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Bitcoin 'Pirate' scandal: SEC steps in amid allegations that the whole thing was a Ponzi scheme

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A digital pirate has captured Bitcoin investors' money

A suspected Ponzi scheme involving the online currency Bitcoin [has unravelled](#), and I can reveal that it has drawn the attention of the American Securities Exchange Commission (SEC).

Bitcoin is a libertarian's dream – and a government's nightmare. An [online, virtual currency created in 2008](#), it is unpoliced by any central authority, almost immune to money-laundering rules, and incredibly hard to track. It's a huge boon to those suspicious of governments or big banks, and has a legion of vocal advocates online, who love both the idea of an Austrian-economics inspired currency immune to meddling politicians, and the open-

source spirit of the cryptography software required to "mine" the currency.

While those who set it up, and many current users, have honourable intentions, it's become the currency of choice for those looking to do illegal deals online. Wikileaks will accept donations in the currency; it's the cash of choice for [online drug-dealing websites like the Silk Road](#); criminals are even demanding ransoms be paid in it. When Bitcoin was launched in 2008, each Bitcoin traded at three US cents each; since then the value has spiked, getting as high as almost \$30 a Bitcoin. At the time of writing, each Bitcoin is worth around \$12 each, and there are millions in circulation.

With so much money at stake, especially with so many users being computer hackers or criminals, it was inevitable that there would be theft. There have been [several disastrous hacks](#), with [Bitcoin "banks" being cleaned out online](#) and then shutting down overnight, leaving users nursing large losses. However, it is the most recent collapse of the so-called "Pirate" scheme that has drawn the attention of law enforcement agencies for the first time.

In November 2011, a user calling himself Pirateat40 launched a "Bitcoin Savings and Trust", which claimed to [allow users to invest their Bitcoins at an interest rate of seven per cent a week](#) – over 3,000 per cent a year. Much like the eponymous Charles Ponzi, originator of the Ponzi scheme, Pirate claimed to be offering such high returns by carrying out arbitrage – moving a commodity that is cheap in one territory to one where it is expensive. In the 1920s, Ponzi claimed he was using telegraphs to move postal coupons from Europe to the USA and making a killing; arguably, the only real difference between the two schemes is that Pirate claimed to be selling on Bitcoins at a profit locally, where they apparently traded at a premium.

With such a tempting rate, many people piled in – as many as 500,000 Bitcoins were sent to Pirate, giving [a value before interest of almost \\$7 million entering Bitcoin Savings and trust](#). That's around five per cent of the total Bitcoins in existence, [according to the most recent figures](#). Sadly, but predictably, on August 17 Pirate announced he was in default and, as the scheme unravelled, suspicions mounted that the whole thing had been a Ponzi scheme from the beginning.

Ultimately, most Ponzi schemes are affinity crimes – often fraudsters rely on trust of an ethnic or social group to sell their impossible returns. With Ponzi, it was fellow Italian Immigrants, with Madoff it was wealthy Americans, many of them Jewish. Ponzi is accused of exploiting the trusting libertarian world of open source hackers. If you look through the Bitcoin forums, many in the community had been vocal defenders of Pirate, explaining away his foibles like his inability to explain his incredible business model as a need to protect it from competitors copying his ideas. I heard exactly the same defences when researching Madoff for a film I made in 2009.

Just as the financial elites conned by Madoff were furious, there has been a huge amount of inchoate rage directed at Pirate. However, there's obviously a crucial difference: while Madoff's victims could seek legal redress, in the Wild West of the internet, trading virtual currencies, there is no such option. Or is there? On September 24, an email was sent by an SEC investigator called Philip Moustakis to many of those who had invested in Pirate's scheme.

The email (seen by the Telegraph) indicated that the SEC is launching an investigation into Bitcoin Savings and Loan. Last night the SEC declined to comment on whether they are investigating, but confirmed that the email carried a correct email address, correct telephone numbers and seemed entirely bona fide. I've since been in contact with several investors in Bitcoin who have confirmed that they have spoken to Mr Moustakis, who is a Senior Attorney in the Enforcement Division of the SEC, with a distinguished record in investigating Ponzi schemes.

What this means for Bitcoin in the long run is anyone's guess. The allegation that Pirate was running a Ponzi scheme dropped the value of the currency by almost 30 per cent. With a user base composed of libertarians and criminals, government involvement and investigation could do more damage than the fraud did in the first place.