

## CSSF Warnings on ICOs, Tokens and Cryptocurrencies

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Fintech leads the way in the rapidly changing world of financial services, and the industry is keen to position Luxembourg as an innovation hub. Among the cognoscenti, buzzwords such as blockchain, initial coin offerings, tokens and cryptocurrencies are being used to encapsulate new ways of doing business and demonstrate market leadership, but such enthusiasm should not obfuscate the risks. Against this background, the two warnings that the Luxembourg regulator (*Commission de Surveillance du Secteur Financier (CSSF)*) has issued on (i) initial coin offerings (ICOs) and tokens and (ii) cryptocurrencies respectively are useful in these intense times of innovation and strong investor appetite. In these warnings, the CSSF, while it acknowledges the advantages that the so-called underlying "blockchain technology" can bring when used in financial sector activities and innovative projects, also cautions the public on the risks of investing and reminds industry actors that certain existing regulatory parameters will apply.

#### Warning on ICOs and tokens

ICOs are used to raise funds to finance the launch of new virtual currencies or other projects. Digital coins or tokens are issued by the initiator in place of (more traditional) securities, which carry certain electronic rights.

The CSSF warning highlights familiar risks concerning fraud, money laundering, volatility, complete loss, embezzlement, lack of regulation and false or unverified information attaching to such type of fundraising and also emphasises new risks such as technological failure. Investors are also encouraged to 'very carefully consider' the white paper that should accompany any ICO. "Investor beware" is key here, maybe more than anywhere else given the

novelty of this technology.

The CSSF further makes clear two points:

1. UCITS and other regulated funds targeting retail clients and pension funds will not be permitted to invest directly or indirectly in such assets; and
2. given that certain Luxembourg regulatory provisions may apply to the otherwise as yet unregulated ICOs, the CSSF will consider existing rules in full to protect the integrity of the market place, and not surprisingly will not hesitate to assess fundraisings made through Luxembourg-based ICOs for potential violations of (for instance) the 2005 prospectus law, the 1993 financial sector law or the anti-money-laundering regulations.

All Luxembourg ICOs are therefore not ruled out.

### **Warning on cryptocurrencies**

As there is no national or EU uniform definition of cryptocurrencies, the CSSF refers to the definitions of the proposed 5th Anti-Money Laundering Directive and the European Central Bank. In summary a cryptocurrency appears to be a numerical representation of a value that is not issued or guaranteed by a central bank or a public authority, and which:

- is not necessarily linked to a legal currency;
- is not legal tender;
- can be used as an alternative to money;
- as such, can serve as a means of exchange between people; and
- is dealt with by electronic means.

The CSSF warning relating to cryptocurrencies identifies risks that are very similar to those attaching to ICOs and tokens and stresses that investors should be very careful when choosing to invest in any such products. Before purchasing cryptocurrencies, investors should take the time to understand what they are buying and how the particular cryptocurrency operates.

As for ICOs, the CSSF makes clear that UCITS and other regulated funds targeting retail clients and pension funds will not be permitted to invest directly or indirectly in such assets, and it further warns that operating cryptocurrencies in Luxembourg would require authorisation from the Ministry of Finance insofar as it constitutes a financial service.

On a more positive note though, the CSSF invites those looking to launch cryptocurrency activities to come and present their ideas to the CSSF, so that it can be determined whether the proposed activities may potentially lead to a regulated activity.

Reference is finally made in the warnings to the existing communications on these topics issued at the EU level.

## Conclusion

In issuing these warnings, the CSSF is echoing the position taken by ESMA and other European bodies to safeguard the public from abuse and preserve the integrity of the financial place. These warnings should not be construed though, as an attempt to limit proper innovation. There are structures in Luxembourg that may already be used by investors to gain exposure to ICOs and cryptocurrencies. The CSSF is open to new ideas and projects, and simply wants the industry to use these products in a responsible manner given the additional risks that can attach to such assets.

Please feel free to contact us if you have any questions.

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