

STATEMENT

ESMA alerts investors to the high risks of *Initial Coin Offerings (ICOs)*

The European Securities and Markets Authority (ESMA) is alerting investors to the high risks of so-called ICOs. If you are considering investing in ICOs or have already done so, be aware of the many risks this may entail, including the total loss of your investment. In particular, be aware that you will have no protection in the case where the ICO is unregulated.

ESMA has observed a rapid growth in ICOs, which raise capital for enterprises, and is concerned that investors may not realise the high risks that they are taking when investing in ICOs.

ICOs are highly speculative investments. ICOs, depending on how they are structured, may fall outside of the [regulated space](#), in which case investors do not benefit from the protection that comes with regulated investments. ICOs are also vulnerable to fraud or illicit activities, owing to their anonymity and their capacity to raise large amounts of money in a short timeframe.

What are the main risks of investing in ICOs?

ESMA stresses that ICOs are extremely risky and highly speculative investments. Investors should realise that they are exposed to the following risks when investing in ICOs:

- **Unregulated space, vulnerable to fraud or illicit activities** – Depending on how they are structured, ICOs may not be captured by the existing rules and may fall outside of the regulated space. Some ICOs may be used for fraudulent or illicit activities, with several recent ICOs having been identified as frauds, while ESMA cannot exclude that some are being used for money laundering purposes. In the case where an ICO does not fall under the scope of EU laws and regulations, investors cannot benefit from the protection that these laws and regulations provide;
- **High risk of losing all of the invested capital** – The vast majority of ICOs are launched by businesses that are at a very early stage of development. Those businesses have an inherently high risk of failure. Many of the coins or tokens that are being issued have no intrinsic value other than the possibility to use them to access or use a service/product that is to be developed by the issuer. There is no guarantee that the services/products will be successfully developed and, even assuming that the project is successful, any eventual benefit may be extremely low relative to the invested capital;

- **Lack of exit options and extreme price volatility** – Investors may not be able to trade their coins or tokens or to exchange them for traditional currencies, such as the Euro. Not all the coins or tokens are traded on virtual currency exchanges and when they are, like virtual currencies, their price may be extremely volatile. Many of those exchanges are unregulated and vulnerable to market price manipulation and fraudulent activities. Investors may be exposed to the lack of exit options or not be able to redeem their coin or token for a prolonged period;
- **Inadequate information** – The information that is made available to investors, e.g. in so-called *white papers*, is in most cases unaudited, incomplete, unbalanced or even misleading. It typically puts the emphasis on the potential benefits but not the risks. It is technical and not easily comprehensible. Investors may therefore not understand the risks that they are taking and make investments that are not appropriate to their needs; and
- **Flaws in the technology** – The distributed ledger or blockchain technology that underpins the coins or tokens is still largely untested. There may be flaws in the code or programs that are used to create, transfer or store the coins or tokens. Investors may not be able to access or control their coins or tokens, or the coins or tokens may be stolen, e.g., in case of a hack. More generally, the technology may not function quickly and securely, e.g. during peaks of activity.

What is an ICO?

An ICO is an innovative way of raising money from the public, using *coins* or *tokens*. An ICO can also be referred to as an *initial token offering* or *token sale*. In an ICO, a business or individual issues coins or tokens and puts them for sale in exchange of traditional currencies, such as the Euro, or more often virtual currencies, e.g. Bitcoin or Ether.

The features and purpose of the coins or tokens vary across ICOs. Some coins or tokens serve to access or purchase a service or product that the issuer develops using the proceeds of the ICO. Others provide voting rights or a share in the future revenues of the issuing venture. Some have no tangible value. Some coins or tokens are traded and/or may be exchanged for traditional or virtual currencies at specialised coin exchanges after issuance.

ICO campaigns are conducted online, using the Internet and social media. The coins or tokens are typically created and disseminated using distributed ledger or blockchain technology (DLT). ICOs are used to raise funds for a variety of projects, including but not limited to businesses leveraging on DLT. Virtually anyone who has access to the Internet can participate in an ICO.