

## What You Should Know About Bitcoin and Other Virtual Currencies

Virtual currency, which includes digital and crypto-currency, are gaining in both popularity and controversy. Thousands of merchants, businesses and other organizations are now accepting Bitcoin, a type of cryptocurrency, in lieu of traditional currency. However, virtual currency is not without risk, both from the consumer and investor perspective.

### What is Virtual Currency?

Virtual currency is an electronic medium of exchange that does not have all the attributes of real currencies. Virtual currencies include cryptocurrencies, such as Bitcoin and Litecoin, which are not issued or backed by any central bank or governmental authority. Virtual currencies have legitimate purposes and can be purchased, sold and exchanged with other types of virtual currencies or real currencies like the U.S. dollar. This can happen through various mechanisms such as exchangers, administrators or merchants that are willing to accept virtual currencies.

### Consumer Considerations

Prior to buying, selling, transacting with, or investing in a virtual currency, consumers should consider the following:

- **Virtual currencies are volatile in value.** Virtual currencies are not backed by a central bank and are highly volatile with the potential for complete loss of value. This may affect investors as well as consumers using virtual currencies as a means of payment. Virtual currency volatility also may make securities offerings tied to these currencies unsuitable for most investors.
- **Virtual currencies can be stolen or otherwise subject to loss.** There is the potential for consumers to incur financial losses if an account is not maintained in a secure manner. Currently, most virtual accounts or “wallets” – unlike funds held in U.S. banks or credit unions – are not insured against loss. There is no way to reverse virtual currency transactions.
- **Virtual currencies have been connected to criminal activities.** There have been instances of virtual currencies and virtual currency exchanges being used to fund illicit activities. Legitimate customers of virtual currencies may be unable to access accounts if an exchange is shut down as part of a criminal investigation or for any other reason.

- **Virtual currency transactions may be taxable.** For federal tax purposes, the Internal Revenue Service announced that virtual currency is treated as property. General tax principles applicable to property transactions apply to transactions using virtual currency. This includes determining the fair market value of virtual currency in U.S. dollars as of the date of payment or receipt, as well as any gain or loss incurred. For more information, go to <http://www.irs.gov/uac/Newsroom/IRS-Virtual-Currency-Guidance>

## Investor Considerations

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 subject to minimal regulation, susceptible to cyberattacks and there may be no recourse should the virtual currency disappear.
- Virtual currency accounts are not insured by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund which insures bank and credit union deposits, respectively, 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 reliant upon unregulated 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 “electronic wallets” from theft.

Also, new technology is often used by scam artists for fraudulent investment schemes. 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

**Do your homework.** Consumers or investors considering using virtual currencies should research any company offering services or investment opportunities. Until this form of currency is regulated, D.C. residents should be aware of the increased risks. We encourage you to call the D.C. Department of Insurance, Securities and Banking with your questions at 202-727-8000 or visit us online at [disb.dc.gov](http://disb.dc.gov) before using or investing in virtual currencies.

## More Information

The D.C. Department of Insurance, Securities and Banking has two missions: to fairly and efficiently regulate financial services in order to protect the people of the District of Columbia; and to attract and retain financial-services businesses to the District. Visit us on the web at [disb.dc.gov](http://disb.dc.gov). This information is courtesy of the Conference of State Bank Supervisors ([www.csbs.org](http://www.csbs.org)) and the North American Securities Administrators Association ([www.nasaa.org](http://www.nasaa.org)).

July 11, 2014