



PRACTICAL COMPLIANCE

Cryptocurrency and Blockchain

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CRYPTO CURRENCY AND BLOCKCHAIN

Cryptocurrencies, e.g. Bitcoin, have been in the news a lot recently, but what are they, what is the technology that drives them and what future for this relatively new form of exchange? This article briefly describes cryptocurrency and the software behind it, Blockchain.

What is Cryptocurrency?

Cryptocurrencies are digital means of exchange. Because most cryptocurrencies aren't regulated by national governments, they're considered alternative currencies - mediums of financial exchange - that exist outside the bounds of state monetary policy.

Most cryptocurrencies, but not all, are defined by finite supply. Their source codes contain instructions outlining the precise number of units that can and will ever exist.

Cryptocurrencies' finite supply makes them inherently deflationary, more akin to gold and other precious metals - of which there are finite supplies - than traditional currencies like Sterling, which central banks can, in theory, produce unlimited supplies of.

It is estimated there are more than 2,000 cryptocurrencies in existence, the most well-known one being Bitcoin, which is generally credited with bringing the movement into the mainstream. Others you may have heard of are Ethereum, Litecoin or Ripple.

Early cryptocurrency proponents shared the goal of applying cutting-edge mathematical and computer science principles to solve what they perceived as practical and political shortcomings of traditional currencies (also known as fiat currencies from the Latin 'let it be done').

Although Bitcoin was the first established cryptocurrency, between 1998 and 2009 there had been previous attempts at creating online currencies with ledgers secured by encryption.

In 2009 the Bitcoin software was made available to the public for the first time and mining - the process through which new Bitcoins are created and transactions are recorded and verified on the blockchain - began.

As it had never been traded, only mined, it was impossible to assign a monetary value to the units of the emerging cryptocurrency. In 2010, someone decided to sell theirs for the first time - swapping 10,000 of them for two pizzas. If the buyer had hung onto those Bitcoins, at today's prices they would be worth more than \$100 million.

What is Blockchain?

Blockchain is the digital ledger that sits behind cryptocurrencies. Blockchains are either the most important technological innovation since the internet or a solution looking for a problem.

The original blockchain is the decentralised ledger behind the digital currency Bitcoin.

The ledger consists of linked batches of transactions known as blocks (hence the term blockchain), and an identical copy is stored on each of the roughly 200,000 computers that make up the Bitcoin network.

Each change to the ledger is cryptographically signed to prove that the person transferring virtual coins is the actual owner of those coins.

However, no one can spend their coins twice, because once a transaction is recorded in the ledger, every node in the network will know about it.

The idea is to both keep track of how each unit of the virtual currency is spent and prevent unauthorised changes to the ledger.

The upshot: No bitcoin user has to trust anyone else, because no one can cheat the system.

How can we help?

Compliance Matters UK Limited offers cost effective and practical guidance in respect of governance, risk and compliance to firms regulated by the FCA.

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