

22 November 2017

**The KNF's statement on selling so-called coins or tokens
(Initial Token Offerings – ITOs or Initial Coin Offerings – ICOs)**

The KNF – Polish Financial Supervision Authority is recently observing sudden increase of the phenomenon called Initial Token Offerings (ITOs) or Initial Coin Offerings (ICOs) (hereinafter jointly called: ICOs) which consists in obtaining funds in order to finance particular projects. Numerous of such offers come from outside Poland or even European Union.

The KNF informs that investing in tokens, as part of ICOs, is highly hazardous.

Realization of such ventures is done by means of new technologies. Entities realizing ICOs make use of the Internet and social media in order to gain funds. Famous persons (sport or show-business representatives) are more and more frequently engaged in promoting particular ICOs investment offers in order to make them more reliable. It shall be underlined that activities concerning ICOs may potentially be subject to numerous legal requirements, including drawing up a prospectus and a public offer, establishing and managing alternative investment funds and investor protection. However, each case shall be assessed on an individual basis.

Therefore, the KNF would like potential investors, as well as entities interested in offering such products, to pay attention to specific and meaningful risks connected with ICOs. Potential buyers shall be especially aware of the possibility of losing all capital invested and possible lack of legal protection.

What are ICOs?

ICOs are a new method of gaining funds in a public way, with the use of so-called tokens or coins (hereinafter jointly called: tokens). By the purchase of a token, its buyer receives particular entitlements. Each and every ICO may differ with respect to its parameters and rights associated with it, which means that entitlements associated with buying a particular token are not standardised. Frequently a token resembles a voucher, since the value offered at its acquisition by its issuer is a product or a service offered by him. Creation or development of a product or a service shall be ensured by funds obtained from ICOs. Some tokens give rights concerning enterprises, which reflect the shareholder's rights such as dividends or voting rights. It may happen that they do not represent goods of material value.

Funds obtained from ICOs by entities organising them are also not uniform. The most frequent phenomenon is lack of direct transfer of funds for tokens. In most cases products in the scope of ICOs are bought for a particular virtual/crypto "currency" (e.g. Bitcoin, Ether).

Campaigns aimed at promoting the sale of tokens are done in the Internet and any person having access to the Internet may buy them. Frequently organisation of secondary trading for tokens which may be sold on dedicated trading platforms takes place.

Tokens are created and distributed by means of so-called Distributed Ledger Technology (DLT).

Risks associated with investments in ICOs

Investors who consider investing in ICOs are therefore exposed to the following risks:

- **Unregulated area, prone to frauds and other irregularities**
Depending on the structure, ICOs may function outside the applicable regulations concerning financial market or may be offered without a required authorisation, and therefore their buyers may be deprived of proper legal protection. ICOs, being a new phenomenon encumbered with legal uncertainty resulting from their innovativeness, attract persons or entities acting on the financial market without required authorisation. Such persons or entities may have dishonest intentions towards investors. Some of the recent ICOs have been qualified as frauds. Taking into consideration lack of guarantees resulting from particular regulations, investors shall be very well oriented as to the status of an entity offering tokens, as well as the content and effects of an agreement they sign when buying tokens. One cannot exclude that some of ICOs are conducted in order to legalize funds stemming from illegal or unrevealed sources.
- **High risk of loss of some or all of the invested funds**
Most of ICOs concern relatively young ventures. Therefore, significant risk of failure may be associated with them. Frequently a token does not represent other value than receiving entitlement to obtain a particular product or service from its issuer. One should be aware of the lack of guarantee whether such a product or service is indeed delivered. It may also happen that, despite the project being successful, the benefit received will be of minor value compared to the capital invested and risk associated.
- **Lack of information, inadequate documentation**
Information given to potential investors in so-called white papers may have not been audited properly or may be unreliable, partial or misleading. Usually such documents underline potential benefits, and remain silent on the risks. Way of presentation may be improper and almost impossible to understand without advanced technical and economical knowledge. Inability to understand the risks connected with an investment prevents from stating whether a particular investment is in fact adjusted to the buyer's investment needs.
- **No possibility to "exit" the investment and extremely high volatility of its value**
Trading in tokens or their exchange into national currencies may be subject to limitations. Not all tokens are traded on virtual "currencies" trading platforms. It means that their buyers may not have the possibility to sell them in order to recover the invested funds. However, even if a token is listed on a trading platform, its rate may be subject to significant volatility. Numerous of such trading platforms are unregulated and prone to price manipulation or other fraudulent practices. Therefore

the tokens' buyers may have, for a longer period of time, limited possibility to sell them at fair value.

- **Flaws of technology used**

Technology used to create and disseminate tokens (DLT/Blockchain) and its implementation is not tested well enough. Codes and programs used to create, keep and transfer tokens may include faults, as a result of which their buyers may not have access to or may not control the tokens owned. What is more tokens, taking into consideration lack of proper cyber-protection, may be stolen e.g. as a result of a hackers' attack. Sound and safe functioning of technologies may also be problematic when intensive activity of its members in the network created with the use of DLT/Blockchain occurs.

Additionally, the KNF asks the entities willing to organise ICOs to pay attention to the fact that they should first comprehensively analyse all legal aspects associated with such projects.

The above mentioned means the necessity to establish whether the proposed activity in the sphere of ICOs is connected with a need to obtain a particular authorisation. The KNF reminds that conducting activity without appropriate authorisation required by the laws regulating financial market is subject to criminal penalty. In case of doubts concerning assessment of activity or necessity of being subject to legal requirements, entities offering ICOs may ask the KNF's Office for information. The KNF's Office, aiming at ensuring stable and safe development of financial innovations, may then analyse a particular case.

Moreover, the KNF informs that on 13 November 2017 the European Securities and Markets Authority (ESMA) issued two statements concerning ICOs, directed to potential investors and entities interested in organising ICOs. Warnings are available in English at the following websites:

https://www.esma.europa.eu/sites/default/files/library/esma50-157-829_ico_statement_investors.pdf

https://www.esma.europa.eu/sites/default/files/library/esma50-157-828_ico_statement_firms.pdf

The KNF supports the ESMA's standpoint, as well as the Authority's steps aimed at protecting the market against threats connected with this phenomenon.

The KNF points out that warnings or statements on ICOs were also issued by supervisory authorities from other jurisdictions, including: USA, Canada, Brazil, Australia, Singapore, Hong Kong, Japan, China, United Kingdom, Germany, France, Switzerland, Belgium and the Netherlands.