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# Warning to consumers on virtual currencies

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## Summary

**The European Banking Authority (EBA) is issuing this warning to highlight the possible risks you may face when buying, holding or trading virtual currencies such as Bitcoin. Virtual currencies continue to hit the headlines and are enjoying increasing popularity.**

**However, you need to be aware of the risks associated with virtual currencies, including losing your money. No specific regulatory protections exist that would cover you for losses if a platform that exchanges or holds your virtual currencies fails or goes out of business.**

**While the EBA is currently assessing all relevant issues associated with virtual currencies, in order to identify whether virtual currencies can and should be regulated and supervised, you are advised to familiarize yourself with the risks associated with them.**

## What are virtual currencies?

A virtual currency is a form of unregulated digital money that is not issued or guaranteed by a central bank and that can act as means of payment. Virtual currencies have come in many forms, beginning as currencies within online computer gaming environments and social networks, and developing into means of payment accepted 'offline' or in 'real life'. It is now increasingly possible to use virtual currencies as a means to pay for goods and services with retailers, restaurants and entertainment venues. These transactions often do not incur any fees or charges, and do not involve a bank.

More recently, the virtual currency 'Bitcoin' has set the scene for a new generation of decentralised, peer-to-peer virtual currencies - often also referred to as crypto currencies. Following the currency's recent growth, dozens of other virtual currencies have followed in Bitcoin's wake.

## How does it work?

Using Bitcoin as an example, virtual currencies can be bought at an exchange platform using conventional currency. They are then transferred to a personalised Bitcoin account known as a 'digital wallet'. Using this wallet, consumers can send Bitcoins online to anyone else willing to

accept them, or convert them back into a conventional fiat currency (such as the Euro, Pound or Dollar).

New Bitcoins are created online using computer-intensive software known as ‘Bitcoin miners’. This software allows consumers to ‘mine’ small amounts of the currency through solving deliberately complex algorithms. However, the increase in the money supply is fixed so only small amounts are released over time.

## What are the risks you need to be aware of?

The EBA has identified several characteristics and risks that you should be aware of when buying, holding, or trading virtual currencies.

### **You may lose your money on the exchange platform**

In order to purchase virtual currencies, you may buy currency directly from someone who owns them or through an exchange platform. These platforms tend to be unregulated. In a number of cases, exchange platforms have gone out of business or have failed - in some instances due to hacking by third parties. The EBA is aware of consumers permanently losing significant amounts of money held on these platforms.

You should be aware of the fact that exchange platforms are not banks that hold their virtual currency as a deposit. If an exchange platform loses any money or fails, there is no specific legal protection – for example through a deposit guarantee scheme – that covers you for losses arising from any funds you may have held on the exchange platform, even when the exchange is registered with a national authority.

### **Your money may be stolen from your digital wallet**

Once you have bought virtual currency it is stored in a ‘digital wallet’, on a computer, laptop or smart phone. Digital wallets have a public key, and a private key or password that allows you to access them. However, digital wallets are not impervious to hackers. Similar to conventional wallets, money may therefore be stolen from your wallet. Cases have been reported of consumers losing virtual currency in excess of US \$1 million, with little prospect of having it returned.

In addition, if you lose the key or password to your digital wallet, your virtual currency may be lost forever. There are no central agencies that record passwords or issue replacement ones.

### **You are not protected when using virtual currencies as a means of payment**

When using virtual currencies as a means to pay for goods and services you are not protected by any refund rights under EU law offered, for example, for transfers from a conventional bank or other payment account. Unauthorised or incorrect debits from digital wallet can therefore not usually be reversed. Acceptance of virtual currencies by retailers is also not permanently

guaranteed and is based on their discretion and/or contractual agreements, which may cease at any point and with no notice period.

### **The value of your virtual currency can change quickly, and could even drop to zero**

The price of Bitcoins and other virtual currencies has risen sharply. This has prompted some consumers to choose to invest in them. However, you need to be aware that the value of virtual currencies has been very volatile and can easily go down as well as up. Should the popularity of a particular virtual currency go down, for example if another virtual currency becomes more popular, then it is quite possible for their value to drop sharply and permanently.

The currencies' price volatility affects you if you buy virtual currencies as a means of payment: unlike money paid into a traditional bank or payment account denominated in a fiat currency, you cannot be assured that the value of your virtual currency funds remains largely stable.

### **Transactions in virtual currency may be misused for criminal activities, including money laundering**

Transactions in virtual currencies are public, but the owners and recipients of these transactions are not. Transactions are largely untraceable, and provide virtual currency consumers with a high degree of anonymity. It is therefore possible that the virtual currency network will be used for transactions associated with criminal activities, including money laundering. This misuse could affect you, as law enforcement agencies may decide to close exchange platforms and prevent you from accessing or using any funds that the platforms may be holding for you.

### **You may be subject to tax liabilities**

You should be aware that holding virtual currencies may have tax implications, such as value added tax or capital gains tax. You should consider whether tax liabilities apply in your country when using virtual currencies.

## **What can you do to protect yourself?**

We recommend that, if you buy virtual currencies, you should be fully aware and understand their specific characteristics. You should not use 'real' money that you cannot afford to lose.

You should also exercise the same caution with your digital wallet as you would do with your conventional wallet or purse. You should not keep large amounts of money in it for an extended period of time, and ensure you keep it safe and secure. You should also familiarise yourself with the ownership, business model, transparency, and public perception of the exchange platforms that you are considering using.