

Initial Coin Offering

What is the issue?

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- Globally, there has been a silent boom in ICO fund-raising, with much of the action focussed on Europe and North America.
- With global regulators issuing warnings about this sprawling market, it is essential to understand its working and the risks associated with it.

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What is an Initial Coin Offering (ICO)?

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 An Initial Coin Offering (ICO) is used by the startups to bypass the rigorous and regulated capital-raising process required by venture capitalists or banks.

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 \bullet More accurately known as <u>token sales</u>, ICOs are unregulated means of raising money from public investors, to finance a startup. \n

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How does it work?

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• When a startup firm wants to raise money through an Initial Coin Offering (ICO), it usually creates a plan on a whitepaper.

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• It specifies the following:

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i. what the project is about

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 $\mbox{ii.}$ what need(s) the project will fulfil upon completion

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iii. how much money is needed to undertake the venture

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iv. how much of the virtual tokens the pioneers of the project will keep for themselves

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 $\boldsymbol{v}.$ what type of money is accepted

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vi. how long the ICO campaign will run for

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• During the ICO campaign, interested public investors buy some of the distributed cryptocoins with fiat or virtual currency.

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• These coins are referred to as 'tokens'.

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• These are much similar to shares of a company sold to investors in an Initial Public Offering (IPO) transaction.

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What are the different kinds?

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Two kinds of ICOs are active in the market.

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• One type raises money to fund a new virtual currency or blockchain project that aims to reflect the success of the Bitcoin or Ether.

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• These ICOs are attractive with the fact that the tokens can be exchanged for the new virtual currency, once it takes off.

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• The other set of ICOs simply raise money to <u>fund tech startups</u>.

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• Simply, a percentage of the cryptocurrency is sold to early supporters of the project.

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• This is in exchange for legal tender or other cryptocurrencies, but usually for Bitcoin.

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- It represents an informal ownership share in the business they fund.
- \bullet The expectation is that the tokens will appreciate in value with the underlying business. $\mbox{\sc h}$

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How is it different from the IPOs?

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• Essentially, while IPOs deal with investors, ICOs deal with supporters that are keen to invest in a new project.

• The word 'informal' is key to understanding the concept of ICOs.

• In an IPO, the rights in the case of shares bought are legally protected by the elaborate securities market regulations.

• On the other hand, the <u>legal status</u> of ICO 'tokens' is uncertain because many countries, including India, haven't yet framed any regulations in this regard.

 Also, companies that raise money through IPOs are required to file and get approval for a detailed prospectus from regulators.

• They are also required to provide ongoing <u>disclosures to investors</u>.

• ICOs, however, evade all these rules and simply issue a white paper sketching out business plans.

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What is the concern?

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- One of the reasons for the recent interest in ICOs is certainly the multifold rise in prices of virtual currencies such as bitcoins.
- India is also seeing a spell of startup action around the virtual currency and blockchain ecosystem.
- However, the regulatory status of ICOs is not firmly established in India.

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- The RBI has warned investors of the risks of experimenting in virtual currencies and is considering regulating crytocurrencies.
- \bullet On the other hand, SEBI is yet to express its official views on ICOs. $\mbox{\sc h}$
- Notably, even SEBI's global counterparts are still grappling with the issue of whether to treat digital tokens as 'securities'.
- Given the absence of any kind of regulatory framework in place, venturing into ICOs would be risky for the public investors.
- \bullet Notably, funds that are lost due to fraudulent initiatives may not be recoverable. $\ensuremath{^{\text{h}}}$

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Source: BusinessLine

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