Today's Digital Currencies Pose a Myriad of Significant Risks for Financial Institutions, According to a New GARP Report

New GARP Risk Institute (GRI) Primer Advises Risk Managers on Cryptocurrencies, Stablecoins, and CBDCs

JERSEY CITY, NJ, August 19, 2021 – A new report from the Global Association of Risk Professionals (GARP) advises risk managers on the background, function, and myriad of risks for financial institutions posed by top digital currencies. Authored by GARP Risk Institute (GRI) Co-President Mark Carey, the report serves as a primer on cryptocurrencies, stablecoins, and central bank digital currencies (CBDCs).

The report arrives at a time where digital currency values have been volatile, and cautionary flags are being raised with heightened scrutiny. For financial institutions, digital currencies also bring strong increases in reputational, legal, regulatory, cyber, and liquidity risks, as well as other key threats for investors.

"Risk managers should be alert to the risks that affect their portfolios and businesses, and should develop new ways to manage such risks," said Carey. "While many of the risks mentioned in this paper should be familiar to risk managers, other hazards — like risks to the continued existence of cryptocurrencies and stablecoins — are less familiar and deserve scrutiny going forward."

Some of the risks discussed include:

- **Cryptocurrency:** Financial institutions that provide crypto products and services usually depend on infrastructure providers to do some of the tasks that are needed. Examples include crypto exchanges and custodians. Until recently, infrastructure providers were unreliable and exposed financial institutions that used them to a lot of risk. Recently more reputable providers have entered the space, but they are still relatively untested so financial institutions must be very attentive to third-party risks.
- **Stablecoin:** Most stablecoin sponsors are unregulated. There have been instances of fraud at some, and some have been criticized for their management of reserves.
- **CBDC:** Most risks associated with CBDCs are borne by the central bank itself, but a financial institution might lose its investments in capacity to use a CBDC if the CBDC is not widely adopted.

According to the report, risks associated with digital currencies can be separated into five broad categories:

- risks borne by financial institutions that provide services related to digital currencies, most of which are risks familiar to financial risk managers – such as legal risk, third-party and counterparty risks (e.g., failures of infrastructure), and loss of liquidity in periods of stress
- investment risk, meaning risk of loss of value of the digital currency itself, which is borne by any investor in digital currencies
- risks borne by investors, such as ownership, quality of information, and their tax status as property
- risks to nonfinancial firms include unexpected costs of converting between crypto and national currency and potential new regulations on reporting
- loss of a financial institution's or nonfinancial firm's investment in its capacity to do business related to digital currencies.

To download and read the GRI's primer on digital currencies and their associated risks, please visit GARP's website.

About the Global Association of Risk Professionals

The Global Association of Risk Professionals is a non-partisan, not-for-profit membership organization focused on elevating the practice of risk management. GARP offers role-based risk certification – the Financial Risk Manager (FRM®) and Energy Risk Professional (ERP®) – as well as the Sustainability and Climate Risk (SCR®) Certificate and on-going educational opportunities through Continuing Professional Development. Through the GARP Benchmarking Initiative and GARP Risk Institute, GARP sponsors research in risk management and promotes collaboration among practitioners, academics, and regulators.

Founded in 1996, governed by a Board of Trustees, GARP is headquartered in Jersey City, NJ, with offices in London, Washington, D.C., Beijing, and Hong Kong. Find more information on garp.org or follow GARP on LinkedIn, Facebook, and Twitter.

Contact:
Louise Holden
Global Association of Risk Professionals (GARP)
press@garp.com