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# ICOs – the good, the bad, and the ugly

*for George Brown College students*

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*The Art and Science of Eternal Blossom*



# ICOs –the good, the bad, and the ugly

## About the Genesis of Blockchain networks

Bitcoin started the Blockchain phenomenon as a peer-to-peer network, which compensates peers for running its software on their own computers. What do you do with Bitcoins?



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## 1 What are ICOs?

- Definitions
- Market size

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# A definition of Initial Coin Offering (ICO)

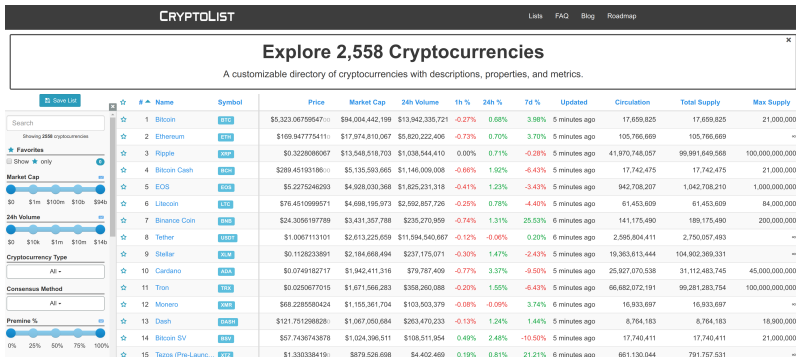
Miriam Webster

an initial offering of a cryptocurrency to the public

*Also called ITO, for Initial Token Offering.*



# Distinction: Cryptocurrency vs. ICOs



# Distinction: Cryptocurrency vs. ICOs

## Cryptocurrency (Oxford dictionary)

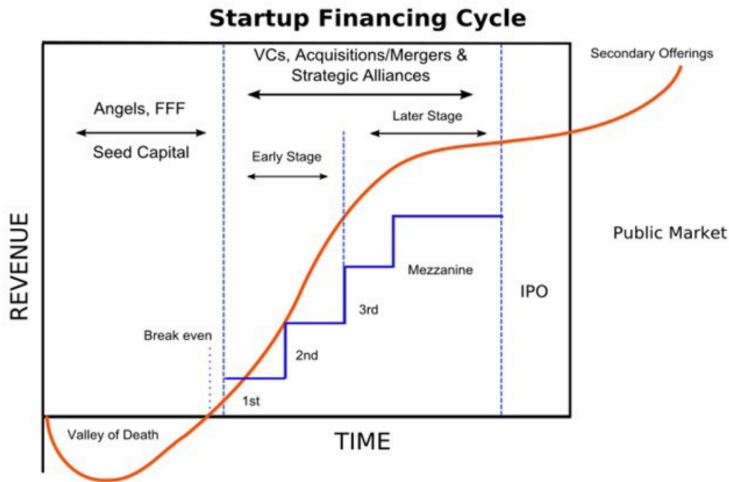
a digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a central bank.

## ICO

a fundraising mechanism leveraging the issuance of a cryptocurrency.



# Source of funding for startups



(\*) Red line = Earnings of a startup. Source: "Technological Entrepreneurism" — Mario W. Cardullo (1999)



# ICO vs. IPO

## IPOs

- need a prospectus
- need an underwriter (big bank e.g. JP Morgan)
- sales on exchanges
- regulatory constraints

## ICOs

- white paper
- anyone can launch a sale
- anyone can buy from anyone
- no limitation allowing schemes such as "pump and dump"





# ICO vs. IEO

## Initial Exchange Offering (IEO)

- register with an exchange
- pay a fee and a % of coins
- sales happen on the exchange
- regulatory burden for the exchange
- marketing and promotion on the exchange

## ICO

- true peer to peer
- no fees to intermediaries
- anyone can buy from anyone
- regulatory burden on the promoters of the ICO
- developers have to promote themselves

See <https://cryptonews.com/guides/what-is-an-initial-exchange-offering.htm>



# Who buys into ICOs?

## Discussion



# Notable ICO scams

- the team runs with the investor's money (e.g. Modern Tech's Pincoin ICO)
- misrepresentation of the team (e.g. fake founders in the case of Benebit)
- Ponzi schemes (e.g. Ponzicoin –it's in the name!; Plexcoin promised a 1,354% return to US and Canadian investors)
- market manipulation (e.g. "pump and dump")
- marketing schemes (e.g. Kodack coin, Centratch ICO backed by DJ Khaled)



And the laws says. . .

SEC (US Regulator)

Framework for “Investment Contract” Analysis of Digital Assets (2019)

OSC (Ontario Regulator)

OSC Investor Guide to Crypto Assets (2019)



# A few instruments and tools

In 2017, the SEC provided guidance on the sale of token, indicating that it would be (most likely) treated as a security.

## The Howey test

Simply put: if it looks like an investment, then it is one.

*The Howey Test refers to a 1946 case which reached the Supreme Court, SEC v. W.J. Howey Co., involving the Howey Company of Florida.*

## Investment contracts

A promise to return a profit on an investment.



# A few instruments and tools

## SAFT

A Simple Agreement for Future Tokens (SAFT) is an assumed investment contract (a security) that brings clarity to the sale of Blockchain-based securities.

*User receives documentation and access to the future token sale. It's not a debt instrument.*

## SAFE

A Simple Agreement for Future Equity (SAFE) allows to accept funds that can be converted to equity at a later stage.



# Finding the right balance

Let's discuss

## Democratization of access to capital

What is the best way to let small investors access lucrative investment opportunities generally available to accredited investors and large portfolio owners?

## Support for innovation

What is the best way to allow startups to access the capital they need at a reasonable cost?

## Protection of the investors

What is the best way to protect investors against evil market manipulations? (Let's discuss some of those)



# Other approaches to coin offerings

- Initial Bounty Offering
- Security Token Offering (more details later)
- Initial Exchange offering
- ...





# Market Size

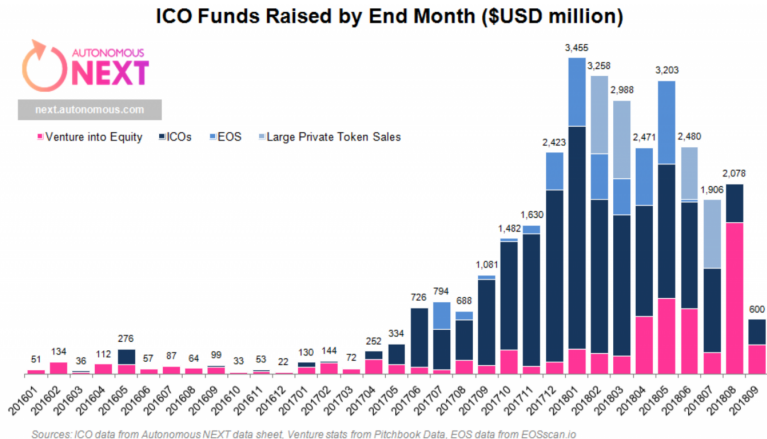


## Top 10 ICOs

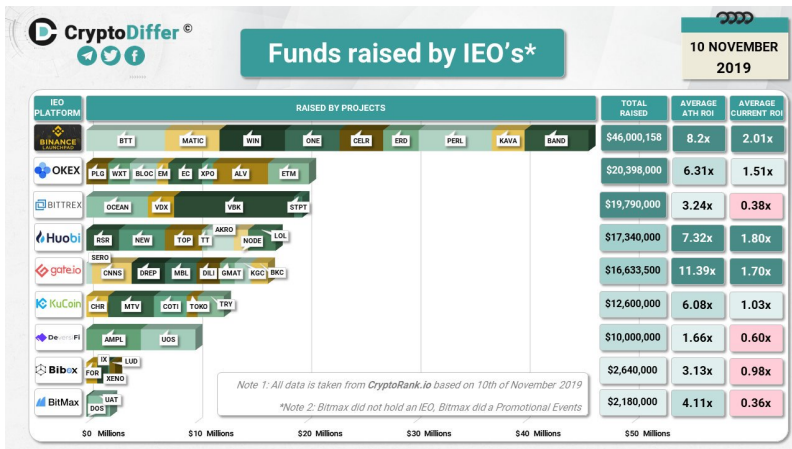
	Amount Raised	ICO Dates	Project
EOS	\$4.1 billion	6/26/17 - 6/18/18	Smart Contracts
Telegram	\$1.7 billion	01/18-02/18	Encrypted Messaging & Blockchain Ecosystem
Dragon	\$320 million	02/15/18 - 03/15/2018	Decentralized Currency for Casinos
Huobi	\$300 million	01/24/18 - 02/28/18	Cryptocurrency Exchange
Hdac	\$258 million	11/27/17 - 12/22/17	IoT Contract & Payment Platform
Filecoin	\$257 million	08/10/17 - 09/10/17	Decentralized Cloud Storage
Tezos	\$232 million	07/01/17 - 07/14/17	Self-Amending Distributed Ledger
Sirin Labs	\$158 million	12/16/17 - 12/26/17	Open-Source Blockchain Smartphone
Bancor	\$153 million	December 6, 2017	Prediction Markets
The DAO	\$152 million	05/01/17 - 05/28/17	Decentralized VC



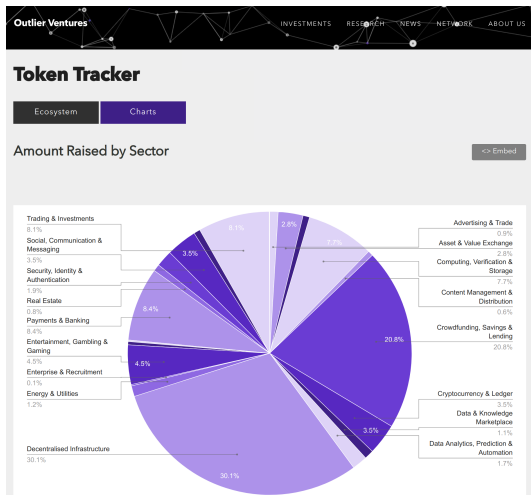
# Proportion of funds raised through ICOs



# Proportion of funds raised through IEOs



# Funding by Industry



# References

<https://icobench.com>

<https://topicolist.com>

<https://icostats.com>



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# Who buys into ICOs?

## Elements of a white paper





# General considerations

## Be careful with your money

Any investment requires due diligence. Ask yourself what the investor gets for his/her money?

## Guarantees

How confident are you the team will complete its end of the bargain?  
What are the available recourse when they do not?

## Compliance

Is this legal? What are the risks and the administrative burden on the investor side?



# Team

- Do these people exist?
- Do their roles and credentials match the domain of expertise?
- Did they agree to be featured?
- How much are they involved in the project? (100% time – 0.001% time?)
- Are they credible? Can they pull it off?
- Which company is backing this project (if any)?



# Project

- Does it have any kind of business or social value?
- What is the business model (including token economics)?
- Is it achievable? (There should be a sensical roadmap)
- How much research and development has already been done so far?
- How many users are currently using the system (if any)? (is there a MVP?)



# Technology

- Why do we need Blockchain for that?
- Is Blockchain (and other) technology used appropriately?
- What is the underlying Blockchain platform? (e.g. Ethereum, Waves)
- How are the engineering constraints addressed? (e.g. throughput in tps, scalability, saturation, cost of transactions, interoperability)
- How maintainable and sustainable the solution is?
- What is the approach to ensure an acceptable level of security?



# Governance and Use of the proceeds

- What does the team plan to do with the funds?
- What is the governance model?
- What's in there for the investor?
- Is the financial model realistic?
- Are legal and compliance risks thoroughly assessed and discussed?



# ICO process

- How is the token issued? (e.g. through an exchange)
- Are all investors treated fairly? (e.g. similar value/risk ratio, unreasonable pre-sale discounts to a certain class of investors)
- Do the founders have an unfair advantage? (e.g. control)
- Is the ICO backed to some level by regulators? (e.g. the OSC in Ontario can issue exemption letters, SEC in the US)
- What does the crypto-community say? (e.g. coverage in journals, podcasts, Youtube, Reddit, etc)



# Putting it all together: a framework to assess white papers

Template on Google Drive

Criteria	Confidence Score (1-5) *	Comment
Team		
Project		
Technology		
Governance and Use of the proceeds		
ICO process		
<b>Overall</b>		
* Score from 1 to 5 where 5 is the highest score		



# Thank you!

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# References

