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## Bitcoin: More than a Bit Risky

Bitcoin and other digital currencies have garnered considerable attention. Media reports have focused on virtual currency's potential promise to businesses and consumers—but also on very real abuses and criminal activity associated with it. [Government hearings](#) have been held on virtual currencies. In 2013 the US Securities and Exchange Commission (SEC) [charged a Texas man](#) and his company with fraud involving an alleged Bitcoin Ponzi scheme. More recently, on February 19, 2014, the SEC [suspended trading](#) in the securities of Imogo Mobile Technologies Corp—which had announced testing of a new mobile platform for Bitcoin a few weeks earlier—because of questions about the company's business, revenue and assets. And on February 24, 2014, the Tokyo-based Mt. Gox, one of the largest bitcoin exchanges, stopped its operations. It subsequently filed for bankruptcy in Japan on February 27<sup>th</sup> and in the U.S. on March 10<sup>th</sup>.

FINRA is issuing this alert to caution investors that buying and using digital currency such as Bitcoin carry risks. Speculative trading in bitcoins carries significant risk. There is also the risk of fraud related to companies claiming to offer Bitcoin payment platforms and other Bitcoin-related products and services.

### How Bitcoin Works

Bitcoin is a peer-to-peer payment system that uses its own currency, called bitcoin, to transact business. Bitcoins are not issued by banks or governments—indeed the Bitcoin platform was designed to offer an alternative to national currencies like the dollar, and commodity-based currencies such as gold or silver coins.

Bitcoin was introduced in 2009 as open source software. Think of it as a sophisticated computer program that encrypts, verifies and records bitcoin transactions. While Bitcoin users are anonymous, a public record or "block chain" is public and shared between Bitcoin system users. Mathematical proofs are used to verify the authenticity of each transaction.

Bitcoins are created by a process called "mining." Like mining for gold, the process is labor intensive. Mining serves two purposes. First, miners use software algorithms to add transaction records to Bitcoin's public ledger of past transactions and verify legitimate bitcoin transactions. For their efforts, Bitcoin miners get transaction fees. In addition, if the miner finds a new "block," the miner is awarded new bitcoins. A finite number of bitcoins can be mined (21 million based on the mathematics underlying Bitcoin mining).

Bitcoins can also be bought and sold online or at physical locations. A growing number of physical establishments and exchanges allow customers to buy and sell bitcoins using cash, credit cards, money orders and other methods. Bitcoins reside in a digital "wallet," where they can be used to purchase items from establishments that accept bitcoins.

Bitcoins can be traded for traditional currency at exchange rates that fluctuate. Bitcoin prices have been extremely volatile, and subject to wide price swings. Recent [IRS guidance](#) notes that Bitcoin, as a virtual currency, is treated as property for U.S. federal tax purposes and subject to the same general tax principles.

### Bitcoin Risks

Buying, selling and using bitcoins carry numerous risks:

- Digital currency such as Bitcoin is not legal tender. No law requires companies or individuals to accept bitcoins as a form of payment. Instead, Bitcoin use is limited to businesses and individuals that are willing to accept bitcoins. If no one accepts bitcoins, bitcoins will become worthless.
- Platforms that buy and sell bitcoins can be hacked, and some have failed. In addition, like the platforms themselves, digital wallets can be hacked. As a result, consumers can—and have—lost money.
- Bitcoin transactions can be subject to fraud and theft. For example, a fraudster could pose as a Bitcoin exchange, Bitcoin intermediary or trader in an effort to lure you to send money, which is then stolen.
- Unlike US banks and credit unions that provide certain guarantees of safety to depositors, there are no such safeguards provided to digital wallets.
- Bitcoin payments are irreversible. Once you complete a transaction, it cannot be reversed. Purchases can be refunded, but that depends solely on the willingness of the establishment to do so.
- In part because of the anonymity Bitcoin offers, it has been used in illegal activity, including drug dealing, money laundering and other forms of illegal commerce. Abuses could impact consumers and speculators; for instance,

law enforcement agencies could shut down or restrict the use of platforms and exchanges, limiting or shutting off the ability to use or trade bitcoins.

### Bitcoin Speculation

Speculators have been drawn to bitcoin trading as a way to make a quick profit. But like any speculative investment, from real estate to gold, you can lose money. With digital currency, profits or losses are virtually impossible to predict.

Bitcoin prices have fluctuated widely, and wildly, almost from the currency's inception for a host of reasons. For example, bitcoin prices plummeted following the Mt. Gox incident—and earlier when the Chinese central bank banned banks from accepting bitcoins. Other factors that affect digital currency prices include supply and demand, rumors and even where bitcoins are traded (since prices are far from uniform from one bitcoin exchange to the next). In short, bitcoin speculation is extremely risky. Never speculate with money you cannot afford to lose.

### Bitcoin-Related Scams

When the SEC first brought the Texas case involving bitcoins, it issued a warning about the potential for fraud. As with so many other "hot" or new trends, fraudsters may see the latest digital currency trend as a chance to steal your money through old-fashioned fraud.

Warning signs of fraud include business claims that are not backed by financial reality. For example, newsletters or press releases might claim a company has a viable product or service, but the company's own filings with the SEC show low revenues and describe the company as a development stage entity. For more information on identifying potential stock frauds in any emerging industry, read [Avoiding Investment Scams](#).

### If a Problem Occurs

If you believe you've been defrauded or treated unfairly by a securities professional or firm, [file a complaint](#). If you suspect that someone you know has been taken in by a scam, [send a tip](#).

### Additional Resources

- FINRA Alert: [Avoiding Investment Scams](#)
- FINRA and SEC Alert: [Inbox Alert—Don't Trade on Pump-And-Dump Stock Emails](#)
- SEC Alert: [Bitcoin and Other Virtual Currency-Related Investments](#)
- SEC Alert: [Ponzi Schemes Using Virtual Currencies](#)
- European Banking Authority: [Warning to Consumers on Virtual Currencies](#)

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