



ICOs AND FINANCIAL REGULATION

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2. Utility tokens?
3. What others are doing?
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1. FOUNDATION MODEL?

- ICOs = (very often also) about making money

=> who disagrees?

- Foundation = non for profit

=> difficult model



2. UTILITY TOKENS?



Tim Draper:

If the purpose of a token is for societal transformation, and all proceeds go to the support and development of the token, it need not register.

Source: Tim Draper, Facebook post of 26 July 2017

=> Tokens that serve a purpose, which is not a financial one

2. UTILITY TOKENS?



➤ Transfer at no cost = utility?



2. UTILITY TOKENS?



Balaji Srinivasan (a16z):

analogy between tokens and paid API keys:

=> buy the right to access a system and use it/work on it (with it)



2. UTILITY TOKENS?



PANTERA

- Token that are absolutely needed
- Platforms cannot work without them
- Typically used to pay for network security.

(Pantera Capital, September 2017)

⇒ utility? not necessarily: Ethereum for example



2. UTILITY TOKENS?

- How many of the tokens issued so far do not fall under that category?
 - many/not many?
 - Will that change?



3. WHAT ARE OTHERS DOING?



135 BLOCKCHAIN STARTUPS WITH ICOs



Source: <https://www.cbinsights.com/research/blockchain-ico-tokens-startup-market-map-expert-research/>

ICO BAN IN CHINA

(4 SEPT. 2017)



➤ ICOs = illegal form of fundraising in China:

« Token fundraising » is an unauthorized and illegal public financing activity, which involves financial crimes such as the illegal distribution of financial tokens, the illegal issuance of securities and illegal fundraising, financial fraud and pyramid scheme

- fundraising through token issuance should stop immediately
- ICOs already made => refund
- financial institutions shall not become involved with ICOs

ICO BAN IN SOUTH KOREA

(28 SEPTEMBER 2017)



Tokens -> violation of the capital market law

=> will the South Korean regulator show more openness in the future?

**INITIAL
COIN
OFFERINGS**

BANNED

CRYPTO VALLEY ASSOCIATION (CVA) - SWITZERLAND

(NON-PROFIT ASSOCIATION FOR BLOCKCHAIN TECHNOLOGY)

- believes Switzerland should support ICOs by developing clear, comprehensible yet flexible regulation.



=> Same for LHoFT



FINMA'S APPROACH (SWITZERLAND)

(2014/2017)



- Bitcoin (BTC) and Ether (ETH) = means of payment => AML/CTF rules apply
- FINMA assesses new financing tools such as ICO in accordance with the existing legal basis for financial markets
- Financial regulation? Question: Do the tokens qualify as financial instruments/securities? If yes, the relevant laws apply.
- FINMA invites the parties interested in launching an ICO to submit detailed information on the planned token offering



SEC - INVESTIGATIVE REPORT

(25 JULY 2017)



- DAO tokens = security => subject to federal securities laws:
 - issuers must register offers and sales of such securities (unless exempt)
 - participating in unregistered offerings => violation of securities laws

- Securities exchanges providing for trading in these securities must register (unless exempt)

SEC - INVESTIGATIVE REPORT

(25 JULY 2017)



Key messages of the report:

- The purpose of the registration provisions of the federal securities laws is to ensure that investors are sold investments that include all the proper disclosures and are subject to regulatory scrutiny for investors' protection.
- SEC Chairman Jay Clayton: « We seek to foster innovative and beneficial ways to raise capital, while ensuring-first and foremost-that investors and our markets are protected ».
- The SEC cautions the industry and market participants: the federal securities laws apply to those who offer and sell securities in the United States, regardless whether:
 - the issuing entity is a traditional company or a decentralized autonomous organization
 - those securities are purchased using U.S. dollars or virtual currencies
 - they are distributed in certificated form or through distributed ledger technology.

SEC - INVESTIGATIVE REPORT

(25 JULY 2017)

In a nutshell:

- No charges in relation to the DAO, but a clear warning for the future.



SEC - INVESTOR BULLETIN: INITIAL COIN OFFERINGS

(25 JULY 2017)

- ICOs may provide fair and lawful investment opportunities
- however: also potentially improper use
- focus of the SEC is on risks (unfortunately)



SEC - INVESTOR BULLETIN: INITIAL COIN OFFERINGS

(25 JULY 2017)

Key messages:

- Depending on the facts and circumstances of each individual ICO, the virtual coins or tokens that are offered or sold may be securities.
 - Federal securities laws apply in such case.
 - 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.



You've entered law land...

and now you'll never come back.

CANADA



- AMF⁽¹⁾: Token sale by Impak Finance⁽²⁾ is a security
 - accepts Impak Finance into its regulatory sandbox⁽³⁾.
 - = the first regulated ICO based in Canada.
- Guidance issued by Canadian Securities Administrators⁽⁴⁾ on August 24: clarify the circumstances under which a token will be considered a security.



- (1) Autorité des marchés financiers au Québec
- (2) a platform for investing in socially responsible enterprises
- (3) the sandbox is meant to jumpstart fintech projects that don't easily fit within the confines of a legacy framework
- (4) an organization composed of Canada's provincial and territorial securities regulators

AUSTRALIA

(28 SEPTEMBER 2017)



ASIC

Australian Securities & Investments Commission

⇒ Status depends on the circumstances

⇒ key: what rights are allocated to the tokens?

⇒ financial regulation applies: broad approach

4. A POSSIBLE EU PERSPECTIVE



4.1. AML/CTF REGULATIONS

Financial activity =>

AML/CTF regulations apply:

- KYC
- Transaction monitoring
- etc



Watch
out

You can become involved in money laundering even if KYC and transaction monitoring do not apply to your business!

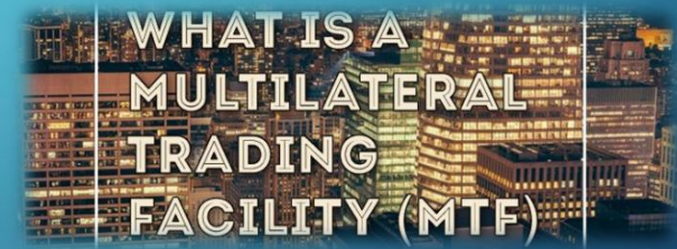
4.2. MIFID

- DIRECTIVE 2014/65/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 May 2014 on markets in financial instruments (MiFID II)
- typical example = stock exchange

Definition of a multilateral trading facility (MTF):

- (i) multilateral system which
- (ii) brings together
- (iii) multiple third-party buying and selling interests
- (iv) in financial instruments ⁽¹⁾

(1) Art. 4, 1) (22) of the Directive



4.2. MIFID

- multilateral: yes
- system: yes
- multiple third party buy/sell interests: yes
- financial instruments: to be discussed



4.3. ICOs AND MIFID

Key: (buy/sell) financial instruments:

- **financial instruments** = (*inter alia*) **transferable securities** ⁽¹⁾

 **transferable securities:**

- classes of securities which are:
- negotiable
- on the capital market, with the exception of instruments of payment, such as:

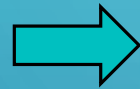
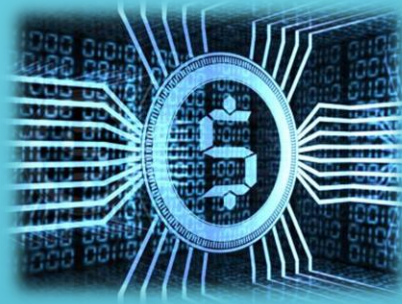
- shares in companies and other securities equivalent to shares in companies and depositary receipts in respect of shares;
- bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
- any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures. ⁽²⁾



(1) Art. 4, 1)(15) of the Directive

(2) Art. 4, 1)(44) of the Directive

4.3. ICOs AND MIFID



token / coin = financial instrument?

4.3. ICOs AND MIFID

- shares and the like
- bonds and the like
- equivalent giving
 - right to acquire or sell OR
 - rise to a cash settlement

by reference to

- Securities
- Currency
- Interest rate
- Yield
- Commodities
- Indices or other measurements



4.3. ICOs AND MIFID



➡ most likely legal status for the issuer?
assumption: coin = financial instrument
=> issuer = investment firm⁽¹⁾



(1) Art. 4, 1) of the Directive

4.3. ICOs AND MIFID



Platform?

do it yourself

or

use an existing MTF



4.3. ICOs AND MIFID

Basic rules for MTFs (non exhaustive list):



- ❑ Trading process and finalisation of transactions in an MTF:
 - transparent and non-discretionary rules and procedures => guarantee for fair and orderly trading,
 - establish objective criteria for an efficient execution of orders;
 - transparent criteria: which financial instruments can be traded under its systems?
 - provide adequate information: users must be able to form an investment judgement;
 - transparent rules based on objective criteria (access);
 - inform members or participants of their respective responsibilities for the settlement of transactions;
 - facilitate the efficient settlement of transactions;
 - for a security traded on an MTF without the consent of the issuer: issuer not responsible for financial disclosure obligations regarding to that MTF; ⁽¹⁾

4.3. ICOs AND MIFID

MTFs:

- ☐ compliance
- ☐ transparency
- ☐ clearing and settlement



COMPLIANCE

A hand holding a blue marker is writing the word 'COMPLIANCE' in blue capital letters on a white rectangular background. A blue line is drawn under the word.

Transparency

A hand holding a black marker is writing the word 'Transparency' in black cursive letters on a white rectangular background. A red line is drawn around the word.

4.4. ICOs AND PROSPECTUS

- DIRECTIVE 2003/71/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading

Offer of securities to the public⁽¹⁾

- offer to the public:

- ☐ communication in any form and by any means presenting sufficient information on the terms of the offer and the securities to be offered
- ☐ so as to enable an investor to decide to purchase or subscribe to these securities

- securities:

- ☐ **means transferable securities** as defined by Article 1(4) of Directive 93/22/EEC with the exception of money market instruments as defined by Article 1(5) of Directive 93/22/EEC, having a maturity of less than 12 months. For these instruments national legislation may be applicable ⁽²⁾ such as:

- shares in companies and all other securities equivalent to shares;
- bonds or other forms of securitised debt **which are negotiable on the capital market**;
- any other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement **excluding instruments of payment**; ⁽³⁾

NB: EU Regulation will repeal Directive 2003/71/EC: Without prejudice to Article 44(2), this Regulation shall apply from 21 July 2019, except for Article 1(3) and Article 3(2) which shall apply from 21 July 2018 and points (a), (b) and (c) of the first subparagraph of Article 1(5) and the second subparagraph of Article 1(5) which shall apply from 20 July 2017. Member States shall take the necessary measures to comply with Article 11, Article 20(9), Article 31, Article 32 and Articles 38 to 43 by 21 July 2019.

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⁽¹⁾ Art. 2(1)(d) of the Directive
⁽²⁾ Art. 2(1)(a) of the Directive
⁽³⁾ Art. 1(4) of Directive 93/22/EEC



4.4. ICOs AND PROSPECTUS

- REGULATION (EU) 2017/1129 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC

Offer of securities to the public⁽¹⁾

- offer to the public:

- ☐ communication in any form and by any means presenting sufficient information on the terms of the offer and the securities to be offered
- ☐ so as to enable an investor to decide to purchase or subscribe to these securities

- securities:

- ☐ **means transferable securities** as defined in point (44) of Article 4(1) of Directive 2014/65/EU with the exception of money market instruments as defined in point (17) of Article 4(1) of Directive 2014/65/EU, having a maturity of less than 12 months;⁽²⁾ such as:

- 'transferable securities' means those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:
 - shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
 - bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
 - any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;⁽³⁾



(1) Art. 2(d) of the Regulation
(2) Art. 2(a) of the Regulation
(3) Art. 4, 1(44) of Directive 2014/65/EU

4.4. ICOs AND PROSPECTUS



➡ same definition than under MiFID

➡ token / coin = security?

4.4. ICOs AND PROSPECTUS

- shares and the like
- bonds and the like
- equivalent giving
 - right to acquire or sell OR
 - rise to a cash settlement

by reference to

- Securities
- Currency
- Interest rate
- Yield
- Commodities
- Indices or other measurements



4.4. PROSPECTUS EXEMPTIONS

Directive (current):

➤ Prospectus + admission to trading requirements not apply:
offer:

- ☐ max. amount of EUR 5 000 000
- ☐ over max. 12 months⁽¹⁾



New EU Regulation (will enter into force 21 July 2018/2019):

- ☐ max. amount will be reduced to EUR 1 000 000⁽²⁾
- ☐ EUR 8.000.000 possible for non passportable offers⁽³⁾



(1) Art. 1, 2)(h) of Directive 2003/71/EC

(2) Art. 1 (3) of the EU Regulation 2017/1129

(3) Recital 13 and Art. 3(2) of EU Regulation 2017/1129

4.4. PROSPECTUS EXEMPTIONS

Directive (current):

➤ Prospectus obligation does not apply to:



(a) offer to qualified investors

(b) offer addressed to fewer than 150 persons per Member State (other than qualified investors)

(c) offer to investors with < EUR 100 000 per investor

(d) offer with unit amounts > EUR 100 000

(e) offer < EUR 100 000₍₁₎



(1) Art. 3(2) of the Directive

4.4. PROSPECTUS EXEMPTIONS

Regulation (1):

➤ Prospectus obligation does not apply to:

(a) offer to qualified investors

(b) offer addressed to fewer than 150 persons per Member State (other than qualified investors)

(c) offer with unit amounts $>$ EUR 100 000

(d) offer to investors with $<$ EUR 100 000 per investor, for each separate offer

(...)



(1) Art. 1(4) of EU Regulation 2017/1129



4.4. PROSPECTUS EXEMPTIONS

Art. 3 (1) of DIRECTIVE 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading:

Member States shall not allow any offer of securities to be made to the public within their territories without prior publication of a prospectus.



Art. 3 (2) of DIRECTIVE 2003/71/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading, n/applicable

4.4. PROSPECTUS EXEMPTIONS

Art. 3 of REGULATION (EU) 2017/1129 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC:

- 1. Without prejudice to Article 1(4), securities shall only be offered to the public in the Union after prior publication of a prospectus in accordance with this Regulation.*
- 2. Without prejudice to Article 4, a Member State may decide to exempt offers of securities to the public from the obligation to publish a prospectus set out in paragraph 1 provided that:*
 - (a) such offers are not subject to notification in accordance with Article 25; and*
 - (b) the total consideration of each such offer in the Union is less than a monetary amount calculated over a period of 12 months which shall not exceed EUR 8 000 000.*

Member States shall notify the Commission and ESMA whether and how they decide to apply the exemption pursuant to the first subparagraph, including the monetary amount below which the exemption for offers in that Member State applies. They shall also notify the Commission and ESMA of any subsequent changes to that monetary amount.

- 3. Without prejudice to Article 1(5), securities shall only be admitted to trading on a regulated market situated or operating within the Union after prior publication of a prospectus in accordance with this Regulation.*

4.5. PAYMENT SERVICES DIRECTIVE

- DIRECTIVE 2007/64/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 13 November 2007 on payment services in the internal market

coin/token = money?

coin/token = means of payment?



4.5. PAYMENT SERVICES DIRECTIVE

= payment account functionality⁽¹⁾?

= payment instrument?⁽²⁾



(1) Art. 4 (14) of the Directive on payment services: “payment account” means an account held in the name of one or more payment service users which is used for the execution of payment transactions.

(2) Art. 4 (23) of the Directive on payment services: “payment instrument” means any personalised device(s) and/or set of procedures agreed between the payment service user and the payment service provider and used by the payment service user in order to initiate a payment order.

4.6. WHAT NEXT ?

- Question/statement n°1:

Token/coin \Rightarrow virtual currency \Rightarrow money

OR

Token/coin \Rightarrow payment functionality

High level
answer



Payments legislation
applies

4.6. WHAT NEXT ?

- Question/statement n°2:

What rights are attached to the token?

High level
answer

=> equity rights?

=> token = like a bond?



Financial regulation
applies

4.6. WHAT NEXT ?

Way forward?

⇒ ICO – Test?

1. Facts – economic rationale
2. Rights of token owner?
3. Purpose of buyer/seller?

3 factor – test



