

Cryptocurrencies: Understand the Risk

Cryptocurrencies burst into the investing mainstream in 2017, as the values of some virtual coins and tokens skyrocketed, led by Bitcoin. Mainstream media now feature daily coverage of new cryptocurrencies, coin exchanges, and related investment products. Stories of 'crypto millionaires' have attracted some investors to try their hand at trading in cryptocurrencies or crypto-related investments. But stories of those who bet big and lost are now starting to appear.

Before you jump into the crypto craze, be mindful that cryptocurrencies and related financial products may be nothing more than public facing fronts for Ponzi schemes and other frauds. And because these products do not fall neatly into the existing provincial regulatory framework, it may be easier for promoters of these products to fleece you. Investing in cryptocurrencies and related financial products accordingly should be seen for what it is: extremely risky speculation with a high risk of loss.

What is a Cryptocurrency?

Cryptocurrencies are digital assets created by companies or individuals that take the form of a virtual coin or token. Anyone can create a cryptocurrency. Cryptocurrencies are intangible and exist only on the internet. Central banks and other governmental authorities do not insure or control cryptocurrencies. You cannot always exchange them for other fiat currencies (i.e., currencies declared 'legal tender' by governments), such as the Canadian or U.S. dollar.

Cryptocurrencies trade on unregulated, opaque exchanges on which there may be little or no opportunity to independently verify their true market value. And given the newness and uniqueness of cryptocurrencies and related instruments, they do not yet have a

clear place in the existing framework of financial regulation.

Canadian regulators are actively working to combat cryptocurrency-related frauds and to develop legislative or rule changes that will establish a more appropriate regulatory framework for cryptocurrencies. Investors should be aware that, at least for now, cryptocurrencies and related instruments trade without the investor protections that regulation provides.

Crypto-Investment Products

Investors looking to get in on what some people consider a modern-day gold rush are finding new investment options opening up to them all the time. Many of these solicitations are marketed aggressively through social media. For example, there are initial

coin offerings (ICOs) or initial token offerings (ITOs). When an issuer makes an ICO or ITO, it sells 'coins' or 'tokens' in order to fund a proposed project. These coins or tokens are not the same as common stock or other securities.

While these offerings may sound like an initial public offering (IPO), they are completely different. IPOs operate in a highly-regulated environment. While securities or commodities regulations apply to ICOs and ITOs, many are unregistered and operate outside of these investor protection regulatory requirements.

Investors also are being pitched crypto-investment funds that pool investors' assets in order to give them exposure to cryptocurrencies and ICOs or ITOs. Even some public companies are trying to cash in on the crypto-craze by changing their business models and names to attract capital.



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Common Schemes

Fraudsters exploit trends by creating schemes that capitalize on new or popular investment products. This is the case with cryptocurrencies and crypto-investments. Here are a few crypto-related schemes:

Fake digital wallets: A digital wallet is used to store, send and receive cryptocurrencies. Scammers design a fake digital wallet to lure users into providing their private key or code that enables the wallet to open. Once a scammer receives the private key, he or she can steal all the cryptocurrency from the owner's digital wallet.

Pump-and-dumps: Groups of individuals coordinate to buy a thinly-traded cryptocurrency, promote the cryptocurrency on social media to push up demand and the price, and then sell it in a coordinated sale. The price plummets and those unaware of the scheme are left with the devalued cryptocurrency.

Multi-level marketing platforms: Companies lure investors through the promise of high interest with low risk. These investors are then incentivized to recruit more members.

For example: A company creates a new token or coin and sells it to investors in exchange for a cryptocurrency with a higher perceived value, such as Bitcoin. The company claims to have some method, often portrayed as 'secret' or 'proprietary,' that pays investors unusually high daily 'interest' on its coin. The company promise commissions to promoters who recruit new investors. The promoters rely heavily on social media platforms (including Facebook, Twitter, and others) to hype the schemes and attract new investors, often using the promise of too-good-to-be-true investment returns (for example, one per cent daily returns). Eventually, the company stops paying 'interest' and shuts down the program, keeping the invested cryptocurrency and leaving investors with worthless tokens or coins.

The Bottom Line:

As with any new type of product, fraudsters are willing and ready to exploit the hype around cryptocurrencies and related products for their own purposes. Cryptocurrencies and related products are not functional equivalents of traditional banking, securities, or insurance investment products. If you choose to invest in a cryptocurrency or related product, be aware that you could lose the entire amount of your investment. For more information, contact the Manitoba Securities Commission at 204-945-2548 or visit mbsecurities.ca

Common Concerns

Here are some common concerns investors should consider before investing in any offering containing cryptocurrency:

Volatility: Cryptocurrency markets are highly volatile, making them unsuitable for most investors looking to meet long-term savings or retirement goals.

No Recourse: Cryptocurrency and many crypto-related investments are subject to minimal regulatory oversight, and there may be no recourse should the cryptocurrency disappear due to a cybersecurity breach or hack.

Untraceable: Cryptocurrency or crypto-related investments only exist on the internet. Issuers can be located anywhere in the world, so it may be impossible to trace and recover lost funds through the courts.

Uninsured: Cryptocurrency accounts are not insured by Canadian or U.S. depository insurance.

Unregulated: Cryptocurrency investors rely upon unregulated exchanges that may lack appropriate internal controls, making them susceptible to fraud, theft and hacking.

Hackable: Creating a digital wallet to store cryptocurrency involves installing software on an investor's computer. As with any software download, hackers may include malicious code.

Vulnerable: Purchasers of cryptocurrencies rely on the strength of their own computer systems as well as systems provided by third parties to protect purchased cryptocurrencies from theft.