

Finance

JPM Coin Is the Wildest Big Bank Idea in Many Years

JPMorgan is making a bold attempt to gain a first-mover advantage in a potentially lucrative new service.

By Aaron Brown

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JPMorgan is making a bold leap into the new age of banking. *Photographer: Andrew Harrer/Bloomberg*

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JPM
JPMORGAN CHASE
 113.65 USD
 ▲ +0.63 +0.56%

YELP
YELP INC
 35.65 USD
 ▲ +0.19 +0.54%

It's been a month since JPMorgan issued a press release announcing JPM Coin, and everyone is as confused now as they were then. No one seems to agree what JPM Coin is, what it's intended to do, what it competes with, or whether it is a vote of confidence in cryptocurrencies, an attempt to hijack crypto ideas in evil big bank ways, or an unremarkable traditional ledger dressed in crypto clothes for publicity purposes.

I think JPM Coin is a bold attempt to gain a first mover advantage in a potentially lucrative new banking service. It shares more DNA with Bitcoin than any product announcement so far from a major financial institution, but it has some traditional bank in there too.

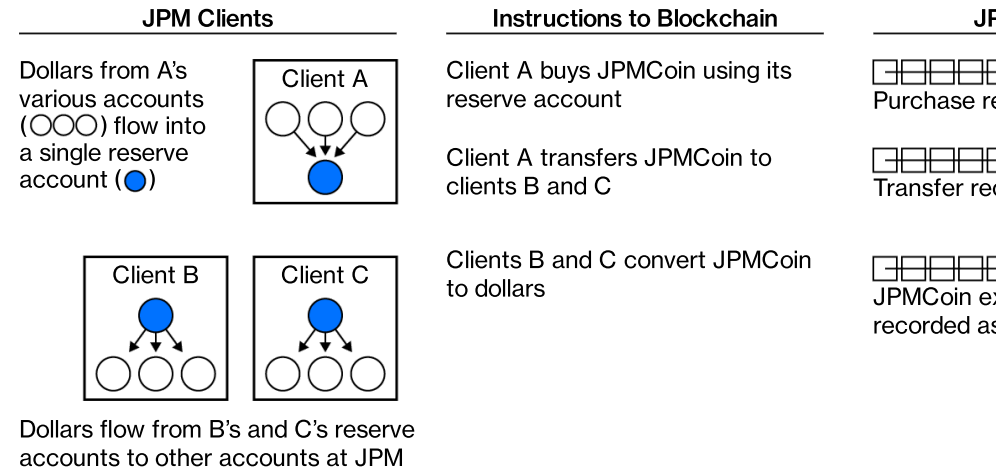
This diagram from JPMorgan caused the confusion. Unidentified forces are pushing down on a "client reserve account" illustrated by the standard clip-art for a bank or the Parthenon. That causes green dots to emerge and attack a "distributed ledger," which consist of blocks connected by lines. In step 2, the dots surround the ledger, apparently looking for a way in, while the client reserve account is

passive. In step 3, the coins switch sides and attack the account, causing it to explode.



I offer JPMorgan my improved version. Some important changes are that the client reserve account in step 1 is a different one than in step 3, and there shouldn't be one in step 2. The green dots don't attack the ledger, they exist in it. I'm not sure about this last bit, there is both a blockchain and a distributed ledger in the JPMorgan idea, but they're not the same thing. I think the artist drew some blocks and connected them to illustrate a blockchain, but connected them in the wrong way. Or the blocks could represent different copies of a ledger, in which case they should be broadcasting, not linked to neighbors.

How JPMCoin Really Works



Why are multiple arrows going in and out of each account? JPMorgan consists of hundreds of legal entities, just like many of its clients. Each legal entity can have many accounts with JPMorgan, of different types. Verifying transfers are legal and correct makes normal bank transfers slow and error-prone.

It appears JPMorgan will solve this by making each client open a single account for JPM Coin purchases and redemptions. Account openings will be slow and careful. Purchases and redemptions may not always be immediate, but once converted to JPMCoin, transfers should be quick and error-free.

But why not call the units in the blockchain “dollars” instead of “JPM Coin”? For one thing, they’re not dollars. Technically, and confusingly, they are “eurodollars.” That is, they are unsecured promises by a bank to give you dollars. One possible reason for using JPM Coin is to reduce regulation, including reserve and capital requirements, but the regulatory view is not yet clear.

I suspect a more important reason is the same one why sovereigns throughout history have issued their own currencies – it’s very profitable. JPMorgan promises to buy JPM Coin for \$1, but it could sell them for more. Or it could create its own JPM Coins for spending or lending, without funding them with dollars. JPMorgan is not allowed to create dollars for spending, and if it does it for lending, it has to adhere to strict rules and set aside capital.

These schemes only work if people decide to hold JPM Coin balances. If JPM Coin is better for certain transactions than dollars, that will happen, and the value of JPM Coin could monetize, rising above redemption value. There’s \$8 trillion of notes and currency in the world, and another \$88

trillion of money broadly defined. If JPM Coin could capture 1 percent of that it's something on the order of 25 years of earnings.

So why use a blockchain? Why not just have an encrypted database? And where does the distributed ledger come in? I'm pretty sure the JPMorgan private blockchain will be a centralized ledger maintained by JPMorgan. However it is designed to interact with any "standard" blockchain. It needs to be a blockchain to play with other blockchains and I think the distributed ledger means that JPM Coin will circulate outside the JPMorgan private blockchain. Those other ledgers might be private or public, centralized or distributed (probably mostly private and centralized), but the overall system is distributed.

Imagine if Yelp decided to issue Yelp Coin to pay reviewers. It would build clever game theory incentives to reward honest and helpful reviews. Review users would pay Yelp Coin to get the best reviews. Merchants would also reward customers with Yelp Coin, and higher merchant rewards, for example from new merchants, would lead to higher payments for reviews. There are many similar ideas in crypto; virtually every website that has user ratings, or is supported by ads, or has a paywall, or gives away content

or functionality for free, or asks for user information like location could be improved by properly designed crypto.

The crypto technology has been developed and is available free. The hard part is building in some fiat cash transfers. Merchants will buy Yelp Coin for, and professional reviews will want to be paid in, fiat currency. Getting and receiving fiat currency, especially with anonymous global parties, is a core bank business. Yelp would find it easier to buy and sell Yelp Coin for JPM Coin than to run its own cash operations. Merchants would buy from, and reviews would sell to, brokers or exchanges.

I don't think JPM Coin is about money transfers, although it has to establish itself for that. I think it's about providing payment services to businesses that build their own blockchains. I think JPMorgan will earn seigniorage creating JPMCoin. I think the exciting potential is circulation outside the JPMorgan private blockchain.

The regulatory attitude toward this remains to be seen, and of course there's no assurance that I have guessed JPMorgan's plans correctly, and that if I have, that those plans will succeed. But JPM Coin could launch the next round of cryptocurrency expansion. It will be tamer than

Bitcoin, but wilder than any other idea to come out of a big bank since 2008.

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