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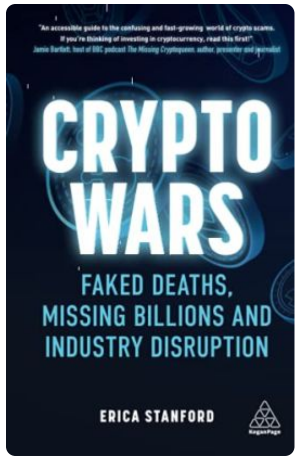

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Crypto Wars

Faked Deaths, Missing Billions and Industry Disruption

Erica Stanford • Kogan Page © 2021 • 264 pages

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Take-Aways

- Cryptocurrency is an innovation that made huge gains for early investors – but it quickly became a "Wild West" of deception.
- By 2019, people had lost billions of dollars to crypto "exit scams."
- OneCoin wasn't a real cryptocurrency, and its mysterious founder vanished.
- Bitconnect was a Ponzi scheme based on a trading bot.
- The biggest crypto fraud ever took place in Asia.
- "Cloud mining" became the next big thing in crypto.
- It's simple to manipulate minor cryptocurrencies' markets.
- Despite the scams, cryptocurrency is changing the world for the better.

Recommendation

After Bitcoin's advent, people conjured countless cryptocurrencies, which at their peak carried a value of more than $1 trillion. But scant regulation has led to scams and Ponzi schemes that have cost investors billions. Crypto expert Erica Stanford offers an enlightening look at some of these major frauds and scandals. Yet she's not anti-crypto: Stanford believes blockchain and the cryptocurrencies it enables are transformative technologies that will live long after the scams and swindles, helping those otherwise excluded from the financial system.

Summary

Cryptocurrency is an innovation that made huge gains for early investors – but it quickly became a "Wild West" of deception.

Cryptocurrency started out as an authentically radical technology. Bitcoin, the inaugural and still central cryptocurrency, also provided its early investors with mind-boggling returns. When Bitcoin launched in 2009, it was worth less than one cent; eight years later, one Bitcoin had a value of more than $1,000.

> *"The allure of easy money and the chance to get rich quick is always strong. For several thousand people, investing in already existing cryptocurrencies just wasn't enough. Many saw creating their own cryptocurrency as the quickest way to make money."*

By 2016, it wasn't difficult to launch a new cryptocurrency – the necessary code was open source, and enough people knew how to use it. This was especially the case if you didn't care whether you were doing something technologically significant or socially beneficial. Blockchain – the foundation for crypto, which provides a noncentralized, secure, transparent method of storing data and transmitting value – seemed as if it might disrupt both industry and finance. Launching a new cryptocurrency with an initial coin offering (ICO) became a new way to raise large amounts of money.

Many early ICOs were honest efforts to provide something useful and valuable – but a good number were scams. Initial public offerings (IPOs) are subject to regulatory scrutiny; at that time, ICOs weren't. People could raise millions, or even hundreds of millions, of dollars with little or no accountability and without even offering a clear product. Most of the ICOs that raised gigantic amounts of capital never did anything notable with the money. Some were outright frauds or Ponzi schemes, while others just didn't have a credible or realistic business plan. Almost none of them needed or provided a valid reason for using cryptocurrencies or blockchain.

By 2019, people had lost billions of dollars to crypto "exit scams."

An exit scam occurs when a sponsor of an ICO raises tens of millions in a cryptocurrency, cashes it in on an exchange – and then disappears. In 2018, at the height of the crypto bubble, a company called Savedroid raised $50 million and then promptly vanished. Soon after, however, the company's CEO returned and announced that the whole thing had been a prank meant to demonstrate how easy it was to scam investors in ICOs. Prank or not, investors ultimately lost their money.

People fall prey to exit scams out of a combination of hope and greed. A Vietnamese company, Modern Tech, issued an ICO for a cryptocurrency called PinCoin. It raised more than $600 million, despite the fact that transactions in cryptocurrency are illegal in Vietnam. Of course, Modern Tech assured investors that PinCoin's value would skyrocket, and, initially, investors got their promised returns. But eventually payment stopped, the platform disappeared and the founders fled the country.

> *"Exit scams have existed in other industries, but nowhere so predominantly as in the crypto space surrounding the 2017–18 ICO bubble."*

In the crypto bubble era, people who barely knew what a cryptocurrency was started opening "crypto exchanges" as an alternative to inventing a new cryptocurrency and launching an ICO. People would send their tokens and government-issued currency to an exchange without really checking the platform's security. Investors found the idea of storing their funds on these exchanges appealing, because it allowed them to immediately cash out the pumped-up coins or to invest in new ICOs that might offer massive profits. However, like ICOs, decentralized exchanges were often get-rich-quick schemes. Most were unregulated and had little built-in accountability – and thus served as perfect vehicles for exit scams.

OneCoin wasn't a real cryptocurrency, and its mysterious founder vanished.

Bitcoin was an entirely new kind of currency. Its value had nothing to do with central banks or governments; algorithms that neither politicians nor financiers could manipulate drove its worth. In 2014, the year Bitcoin's value reached $800, people began talking about a new cryptocurrency: OneCoin. OneCoin's founder, the charismatic Dr. Ruja, claimed that OneCoin would soon overtake Bitcoin and do things Bitcoin could never accomplish.

> *"[OneCoin] would be a new global currency that would democratize money, bring banking to the unbanked, change the financial markets and bring its investors wealth beyond their wildest dreams."*

By pairing crypto hype with a multilevel marketing (MLM) structure, Dr. Ruja and her associates raked in between $4 and $15 billion for OneCoin. Unlike other cryptocurrencies, however, investors couldn't exchange OneCoin for Bitcoin or fiat money. Indeed, the only items of potential value investors could get with OneCoin were plagiarized educational packages.

The FBI caught on to the OneCoin scam, partly because Dr. Ruja's lover became an informant. Nevertheless, she managed to disappear with a minimum of half a billion dollars. No one knows what happened to Dr. Ruja – the "cryptoqueen" – or to the money she and others stole from millions of investors. In the end, OneCoin wasn't a cryptocurrency at all but a pure scam, invented to both mislead its investors and fill them with hope.

Bitconnect was a Ponzi scheme based on a trading bot.

Bitconnect launched via an ICO in early 2016. At the time, it seemed like just another ICO, complete with anonymous founders and precious little information about what it was supposed to do. Initially, its website offered investors the chance to earn interest on coins purchased and held in a Bitconnect wallet.

> *"By early 2017, the Bitconnect website had been updated to say they had developed their own proprietary trading bot and volatility software, providing its users with a way to trade their money against Bitcoin."*

Soon Bitconnect added a new incentive: the ability to earn profits trading Bitconnect against Bitcoin. Those who used Bitconnect didn't have to engage in any trading activity themselves, however; they just had to lend their coins back to Bitconnect, and a proprietary bot would do the trading for them. Bitconnect promised investors a minimum 90% annual return on their lent coins; they would, however, have to "lock up" the coins for up to 299 days. It was never clear how this was all supposed to work, but no trader or investment banker can guarantee a return on an investment, much less one as high as the one Bitconnect promised.

As it turned out, Bitconnect wasn't making money on a brilliant trading bot; it profited from its MLM strategy, in which participants got substantial bonuses for bringing in new investors. Like OneCoin, Bitconnect was, in the end, little more than a classic pyramid scheme. Every level of the pyramid got a percentage of the investments gathered by the levels below it.

It didn't take long before people in the crypto community and law enforcement realized there was something seriously wrong with Bitconnect. In late 2017, the UK Companies House demanded that Bitconnect prove its legitimacy. In 2018, the states of Texas and North Carolina accused Bitconnect of illegal securities sales and eventually demanded it shut down operations. On January 15, 2018, Bitconnect's value crashed by almost 90%.

The biggest crypto fraud ever took place in Asia.

In 2018, at about the same time various crypto scams were going under in Europe, another massive crypto Ponzi scheme – PlusToken – was spreading across China and Asia. The scheme involved $7 billion in investors' money, with a valuation of $17 billion at its peak. PlusToken's crypto wallet and exchange first appeared in Chinese social media and spread across the region via messaging apps like WeChat. For an initial investment of only $500, PlusToken guaranteed an investor a 6% to 18% monthly return.

> *"Just as with OneCoin and Bitconnect, the organizers behind PlusToken knew how to draw crowds."*

PlusToken's organizers attracted people fascinated by the new buzzwords associated with cryptocurrencies, like "decentralized" and "blockchain," to lavish conferences. The organizers stated that they had developed an AI bot designed for "arbitrage trading" that would make money from price fluctuations in Bitcoin and various other cryptocurrencies. While they claimed the bot would earn profits for everyone who invested, they offered no warning about arbitrage trading's considerable risks. But then, they weren't seeking investors with significant crypto or market experience. PlusToken probably did provide the promised return on investment to some for a while – but it was never sustainable.

By June 2019, PlusToken investors were having trouble withdrawing their money, and soon they couldn't access their holdings at all. An unknown Korean man had purportedly founded PlusToken, so investors demanded South Korean authorities investigate. The Ponzi scheme soon became clear, and PlusToken's principals took off. As they were stealing the last of their investors' money, one founder embedded a message that read, "sorry we have run."

"Cloud mining" became the next big thing in crypto.

Bitcoin is grounded in a process called "mining." Bitcoin's enigmatic founder generated algorithms that people needed to solve to gain Bitcoins, but early Bitcoins weren't worth much, and individuals didn't seek them to become rich. It was easy to solve the algorithms. When Bitcoin's value rose and its use became more widespread, more people wanted to get involved. The computing power necessary to solve the algorithms, or to mine, rose dramatically.

> *"Cloud mining promised investors the chance to get cryptocurrencies mined for them, remotely, without them having to do any of the work or have to look after the machines themselves."*

Enter cloud mining. Cloud mining companies' pitch was simple: They would use their equipment for mining and pay passive profits to investors. The setup was yet another "crypto scam heaven." One such enterprise, BitClub Network, drew investors in with the promise that, for as little as $500, they would gain part ownership of a "mining pool" and thus access to a steady income stream. In truth, however, that company and others relied on MLM strategies to generate funds. Investors' money went primarily to paying commissions – both to sales and marketing staff and to investors who referred new people to the network. Eventually, a lack of fresh investors brought the Ponzi scheme down and, in 2020, authorities arrested the main leaders.

It's simple to manipulate minor cryptocurrencies' markets.

Small cryptocurrencies are volatile – their values soar and plummet. These dramatic fluctuations aren't random. They are often caused by a legal, if dubious, strategy called "pump and dump." If you place large enough buy orders for a cryptocurrency, you can raise its value dramatically. Similarly, if you place a sell order, even if it's artificial, you can drag down a currency's value.

> *"In a market so volatile that even individual traders could manipulate cryptocurrencies, organized, orchestrated group manipulations run by experts caused chaos."*

Many victims of such schemes were naive and inexperienced. Yet the majority of the pump-and-dump schemes in crypto occurred in full public view, fueled by well-known, influential people. One of the significant "influencers" for pump-and-dump schemes was John McAfee, founder of the McAfee anti-virus software, which had earned him hundreds of millions of dollars. McAfee used Twitter to manipulate cryptocurrency markets on the back of his renown as a tech guru, but eventually the law caught up to him – on his yacht. He was arrested and charged with committing fraud to the tune of tens of millions of dollars.

Despite the scams, cryptocurrency is changing the world for the better.

In the early 1990s, in Northern California, a group of "cyberpunks" arose that sought to defend people against state incursions.They didn't want the government involved in people's personal lives – and thus able to influence and manipulate them. In that context, in 2009, an unknown person who went by the name of Satoshi Nakamoto created Bitcoin and its algorithms, and in so doing, changed the way people look at money. The many scams and frauds connected to this innovation are secondary.

> *"Crypto, for the first time ever, makes it possible for anyone in the world to send and receive money from anyone else without needing to rely on any third party."*

Many people don't use banks, especially the billions living in poverty worldwide. Crypto makes participation in financial life possible for these individuals. Today, crypto is going global on a number of different levels. For instance, PayPal now accepts Bitcoin and other cryptocurrencies. Despite the scams, crypto has the potential to do a lot of good by providing ways of making payments outside the traditional financial system, from which many have been excluded for too long.

About the Author

Erica Stanford is the founder of the United Kingdom's top-rated crypto networking and events organization, the Crypto Curry Club, and she is a guest lecturer on the subject of cryptocurrencies at Warwick Business School.