

# FMA Focus

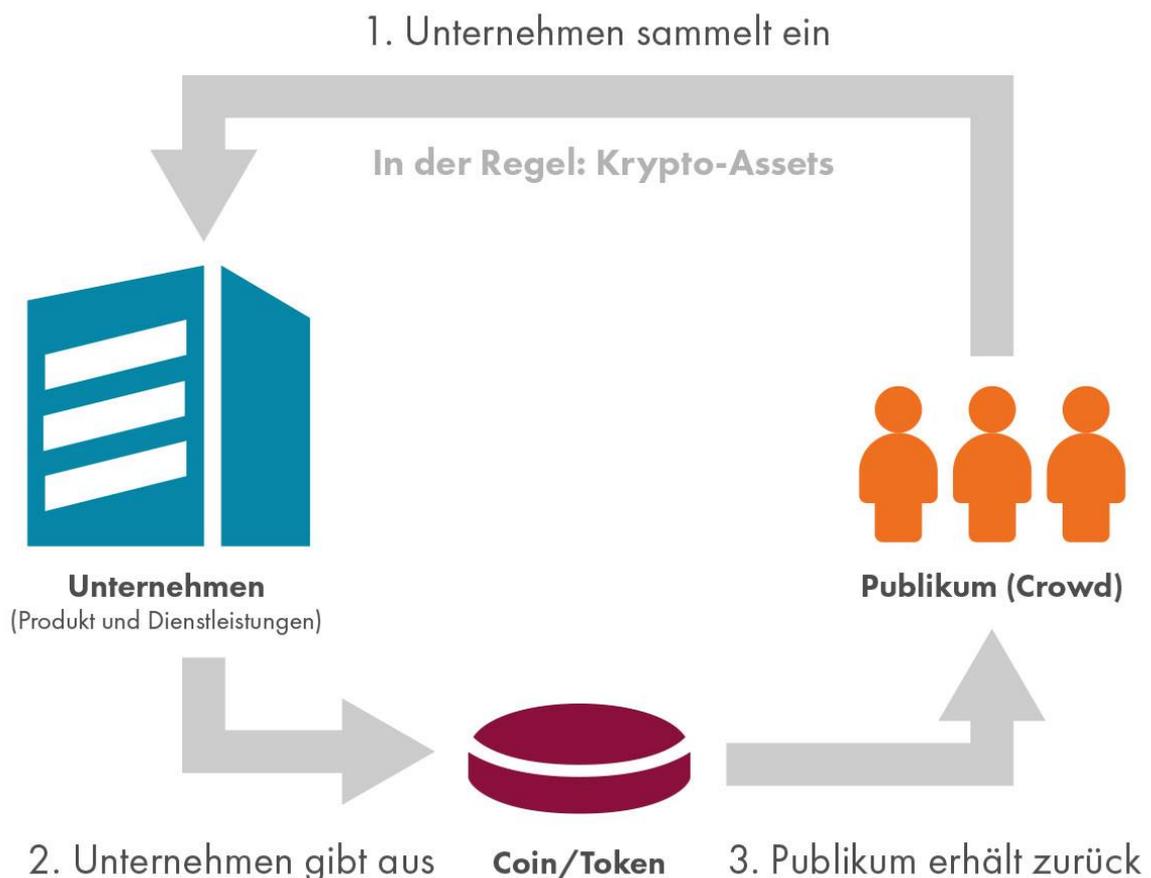
## Initial Coin Offerings (ICOs) from an investor protection perspective

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# INITIAL COIN OFFERINGS (ICOS) FROM AN INVESTOR PROTECTION PERSPECTIVE

## What is an ICO?

An ICO, as a rule, is a form of corporate or project financing based on the blockchain technology. During an ICO capital is usually collected in the form of specific crypto assets (Bitcoin, ETH or similar coins or tokens <https://www.fma.gv.at/en/glossary/coin-token/>). In return the capital providers receive a coin or token from the issuer who is connected to the company or project of the organiser of the ICO. The coin or token may also take the form of a shareholding in a company, frequently that of a start-up, or a claim to a promise in relation to profits to be realised in the future.



Generally ICOs constitute a highly speculative and commensurately risky financial transactions. The material risks associated with investments in an ICO for wholesale investors and consumers are listed.

## What is the purpose of a "Token" or a "Coin"?

These terms are often used as synonyms for one another or there is no differentiation made between them. Both are a type of digital “container”, which may embody a right or a claim. They may be equipped with different function as well as being technically differently designed. Where an already existing blockchain is used, then Token is more frequently used, whereas Coin is more frequently used in the case that a separate blockchain is used. Since in practice, however, the terms are used interchangeably, the FMA generally uses them synonymously.

**Investing in an ICO is generally associated with a high level of risk. It may also result in a total loss of the invested capital.**

## What risks may be associated with an ICO?

- **Uncertain prospects of success:** typically ICO projects are at a very early stage of development and their business models are experimental. It is uncertain whether the business idea will bring profits. The prospect of the ICO being financially success is therefore not guaranteed, and the development of the value of the investment is uncertain.
- **IT Risk:** the underlying technology (distributed ledger or blockchain) is usually relatively new and has not been adequately tested, and therefore might lead, not only for the project to be financed, but also for the technology used to problems (hacks, coding errors etc.)
- **Liquidity risk:** the possibility to trade or cash in the acquired Token on a platform, or to exchange it for a legal payment instrument, may be limited. Trading platforms are furthermore currently unregulated and are therefore not subject to the same strict transparency and trading regulations as say securities exchanges.
- **Increased Risk of Fraud:** Some companies may potentially not have the intention of using the collected funds or virtual currencies in the way that they promised they would be used.
- **Inadequate documentation:** ICOs as a rule only provide a "white paper". This "white paper" is not subject to any legal norms, and therefore may be incomplete or misleading.
- **Insufficient transparency:** investors as rule do not obtain any impression about the company or the development of the project. It is often necessary to have a complex technical comprehension to be able to understand the features and risks of the ICO in their entirety. No legal information obligations therefore exist, unless the offering falls

within the scope of the obligation to produce a prospectus under the Capital Market Act (KMG).

- **No investor protection:** there is no deposit guarantee scheme and no legal investor protection.
- **Lack of supervision:** ICOs are as a rule not subject to any kind of regulation or supervision. Consequently, legal enforcement may be significantly hindered to the extent of being rendered impossible.

Further information on this topic can be found in the FinTech Navigator:

<https://www.fma.gv.at/en/cross-sectoral-topics/fintech-navigator/>

## European Supervisory Authorities

The European Banking Authority (EBA) made consumers and supervisory authorities aware of the risks relating to the purchasing, holding or trading in virtual currencies in December 2013 and in July 2014 <https://www.eba.europa.eu/-/eba-warns-consumers-on-virtual-currencies>; <http://www.eba.europa.eu/-/eba-proposes-potential-regulatory-regime-for-virtual-currencies-but-also-advises-that-financial-institutions-should-not-buy-hold-or-sell-them-whilest-n>

In November 2017 the European Securities and Markets Authority (ESMA) issued a warning in relation to the high risks attached to Initial Coin Offerings (ICOs) <https://www.esma.europa.eu/press-news/esma-news/esma-highlights-ico-risks-investors-and-firms>

In February 2018 the EBA, ESMA and the European Insurance and Occupational Pensions Authority (EIOPA) issued a joint warning (as "the three European Supervisory Authorities", or "ESAs"). In this warning consumers are warned about the high risks that are associated with the purchase and/or holding of virtual currencies, (VCs) (<https://www.esma.europa.eu/press-news/esma-news/esas-warn-consumers-risks-in-buying-virtual-currencies>; <https://eiopa.europa.eu/Publications/Press%20Releases/ESAs%20warn%20consumers%20of%20risks%20in%20buying%20virtual%20currencies.pdf>)