MARYLAND COMMISSIONER OF FINANCIAL REGULATION

CONSUMER ADVISORY

August 4, 2022

Cryptocurrency: Potential Risks to Consumers

Cryptocurrencies are a type of privately created, electronic money that may be accepted by some businesses and others as a means to pay for goods or services. When you buy cryptocurrency, you don't receive a physical bill or coin; instead, you receive a computer code/link (e.g., a key) representing that currency. You receive that code/key because the record of currency ownership is maintained on a public digital ledger called a *blockchain*, and that code is needed to access the blockchain. Cryptocurrency can be held in a digital wallet, on a trading platform, with a custodian, or through other cryptocurrency entities. Cryptocurrency can also be lent or traded as a speculative investment. Recent volatility in the cryptocurrency market, as well as the failure of several large cryptocurrency service companies and cryptocurrencies, have highlighted the risks to consumers purchasing, holding, and using cryptocurrencies.

Carefully consider the following facts before deciding to purchase, hold, sell, transact with, or invest in cryptocurrency:

- **Cryptocurrencies and companies dealing in cryptocurrencies may only be partially regulated or not regulated at all.** Existing laws contain few consumer protections. There are currently limited federal or state regulations relating to cryptocurrencies, cryptocurrency lenders and custodians, or other cryptocurrency-related services. For example, an administrator or exchanger that accepts and transmits a cryptocurrency, or buys or sells cryptocurrency for any reason, may be deemed to be a "money transmitter" under federal regulations and therefore should be federally registered as a money services business (MSB). The federal requirements, however, provide minimal consumer protections.

  Furthermore, a company that offers to exchange, administer, or maintain cryptocurrencies may be subject to Maryland regulation and licensing as a money transmitter, however Maryland's regulations only apply to those activities that are considered money transmission – that is, receiving your currency or cryptocurrency and transferring it to another person. *The underlying cryptocurrency is not regulated* and there are no guarantees of a cryptocurrency's value. Also consider that your agreement to allow an MSB or Maryland-licensed money transmitter to use your cryptocurrency for other purposes (e.g., lending to others) in exchange for compensation to you is not regulated, and the failure of that entity could result in the loss of some or all of your cryptocurrency held by that entity.

- **Cryptocurrencies are not insured by the government.** Cryptocurrencies are not deposits in banks or credit unions, nor are they U.S. currency. Therefore, they are not federally insured by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration

(NCUA). Instead, they are stored in crypto accounts or "digital wallets" that are identified and accessed by public and private keys. Your agreement with a custodian or trading entity may allow that entity to transfer your cryptocurrency into their own wallet or account. At that point, your cryptocurrency may be outside the scope of any regulation of the entity, even if it is licensed as a money transmitter. See the FDIC factsheet available for download at www.fdic.gov/news/fact-sheets/crypto-fact-sheet-7-28-22.pdf for more information about deposit insurance and crypto companies.

- **Your cash held by a cryptocurrency company also may be at risk.** If a cryptocurrency custodian or trading entity faces bankruptcy, the consumer's "digital wallet" U.S. dollar funds at that entity may also be lost or access to the funds may be restricted during a company's bankruptcy proceeding. There generally is no FDIC or NCUA insurance coverage for a consumer's account if the cryptocurrency company goes bankrupt. Federal deposit insurance only protects a depositor if the bank or credit union goes into receivership.

- **Cryptocurrencies experience large price fluctuations.** Cryptocurrencies are not supported by a central bank and are highly volatile, with the potential for complete loss of value (Luna coin is a recent example of such an outcome). Initial coin offerings and subsequent sales are not regulated. This may affect consumers using cryptocurrencies as a means of payment or as a form of investment. This volatility may make securities offerings that are linked to cryptocurrencies unsuitable for most investors. Cryptocurrencies offered as "stablecoins" (cryptocurrencies with values pegged to a fiat currency) may also experience volatility, despite their name. You need to fully understand the investments that are claimed to be backing the value of the stablecoin and ensure there are adequate controls in place regarding those investments. These cryptocurrencies may not be suitable to hold and use for payments.

- **Cryptocurrencies can be stolen through fraud.** There is no way to reverse a cryptocurrency transaction if a payment is made to the wrong person or business, or if a consumer is dissatisfied with the goods or services received.

- **Cryptocurrency custodians and trading platforms can be hacked.** You could incur financial losses if an account is not maintained in a secure manner. Electronic devices, crypto accounts, and cryptocurrency service providers can all be hacked, and a consumer's personally identifiable information compromised. Bank accounts or payment cards linked to a consumer's digital wallet can also put the consumer at risk in the event of unauthorized access.

- **Cryptocurrencies have been connected to criminal activities.** Cryptocurrencies and cryptocurrency exchanges have been used to fund illicit activities. Consumers with cryptocurrencies may be unable to access their accounts if a custodian or trading platform is shut down as part of a criminal investigation or for any other reason.

- **Cryptocurrency transactions may be taxable.** The Internal Revenue Service (IRS) treats cryptocurrency as property, and general tax principles applicable to property transactions also apply to cryptocurrency transactions. This includes determining the fair market value of cryptocurrency in U.S. dollars as of the date of payment or receipt, as well as any gain or loss incurred. For more information, see irs.gov/uac/Newsroom/IRS-Virtual-Currency-Guidance.

If you have questions about the content of this advisory, please contact us by email at DLFRFinReg-LABOR@maryland.gov.

The Office of the Commissioner of Financial Regulation, a division of the Maryland Department of Labor, is Maryland's consumer financial protection agency and financial services regulator. For more information, please visit our website at www.labor.maryland.gov/finance.

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