

Cryptocurrency: 'trustless' nature irks regulators

Last October, the Board of the International Organization of Securities Commissions (IOSCO) discussed the growing usage of Initial Coin Offerings (ICOs) to raise capital as an area of concern.

"There are clear risks associated with these offerings," IOSCO had warned all nations in a statement after the discussions. The world body also said that ICOs are highly speculative investments in which investors were putting their entire invested capital at risk.

To be fair, some operators provide legitimate investment opportunities to fund projects or businesses. But, the increased targeting of retail investors through online distribution channels by parties often located outside an investor's home jurisdiction — which may not be subject to regulation or may violate laws — "raises investor protection concerns."

In Budget 2018, Finance Minister Arun Jaitley said the government did not consider cryptocurrencies legal tender and would aim to eliminate their use in financing illegitimate activities.

Many regulatory and self-regulatory authorities globally have cautioned investors on ICOs. ICOs, also known as token sales or coin sales, typically involve the creation of digital tokens — using distributed ledger technology — and their sale to investors in return for a cryptocurrency such as bitcoin or ether.

A survey by the North American Securities Administrators Association (NASAA) of state and provincial securities regulators showed 94% believed there was a "high risk of fraud" involving cryptocurrencies. Regulators also were unanimous in their view that more regulation was needed for cryptocurrency to provide greater investor protection.

'Not for faint of heart'

"Cryptocurrencies and investments tied to them are high-risk products with an unproven track record and high price volatility. Combined with a high risk of fraud, investing in cryptocurrencies is not for the faint of heart," it added.

"Investors should go beyond the headlines and hype to understand the risks associated with investments in cryptocurrencies, as well as cryptocurrency futures contracts and other financial products where these virtual currencies are linked in some way to the underlying investment," said Joseph P. Borg, NASAA President in a statement last month.

German regulator Federal Financial Supervisory Authority said the acquisition of cryptocurrency coins may result in substantial risks for investors. As ICOs are a highly speculative form of investment, investors should be prepared for the possibility of losing their investment completely. It also said that the term ICO, stems from "initial public offering" (IPO), i.e. a floatation on a stock exchange. The apparent similarity of the terms gives the impression that ICOs are comparable to the issuance of shares. This is not the case, either technically or legally.

In a recent interview published by the Federal Reserve Bank of New York, its economists Michael Lee and Antoine Martin raised the issue of the trustworthiness of such currencies. They highlighted the "trustless" nature as virtual currencies are "not backed by anything real" such as gold. "Trust is implicit for practically any means of payment," they added.

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