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Launching an ICO? Follow This Advice from the SEC

Lost in the headlines over the SEC's recent pronouncements on cryptocurrency was important practical advice for both promoters of and participants in initial coin offerings (ICOs).

Most coverage was rightfully garnered from the [Report](#) by the SEC's enforcement division which deemed that DAO Tokens are securities, after subjecting the offering to the Howey test. However, the simultaneously issued [Investor Bulletin](#) should also be closely read by issuers of ICOs and their counsel.

Advice for Issuers and Counsel

Even though the bulletin was prepared as a cautionary statement to investors, it contains at least one disclaimer (in boldface type) that attorneys advising ICOs should add the following language to any offering document or white paper:

Investing in an ICO may limit your recovery in the event of fraud or theft. While you may have rights under the federal securities laws, your ability to recover may be significantly limited.

We have previously discussed the [importance of these disclaimers and risk factors](#). By discussing the vulnerabilities of cryptocurrency exchanges and the potential difficulties associated with any recovery of invested or stolen funds, the SEC signals at least some of the risk factors counsel should consider adding to ICO offering materials.

In fact, prudent attorneys advising their ICO clients would be wise to employ the cut-and-paste function, adding the above caveat to all their documents.

This additional wording is significant in that it spells out three key characteristics of ICOs:

(i) the difficulty of tracing or securing virtual currency;

- (ii) the international scope of ICOs; and
- (iii) the fact that lack of any central authority may limit an investor's remedies against an issuer.

Practical Advice for Investors

Besides the usual bromides about being wary of any offer that sounds "too good to be true," the SEC demonstrated an appreciation for the unique due diligence required in carefully evaluating an ICO.

According to the bulletin, investors should "ask whether the blockchain is open and public, whether the code has been published, and whether there has been an independent cybersecurity audit." The SEC is communicating that those factors are indicative of companies whose products are verifiably real and secure.

Given the importance the SEC placed on these three items, rather than await questions, such points should be clearly addressed by an issuer in its ICO materials distributed to potential investors. Issuers of ICOs should include those factors and other "good facts" that can help to demonstrate their product's value, security and legitimacy.

While the recent flurry of documents emanating from the SEC likely has given issuers of ICOs and their counsel pause (and caused them to walk each token through the Howey test), it does not appear to have stifled these transactions.

However, where the report reiterates the conceptual framework under which any potential token offering be evaluated to determine whether it constitutes a securities offering, the bulletin provides practical advice, and investors should expect to see some of the SEC's language repeated in ICO offering documents going forward.

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