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RISK ASSOCIATED WITH CRYPTOCURRENCY

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ABSTRACT:

Investors and the media are showing an increasing amount of interest in cryptocurrencies. Due to their additional advantages, including diversification and hedging potential, they are being seen as a new class of assets more often. Cryptocurrencies can still be dangerous investments, despite the fact that this does not exclude it. Numerous investigations at varying risk levels were conducted in this setting. Our chapter seeks to reconcile different views on risk across cryptocurrencies and fills up this gap. In particular, we offer a thorough analysis of the key risks that crypto traders should take into account, particularly the risks associated with technology, fraud, the law, markets, liquidity, and the COVID-19 epidemic. The primary conclusions demonstrate that every technological failure tends to increase people's uncertainty and mistrust about bitcoin technology.

Through fraud schemes and phoney trade volumes, this fact may be further tainted. The cryptocurrency's legal foundation is also still up for debate. There is a huge risk contagion across large-cap cryptocurrencies, making these crypto-assets riskier than fiat money in terms of market risk. Therefore, there is a strong correlation between market efficiency and liquidity in the context of cryptocurrencies since price movements might affect market liquidity. Ultimately, it becomes clear that the COVID-19 outbreak had a significant impact on the cryptocurrency markets. For investors, regulators, and policymakers, our chapter highlights current problems.

INTRODUTION:

Cryptography is used to safeguard transactions and regulate the formation of new units in cryptocurrencies, which are digital or virtual tokens. Furthermore, traditional currencies like US dollars or euros are frequently used to purchase cryptocurrencies, or "fiat" currency. On the other hand, cryptocurrencies like Bitcoin or Ethereum may also be used to purchase them.

The value of a cryptocurrency is unrelated on commitments made by a government or central bank, unlike the majority of traditional currencies like the US dollar. You don't have the same safeguards as a bank account if you store your Bitcoin online. Similar to how American bank accounts are protected, holdings in internet "wallets" are not.

The value of a cryptocurrency is subject to sudden and significant changes. Even if an investment can be worth thousands of dollars right now, it might only be worth a few hundred dollars tomorrow. There is no assurance that a value's decline will be followed by a subsequent increase.

Cryptocurrencies are not a risk-free investment due to their inherent characteristics. There are no guarantees, just as there are with any other investing opportunity. Nobody is able to promise that your investment will provide a profit. You should be wary of anyone who guarantees you a profit or return. A cryptocurrency is not necessarily a smart investment just because it is well-known or has celebrity endorsements.

To safeguard your cryptocurrency, heed the following advice:

Think before you jump! Make sure you comprehend a cryptocurrency's operation, potential applications, and exchange procedures before making an investment. To properly grasp a currency's operation, study its official website (such as those for Ethereum, Bitcoin, or Litecoin), as well as unbiased publications about the cryptocurrencies you are considering.

Make use of a reliable wallet. You'll need to conduct some study to select the best wallet for your requirements. You must maintain a degree of security appropriate to your investment if you decide to handle your cryptocurrency wallet using a local application on your computer or mobile device. Avoid using an obscure or less-known wallet to store your bitcoin, just as you wouldn't carry a million dollars around in a paper bag. Utilising a reliable wallet is something you should be careful of.

Establish a fallback plan. Consider what would happen if your laptop, smartphone, or other wallet-storing location were to be lost, stolen, or otherwise inaccessible. If you don't have a backup plan, you won't be able to recover your cryptocurrencies and you risk losing your money.

Typical risks faced by bitcoin investors include user risk, regulatory framework, and others.

User risk: A cryptocurrency transaction cannot be stopped or reversed after it has been transferred, unlike traditional money. Some estimates state that a fifth of all bitcoins are currently unavailable because of forgotten passwords or invalid transmitting addresses. It is a common danger that bitcoin investors face.

Risks related to regulation: Many countries are attempting to regulate cryptocurrencies as either securities, currencies, or both, although the status of some of them is still uncertain. The rapid implementation of new regulations might make it challenging to sell cryptocurrencies or result in a decline in market value.

Risks associated with third parties: To keep their cryptocurrencies, many investors and business owners use exchanges or other custodians. One may lose their entire investment if one of these third parties was to commit theft or suffer a loss. It is a common danger that bitcoin investors face.

Risks related to management: There are minimal safeguards against dishonest or unethical management practises because of the absence of comprehensive legislation. Because management teams couldn't provide a product, many investors lost a lot of money.

Due to the lack of government regulation over: cryptocurrency transactions as well as the lack of a data trail, or in the case of bitcoin transactions, the anonymity of the users on both sides of the transaction, it is vulnerable to illicit activity. Terrorists and criminals frequently use this feature of bitcoin. Numerous instances of hackers extorting bitcoins from victims have taken place. The majority of consumers discovered that their data had been lost in this assault even after complying with their requests. It is a common danger that bitcoin investors face.

Comparison to Ponzi schemes: Many experts have drawn parallels between this cryptocurrency and Ponzi schemes due to the operational difficulties and doubtful nature of this money. This comparison was made since there isn't enough information available on trading bitcoin. It is among the causes you ought to steer clear of cryptocurrency investments in 2023.

Unregulated: No organisation or authority has any control over cryptocurrencies. Banks or authority organisations regulate other investments like mutual funds, etc. If there are any errors with any transactions, we conduct using credit cards or bank accounts, we can contact the banks. Bitcoin transactions are not subject to the same rules. If defaults occur, it may put investors in a precarious position. One of the common hazards that bitcoin investors face is this one.

Security flaws with stablecoins:

When opposed to the significant volatility of unbacked crypto-assets, stablecoins offer perceived stability. They try to maintain a stable value with reference to a designated asset (usually US dollars) or basket of assets. However, because to differences in how they are pegged, the type of reserve assets (if any), and their governance structure, relative price stability may not be the case for all stablecoins. Typically, stablecoins are produced and distributed via trading platforms in return for fiat money. The fiat currency's revenues can be invested in reserves or other assets by the stablecoin's issuer.

However, some issuers don't seem to follow any standards when it comes to the make-up of the reserve assets backing the stablecoin, and there might not be a direct right of a user to redeem against the issuer or reserve. These factors all affect the composition and amount of the stablecoin's reserve assets. As a result, depending on how each stablecoin is designed, including its reserve assets and redemption rights, its risks may vary. Furthermore, there is a substantial concentration risk due to the fact that the two biggest stablecoins account for around 73% of the market capitalization.

Options for resolving the dangers of cryptocurrency:

The same goals that have supported the approach to trading finance for decades should also guide efforts to address the dangers posed by cryptocurrencies. These generally aim to:

(i) protect consumers and investors in a suitable manner;
(ii) defend market integrity from fraud, manipulation, money laundering, and the funding of terrorism; and
(iii) maintain financial stability. Maintaining the credibility of the monetary system is a crucial extra factor for central banks.

The question of monetary sovereignty has also grown urgent for many emerging market economies (EMEs). Residents have incentives to move assets into claims denominated in more stable currencies, particularly in nations with significant inflation risks and macroeconomic uncertainty. A practical method is stablecoins connected to well-known fiat currencies.

Three possible courses of action might be taken at a high level. These can be coupled in specific ways to reduce the dangers associated with cryptocurrency activities and are not mutually exclusive. According to Graph 2, they are to:

1. Ban certain cryptocurrency-related activities ("ban"),
2. confine cryptocurrency from TradFi and the actual economy ("contain"), and
3. govern the industry in a way that is similar to TradFi ("regulate").

The capacity to enforce any new rules, including ensuring that the necessary resources are available, is a vital factor to take into account when deciding which choices to pursue.

CONCLUSION:

The booms and busts in the market for crypto assets have been astounding, sometimes leaving investors with substantial losses. The conventional financial system and the actual economy have not yet been affected by these problems, but as DeFi and TradFi grow increasingly entwined, there is no guarantee that they won't in the future. As they endeavour to enhance the current monetary system in the public interest, authorities can now take into account a number of policy philosophies.

In light of the technical risk, every technological failure, like as network issues or the loss of private keys, among other things, has a tendency to increase people's sense of fear and mistrust towards the technology behind cryptocurrencies. Additionally, it is very possible that situations like exchange failures and hackers will occur. In order to control crypto-traders' wealth and reduce the danger of fraud and theft, crypto-exchanges frequently reveal wash trading volumes. The regulations imposed on the bitcoin sector were somewhat criticised in the literature. In reality, the legal system is still ambiguous, which shows that there isn't much transparency in this kind of market.

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