Investor Advisory:

Inherent Risks of Cryptocurrencies
June 6, 2018

As Bitcoin and other cryptocurrencies continue to generate headlines as the latest investment craze, the Indiana Securities Division again reminds Hoosiers to be cautious concerning investments involving cryptocurrencies and to warn about the risks involved in using cryptocurrency as an investment.

What is a Cryptocurrency?
Cryptocurrencies are an online medium of exchange created and stored electronically in the blockchain, a distributed public database that keeps a permanent record of digital transactions. Current common cryptocurrencies include Bitcoin, Ethereum, and Litecoin. Unlike traditional currency, these alternatives have no physical form. They are not insured or controlled by a central bank or other governmental authority, cannot always be exchanged for other commodities, and are subject to little or no regulation. Wild price fluctuations are a common trait of cryptocurrencies.

Recently, cryptocurrency futures contracts and Initial Coin Offerings (ICO) have become more common in the marketplace, especially online. Hoosiers need to consider the risks before deciding whether to purchase a cryptocurrency-related investment. While some of these opportunities may not be scams, anyone investing in an ICO should be prepared to lose their entire investment.

Similar in name to an Initial Public Offering (IPO) when a company sells stocks in order to raise capital, an ICO sells “tokens” in order to fund a project, usually related to the blockchain. The token likely has no value at the time of purchase. Some tokens constitute, or may be exchangeable for, a new cryptocurrency to be launched by the project, while others may give investors a discount, or early rights to a product or service proposed to be offered by the project.

Cryptocurrency IRAs are another emerging trend where investors are being put at risk. Companies offer a product where investors can purportedly hold Bitcoin or other cryptocurrency while it grows tax free. Although owning and holding cryptocurrencies is legal, these self-directed IRA companies often charge outrageous commissions and yearly fees – which are only described in the fine print. One such company charges a commission of 20% in addition to a large yearly fee. The Securities Division urges investors to do their homework when dealing with self-directed IRA companies aimed at cryptocurrencies. Investors may not only incur a tax penalty when rolling over an existing IRA to an unqualified account, the company may then charge an unreasonable fee. Don’t get caught off-guard!
Common Cryptocurrency Risks
Some common concerns investors should consider before investing in any offering containing cryptocurrency include the following:

• Cryptocurrency is subject to minimal regulatory oversight, susceptible to cybersecurity breaches or hacks, and there may be no recourse should the cryptocurrency disappear.
• Cryptocurrency accounts are not insured by the Federal Deposit Insurance Corporation (FDIC).
• The high volatility of cryptocurrency investments make them unsuitable for most investors, especially those investing for long-term goals or retirement.
• Investors will have to rely upon the strength of their own computer security systems, as well as security systems provided by third parties, to protect purchased cryptocurrencies from theft.
• Many ICOs are based entirely overseas, so if something goes wrong, there may be no recourse for investors or authorities to recover money lost in a fraudulent scheme.

Common Red Flags of Investment Fraud
Secretary Lawson also reminds investors to always be on the lookout for these common red flags of investment fraud:

• “Guaranteed” high investment returns. There is no such thing as guaranteed investment returns, and there is no guarantee that the cryptocurrency will increase in value.
• Unsolicited offers. An unsolicited sales pitch may be part of a fraudulent investment scheme. Cryptocurrency investment opportunities are promoted aggressively through social media.
• Sounds too good to be true. If the project sounds too good to be true, it probably is. Watch out for exaggerated claims about the project’s future success.
• Pressure to buy immediately. Take time to research an investment opportunity before handing over your money.
• Unlicensed sellers. Many fraudulent investment schemes involve unlicensed individuals or unregistered firms. The Securities Division can help investors research the background of those selling a security and verify that they are registered. The Division may be reached via phone at 317-232-6681 or online at http://www.in.gov/sos/securities.