

Financial Industry Regulatory Authority (FINRA) Issues Investor Alert Concerning Bitcoin Trading and Speculation

Article By:

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Bitcoin remains fixed on the front pages of the business and technology news for both the salacious and the positive. Much attention has been paid to the collapse of the former top bitcoin exchange, Mt. Gox, stemming from the purported theft of nearly \$500 million in bitcoins. The temporary suspension of trading in the securities of one technology company producing a mobile bitcoin platform, the venture capital investment in bitcoin-related startups, and the rash of cyberhacking incidents against digital wallet services have all been prominently featured in the press. In addition, the advent of alternative cryptocurrencies beyond bitcoin, the dubious discovery of mysterious bitcoin founder Satoshi Nakamoto, and the increased acceptance of bitcoin by major e-commerce sites have made the headlines as well.

Amid the news coverage, interest in bitcoin has grown, but so has the scrutiny.

On March 11, 2014, FINRA issued an Investor Alert to caution investors of the “significant risks” of buying and speculating in bitcoin and other digital currencies, as well as the risk of fraud and cybercrime related to online bitcoin exchanges and other bitcoin-related service providers.

Specifically, the alert outlines several risks surrounding the usage of and speculating in bitcoins, including:

- Bitcoin and other digital currencies are not legal tender and if the trust built up among individual users and businesses should vanish, bitcoins would be valueless.
- Online exchanges that allow users to buy and sell bitcoins and digital wallet services that allow users to store bitcoin are magnets for cyberthieves. Unlike banks that offer federal protections for depositors, there are no safeguards for bitcoins stored with service providers.
- Because bitcoin transactions are essentially anonymous, users must take extra care to avoid fraudsters posing as legitimate services. Importantly, a completed bitcoin transaction cannot be reversed and refunds are contingent on the willingness of the parties. The alert cautions that fraudulent schemes are not limited to the web – for instance, last year, the SEC brought

suit against the operator of a bitcoin-related Ponzi scheme and even issued its own Investor Alert about Ponzi schemes involving virtual currencies.

- Bitcoins have been used for illicit transactions and such activities could impact users and speculators if an online exchange or service is shut down by law enforcement.
- Bitcoin speculation, like any investment, brings financial risk. Price volatility has been bitcoin's hallmark in recent years, and there is no uniform value of bitcoin across the various exchanges. Moreover, outside events such as the collapse of an online exchange, a hacking incident of an e-wallet service or regulation imposed by a foreign government can dramatically affect the currency's value. As the alert states: "In short, bitcoin speculation is extremely risky."

State regulators have also taken note of the risks to investors and users of bitcoin. Notably, the FINRA alert comes on the heels of the New York Department of Financial Services [announcing](#) that it is accepting formal proposals to operate digital currency exchanges in New York in conjunction with the agency establishing its oversight of the nascent industry, as well as the Texas Securities Commissioner entering an Emergency Cease and Desist Order against a Texas energy exploration company that sought bitcoins from potential investors. The Texas State Securities Board also issued its own bitcoin Investor Alert.

Where is it all headed? Given the variable nature of bitcoin, it's hard to foresee the future. Still, many questions remain: How will state or federal regulation affect the bitcoin ecosystem in the coming year? Will volatility and data security lapses destroy confidence in bitcoin and chill speculation, or will bitcoin persevere and gain more legitimacy? Will bitcoin emerge as a standard payment option, remain a niche product, or otherwise become less interesting, but more predictable under new regulations?

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