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# ARKANSAS SECURITIES DEPARTMENT

## Are You an Informed Investor?

## What's in your e-Wallet?

*Virtual currency, which includes digital and crypto-currency are gaining in both popularity and controversy. Thousands of merchants, businesses and other organizations currently accept Bitcoin, one example of crypto-currency, in lieu of traditional currency. An ATM in Las Vegas and the arena of the NBA's Sacramento Kings professional basketball team both accept Bitcoin.*

*Two attractive characteristics of virtual currency are lower transaction fees and greater anonymity. However, virtual currency is not without risk. Bitcoin exchanges claim to have suffered losses from hacking. MtGox, one of the largest Bitcoin exchanges, recently shut down after claiming to be the victim of hackers and losing more than $350 million of virtual currency. Despite the controversy, virtual currency may find its way into your e-Wallet.*

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### *What is Virtual Currency?*

Virtual currency is an electronic medium of exchange that, unlike real money, is not controlled or backed by a central government or central bank. Virtual currency includes crypto-currency such as Bitcoin, Ripple or Litecoin. This currency can be bought or sold through virtual currency exchanges and used to purchase goods or services where accepted. These currencies are stored in an electronic wallet, also known as an e-Wallet.

An e-Wallet is a digital system that allows payments online via a computer or mobile device such as a smartphone. While in some instances virtual currency has been recognized as a monetary equivalent, the Internal Revenue Service has announced that it would treat virtual currency as "property" and not "currency" for tax purposes.

### *Risks Associated with Virtual Currency*

As with all investments, those tied to virtual currency have risk. Some common concerns and issues you should consider before investing in any product containing virtual currency include:

- Virtual currency is susceptible to cyber-attacks and there may be no recourse should the virtual currency disappear.
- Virtual currency accounts are not insured by the Federal Deposit Insurance Corporation (FDIC), which insures bank deposits up to $250,000.
- Investments tied to virtual currency may be unsuitable for most investors due to their volatility.
- Investors in virtual currency will be highly reliant upon companies that may lack appropriate internal controls and may be more susceptible to fraud and theft than regulated financial institutions.
- 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 their e-Wallets from theft.

## *Virtual Currency as an Investment*

**Commodities.** Virtual currency can be used as an investment in essentially the same way as gold or other commodities. Investors may purchase virtual currency with the expectation that they will be able to sell the currency for a higher price in the future. This can be highly speculative because virtual currency values can fluctuate dramatically throughout the day and each exchange can value the currency differently. (For details: *NASAA Commodity Alert*.)

**Exchange Traded Funds.** A traditional Exchange Traded Fund (ETF) tracks a basket of stocks or a commodity and is traded on a stock market. An ETF may be made up of only virtual currencies, each with a value that fluctuates differently. *(For details: NASAA ETF Advisory.)*

**Derivatives.** A derivative is a financial product with value that stems from an underlying asset (i.e. stocks, bonds, or Bitcoin) that contains an agreement between parties. The most common types of derivatives are futures, warrants, convertible bonds and swaps. In this case, an investor bets on the price swing of the virtual currency. *(For details: NASAA Derivatives Advisory.)*

## *Schemes Involving Virtual Currency*

The Securities and Exchange Commission took enforcement action against a man in Texas who convinced others to give him their Bitcoin holdings in exchange for the promise of receiving even more Bitcoins in the future, plus seven percent interest a week. The scam was exposed when the promoter was not able to pay the promised returns. (For details: *SEC v. Shavers, et al.*)

## *The Bottom Line*

It pays to do your homework before you invest in any investment opportunity, including virtual currency. If you have any questions about virtual currency, contact the Arkansas Securities Department at 1-800-981-4429.

To learn more about virtual currency, additional resources are provided below:

- *Bitcoin: More than a Bit Risky*, FINRA
- *Ponzi Schemes Using Virtual Currency*, U.S. Securities and Exchange Commission