentioned, there are currently 13 million servers around the world connected and mining bitcoins. The cost of mining a bitcoin is currently estimated to be approximately £10,000, the bulk of which is electricity costs. The current value of a bitcoin is approx. £31,300, although at it's peak it was over £50,000. The high cost of mining or creating bitcoins, and the fact that there is a finite number of them gives them their value, although not quite the same as the intrinsic value of a gold bar.

While bitcoin and other cryptocurrencies are independent of government and bank direct control, they are not completely immune. Legislative changes could and does affect the value of these currencies, as does the adoption of them by companies and institutions.

For example, in 2020, Tesla announced that they would accept Bitcoin in payment for their vehicles. However, when they reversed this decision a few months later, citing climate change as the reason, Bitcoin dropped 10% in value. The possible introduction of government backed crypto currencies in the future could potentially

influence the value of cryptocurrencies in the future.

Growing concerns over the vast amounts of power being used to mine and maintain the huge server farms could also lead to backlash against the technology. Currently, Bitcoin is using .55% of world global electricity usage – approximately the same amount as the entire country of Sweden. This is the power to run the powerful computers, and the air conditioning to keep them cool.

There are various other cryptocurrencies available, for example Ethereum, Litecoin and Bitcoin Cash. There are also different types of cryptocurrencies, working on different mathematical algorithms, such as the Stablecoin. This is growing in popularity as it is designed to maintain a stable market value, through linking the value of the currency to that of a relatively stable asset such as gold, the pound or the dollar. Even Facebook (now known as Meta) have been busy developing their own cryptocurrency called Diem, although there is no release date currently.

So, are cryptocurrencies something in which to invest? You can buy a small part of a Bitcoin, and they are becoming easier to purchase through online crypto exchanges, which are analogous to stock brokers and in some cases even PayPal.

There are undoubtedly investment gains still to be made, but at the moment, the highly volatile nature and the potential for disruption probably make it an investment for the more adventurous.

What is important is that as solicitors, we need to be aware of the potential AML type issues, and ensure we adhere to FCA and other regulations as they evolve. I hope this has helped in some small way to improve your understanding of the strange and evolving world of cryptocurrency.

**Joanna Connolly LLB (Hons) MBA**

Solicitor Advocate  
Joanna Connolly Solicitors  
33 Cheadle Avenue  
Liverpool  
L13 3AE

[www.joannaconnollysolicitors.co.uk](http://www.joannaconnollysolicitors.co.uk)