Could Bitcoin Futures Add Legitimacy to Initial Coin Offerings?

The rise of bitcoin has generated a frenzy around ICOs, but the SEC and some experts argue that investors should be wary of scams.

BY ANNIE PALMER
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TheStreet Video

The first bitcoin futures have added some legitimacy to the cryptocurrency and now industry watchers are eyeing whether it will have a similar effect on one of this year's hottest fundraising mechanisms.

Initial coin offerings have picked up some serious steam amid the broader bitcoin craze. ICOs are similar to initial public offerings in that they are a vehicle for startups to raise money, but instead of issuing stock, digital currency, or tokens, are offered. Over 200 companies have raised about $3.6 billion via ICOs this year, with more than $800 million being raised in September alone, according to data from ICO tracker CoinSchedule.

Institutional investors have been drawn to bitcoin futures as it gives them a way to trade the highly volatile currency on regulated and liquid exchanges. The introduction of bitcoin futures has generated some buzz around the rise and regulation of cryptocurrencies like bitcoin, ethereum and litecoin, enough that it prompted U.S. Securities and Exchange Commission chairman Jay Clayton to issue a 2,300 word statement on ICOs.

Clayton warned investors not to believe anyone who says their ICO listing has been approved by the SEC or any celebrity endorsements of ICOs -- of which there have been many, including boxer Floyd Mayweather and hotel heiress Paris Hilton.

"As with any other type of potential investment, if a promoter guarantees returns, if an opportunity sounds too good to be true, or if you are pressured to act quickly, please exercise extreme caution and be aware of the risk that your investment may be lost," Clayton said.

That being said, Clayton did give a tepid endorsement of ICOs, saying he believes they can be effective ways for companies to raise funding, "including for innovative projects." He also reiterated that the physical tokens offered to investors should be considered a security, making it all the more clear that the offerings should be regulated by the SEC.

On Tuesday, the SEC shut down an ICO by Munchee, a California-based restaurant review app, that was seeking to raise $15 million. The SEC discovered that Munchee had been classifying its tokens as "utilities," when they should have been classified as securities.

The action will likely fuel the ongoing debate over whether ICOs are funding innovators or scammers.

"Most [ICOs] you don't want to go near, but there could also be the potential Amazon's (**AMZN** - *Get Report*) or Facebook's (**FB** - *Get Report*) that are out there in these existing assets," said Jack Tatar, a cryptocurrency advisor, author and angel investor. "There are some real potential nuggets for innovation and companies that could carry us into the next century.

Tatar invested in the software company FileCoin, which has launched the most successful ICO in 2017, raising $257 million from investors including Sequioa Capital, Andreessen Horowitz, Winklevoss Capital and other Silicon Valley investors.

He cautioned that investors should be careful when considering an investment in an ICO, saying people should examine the startups' valuation, while looking at how the money is being raised and which advisers are backing the ICO.

Others remain even more skeptical of the investment value behind ICOs. Campbell Harvey, a professor of finance at Duke University, said ICOs are akin to the "Wild West."

"Most of those have no value whatsoever," Harvey said. "It's the modern day equivalent of snake oil."

With some ICOs, investors are being promised huge returns on their investment, while in other cases, it's not entirely clear how investors' money is being used. Above all, investors should be aware of the high-risk nature of ICOs, due to the fact that they aren't regulated and provide no protections for investors should something go wrong.

The ICO market may be "frothy" right now, but Harvey said it's ultimately something for the average retail investor to avoid.

"There's some good ideas out there, but there's also a lot of bad ideas," Harvey said. "This is not something for the average retail investor."

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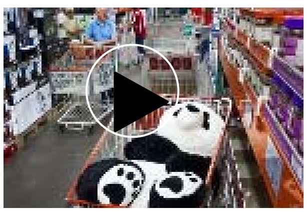

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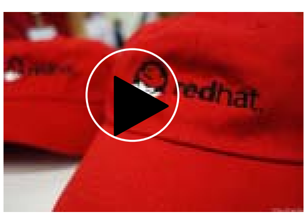

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