SEC Issues Investor Alert to Warn Investors About ICO-Related Claims

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Banking + Financial Services, Emerging Companies + Venture Capital, Financial Technology, Financial Transactions, Private Equity Funds, and Technology Transactions

Client Alert

On August 28, 2017, only slightly more than one month after the United States Securities and Exchange Commission (the "SEC") issued formal guidance regarding token offerings [1] [2] (including an investor bulletin on token offerings as part of its investor education and investor protection mission (the "Investor Bulletin")), [3] the SEC spoke again–this time releasing an investor alert (the "Investor Alert") to warn investors about public companies making token offering-related claims. [4]

Citing a wave of recent temporary trading suspensions, the SEC’s Office of Investor Education and Advocacy warned investors about “potential scams involving stock of companies claiming to be related to, or asserting they are engaging in, Initial Coin Offerings (or ICOs). Fraudsters often try to use the lure of new and emerging technologies to convince potential victims to invest their money in scams. These frauds include ‘pump-and-dump’ and market manipulation schemes involving publicly traded companies that claim to provide exposure to these new technologies.”

The Investor Alert specifically mentioned four companies that have been affected by the SEC’s recent temporary trading suspensions. One of them, First Bitcoin Capital Corp. (“BITCF”) is a Canadian corporation. On August 24, 2017–the same day on which the Canadian Securities Administrators (“CSA”), an organization comprised of Canada’s provincial and territorial securities regulators, released Staff Notice 46-307 Cryptocurrency Offerings (the “CSA Notice”), addressing how Canadian securities laws may apply to cryptocurrency [5] offerings, investment funds and exchanges [6] that trade such products [7]–the SEC temporarily suspended trading in the securities of BITCF due to concerns about “the accuracy and adequacy of publicly available information about the company including, among other things, the value of BITCF’s assets and its capital structure.” [8]

Some have asked why the SEC chose to release the Investor Alert on Monday. While the answer is unclear, some may point to the sheer number of token offerings that have been launched or are planned, or the estimates by some that, as of August 25, 2017, nearly $1.8 billion had been raised via token offering. [9] Others may note that the dangers that “pump-and-dump” and market manipulation schemes pose to investors, especially unsophisticated investors, are reason enough to issue such an Investor Alert educating investors about how to recognize certain potential scams.

It is interesting to consider, however, whether the SEC’s Investor Alert may have been motivated in part by something else that was issued on August 24, 2017: BITCF’s letter to its shareholders, commenting on the SEC’s temporary suspension (the “BITCF Letter”). [10]

In the BITCF Letter, BITCF characterized the SEC’s actions as likely being based on a misunderstanding and constituting “drastic actions.” Specifically, BITCF said, “We believe that there is likely a misunderstanding or a simple clarification necessary and that it would have been better for the SEC to ask us for this information before taking such drastic action. In fact, the SEC was so hurried in stopping trading that they inadvertently left in the symbol of another company (CIAU) as if
our symbol which has nothing to do with BITCF. In the unrelated case of CIAU we applaud the SEC for that suspension and that of two other so-called cryptocurrency companies that were either mimicking BITCF for publicity or were obvious scams. There are many more quickly emerging and we hope the SEC will move against those more rapidly."

The BITCF Letter also suggested that the SEC’s suspension may have resulted from “the need to diminish the extraordinary demand for shares that have increased more than 24,000 percent in the 12 months–according to the Dow news release.” In addition, BITCF asserted that investigations by law firms with respect to potential securities law violations by companies whose shares temporarily are suspended from trading “mostly result in no action taken and are often intended for publicity and finding new clients.”

Could it be that the SEC’s Investor Alert was released, in part, to combat communications, like the BITCF Letter, that seek to minimize the gravity of a temporary trading suspension? Perhaps.

In any event, the SEC’s release of the Investor Alert on the heels of the Investor Bulletin suggests that the SEC is closely monitoring the token offering market, and that it wants investors—and issuers—to be aware that it is watching.

[1] The term “token offering” refers to initial token offerings (ITOs), token launches, token sales and initial coin offerings, a new capital-raising method being explored by issuers and others hoping to raise significant amounts of money from a broad base of potential participants.


[5] The CSA Notice explains, “Cryptocurrency may also be referred to as virtual or digital currency, among other terms. ICOs and ITOs may also be referred to as token generation events (TGE), among other terms.”

[6] The CSA Notice clarifies that the term “exchange” “used in this context is not intended to be the same as the term used in National Instrument 21-101 Marketplace Operation and securities legislation of the jurisdictions of Canada, but instead reflects what these entities are commonly referred to [as] today.”

[7] The CSA Notice states that it was being published in all of the jurisdictions of Canada except Saskatchewan. The CSA Notice specifies that the Financial and Consumer Affairs Authority of Saskatchewan will advise of its approach in this matter after the provincial by-election in Saskatchewan on September 7, 2017.

