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Newsflash – Fintech - Capital Markets

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Cryptocurrencies:

ESMA, EBA and EIOPA alert consumers on risks of investing in cryptocurrencies

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WHAT?

By definition, a cryptocurrency or virtual currency (**VC**) is a digital or virtual representation of value using cryptography to secure its transactions. Contrarily to centralised electronic money and traditional/fiat currencies (central banking system), cryptocurrencies use decentralized control, which works through the Blockchain technology. Well-known VCs include notably (i) Bitcoin, (ii) Ether and (iii) Ripple.

Over the last 12 months, VC transactions have increased and the value of Bitcoin augmented drastically from around EUR 1,000 for 1 Bitcoin in January 2017 to circa EUR 16,000 for 1 Bitcoin in December 2017 while today it is around EUR 8,700. Thus, VCs have suffered from significant daily fluctuations in their prices, leading to high risk of volatility.

WHEN?

On 12th February 2017, The European Securities and Markets Authority (**ESMA**), the European Banking Authority (**EBA**) and the European Insurance and Occupational Pensions Authority (**EIOPA**) (together defined as **European Authorities**) issued a warning notice (the **Warning Notice**) to the attention of consumers on the high risks related to the purchase/investment of VCs.

WHY?

The European Authorities have resolved to issue such Warning Notice based on article

9(3) of their respective founding regulations, which states that they may issue warnings in the event of a financial activity representing a serious threat to the objectives laid down in the said founding regulations, such as the improvement of the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision, or the safeguarding of the integrity, transparency, efficiency and orderly functioning of financial markets.

PRECEDENT

Such Warning Notice follows in particular the publication of a statement issued by ESMA on Initial Coin Offerings, on which the *Commission de Surveillance du Secteur Financier (CSSF)* relied on.

For more information on this topic, please see our NewsFlash on CSSF Press Release 17/38 on risks of ICOs for investors dated 16th November 2017¹.

STATEMENT?

According to European Authorities, investing in VCs represents a risk considering the highly

¹ www.bsp.lu/publications/newsletters-legal-alerts/newsflash-cssf-press-release-1738-risks-icos-investors

speculative nature of such VCs which could potentially lead to financial losses for the consumers.

European Authorities have listed several risks which need to be taken into account by the consumers when investing in VCs, as follows:

- **Extreme volatility and bubble risk:** extreme price volatility and signs of a pricing bubble that could potentially lead to financial losses for the consumers;
 - **Absence of protection:** for the time being VCs are not regulated under EU law; thus consumers will not benefit from the guarantees and safeguards associated with EU law that regulate financial services. Furthermore, EU law does not offer any specific legal protection that would cover consumers' financial losses;
 - **Lack of exit options:** difficulties to exchange VCs for traditional/fiat currencies;
 - **Lack of price transparency:** risk to pay/not to receive a fair and accurate price when buying or selling VCs;
 - **Operational disruptions:** risks of operational problems, such as trading disruptions, whereby consumers would be unable to buy and sell VCs at a specific moment (risks of losses due to the price fluctuation during the disruption period);
 - **Misleading information :** incomplete and unintelligible information made available to consumers wishing to buy VCs, in particular regarding the risk to invest in VCs;
- **Unsuitability of VCs for most purposes, including investment or retirement planning:** due to the high volatility of VCs, VCs may be unsuitable investments for consumers, including for short-term investments or long-term investments (saving for retirement).

As mentioned above, the warning notice solely intends to outline the risk associated with blind or uninformed investments in VCs. In other words, the Warning Notice does not intend to regulate or restrict the VCs in any manner. Moreover, it is clear that the Blockchain technology and any other potential applications thereof are absolutely not questioned as such.

Should you need any further information, please contact [Pierre-Alexandre Degehet](mailto: pierre-alexandre.degehet@bsp.lu).