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# **Bitcoin: Effects On Market And Result Of Insider Trading On Bitcoin**

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## **ABSTRACT**

With the rapid flow of internet based services the traditional ways of doing business has also changed. It has explored new thinking and new possibilities. The digital era is the reflection of changing needs and desires of the society. The love for digital technology is growing rapidly with each passing day. The Life has changed many folds in last two decades after much invasion of technology. The modes of e-payments, cashless payments and using digital applications to make the payments have been in trend now. A currency neither supported by the government nor published by the government but still acquires the substantial share in the market and people are investing in it. This is called Bitcoin. Bitcoin is an open source peer-to-peer digital currency. The digital currency has changed the traditional ways of payment and has the substantial power to overawe the traditional currency to large extent. Bitcoin is the latest trend in the world. Big companies have started to receive Bitcoin as mode of payment. Bitcoin is the world's first decentralized digital payment system. It was emerged in 2009 only and only handful of people was aware about it. The price for one Bitcoin in 2009 was less than one dollar but now the price of one Bitcoin is nearly one lac rupee. It shows the rapid growth in the price of Bitcoin and how people heavily investing in it.

The investment in share market all over the world has increased to many folds in recent years. The menace of insider trading has earned a bad name in recent times. The use of

non published price sensitive information by insiders of the company to make profit or avoid losses is insider trading. The impact of insider trading is also evident on new digital payment Bitcoin also. This paper aims to provide history of Bitcoin, the characteristics of Bitcoin, concerns of Bitcoin and impact of insider trading on Bitcoin. It will describe the benefits of allowing the Bitcoin network to develop and innovate, while highlighting issues of concern for consumers, policymakers, and regulators.

**Keywords:** *Bitcoin, digital currency, insider trading.*

## Introduction-

*“Bitcoin is exciting because it shows how cheap it can be. Bitcoin is better than currency in that you don’t have to be physically in the same place and, of course, for large transactions, currency can get pretty inconvenient.”*

Bill Gates

Bitcoin is a crypto currency and worldwide payment system. It is the first decentralized digital currency, as the system works without a central bank or single administrator. Bitcoin economy is larger than the economies of some of the world’s smaller nations. The current market capitalization of the bitcoin economy is estimated to be more than \$1 billion. Businesses big and small have shown interest in integrating the Bitcoin platform into their operations and providing new services within the bitcoin economy. Venture capitalists, too, are eager to put their money behind this growing industry. Big companies such as Microsoft and Dell have started to receive bitcoins as mode of payment. The development of Bitcoin and its early successes are an exciting testament to the ingenuity of the modern entrepreneur.<sup>1</sup>

The world of money and finance is transforming before our eyes. Digitized assets and innovative financial channels, instruments and systems are creating new paradigms for financial transaction and forging alternative conduits of capital. The common element of these different crypto currency systems is the public ledger (‘blockchain’) that is shared between network participants and the use of native tokens as a way to incentive participants for running the network in the absence of a central authority. There are many crypto currencies apart from bitcoins which are dominating the market. For example ETHEREUM

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<sup>1</sup>. Jerry Brito & Andrea Castillo (2013). "Bitcoin: A Primer for Policymakers" (PDF). *Mercatus Center*. George Mason University. Available at [https://www.mercatus.org/system/files/Brito\\_BitcoinPrimer.pdf](https://www.mercatus.org/system/files/Brito_BitcoinPrimer.pdf) (Visited on January 14, 2018)

(ETH), DASH, MONERO (XMR), RIPPLE (XRP), LITECOIN (LTC) etc. Bitcoins are created as a reward for a process known as mining. They can be exchanged for other currencies, products, and services. As of February 2015, over 100,000 merchants and vendors accepted bitcoin as payment. Research produced by the University of Cambridge estimates that in 2017, there are 2.9 to 5.8 million unique users using a crypto currency wallet, most of them using bitcoin. When comparing the average number of daily transactions performed on each crypto currency's payment network, Bitcoin is by far the most widely used.<sup>2</sup>

## History of Bitcoin-

Bitcoin was invented by an unknown person or group of people under the name Satoshi Nakamoto and released as open source software in 2009. The network is peer to peer and transactions take place between users directly, without an intermediary. These transactions are verified by network nodes through the use of cryptography and recorded in a public distributed ledger called a blockchain.<sup>3</sup>

On 18 August 2008, the domain name bitcoin.org was registered. Later that year on 31 October, a link to a paper authored by Satoshi Nakamoto titled Bitcoin: "A Peer-to-Peer Electronic Cash System" was posted to a cryptography mailing list. This paper detailed methods of using a peer-to-peer network to generate what was described as "a system for electronic transactions without relying on trust". In January 2009, the bitcoin network came into existence with the release of the first open source bitcoin client and the issuance of the first bitcoins with Satoshi Nakamoto mining the first block of bitcoins ever (known as the genesis block), which had a reward of 50 bitcoins.<sup>4</sup>

## HOW BITCOIN WORKS-

It is an electronic or digital currency that works on a peer-to-peer basis. This means that it is decentralized and has no central authority controlling it. Like currency notes, it can be sent from one person to another, but without a central bank or the government attempting to track it. The system depends on cryptography to control the

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<sup>2</sup>. Dr.Garrick Hileman, Michel Rauchs, "Global Cryptocurrency Benchmarking Study" Cambridge University 2017. Available at [https://www.jbs.cam.ac.uk/fileadmin/user\\_upload/research/centres/alternative-finance/downloads/2017-global-cryptocurrency-benchmarking-study.pdf](https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2017-global-cryptocurrency-benchmarking-study.pdf)(Visited on January 14, 2018)

<sup>3</sup>. Davis, Joshua "The Crypto-Currency: Bitcoin and its mysterious inventor". *The New Yorker*. (10 October 2011). Available at <https://www.newyorker.com/magazine/2011/10/10/the-crypto-currency> (Visited on January 14, 2018)

<sup>4</sup>. Wikipedia, "History of Bitcoin" available at [https://en.wikipedia.org/wiki/History\\_of\\_bitcoin](https://en.wikipedia.org/wiki/History_of_bitcoin) (Visited on January 14, 2018)

creation of the currency. While no one authority controls the generation of the coins or tracks them, the system itself is designed in such a way that the network maintains a foolproof system of the record of every transaction as well as tracking issuance of the currency. The beauty of this crypto currency is that if you receive a bitcoin from another, you can be as sure of the payment as you would on receiving physical currency notes, with the same anonymity ascribed to it. No one need know if your neighbor spent 2 bitcoins this morning to buy gold, but the transaction is recorded for posterity. This anonymity is lacking in other forms of digital payment such as online banking or e-wallets.<sup>5</sup>

Until Bitcoin's invention online transactions always required a trusted third-party intermediary. For example, if A wanted to send \$100 to B over the Internet, A would have had to rely on a third-party service like PayPal or MasterCard. Intermediaries like PayPal keep a ledger of account holders' balances. When A sends B \$100, PayPal deducts the amount from her account and adds it to Bob's account. Without such intermediaries, digital money could be spent twice. Imagine there are no intermediaries with ledgers, and digital cash is simply a computer file, just as digital documents are computer files. A could send \$100 to B by attaching a money file to a message. But just as with email, sending an attachment does not remove it from one's computer. A would retain a copy of the money file after sent it. A could then easily send the *same* \$100 to C. In computer science, this is known as the "double-spending" problem, and until Bitcoin it could only be solved by employing a ledger-keeping trusted third party.<sup>6</sup>

After the Bitcoin's invention the problem of double spending problem has been solved without the need for a third party. Bitcoin does this by distributing the necessary ledger among all the users of the system via a peer-to-peer network. Every transaction that occurs in the bitcoin economy is registered in a public, distributed ledger, which is called the block chain. New transactions are checked against the block chain to ensure that the same bitcoins haven't been previously spent, thus eliminating the double-spending problem. The global peer-to-peer network, composed of thousands of users, takes the place of an intermediary. One thing to note right away is that transactions on the Bitcoin network are not denominated in dollars or euros or yen as they are on PayPal, but are instead denominated in

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<sup>5</sup>K. Bharat Kumar, "All about Bitcoins" available at <http://www.thehindu.com/opinion/op-ed/all-about-bitcoins/article17961273.ece>. April 13, 2017

<sup>6</sup>. *Supra* note 2

bitcoins. This makes it a virtual currency in addition to a decentralized payments network. The value of the currency is not derived from gold or government fiat, but from the value that people assign to it. The dollar value of a bitcoin is determined on an open market, just as is the exchange rate between different world currencies.<sup>7</sup>

The Bitcoin transactions are verified, and double-spending is prevented, through the clever use of public-key cryptography. Public-key cryptography requires that each user be assigned two “keys,” one private key that is kept secret like a password, and one public key that can be shared with the world. This network depends on users who provide their computing power to do the logging and reconciling of transactions. These users are called “miners” because they are rewarded for their work with newly created bitcoins. Bitcoins are created, or “mined,” as thousands of dispersed computers solve complex math problems that verify the transactions in the block chain.<sup>8</sup>

Bitcoin is one of the first digital currencies to use peer to peer technology to facilitate instant payments. The independent individuals and companies who own the governing computing power and participate in the Bitcoin network, also known as miners, are motivated by rewards (the release of new bitcoin) and transaction fees paid in bitcoin. These miners can be thought of as the decentralized authority enforcing the credibility of the Bitcoin network.<sup>9</sup>

New bitcoin is being released to the miners at a fixed, but periodically declining rate, such that the total supply of bitcoins approaches 21 million. One bitcoin is divisible to eight decimal places (100 millionth of one bitcoin), and this smallest unit is referred to as a Satoshi. If necessary, and if the participating miners accept the change, Bitcoin could eventually be made divisible to even more decimal places. Bitcoin mining is the process through which bitcoins are released to come into circulation. Basically, it involves solving a computationally difficult puzzle to discover a new block, which is added to the blockchain, and receiving a reward in the form of few bitcoins. The block reward was 50 new bitcoins in 2009; it decreases every four years. As more and more bitcoins are created, the difficulty of the mining process – that is, the amount of computing power involved – increases.<sup>10</sup>

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<sup>7</sup>. *Supra note 2*

<sup>8</sup>. *Ibid*

<sup>9</sup>. available at <https://www.investopedia.com/terms/b/bitcoin.asp>

<sup>10</sup>. *Supra note 10*

# BITCOIN EFFECT ON BANKING, FINANCE AND ECONOMY:

1. **Power of dark web:** Dark web is the section of the web that is not accessible through the search engine. What we are given access to is the surface web which is not even half of the existing internet. Dark web is accessible only through special software like Tor Browser which enables anonymous searching of the internet. By using crypto currencies like BitCoins people can make illegal transactions without giving any information about themselves. Crypto currencies like Bitcoins are a way to empower such transactions across the globe which will ultimately result in increased cyber crime.<sup>11</sup>
2. **Speculations:** In two years the value of bitcoin has drastically increased from \$170 as on 14th January 2015, to \$14907.50 as on 5th January 2017. There have been many ups and downs in the value of Bitcoins and this scenario is likely to continue. Due to the extreme highs and lows BitCoins present a massive possibility for speculation. Just like trading in shares, trading in Bitcoins is massive and seeing the rise in traction around crypto currencies it is likely to grow further. Another reason accounting to this is the increasing cost of investing in the stock markets which makes it an easy target for speculative gains.<sup>12</sup>
3. **Politicization of Money:** Earlier all the monetary transactions were enabled through central banks (directly or indirectly). Now, with the evolution of Bitcoins, the scenario has changed. The power that was vested in the governments and central banks is shifting to the masses. This revolutionary change in transaction handling has the power to change the economic structure. To bring security and enable scrutiny, central banks and financial institutions maintain a record of all the transactions undertaken by the people. Now with digital currencies, this economic power can be challenged by people. This has led to the creation of a new autonomous body which can facilitate transactions. Ultimately if adopted on a large scale, Bitcoins can lead to the politicization of money.<sup>13</sup>

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<sup>11</sup>. available at <https://www.newgenapps.com/blog/impact-of-bitcoins-on-the-economy-banks-finance>

<sup>12</sup>. *Ibid*

<sup>13</sup>. *Ibid*

4. **Apprehension among the Central Banks:** There have been implications that Bitcoins can be used to secretly launder money outside the country. Central banks across the world have been wary of Bitcoins as an uncontrollable and unpredictable form of currency. Crypto currencies are leading to loopholes in the current bank's data about the money transactions leading to inability to track economic activities. Crypto and Cyberspace has emerged as a power in itself thus bringing a check on the activities of the so powerful governments.<sup>14</sup>
  
5. **The Emergence of New Markets:** Crypto currencies have led to the emergence of new markets. Currencies like Bitcoin and Ethereum have opened gates for a new kind of market which unlike present money market is controlled by no one. Cyberspace will rise up as the managing body that will handle and maintain such disruptive markets. The near zero transaction cost (along with other characteristics) has made these currencies even superior to the traditional money we are accustomed to using. What can be surely stated is that it is just the beginning and the number of possibilities is endless. Both systems currently co-exist alongside each other. Both look like they are here to stay for the foreseeable future, although the rise of bitcoin is causing banks to rethink certain areas like transaction fees and how they link between countries, among other things. The banking system is open to manipulation while bitcoin is pretty much tampering proof and allows the control of no one individual or corporation.<sup>15</sup>
  
6. **Security Breaches:** As a digital currency, Bitcoin presents some specific security challenges. If people are not careful, they can inadvertently delete or misplace their bitcoins. Once the digital file is lost, the money is lost, just as with paper cash. If people do not protect their private Bitcoin addresses, they can leave themselves open to theft. Bitcoin wallets can now be protected by encryption, but users must choose to activate the encryption. If a user does not encrypt his or her wallet, bitcoins could be stolen through malware.<sup>16</sup>
  
7. **Criminal Uses:** There are also reasons for policymakers to be apprehensive about some of Bitcoin's exaptations. Because Bitcoin is pseudonymous, policymakers and journalists have questioned whether criminals can use it to launder money and accept payment for illicit goods and services. Indeed, like cash, it can be used for ill as well as for good. Another

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<sup>14</sup>. *Ibid*

<sup>15</sup>. *Supra note 12*

<sup>16</sup>. *Supra note 2*

concern is that Bitcoin can be used to launder money for financing terrorism and trafficking in illegal goods. Although these worries are currently more theoretical than evidential, Bitcoin could indeed be an option for those who wish to discreetly move ill-gotten money.<sup>17</sup>

## Reasons For Not Allowing Bitcoin Currency In India-

There are many reasons for not allowing the crypto currency in India as well. The crypto currency will fuel laundering of black money and financing of terrorism. It will render monetary policy ineffective. However, for a nation that has launched an outright war against black money, which could also have meant compromising growth in the short run through demonetisation, allowing crypto currency would be a contradictory act. The concept of bitcoin has caught on in the world and there is evidence of its use in India, too. Also, the start of a new currency of a similar variety cannot be ruled out; hence, it is necessary to take a stance on the same. The reasons that were given in support of demonetisation can be extended to not allowing crypto currency in the country. Black money can proliferate easily with the use of a crypto currency. People can automatically convert all earnings in dollars outside the country into a crypto currency which can be used within the country or even outside where it is accepted.<sup>18</sup>

Drug money would get the biggest boost as it would be impossible to capture these transactions. Second, terror funding becomes easy once it is accepted as medium of exchange and the entire exercise of demonetisation would be defeated by allowing such parallel currencies to run. Third, counterfeiting was another strong reason put forward for removing high denomination notes from the financial system. If crypto currency is permitted it is akin to the use of counterfeit currency, as transactions would take place in currency which is not recognised by the central bank. Therefore, in the context of the attack on black money, crypto currency definitely not finds space in the financial architecture of any country.<sup>19</sup>

From the economic standpoint, crypto currency makes no sense. A currency carries value because it is issued by a central bank on behalf of the government and the latter promises to pay the bearer the sum written on the currency. The moment one moves into the

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<sup>17</sup>. *Ibid*

<sup>18</sup>. MADAN SABNAVIS, "Why bitcoin should not be allowed", The Hindu, (Published on October 9, 2017) available at <http://www.thehindubusinessline.com/opinion/bitcoin-should-not-be-allowed-in-india/article9895638.ece>. (Visited on January 13, 2018)

<sup>19</sup>. *Ibid*

realm of crypto currency there is no guarantor. In fact, given that no one has seen the face of the creator of bitcoin it is hard to even trace the same to the source.<sup>20</sup>

## INSIDER TRADING

In the era of globalization, and competitive world, the general public has started to invest their money in different modules taking derivation from traditional means of investment. The trading of shares in the securities market has become the common place to invest for everyone. One such trading which has earned a bad name in recent times is insider trading. The menace of insider trading is a fraud on the trust of common investors who invest in the market on the basis of available price sensitive information. The problem of insider trading is growing with each passing day and every market regulator all over the world is making regulations to curb insider trading. The use of non published price sensitive information by insiders of the company to make profit or avoid losses is insider trading. The impact of insider trading is also evident on new digital payment Bitcoin also. Insider trading not only impacts the flow of trading in the market but also earns a bad name for the nation. In the era of competitive world, each nation needs investment and for such investment each nation needs transparent and progressive market. The growth of market reflects the development of a nation. Recent instances of insider trading in crypto currency have raised the many eyebrows all over the world. Even in making crypto currency payments or in deciding their value, the insiders are using the inside information to make profits or avoid losses.

## BITCOIN AND INSIDER TRADING: CASE STUDY

On 12 Oct 2017, Coinbase announced to sell digital currency **bitcoin, ethereum and litecoin** using a US bank account as earlier, customers who purchased digital currency using a bank account had to wait several days before receiving that actually. Customers can now buy up to \$25,000 and receive access to their digital currency immediately. The prime intention of coinbase was to make itself the most trusted, safe, and easy-to-use digital currency exchange. Coinbase made instant purchases easier and faster for customers to invest in the digital currency ecosystem with a feature in reduction of time to receive digital currency which was much required by the customers. Soon after its launch Coinbase, froze transactions just a few

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<sup>20</sup>. *Ibid*

hours after they began in order to investigate numerous accusations of insider trading. Observers noticed that the price of Bitcoin Cash rose sharply before news of its availability on the exchange broke, and that there was a sharp selloff virtually the moment trading started. From a cursory glance, it looked like someone knew about the Coinbase move in advance, triggered a flurry of trading that led to a spike in price, and took advantage of this for a massive windfall. The price of BCH hit a high of \$8500 on Coinbase and its GDAX service for professional investors, which was almost three times higher than the \$3500 price on all other exchanges. That led to calls of insider trading from coinbase staff who, in theory, could have profited by buying BCH on other exchanges in the knowledge that it was about to be added to coinbase, a move that would (and did) trigger increased trading volume and a higher price as the exchange's 10 million plus users got a piece of the auction.<sup>21</sup>

However, at the end despite coinbase, gaining the top position in the US app store and crypto currency hitting \$20,000, the BCH has ended in frustration for users who were either unable to get their hands on the coin, or were forced to pay way over the odds for it. It's not certain when Bitcoin Cash transactions will return to the exchange. Whenever they do, the unusual activity is a reminder that digital currency is still a relatively untamed space. Even with future trading and tighter regulation in place to add some stability, virtual money still tends to be volatile it doesn't take much to create havoc.<sup>22</sup>

## Conclusion-

Bitcoin is an exciting innovation that has the potential to greatly improve human welfare and jump-start beneficial and potentially revolutionary developments in payments, communications and business. Bitcoin's clever use of public-key encryption and peer-to-peer networking solves the double-spending problem that had previously made decentralized digital currencies impossible. These properties combine to create a payment system that could lower transactions costs in business and remittances, alleviate poverty, provide an escape from capital controls and monetary mismanagement, allow for legitimate financial

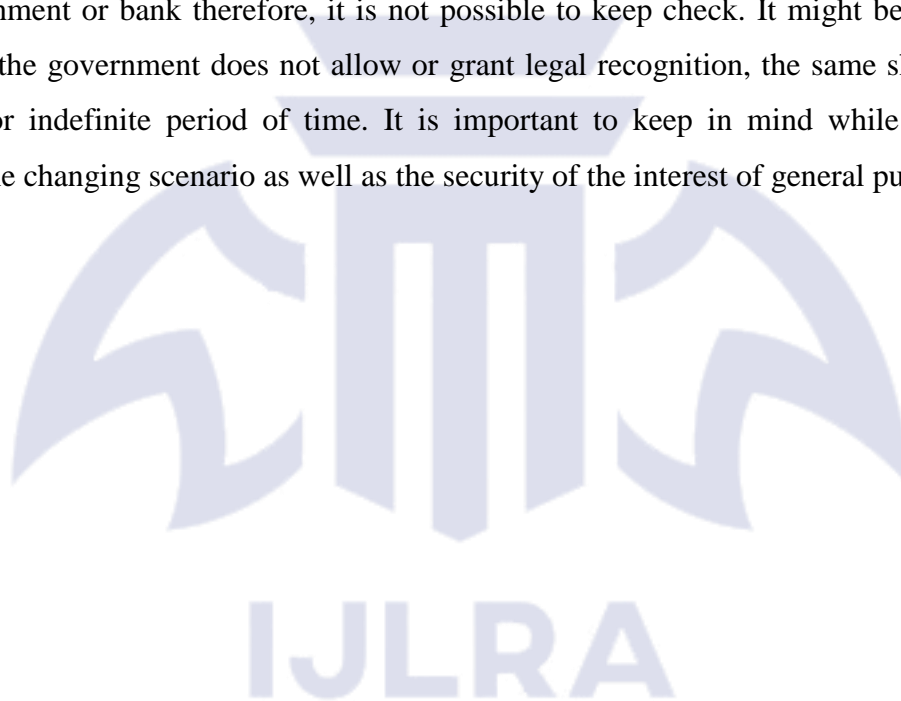
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<sup>21</sup>Jon fingas, "Coinbase halts bitcoin cash transactions over insider trading fears" available at <https://www.engadget.com/2017/12/20/coinbase-stops-bitcoin-cash-transactions-over-insider-trading/> (Visited on January 14, 2018)

<sup>22</sup>Jon rusell, "Coinbase is investigating claims of insider trading from its Bitcoin cash", available at <https://techcrunch.com/2017/12/19/coinbase-inside-information-bitcoin-cash-launch/> (Visited on January 14, 2018)

privacy online, and spur new financial innovations. On the other hand, as “digital cash,” Bitcoin can be used for money laundering and illicit trade. Banning Bitcoin is not the solution to ending money laundering and illicit trade, just as banning cash is not a solution to these same ills. Policymakers should work to clarify how Bitcoin is regulated and to normalize its regulation so that we have the opportunity to learn just how innovative Bitcoin can be.<sup>23</sup>

The policy makers should keep in mind the changing scenario, new age techniques and new modes of digital payments. Bitcoin is an exciting innovation which makes the payment easier and payment system is so secure that it cannot be easily hacked. But the main drawback is the use of black money which can be used in illicit trade. There is no control of any government or bank therefore, it is not possible to keep check. It might be a stipulated bubble. If the government does not allow or grant legal recognition, the same should not be allowed for indefinite period of time. It is important to keep in mind while formulating policies, the changing scenario as well as the security of the interest of general public.



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<sup>23</sup>. *Supra note 2*