



Bitcoin (not) for dummies

When sitting down to assess what bitcoin means for corporate treasurers, one of the first hurdles was finding voices willing to offer clear advice and guidance on any certainties for corporate treasurers to deduce around the existence of bitcoin. At Treasury Today Group we feel it is our duty to nurture your intellectual curiosity and cut through the hubbub of mainstream financial coverage and that is why we wanted to present our thoughts and insights on bitcoin right now and explore what the noise around this cryptocurrency means for treasurers today.

So let's start with the basics of how we can categorise bitcoin vis a vis other digital currencies. When it comes to digital currencies there are broadly speaking two camps which currencies can sit within – centralised and decentralised. Centralised digital currencies are those where there is a central point of control over the money supply, ie a central bank. Decentralised digital currencies or peer to peer money enables investors to create their own ecosystem where they deal directly with one another without a centralised exchange. Cryptocurrencies such as bitcoin operate on this principal. Bitcoin transactions are recorded in a distributed ledger called a blockchain and are open to market fluctuations without centralisation, as we have seen recently.

Something of the bad boy of the digital currency landscape, bitcoin's origins and utilisation are infamous and much discussed <https://www.wired.com/story/guide-bitcoin/> and, after languishing at the outskirts of the mainstream conscious, it is having something of a moment, to put it mildly. So, what

does its advent mean for treasurers, what are the opportunities and the risks of bitcoin for corporates and why should treasurers be staying on top of the latest developments surrounding bitcoin?

Bitcoin's evolution in public opinion as a cryptocurrency is explained as follows by Seng Ti Goh, Director at Focal Partners Private Ltd and President of the ACTS, "Bitcoin's genesis should be attributed to the white paper titled 'Bitcoin: A Peer-to-Peer Electronic Cash System' by Satoshi Nakamoto in 2008, and only garnered much attention in recent years, much to the chagrin of the central bankers, traditional Wall Street and main street folks. Ironically, the volatility and attention can be arguably linked to the loose monetary policies and the general sense of distrust in the banking system. The idea of a cryptographic, DLT, and de-fi based system appealed to many. It is only of late that some of the biggest names on Wall Street and at hedge funds have been so vocal and now even Elon Musk is tweeting about #BTC!"

Although the volatility and risk associated with bitcoin should serve as severe warning for all those whose role it is to protect and preserve their company's liquidity, cryptocurrencies like bitcoin are becoming an ever increasing power on the global financial stage and it is wise for treasurers to intellectually explore this space. As Seng Ti expanded, "What is bitcoin to traditional corporate treasurers and CFOs? What about the others like Ethers and even Central Bank Digital Currencies (CBDCs) which are centralised digital currencies issued by a central bank? CFOs and Corporate Treasurers' primary and rightful roles are to support the fundamental businesses on all things finance and treasury; while safeguarding and protecting the organisation's financial health. Bitcoin should not be used as a profit generator, nor a meaningful hedge (under current volatilities). However, CFOs and treasurers should understand its mechanics and understand the implications to their organisation; and look for proxy hedges if their underlying businesses ever need to accept payments in cryptos or CBDCs."

We spoke with Kieran Smith of Qredo <https://www.qredo.com/product>, a cross-chain liquidity protocol that provides secure decentralised custody and a layer-2 peer-to-peer trading network. Smith explained, "Tesla, MicroStrategy and Square are setting a new trend by adding bitcoin to their balance sheets. This marks an inflection point in the gradual institutional acceptance of cryptocurrency." Smith sees this as being spurred by several trends which he outlined as follows:

- **Macroeconomic tailwinds are blowing bitcoin higher.** Inflation fears have become widespread amid ballooning public debt and massive amounts of money printing, putting the limited supply of bitcoin in stark relief. As a result, the idea of bitcoin as 'digital gold' has hit prime time. At the same time, corporations are holding record amounts of cash with ultra-low interest rates. This makes opportunities to earn yield in decentralised finance too lucrative to ignore. While 3-5% is reason to get excited in traditional finance, lending stablecoins and crypto assets in DeFi can offer yields of more than 10%, with relatively higher risk.
- **Market infrastructure is rapidly maturing.** It is no longer just crypto-native tech start-ups offering digital asset services, but big banks like BNY Mellon building out offerings. On the payments side, the global payment processors including Visa, Mastercard and PayPal are now building out crypto support.
- **Regulatory approval now seems inevitable.** The top US bank regulator (OCC) published letters late last year saying that banks can store crypto and participate in blockchain networks, and Biden has appointed what is expected to be a largely balanced and proactive set of regulators at the head of the SEC and CFTC.

Many are dubious about the opportunities that bitcoin can realistically offer to corporate teams, but ultimately treasury must support the direction of their board and organisation. For those considering what the journey may look like, here is some further insight from Smith and Qredo, "As a cryptographic asset controlled by a string of code, bitcoin doesn't neatly slot into traditional treasury management systems: It cannot easily be managed in the same way as you might cash, stock, or bonds in corporate treasury systems.

"Much of the existing infrastructure for digital asset custody was designed for individuals securing personal funds. These solutions are not necessarily suited to institutional needs of safeguarding, compliance, reporting, and access control."

So what are the practical implications for treasurers who may need to manage bitcoin as a result of a corporate decision at board level, as in the case of Tesla? As Smith explains, "A typical institutional setup would involve keeping the majority of funds in cold storage, which keep private keys offline where they are secure but difficult to access. Day-to-day working capital is then kept in more accessible hot wallets which carry significant operational risks."

Smith further expands on the challenges and risk implications of such a strategy, "Moving funds on-chain between wallets, or between multiple custodians or corporate departments, can be subject to high network fees and delays from limitations of the underlying blockchains. This makes simple tasks like managing treasuries and rebalancing portfolios expensive and inefficient. At the same time, there is a lack of dedicated infrastructure for providing transaction records, meaning a lot of crypto treasury is run through spreadsheets which also carry a lot of operational risks.

"There is also no way to track transactions for compliance and governance needs, easily retrieve an audit log, or get live reliable data on transactions to perform EOD reconciliations. This creates heavy burdens of manual reporting. Similarly, there are no automated workflows for tasks like reconciliation, and no way to get full visibility across different holdings, making it tricky to manage capital and risk."

At the moment this 'one to watch' space is just that it seems. For the moment there are not elaborate enough frameworks or hardy enough tools and products for treasurers to securely navigate the landscape. David Blair of Acarate Consulting confirms that position, explaining, "Like gold, another popular inflation hedge, bitcoin has no intrinsic use and does not generate any yield. The latter may seem moot in a time of zero interest rates, and even attractive compared to negative interest rates. But corporates need to report results in fiat currency, and bitcoin's volatility will cause mark to market variances that will need explaining to shareholders. Buying bitcoin and then hedging it into fiat currency obviates the point of the investment. Basically buying bitcoin is buying balance sheet volatility. Most treasurers goal is to reduce risk, not to increase it."

As Blair states, there really is not much of a use case for corporates to adopt bitcoin as a medium of exchange. He expands, "As an inflation hedge, bitcoin has higher volatility and transaction costs and operational risks than gold. One also needs to question the need for corporates to hedge inflation – for most corporates, inflation will affect both inputs and outputs and have roughly neutral effect over time. Of course, this last is not true for corporates with large net cash positions."

Blair sums up his assessment with this flourishing finale, "We owe a great debt to Satoshi Nakamoto for his pioneering work in bringing together different technologies into a robust working blockchain – bitcoin. There will doubtless be many interesting use cases for digital ledger technology (DLT aka blockchain), especially across supply chains with smart contracts and the like. Alternative mediums of exchange and store of value are unlikely to be the most interesting DLT use case for corporates."