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‘Initial Coin Offerings’ (ICOs)

Scope:

This communication addresses to offerors of ICOs and to consumers.

Summary/Objectives:

In this communication, the FSMA addresses both offerors of ICOs and consumers. It provides an overview of the legislation and regulations that may apply to offerors. In addition, the FSMA draws consumers’ attention to the risks associated with investments in ICOs and to signs that may point to fraud.

In 2017, more than 3 billion dollars in financing has been obtained worldwide by the sale of digital *tokens* (*Initial Coin Offerings* or ICOs¹). The FSMA has noted that the hype concerning ICOs, virtual currencies and blockchain technology can lead to speculative behaviour with only very limited attention to the underlying project and the risks associated with it. It is for this reason that the FSMA has decided to publish this communication.

In a sale of tokens, project developers offer digital tokens to the public via the internet as a way of funding the development of the project. During a set period, the tokens can be purchased via a website in exchange for a cryptocurrency² that is accepted by the developer. The characteristics of the tokens and the rights associated with them depend on the specific ICO.

The creation and offering of tokens is done via distributed ledger technology (DLT).³ The developers generally use ‘smart contracts’ and other functionalities made available, for example, on the Ethereum platform⁴. The characteristics of a token may be similar to:

- Investment instruments, given that they may provide rights, offer the prospects of revenues or returns, or involve a pooling of funds with a view to investment in tokens;
- A means of storage, calculation and exchange, given its convertibility into other tokens, cryptocurrencies or fiat money; and/or
- A utility token, given the access which the token provides to the product or service.

¹ Also known as (initial) token sales, coin sales or crowdsales.

² Also referred to as virtual money. The best known cryptocurrencies are Bitcoin and Ether (including Ether Classic), followed by Ripple, Litecoin, Dash, Nem, Neo, IOTA and Monero. It is estimated that there are more than a thousand such cryptocurrencies in circulation.

³ DLT is a decentralized, digital database that makes it possible to register and share transactions across a network. DLT uses what is known as ‘blockchain’ technology.

⁴ Ethereum is an open software platform based on blockchain technology in which developers can build and implement decentralized applications (“DApps”).

In light of the great variety of ICOs on offer, the status of tokens and the responsibility of the issuing entity under the current financial legislation and regulations are not entirely clear.⁵ [The European Securities and Markets Authority \(ESMA\) has published a statement alerting investors to the risks of ICOs.](#)

The FSMA, as a member of ESMA, fully endorses its statement. As regards ICO activity in Belgium, the FSMA wishes to emphasize the following points.

Points requiring the attention of issuers of ICOs: potentially applicable legislation

ESMA has determined, for now, that depending on how ICOs are structured, various financial regulations may apply to them, such as: the Prospectus Directive, Markets in Financial Instruments Directive (MiFID), Alternative Investment Fund Managers Directive (AIFMD), Market Abuse Regulation (MAR), Fourth Anti-Money Laundering Directive (AMLD4), etc.

It is possible that other rules may also apply, such as those governing accounting standards, tax obligations, electronic money, or prudential regulations.

In Belgium, the following legislation and regulations may apply in addition to the aforementioned European legislation:

- FSMA Regulation of 3 April 2014 on the ban on distribution of certain financial products to retail clients. This regulation forbids the professional distribution in Belgium to one or more retail clients of financial products of which the return is directly or indirectly dependent on a virtual currency.
- The Law of 16 June 2006 on public offers of investment instruments and on the admission of investment instruments to trading on regulated markets. This Law requires the preparation of a prospectus to be approved by the FSMA in the event of a public offering of investment instruments within the territory of Belgium, establishes a monopoly on intermediation for the placement of investment instruments within the territory of Belgium and determines that advertisements used in connection with the public offering must receive prior approval from the FSMA.
- Law of 18 December 2016 regulating the recognition and definition of crowdfunding and containing various provisions on finance: this Law sets out the conditions for authorization as a recognized alternative finance platform (that is, the financial form of crowdfunding) and the rules that apply to the providers of alternative finance service.

The application of the above rules depend on the way in which the ICO in question is structured, and this must be examined on a case-by-case basis.

⁵ The United States (SEC), United Kingdom (FCA), Singapore (MAS), Canada (CSA), Hong Kong (SFC) and Australia (ASIC), among others, have in the course of 2017 warned that some tokens are in fact investment instruments (and thus subject to the legislation that applies to the latter), while other tokens are not. Some countries (including China) have declared that cryptocurrency markets require authorization and are therefore operating illegally, and have taken measures to ban current trading activities in these products.

Points requiring the attention of investors: ICOs are complex, risky and unregulated, and investors are unprotected

Nearly every ICO is in a very early stage of development and begins with an idea, the creation of a website, the online publication of a “white paper”, the creation of tokens and the actual initial coin/token offering.

The white paper is an unregulated document. It sets out the project or idea and indicates how the funds collected will be used. It also describes the expected milestones and their timetable, in the event that the project has yet to be worked out in detail. Sometimes the white papers include the opinions of peers as to the feasibility of the project or the professional skills of the developers and other technical questions, or contains a legal opinion on the potential legal and tax aspects.

A not insignificant part of the white paper is an explanation of the price setting and the chosen sales method for the ICOs and on the policy to be followed as regards the tokens that remain in the hands of the developers.

The marketing of the ICO is done mainly via social media such as Instagram, Facebook, YouTube and Twitter, websites, chat rooms, specialized communities and on/offline events. Sometimes celebrities are invoked (with or without their knowledge) to give the project a certain momentum.

Specific points that participants in ICOs need to take into consideration are:

- Depending on their characteristics, ICOs may lie outside of any legal framework. In many cases, there is thus no protection for the consumer/investor.
- Their (potentially) unregulated and anonymous nature render ICOs susceptible to fraud and illicit practices (such as money laundering and terrorist financing).
- The generally summary, non-standardized, convoluted, subjective and unaudited information about ICOs makes it difficult to estimate the associated risks. Anyone who is not well acquainted with online technologies may find the technical and detailed information about an ICO incomprehensible.
- Start-ups are risky, and there is thus a realistic chance of loss of (part of) the capital invested in an ICO.
- Promotion takes place entirely digitally, and is usually complex. Many things can go wrong⁶, yet there is no recourse in the event of a dispute relating to a transaction. In other words, the consumer/investor is left entirely to his/her own devices.
- The value of an ICO is determined subjectively and arbitrarily by the developers.⁷
- There is no guarantee that the project will effectively go to market or that there is a market for that particular proposal.

⁶ The entire participation process is complex and may be difficult to understand for someone not well acquainted with the process of transactions in virtual currencies.

⁷ The price setting of tokens appears to be very sensitive to perceptions and rumours, and is therefore highly volatile. Traditional supply and demand factors or valuation models for financial assets are mostly not applicable to the valuation of ICOs.

- DLT – which underpins ICOs – is still in its infancy and still has flaws. One must be wary of **hacking** and **phishing**. These may occur in the course of the purchasing process or may target the application developed by the offerors.
- There are specific risks associated with cryptocurrencies.⁸ In the case of most ICOs, would-be participants must first acquire a cryptocurrency in order to be able to obtain tokens. If the price of the cryptocurrencies used should fall sharply, there is the risk that the developers will have insufficient funds to continue developing their project. In that case, the project may come to a halt, and the tokens could therefore lose their value.

ICO: Fraud and bad practices

Some ICOs are set up in order to defraud users and investors (scams or PonziCOs), and there are others that serve as examples of how not to do things.

The following signs may help to identify dubious ICOs:

- The white paper is of poor quality and has only limited information.
- Hype is created around the ICO (for example, with a very short period for the ICO, pushy advertisements, campaign by a celebrity). These are known as “pump and dump” ICOs.
- The token is positioned principally as an investment instrument, and for the time being the platform’s sole functionality platform is for secondary trading in the specific token.
- There are no background checks on the ICO participants.
- The developers are anonymous, the project is still only an idea rather than a product, and no external validation is available.
- There is no access to the smart contract or to the code or technical information about the token creation.
- The project does not use a decentralized network or a DLT application, and the ICO thus serves exclusively to raise funds.
- The project sets out unrealistic objectives (the amount of capital to be raised, for example, is disproportionate to the value that the project will create).

Should you have any suspicions about dubious ICOs being offered to the Belgian public, feel free to report it to the FSMA via our [consumer contact form](#).

⁸ See the warnings issued by the FSMA and the NBB in [2014](#) and [2015](#).