



Should You Consider Crypto?

FDPL Academy
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Learn the markets. Know the risks. Make a plan.





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Office of Customer
Education and
Outreach

- What are they?
 - Digital recordkeeping systems
- Custody and wallets
 - Custodial, non-custodial, hot/cold, & hardware
- What are the risks?
 - Operational risks, market risks, cyber security risks, fraud risks
- Fraud resources
 - Common frauds, warning signs, and more

- Volatile
- Opaque
- Unprotected
- Novel
- Speculative

CFTC authority

	Derivatives Market 	Cash or "Spot" Market 
Characteristics:	Financial market. Futures contracts, options, swaps. A standardized contract to buy or sell at some point in the future.	Physical market. Cash for the 'physical' or actual commodity. The commodity itself.
CFTC's authority:	<ul style="list-style-type: none"> ➤ Regulatory authority ➤ Supervisory authority ➤ Enforcement authority 	<ul style="list-style-type: none"> ➤ Enforcement authority over fraud or manipulation
Example:	CME Bitcoin futures contract	Buying bitcoin for dollars from an online seller

Crypto is ...

“Token” or
“coin”

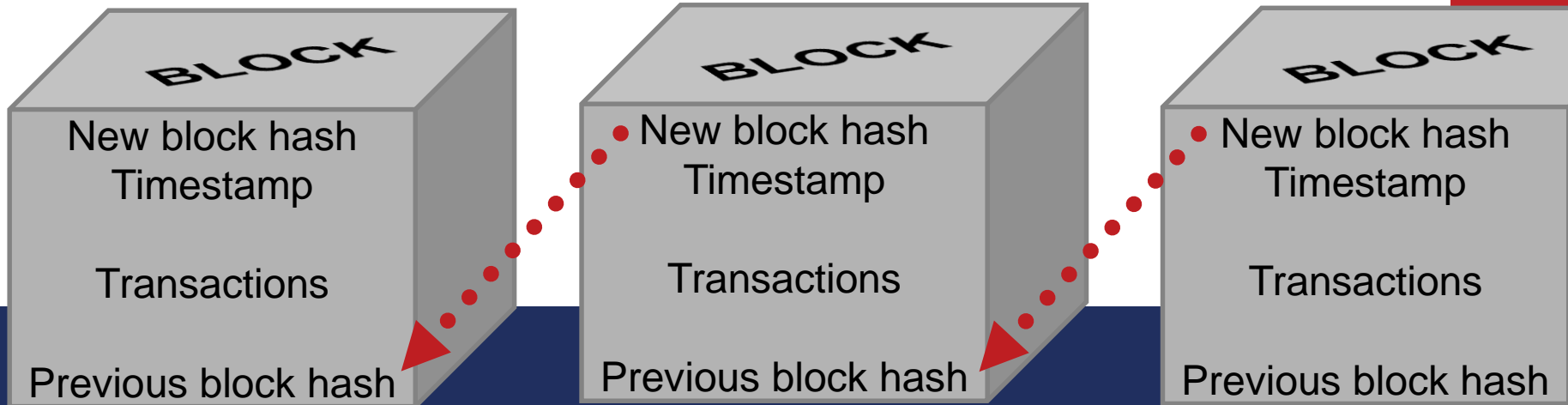


+

Distributed ledger



+ Blockchain



Distributed ledger

Centralized ledger



Single ledger owned and controlled by a central entity.

LEDGER

Date	From/To	Debit	Credit

Distributed ledger

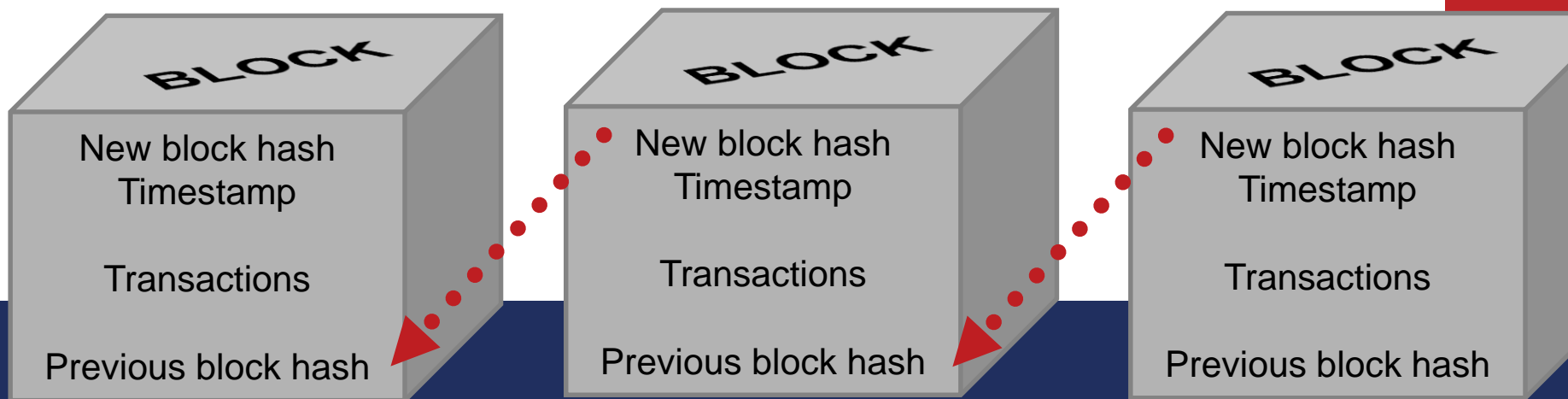


Identical copies of the same ledger shared on a network of computers.

Blockchain

An **append-only, distributed** recordkeeping system that uses **cryptography** and **consensus** to keep track of digital records that convey:

1. Value,
2. Ownership, or
3. A right or obligation



Cryptography

- SHA 256 Algorithm
 - Any amount of data can go in
 - A “hash” with a fixed number of digits comes out:
000000000000000000000000590fc0f3eba193a27853422
0b2b37e9849e1a770ca959
 - Any change in underlying data changes the hash.
- Used for
 - Privacy/protection of personal information
 - Consensus
 - Secure the blockchain

Bitcoin: The first

- Created in 2008 as a **peer-to-peer** online payment system.
 - Creator unknown (“Satoshi Nakamoto”).
 - Designed to take banks and other intermediaries out of the equation.
- The first successful cryptocurrency and most popular by market capitalization.*
- Considered property by the IRS.**

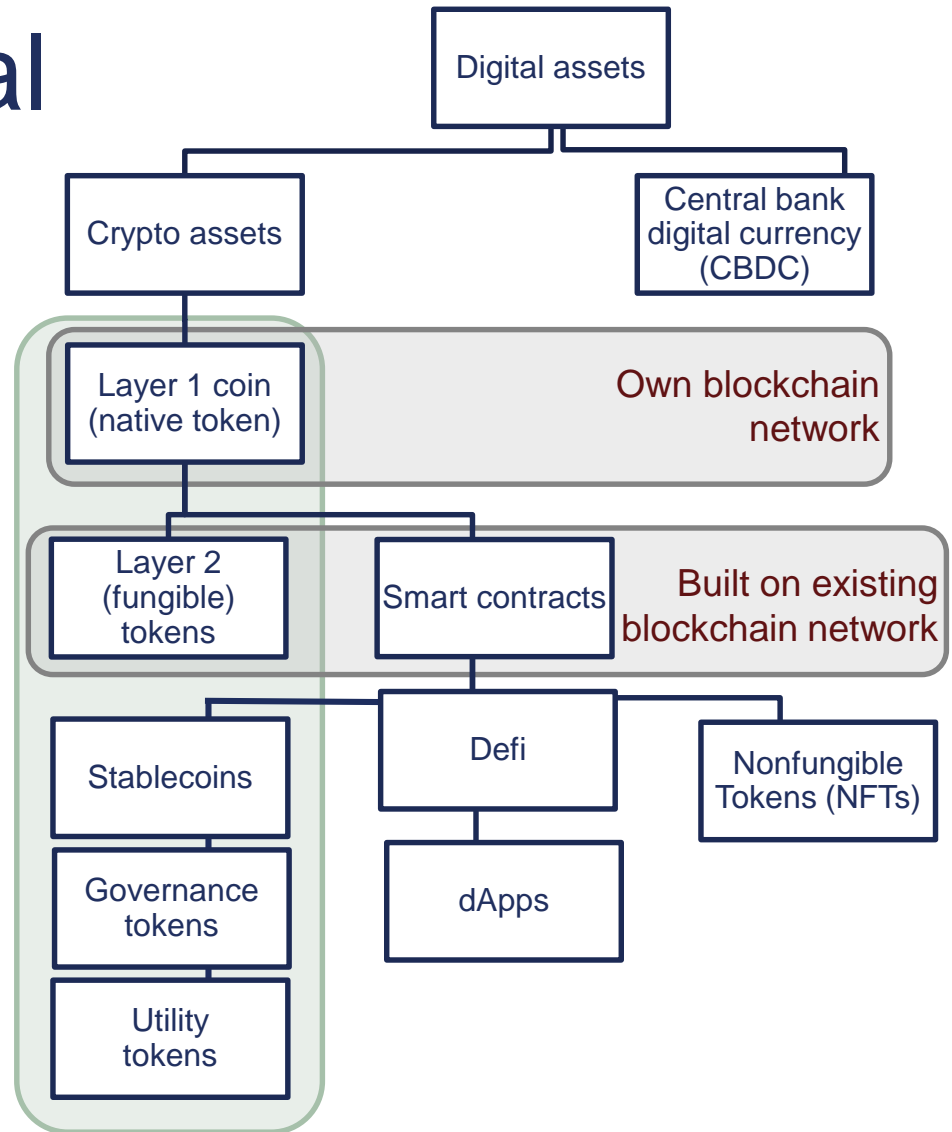
* \$566 billion as of Aug. 7, 2023. Reached a high of \$1.27 trillion in Nov. 2021. By comparison, META’s market cap is approximately \$814 billion and AAPL is \$2.8 trillion.

** For tax information, visit <https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets>

What are digital assets?

A lot of terminology, but no official taxonomy.

Broadly called “cryptocurrency”



NFTs

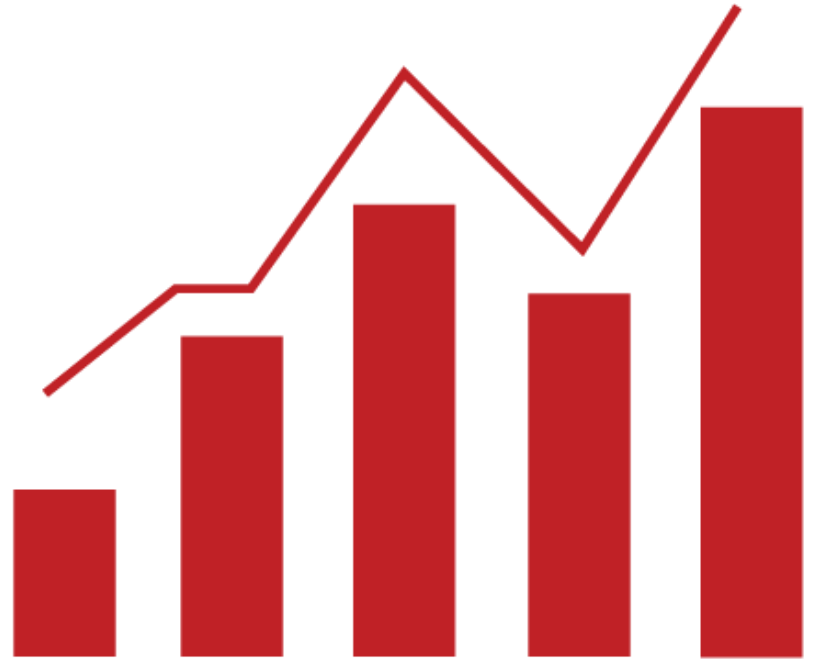
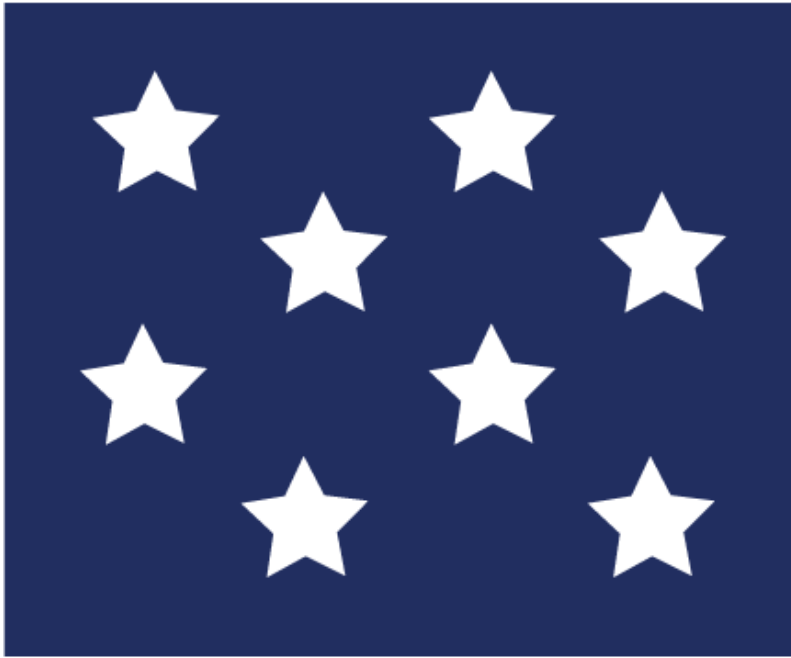
- Unique, one-of-a-kind tokens that are
 - A description of ownership, use rights, certification, identity
 - Linked to an off-chain asset (digital or physical)
 - Tradeable
 - Fractionable
 - Not interchangeable
 - Not copyright or transfer of intellectual property
- Use cases: Representations of
 - collectible items
 - digital goods (video games, virtual worlds)
 - Identification/credentials
 - access keys
 - property deeds or titles
 - tickets for travel or events
- Legal rights are unclear and have been subject to litigation.
- IRS: Property or collectible? Determination pending.
- Wash trading, fraud, plagiarism, hacks

RECEIPT	
Collectible record	\$10
Tax	\$0.70
Total.....	\$10.70

Where do crypto assets get their value?

- Most crypto assets are not backed or supported by “real” assets or governments.
 - Some stablecoins claim to have 1:1 currency reserves. Do they?
- Network value.
- Supply, demand.
- Opinions, FOMO.
- “Tokenomics.”
- **Speculation.**

This also contributes to **volatility, runs, freezes**



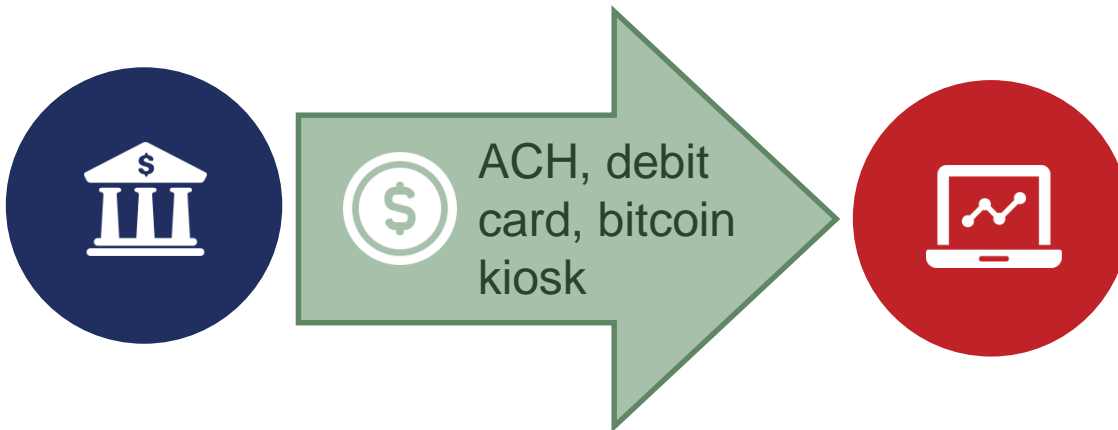
How to talk about crypto

CUSTODY & WALLETS



The on-ramps: Centralized “exchanges”

- Transfer money from bank to **cash market** trading platform.
 - ⊘ NOT **supervised** or **regulated** like traditional exchanges.
 - ⊘ NO FDIC or SIPC insurance.
- Bank fees, platform fees, network fees.



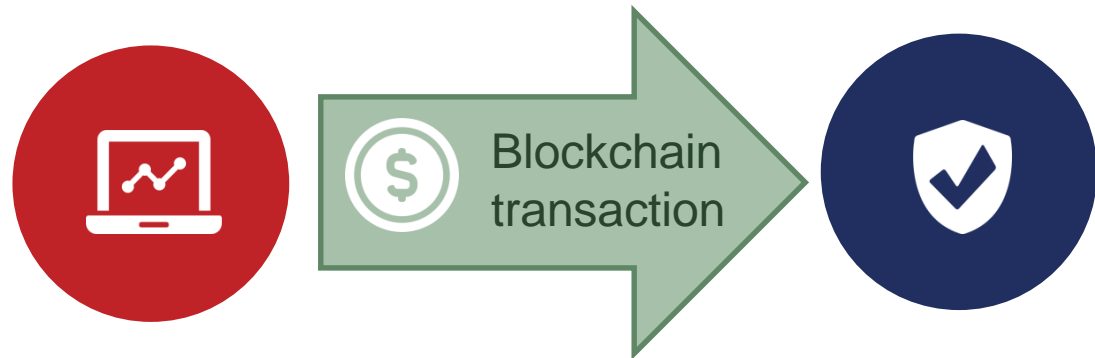
Custodial wallets

- Centralized
- “Off-chain”
- Co-mingled with other customer or company assets?
- Does the platform have adequate reserves?
- Subject to freezes
- May belong to platform



Self-custody

- Transfer money from cash market trading platform to a non-custodial wallet.
- Software, mobile app, or hardware.
- Creates and manages your **private** and **public keys**.
- “Whoever holds the keys holds the crypto.”
- “On-chain”
- Fully on your own – theft, hacks, etc.

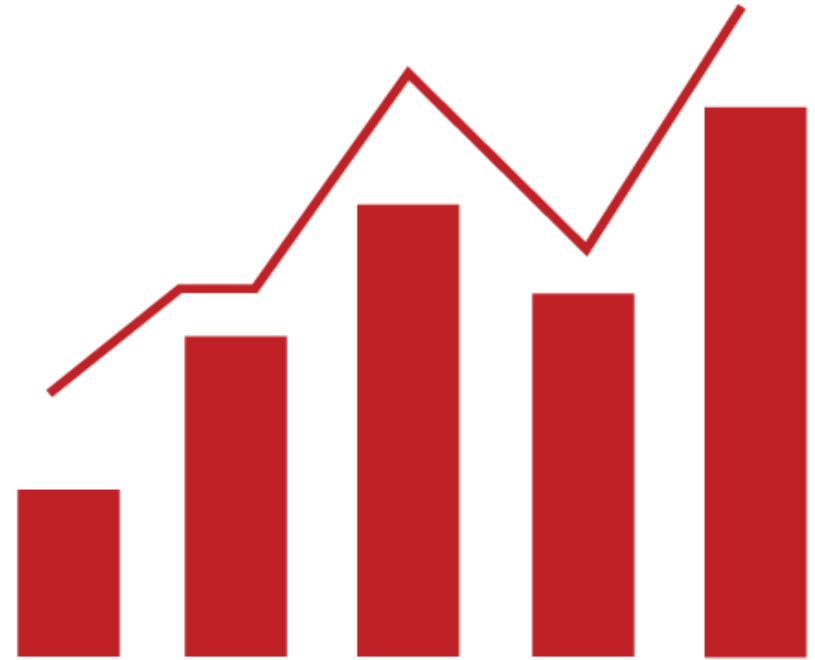
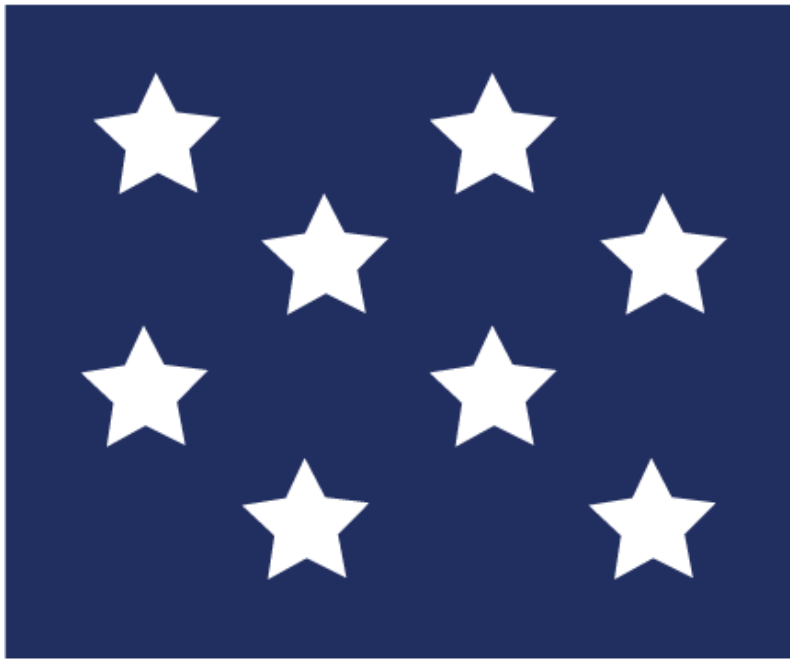


Non-custodial wallets

- Non-custodial = self custody
- “Hot” wallets = software, mobile app; connect to internet.
- “Cold” wallets = Hardware with software; not connected to the internet.



 Only keep funds you plan to spend or trade in “hot” or exchange wallets. Other funds should be moved to “cold” or offline wallets.



**LEARN THE MARKETS, KNOW
THE RISKS, HAVE A PLAN**

Learn the Markets.

Know the Risks. Make a Plan

➤ Learn

- How markets and products operate
- How product makes/loses money
- Tech, tokenomics, business case, competition

➤ Know

- Operational risks
- Cybersecurity risks
- Market risks
- Fraud risks

➤ Plan

- Risk management
 - “Risk capital:” How much can you afford to lose?
 - Overall financial plan
 - Living expenses
 - Short-term savings needs
 - Long-term savings needs
 - Speculate?
- Investment Strategy
 - Hodl
 - Speculate
- Exit points?
- Education/information

Operational risks

1. Unsupervised trading.
 - Conflicts of interest
 - Price manipulation
 - Oracle manipulation (DeFi)
2. Inconsistent customer protections.
 - Missing safeguards
 - Reserves, segregation
3. Commingled customer assets.
 - Mixed with other customer funds or used for company operations.
 - Hacks, runs, bankruptcy
4. Most DeFi projects fail.
Research and understand:
 - The project
 - Use-case
 - Demand/competing projects
 - Governance/tokenomics
 - The developers
 - How your money will be used, and when or if you can get it back.
 - The technology
 - Was the code audited and security tested?
 - White papers and other documents.

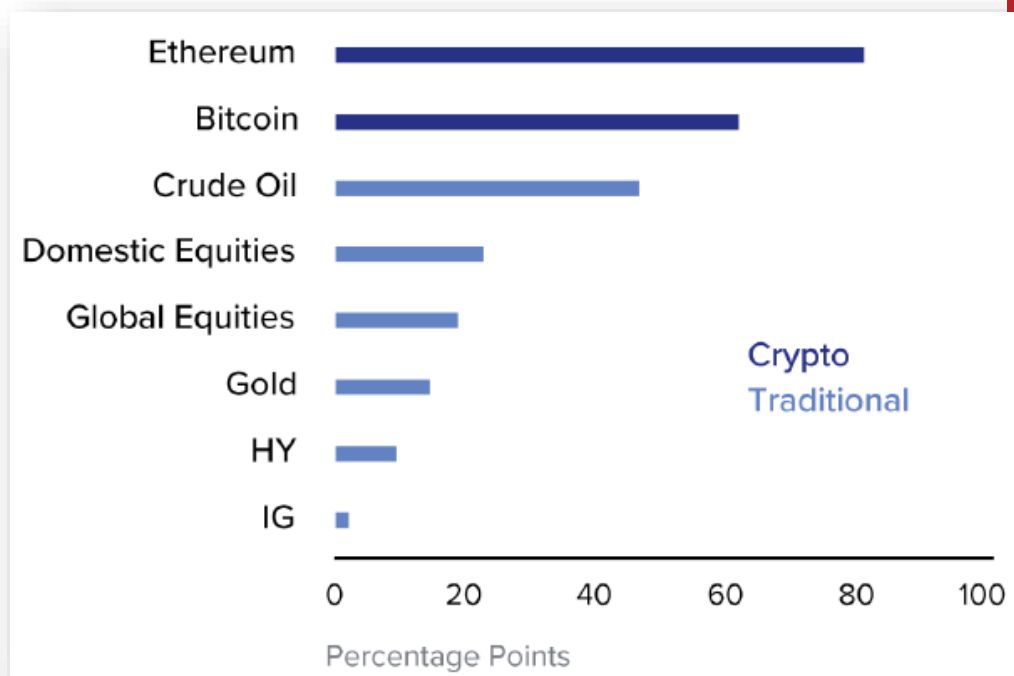
Cybersecurity risks

- Hacks
 - Targets = most money + least resistance
 - Defi: Bridges, liquidity pools, dApps
 - Platforms: Steal from customer accounts
 - Wallets: Private key theft, fraudulent smart contracts
- Most hacks stem from phishing and other social-engineering attacks.
 - Account verifications; transactions; new products/upgrades; urgent customer support.
 - Links/QR codes to imposter websites, wallet apps
- Lost or stolen private keys or seed phrases.
 - Your digital signature. If lost or stolen you will no longer have access to your assets.
 - Never give your private key or seed phrase to anyone.

Market risks

- Volatility
- New and novel
- Liquidity
 - Manipulation
 - Run risk
- Counterparty risk
 - Stablecoins
 - dApps
 - Staking
 - Bridges
 - ICOs

Annualized real volatility of crypto-assets and traditional assets



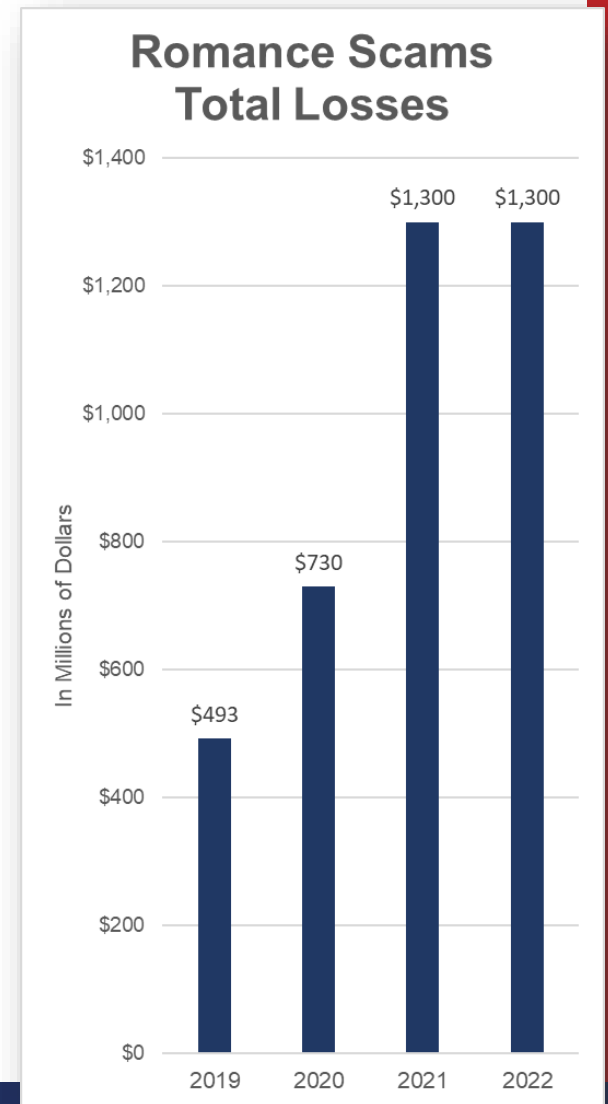
Note: Data from 2018 through July 2022. *FSOC Report on Digital Asset Financial Stability Risks and Regulation, 2022.*

Fraud risks

- Most popular medium for fraudsters
 - Electronically transferrable
 - Obscures real-world identities
 - All transactions are final
 - Easily convertible
- In an online environment, anything can be faked
 - People
 - Brands
 - Platforms
 - Data, balances, performance

Crypto frauds on social media

1. Romance or friendship scams
2. Fraudulent platforms
3. DeFi hacks & rug pulls
4. Pump-and-dumps
5. Giveaway scams



Data: FTC Consumer Sentinel Database

Digital asset romance scams

Victims:



- All genders and sexual orientations.
- All ages, but tend to skew younger because of interest in crypto.
- Introduced via social media, dating apps, messaging apps.

Criminals:

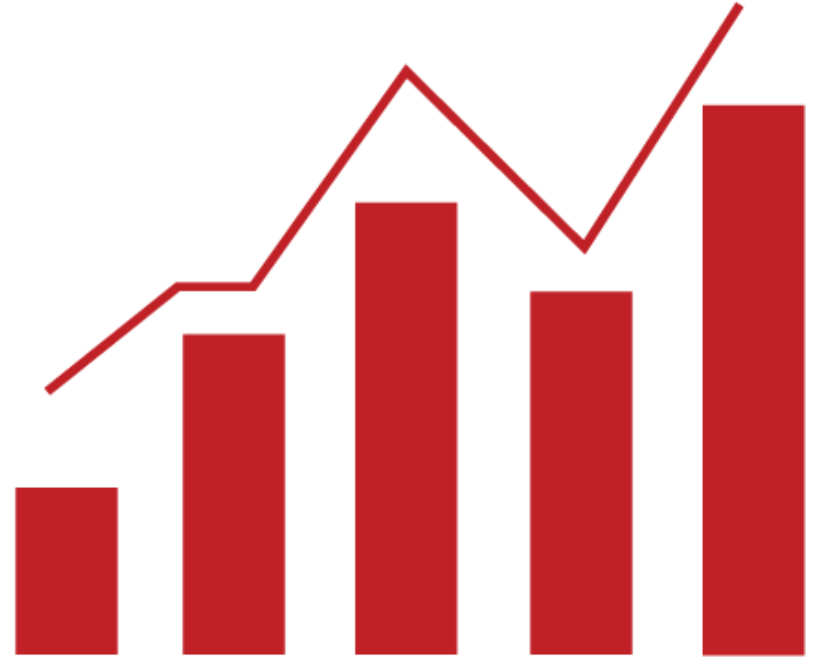
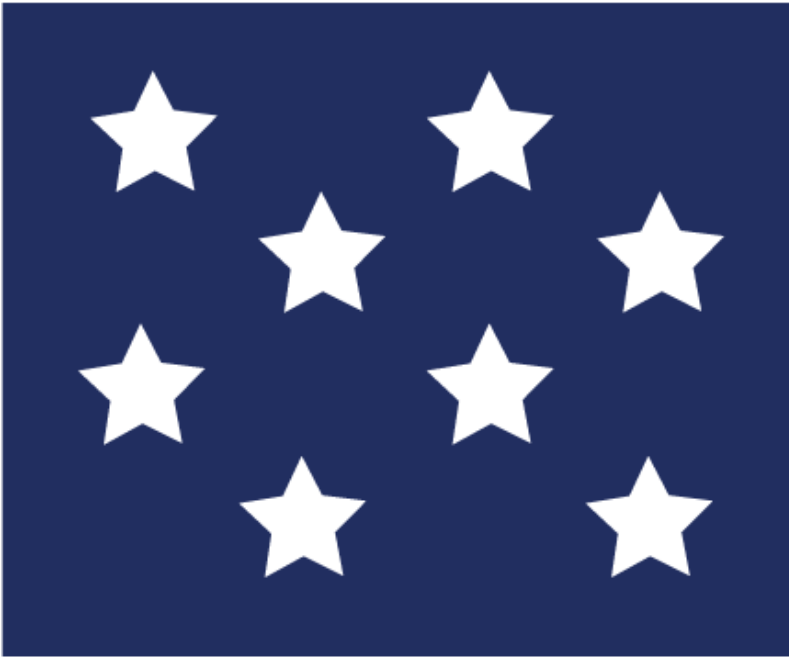


- May use extensive social media personas to support their stories.
- Pose as wealthy business owners or executives who travel frequently.
- Texts multiple times per day.
- Never meets in person.
- Making lots of money in crypto, while the rest of the market is going nowhere.

The scam:



- Soon after introduction, wants to move conversation to messaging app.
- Grooming can last several weeks or months.
- Starts talking about future together.
- Offers to teach you to trade.
- Victims are commonly encouraged to start small.
- Urgent opportunity!
- Can't make withdrawals.
- Nonresponsive websites, angry love interests, even blackmail and threats.



RESOURCES

Signs of a Fraudulent Site

- Centralized trading platform but no physical address
 - Offshore address
 - Fake address
 - Do a street-level map search
- No phone line for customer service
 - App phone numbers, live chat, email, “contact us” form
- Website’s age doesn’t match its claims
 - Look up domain registrations at lookup.icann.org
- Won tons of awards you’ve never heard of
- On-site testimonials
 - Search for third-party reviews: Site’s domain name + “scam,” “fraud,” or “reviews”
 - check scam detection websites
- Broken links, poor spelling and grammar

10 Signs of a Scam Crypto or Forex Trading Website

<https://www.cftc.gov/LearnAndProtect/Publication/index.htm>

Red Flags: Avoid ...

- ❗ Guaranteed, oversized returns.
- ❗ The more money you commit, the more you are guaranteed in return.
- ❗ Loan offers, excessive margin, or matching funds.
- ❗ Won't connect to your bank. Have to convert to digital assets on another platform.
- ❗ Invitations to trade or invest by someone you've met online.
- ❗ The company or adviser is not registered.
- ❗ Unable to withdraw your money.

Curious About Crypto? Watch Out for Red Flags

<https://www.cftc.gov/sites/default/files/2022-10/DigitalAssetRedFlags.pdf>

Verify claims and check registrations, but...

Registered ≠ safe

- Be sure the people or firms you trade with are registered with federal or state authorities.
 - most scams involve unregistered entities, people, and products.
- Relying on registration alone won't protect you from fraud.
 - Follow “know-your-customer” and anti-money-laundering paperwork requirements, and has U.S. location
- Learn more, visit cftc.gov/check.
 - For virtual currency, see if the platform is registered as a money service business with the Financial Crimes Enforcement Network (fincen.gov/msb-registrant-search) or with your state using the Nationwide Multistate Licensing System (csbs.org/nationwide-multistate-licensing-system).
 - For securities, broker/dealers, investment advisors, check brokercheck.finra.org and your state securities regulator.

Federal Government Resources

- CFTC Digital Asset resources:
<https://www.cftc.gov/digitalassets/index.htm>
- 14 Digital Asset Risks to Remember
<https://www.cftc.gov/sites/default/files/2022-09/DigitalAssetRisks.pdf>
- Curious About Crypto? Watch Out for Red Flags
<https://www.cftc.gov/sites/default/files/2022-09/DigitalAssetRedFlags.pdf>
- 10 Digital Asset Terms You Should Know
<https://www.cftc.gov/sites/default/files/2022-09/KeyTerms.pdf>
- MyMoney.gov – Dept. of Treasury
<https://www.mymoney.gov/flec-crypto-asset-recourses>
- Investor.gov – SEC, Crypto Assets
<https://www.investor.gov/additional-resources/spotlight/crypto-assets>
- FTC, What To Know About Cryptocurrency and Scams
<https://consumer.ftc.gov/articles/what-know-about-cryptocurrency-and-scams>
- IRS Digital Asset Resources
<https://www.irs.gov/businesses/small-businesses-self-employed/digital-assets>

Additional questions,
comments, connections...

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Thank you