Customer Advisory: Use Caution When Buying Digital Coins or Tokens

The Commodity Futures Trading Commission (CFTC) is alerting customers to exercise caution and conduct extensive research before purchasing digital coins or tokens, including those self-described as "utility coins" or "consumption coins." Understand what rights are attached to the coin or token being sold, and what underlying factors could affect its value. Be especially wary of promises or guarantees of future value.

The market for digital coins and tokens is still very young, and there is no widely-accepted standard for placing a value on a particular digital coin or token. This includes coins or tokens sold today with the claim that they can be used to purchase goods, services, or platform access in the future.

Hundreds of different digital coins are being sold for a wide variety of peer-to-peer applications, software platforms, or networks that promise to provide the public with goods and services. These businesses, many still in the proposal stage, may use funds from coin sales to start or grow their ventures. Commonly, a company will also require that its digital coins or tokens be redeemed to purchase its product or service. Even future customers would need to purchase and redeem the digital tokens for access. These offerings may contend that if the product, service, or network becomes more popular, then the digital tokens may increase in value due to a "network effect" and could be sold to other buyers for a profit.

Depending on the facts and circumstances, if initial buyers are told that the developers or promoters will bring them a return on their investments, or if the buyers are promised a share of future returns of the project, the digital coins may be securities and the offer and sale would be subject to federal securities laws.[2] Digital tokens and coins can also be derivatives or commodities, depending on how they are structured.

Many Initial Coin Offerings End in Fraud or Failure

Several studies and news reports indicate that a large number of Initial Coin Offerings (ICOs) are fraudulent or the underlying products or services fail to live up to their promises. Estimates of fraud range from 5 percent to more than 80 percent of ICOs. One report also identified nearly 300 offers that contained plagiarized investment documents, promises of guaranteed returns or fake executive teams.

Another report indicates that after one year from their ICO, nearly half of the projects or companies have failed or shut down.[1]

[1] See generally Buyer Beware: Hundreds of Bitcoin Wannabes Show Hallmarks of Fraud, Wall Street Journal, May 17, 2018; Crypto Coin Graveyard Fills Up Fast as ICOs Meet Their Demise, Bloomberg, June 28, 2018.
[2] See Investor Bulletin: Initial Coin Offerings, U.S. Securities and Exchange Commission, 2017.

Many Factors Can Impact Future Value

If you are considering the purchase of a digital coin or token, it is important to weigh factors that could impact its current or longer-term value, including:

- The potential for forks in open-source applications that could split away market participants, increase the number of digital coins, or make your coins obsolete.
- Decreasing mining or validation costs (if price is tied to those factors).
- Acceptance of other currencies, coins, or tokens for offered goods and services.
- The link between the value of a digital coin or token and the offered product or service.
- Adoption of the digital coin or token as a broad medium of exchange or store of value.
- Future competitors or technological changes that could disrupt the underlying business.
- Future demand or uses for an application, network, product, or service.
- Liquidity in the market for a specific digital coin or token.
- Changes to the underlying technology that could devalue your digital coins or tokens.
- Risk of theft from hacking.

Protect Yourself

Buying digital coins or tokens only because you expect to sell them at a higher price later is the definition of speculation and carries considerable risk, regardless of how good a white paper, application or business plan sounds. Unfortunately, **fraud** is another significant risk to consider. Your best protection is to thoroughly research digital coins or tokens and exercise caution.

Remember:

- Conduct extensive due diligence on any individuals and entities listed as affiliates of a digital coin or token offering. Are they participating in the coin offering? If you can't easily find information about affiliated entities or individuals, that should be a red flag.
- Before investing in an ICO, ask whether the digital coins or tokens are securities and if the offering is registered with the Securities and Exchange Commission (SEC).[3]
- Find out how your money will be used, if you can get it back, and what rights the digital coin or token provides you. These rights should be clearly spelled out in the business plan, white paper or development plan. Make and keep copies of this information.
- Many ICOs have been identified as frauds. If fraud or theft occurs, you may not be able to get your money back. You can report fraud at **CFTC.gov/TipOrComplaint.** Beware promises of quick wealth or guaranteed returns. There is no such thing as a guaranteed investment or trading strategy.

For more information about virtual currencies, including podcasts, primers, advisories and more, visit **CFTC.gov/Bitcoin**.

[3] If an offering is registered, you can find information (such as a registration statement or "Form S-1") on SEC.gov through EDGAR. Those selling digital coins or tokens also may need to have licenses or registrations.