TOKEN ALLIANCE

CHAMBER OF DIGITAL COMMERCE

UNDERSTANDING DIGITAL TOKENS:

Market Overviews and Proposed Guidelines for Policymakers and Practitioners

PREPARED BY - TOKEN ALLIANCE

AN INDUSTRY INITIATIVE OF THE CHAMBER OF DIGITAL COMMERCE

CHAMBER OF DIGITAL COMMERCE

The Chamber of Digital Commerce is the world's largest trade association representing the blockchain industry. Our mission is to promote the acceptance and use of digital assets and blockchain technology. Through education, advocacy, and working closely with policymakers, regulatory agencies, and industry, our goal is to develop a pro-growth legal environment that fosters innovation, jobs, and investment.

TOKEN ALLIANCE

The Token Alliance is an industry-led initiative of the Chamber of Digital Commerce, developed to be a key resource for the emerging industry surrounding the generation and distribution of tokens using blockchain technology. Comprised of over 350 global industry participants, the Alliance includes blockchain and token experts, technologists, economists, former regulators, and practitioners from over 20 law firms. The Token Alliance develops community-driven guidelines for the responsible development of tokens.

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I. ACKNOWLEDGEMENTS

TOKEN ALLIANCE CO-CHAIRS

PAUL ATKINS

Chief Executive Officer, Patomak Global Partners

Non-Executive Chairman, BATS Global Markets, Inc. (2012-2015)
Commissioner, U.S. Securities and Exchange Commission (2002-2009)

JAMES NEWSOME, PH.D.

Founding Partner, Delta Strategy Group

President & CEO, New York Mercantile Exchange (2004-2008)
Chairman, U.S. Commodity Futures Trading Commission (2001-2004)
Commissioner, U.S. Commodity Futures Trading Commission (1998-2001)

TOKEN ALLIANCE LEADERSHIP COMMITTEE

The Chamber of Digital Commerce would like to recognize the following individuals for their thought leadership, contributions and support to the Token Alliance in the production of this report.

KEVIN BATTEH

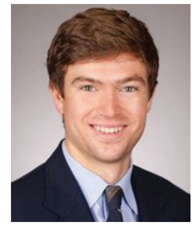
Partner, Delta Strategy Group

PERIANNE BORING

Founder and President, Chamber of Digital Commerce

JOE CUTLER

Partner, Perkins Coie LLP



ROBERT GREENE

Strategic Advisor, Patomak Global Partners

DAX HANSEN

Partner, Perkins Coie LLP

CHRIS HOUSSER

Co-Founder, Polymath

JONATHAN JOHNSON

President, Medici Ventures

AMY DAVINE KIM

Chief Policy Officer, Chamber of Digital Commerce

KARI LARSEN

Counsel, Reed Smith LLP

BRIAN LIO

Chief Executive Officer, Smith + Crown

MATTHEW ROSZAK

Chairman and Co-Founder, Bloq

BILL SHIHARA

Chief Executive Officer, Bittrex

TOM SPORKIN

Partner, BuckleySandler LLP
Strategic Advisor,
Token Alliance

JOSHUA STEIN

Chief Executive Officer, Harbor

RUMI MORALES

Partner, Outlier Ventures

COLLEEN SULLIVAN

CEO, CMT Digital

EXPERT CONTRIBUTORS

The Chamber of Digital Commerce would like to thank the following individuals and organizations for their valuable contributions to the Token Alliance in the production of this report.

THOMAS AHMADIFAR
Associate, Perkins Coie LLP

STEVE BUNNELL
Chief Legal Officer, Bittrex

MATT CHWIERUT
Research Director, Smith + Crown

LEWIS COHEN
Lawyer, DLx Law LLP

MICHAEL DIDIUK
Partner, Perkins Coie LLP

FREDERICK FEDYNYSHYN
Senior Counsel, Perkins Coie LLP

DROR FUTTER
Partner, Rimon Law, P.C.

PARITOSH GAMBHIR
Partner, KPMG

GREGORY GROVE
Principal, Much Shelist, P.C.

KATE GUIMBELLOT
Executive Director, TravelCoin Foundation

SHARON HAVERLAH
IT Research and Innovation Technology Leader, USAA

RAMON LAFEE
Chief Executive Officer, G Coin

STEPHEN KEEN
Senior Counsel, Perkins Coie LLP

KIRAN NAGARAJ
Managing Director, KPMG

JAY NATARAJAN
Senior Global Solutions Architect, Microsoft

LINDSAY NELSON
Research, Smith and Crown

KWON PARK
Director of Business Development, Bittrex

SCOTT PARSONS
Managing Principal, Delta Strategy Group

KIRAN RAJ
Chief Strategy Officer, Bittrex

ANDRE REINA
Product Manager, Elliptic

ERIC SIBBITT
Partner, O'Melveny & Myers LLP

JAMES SISNEROS
Founder and CEO, Zaahah

JAMES SMITH
Chief Executive Officer, Elliptic

J. GRAY SASSER
Attorney, Frost Brown Todd

STEVEN SPRAGUE
CEO and Co-Founder, Rivetz

QUAN TRINH
Co-Founder, Secure Identity Ledger Corporation

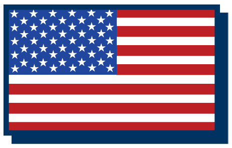
SARDORBEK UMAROV
Co-Founder, BookLocal

JASON WEINSTEIN
Partner, Steptoe

LES WILKINSON
Chief Development Officer, Hashed Health

GLOBAL SUBJECT MATTER EXPERTS

The Chamber of Digital Commerce would like to express its gratitude to the following firms and individuals for authoring the country specific Sections contained in this report.



UNITED STATES:

Paul Atkins, Chief Executive Officer, Patomak Global Partners

John Cobb, Associate, Steptoe

Matthew Comstock, Partner, Murphy & McGonigle, P.C.

Michael Fletcher, Partner, RSM

Robert Greene, Strategic Advisor, Patomak Global Partners

Amy Davine Kim, Chief Policy Officer, Chamber of Digital Commerce

Kari Larsen, Counsel, Reed Smith LLP

Chelsea Parker, Blockchain Industry Analyst, Steptoe

Michael Selig, Associate, Perkins Coie LLP

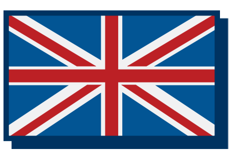
Lisa Zarlenga, Partner, Steptoe

CANADA:

Paritosh Gambhir, Partner, KPMG

Ross McKee, Partner, Blakes

Stefania Zilinskas, Associate, Blakes



UNITED KINGDOM:

Tim Dolan, Partner, Reed Smith LLP

Claude Brown, Partner, Reed Smith LLP

Karen Butler, Senior Associate, Reed Smith LLP

AUSTRALIA:

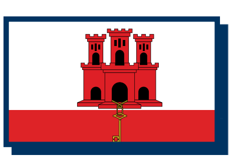
Alex Cook, Lecturer, University of Western Australia Law School

Nick Giurietto, CEO and Managing Director, Australian Digital Commerce Association

Ivan Oshry, Head of Corporate, Kemp Strang

Ronald Tucker, Founder and President of the Board, Australian Digital Commerce Association

Michael Zheng, Senior Associate, Maddocks



GIBRALTAR:

Joey Garcia, Partner, ISOLAS LLP

Jonathan Garcia, Partner, ISOLAS LLP

TOKEN ALLIANCE MEMBER PARTICIPANTS

The Chamber of Digital Commerce would like to thank the following companies for their support of and participation in the Token Alliance.

Accenture
AlphaPoint
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Vertex
Votem
Wanchain
Wipfli, LLP
Wyrick Robbins Yates and Ponton LLP
Zaahah
Zen Blockchain Foundation

II. FOREWORD

Paul Atkins and James Newsome

The last 24 months has seen incredible development in the blockchain industry. We saw two of the world's largest exchanges introduce bitcoin futures contracts, market capitalization for digital tokens grew over 3000 percent, and over a dozen central banks and many major financial institutions around the world announced their interest in blockchain-based technologies. The transformative possibilities of blockchain technology and the tremendous positive impact that it could have for our economy were front and center in the news and headlines. This past year also brought along another phenomenon – the rise of so-called "initial coin offerings." Digital token projects and distributions have revealed some of the strengths and weaknesses of the industry.

WHY TOKENS?

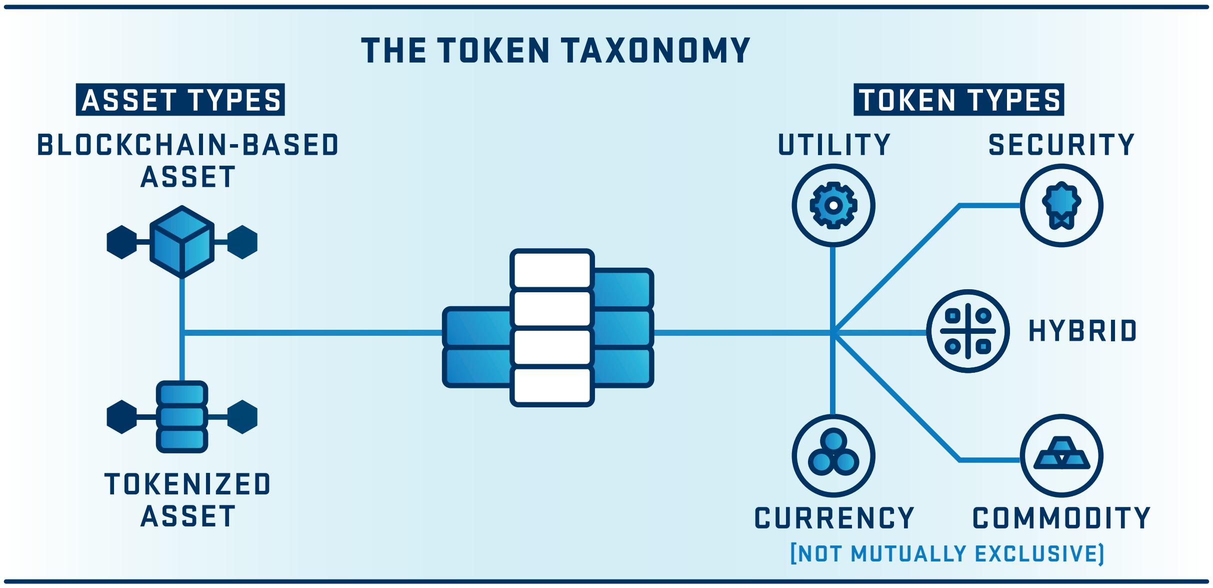
When Bitcoin, the first-ever blockchain network, was released pseudonymously, the author(s) published the code open source - anyone could review the code, improve upon it, and innovate with it. This was a boon to society – anyone could review the code, improve upon it, and innovate with it. Over the past nine years, technologists from all over the world, inspired by this revolutionary development, have created new digital tokens – all with their own native functionalities and features.

For example, while Bitcoin was created as a "Peer-to-Peer Electronic Cash System," ether, the second largest distributed token by market cap (estimated at $72 billion as of July 20, 2018), was created to be a "decentralized platform that runs smart contracts," with ether functioning as the "fuel…for operating the distributed application platform."

Many token projects and token generation events have relied upon ether to facilitate the development of blockchain-enabled platforms or applications. Depending on its attributes and functions, a token can be classified in various ways: as a security/equity, a currency/medium of exchange, a commodity, or a means of access to a network that provides utility to its users. A digital token can also be a hybrid that includes several of these characteristics, and some have suggested that a token may start representing one (or more characteristics) and then shift to encompass others.

THE TOKEN POLICY DEBATE: ACTIVITY UNDERWAY IN WASHINGTON

The biggest policy debate currently underway in the blockchain industry is when is a token considered to be a "*security*" and, perhaps more importantly, when is it *not*? In many circumstances, digital tokens are not securities. Indeed, the two largest digital tokens – bitcoin and ether – are not securities, but rather, are commodities. However, if the token and/or the method of token distribution meets certain criteria, such as offering an expected rate of return or potential for growth in value in some circumstances (what securities lawyers call meeting the *Howey* Test, derived from a United States Supreme Court case dating back to 1946), then it can be deemed a security. A security issuer must follow prescribed procedures promulgated by the United States Securities and Exchange Commission ("SEC") for issuance and distribution of securities (or qualify for an exemption or exclusion from such rules) or risk enforcement action by the government and potential private legal action.



Unfortunately, several entities purported to create and distribute "utility tokens," but were charged by the SEC, either by using the *Howey* Test as having issued unregistered securities, or for fraud. The resulting settlements, statements by SEC officials, and subpoenas have created regulatory uncertainty, because the *Howey* Test is a case-by-case examination of facts and circumstances. An overly expansive interpretation and application of the *Howey* Test could threaten the utility of blockchain technology and could stifle innovation. Regulatory certainty is needed to enable innovative blockchain-based networks to flourish and fuel prosperity.

On the other hand, ensuring that safe, accessible markets exist is also critical to enabling distributed token networks to grow and succeed. Government has an essential role to play in supporting confidence in the rule of law and investor protection against malfeasance. Private infrastructure, such as Token Trading Platforms,[1]

1 For a definition of Token Trading Platforms, *see* p. 20.

facilitate these markets, and in doing so, bear consumer protection and market stability responsibilities. Yet Trading Platforms also confront major challenges related to perceptions of regulators regarding the legal status of tokens traded on their platforms.

THE TOKEN ALLIANCE: CREATING GUIDANCE FOR TOKEN GENERATION EVENTS

We believe that it is the industry's responsibility to actively engage firms, individuals, and businesses involved in the generation, distribution, and trading of digital tokens to ensure that (1) they have a comprehensive understanding of the regulatory environment, and that (2) token project teams and Token Trading Platforms understand and appropriately react to this environment. To meet this need, we have formed the **Token Alliance**, an initiative of more than 350 blockchain and token experts from around the globe. These experts are in active discussions to create guidelines for token distributions and Token Trading Platforms. These principles are designed to help market participants understand the parameters around their activity and to act in a fair and responsible manner toward potential purchasers.

These principles will also help guide policymakers as they attempt to steer this industry. Understanding the wide variety of token types is critical to ensuring that regulators act with carefully guided steps. The wrong regulatory approach could create an environment of regulatory arbitrage, or even worse, unintentionally decrease the attractiveness of a jurisdiction regarding innovation and jobs creation.

The guidelines in this report are reactive to the current regulatory state of affairs. Ideally, agencies will simplify, stabilize, and improve regulatory environments so that entrepreneurs using blockchain networks can spend less time worrying about uncertain compliance obligations and regulatory interpretations, and more time developing tokenized networks that improve peoples' lives. We invite all those dedicated to supporting and growing this thriving ecosystem to join our efforts.

III. INTRODUCTION – THE CASE FOR DIGITAL TOKENS

For the purposes of this report, digital tokens (or “tokens”) are defined as transferable units generated within a distributed network that tracks ownership of the units through the application of blockchain technology. The oversight and regulation of digital tokens has become a crowded space. Many regulators have reviewed and continue to analyze their jurisdiction in this rapidly growing market. The intensity has increased to such a point that lawyers and advisors are poring over responses made at Congressional hearings, speeches by government officials, and enforcement actions as the new form of “reading the tea leaves.” In such a volatile regulatory regime (not to mention economic market), reasonable guidelines are imperative.

DIGITAL TOKENS

Transferable units generated within a distributed network that tracks ownership of the units through the application of blockchain technology.

This report is the first installment of guidelines for one type of token in particular – digital tokens that are not securities or CFTC regulated instruments (defined below). This type of token is under threat of extinction by regulation; thus, a methodical, reasonable, and thoughtful discussion of appropriate oversight is critical. Two topics in particular—digital token distributions and secondary markets—have garnered more attention than the rest, particularly from media, but also from many aspiring application developers and entrepreneurs. Some commentators have referred to these issuances as “Initial Coin Offerings,” but that term is too limited in scope and attaches certain connotations that do not aptly apply to all digital token distributions.

Oftentimes, digital tokens are generated or distributed by a “Token Sponsor” (or “Sponsor”), which, within the context of this report, means any clearly defined individual or group that generates or distributes a digital token that is not intended to be an investment contract or CFTC Regulated Instrument.

In the last 12 months, token issuances proliferated as a rush of capital and a wellspring of new ideas flowed into the blockchain ecosystem. In 2017 alone, there have been more than 550 token generation events raising over $7.3 billion. Many digital tokens are distributed to serve a fundamental purpose—as an integral part of a service offering. These tokens are sometimes referred to as "utility" tokens, although that term has also been used, sometimes inappropriately, by entities whose tokens do not serve a purpose other than to raise funds.

A token's underlying purpose and how it is generated and distributed is instrumental to the regulators' analysis regarding its categorization – such as a security or commodity. Some tokens may serve as a virtual currency, others may represent or track physical assets in the real world, some may explicitly represent a security, and others may have a utility function. These functionalities are not necessarily mutually exclusive, and a token's legal treatment may depend on the manner in which the token was marketed. Further, there are different types of token generation events, including the public release of code associated with the token, direct distributions by a Token Sponsor, "air drops"—whereby digital tokens are freely given to identified parties, and mining events—whereby tokens are distributed to specific individuals that maintain the integrity of the platform by validating new blocks of data, to name a few. The nature of a digital token's features and its generation event will greatly impact the legal landscape by which it is governed.

Within this matrix, regulators have begun to weigh in and claim jurisdiction over certain types of activities surrounding digital tokens. In the United States, the Securities and Exchange Commission ("SEC") and state regulators view many digital tokens to be securities – triggering application of registration and offering rules of the U.S. The Commodity Futures Trading Commission ("CFTC"), on the other hand, has deemed virtual currencies (a subset of digital tokens) to be commodities. Participants in the underlying spot markets for virtual currencies are thus subject to CFTC anti-fraud and anti-manipulation powers, and the CFTC's regulatory powers over digital token markets are increased when accompanying futures markets exist. The Financial Crimes Enforcement Network ("FinCEN") may regulate Token Sponsors as money transmitters, depending on the facts and circumstances surrounding the flow of funds (or the value of funds).[2] Other regulators may also seek to intervene in this debate and exercise their jurisdiction.

2 *See* FIN-2013-G001, Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (Mar. 18, 2018); *see also*, FIN-2014-R001, Application of FinCEN's Regulations to Virtual Currency Mining Operations (Jan. 30, 2014); *see e.g.*, Letter from Drew Maloney, Assistant Sec'y, U.S. Dep't of the Treasury, to Senator Ron Wyden, U.S. Senate Comm. on Fin. (Feb. 13, 2018) (clarifying that Token Sponsors may be subject to FinCEN's regulations depending on the facts and circumstances).

The guidelines presented in this report seek to address ONLY the sale and trading of commodity tokens that do not constitute securities. While developers can issue token-based securities in compliance with United States securities laws, this report does not address that topic. **Significantly, the topics addressed in this document remain in flux, as regulators and Congress continue to study and react to this fast-growing industry.**

Industry and government need to work together to create a regulatory landscape that enables participants in digital token markets to more clearly determine when a token is a commodity and when it is a security. Legal predictability advances market efficiency by removing unnecessary expense and hindrances, facilitating development of new projects that will benefit consumers. Legal clarity will also help government to weed out the bad actors that have taken advantage of the dearth of regulatory guidance, consumers' general excitement surrounding blockchain-based technologies, and a crowded but growing marketplace for new tokens. "Regulation by enforcement" is not an acceptable approach in such an environment.

Further complicating the matter, a number of governments and central banks are considering and weighing the benefits of issuing their own virtual currency tokens. In one instance, the United States government has already determined how another country's virtual currency issuance is viewed under United States sanctions laws. The potential proliferation of central bank-issued digital currencies is yet another example of why industry and government policy makers need to think critically about the rules that are created to govern tokens, including their issuance and trading, so as not to be over-inclusive in one category or another.

The Token Alliance seeks to address these issues and it is well-positioned to do so. Comprised of industry thought leaders, professionals, technologists, and innovators from across technology, legal, and advisory firms, the Token Alliance seeks to develop community-driven guidelines for the responsible issuance of tokens. This industry-led initiative is primarily developed to be a key resource for the emerging industry with respect to blockchain token issuances.

TOKEN ALLIANCE

"FOSTERING BEST PRACTICES AND FRAMEWORKS FOR THE RESPONSIBLE ISSUANCE OF TOKENS."

This report is offered specifically to provide leadership on a specific subset of the pressing issues facing the token issuance space – tokens that are not regulated as securities. It is organized as a three-part narrative that covers: (i) a regulatory overview, addressing the legal landscape impacting token issuances and trading in the United States, Canada, the United Kingdom, Australia, and Gibraltar; (ii) proposed guidelines that address, with regard to digital tokens that are NOT securities, Token Sponsors, Token Trading Platforms, and interactions between the two; and (iii) a report providing key economic metrics concerning token issuances.

The practices discussed in this report have evolved concurrently with the evolution of digital token technology, and many nascent practices were enhanced and refined in response to input from regulators. Therefore, it is necessarily the case that many digital tokens were not distributed or traded in conformity with the principles and guidelines discussed in this report. **This makes it critically important that earlier generations or distributions of digital tokens by Token Sponsors not be retroactively analyzed by applying the principles and guidelines set forth in this report, as past Token Sponsors did not have the benefit of the experience, regulatory guidance, and interpretations underlying this report.**

A few words of caution.

THIS REPORT DOES NOT CONSTITUTE LEGAL ADVICE

- » **Specifically, nothing in this report should be construed as advice regarding the law of the United States, Canada, England and Wales, Australia, and Gibraltar.**
- » **This report's analysis of the criteria under which it is determined that tokens constitute securities or commodities do not constitute a restatement of law.**
- » **This report, including its suggested guidelines, merely express the general views of the Token Alliance, and compliance with such guidelines cannot assure that the distribution or trading of tokens will fully comply with the laws discussed herein.**
- » **These views are being offered for discussion purposes only, and they have not been sanctioned by the SEC, the CFTC, or any other regulator.**

CONSULT LEGAL COUNSEL BEFORE DISTRIBUTING OR HOSTING TRADES OF TOKENS

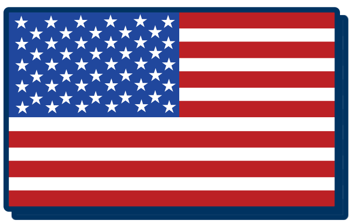
- » Token Sponsors and associated parties seeking to generate or distribute a blockchain-based token should seek independent legal counsel with expertise in this area before proceeding with their project, particularly given the fast-paced nature of this industry and the quickly evolving legal landscape.
- » Counsel can help consider the facts and circumstances surrounding particular issues within the contours of then-current regulatory and enforcement activity.
- » This report does not attempt to address any individual case, and the thought leadership contained herein is not appropriate for use as a substitute for independent counsel.
- » **Further, the digital token market is rapidly shifting and therefore the cases and regulatory interpretations discussed in this report may be overtaken by future events.**

The Token Alliance will continue to study the issues surrounding appropriate regulation for tokens and it will offer additional insights, as appropriate, when new developments arise.

IV. PART 1: REGULATORY OVERVIEW OF DIGITAL TOKEN MARKETS

This part includes five Sections, each providing an overview of the regulatory and legal landscape in a different jurisdiction. Section 1 focuses on the United States; Section 2 focuses on Canada; Section 3 focuses on the United Kingdom; Section 4 focuses on Australia; and Section 5 focuses on Gibraltar.

SECTION 1: UNITED STATES



I. INTRODUCTION

This Section provides an overview of United States rules and regulations applicable to digital tokens, primarily focusing on the distinct regulatory frameworks for digital tokens that are commodities, versus those that are securities. In doing so, this Section sets forth criteria used by regulators to assess whether a digital token meets either regulatory classification. It also provides a summary of various regulatory considerations related to consumer protection, state money transmission laws, and federal money laundering rules. Subsequent parts present overviews of the regulatory environment in Canada, the United Kingdom, Australia, and Gibraltar for digital tokens.

In the regulatory sense, digital tokens largely, though not exclusively, fall into two broad categories: 1) commodities; and 2) tokenized securities. Each category brings about important regulatory considerations, although some digital tokens likely fall into neither regulatory category.

United States Securities and Exchange Commission ("SEC") Chairman Jay Clayton has stated publicly that he does not view virtual currencies to be securities[3] and SEC Director of Corporation Finance William Hinman has stated publicly that bitcoin and ether are not securities;[4] however, to date, the SEC has not formally determined that virtual currencies are not securities. Meanwhile, the United States Commodity Futures Trading Commission ("CFTC") has determined that virtual currencies like bitcoin are

3 Interview by Bob Pisani with Jay Clayton, Chairman, U.S. Sec. and Exch. Comm'n, in New York, N.Y. (June 6, 2018).

4 William Hinman, Digital Asset Transactions: When Howey Met Gary (Plastic): Remarks at the Yahoo! Finance All Markets Summit: Crypto (June 14, 2018), https://www.sec.gov/news/speech/speech-hinman-061418.

commodities,[5] and at least one court has upheld that view.[6] Tokenized securities, like other securities, are subject to SEC jurisdiction, but are different than other securities in that they may apply blockchain technology to raise funds, track ownership, and deliver value to owners. "Utility tokens" (also known as "app-coins") – which, as SEC Commissioner Hester Peirce recently remarked, can "function as a means of executing a transaction, as a way to get access to a product or service or participate in a community, or in any number of ways that have yet to be dreamed up"[7] – may be commodities, or may be neither securities nor commodities. Tokens that are neither securities nor commodities are presumably regulated under the Federal Trade Commission's ("FTC") anti-fraud and other consumer protection authorities, as well as other regulatory regimes. Unfortunately, some distributions of tokenized securities have characterized or claimed the offered assets as "utility tokens," to steer clear of securities-registration requirements. These tokens are not "utility tokens."

Broadly, state attorneys general and the FTC have the authority within their jurisdictions to enforce a variety of anti-fraud and consumer protection laws in markets for all types of digital tokens, while the United States Treasury Department has a range of anti-money laundering and sanctions enforcement powers. Additionally, markets for digital tokens are subject to a number of tax law implications.

II. LEGAL CLASSIFICATIONS & RELATED REGULATORY CONSIDERATIONS

A. VIRTUAL CURRENCIES AND MANY APP-COINS – COMMODITIES, NOT SECURITIES

The term "commodity," as defined in the Commodity Exchange Act ("CEA"), is very broad, and includes "all services, rights, and interests… in which contracts for future delivery are presently or in the future dealt in."[8] Only onions and box office receipts are expressly excluded from the definition. The CFTC, in prior enforcement actions, has determined that "bitcoin and other virtual currencies" are a type of "commodity,"[9] and as mentioned above, a federal court has likewise ruled that the term "'commodity' encompasses virtual currency both in economic function and in the language of the statute."[10] While no statutory definition for the term virtual currency exists, in December 2017, the CFTC stated in a proposed regulatory interpretation that it interprets the terms "virtual currency" and "digital currency" to encompass:

5 *See infra* note 8 and accompanying text.

6 *Commodity Futures Trading Comm'n v. McDonnell*, No. 1:18-cv-00361-JBW-RLM, slip op. (E.D.N.Y. Mar. 6, 2018), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoindroporder030618.pdf.

7 Hester Peirce, Beaches and Bitcoin: Remarks before the Medici Conference (May 2, 2018), https://www.sec.gov/news/speech/speech-peirce-050218.

8 The term "commodity" is defined in the Commodity Exchange Act ("CEA") as "wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by section 13–1 of this title) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in."

9 See In the Matter of: Coinflip, Inc., d/b/a Derivabit, and Francisco Riordan, CFTC Docket No. 15-29 (Sep. 17, 2015), 3, http://www.cftc.gov/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoinfliprorder09172015.pdf.

10 CFTC v. McDonnell, *supra* note 6.

» any digital representation of value (a "digital asset") that functions as a medium of exchange, and

» any other digital unit of account that:

- is used as a form of a currency (i.e., transferred from one party to another as a medium of exchange);
- may be manifested through units, tokens, or coins, among other things; and
- may be distributed by way of digital "smart contracts," among other structures.[11]

On the other hand, bitcoin and other similarly designed digital tokens do not appear to be securities, as that term has been interpreted under the United States Supreme Court's holding in *SEC v. W.J. Howey Co.*,[12] subject to SEC regulation. Indeed, SEC Chairman Jay Clayton recently noted that bitcoin "has been determined by most people to not be a security."[13] His colleague SEC Commissioner Hester Peirce similarly remarked in May 2018 that she is not yet "willing to make a blanket statement that everything other than bitcoin is a security,"[14] and in April 2017, SEC's Division of Corporate Finance Director Bill Hinman noted that "it is certainly possible that there are tokens that would not have the hallmarks of a security."[15] Regarding the features of non-security digital tokens, Mr. Hinman noted that such tokens would include those for which the token holder is buying a token "for its utility rather than investment, especially if it's a decentralized network in which it's used with no central actors." The SEC's recent interpretations of the *Howey* Test with regards to digital tokens, and regulatory considerations associated with tokenized securities, are described in greater detail below.

BRIAN QUINTENZ
CFTC COMMISSIONER

Clearly, the range of digital tokens that are not deemed by United States regulators to be securities may be quite broad. For example, Filecoin is a so-called "utility token" according to CFTC Commissioner Brian Quintenz.[16] Commissioner Quintenz recently drew a distinction between virtual currencies and "utility tokens" in a speech before the Chamber of Digital Commerce,[17] and in more recent remarks, noted that a motivation for creating digital token markets "is to utilize the transferability of tokens to create a secondary market for… non-tangible things."[18] He also expressed his belief that "[e]mpowering a secondary market's price discovery

11 Retail Commodity Transactions Involving Virtual Currency, 82 Fed. Reg. 60,335 (Dec. 20, 2017) (hereinafter "Actual Delivery Proposed Interpretation").
12 SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).
13 *FY 2019 U.S. Securities and Exchange Commission: Hearing Before the Subcomm. on Fin. Services and General Government of the H. Comm. on Appropriations*, 115th Cong. (2018) (statement of Jay Clayton, Chairman, U.S. Sec. and Exch. Comm'n).
14 Kia Kokalitcheva, *SEC Commissioner Won't Declare All Tokens Are "Securities,"* AXIOS (May 3, 2018), https://www.axios.com/sec-crypto-securities-1525340196-82046d9e-a0ac-47c2-ae95-16ddae8a2b63.html (quoting SEC Comm'r Hester Peirce's speech delivered on May 2, 2018, Remarks at the Medici Conference).
15 *Oversight of the SEC's Division of Corporate Finance: Hearing Before the Subcomm. on Capital Markets, Securities, and Investment of the H. Comm. on Fin. Services,* 115th Cong. (2018) (statement of William Hinman, Director of the Division of Corporation Finance, U.S. Sec. and Exch. Comm'n).
16 Brian Quintenz, Comm'r, Commodity Futures Trading Comm'n, Keynote Address before the DC Blockchain Summit (Mar. 7, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz8.
17 *Id.*
18 Brian Quintenz, Comm'r, Commodity Futures Trading Comm'n, Remarks Before the Eurofi High Level Seminar 2018 (Apr. 26, 2018).

and valuation functions for products that were previously untransferable – such as extra storage space on a home computer – is a fascinating development."

If the CFTC determines that a digital token is a "commodity," then it may exercise general anti-fraud and anti-manipulation authority over "spot transactions" in that digital token. The CFTC defines spot transactions as those involving the exchange of a commodity for payment where immediate delivery and payment for the commodity is typically expected to occur on or within a few days of the transaction date.[19] In determining whether transfer of possession and control of the commodity has been made to the buyer, the CFTC considers: (i) "how the agreement, contract, or transaction is marketed, managed, and performed" and (ii) the facts regarding "[o]wnership, possession, title, and physical location," as well as the "relationship[s] between the buyer, seller, and possessor of the commodity… and the manner in which the… sale is recorded and completed."[20]

The CFTC's general anti-fraud and anti-manipulation rule ("Rule 180.1"), which was amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to expand CFTC authority over spot transactions, prohibits persons "in connection with any… contract of sale of any commodity in interstate commerce" from:

» using or employing a manipulative device or scheme to defraud;

» engaging in or attempting to engage in market manipulation or fraud;

» making or attempting to make untrue or misleading statements of a material fact or omitting to state a material fact necessary in order to make statements made not untrue or misleading; and

» delivering false or misleading or inaccurate reports concerning market information or conditions that affect or tend to affect the price of a commodity.[21]

In a recent virtual currency-related regulatory action, the CFTC stated that Rule 180.1 grants it the "ability to bring enforcement actions for fraud or manipulation in connection with… contracts of sale of any commodity in interstate commerce."[22] Previously, the CFTC has relied upon Rule 180.1 to assert its jurisdiction over interstate trading in spot markets for commodities such as silver.[23] In September 2017, the CFTC cited Rule 180.1 in a complaint against a pooled fund operator for fraudulently inducing persons to invest in his bitcoin trading operation.[24] Commentators note that in this complaint, the CFTC "took a step beyond [its] traditional limit" of intervening in commodity spot markets only when "manipulative trading in the spot market affected the associated derivatives market."[25] At the time of the action, no Bitcoin futures market existed.

19 CFTC Letter No. 98-73, Comm. Fut. L. Rep. (CCH) P27,449 (Oct. 8, 1998), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/98-73.pdf.
20 Retail Commodity Transactions Under Commodity Exch. Act, 78 Fed. Reg. 52,426, 52428 (Aug. 23, 2013).
21 17 C.F.R. § 180.1(a) (2018).
22 Actual Delivery Proposed Interpretation, *supra* note 11 at fn 6.
23 *See* Complaint, CFTC v. Atlantic Bullion & Coin, Inc. and Ronnie Gene Wilson, S.C.D., No. 8:12-1503-JMC (June 6, 2012).
24 Complaint, CFTC v. Gelfman Blueprint, Inc. and Nicholas Gelfman, S.D.N.Y, No. 17-7181 (Sep. 21, 2017).
25 Brian T. Daly and Jacob Preiserowicz, *Bitcoin Derivatives and Expanded CFTC Jurisdiction*, Schulte Roth & Zabel (Nov. 14, 2017), https://www.srz.com/resources/bitcoin-derivatives-and-expanded-cftc-jurisdiction.html.

More recently, a March 2018 court ruling regarding a January 2018 CFTC complaint against market participants engaged in the non-leveraged purchase and sale of virtual currencies on behalf of retail customers found that the "CFTC may exercise its enforcement power over fraud related to virtual currencies sold in interstate commerce."[26] Notably, Litecoin, for which no futures market exists, was one of the virtual currencies traded on behalf of investors by the defendants in the complaint.

According to the CFTC, "a key component" of its "ability to effectively regulate [virtual currency] markets" is this ability to "assert legal authority over virtual currency derivatives in support of the CFTC's anti-fraud and manipulation efforts, including in underlying spot markets."[27] Thus the creation by the Chicago Mercantile Exchange ("CME") and Chicago Board Options Exchange ("CBOE") of futures markets for virtual currencies (limited to bitcoin futures to date) will likely lead to heightened CFTC scrutiny over the underlying spot markets for virtual currencies for which a corresponding, CFTC-regulated futures market exists.

Numerous retail customer-oriented spot markets have emerged through which market participants can convert virtual currency, fiat currency, or other digital tokens into other virtual currency, fiat currency, or other digital tokens. Entities that host these markets and that are neither (a) registered with the SEC pursuant to the Exchange Act as a "national securities exchange" or an "alternative trading system" nor (b) registered with the CFTC pursuant to the CEA as a "registered entity," are referred to in this report as "Token Trading Platforms." In some cases, as the CFTC recently noted, "[t]hese platforms provide a place to immediately exchange one commodity for another 'on the spot.'" There are a number of regulatory implications for these "centralized platforms" if a non-security digital token (being converted on a Token Trading Platform into another non-security digital token or into fiat currency) is deemed to be a virtual currency and thus a commodity by the CFTC. One important issue relates to "actual delivery" – a customer using a Token Trading Platform must, according to the CFTC's interpretation of CEA rules, receive "actual delivery" of that virtual currency within in 28 days of sale in order for the sales contract offered by the Token Trading Platform to be excluded from the definition of a futures contract, thus requiring it to be traded on a CFTC-regulated entity.

The CFTC has characterized virtual currencies as intangible commodities capable of actual delivery.[28] In an enforcement action involving Bitfinex, a Token Trading Platform, the CFTC found that actual delivery did not occur in that case because Bitfinex held customers' bitcoin in an omnibus settlement wallet in its own database rather than having transferred possession and control of the bitcoin to the customers.[29] The CFTC interpreted "actual delivery" to mean the delivery to a consumer of the purchased bitcoins' "private key" – the "secret number…associated with a deposit wallet that allows [the bitcoin] in that wallet to be spent."[30] That stance was challenged through a petition that noted:

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26 Memorandum & Order, CFTC v. Patrick K. McDonnell and Cabbagetech, Corp. d/b/a Coin Drop Markets, 3-4, (E.D.N.Y. 2018).

27 CFTC, CFTC Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets (Jan. 4, 2018), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/backgrounder_virtualcurrency01.pdf.

28 *See* Actual Delivery Proposed Interpretation, *supra* note 11 at 60,337.

29 BFXNA INC. d/b/a Bitfinex, Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the CEA, as Amended, Making Findings and Imposing Remedial Sanctions, CFTC Docket No. 16-19 (June 2, 2016), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfbfxnaorder060216.pdf.

30 *Id.*

"[M]aking control of private keys a prerequisite to having ownership and control of a cryptocurrency would be artificial and harmful to [cryptocurrency] markets because private keys have no innate legal significance with regard to the transfer, control, and possession of cryptocurrency on the blockchain… Rather, private keys are a modality to effectuate the parties' contractual agreements…and the significance or lack of significance of private keys…is determined entirely by the transacting parties."[31]

In December 2017, the CFTC issued a proposed interpretation regarding actual delivery of virtual currency, which notes that for actual delivery to occur, (1) a customer must have the ability to (i) "take possession and control" of the virtual currency, and (ii) "use it freely in commerce … no later than 28 days from the date of the transaction," and (2) the offeror or counterparty must not retain "any interest in or control over any of the [virtual currency]." Examples of actual delivery provided by the CFTC note that "title may be reflected by linking an individual purchaser with proof of ownership of the particular wallet to wallets that contain the purchased virtual currency."[32] A March 2018 court ruling calls the CFTC's stance into question, however, noting that "actual delivery" "does not require that a buyer take actual possession and control of the purchased commodities; it requires instead that the possession and control of commodities that exist in fact be transferred from the seller."[33]

Because the CFTC has deemed "virtual currency"[34] not to fall under the definition of "currency," it is not subject to a 2-day actual delivery requirement for retail foreign currency transactions. The agency, however, has requested public comment on whether a shortened actual delivery requirement would be appropriate for virtual currencies, and whether Congress should act to shorten the actual delivery requirement for these instruments.[35]

Regardless, in its Actual Delivery Proposed Interpretation, the CFTC noted that "depending on their use," tokens "may be commodities, commodity options, derivatives, or otherwise fall within the Commission's virtual currency definition described in this interpretation."[36] Indeed, agreements for the future delivery of digital tokens may qualify as derivatives contracts (futures or swaps) for an underlying commodity if the agreement includes optionality and/or does not provide for physical delivery. Such agreements can be thought of as commonplace commodity market forward agreements that provide for future delivery in instances where the commodity has not yet been harvested or extracted for delivery. Such digital tokens would be subject to a variety of futures and swaps regulations as **"CFTC Regulated Instruments"** which, for purposes of this report, means any arrangement involving a digital token that would be subject to regulation by the CFTC as a future, swap, option or retail commodity transaction – as opposed to spot market transactions.

31 *See* Letter, ''Petition for Rulemaking Concerning the Requirements of 'Actual Delivery' and the Transfer of Ownership under the Commodity Exchange Act in the Context of Cryptocurrency Markets Utilizing Blockchain for Executing Transactions'' from Michael Dunn & Micah Green, Steptoe & Johnson LLP, to Chris Kirkpatrick, Secretary, CFTC (July 1, 2016), https://poloniex.com/press-releases/2016.10.18-Our-request- for-no-action-relief/Steptoe-Petition-for-CFTC- Rulemaking-(07-01-2016).pdf.

32 *Id.*

33 Tentative Order Regarding Motion to Dismiss, Motion for Preliminary Injunction, and Motion to Exclude, *CFTC v. Monex Deposit Co.*, et al., SACV 17-1868 JVS (DFM) (2018), (citing *CFTC v. Hunter Wise Commodities*, LLC, 749 F.3d 967, 970 (11th Cir. 2014)).

34 The CFTC has drawn a distinction between "real currency" – which it defined in the action as "the coin and paper money of the United States or another country that are designated as legal tender, circulate, and are customarily used and accepted as a medium of exchange in the country of issuance" – and "virtual currency." Coinflip Order *supra* note 9 at fn 2.

35 Actual Delivery Proposed Interpretation, *supra* note 11 at 60,335.

36 *Id.* at 60,341.

The likelihood that any arrangement involving a digital token may constitute a CFTC Regulated Instrument from the perspective of the CFTC is higher if the arrangement involves optionality, does not provide for immediate delivery of the token to the purchaser, the offer or sale of a commodity on a margined or financed basis where actual delivery does not occur within 28 days, or the exchange of one or more payments based on the value of one or more rates for, or prices of, intangible or tangible commodities.

B. TOKENIZED SECURITIES

The SEC and its staff have historically interpreted the definition of "security" under the Securities Act of 1933 (the "1933 Act" or the "Securities Act") and the Securities Exchange Act of 1934 (the "1934 Act" or the "Securities Exchange Act") broadly.[37] In addition to enumerating specific types of securities, such as stock and bonds, the 1933 Act definition of security also includes an "investment contract," which is essentially a catchall for securities that are not otherwise set out in Section 2(a)(1) of the 1933 Act. In the seminal 1946 case *SEC v. Howey*, noted above, interpreting the scope of the term "investment contract," the Supreme Court held that the term encompasses "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party."[38] Under the *Howey* Test, an investment contract exists if there is: (1) an investment of money; (2) in a common enterprise; (3) with a reasonable expectation of profits; and (4) to be derived from the entrepreneurial or managerial efforts of others.[39]

In July 2017, the SEC considered whether so-called "initial coin offerings" involve, or could involve, the issuance of securities. It issued a Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 in which it concluded, based on an investigation by its Division of Enforcement, that the digital tokens issued by the Decentralized Autonomous Organization (the "DAO") were securities (the "DAO Report") within the meaning of the 1933 Act and 1934 Act.[40] As described in the DAO Report, the DAO, an unincorporated association, issued tokens (the "DAO Tokens") via a website. Investors purchased DAO Tokens with ether. The DAO intended to use the funds it raised through the sale of DAO Tokens to fund "projects." DAO Token holders stood to share in the anticipated earnings from these projects as a return on their investment. After the initial issuance of the DAO Tokens, a secondary market for trading the DAO Tokens developed.

In the DAO Report, the SEC analyzed whether the DAO Token was a security. Because a digital token such as the DAO Token is not a specifically-enumerated type of security under the 1933 Act, such as a stock or a bond, the SEC considered whether the DAO Token was an "investment contract."

37 Robert H. Rosenblum, Chapter 2, Investment Company Determination under the 1940 Act: Exemptions and Exceptions, 2 (2003), https://apps.americanbar.org/buslaw/newsletter/0014/materials/investmentch2.pdf.

38 *W.J. Howey and Co.*, 328 U.S. at 298-299.

39 *Id*. at 301.

40 SEC, *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO*, Securities Act Release No. 81207 (July 25, 2017), https://www.sec.gov/litigation/investreport/34-81207.pdf.

To answer that question, the SEC applied the *Howey* Test and concluded that the DAO Tokens qualified as investment contracts and thus were securities for purposes of the Securities Act and the Exchange Act.[41] Specifically, the SEC found that:

» the purchase of DAO Tokens with ether was an "investment of money," noting that "money" need not take the form of cash;

» investors in DAO Tokens were investing in a common enterprise, *i.e.*, the DAO, which was created to pool resources and invest in a variety of projects;

» investors reasonably expected to earn profits by sharing in the return on projects that the DAO would fund from the proceeds of the DAO Token sales; and

» DAO Token holders' profits were to be derived from the managerial efforts of others, namely the founders and other key personnel associated with the DAO who would direct investments in projects.

Accordingly, the SEC concluded that DAO Tokens were securities that were issued without being registered under the Securities Act.

This was the first time that the SEC publicly found that a digital token constituted an investment contract under the Howey Test.

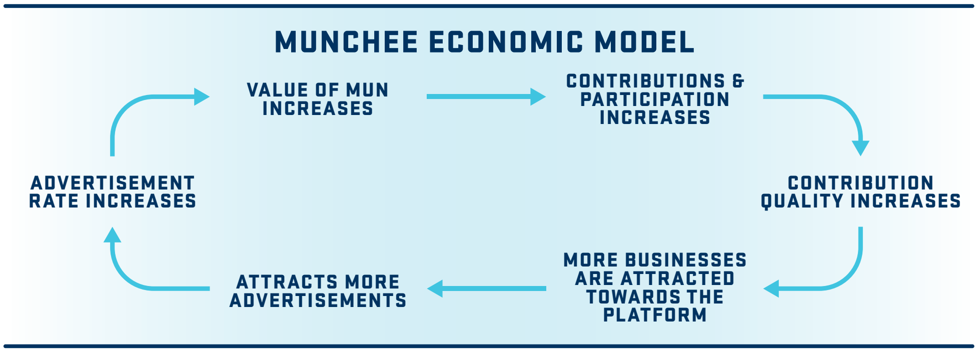
After publishing the DAO Report, the SEC brought a number of enforcement actions related to so-called ICOs. Most of those actions, however, were brought against persons who launched Ponzi schemes or other outright frauds.[42] Yet in the December 2017 *Munchee* Order, the SEC took the opportunity to expand upon the DAO Report.[43] *Munchee* involved the creator of a restaurant review smartphone application, Munchee, that wanted to raise capital through the sale of digital tokens to expand its business. Munchee issued a white paper describing its proposed business expansion and

41 *Id.*

42 Complaint, REcoin Group Foundation, LLC et al. (Sep. 29, 2017), http://www.sec.gov/litigation/complaints/2017/comp-pr2017-185.pdf; Complaint, SEC v. PlexCorps et al. (Dec. 1, 2017), http://www.sec.gov/litigation/complaints/2017/comp-pr2017-219.pdf; Order, Munchee, Inc. (Dec. 11, 2017), http://www.sec.gov/litigation/admin/2017/33-10445.pdf; Complaint, AriseBank et al. (Jan. 25, 2018), https://www. sec.gov/litigation/complaints/2018/comp-pr2018-8.pdf; Complaint, Jon E Montroll and Bitfunder (Feb. 21, 2018), https://www.sec. gov/litigation/complaints/2018/comp-pr2018-23.pdf; Complaint, Centra Tech., Inc. (Apr. 2, 2018), https://www.sec.gov/litigation/complaints/2018/comp-pr2018-70.pdf; Complaint, Longfin Corp., et al. (Apr. 6, 2018), http://www.sec.gov/litigation/complaints/2018/comp-pr2018-61.pdf.

43 Munchee Inc., Securities Act Release No. 10445 (Dec. 11, 2017), https://www.sec.gov/litigation/admin/2017/33-10445.pdf.

plan to raise $15 million by issuing so-called "MUN tokens" in exchange for bitcoin and ether. Munchee characterized the MUN tokens as "utility tokens" and promised they could be used in the future to purchase goods and services in the ecosystem that Munchee would create. Munchee also stated that as use of its app increased, the value of MUN tokens would increase. Moreover, it promised to help increase the value of MUN tokens by "burning" tokens in the future, i.e., taking tokens out of circulation, and by working to ensure that the tokens would trade on a number of trading platforms.



The SEC's Division of Enforcement contacted Munchee and communicated its view that Munchee was engaged in an unregistered offering of securities in violation of the federal securities laws. Munchee terminated its offering, did not deliver any MUN tokens, and returned all proceeds it received from investors. In its cease-and-desist order concluding that MUN tokens were securities under the *Howey* Test, the SEC took the position that "[p]urchasers reasonably would have viewed the MUN token offering as an opportunity to profit… whether or not they ever used the Munchee App or otherwise participated in the MUN 'ecosystem.'"[44] Specifically, the SEC referenced online and social media statements made by Munchee in which, as the SEC notes, MUN token holders were told they "could count on the 'burning' of MUN tokens to raise the value of remaining MUN tokens." The order also highlights that Munchee promised to take action to increase the value of MUN tokens by expanding its business and agreed to use its efforts to allow investors to take advantage of the increased value of MUN tokens by helping to establish a secondary market that would allow holders to sell their tokens. That profit, moreover, would derive from the entrepreneurial efforts of Munchee and its agents, who were working to build out Munchee. The SEC also emphasized that characterizing a digital token as a "utility token" was not in and of itself sufficient to take MUN tokens outside of the definition of a security, even if the tokens had practical use. Rather, the key was the economic reality underlying a token sale; yet the *Munchee* Order made clear that MUN tokens had no utility at the time of issuance outside of their potential to trade on the secondary market, given that Munchee had not yet built out its ecosystem.

Since *Munchee*, the SEC has continued to urge caution with respect to digital token distributions. Chairman Clayton remarked during a February 2018 United States Senate hearing that he views many

44 *Id.*

new digital tokens to be securities,[45] although more recently, he noted that it is "absolutely not" the case that all digital tokens are securities.[46] Yet, as Chairman Clayton explained during his February testimony, and as noted in the DAO Report, whether a digital token distribution involves a security is a facts-and-circumstances determination.

Of course, as explained above, SEC officials appear to recognize that some digital tokens are not securities.[47] Notably, the SEC did not deem ether to be a security in its DAO Report, and both the SEC and Chairman Clayton seemingly draw a distinction between "coins" (such as virtual currencies, which are commodities) and "virtual tokens."[48] With regard to the distinction between securitized tokens and other digital tokens, Chairman Clayton remarked in 2017,

"A KEY QUESTION FOR ALL ICO MARKET PARTICIPANTS IS, 'IS THE COIN A TOKEN OR A SECURITY?'"

- Chairman Jay Clayton, U.S. Securities and Exchange Commission

"A key question for all ICO market participants: 'Is the coin or token a security?' As securities law practitioners know well, the answer depends on the facts. For example, a token that represents a participation interest in a book-of-the-month club may not implicate our securities laws and may well be an efficient way for the club's operators to fund the future acquisition of books and facilitate the distribution of those books to token holders."[49]

Furthermore, in April 2018, he stated that digital tokens can evolve from being securities into non-securities, using the example of a laundry token:

"If I have a laundry token for washing my clothes, that's not a security. But if I have a set of 10 laundry tokens and the laundromats are to be developed and those are offered to me as something I can use for the future and I'm buying them because I can sell them to next year's incoming class, that's a security. . .What we find in the regulatory world [is that] the use of a laundry token evolves over time. . .[and] [t]he use can evolve toward or away from a security."[50]

45 *Virtual Currencies: The Oversight Role of the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 115th Cong. (2018) (statement of Jay Clayton, Chairman, U.S. Sec. and Exch. Comm'n).

46 Nikhilesh De and Mahishan Gnanaseharan, *SEC Chief Touts Benefits of Crypto Regulation*, COINDESK (Apr. 5, 2018), https://www.coindesk.com/sec-chief-not-icos-bad/.

47 *See supra* notes 13 to 15 and accompanying text.

48 SEC, *Statement Urging Caution Around Celebrity Backed ICOs*, (Nov. 1, 2017), https://www.sec.gov/news/public-statement/statement-potentially-unlawful-promotion-icos; SEC, *Investor Bulletin: Initial Coin Offerings,* (July 25, 2017), https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-initial-coin-offerings.

49 SEC, *Statement on Cryptocurrencies and Initial Coin Offerings*, (Dec. 11, 2017), https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11.

50 De and Gnanaseharan, *supra* note 46.

No formal SEC statement exists listing the criteria under which the SEC would determine that a particular digital token is or is not a security. As explained above, the SEC relies upon facts and circumstances using the *Howey* Test and has provided insights into its digital token-specific considerations in these matters through the DAO Report and the *Munchee* enforcement action. If the SEC does determine that a particular digital token is a security, then a panoply of federal securities laws applies to the distribution and trading of that token, as outlined below.

1. REGISTRATION OF OFFERS AND SALES

Section 5 of the Securities Act prohibits the sale of securities to the public unless a registration statement for such securities has been filed with the SEC and is in effect, and the issuer has delivered a prospectus to investors. The SEC's DAO Report observes that the term "issuer" is flexibly construed, and, therefore, that The DAO was an issuer required to provide needed information material to the investors in deciding whether to purchase the DAO Tokens.

Section 12(a)(1) of the Securities Act imposes liability on persons who offer or sell securities in violation of Section 5.[51] Under limited circumstances, offers to sell securities can be made prior to the filing of a registration statement (pre-filing period). There is no defined period as to when the pre-filing period commences; therefore, token issuers should consider whether publishing of white papers on websites could be construed as an offer to sell.

There are several potential exemptions from the registration requirements, including:

» Section 4 of the Securities Act permits sales of securities without registration with the SEC under specified circumstances:

- Section 4(a)(2) Non-public offerings – Issuers must limit sales to so-called "sophisticated investors" who have sufficient knowledge and experience in finance and business to evaluate the risks and merits of investment, or who have the ability to bear the risk of loss associated with the investment.
- Section 4(a)(5) – This paragraph permits non-public offers and sales made solely to accredited investors (a term discussed below), up to a maximum issuance of $5 million.
- Section 4(a)(6) – This paragraph provides a crowdfunding exemption that permits the issuance of securities that does not exceed $1 million in value. It also imposes maximum amounts that individual investors may invest in a given crowdfunding offering.
- Section 4(a)(7) – This paragraph provides that sales of securities are permitted where, among other things, issuers have limited sales to accredited investors; have not engaged in general solicitation or general advertising, and make specified information available to prospective purchasers, including the issuer's most recent balance sheet and profits and loss statement, as well as similar financial statements.

51 Violations of securities laws are subject to civil and criminal penalties.

» Rules 504 and 506 of Regulation D under the Securities Act[52] – Regulation D is intended to clarify the scope and requirements of certain securities offering exemptions under Section 4 of the Securities Act. The rules permit issuance of securities without SEC registration. Securities offerings under Rule 504 are open both to accredited and non-accredited investors,[53] but general solicitation of investors is prohibited. Offerings under Rule 506 are limited to accredited investors, but general solicitation is permitted for offerings conducted under paragraph (c) of Rule 506 (intended to allow access to the capital markets for small companies unable to bear costs of normal registration. Sales are generally limited to accredited investors.)

» Regulation A under the Securities Act – allows companies to raise money under two different tiers:

- Tier 1 – eligible up to $20 million in a 12-month period; requires an offering circular to be filed with and qualified by the SEC as well as relevant state regulators; submission of unaudited financial statements; no ongoing reporting obligations.
- Tier 2 – eligible up to $50 million in a 12-month period; requires an offering circular to be filed with and qualified by the SEC; submission of audited financial statements; and ongoing reporting obligations.

Issuers also need to be aware of potential state law securities registration requirements.

2. SECONDARY MARKET TRADING

Investors can resell securities that they acquire in private and public offerings in private transactions, on registered securities exchanges or in over-the-counter ("OTC") transactions. Each type of resale transaction is subject to certain requirements and considerations. This report focuses on secondary market transactions on exchanges and OTC markets.

Both the exchanges and the securities that trade on them are subject to requirements under the Exchange Act. Section 5 of the Exchange Act makes it unlawful to effect any transaction in a security on an exchange unless it is registered as a national securities exchange under Section 6 of the Exchange Act or exempted from such registration. An exchange is defined as "a marketplace or facilities for bringing together purchasers and sellers of securities."[54] In the DAO Report, the SEC concluded that the platforms that permitted secondary market trading in DAO Tokens were unregistered exchanges not exempt from registration and, thus, their trading of DAO Tokens, which were securities, violated Section 5 of the Exchange Act.

52 17 C.F.R. § 230.500 *et seq.* (2018).

53 Under Rule 501 of Regulation D, the term "accredited investor" includes, among others, certain financial institutions, such as broker-dealers, registered investment companies and insurance companies. It also includes natural persons whose net worth, or joint net worth with that person's spouse, exceeds $1 million (excluding the value of the person's residence). The term also includes natural persons whose income in each of the two most recent years was in excess of $200,000 or jointly with that person's spouse was in excess of $300,000.

54 Exchange Act Section 3(a)(1), 15 U.S.C. § 78c(a)(1) (2012), and Exchange Act Rule 3b-16(a), 17 C.F.R. § 240.3b-16(a) (2018).

Securities that trade on an exchange are either listed to trade on that exchange, or entitled to unlisted trading privileges on that exchange (a security may obtain unlisted trading privileges on an exchange only if it is listed on another exchange). Section 12 of the Exchange Act prohibits a security from trading on a national securities exchange unless there is in place an effective registration with respect to that security for the exchange. Exchanges display quotations in securities in accordance with applicable securities laws, regulations and rules, such as Regulation NMS.[55]

Securities can also trade on an OTC basis, typically on alternative trading systems ("ATS"). An ATS is a marketplace that provides for secondary market trading of securities. Instead of registering as a national securities exchange, however, an ATS registers as a broker-dealer and files Form ATS with the SEC in accordance with the requirements of Regulation ATS.[56] An ATS does not list securities. Rather, an ATS typically displays quotations in securities that broker-dealer subscribers to the ATS provide in compliance with Rule 15c2-11 under the Exchange Act. Rule 15c2-11 requires a broker-dealer wishing to publish any quotation for a security in a "quotation medium" (which includes an ATS) to gather specified information regarding the issuer.[57] Securities issued in a private placement, however, are not freely tradeable and, thus, cannot be subject to quoting on an ATS unless and until they have met certain requirements, such as a six-month or one-year restricted period, i.e., a period during which the security may not be traded, as set out in Rule 144 under the Securities Act.[58]

3. ANTI-FRAUD, ANTI-MANIPULATION, AND RELATED RULES

Federal securities laws, rules, and regulations (*e.g.*, Rule 10b-5 under the Exchange Act) prohibit, directly or indirectly, fraud and manipulation in connection with the purchase or sale of any security as well as with security-based swap transactions. Such behavior includes: (a) fraudulent or deceitful devices and schemes; and (b) material misstatements or omissions.

Separately, Section 11(a) of the Securities Act imposes liability for untrue statements of material facts in registration statements, or omissions of material facts that are needed to make statements in registration statements not misleading. Furthermore, Section 12(a)(2) of the Securities Act allows for the rescission of securities purchases (or a suit for damages) if the offer/sale was made using a prospectus or oral communication containing material misstatements or omissions.

Additionally, there are a number of state laws, such as the Martin Act of New York State, related to fraud and manipulation in securities markets.

55 17 C.F.R. § 242.600 *et seq.* (2018).
56 17 C.F.R. § 242.300 *et seq.* (2018).
57 17 C.F.R. § 240.15c2-11 (2018).
58 17 C.F.R. § 230.144 (2018).

4. OTHER ISSUES

If a derivatives market emerges for which the underlying asset is a tokenized security, either the SEC or the CFTC would regulate the derivatives. Options, swaps on single names or narrow indexes, or futures on single names would be subject to the SEC's jurisdiction. Swaps on broad-based indices and futures on other than single names would be subject to CFTC jurisdiction.

A person that "engages on behalf of an issuer of securities or on behalf of itself in… transferring record ownership of securities by bookkeeping entry without physical issuance of securities certificates" would fall within the definition of "transfer agent" in the Exchange Act.[59] Unless exempted, a transfer agent that makes use of the jurisdictional means to perform that function with respect to a security registered under Exchange Act Section 12[60] must register as such with the SEC.[61] Therefore, a system that uses distributed ledger technology to electronically transfer record ownership of securities as or on behalf of an issuer may be subject to the registration requirements of Section 17A of the Exchange Act.

C. WHEN DIGITAL TOKENS ARE NEITHER SECURITIES NOR COMMODITIES

As suggested earlier, it is possible – and perhaps appropriate – for some digital tokens to be viewed as neither a security nor a commodity by regulators. In these instances, digital tokens can bear a closer resemblance to participatory rights in channels of communication, collaboration, and commerce, rather than as an intangible commodity or security that is bought and sold.

For example, airline miles and other loyalty and rewards points programs constitute neither securities nor commodities. Yet points in many such programs can oftentimes be purchased for fiat currency and even transferred for cash. Of course, these instruments are not generated using blockchain technology, but nonetheless illustrate that in the United States regulatory context it is plausible that cash conversion markets for particular tokens could exist, even though tokens do not constitute securities or commodities, but rather, participatory rights in a system of communication or commerce.

Federal and state consumer protection laws and escheat laws apply to gift cards, gift certificates, and similar kinds of property, and presumably would apply to tokens that are neither securities nor commodities. Indeed, the broader regulatory considerations set forth below apply not just to tokens that are neither securities nor commodities, but also to all other digital tokens, broadly defined.

59 15 U.S.C. § 78c(a)(25)(E) (2012). Other provisions of the definition also may be relevant to this discussion. *See, e.g.*, § 78c(a)(25)(B) and (C) (2012).
60 15 U.S.C. § 78l (2012).
61 78 U.S.C. § 78q-1(c)(1) (2012).

III. BROADER REGULATORY CONSIDERATIONS

A. CONSUMER PROTECTION ISSUES

Regardless of the legal category (security versus commodity versus neither) of a particular digital token, state attorneys general ("AG") would have jurisdiction to enforce their states' consumer protection and anti-fraud statutes as those laws relate to the purchase and sale of tokens. AG offices would likely have jurisdiction to bring enforcement actions if residents of their states were affected, or if bad actors conducted business in their state. The FTC is also charged with protecting consumers from unfair or deceptive acts and practices that affect commerce.[62] The FTC has authority to conduct investigations, issue subpoenas, and file enforcement actions in administrative tribunals or in federal court. If securities laws do not apply, it is likely that the FTC would have jurisdiction to bring antifraud claims against bad actors.[63] In 2014, the Consumer Financial Protection Bureau ("CFPB") issued a statement regarding virtual currency products and services, noting that it will use complaints it receives from consumers regarding bitcoin and other virtual currencies to "help enforce federal consumer financial laws and, if appropriate, take consumer protection policy steps."[64] So far, the agency has yet to take any enforcement actions related to virtual currencies or digital tokens. Notably, in 2016, the Bureau's final prepaid card rule was issued without referring to virtual currency products within its "prepaid access" definition, and the agency stated that the "application of Regulation E and this final rule to [virtual currency] products and services" was "outside of the scope" of its rulemaking.[65] It also noted that, "as part of its broader administration and enforcement of the enumerated consumer financial protection statutes and Title X of the Dodd-Frank Act, the Bureau continues to analyze the nature of products or services tied to virtual currencies."[66]

B. STATE MONEY TRANSMISSION LAWS

Trading Platforms that receive for transmission or transmit U.S. dollars in exchange for virtual currency are regulated as money transmitters in many U.S. states in which they operate or have customers. Money transmitter regulatory regimes entail a variety of regulations aimed primarily at protecting consumers, which often include regular examinations, minimum net worth standards, disclosures of key employee criminal convictions, descriptions of the organization's structure, and a copy of recent audited financial statements.[67] Some state regulatory regimes may entail particularly stringent obligations and/or may be geared particularly towards firms engaged in the purchase, sale, generation, or distribution of convertible virtual currencies. For example, the New York Department of Financial Services "BitLicense" requirements are triggered when a company engages in a "virtual

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62 *See* Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) (2012).

63 *See, for example*, Complaint for Permanent Injunction and Other Equitable Relief at 1-2, FTC v. BF Labs, Inc., No. 4:14-cv-0815 (W.D. Mo. Sept. 15, 2014). For more information on this case, see Darren J. Sandler, "Citrus Groves in the Cloud: Is Cryptocurrency Cloud Mining a Security?," 34 SANTA CLARA HIGH TECHNOLOGY LAW JOURNAL 250, 267-268 (Jan. 2018).

64 CFPB, *CFPB Warns Consumers About Bitcoin*, (Aug. 11, 2014), https://www.consumerfinance.gov/about-us/newsroom/cfpb-warns-consumers-about-bitcoin/.

65 CFPB, *Prepaid Accounts under the Electronic Fund Transfer Act (Regulation E) and the Truth In Lending Act (Regulation Z)*, 164 (Oct. 3, 2016), https://files.consumerfinance.gov/f/documents/20161005_cfpb_Final_Rule_Prepaid_Accounts.pdf.

66 *Id*.

67 CSBS, *The State of State Money Service Businesses Regulation and Supervision*, (May 2016), https://www.csbs.org/sites/default/files/2017-11/State%20of%20State%20MSB%20Regulation%20and%20Supervision%202.pdf.

currency business activity." All holders of a BitLicense must maintain a written anti-fraud policy as well as other enumerated policies. Further, federal law makes it a crime to fail to obtain state money transmitter licenses when required to do so.[68]

C. ANTI-MONEY LAUNDERING AND SANCTIONS REGULATIONS

Anti-money laundering ("AML") regulations and associated requirements are significantly important to how digital tokens can be distributed and purchased. The relevant AML rules relate to the Bank Secrecy Act ("BSA"),[69] which requires financial institutions to comply with recordkeeping and reporting requirements, and to develop and implement AML compliance regimes. Similar requirements exist for asset management firms and broker-dealers, including under FINRA Rule 3310. Money transmitters must also register as money services businesses ("MSBs") with the United States Treasury Department's Financial Crimes Enforcement Network ("FinCEN").

The sanctions programs maintained by the Office of Foreign Assets Control ("OFAC") also apply to digital token market participants.

Companies engaged in financial transactions are advised to maintain both AML and OFAC compliance programs to ensure they do not run afoul of these obligations and restrictions. To maintain compliance with both of these regimes, companies must have some understanding of persons with whom they interact.

1. BANK SECRECY ACT & RELATED REGULATORY REQUIREMENTS

In 1970, the United States Congress passed the Currency and Foreign Transactions Reporting Act, commonly known as the BSA, which established requirements for recordkeeping and reporting by private individuals, banks, and other financial institutions. The BSA was designed to help identify the source, volume, movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited in financial institutions. The statute requires individuals, banks, and other financial institutions to file reports with the United States Department of the Treasury, properly identify persons conducting transactions, and maintain appropriate records of financial transactions. These reports and records enable law enforcement and regulatory agencies to pursue investigations of criminal, tax, and regulatory violations, and provide evidence useful in prosecuting money laundering and other financial crimes.

Various statutes since then expanded on the authority of the BSA, including the Money Laundering Control Act of 1986, the Annunzio-Wylie Anti-Money Laundering Act of 1992, the Money Laundering Suppression Act of 1994, and the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT Act").

68 18 U.S.C. § 1960 (2012).
69 31 U.S.C. § 5311 *et seq* (2012); 12 U.S.C. §§ 1829b, 1951-1959 (2012).

Pursuant to guidance published on March 18, 2013 by the FinCEN, the Treasury agency charged with administering and enforcing the BSA, "administrators" and "exchangers" of convertible virtual currency are treated as money transmitters under the BSA and are thus subject to its AML requirements. [70]

Specifically, money transmitters – such as certain Trading Platforms – must develop, implement, and maintain effective AML programs that address the ever-changing strategies of money launderers and terrorists who attempt to gain access to the United States financial system.

ANTI-MONEY LAUNDERING COMPLIANCE PROGRAM MINIMUM ELEMENTS

1	2	3	4
A SYSTEM OF POLICIES, PROCEDURES, AND INTERNAL CONTROLS	A DESIGNATED BSA OFFICER	TRAINING FOR APPROPRIATE PERSONNEL	INDEPENDENT TESTING

At a minimum, an AML compliance program must contain the following elements:

1. A system of policies, procedures, and internal controls to ensure compliance with the BSA;
2. A designated BSA Officer who is responsible for ensuring the Company's compliance with the BSA and Office of Foreign Assets Control ("OFAC") requirements;
3. Training for appropriate personnel; and
4. Independent testing of the program.

The program must also address specific recordkeeping and reporting obligations, such as filing suspicious activity reports ("SARs") and currency transaction reports ("CTRs").

70 FIN-2013-G001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (Mar. 18, 2013). Note that money transmitters must also obtain state money transmitter licenses in almost every U.S. state and territory. Failure to do so constitutes a federal crime under 18 U.S.C. § 1960.

Similar requirements apply to broker-dealers,[71] mutual funds,[72] and futures commission merchants and introducing commodity brokers.[73] Broker-dealers also must comply with FINRA's AML compliance rule, FINRA Rule 3310.[74] Further, general prohibitions against promoting or conducting a transaction knowing the proceeds facilitate money laundering or other crimes, whether or not a company is a "financial institution" under the BSA, apply to all persons.[75]

Appropriate procedures for KYC at customer onboarding and then monitoring the customer's ongoing transactions are essential to determining whether suspicious activity is occurring.

It is also worth noting that various state regulatory regimes may entail additional AML standards. For example, holders of New York's "BitLicense" must, among other things:

» Conduct AML risk assessments, and maintain and enforce an AML program very similar in structure to that required by FINRA Rule 3310;

» Verify customer identities at account opening and maintain transaction records that reflect the identity and physical addresses of customers and other parties to the transaction to the extent practicable;

» File SARs as required under federal law, and make certain SAR-like filings to NY state if not required to make such filings to federal regulators; and

» Maintain a written anti-fraud policy.

2. Office of Foreign Assets Control Requirements

The Office of Foreign Assets Control ("OFAC") administers and enforces both comprehensive and targeted economic and trade sanctions to further United States foreign policy and national security goals against certain foreign countries and regimes, nationals of certain of those countries, designated terrorists, foreign terrorist organizations, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy, or the economy of the United States. OFAC acts under Presidential national emergency powers, as well as authority granted by specific legislation, to impose controls on transactions and freeze assets under United States jurisdiction.

OFAC requirements apply to all "U.S. persons" or "Persons subject to U.S. jurisdiction", including United States incorporated companies and their foreign branches, persons and companies located or physically in the United States, and United States citizens and permanent resident aliens wherever located. In certain sanctions programs, foreign subsidiaries owned or controlled by United States companies must also comply.

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71 31 C.F.R. § Part 1023 (2018).
72 31 C.F.R. § Part 1024 (2018).
73 31 C.F.R. § Part 1026 (2018).
74 FINRA Rule 3310.
75 18 U.S.C. §§ 1956, 1957 (2012).

The specific prohibitions vary depending on the program; however, OFAC sanctions generally prohibit transactions or dealings with a person or entity identified on the OFAC list of Specially Designated Nationals and Blocked Persons (the "SDN List") or the assets of a SDN, as well as certain transactions and activities with countries or sectors subject to economic sanctions. OFAC regulations maintain specific instructions on what to do if such a transaction or dealing is attempted, including "blocking" (freezing) of accounts or property, or prohibiting or rejecting the transaction.

3. EXECUTIVE ORDER 13827 AND VENEZUELA-RELATED SANCTIONS

On January 19, 2018, OFAC published FAQ 551 stating that United States persons who engage in purchasing or otherwise dealing with the Venezuelan petro (a state-sponsored virtual currency backed by oil) may violate United States sanctions imposed against Venezuela because of rights attached to it to receive commodities, such as oil, in a specified quantity at a later date.[76] This right to receive commodities would violate Executive Order 13808, issued on August, 24, 2017, which, among other things, prohibits transactions, financing, and other dealings regarding "new debt with a maturity of greater than 30 days, or new equity, of the Government of Venezuela."[77]

On March 19, 2018, President Trump signed Executive Order 13827, Taking Additional Steps to Address the Situation in Venezuela and memorializing the policy position taken in FAQ 551. This Executive Order provides that United States persons may not transact, deal, or provide financing related to any digital currency, digital coin, or digital token that was issued by, or on behalf of the Government of Venezuela on or after January 9, 2018.[78] Executive Order 13827 also covers the broad concepts of "digital currency," "digital coin," and "digital token," which are undefined in the Order but are explained in OFAC FAQs 564-566.

Following the issuance of Executive Order 13827, OFAC amended its list of FAQs related to sanctions imposed against Venezuela to add FAQs 564-66. FAQ 564 clarifies that for the purposes of Executive Order 13827, Venezuela's petro and petro-gold are considered to be a digital currency, digital coin, or digital token issued by the Government of Venezuela on or after

76 OFFICE OF FOREIGN ASSETS CONTROL, FAQ 551 (2018). Superseded by Exec. Order No. 13,827 (Mar. 19, 2018), 83 Fed. Reg. 12,469 (2018), https://www.federalregister.gov/d/2018-05916.

77 *Id.*

78 Exec. Order No. 13,827 (Mar. 19, 2018), 83 Fed, Reg. 12,469 (2018), https://www.federalregister.gov/d/2018-05916.

January 9, 2018; thereby prohibiting transactions by United States persons related to the petro and petro-gold.[79] FAQ 565 clarifies that Venezuela's fiat currency, the bolivar fuerte, does not constitute a digital currency, digital coin, or digital token. Finally, FAQ 566 provides that OFAC would consider license applications related to digital currencies, digital coins, or digital tokens issued by the Government of Venezuela on a case-by-case basis, but generally, absent OFAC's authorization, United States persons may not "engag[e] in transactions related to, provid[e] financing for, and otherwise deal" in Venezuelan-issued digital currencies, digital coins, or digital tokens.

On March 19, 2018, OFAC amended its FAQs to clarify its policy position on virtual currencies generally.[80] FAQ 559 defines "virtual currency," "digital currency," "digital currency wallet," and "digital currency address."[81]

FAQ 560 states that OFAC compliance obligations are the same for United States persons whether transactions are denominated in a digital currency or a traditional fiat currency. Further, OFAC specifically notes that the compliance obligations extend to firms that are using digital currency when facilitating or engaging in online commerce or processing transactions, as well as trading platforms and others. In addition, the FAQ states that technology companies, digital currency users, digital currency trading platforms, digital currency administrators, and other payment processors, among others, should develop tailored, risk-based compliance programs that include sanctions list screening.

FAQ 561 explains that OFAC will use pre-existing government strategies designed to combat illicit use of digital currencies in order to sanction perpetrators. In addition, OFAC reserved the right to amend its SDN list to include specific digital currency addresses that are associated with blocked persons or entities that appear on the list.

FAQ 562 explains that OFAC may also add digital currency addresses associated with blocked persons to the SDN list, and reminds companies that any such digital currency must be blocked and to file a blocking report with OFAC.

FAQ 563 states that the format in which a digital currency address is included on the SDN list will include its corresponding digital currency.

79 OFFICE OF FOREIGN ASSETS CONTROL, FAQ 564-66 (2018), https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_other.aspx#venezuela.

80 OFFICE OF FOREIGN ASSETS CONTROL, FAQ 559 (2018), https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_compliance.aspx.

81 *Id.* Virtual currency is defined as a "digital representation of value that functions as (i) a medium of exchange; (ii) a unit of account; and/or (iii) a store of value; is neither issued nor guaranteed by any jurisdiction; and does not have legal tender status in any jurisdiction." Digital currency "includes sovereign cryptocurrency, virtual currency (non-fiat), and a digital representation of fiat currency." *Id.* Digital currency wallet is defined as "a software application (or other mechanism) that provides a means for holding, storing, and transferring digital currency. A wallet holds the user's digital currency addresses, which allow the user to receive digital currency, and private keys, which allow the user to transfer digital currency. The wallet also maintains the user's digital currency balance. A wallet provider is a person (individual or entity) that provides the software to create and manage wallets, which users can download. A hosted wallet provider is a business that creates and stores a digital currency wallet on behalf of a customer. Most hosted wallets also offer exchange and payments services to facilitate participation in a digital currency system by users." *Id.* Digital currency address is defined as "an alphanumeric identifier that represents a potential destination for a digital currency transfer. A digital currency address is associated with a digital currency wallet." *Id.*

D. FEDERAL INCOME TAX TREATMENT

The federal income tax consequences of transactions involving digital tokens is a developing area of law. The IRS has issued some guidance in Notice 2014-21, which generally treats convertible virtual currencies as property for United States tax purposes, rather than, for example, as foreign currency. However, Notice 2014-21 does not cover all of the terrain, and there are a number of areas of remaining uncertainty.

1. TREATMENT OF CONVERTIBLE VIRTUAL CURRENCIES UNDER NOTICE 2014-21

In April 2014, the IRS issued Notice 2014-21, which explains, in question and answer format, the application of existing general tax principles to transactions using virtual currency.

The guidance in the Notice only applies to "convertible virtual currency," defined as "[v]irtual currency that has an equivalent value in real currency, or that acts as a substitute for real currency." The Notice cited bitcoin as one example of a convertible virtual currency, noting that it "can be digitally traded between users and can be purchased for, or exchanged into, United States dollars, Euros, and other real or virtual currencies."

The Notice provides that, in general, the sale or exchange of convertible virtual currency, or the use of convertible virtual currency to pay for goods or services in a real-world economy transaction, has tax consequences that may result in a tax liability. The Notice provides that virtual currency is treated as property for tax purposes and that "[g]eneral tax principles applicable to property transactions" apply to transactions using virtual currency. The Notice provides that virtual currency is not treated as currency that could generate foreign currency gain or loss for tax purposes.

The Notice describes some of the tax consequences of mining virtual currency. The Notice provides that when a taxpayer successfully mines virtual currency, the fair market value of the virtual currency as of the date of receipt is includible in gross income. The Notice further provides that if a taxpayer's mining of virtual currency constitutes a trade or business, and the mining activity is not undertaken by the taxpayer as an employee, the net earnings resulting from those activities constitute self-employment income and are subject to the self-employment tax.

The Notice also describes some of the tax consequences of exchanging virtual currency for other property. If the fair market value of property received in exchange for virtual currency exceeds the taxpayer's adjusted basis of the virtual currency, the taxpayer has taxable gain. The taxpayer has a loss if the fair market value of the property received is less than the adjusted basis of the virtual currency. The Notice provides that the basis of virtual currency is generally equal to the fair market value of the virtual currency in United States dollars as of the date of receipt. The Notice also provides that if a virtual currency is listed on an exchange and the exchange rate is established by market supply and demand, the fair market value of the virtual currency is determined by converting the virtual currency into United States dollars (or into another real currency which in turn can be converted into United States dollars) at the exchange rate, in a reasonable manner that is consistently applied.

The character of the gain or loss generally depends on whether the virtual currency is a capital asset in the hands of the taxpayer. Virtual currency held for investment typically should be treated as a capital asset. Virtual currency held mainly for sale to customers in a trade or business typically should not be treated as a capital asset. In general, gain on the sale or exchange of a capital asset is treated as long-term capital gain (taxed at preferential rates) when the capital asset has been held for longer than one year. When a capital asset has been held for less than one year, gain generally is treated as short-term capital gain (taxed at ordinary income rates). Gain on the sale or exchange of a non-capital asset generally is treated as ordinary income.

The Notice provides that payments made using virtual currency are subject to information reporting to the same extent as any other payment made in property. The fair market value of virtual currency paid as wages is subject to federal income tax withholding, Federal Insurance Contributions Act ("FICA") tax, and Federal Unemployment Tax Act ("FUTA") tax and must be reported on Form W-2. Generally, a person who in the course of a trade or business makes a payment of $600 or more in a taxable year to an independent contractor for the performance of services is required to report that payment to the IRS and to the payee on Form 1099-MISC. A third party that contracts with a substantial number of unrelated merchants to settle payments between the merchants and their customers is a third-party settlement organization that is required to report payments made to a merchant on a Form 1099-K.

Payments made using virtual currency are subject to backup withholding to the same extent as other payments made in property. Therefore, payors making reportable payments using virtual currency must solicit a taxpayer identification number ("TIN") from the payee. The payor must backup withholding from the payment if a TIN is not obtained prior to payment or if the payor receives notification from the IRS that backup withholding is required.

2. OTHER TAX ISSUES INVOLVING VIRTUAL CURRENCIES

Notice 2014-21 does not provide guidance on certain issues relating to the tax treatment of virtual currencies, including: (i) whether and how virtual currency brokers or dealers must report transactions involving virtual currency on Form 1099-B; (ii) whether holders of virtual currency should report their holdings on FinCEN Form 114 (FBAR reporting) or Form 8938 (FATCA reporting); (iii) the circumstances under which two different kinds of virtual currency may be regarded as like kind property for purposes of Section 1031 of the Internal Revenue Code; and (iv) the treatment of a "hard fork" in the blockchain of a virtual currency or of an "airdrop" of virtual currency.

In general, a broker or dealer that effects the sale of certain securities, commodities, options, regulated futures contracts, securities futures contracts, or forward contracts by a customer in the ordinary course of a trade or business must report information concerning its customer's name, address, and TIN, the property sold, the gross proceeds of the sale, the sale date, and other information required by Form 1099-B. In addition, with respect to certain "covered securities," the broker or dealer must report the adjusted basis of the security sold and whether any gain or loss with respect to the security sold is long-term or short-term. If reportable sales are not reported on a Form 1099-B, then the broker or dealer generally is subject to backup withholding. Treasury and the IRS have not produced guidance on whether or how brokers or dealers should comply with Form 1099-B reporting with respect to virtual currency.

In general, United States persons that have a financial interest in or signature authority over foreign financial accounts that exceed specified value thresholds must file a Report of Foreign Bank and Financial Accounts ("FBAR"), Form 114, through the e-filing system of FinCEN. In addition, under the Foreign Account Tax Compliance Act ("FATCA"), certain taxpayers that have an interest in specified foreign financial assets that exceed specified value thresholds must report those assets on a Statement of Specified Foreign Financial Assets, Form 8938, filed with their annual tax return. Treasury, the IRS, and FinCEN have not produced any guidance on whether virtual currency accounts could be subject to these reporting requirements.

Prior to 2018, under Section 1031 gain or loss generally was not recognized on the sale or exchange of property held for productive use in a trade or business or for investment if such property was exchanged solely for property of like kind which was to be held either for productive use in a trade or business or for investment. Whether intangible personal property was of a like kind to other intangible personal property generally depended on the nature and character of the rights involved and on the nature or character of any underlying property. Treasury and the IRS have not issued guidance on the circumstances under which two different kinds of virtual currency may be regarded as like kind property for purposes of Section 1031. The IRS has historically taken a narrow view of the type of property that can qualify as like-kind (for example, treating gold and silver bullion or gold numismatic and gold bullion coins as not like-kind but treating gold bullion for Canadian Maple Leaf gold coins or Mexican and Austrian noncurrency bullion coins as like-kind). Nonetheless, it may be possible to argue that two cryptocurrencies are similar enough to qualify as like-kind (for example, two mined cryptocurrencies on the same blockchain as opposed to a digital currency and a smart contract based token). As a result of the 2017 tax reform legislation,[82] however, Section 1031 can only apply to exchanges of real property, so like-kind exchanges of virtual currencies are no longer possible after 2017.

Treasury and the IRS have not issued any guidance concerning the appropriate treatment of a virtual currency hard fork. A fork is potentially analogous to a number of different kinds of transactions that are treated differently for tax purposes. As a result, the timing and character of any income that may be realized in connection with a fork or subsequent sale of virtual currency that is created by a fork is uncertain. In particular, it is not clear: (i) whether income is recognized at the time of the fork, at the time that a taxpayer exercises dominion and control over virtual currency created in the fork, or only at the time that a taxpayer sells or disposes of

82 Tax Cuts and Jobs Act, Pub. L. No. 115-97.

virtual currency; (ii) how dominion and control should be interpreted in the context of virtual currency created in a fork; (iii) how the basis in virtual currency created in a fork should be determined; and (iv) how the holding period of virtual currency created in a fork should be determined.

Treasury and the IRS have also not released guidance on the treatment of so-called “airdrops” of virtual currency or tokens—where holders of one digital token are given other digital tokens for free. The timing of income recognition in an airdrop is unclear, and airdrops may present valuation issues as well.

3. TAX TREATMENT OF TOKEN DISTRIBUTIONS AND SAFTS

Treasury and the IRS have not issued any guidance concerning the tax treatment of token distributions. In general, the facts and circumstances of a particular token distribution, including the nature of any rights associated with a token, must be analyzed to determine the appropriate characterization of the tokens for tax purposes. Depending on these facts, a token might properly be treated as convertible virtual currency under Notice 2014-21, as debt or equity interests in an entity established by the issuer, as equity in a de facto partnership among holders of the tokens, as a prepayment for goods and services, or as some other type of property. The tax consequences to issuers and holders of a particular token will depend upon this characterization of the token. In addition, token issuers may be subject to barter exchange reporting rules if the tokens are properly characterized as “scrip” through which clients of the issuer exchange property or services.

Some Token Sponsors pre-sell some amount of the digital tokens that the sponsor intends to distribute through a Simple Agreement for Future Tokens (“SAFT”). Under this model, the SAFT holder typically pays a fixed amount (usually in fiat currency or in a virtual currency) for the right to receive a determinable amount of tokens upon the occurrence of a “launch event,” at which point the Token Sponsor distributes tokens. SAFTs typically provide that the intended tax treatment of the SAFT is as a forward contract. If this treatment is respected, then the issuance of the SAFT generally should not be a taxable event, and taxation of the purchase amount under the SAFT should be deferred until delivery of the tokens to the SAFT holder.

However, the characterization of a SAFT as a forward contract may not necessarily be respected by the IRS. For example, depending on the facts and circumstances, the IRS may seek to re-characterize a SAFT as a debt instrument or to distinguish a SAFT from a traditional prepaid forward contract and tax the proceeds upon receipt. The efficacy of the SAFT approach to token generation remains controversial, and is not a settled regulatory matter.

SECTION 2: CANADA

I. INTRODUCTION

Digital token units, often referred to as "coins" or "tokens", issued as part of an ICO or initial token offering ("ITO") – terms for digital token distributions that have been used by Canadian Securities Administrators – can represent many different things, including a portion of an asset, whether tangible or intangible; services or units of services; or an ownership interest in a business. Whether Canadian securities laws apply to ICOs and ITOs will likely depend on the use to which the coin or token may be put and what rights it represents.

There may be a distinction between tokens that fall within the ambit of securities regulation and those that fall outside of it. Proponents of this view conceive of at least two distinct types of tokens. The concept of a "utility token" involves a token or coin that represents services or units of services, for example, using tokens to play a game at an arcade. On the other hand, a "securities token" entitles the holder of the token or coin to certain rights in the business' assets, revenues or profits. Since a securities token functions similar to a typical security such as a share, Canadian securities laws are likely to apply.

While reference is made throughout this discussion to "securities tokens," it is important to note that any distinction between utility tokens and securities tokens has not been explicitly accepted by Canadian securities regulatory authorities. On August 24, 2017, Canadian Securities Administrators ("CSA") staff, with the exception of Saskatchewan, published Staff Notice 46-307 – *Cryptocurrency Offerings*[83] ("CSAN 46-307"), in response to requests from fintech businesses for guidance on the applicability of Canadian securities laws to "cryptocurrency offerings," "cryptocurrency exchanges," and "cryptocurrency-focused investment funds." CSAN 46-307 articulated a general view that "in many instances" digital tokens associated with ICOs/ITOs are securities.

On June 11, 2018, the CSA published Staff Notice 46-308 *Securities Law Implications for Offerings of Tokens*[84] ("CSAN 46-308"), which provides additional guidance on the applicability of securities law to offerings of blockchain-based tokens or coins.

The discussion that follows outlines certain of the Canadian securities law considerations that may apply to the distribution or trading of a digital token that qualifies as a "security" within the meaning of Canadian securities laws.

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83 Canadian Securities Administrators, *CSA Staff Notice 46-307 Cryptocurrency Offerings* (Toronto: Ontario Securities Commission, 2017), online: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20170824_cryptocurrency-offerings.htm.

84 Canadian Securities Administrators, CSA Staff Notice 46-308 Securities Law Implications for Offerings of Tokens (Toronto: Ontario Securities Commission, 2018), online: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20180611_46-308_securities-law-implications-for-offerings-of-tokens.htm

II. THE CANADIAN LEGAL FRAMEWORK

Securities legislation in Canada is principally governed by Canada's ten provincial and three territorial governments with the view of balancing investor protection against efficient capital markets.[85] While each province and territory has its own securities legislation, some coordination among jurisdictions is achieved through the CSA as an umbrella organization.[86] While the following discussion will focus mainly on the securities laws of the Province of Ontario, the rules in many areas of securities regulation have been standardized among the provinces and territories and cooperative systems have been established among the regulators through the CSA.

A. THE DEFINITION OF "SECURITY" AND ITS APPLICATION TO DIGITAL TOKENS

The provincial securities Acts have expansive statutory definitions of "security."[87] The statutory definitions of "security" include as one category, an "investment contract", which is the category Canadian courts and securities regulators generally use to assess whether a new type of transaction involves a security.

The leading case in Canadian jurisprudence on the meaning of investment contracts is *Pacific Coast Coin Exchange v. Ontario Securities Commission*[88] ("Pacific Coast"), which was expressly cited as the relevant case law in CSAN 46-307. The Supreme Court of Canada in Pacific Coast considered and adopted certain United States jurisprudence on the meaning of investment contracts, and in particular, the common law test set out in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) and other United States cases.

The application of this Canadian case law to so-called "utility" tokens has not been further elaborated upon directly by the Canadian courts.

In its application to "cryptocurrency offerings," the CSA has stated that it will conduct an evaluation of whether a "cryptocurrency" – a term that it leaves undefined – qualifies as a "security" on a case-by-case basis and that substance will be considered over form. In CSAN 46-307, the CSA noted that the appropriate interpretive test was the four-prong test: does the ICO/ITO involve (1) an investment of money, (2) in a common enterprise, (3) with the expectation of profit, (4) to come significantly from the efforts of others. The CSA further stated in CSAN 46-307 that the case law requires an assessment of the economic realities of a transaction and a purposive interpretation, keeping in mind the objective of investor protection.[89]

The CSA did not provide any clear guidance in CSAN 46-307 on the characteristics that would indicate that "securities may not be involved." Generally, however, it can be concluded that a token that entitles the holder to share in the business profits of the entity distributing the token will likely be considered a security.

85 *See* section 1.1 ("Purposes of Act") of Ontario's Securities Act R.S.O. 1990, c. S.5.
86 Canadian Securities Administrators, online: https://www.securities-administrators.ca/.
87 *See, e.g.*, section 1(1) of the Ontario *Securities Act* R.S.O. 1990, c. S.5 for the definition of "security."
88 *Pacific Coast Coin Exchange v. Ontario Securities Commission*, [1978] 2 S.C.R. 112.
89 *Canadian Securities Administrators, supra* note 83.

In CSAN 46-308, the CSA emphasized that one should assess not only the technical characteristics of the token itself, but the economic realities of the offering as a whole, with a focus on substance over form. With respect to utility tokens, CSAN 46-308 noted that, "the fact that a token has a utility is not, on its own, determinative as to whether an offering involves the distribution of a security."

CSAN 46-308 provided additional guidance on how the CSA staff have viewed certain examples, based on situations seen to date. The anonymized examples focused on various elements of the *Howey* test.

In CSAN 46-308, the CSA staff expressed the view that if management "clearly and uniformly promotes the token in a manner that, taken as a whole, promotes only its utility and not its investment value, the implication that purchasers have an expectation of profit may be reduced."

If tokens are not fungible or interchangeable and each token has unique characteristics, and any future market value of the token is primarily based on market forces, the value of the token may be based on its unique characteristics, and not on the efforts of others. There may not be a common enterprise.

If tokens have a fixed value on the platform that does not automatically increase over time, or change based on non-commercial factors, this may reduce the purchaser's expectation of profit.

If the token's software, platform or services are not yet available or are still in development, the CSA said this could indicate that the purchaser is not purchasing the tokens for their immediate utility, but because of an expectation of profit. "Although some purchasers may be purchasing the token for the utility function, many purchasers may be purchasing the token in order to sell it on a cryptoasset trading platform or otherwise in the secondary market." This is particularly true where the existence of secondary trading is critical to the success of the offering of tokens or is featured prominently in the marketing of the offering. This could also indicate the existence of a common enterprise because management's efforts are still needed to develop or deliver the software, online platform or application or goods and services.

B. CSA SANDBOX APPROVALS

The CSA established a regulatory sandbox[90] in February 2017 (the "CSA Sandbox"), a program whereby issuers seeking to offer innovative products, services and applications, such as digital tokens, are invited by the CSA to discuss their business model and applicable securities laws, and possible exemptive relief, directly with the applicable securities regulators on a coordinated and flexible basis. As CSA Sandbox approvals are intended to allow the issuers to operate in a test environment, the approvals are time-limited, so far to one or two years.

To date, only two limited exemptions relating to digital tokens have been granted through the CSA Sandbox process.

90 Canadian Securities Administrators, *CSA Regulatory Sandbox* (Montreal: Canadian Securities Administrators, 2017) online: https://www.securities-administrators.ca/industry_resources.aspx?id=1588.

The first limited exemption was for Montreal-based Impak Finance Inc. ("Impak"), which received exemptive relief on August 16, 2017 from the Québec Autorité des marchés financiers ("AMF") and seven other Canadian jurisdictions from the dealer registration requirement and the prospectus requirement in respect of the resale of Impak Coins ("MPK").[91] The initial distribution of MPK was made in accordance with the standard terms of an already existing statutory offering memorandum prospectus exemption. This allowed Impak to carry out the ICO. The issuance of MPK, a new digital currency based on the Waves blockchain platform, was proposed in order to fund the development of Impak's online social network dedicated to the impact economy. The MPK network did not exist at the time of the ICO. MPK were not delivered to purchasers upon closing of the offering, rather, only once Impak launches its digital wallet sometime in the future.

DIGITAL TOKEN PRODUCTS RECEIVING EXEMPTIVE RELIEF IN THE CSA REGULATORY SANDBOX

COMPANY	PURPOSE OF SANDBOX TRIAL
IMPAK	Issue MPK tokens to fund the development of Impak's online social network, impak.eco.
TOKEN FUNDER	Offer FNDR Tokens on the Ethereum blockchain to investors to fund the creation of Token Funder's smart token asset management platform, intended to facilitate third-party issuers raising capital through the offering of blockchain-based securities.

The Impak exemption order had a number of significant conditions. Impak was required to conduct both know-your-client and suitability reviews for each MPK purchaser. In this context KYC means more than simply identity verification, and includes knowing clients' overall investment experience and objectives, in order to assess investment suitability for the client. Impak was permitted to accomplish this through an online interactive questionnaire. There was no prospectus relief granted for any resale by a holder of MPK, except for a transfer by a participant to a social impact merchant. MPK cannot be listed and traded on any exchange unless it is done in accordance with Canadian securities laws and first approved by the AMF. The exchange rate for MPK to the Canadian dollar is established by an MPK governance body, and MPK may be redeemed for Canadian dollars at that rate, although Impak does not guarantee the purchase or conversion of MPK to participants. The exemption expires 24 months from the date of the decision.

The second limited exemption was for Toronto-based Token Funder Inc. ("Token Funder"), which received exemptive relief on October 17, 2017 from the Ontario Securities Commission ("OSC") and other Canadian securities regulators from the dealer registration requirement to allow it to sell its own digital tokens, called FNDR Tokens, to the public.[92] The initial distribution of FNDR Tokens would be made in accordance with the standard terms of an already existing statutory offering memorandum

91 *Re Impak Finance Inc.* (16 August 2017), online: http://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20170921_215_impak.htm.
92 *Re Token Funder Inc.* (17 October 2017), online: http://www.osc.gov.on.ca/en/SecuritiesLaw_ord_20171023_token.htm.

prospectus exemption. Token Funder was seeking to offer FNDR Tokens on the Ethereum blockchain to investors in order to fund the creation of its smart token asset management platform, intended to facilitate third-party issuers raising capital through the offering of blockchain-based securities. FNDR Tokens were designed to share in distributions from Token Funder arising from the operation of the platform, in the discretion of the Board of Directors of Token Funder and will have certain voting rights on the entities entitled to use the platform. FNDR Tokens cannot be listed and traded on any exchange unless done in accordance with Canadian securities laws and first approved by the OSC. The exemption will expire 12 months from the date of the decision.

Unlike the FNDR Tokens, MPK was unusual in that it was generally not freely transferable by its terms, but was redeemable at a non-guaranteed rate to be established. Given that the Impak network was still a work in progress, the MPK tokens had no utility at the time of the ICO and were treated by the issuer and the AMF as being investment contracts. The FNDR Tokens are more clearly securities tokens due to their distribution entitlements. From these two narrow examples, few clear factors on the broader application of the law around investment contracts to tokens can be elucidated.

C. FACTORS RELATING TO THE CONSIDERATION OF WHETHER A TOKEN IS A SECURITY

While the following factors are relevant to the analysis of whether a token does or does not qualify as a "security," it is not clear whether the securities regulatory authorities in Canada will consider any particular factor or set of factors as determinative:

- What is the token's use or purpose?
- Does the token represent access to a business' platform, or does it represent an ownership stake in a business that could increase or decrease in value depending on the success of the business?
- At the intended time of sale of the token, does the relevant platform still need to be developed or is there an existing, functioning ecosystem in which the token can be utilized?
- Will the purchaser receive the token upon payment of the full price?
- Is the token's market value reflective of the general attractiveness of the business?
- Is the token transferable, and is the anticipated value derived from future market demand?
- Does the token expire after a certain period of time of not being in use?
- Is the purchaser's purpose for purchasing the token personal use or consumption, rather than merely investment purposes?

III. CONSIDERATIONS REGARDING "ICOS" OF A "SECURITY"

A. ISSUING A SECURITIES TOKEN

1. PROSPECTUS REQUIREMENT OR EXEMPTION

If the purchaser of a securities token is located in a Canadian jurisdiction, Canadian securities laws must be considered regardless of the location of the issuer of the token. Canada's prospectus requirement creates a closed-system whereby any distribution of a security, even if made by a private company, must either be qualified by a prospectus or must qualify for a prescribed prospectus exemption.

To date, there has been no prospectus filed and approved to undertake an ICO in Canada. Upon filing and receiving a receipt for a final prospectus, the issuer would become a "reporting issuer" in Canada. A reporting issuer is subject to all of the continuous and timely disclosure requirements of Canadian securities laws, which are extensive and include the requirement to prepare and disseminate quarterly and audited annual financial statements.

As an alternative to a public prospectus, one of the most commonly used prospectus exemptions is the "accredited investor" exemption.[93] This exempts an issuer or selling security holder from the prospectus requirement when distributing securities to certain institutional investors or wealthy individuals (for example an individual whose financial assets before taxes but net of liabilities of over $1 million, or whose net income exceeds $200,000 in each of the two most recent calendar years).[94] Individual accredited investors below certain financial thresholds are required to receive and sign a prescribed risk acknowledgment form.

Token Funder and Impak each relied on the "offering memorandum" prospectus exemption[95] in respect of the initial distribution of their securities tokens. While the details vary by Canadian jurisdiction, the offering memorandum exemption allows an issuer to distribute its securities to purchasers who are not accredited investors or eligible investors (which are investors who meet a slightly less stringent financial test than the accredited investor test), so long as the issuer provides purchasers with a prescribed form of offering memorandum (which is similar to a prospectus), the issuer obtains a signed risk acknowledgment form from the purchaser and the purchaser's acquisition cost does not exceed a prescribed maximum amount. While the prescribed maximum amount in many jurisdictions is ordinarily $10,000 for non-eligible investors, the OSC and the AMF in their exemptive relief decisions in respect of Token Funder and Impak, imposed lower $2,500 investment limits for investors who did not qualify as accredited investors or eligible investors.

93 Section 2.3 of National Instrument 45-106 — *Prospectus Exemptions*.
94 Ontario Securities Commission, *Summary of Key Capital Raising Prospectus Exemptions in Ontario* (Toronto: Ontario Securities Commission, 2016), online: http://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20160128_45-106_key-capital-prospectus-exemptions.htm.
95 Section 2.9 of National Instrument 45-106 — *Prospectus Exemptions*.

2. MARKETING RESTRICTIONS

"Trading" of securities includes any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of a distribution of securities, and thus triggers the prospectus requirement.[96]

If the accredited investor exemption is to be relied upon, before a marketing document, such as a term sheet or offering memorandum, is provided to potential investors, their eligibility for the accredited investor exemption must already have been assessed. In the case of reliance on the offering memorandum exemption, an offering memorandum in the prescribed form and in many cases, a risk acknowledgment form, must be obtained from the purchaser prior to signing the agreement to purchase the security.

In order to meet these requirements, issuers have used a "walled garden" approach whereby potential investors may access the electronic marketing materials on the issuer's website only once their compliance with the applicable exemption has been verified.

3. EXEMPT DISTRIBUTION REPORTING

Certain prospectus exemptions, including the accredited investor and offering memorandum exemptions, require the filing of exempt distribution reports (and in some cases offering memoranda) with the CSA within ten days after the distribution.[97] The names of any agents or underwriters that assist with an offering of securities tokens and their fees must also be recorded on the reports. As these exempt distribution reports require detailed information about purchasers, issuers of securities tokens must ensure their purchase procedures have the capability of capturing and recording information in respect of each purchase of securities, including the name, address and telephone number of each investor in Canada, their particular sub-category of accredited investor, if applicable, as well as the price and number of securities purchased by each investor. Issuers based in the Canadian provinces of Alberta, British Columbia or Québec have additional reporting obligations, even for distributions made outside Canada.

4. RESALE RESTRICTIONS

Securities tokens purchased in reliance upon a prospectus exemption are subject to restrictions on resale pursuant to National Instrument 45-102 – *Resale of Securities* ("NI 45-102"). NI 45-102 generally prohibits resale of a security purchased under the accredited investor exemption unless either (i) the issuer of the security has been a reporting issuer in a jurisdiction of Canada for the four months preceding the trade, or (ii) the resale is made under another prospectus exemption, such as the accredited investor exemption, which would entail continued resale restrictions, or the security is of a foreign issuer and is resold outside Canada under certain

96 *See, e.g.*, the definition of "trade" under section 1(1) of the Ontario *Securities Act* R.S.O. 1990, c. S.5.
97 *See, e.g.*, Form 45-106F1 *Report of Exempt Distribution* (Form 45-106F1).

conditions.[98] Unless the issuer of a securities token becomes a reporting issuer in Canada, the resale restrictions continue indefinitely and do not expire, so the tokens would never become freely tradeable in Canada.

B. TRADING OR ADVISING IN SECURITIES TOKENS

Persons in the business of trading or advising in securities, or holding themselves out as being in the business of trading or advising in securities, must register as dealers or advisers with the relevant CSA regulator and meet the requirements set out in National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.[99] The determination of whether one is, or holds oneself out to be, in the business of trading or advising in securities is a factual determination commonly referred to as the "business trigger" for registration.

Startup issuers that are raising capital to advance their operating business plans would typically not be considered to be in the business of trading in securities unless they engage an employee with primary responsibility and/or compensation for capital raising activities. However, it is notable that both Token Funder[100] and Impak[101] sought and received temporary exemptions from the dealer registration requirement upon conditions, including: conducting investment know-your-client and suitability reviews of purchasers, not providing investment advice to purchasers, and establishing policies and procedures that establish a system of controls and supervision sufficient to manage the risks of the business.

On September 6, 2017, Canada's first "Cryptocurrency Fund," a term used by the CSA to refer to an investment fund that invests solely in specified digital tokens, was established. The British Columbia Securities Commission ("BCSC") and the OSC granted to First Block Capital Inc. ("First Block") the first registration in Canada to an investment fund manager ("IFM") and exempt market dealer ("EMD") solely dedicated to digital token investments, in order to operate a bitcoin investment fund.[102] First Block's registration was granted subject to a number of tight restrictions and requirements, including:[103]

- Prior approval must be granted by the BCSC for any new Cryptocurrency Fund established by First Block;
- A specific custodian (Xapo) was prescribed and changes to a Cryptocurrency Fund's custodian or to the entity principally responsible for the execution of trades for such fund will also be subject to prior approval;

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98 Resale of Securities, OSC NI 45-102 (30 April 2016), online: https://www.osc.gov.on.ca/documents/en/Securities-Category4/rule_20170119_45-102_unofficial-consolidation.pdf.

99 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, OSC NI 31-103 (11 January 2015), online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/ni_20150111_31-103_unofficial-consolidated.pdf.

100 *Ontario Securities Commission, supra* note 92.

101 *Ontario Securities Commission, supra* note 91.

102 British Columbia Securities Commission, *B.C. Securities Commission grants landmark Bitcoin investment fund manager registration* (Vancouver: British Columbia Securities Commission, 2017), online: https://www.bcsc.bc.ca/News/News_Releases/2017/69_B_C__Securities_Commission_grants_landmark_bitcoin_investment_fund_manager_registration/.

103 First Block Capital Inc. (5 September 2017), online: https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/DE_First%20Block.pdf.

- First Block must require its custodians and brokers to maintain compliance systems that provide reasonable assurance of compliance with regulatory requirements, and to manage business risks in accordance with prudent business practices;
- Independent auditor reports reviewing the sufficiency of the Cryptocurrency Fund's custodian's security practices as well as regulatory compliance documents received by First Block from its custodians and brokers must be provided to the BCSC;
- Annual audited financial statements must be available to security holders for each Cryptocurrency Fund, and net asset value reports must be available on a monthly or more frequent basis for each Cryptocurrency Fund; and
- Prior to making a trade in a digital token, First Block must make its own determination of a current and reasonable fair price for the digital token.

Subsequently, the Alberta Securities Commission ("ASC"), OSC and AMF imposed similar restrictions on the registrations of Ross Smith Asset Management ULC ("RSAM"),[104] 3iQ Corp.,[105] and Majestic Asset Management LLC ("Majestic"),[106] respectively, each of which notified the relevant regulator that it intended to establish, manage and distribute securities of a fund that will invest solely in "cryptocurrencies," which, for the purposes of the decision documents, the ASC, OSC, and AMF (as applicable) defined to mean bitcoin, ether, Litecoin (in the case of the 3iQ Corp. decision document) and "anything commonly considered a cryptocurrency, digital or virtual currency, or digital or virtual token."[107] The decision documents note that an investment fund that invests solely in one or more specified "cryptocurrencies" is a novel business model in Canada and, as such, additional reporting is required in order to monitor developments in the area.

It was significant at the time that First Block was not also required to register as a portfolio manager in order to manage investment activity for the initial bitcoin trust, as this implied that the underlying bitcoin was not considered by the BCSC and OSC to be a security. However, RSAM, 3iQ Corp., Majestic and Rivemont Investments Inc., investment portfolio manager of the fund created by Majestic, are all also registered as portfolio managers, implying that the issue is not yet settled.

On December 5, 2017, the OSC issued a notice to all registered firms (dealers, advisers or investment fund managers) saying that any firms that plan to establish, manage, advise and/or trade in securities of investment funds with portfolios of "[b]itcoin and/or other cryptocurrencies, cryptocurrency assets and coins and token offerings" are required to report changes in their business activities "to include cryptocurrency products and/or services" by completing and filing a prescribed form of notice of

104 *Ross Smith Asset Management ULC* (22 September 2017), online: https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/TC_RossSmith.pdf.

105 3iQ Corp. (19 January 2018), online : https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/TC_3iQ%20Corp_ProposedOntariotermsandconditions.pdf.

106 *Majestic Asset Management LLC* (26 January 2018), online: https://www.securities-administrators.ca/uploadedFiles/Industry_Resources/TC_MajesticEn_2018-01-25.pdf

107 *3iQ Corp., supra* note 105.

change of registration information.[108] The OSC said that following reviews of the information provided, the OSC may impose terms and conditions on the firm's registration to ensure adequate investor protection.[109]

C. CREATING A MARKET FOR SECURITIES TOKENS

As part of CSAN 46-307, the CSA signaled its concern that platforms facilitating trades in coins, tokens or cryptocurrencies that qualify as securities may also be subject to Canadian securities law requirements involving recognition or exemption from recognition as an exchange or as a quotation and trade reporting system.[110] At this point in time, no entity has obtained the recognition required, nor an exemption from such recognition requirement, in order to allow Canadians to participate in on-exchange trading of tokens that are securities.

The definition of "marketplace" in the Ontario *Securities Act* and other relevant rules is broad and includes an exchange, a quotation and trade reporting system, or any person or company that constitutes, maintains or provides a market or facility for bringing together orders for securities from multiple buyers and sellers using established, non-discretionary methods under which orders interact with each other and the buyers and sellers entering into the orders agree to the terms of a trade.[111]

A person or company is considered to bring together orders for securities if it (a) displays, or otherwise represents to marketplace participants, trading interests entered on the system; or (b) receives orders centrally for processing and execution. Merely routing orders to marketplace or a dealer for execution is not considered to be providing a market or facilities for bringing together buyers and sellers of securities.[112]

Marketplaces will generally be found to be exchanges if the marketplace provides a listing function, provides a guarantee of a two-sided market for a security on a continuous or reasonably continuous basis, sets requirements governing the conduct of marketplace participants or disciplines marketplace participants, for example by levying fines or taking enforcement action.[113] A marketplace that does not meet these exchange indicia and is not a quotation and trade reporting system may be characterized as an "alternative trading system" ("ATS"). An ATS proposing to carry on business in Canada is required to become registered as an investment dealer and provide detailed specified information to the CSA.

108 Ontario Securities Commission, *Form 33-109F5 requirement for registered firms that establish, manage, advise and/or trade in securities of cryptocurrency investment funds* (Toronto: Ontario Securities Commission, 2017), online: http://www.osc.gov.on.ca/en/Dealers_eb_20171205_registered-firms-33-109.htm.

109 *Id*

110 *Canadian Securities Administrators, supra* note 83.

111 *See* section 1(1) of the Ontario *Securities Act* R.S.O. 1990, c. S.5 for the definition of marketplace.

112 *See* section 2.1(3) of *Marketplace Operation*, OSC NI 21-101 (1 January 2015).

113 Ontario Securities Commission, *Exchanges* (Toronto: Ontario Securities Commission, 2018), online: http://www.osc.gov.on.ca/en/Marketplaces_exchanges_index.htm.

IV. ANTI-MONEY LAUNDERING

In 2014, the federal government proposed amendments to the Proceeds of Crime (Money Laundering) and Terrorist Financing Act ("PC Act")[114] that, once in force, will require entities engaged in the business of "dealing in virtual currencies" to register as money services businesses with the Financial Transactions and Reports Analysis Centre ("FINTRAC"). In June 2018 the Department of Finance published proposed regulations defining what "virtual currency" means. In that regard virtual currency is defined as (a) a digital currency that is not fiat currency and that can be readily exchanged for funds or for another virtual currency that can be readily exchanged for funds; or (b) information that enables a person or entity to have access to a digital currency referred to in paragraph (a). The proposed regulations would limit AML/ATF obligations to virtual currencies that are exchangeable, also known as convertible. This would include both centralized virtual currencies which are administered by a single authority and decentralized virtual currencies such as bitcoin, where authority is distributed across a network. The definition of virtual currency also includes information that provides access to the use of virtual currency, such as a private key in a cryptographic key pairing. There is a comment period in respect to the proposed regulations until September 7, 2018, and accordingly the final language will not be finalized until after that time. The proposed amendments to the PC Act have already received Royal Assent but the in-force date is not known.

Once the proposed amendments are in force, entities that must register as money services business will need to report certain transactions to FINTRAC, verify the identities of customers and maintain records with respect to transactions beyond a financial threshold and implement an anti-money laundering and counter-terrorist financing compliance regime. These requirements will apply to entities that have a place of business in Canada as well as entities that do not, provided they direct their services to persons or entities in Canada. As they are drafted, the proposed amendments will not apply to entities or individuals that simply use, and do not otherwise deal in, digital tokens.

Until the proposed amendments are in force, platforms that trade digital tokens that are not securities are not directly addressed in the PC Act. Such an entity may remit, transmit, or deal in digital tokens that are not securities and because these tokens are not a recognized national currency of a foreign country and are not considered "funds" within the meaning of the PC Act, such activities alone do not yet bring the entity within the scope of acting as a money services business under the PC Act.

However, entities dealing in digital tokens that are not securities do not operate in a legislative vacuum across Canada. If an entity operates an automated teller machine or trading platform for digital tokens in Québec, the AMF has taken the position that such entities are money services businesses for the purposes of Québec legislation and must be licensed as such.[115]

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114 *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* S.C. 2000, c. 17.

115 Autorité des marchés financiers, *Virtual currency ATMs and trading platforms must be authorized* (Montreal: Autorité des marchés financiers, 2015), online: https://lautorite.qc.ca/en/general-public/media-centre/news/fiche-dactualites/virtual-currency-atms-and-trading-platforms-must-be-authorized/.

V. COMMODITIES AND DERIVATIVES

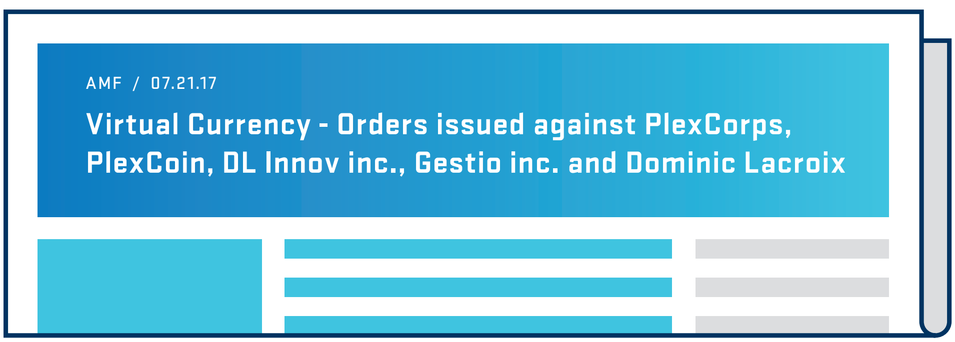
Although the Bank of Canada has said that "digital currencies" are currently treated as commodities,[116] this has not been formally accepted or adopted by the CSA or other regulators. Some OSC staff have publicly complained that the Bank of Canada has not come out with a position as to whether bitcoin, ether, or any other coin is currency.[117]

In Canada, contracts for the sale of commodities, other than exchange-traded commodity futures contracts, could still qualify as investment contracts and thus be "securities" regulated by the provincial and territorial securities laws.

The CSA noted in CSAN 46-307 that digital tokens may also constitute derivatives and be subject to the derivatives laws adopted by the Canadian securities regulatory authorities;[118] however, the application of commodity trading laws and derivatives laws to digital tokens in Canada remains to be determined.

VI. ENFORCEMENT PROCEEDINGS

Recent events suggest that caution must be exercised when considering the launch of, or the investment in, digital token distributions.



On July 20, 2017, the AMF obtained prohibition orders against various parties in connection with soliciting investments in PlexCoin, a digital token.[119] The PlexCoin "purported" ICO proceeded regardless in August. On December 8, 2017, the Québec Superior Court sentenced the individual behind PlexCoin to jail and fines for contempt of the court orders. On December 1, 2017, the United States Securities and Exchange Commission filed charges against the parties behind PlexCoin, describing the individual as "a recidivist Quebec securities law violator" and the ICO as a "full-fledged cyber scam."[120]

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116 Bank of Canada, *Briefing on Digital Currencies* (Ottawa: Senate of Canada, 2014), online: https://www.bankofcanada.ca/2014/04/briefing-on-digital-currencies/.

117 Alexandra Posadzki, "Bank of Canada has 'head in the sand' on Bitcoin: OSC", *The Globe and Mail* (30 October 2017), online: https://www.theglobeandmail.com/report-on-business/streetwise/bank-of-canada-has-head-in-the-sand-on-bitcoin-osc/article36772878/.

118 *Canadian Securities Administrators, supra* note 83.

119 Autorité des marchés financiers, *Virtual Currency - Orders issued against PlexCorps, PlexCoin, DL Innov inc., Gestio inc. and Dominic Lacroix* (Montreal: Autorité des marchés financiers, 2017), online: https://lautorite.qc.ca/en/general-public/media-centre/news/fiche-dactualites/virtual-currency-orders-issued-against-plexcorps-plexcoin-dl-innov-inc-gestio-inc-and-dominic/.

120 U.S. Securities and Exchange Commission, *SEC Emergency Action Halts ICO Scam* (Washington: U.S. Securities and Exchange Commission, 2017), online: https://www.sec.gov/news/press-release/2017-219.

SECTION 3: UNITED KINGDOM

I. INTRODUCTION

The regulation of digital tokens is a developing area as the current United Kingdom ("U.K.") financial services law was not developed with the use of digital tokens in mind. Over time new legislation may well be introduced (and interpretations of current legislation may change) to take account of the expected increase in the use of digital tokens, sharp and frequent price volatility of digital tokens and to safeguard the economy against the use of digital tokens (such as virtual currencies) for criminal purposes and intent. It also is important to bear in mind that subtle differences in the legal structure and commercial function of a digital asset can have significant regulatory consequences. It is not a "one size fits all" regime.

II. POTENTIAL LEGAL CLASSIFICATION AND RELATED REGULATORY CONSIDERATIONS

A. OVERVIEW

Broadly, there are several generic approaches to the regulation of digital tokens in the U.K. One is to treat them as a commodity or other form of physical property. Where this is the case, the marketing, purchase and sale of the digital token will largely be unregulated from a U.K. financial services law perspective, save if the contracts for the trading of the digital tokens fall within the scope of the U.K. law definitions of a derivative. Another is to treat them as a financial instrument (principally a security) but also possibly a unit in a fund (including a collective investment scheme, which is broadly defined

GENERIC REGULATORY APPROACHES TO TOKENS IN THE U.K.

1 A COMMODITY OR OTHER FORM OF PHYSICAL PROPERTY

2 A FINANCIAL INSTRUMENT

3 MONEY OR FORM OF CURRENCY

and capable of capturing arrangements involving digital tokens or an alternative investment fund). The third approach is to treat them as money or a currency (potentially e-money or entailing the provision of a payment service).

In this regard, whether the digital token will be subject to regulation will depend on whether it is designed as a medium of exchange or whether it has more narrow functions such as solely enabling for the payment for services provided within the particular digital token's closed infrastructure.

The regulatory categorization of the digital token is important as it will determine the extent to which (if at all) any U.K. authorization, prospectus, marketing restrictions, systems, controls, procedural, conduct of business, anti-money laundering and anti-terrorist financing requirements apply.

B. U.K. COLLECTIVE INVESTMENT SCHEME ANALYSIS

The term "Collective Investment Scheme" ("CIS") is deliberately broad and vague and so it is capable of capturing a wide range of arrangements even if the parties to the arrangements do not intend to create or establish a 'fund' or a collective investment.

Section 235 of the Financial Services and Markets Act 2000 (as amended from time to time) ("FSMA") defines a CIS as "any arrangements with respect to property of any description… the purposes or effect of which is to enable persons taking part in the arrangements… to participate in or receive profits or income arising from the acquisition, holding, management, or disposal of the property or sums paid out of such profits or income."[121]

Further elements of the definition are that the participants do not have day-to-day control over the management of the property.[122]

In addition, the arrangements must have either of the following characteristics:[123]

- pooling of contributions and profits or income of the participants in the scheme (which would include the holders of the digital tokens); and
- the property is managed as a whole on behalf of the operator of the scheme.

Typically, a CIS takes in money from investors and invests it in some other type of property. It is that other property, plus any uninvested contributions and undisbursed profits and income, which would normally be regarded as the underlying property of the CIS.

In the context of digital tokens, arrangements are capable of being a treated as a CIS in circumstances where participants pay cash to an 'issuer' in exchange for a certificate or token which gives the participants/investors an entitlement to underlying property (*e.g.*, gold, silver, wine, art, etc.), if the underlying property is managed by a third party (the term managed could entail administrative functions such as arranging for the property to be stored and/or insured) or if the contributions or profits of the participants/investors are pooled. Therefore arrangements relating to digital tokens need to be carefully scrutinized to determine whether they are within the U.K. CIS regime even if the intention is not to create a fund or collective investment.

121 Section 235 of FSMA.
122 *Id.*
123 *Id.*

Even if the arrangements fall within the basic definition of a CIS, they will not be caught if an exemption in the Schedule to the FSMA Collective Investment Scheme Order 2001 (the Order) applies. There are exemptions for arrangements relating to debt instruments, joint venture arrangements and those structured as bodies corporates.

The regulatory consequences of an arrangement relating to a digital token being a CIS are twofold:

- A CIS arrangement triggers authorization requirements and compliance with certain rules for certain parties.

  For example, establishing, operating or winding up a CIS is a regulated activity under Section 19 of FSMA and no exemption applies. This may be relevant to the person who is charged with establishing the arrangements, or arranging for the issuance of the certificates or tokens relating to digital tokens or arranging for the tokens to be stored and/or insured. Therefore, if this is done in the U.K., the operator will require authorization from the U.K. Financial Conduct Authority (FCA). Other activities that may require authorization, in relation to arrangements that amount to a CIS include managing investments, advising, dealing as principal or agent and arranging. It is an offence to carry on a regulated activity without authorization under Section 23 FSMA. Any contracts made by an unauthorized person (with participants/investors) in carrying on a regulated activity are unenforceable unless the court is satisfied that it is just and equitable to allow them to be enforced pursuant to Section 28 of FSMA.

- A CIS arrangement will have an impact on the ability to market the CIS to investors in the U.K.

  For example, it may only be possible to market the CIS to certain professional investors, high net worth individuals or certified sophisticated investors as units in a CIS are "controlled investments" under FSMA, and so Section 21 and Section 238 of FSMA will apply to their marketing.[124,125]

C. U.K. ALTERNATIVE INVESTMENT FUND ANALYSIS

An Alternative Investment Fund ("AIF") is defined in Article 4(1)(a) of the Alternative Investment Fund Managers Directive ("AIFMD") as any "collective undertaking including investment compartments thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy and which is not required to be authorized under Article 5 of Directive 2009/65/EU" (the EU Directive dealing with authorization of open ended retail funds). All elements of the AIF definition must be present in order for the digital token arrangements to be treated as an AIF.

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124 Section 238(1) of FSMA restricts the marketing by authorized persons of an unregulated CIS unless it falls within one of the exemptions to this restriction (under FSMA (Promotion of Collective Investment Schemes) (Exemptions) Order 2001) (as amended) (the "CIS Promotion Exemptions Order") or under Chapter 4 of the Conduct of Business Sourcebook of the FCA Handbook.

125 Authorized persons may market unregulated CISs to certain categories of persons in the U.K. under the CIS Promotions Order, including, investment professionals (Article 14), certified high net worth individuals (Article 21), high net worth companies (Article 22), sophisticated investors (Article 23), self-certified sophisticated investors (Article 23a), associations of high net worth or sophisticated investors (Article 24).

An AIF is a particular type of fund or collective investment vehicle, which overlaps in certain respects with the definition of a CIS, but they are not exactly the same. For example, an arrangement structured as a closed ended body corporate is capable of being categorized as an AIF whereas such an entity would not be a CIS.

Arrangements that relate to body corporates, partnerships, unincorporated associations and a fund set up as a trust, which pool together capital raised from participants/investors for the purposes of investment (*e.g.*, the pooled capital is used to purchase gold or silver) with a view to generating a pooled return for those investors from investments (*e.g.,* the arrangements are capable of generating a return for the participants) may amount to an AIF.

An arrangement relating to digital tokens that meets the basic definition of an AIF under the AIFMD will not constitute an AIF if it falls within an exemption under Article 2 of the AIFMD. There are exemptions for holding companies, certain joint ventures and securitization special purpose vehicles.

The regulatory consequences of an arrangement being an AIF may trigger a requirement for the manager to be authorized (known as the AIFM), the appointment of a depositary, and compliance with various procedures, controls, capital and conduct requirements. There are restrictions in relation to the marketing of AIFs, including the type of investors who can be marketed to, prior notifications to EU regulators and reliance on private placement rules.

D. U.K. E-MONEY ANALYSIS

E-money is defined in the Directive 2009/110/EC as electronically (including magnetically) stored monetary value represented by a claim on the electronic money issuer which: (i) is issued on receipt of funds for the purposes of making payment transactions; (ii) is accepted by a person other than the electronic money issuer; and (iii) is not otherwise excluded. The E-money directive is implemented in the U.K. through the Electronic Money Regulations 2011.

There is an explicit exclusion for monetary value stored in instruments that can be used to acquire goods or services only in the issuer’s premises or under a commercial agreement with the electronic money issuer, either within a limited network of service providers or for a limited range of goods and services (the limited network exclusion) which may be relevant for arrangements involving digital tokens. The Payment Services Regulations 2017 introduced a notification obligation on firms relying on this exclusion where the total value of the payment transactions executed by the firm under the limited network exclusion exceeds € 1 million over a 12-month period.

In many instances, the digital token will not be treated as e-money because:[126]

- there is no claim against the issuer of the digital token for the value of the digital token acquired (indeed, in many instances, there will not even be an issuer);

126 Article 2(1) of the Electronic Money Regulations 2011, Article 2(1) of the Payment Services Regulations 2017 and Glossary of the UK FCA Handbook.

- it does not have ‘monetary value’ (as it is not a currency); and
- the digital token is not issued on receipt of funds (*e.g.*, assuming that the term “funds” means fiat currency, which is a term used to differentiate between “real currency” - meaning traditional currency such as USD, GBP, Euro, and Yen – from virtual currency).

However, the success of the digital token over time could alter how it is categorized from a regulatory perspective (*e.g.*, it is accepted as a medium of exchange – i.e., currency – and therefore has monetary value).

If the digital token is e-money, this may require the issuer of e-money to be registered with the FCA, though there is a lighter touch regime for small e-money issuers. E-money issuers are subject to certain capital requirements, systems and controls, reporting and operational requirements.

E. U.K. PAYMENT SERVICES ANALYSIS

The Payment Services Directive (“PSD”) regulates a broad range of services including those that enable: (i) cash to be placed on a payment account, (ii) cash withdrawals to be made from a payment account, (iii) the transfer of E-money; (iv) the execution of payment transactions where the funds are covered by a line of credit (*e.g.*, direct debits, credit transfers), (v) customers to purchase goods and services through their online banking facilities or by e-money, and (vi) money remittance that does not involve the creation of payment accounts .

In many cases, the issuance as well as the purchase and sale of the digital token will not amount to the provision of a payment service subject to regulation under PSD, on the basis that the arrangements do not:

- enable cash to be placed on a payment account or cash withdrawals to be made;
- enable direct debits or credit transfers (*e.g.*, standing orders) to be made;
- facilitate payment transactions where the funds are covered by a credit line since the digital token holders have to pay for the digital token upfront (i.e., they are pre-paid); and
- there are no money remittance services as funds are not received from a payer for the sole purpose of transferring a corresponding amount to a payee or to another payment service provider acting on behalf of the payee, and the funds are not received on behalf of, and made available to, the payee.

There is an exclusion for services based on specific payment instruments that can be used only in a limited way, which may be relevant in the context of digital tokens provided that they meet one of the following conditions:[127]

- they allow the holder to acquire goods or services only in the issuer’s premises;
- they are issued by a professional issuer and allow the holder to acquire goods or services only within a limited network of service providers which have direct commercial agreements with the issuer;

127 Schedule 1, Part 2, 2(k) of the Payment Services Regulations 2017.

- they may be used only to acquire a very limited range of goods or services; or
- they are valid only in a single EEA State, are provided at the request of an undertaking or a public sector entity, and are regulated by a national or regional public authority for specific social or tax purposes to acquire specific goods or services from suppliers, which have a commercial agreement with the issuer.

Those who provide payment services may be required to be authorized by the FCA and must comply with certain systems, controls and conduct requirements.

F. OTHER U.K. REGULATED ACTIVITIES ANALYSIS

Arrangements relating to digital tokens may entail the carrying on of a regulated activity. Section 19 of FSMA states that a person must not carry on a regulated activity in the U.K., or purport to do so, unless he is an authorized person or exempt person or an exclusion applies. This is referred to as the "general prohibition." Carrying on a regulated activity in breach of the general prohibition is a criminal offence and may result in certain agreements being unenforceable.

A regulated activity is described in FSMA as a specified activity that relates to a specified investment or property of any kind and is carried on by way of business (Section 22, FSMA). Specified activities include dealing as principal or agent in a specified investment, making arrangements "with a view" to persons buying and selling certain specified investment, bringing about transactions in specified investments as well as safeguarding and administering tokens. Specified investments include shares, debt instruments, collective investment schemes, e-money and derivatives as defined in the FSMA ("Regulated Activities") Order 2001 ("RAO"). Whilst digital tokens are not specifically identified as a specified investment, the characteristics of the digital token would have to be assessed against the criteria of each specified investment to determine whether it is within scope.

In addition, any platform on which the digital tokens are traded or exchanged may be considered to be a regulated market, a multilateral trading facility or an organized trading facility if the digital token is categorized as a specified investment.

Even if a regulated activity is being performed, authorization under FSMA may not be required if an exclusion is available. There are various exclusions in the RAO that may be relevant in the context of digital tokens including for overseas persons or whether the activity is carried out in connection with the sale of goods or the supply of services or there is an absence of holding out.

In the event of a regulated activity being performed and there is no available exclusion, there are three consequences to the digital token being categorized as a specified investment under the FSMA and the RAO as follows:

- the marketing of the digital token may be restricted under Section 21 and/or Section 238 of FSMA or subject to compliance with certain conduct rules;
- accessing the platform or exchange and its use by participants may be restricted; and

- the operator of the platform, the custodian of the digital tokens, the issuer of the digital token and those who make arrangements for others to acquire the digital tokens may be required to be authorized. This in turn would trigger the requirement to comply with certain capital, systems, controls and conduct requirements.

Even if the digital token is not categorized as a specified investment under FSMA and the RAO, the platform or exchange on which the digital token is bought or sold may be considered to be a commodity trading platform. It should be noted that there is no EU-wide regime for commodity trading platforms and so the analysis of whether a commodity trading platform needs to be regulated in a particular EU Member State will have to be considered on a country by country basis. A pure commodity platform would not currently be required to be regulated in the U.K. under FSMA.

G. REGISTRY, SETTLEMENT AND CLEARING

Many digital token systems will operate on a distributed ledger technology basis to register transfers of digital tokens between parties. As such, it is not considered likely that such a system will fall within the current boundaries of regulation in the U.K. However, systems which involve the transfer of digital tokens against value are being reviewed by a number of regulators including in the U.K. because of their resemblance to payment systems.

Digital token arrangements may also require a settlement system in order to transfer the digital token from one account or e-wallet to another and record the transaction pursuant to which the digital token is transferred and the movement of the corresponding “consideration.” Indeed, if over time, the digital token becomes accepted as a medium of exchange for goods and services, then it may be necessary either to expand its registry system into a payment system or settlement system or to develop interoperability between the digital token settlement system and other virtual currency and/or fiat currency payment systems, which may result in it developing into a clearing system.

An entity which interposes itself between “counterparties” to certain types of contracts, thereby becoming the buyer to every seller and the seller to every buyer may be required to be authorized or registered as a central clearing party (“CCP”). This may be applicable to certain infrastructure arrangements involving digital tokens, depending on how they are categorized under the financial system. In the U.K., CCPs are supervised by the Bank of England and are subject to various capital, systems and controls, margin, and procedural requirements.

H. FUTURE U.K. REGULATORY DEVELOPMENTS

European regulators, including the FCA, have recently issued warnings regarding the risks associated with investing in digital tokens such as bitcoin and ether. This has principally been driven by the recent volatility in the price of these virtual currencies. The FCA has warned investors that:

(a) virtual currencies are not issued or guaranteed by a central bank or public authority; (b) virtual currencies do not have any legal status as a "fiat currency"; and (c) the purchase and sale of virtual currencies are not subject to safeguards and protections as they are unregulated in the U.K.[128]

The U.K. Government has signaled its intention to extend certain anti-money laundering and counter terrorist financing rules to virtual currency exchange platforms and certain custodial e-wallet providers through proposed changes to the EU Fourth Anti-Money Laundering Directive and the Fifth EU Anti-Money Laundering Directive.

If adopted, the Fifth EU Anti-Money Laundering Directive, which is expected to be agreed at the EU level this year, will require virtual currency exchange platforms and custodial e-wallet providers to conduct KYC due diligence checks on traders and users to determine their source of wealth and their source of income. Additional checks would be required if the trader or user is located in a "high risk" jurisdiction. In essence this will require virtual currency traders/users to disclose their identities and exchange platforms and e-wallet providers will be required to report any suspicious activity to the national crime agency.

Whether this will ultimately lead to virtual currencies and other digital tokens being subject to bespoke general regulatory rules which introduce authorization requirements, prospectus-like disclosures, marketing restrictions, systems, controls, procedural, and conduct of business requirements remains to be seen. In a recent statement the FCA announced that it will be issuing joint guidelines (expected in late 2018) with the Bank of England on the possible future regulatory treatment of virtual currencies.

The FCA also recently stated that:

» "cryptocurrency derivatives are...capable of being treated as financial instruments under [MiFID II], although [the FCA] does not consider cryptocurrencies to be currencies or commodities for regulatory purposes...Firms conducting regulated activities in cryptocurrency derivatives must, therefore, comply with all applicable rules...and regulations;"[129] and

» it is "likely" that firms engaging in certain activities (*e.g.*, dealing, arranging and advising) "in relation to derivatives that reference either cryptocurrencies or tokens issued through an initial coin offering (ICO), will require authorization by the FCA."[130]

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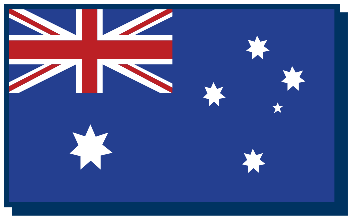
128 FCAWebsite: Consumer Warning about the risks in investing in cryptocurrency CFDs (dated 14/11/2017). FCA Website: Consumer warning abut the risks of Initial Coin Offerings (dated 12/09/2017).

129 https://www.fca.org.uk/news/statements/cryptocurrency-derivatives The FCA does not provide a definition for "so-called cryptocurrencies."

130 Ibid.

SECTION 4: AUSTRALIA



I. INTRODUCTION

The laws and regulations governing the securities and financial sectors in Australia are designed to ensure transparency and allow financial transactions to take place in a regulated and well-informed market. Protection of the consumer and participants in equity style transactions is paramount.

Token Sponsors in Australia operate in an evolving area of the law which currently sits on the periphery of regulations that apply to Australia's financial markets. To date, regulators have not taken steps to directly regulate the generation of digital tokens or crypto-assets. The current approach is to apply the securities and financial legal framework if the token has the characteristics of a security or financial product. If not, the token will be governed by existing consumer protection and general laws.

DIGITAL TOKENS MAY BE CLASSIFIED AS "FINANCIAL INSTRUMENTS" UNDER THE FOLLOWING:	
SECURITY	An interest that typically carries rights regarding the ownership of a company, voting rights in the decisions of a body and some entitlement to share in future profits.
MANAGED INVESTMENT SCHEME	When contributions from investors are pooled or used in common enterprise and participants do not have operational control over the scheme's management.
DERIVATIVE	An arrangement where the quantum of some required future consideration is determined by reference to an underlying asset.
NON-CASH PAYMENT FACILITY	An arrangement through which a person makes payments, or causes payments to be made, other than by physical delivery of money.
CROWDFUNDING	A method of raising small amounts of money from a large number of investors to finance a business.

In an attempt to deal with the increasing regulatory uncertainty surrounding digital tokens, the Australian Securities and Investments Commission ("ASIC"), the independent government body responsible for enforcing and regulating company and financial services laws in Australia, has issued a series of regulatory guidelines in the last 12 months setting out the factors in determining whether a token constitutes a security or a financial product. Importantly, if a token constitutes a security or a financial product, then the guidelines suggest that the token would be governed by existing securities legislation. Further, if the event creating, or mechanism to distribute, the tokens constituted a managed investment scheme, it would also be governed by existing securities legislation. In the event of uncertainty, ASIC also operates a service known as the Innovation Hub that allows industry to discuss regulatory issues with specialized personnel at ASIC to obtain clarity on compliance issues.

Unfortunately, apart from ASIC's regulatory guidelines and access to the Innovation Hub, there is no legal precedent and only limited literature on which a Token Sponsor may rely for clarification as to the applicability of existing law. Each token creation must be judged on its own facts and circumstances as to whether the token will constitute a security or financial product. However, ASIC has acknowledged that "crypto-assets and the use of distributed ledger technology has the potential to make an important contribution to fintech innovation,"[131] so it is hopeful that specific regulation will be introduced in the near future.

II. REGULATION OF DIGITAL TOKENS AND CRYPTO-ASSETS

The capital and financial markets in Australia are governed by various statutes that define and regulate securities, financial products, managed investment schemes, crowdfunding, and non-cash payment facilities. They also address events and circumstances that constitute deceptive and misleading conduct and impose sanctions and penalties for breach.

This report discusses the salient issues that may apply to digital tokens, crypto-assets, and Token Sponsors. Broadly, the relevant considerations relate to whether a digital token or crypto-asset will be classified as a security or financial product or whether the vehicle through which the token is generated constitutes a managed investment scheme.

A. WHAT IS A "SECURITY"?

"Securities" are defined in the *Corporations Act 2001* (Cth) ("Corporations Act") as including shares or debentures in a company, interests in a managed investment scheme or units of such shares and further includes legal or equitable rights or interests in the foregoing and options.[132]

"Shares" are generally regarded as an interest that carries rights regarding the ownership of a company, voting rights in the decisions of a body and some entitlement to share in future profits through dividends as well as a claim on the residual assets of a company if wound up.

ASIC's approach to digital tokens is that if the purpose of the token is to fund a company, or if the bundle of rights attaching to the token are similar to rights commonly attaching to a share in a company, then it is likely that the token will fall within the definition of a share (security).[133] If so, the Token Sponsor must comply with the requirements of the Corporations Act in relation to the issue of securities, including the preparation of a prospectus, its registration with ASIC, and the necessary disclosures the prospectus must contain.

131 Australian Securities & Investments Commission, 'Initial Coin Offerings And Crypto-Currency' *Information Sheet No 225* (May 2018) <http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/>.
132 *Corporations Act 2001* (Cth) s 92.
133 Australian Securities & Investments Commission, 'Initial Coin Offerings And Crypto-Currency' *Information Sheet No 225* (May 2018) <http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/>

B. WHAT IS A "FINANCIAL PRODUCT"?

The Corporations Act provides both a general definition of "financial product," as well as a list of deemed financial products.

1. DEEMED FINANCIAL PRODUCTS

The list of deemed financial products includes securities (see above analysis), as well as derivatives and managed investment schemes.[134] ASIC has identified these deemed financial products as potential categories under which a digital token or crypto-asset may be captured.[135]

a. DERIVATIVES

In broad terms, a derivative involves an arrangement where the quantum of some required future consideration is determined by reference to some underlying asset, which may include a crypto-asset or digital token.[136] Recently, bitcoin futures contracts have become a popular investment and such a product is likely to be classified as a derivative under the Corporations Act.

b. MANAGED INVESTMENT SCHEME

Certain digital tokens or crypto-assets may fall under the umbrella of a Managed Investment Scheme ("MIS"). This is most likely the case when contributions from investors are pooled or used in common enterprise, and participants do not have operational control over the scheme's management.[137] Whether a digital token or crypto-asset constitutes a MIS will depend on the facts and circumstances, the assessment of which should include an assessment of what rights are attached to the tokens generated by the Token Sponsor. What constitutes a right should be interpreted broadly. These rights are likely to be set out in the Token Sponsor's white paper.

For example, payment for the purchase of a crypto-asset may be described as a receipt for a purchased service. However, if the value of the crypto-asset acquired is affected by the pooling of funds from investors or use of those funds under the arrangement, then the sale of the digital token may constitute a MIS. Use of a managed investment scheme triggers a range of product disclosure, licensing, and potential managed investment schemes registration obligations under the Corporations Act.[138]

134 *Corporations Act 2001* (Cth) s 764A(1).
135 Australian Securities & Investments Commission, 'Initial Coin Offerings And Crypto-Currency' *Information Sheet No 225* (May 2018) <http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/>.
136 *Corporations Act 2001* (Cth) s 761D.
137 *Corporations Act 2001* (Cth) s 9.
138 See broadly Australian Securities & Investments Commission, 'Offering Securities Under a Disclosure Document' *Regulatory Guidance No 254* (March 2016) <http://download.asic.gov.au/media/3578442/rg254-published-17-

New products may also be deemed to be financial products through regulations.[139] However, as of the date of this report, neither digital tokens nor crypto-assets have been designated as financial products. Importantly, ASIC has indicated that it does not consider bitcoin to be a financial product.[140]

2. THE GENERAL TEST FOR "FINANCIAL PRODUCTS"

"Financial product" is a term first introduced as part of financial services regulation reform in 2001. The term was intended to be sufficiently broad and flexible to allow emerging products to be captured under the regulation.

Importantly, the general test for what constitutes a financial product still applies to digital tokens and crypto-assets. Token Sponsors should consider all of the characteristics of the digital token or crypto-asset to determine whether it is a financial product at time of generation, or whether it may become a financial product after it is generated.

Section 763A(1) of the Corporations Act defines a financial product as a "facility through which, or through the acquisition of which, a person does one or more of the following:

a. MAKES A FINANCIAL INVESTMENT;

b. MANAGES FINANCIAL RISK; OR

c. MAKES NON-CASH PAYMENTS."

The financial investment limb is likely to be the most relevant for digital tokens and crypto-assets. Under the Corporations Act, a person makes a financial investment if:

a. "THE INVESTOR GIVES MONEY OR MONEY'S WORTH (THE CONTRIBUTION) TO ANOTHER PERSON AND ANY OF THE FOLLOWING APPLY:

i. the other person uses the contribution to generate a financial return, or other benefit, for the investor;

ii. the investor intends that the other person will use the contribution to generate a financial return, or other benefit, for the investor (even if no return or benefit is in fact generated);

iii. the other person intends that the contribution will be used to generate a financial return, or other benefit, for the investor (even if no return or benefit is in fact generated); and

139 Corporations Act 2001 (Cth) s 764A.
140 Australian Securities & Investments Commission, 'Initial Coin Offerings And Crypto-Currency' *Information Sheet No 225* (May 2018) <http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/>.

b. THE INVESTOR HAS NO DAY-TO-DAY CONTROL OVER THE USE OF THE CONTRIBUTION TO GENERATE THE RETURN OR BENEFIT."[141]

ASIC has also made clear that simply describing a coin or token as a "utility" token or digital currency (in the relevant white paper or elsewhere) will not exclude it from being characterized as a financial product.[142] Instead, the Token Sponsor should assess the digital token or crypto-asset based on all of the rights and features associated with the product and obtain formal legal advice.

C. LICENSING REQUIREMENTS FOR FINANCIAL PRODUCTS

If a digital token or crypto-asset constitutes a financial product, the Token Sponsor may be required to obtain an Australian Financial Services License ("AFSL").[143]

Under Section 991A of the Corporations Act, "a person who carries on a financial services business… must hold an Australian financial services license covering the provision of the financial services." As the definition of "financial service" includes the issuing of a financial product,[144] issuers of applicable digital tokens and crypto-assets may fall within this requirement.

The process for applying for an AFSL includes providing substantial material to ASIC, employing or contracting with specialized staff to manage the provision of the relevant financial product and compliance generally, as well as the creation of compliance programs. The timeframe for obtaining an AFSL will vary depending on the circumstances of the application, but will typically require a number of months.

The need for an AFSL may be removed if one of the exemptions in Section 911A(2) of the Corporations Act applies. In particular, a product generator may not require an AFSL if:

a. THE PRODUCT IS OFFERED TO POTENTIAL INVESTORS THROUGH A THIRD PARTY WHO HOLDS AN AFSL WHICH COVERS THE GENERATION OF THAT PARTICULAR PRODUCT; AND

b. THE PRODUCT GENERATOR PROVIDES THE PRODUCT TO INVESTORS BASED ON THE OFFER PROPOSED BY THE THIRD PARTY LICENSEE.

Prohibitions on these kinds of outsourcing arrangements exist in particular circumstances, so Token Sponsors should evaluate the applicability of these exemptions on a case by case basis.

D. CROWDFUNDING

Raising funds by generating tokens can sometimes be considered a form of crowdfunding. If so, this activity will be covered by the crowd-sourced funding provisions of the Corporations Act.[145] It should be noted that crowd-sourced funding is regarded as a financial service. Accordingly, and in addition to compliance with the regulatory laws, an AFSL will be required to provide this service.

141 *Corporations Act 2001* (Cth) s 763B.
142 Ibid.
143 *Corporations Act 2001* (Cth) s 766C.
144 *Corporations Act 2001* (Cth) s 766A.
145 See generally Part 6D.3A of the *Corporations Act 2001* (Cth).

ASIC has warned Token Sponsors not to use the phrase 'crowd-sourced funding' unless the offering is in fact taking place under the crowd-sourced funding regime.[146] In addition, there is a $5 million cap on crowdfunding in Australia,[147] and the regime is currently only open to public unlisted companies.[148] However, amendments are currently being passed through the Parliament to open up the framework to proprietary companies, and there is a chance that these will be passed into law before the end of 2018.[149]

E. NON-CASH PAYMENT FACILITIES

Non-cash payment facilities are arrangements through which a person makes payments, or causes payments to be made, other than by physical delivery of money.[150] A typical example is a credit or debit card. If the token constitutes a non-cash payment facility, it will be governed by and must comply with the Corporations Act.

ASIC is presently of the view that, provided the token is more in the form of a gift card or utility token, it will not constitute a non-cash payment facility. [151]

F. DIGITAL TOKENS THAT ARE NOT FINANCIAL PRODUCTS

Even if digital tokens and crypto-assets (including bitcoin) are not regarded as securities or financial products, they must still comply with consumer law, contract law, and general Australian law.

One of the key laws that applies to all ICOs and crypto-assets (including those that are not financial products) is the general prohibition on parties engaging in misleading and deceptive conduct in the course of trade or commerce. Specifically, Section 18 of the Australian Consumer Law ("ACL") states that a person must not "in trade or commerce, engage in conduct that is misleading and deceptive or is likely to mislead or deceive." This prohibition has been extensively tested and developed through the courts and is considered a broad ranging prohibition.

ASIC has provided some guidance on potential conduct by a Token Sponsor that may be misleading or deceptive, including:

a. "the use of social media to generate the appearance of a greater level of public interest in a digital token or crypto-asset;

b. undertaking or arranging for a group to engage in trading strategies to generate the appearance of a greater level of buying and selling activity for a digital token or a crypto-asset;

c. failing to disclose adequate information about the Token Sponsor, the digital token, or the crypto asset, or

146 Australian Securities & Investments Commission, 'Initial Coin Offerings And Crypto-Currency' *Information Sheet No 225* (May 2018) <http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/>.
147 *Corporations Act 2001* (Cth) s 738G.
148 *Corporations Act 2001* (Cth) s 738H.
149 Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017.
150 *Corporations Act 2001* (Cth) s 763D.
151 Australian Securities & Investments Commission, 'Initial Coin Offerings And Crypto-Currency' *Information Sheet No 225* (May 2018) <http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/>.

d. suggesting that the digital token or crypto-asset is a regulated product or the regulator has approved of the offering if that is not the case."[152]

A breach of this prohibition can result in serious penalties, including pecuniary penalties, for each instance of misleading and deceptive conduct.[153]

The power to enforce the prohibition on misleading and deceptive conduct in the area of digital tokens and crypto-assets has been specifically delegated to ASIC.[154] ASIC has also provided in depth information on this law in its latest guidance note,[155] so it is likely that this prohibition will be a key focus for the regulator when investigating Token Sponsors.

III. REGULATION OF DIGITAL CURRENCY EXCHANGES

In April 2018, new laws and policy principles were introduced to regulate the operation of Digital Currency Exchanges ("DCEs") in Australia. DCEs are businesses that exchange digital currency for fiat currency (*e.g.*, Dollars, Euros, RMB) and vice versa. The new laws require an entity to be enrolled and registered with the Australian Transaction Reports and Analysis Centre ("AUSTRAC") before operating as a DCE. All DCEs must also comply with obligations under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (Cth) ("AML/CTF Act") including the establishment and continued operation of a compliance program.

For those DCEs intending to offer exchange services for Token Sponsors in relation to digital tokens that are financial products, the DCE may also need a financial markets license or receive an exemption from ASIC in relation to their exchange services.

A. REGISTRATION OF DIGITAL CURRENCY EXCHANGES

The AML/CTF Act was amended in April 2018 to require DCEs to enroll and register their business with AUSTRAC before engaging in digital currency exchange services.[156] The amendments also set out the process for enrollment and registration, the establishment of the Digital Currency Exchange Register, and penalties for breaches of the registration requirements.

A set of policy principles and exemptions also came into effect in and around April 2018 stating that AUSTRAC will exercise leniency in relation to enforcement action until 2 October 2018.[157] During this time, AUSTRAC may only take enforcement action if a DCE fails to take reasonable steps to comply with the AML/CTF Act. Examples of 'reasonable steps' include:

a. complying with any breaches of the AML/CTF Act as soon as practicable;

152 Ibid.
153 *Australian Consumer Law* ss 236, 237.
154 Australian Securities & Investments Commission, 'ASIC Takes Action On Misleading Or Deceptive Conduct In ICOs' (Media Release, 18-112MR, 1 May 2018) <https://asic.gov.au/about-asic/media-centre/find-a-media-release/2018-releases/18-122mr-asic-takes-action-on-misleading-or-deceptive-conduct-in-icos/>
155 Australian Securities & Investments Commission, 'Initial Coin Offerings And Crypto-Currency' *Information Sheet No 225* (May 2018) <http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/>
156 AUSTRAC, 'Digital Currency Exchange Providers' *austrac.gov.au* (June 2018) <http://www.austrac.gov.au/digital-currency-exchange-providers/>
157 Anti-Money Laundering and Counter-Terrorism Financing (Digital Currency Exchange Register) Policy Principles 2018.

b. implementing a transition plan outlining actions and timeframes to achieve compliance; and

c. allocating sufficient resources to enable compliance.[158]

Once the leniency period ends, it is likely that AUSTRAC will be diligent and prompt in pursuing enforcement action. The penalties that apply to breaches of the DCE obligations range from 2 to 7 years imprisonment and pecuniary penalties of $105,000 to $420,000.

B. PROCESS FOR ENROLLMENT AND REGISTRATION

A DCE can enroll and register with AUSTRAC using an online process based on the AUSTRAC business profile form.[159]

The DCE will need to provide certain information to AUSTRAC, including:

a. national police certificates and checks for certain personnel; and

b. certain information in relation to the business entity.

Foreign companies (whether or not they are registered in Australia) can apply for enrollment and registration. However, AUSTRAC requires the foreign company to provide certain information including any registration details, company history and details regarding any previous legal infringements.

C. FINANCIAL MARKET LICENSE

Section 791A of the Corporations Act states that a person must only operate a financial market if:

a. the person has an Australian market license that authorizes the person to operate the market in this jurisdiction; or

b. the market is exempt.

This provision will be relevant to DCEs offering exchange services for digital tokens and crypto-assets constituting financial products. This is because a financial market is defined as "a facility through which:

a. offers to acquire or dispose of financial products are regularly made or accepted; or

b. offers or invitations are regularly made to acquire or dispose of financial products that are intended to result or may reasonably be expected to result, directly or indirectly, in:

i. the making of offers to acquire or dispose of financial products; or

ii. the acceptance of such offers."[160]

158 Ibid.
159 AUSTRAC, 'Enrollment and Registration' *austrac.gov.au* (April 2018) <http://www.austrac.gov.au/businesses/enrolment-and-registration/enrolment-and-registration>.
160 *Corporations Act 2001* (Cth) s 767A.

It is also important to note that a financial market may operate simultaneously in Australia and other jurisdictions. As such, DCEs that can be accessed in Australia but have been established outside of Australia may also need to obtain a financial markets license if the DCE offers to acquire or dispose of financial products are regularly made or accepted.

ASIC has also highlighted the financial market regulations and licensing requirements in its latest guidance note.[161] Due to the increased awareness of the financial markets license requirements, a number of DCEs operating in Australia have stopped listing new tokens and some DCEs have removed all tokens other than the mainstream tokens (bitcoin, Ethereum, and Ripple).

Even if a financial markets license is required to operate a DCE, such activity may be exempted by Ministerial power for a particular financial market or a class of financial markets.[162] As of the date of this report, no exemption has been given for a financial market for digital tokens and crypto-assets.

IV. ASIC'S INNOVATION HUB AND REGULATORY SANDBOX

In an effort to allow regulation to follow rather than restrain innovation and change in the FinTech markets, ASIC has developed programs and tools to assist industry in Australia with navigating the regulatory environment and foster the creation of crypto-asset businesses.

In March 2015, ASIC launched the Innovation Hub, an initiative to help fintech businesses navigate the regulatory system in the financial services sector. The main service provided by the Innovation Hub is direct access to senior staff at ASIC to streamline licensing and offer informal guidance in relation to the regulatory requirements for the business.[163] Since its inception, the Innovation Hub has assisted in the granting of over 36 licenses to FinTech businesses and these businesses received their licenses much faster than those applying through the standard process.[164] Recently, the Innovation Hub has focused on digital tokens and crypto-assets and members of the Innovation Hub are key contributors to the regulatory guidelines that have been issued by ASIC.

As part of the Innovation Hub initiative, ASIC established a licensing relief framework dubbed the ASIC "regulatory sandbox" allowing users to work cooperatively with ASIC on regulatory issues to achieve a solution that suits both the relevant firm and government.[165]

The sandbox comprises the following three relief options:

a. assistance to identify existing statutory exemptions or flexibility;

b. relief for testing certain specified products and services; or

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161 Australian Securities & Investments Commission, 'Initial Coin Offerings And Crypto-Currency' *Information Sheet No 225* (May 2018) <http://asic.gov.au/regulatory-resources/digital-transformation/initial-coin-offerings/>.

162 *Corporations Act 2001* (Cth) s 791C.

163 Australian Securities & Investments Commission, 'ASIC's Innovation Hub And Our Approach To Regulatory Technology' *Report 523* (May 2017) <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-523-asic-s-innovation-hub-and-our-approach-to-regulatory-technology/>.

164 Commissioner John Price, 'The Fintech Sector Opportunity: ASIC's Perspective'(Speech delivered at the 4th Annual Fintech Summit 2017, Sydney, Australia, 2 November 2017).

165 Australian Securities & Investments Commission, 'ASIC Releases World-First Licensing Exemption For Fintech Businesses' (Media Release, 16-440MR, 15 December 2016) <https://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-440mr-asic-releases-world-first-licensing-exemption-for-fintech-businesses/>

c. for other services, where ASIC grants individual relief.[166]

The sandbox may be used by new-to-market Token Sponsors to liaise with ASIC to determine whether their token would be considered a financial product. However, the sandbox is not available for testing the issuance of financial products (including any digital tokens or crypto-assets considered financial products).[167]

V. TAXATION

The tax treatment of Token Sponsors remains a pressing issue relative to both the classification of the digital token as either belonging to the capital or revenue account, and the uncertain applicability of the goods and services tax ("GST").

For digital tokens that are caught by the existing financial product or securities regimes, the tax treatment is relatively settled, with significant bodies of law, including statute, case law, and guidance from the Australian Taxation Office ("ATO"), clarifying the tax treatment of securities and financial products. However, for those tokens that sit outside of the existing regulatory frameworks, the tax treatment is unclear.

If a digital token is not a regulated security or financial product, its sale will likely be treated as revenue of the Token Sponsor and taxed accordingly at the corporate tax rate. There is currently significant discussion in Australia around the granting of deferred taxation liability for Token Sponsors, in recognition of the fact that the funds raised by most Token Sponsors are often allocated to a roadmap stretching years into the future. However, no amendments have yet been suggested to the existing law.

The ATO has repeatedly stated that the tax treatment of Token Sponsors will turn upon the facts and circumstances of the triggering event. Accordingly, many Australian Token Sponsors have taken the path of seeking a private ruling from the ATO to clarify their tax position. While these private rulings will be released by the ATO in redacted form, they may not be relied upon by third parties. In any event, as at the time of writing, no private rulings have been handed down by the ATO in relation to Token Sponsors, despite many currently being underway.

The GST treatment of tokens remains contentious. Prior to 1 July 2017, GST was payable in relation to sales and purchases of "digital currency." From 1 July 2017, these activities were specifically exempted from the GST regime. While the ATO has expressly recognized that bitcoin, Ethereum, Litecoin, Dash, Monero, Zcash, Ripple, and Ybcoin fall within the definition of "digital currency,"[168] the definition is relatively narrow. Guidance from the ATO released in March 2018 clarifies that Australian Token Sponsors, as well as foreign Token Sponsors selling into the Australian market, may still be required to pay GST on their offerings, particularly where the token provides a right or entitlement to goods or services.[169]

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166 Australian Securities & Investments Commission, 'Testing Fintech Products And Services Without Holding An AFS Or Credit License' *Regulatory Guide No 257* (August 2017) <https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-257-testing-fintech-products-and-services-without-holding-an-afs-or-credit-licence/>.

167 Ibid.

168 Australian Taxation Office, 'GST And Digital Currency' ato.gov.au (March 2018) <https://www.ato.gov.au/Business/GST/In-detail/Your-industry/Financial-services-and-insurance/GST-and-digital-currency/>.

169 Ibid.

VI. CONCLUSION

Overall, both Australian Token Sponsors and foreign Token Sponsors maintaining a presence within the Australian market are currently operating in an uncertain legal environment. The Australian regulators, like almost all of the regulators in other jurisdictions discussed in this report, have adopted an approach based on functional equivalence. Where a digital token or crypto-asset falls within the existing framework, the answer is clear. However, the majority of digital tokens do not easily fit within existing frameworks. The result is less than optimal both for regulators and Token Sponsors on the one hand and the general public on the other. Industry groups, including the Australian Digital Commerce Association,[170] have recognized that clearer guidelines and principles are required. Best practice guidelines are currently being drafted in the expectation that industry will embrace and adhere to these in the hope that they will form the basis for future regulation.

Ultimately, activity from Token Sponsors will continue to grow in Australia as clear economic and technical drivers accelerate market activity. It is hoped that this report encourages regulatory activity to grow as well.

170 For more information on the Australian Digital Commerce Association, see https://adca.asn.au/.

SECTION 5: GIBRALTAR

I. INTRODUCTION

On 1st January 2018, Her Majesty's Government of Gibraltar ("HMGOG") brought into effect a new distributed ledger technology ("DLT") regulatory framework ("DLT Framework") defined on a principles basis with the ability to be applied proportionately to the business in question, providing businesses with the regulatory certainty that has been pursued by so many for so long. The intention is not to exclude certain activity from the existing regulatory framework but, rather, to build out a specific framework for businesses that use DLT to "store or transmit value belonging to others" by way of business, and that may not have been subject to regulation under another existing framework in Gibraltar. Similarly, the purpose is to build a framework that can continue to evolve and allow for the Gibraltar Financial Services Commission ("GFSC") to set appropriate and proportionate conditions or restrictions.

The DLT Framework includes nine principles applied to DLT firms operating in Gibraltar. The response to this approach has been global and truly significant with a large number of well-known businesses applying for licenses under the regulatory regime. Those who know nothing about Gibraltar may be surprised, but those who know the history of a small jurisdiction being able to adapt and evolve to attract the right opportunities at the right level, with the speed and flexibility needed to accomplish such goals, will not be surprised at all.

In addition to the above, the GFSC released a public statement on 22nd September 2017 noting the increasing use of digital tokens based on DLT as a means of raising finance, especially by early stage start-ups. The GFSC also noted that these new ventures were highly speculative and risky, that early-stage financing is often best undertaken by experienced investors, and set out matters that ought to be considered by anyone thinking of investing in digital tokens. In addition, the statement set out an intention to regulate the "promotion and sale of [digital] tokens."[171,172] HMGOG has publicly announced its intention to introduce regulations relating to, amongst other things, the promotion and sale of digital tokens in and from Gibraltar and set out its proposals in a document issued on 12th February 2018 (the "Token Framework Proposal").

171 Gibraltar Financial Services Commission, Statement on Initial Coin Offerings, http://www.fsc.gi/news/statement-on-initial-coin-offerings-250.

172 The terms used in this Section are exclusive to the enacted and proposed legislation of Gibraltar.

II. THE GIBRALTAR REGULATORY FRAMEWORK

Digital tokens vary widely in design and purpose. In some cases, they may represent securities, such as shares in a company, and their generation and distribution are already covered by existing securities legislation in Gibraltar such as the Prospectuses Act 2005.[173] The classification as a security triggers various consequences, in particular regulatory consequences. The requirement to issue a prospectus when offering securities publicly is only one example of such a requirement. A distinction must be drawn between the concept of a security on the one hand and a financial instrument on the other, with the latter being the broader term. "Securities" are one of several sub-categories of financial instruments. Regulatory requirements may therefore also arise for non-securities that are classified as financial instruments. This includes the requirements arising under the Markets in Financial Instruments Directive (MiFID) II,[174] transposed into Gibraltar law through the Financial Services (Markets in Financial Instruments) Act 2018,[175] which, in addition to applying to businesses providing certain investment services or engagement in certain activities with clients in relation to financial instruments, also defines "financial instruments" in a wide form, including forms of commodity derivative contracts and arrangements that may apply to any asset or right of a fungible nature (under certain conditions).

As a British Territory and current member of the European Union ("E.U."), the applicability of other existing frameworks would also need to be considered in the digital token context - electronic money issuance ("E-money") being an example. Even within the E.U., there are differing interpretations of the applicability of different regimes or rules. In the context of digital tokens, the tokens must represent a claim on the issuer in order to fall within the definition of "electronic money."[176] This might be the case for some digital tokens; however, utility tokens, as a rule, are usually not issued for the purpose of making payment transactions. This may not be the case for digital tokens that serve a cryptocurrency use; but even then, these tokens usually tend not to represent monetary value. It is characteristic for E-Money that it represents fiat and stores its value, backed by a claim on the token issuer for redemption against fiat. Conversely, digital tokens issued at par value against fiat and furnished with the promise of the token issuer to be redeemed in exchange for fiat, and therefore being accepted as means of payment by third parties, would qualify as E-Money.

Similarly, collective investment scheme ("CIS")[177] law such as the Financial Services (Collective Investment Schemes) Act 2011[178] is another relevant legal consideration. A collective investment scheme is described as: "any arrangement with respect to property, the purpose or effect of which is to enable persons taking part in the arrangement, whether by becoming owners of the property or any part of it or otherwise, to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income."[179] There can be many scenarios where digital

173 Prospectuses Act 2005, http://www.gibraltarlaws.gov.gi/articles/2005-46o.pdf.
174 Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.
175 Financial Services (Markets in Financial Instruments) Act 2018, http://www.gibraltarlaws.gov.gi/articles/2006-32o.pdf.
176 Financial Services (Electronic Money) Regulations 2011, http://www.gibraltarlaws.gov.gi/articles/2011s167.pdf.
177 Financial Services (Collective Investment Schemes) Act 2011, http://www.gibraltarlaws.gov.gi/articles/2005-48o.pdf; Financial Services (Collective Investment Schemes) Regulations 2011, http://www.gibraltarlaws.gov.gi/articles/2011s190.pdf; Financial Services (Alternative Investment Fund Managers) Regulations 2013, http://www.gibraltarlaws.gov.gi/articles/2013s103.pdf.
178 Financial Services (Collective Investment Schemes) Act 2011, http://www.gibraltarlaws.gov.gi/articles/2005-48o.pdf.
179 Financial Services (Collective Investment Schemes) Act 2011, http://www.gibraltarlaws.gov.gi/articles/2005-48o.pdf.

tokens may not be defined as "securities" but may still be deemed to represent units in a collective investment scheme. In this case, a number of points would need to be considered, including the relevant exemptions and carve outs that may, under certain circumstances, also be relevant.

In addition to the above, the definition of an alternative investment fund ("AIF") under the Financial Services (Alternative Investment Fund Managers) Regulations 2013,[180] which transposes the E.U. Directive relating to alternative investment funds, needs to be considered. An AIF is deemed to be any collective investment undertaking that raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. If the arrangement is considered to form an AIF, or a token is deemed to represent a unit in an AIF, there are multiple considerations that become relevant, both in terms of the sale, promotion, and management of that scheme as well as the depositary arrangements for those units.

In many cases, digital tokens should not normally risk being a CIS. More often, however, digital tokens serve some cryptocurrency or functional use that is unregulated, such as the advance sale of products that entitle holders to access future networks or consume future services, or virtual currency, serving principally as a medium of exchange within an ecosystem (or marketplace) of consumers and service providers. However, entities issuing such types of digital tokens may still have to comply with classic consumer protection law,[181] depending on the design of the digital token.

A. GIBRALTAR CONTRACT LAW

The law of contract in Gibraltar is similar to the law in England and Wales. English common law applies in Gibraltar in accordance with the English Law (Application) Act 1962.[182] Unlike certain civil law jurisdictions, there is no general duty of disclosure in pre-contractual negotiations relating to digital token sales. Such a duty only exists when there are particular reasons for disclosure. These can be based on a pre-existing relationship between the parties (*e.g.*, a fiduciary or confidential relationship)[183] or when the nature of the contract carries specific duties of disclosure (this can be the case in consumer contracts, where duties of disclosure are imposed by the relevant legislation – see below).

Participants in digital token issuances dealing with token issuers at arm's length are therefore expected to conduct due diligence. Unless one party's mistake of fact is due to misrepresentation by the other party (or some other vitiating factor, such as duress), the parties will usually be held to their contractual commitments under Gibraltar law.

In short, a token issuer in Gibraltar is under no general duty of pre-contractual disclosure, but is prevented from inducing a purchase of digital tokens by misrepresenting (whether fraudulently or negligently) the nature of the arrangement.

180 Financial Services (Alternative Investment Fund Managers) Regulations 2013, http://www.gibraltarlaws.gov.gi/articles/2013s103.pdf.
181 Consumer Protection (Unfair Trading) Act 2008, http://www.gibraltarlaws.gov.gi/articles/2008-18o.pdf; Financial Services (Distance Marketing) Act 2006, http://www.gibraltarlaws.gov.gi/articles/2006-23o.pdf.
182 English Law (Application) Act 1962, http://www.gibraltarlaws.gov.gi/articles/1962-17o.pdf.
183 Tate v. Williamson LR 2 Ch App 55 (1866).

B. IMPLEMENTATION OF E-COMMERCE AND CONSUMER PROTECTION REGULATIONS INTO GIBRALTAR LAW

All relevant E.U. legislation covering e-commerce and consumer protection has been transposed into Gibraltar law via various Acts of Parliament or Regulations. The E.U. e-commerce and consumer protection rules (E-Commerce Directive,[184] Consumer Rights Directive,[185] Directive on Distance Marketing of Consumer Financial Services[186]) all specify the information that should be disclosed. The relevant provisions applicable under Gibraltar law are detailed below.

1. INFORMATION OBLIGATIONS WHEN GENERATING DIGITAL TOKENS VIA THE INTERNET

If the digital token is offered online, it falls within the scope of the E.U.'s e-commerce Directive, which has been transposed in Gibraltar through the Electronic Commerce Act 2001.[187] Regarding the type of information that must be provided when concluding electronic contracts, Section 6(1) states:

A service provider shall ensure (unless agreed otherwise with a prospective party to the contract who is not a consumer) that the following information is available clearly and in full before conclusion of the contract –

(a) the steps to follow to conclude the contract;

(b) whether the contract, when concluded, will be accessible and, if so, where;

(c) the steps to follow to correct any errors made in input by the recipient of the service; further, such steps must be effective and accessible allowing the recipient to identify and correct any errors without difficulty;

(d) any general terms and conditions imposed by the service provider, further, such general terms and conditions must be accessible to the recipient of the service for him to store and retrieve them.[188]

2. DUTY TO PROVIDE INFORMATION UNDER CONSUMER PROTECTION LAW

If the contract on which a digital token is based constitutes a consumer contract, further consumer protection rules apply, as set out in the Consumer Rights on Contracts Regulations 2013[189] (which transposes, inter alia, the EU Consumer Rights Directive). These rules are highlighted under Part 2 of the Consumer Rights on Contracts Regulations 2013. The Regulations further split the specific information obligations in relation to off-premises and on-premises contracts under Schedule 1 and Schedule 2 respectively.

184 Directive 2000/31/EC of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market.
185 Directive 2011/83/EC of 25 October 2011 on consumer rights.
186 Directive 2002/65/EC of 23 September 2002 concerning the distance marketing of consumer financial services.
187 Electronic Commerce Act 2001, http://www.gibraltarlaws.gov.gi/articles/2001-07o.pdf.
188 Electronic Commerce Act 2001, http://www.gibraltarlaws.gov.gi/articles/2001-07o.pdf.
189 Consumer Rights on Contracts Regulations 2013, http://www.gibraltarlaws.gov.gi/articles/2013s177.pdf.

C. MONEY LAUNDERING

The E.U. Anti Money Laundering Directive has been transposed into Gibraltar law by the Proceeds of Crime Act ("POCA").[190] It should be noted that Section 9(1)(p) of the POCA now includes within the definition of "relevant financial business" that include "undertakings that receive, whether on their own account or on behalf of another person, proceeds in any form from the sale of tokenized digital assets involving the use of distributed ledger technology or a similar means of recording a digital representation of an asset."[191] POCA also requires reporting (by businesses and by the GFSC) when there is a suspicion (rather than actual knowledge) of money laundering. Essentially, the addition of the new definition of relevant financial business specifically brings sales of a tokenized digital asset clearly within existing AML laws, which in turn have been very well received by other service providers in the industry. Amongst other things, customer due diligence is required before a business may receive proceeds from the sale of tokenized digital assets. These businesses would also be required to appoint a money-laundering reporting officer (''MLRO''), as well as apply certain record keeping requirements. The business must also maintain an AML compliance program and report suspicious activity.

III. PROPOSED REGULATORY FRAMEWORK

As set out above, most often digital tokens do not qualify as securities under Gibraltar or E.U. legislation.[192] In the event that they do constitute securities, there is currently an E.U.-wide framework[193] dealing with this. Accordingly, Gibraltar is not looking to introduce a framework that will replace securities law or prospectus directive requirements. That is to say, the public offering of tokens that constitute securities do not require further regulation from a Gibraltar perspective and will continue to fall under current frameworks governing issuances of securities.

As of the date of writing, we do not know the full extent of HMGOG's legislative proposals for the regulation of digital token issuances, as the draft legislation has not yet been published. However, the Token Framework Proposal ("Framework")[194] provides a high-level outline of what lies in store. It is proposed that new legislation will regulate the following activities conducted in or from Gibraltar:

» The promotion and sale of digital tokens;

» The operation of secondary market platforms trading in digital tokens; and

» The provision of investment and ancillary services relating to digital tokens.

190 Proceeds of Crime Act 2015, http://www.gibraltarlaws.gov.gi/articles/2015-22o.pdf.
191 Proceeds of Crime Act 2015, http://www.gibraltarlaws.gov.gi/articles/2015-22o.pdf.
192 HM Government of Gibraltar, Proposals for the regulation of token sales, secondary token market platforms, and investment services relating to tokens, http://gibraltarfinance.gi/20180309-token-regulation---policy-document-v2.1-final.pdf.
193 Prospectuses Act 2005, http://www.gibraltarlaws.gov.gi/articles/2005-46o.pdf.
194 HM Government of Gibraltar, Proposals for the regulation of token sales, secondary token market platforms, and investment services relating to tokens, http://gibraltarfinance.gi/20180309-token-regulation---policy-document-v2.1-final.pdf.

It is proposed the GFSC will regulate:

- Authorized sponsors of public digital token offerings;
- Secondary token market operators; and
- Digital token investment and ancillary service providers.

The Framework will not regulate:

- Technology;
- Digital tokens, smart contracts, or their functioning;
- Individual public offerings; or
- Persons involved in the promotion, sale, and distribution of digital tokens.

The following Sections set out at a high level the scope of the new proposed Framework.

D. DISCLOSURE RULES

The first limb of the Framework intends to deal with digital tokens that are not regarded as securities within the meaning of Gibraltar law. As set out above, this would typically cover circumstances where a digital token constitutes a product or service that does not yet exist (or is not substantially functional at the time of sale), in effect no more than a hope or ambition to deliver that product or service in the future. In such cases, purchasers risk that the product might never be delivered and often waive the right to the return on the price paid. HMGOG aims to ensure that whilst the purchaser may be prepared to take that risk, it is appropriate that they be presented with all the relevant information to enable them to make an informed decision. This limb of the Framework will therefore counter the current position in Gibraltar whereby a token issuer is under no general duty of pre-contractual disclosure.

With respect to the promotion, sale, and distribution of digital tokens, the Framework will require adequate, accurate, and balanced disclosure of information to enable anyone considering purchasing digital tokens to make an informed decision. The regulations may prescribe what, as a minimum, constitutes adequate disclosure, and in what form disclosures are made (*e.g.*, in a key facts document not exceeding two (2) pages). From time to time, guidance on disclosure rules may be published by GFSC.

The digital token industry often refers to the concept of "self-regulation," and best practice frameworks for token offerings have already been established. The key difference with the proposed regulations is that the concept of self-regulation, while being attractive in the sense that it may be said to decentralize certain standards and requirements, it is also in many senses 'voluntary' and does not necessarily raise the standards through any legally enforceable framework such as the one being proposed in Gibraltar. As a result, the GFSC can ensure and enforce their regulatory objectives through the implementation of the Framework.

E. FINANCIAL CRIME PROVISIONS

As discussed above, a recent amendment to POCA under Section 9(1)(p) means that token issuers now fall under its scope. It remains to be seen whether this amendment is a temporary measure which will be replaced by specific regulations on AML and CFT once the Framework comes into force or whether these amendments were in fact what was contemplated in the Framework. Nevertheless, this demonstrates the intention of the Gibraltar Government to ensure that, even before the proposed digital token regulations come into force, existing statutory safeguards require all token issuers to carry out due diligence on digital token purchasers and to mitigate AML/CFT risks.

F. AUTHORIZED TOKEN SPONSORS

As outlined above, the GFSC intends to regulate:

- Authorized sponsors of public token offerings;
- Secondary token market operators; and
- Digital token investment and ancillary service providers.

It therefore appears that the onus of ensuring compliance with appropriate standards will be on the service providers and secondary token market operators and the GFSC does not intend to regulate token issuers, nor will it regulate the underlying technology or the digital tokens themselves.

The Framework will establish a regime for the authorization and supervision of token sponsors possessing appropriate relevant knowledge and experience who will be responsible for compliance with this limb of the regulations. It is intended that an authorized token sponsor will need to be appointed in respect of every public token offering promoted, sold or distributed in or from Gibraltar.

Token sponsors will be subject to an authorization and supervision process by the GFSC and must possess suitable knowledge and experience of the industry to be admitted into the sponsorship regime. A critical component for token sponsors to be authorized is to have local presence in Gibraltar, with "mind and management" based in the jurisdiction. The onus will also be on token sponsors to produce their own codes of conduct, setting out what they consider to be best practices relating to token offerings. These codes will form part of a prospective token sponsor's application for authorization. The introduction of a token sponsor regime is comparable to what currently exists today in the U.K. in relation to regulated public market listings, where Sponsors and Nominated Advisors effectively act as listing agents that guide prospective issuers through the flotation process. It appears this same model is being adapted under the token sponsor regime to handhold prospective token issuing entities through a compliant token sale process.

The GFSC will establish and maintain a public register of authorized sponsors and their respective past and present codes of practice.

G. SECONDARY MARKET OPERATIONS

Apart from the DLT Framework, operating a secondary market platform for trading tokens is not currently regulated in Gibraltar. The Framework will regulate the conduct of secondary market platforms, operated in or from Gibraltar and, to the extent not covered by other regulations, their derivatives, with the aim to ensure that such markets are fair, transparent, and efficient.

At this stage, the Framework does not elaborate on the specific regulatory obligations that will be imposed. However, it does highlight the introduction of further transaction reporting and disclosure requirements, as well as extending the application of the Framework to cover trading of derivative token products. The Framework does, however, mention modeling the proposed regulations on market platform provisions under MiFID II[195] and the Markets in Financial Instruments Regulation (MiFIR),[196] so far as is appropriate, proportionate, and relevant.

H. INVESTMENT AND ANCILLARY SERVICE PROVIDERS

Providing investment and ancillary services relating to digital tokens is not currently regulated in Gibraltar. HMGOG has proposed to regulate the provision of investment and ancillary services in or from Gibraltar and, to the extent not otherwise caught by regulations, their derivatives. These regulations aim to ensure that such services are provided fairly, transparently, and professionally. This limb of the Framework will intend to cover advice on investment in digital tokens, virtual currencies, and central bank-issued digital currencies, including:

» generic advice (setting out fairly and in a neutral manner the facts relating to token investments and services);

» product-related advice (setting out in a selective and judgmental manner the advantages and disadvantages of a particular token investment and service); and

» personal recommendations (based on the particular needs and circumstances of the individual investor).

This limb of the Framework will be proportionately modeled on provisions that currently exist under MiFID II[197] with the aim of ensuring that such services are provided fairly, transparently, and professionally. However, at this stage, little guidance has been given on the specific types of advisors involved in a digital token distribution process that will be caught by the proposals (*e.g.*, introducers, marketing professionals, technical developers and smart contract auditors, economic, legal and tax advisors, cybersecurity firms, escrow agents, etc.).

195 Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.
196 Regulation (EU) No 600/2014 of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.
197 Directive 2014/65/EU of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

IV. DLT SERVICES

As set out above, the DLT Framework is a licensing regime for individuals and firms that engage in activities that, for business purposes, use DLT for the transmission or storage of customers' assets. It is generally accepted that the DLT Framework does not extend to the generation and sale of digital tokens. This is in line with public statements made by various bodies, including HMGOG, and is consistent with the Framework which will be introduced for these purposes. However, there may be instances where a token issuer may fall within the scope of the DLT Framework, although this should be considered separately from the actual digital token sale, which may remain unregulated until the new legislation referred to above comes into effect.

V. PART 2: TOKEN PRINCIPLES AND GUIDELINES

SECTION 1: PRINCIPLES AND GUIDELINES FOR TOKEN SPONSORS

This Section[198] provides introductory principles and guidelines for Token Sponsors as a way to promote sound business practices. As explained in the Introduction, within the context of this report, a "**Token Sponsor**" or "**Sponsor**" is any clearly defined individual or group that (a) generates or distributes, or (b) undertakes to lead or control the development, adoption, or distribution of, a digital token that is not intended to be a security or CFTC Regulated Instrument (as defined above in Part 1). For these purposes, the activities of a Token Sponsor inherently entail more than the development and publication of a blockchain protocol that uses tokens. Hence, not all digital tokens are generated through the efforts of a Token Sponsor — indeed, bitcoin was generated independent of a Token Sponsor.

As explained in the United States Regulatory Overview provided in Part 1 and illustrated in the examples provided in Part 3, digital tokens can take a variety of forms and serve many purposes. This Section provides principles and guidelines for Token Sponsors to manage the risk that the offering and distribution of a digital token may run afoul of certain federal securities and commodity laws by (a) discussing why a digital token may become subject to certain securities and commodities laws and regulations, (b) presenting steps that may reduce the risk of the token being treated as a security or a CFTC Regulated Instrument, (c) explaining a suggested path for Token Sponsors to follow when launching a digital token, and (d) offering guidelines for drafting token projects' white papers and other marketing materials.

TOKEN SPONSOR

Any clearly defined individual or group that (a) generates or distributes, or (b) undertakes to lead or control the development, adoption, or distribution of, a digital token that is not intended to be a security or CFTC Regulated Instrument (as defined above in Part 1).

198 While this report includes in Part 1 a discussion of, Canadian, U.K., Australian, and Gibraltar law, these principles and guidelines apply within U.S. securities and commodity regulatory regimes.

This report, including its suggested principles and guidelines, merely expresses the general views of the Token Alliance, and compliance with such principles and guidelines cannot assure that the sale or trading of tokens will fully comply with law. These views are being offered for discussion purposes only, and they have not been sanctioned by the SEC, the CFTC, or any other regulator. You should consult legal counsel before offering, distributing, or trading digital tokens.

I. WHEN IS A DIGITAL TOKEN SUBJECT TO REGULATION BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION OR COMMODITY FUTURES TRADING COMMISSION?

CHARACTERISTICS OF A SECURITY

As explained in the United States Regulatory Overview provided in Part 1, United States federal securities laws define "security" broadly. A digital token that demonstrates ownership of an instrument enumerated in these definitions, such as a note or other evidence of indebtedness, share of stock, or undivided fractional interest in mineral rights, would typically be subject to regulation by the SEC under the federal securities laws and by state authorities under their "blue sky" laws.

Although the application of United States federal securities laws and related regulations to particular situations, including interpretations by courts, emphasizes the underlying substance of a transaction, Token Sponsors must be cognizant of confusion that might arise in the marketplace from their use of imprecise or inapposite terminology. If a digital token is not intended to be a security, then it is advisable to avoid using securities-related terminology in white papers and other marketing materials that may confuse readers as to the nature of the token. Examples may include statements such as:

» Token holders will "own" or "profit" from a blockchain or network;

» Token holders will receive "interest" or "dividends" on their tokens; or

» References to the token's "market capitalization" or "market cap."

Even referring to an "initial coin offering" or "ICO" may invite comparison to an initial public offering of securities.

THE *HOWEY* TEST

As explained in the United States Regulatory Overview, digital tokens may trigger United States federal securities laws if they are an "investment contract" – a catchall for securities that are not otherwise set out in the definition of a "security." The test for whether any instrument is an "investment contract" under the United States federal securities laws[199] is commonly referred to as the "*Howey* Test." Stemming from a 1946 Supreme Court case of the same name,[200] the *Howey* Test holds an investment contract to exist if there is:

199 For the purposes of these Principles and Guidelines, "U.S. federal securities laws" refers to the Securities Act and the Exchange Act.
200 *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

THE HOWEY TEST AN INVESTMENT CONTRACT EXISTS IF THERE IS:

1	2	3	4
AN INVESTMENT OF MONEY	IN A COMMON ENTERPRISE	REASONABLE EXPECTATION OF PROFITS	PROFITS DERIVED FROM THE SUBSTANTIAL EFFORTS OF OTHERS

*BASED ON 1946 SUPREME COURT CASE SEC V. HOWEY

All four elements of the *Howey* Test must be met for an instrument (such as a token) to be considered an investment contract. Form and nomenclature hold no weight, rather it is the substance of the instrument in question that is important. **Thus, it is important for Token Sponsors to have an attorney expert in United States federal securities laws analyze the application of the *Howey* Test to a Token Sponsor's proposed digital token before the token is offered or distributed. This includes any form of distribution, including system-based rewards, "airdrops," and distributions to employees, founders, contractors, and consultants.**

COMMODITY REGULATION

The United States Regulatory Overview explains how the CFTC may exercise general anti-fraud and anti-manipulation authority over any digital token it deems to represent a "commodity," as broadly defined under the Commodity Exchange Act. Moreover, any arrangement that involves the future delivery of a digital token may subject the arrangement or the token to regulation by the CFTC as a futures agreement, swap, option to buy or sell the token, or retail commodity transaction, which were defined in Part 1 as "**CFTC Regulated Instruments**."

It thus should be a common practice for the Token Sponsor's legal counsel also to consider whether a digital token may create a CFTC Regulated Instrument under the CEA, or the impression of such an instrument. Even when this is not the case, working with counsel to conduct such analyses may provide valuable guidance regarding how the digital token should be distributed in compliance with the CFTC's anti-fraud and anti-manipulation regulations.

II. HOW CAN A TOKEN SPONSOR MANAGE THE RISKS OF HAVING A DIGITAL TOKEN TREATED AS AN INVESTMENT CONTRACT OR CFTC REGULATED INSTRUMENT?

Ultimately, there is no better means of assisting a Token Sponsor in complying with SEC and CFTC regulations than a candid assessment by experienced legal counsel of the token's intended uses and the means by which the tokens will be generated, offered, and distributed. This assessment should be updated as circumstances of the digital token change and the regulatory landscape evolves.

The SEC, CFTC, and United States courts will consider all relevant facts and circumstances when considering whether a Token Sponsor's activities entail the offering or sale of an investment contract or a CFTC Regulated Instrument. Although the SEC's and CFTC's positions regarding digital tokens are evolving, the following factors may reduce the risk of a digital token becoming subject to such regulations.

» **Full development of requisite system(s) and/or application(s) before distribution:** A digital token distributed by a Token Sponsor should be one component of fully-developed system(s) and/or application(s) designed by a Token Sponsor. Upon distribution, the token should provide access to any affiliated services or applications. Otherwise, the Token Sponsor's continued development efforts may be (i) viewed by the SEC as efforts from which token holders reasonably expect to profit, or (ii) viewed by the CFTC as a promise for the delivery of a commodity at a future date.

» **Timing of the distribution of a digital token:** A Token Sponsor should not deliver its digital token to purchasers until everyone who receives tokens can use them to access applicable system(s) and/or application(s), unless expert counsel confirms that the token can be delivered at an earlier point in compliance with applicable SEC or CFTC regulations.

» **Tokenized commodities should be accessible:** If a Token Sponsor's digital token is designed to represent ownership interest in a specified commodity (including another token), the digital token should be related to a system or application that is able to provide token holders with timely access to the specified commodity. A token designed to adjust in price in response to the price, or change in price, of a commodity without entitling the token holder to obtain or control a corresponding amount of the commodity may viewed by the CFTC as a CFTC Regulated Instrument.

» **Token holders should not sell digital tokens on credit:** Selling digital tokens on credit, requiring purchasers to post collateral, or otherwise providing a leveraged exposure to the token or any underlying commodity may qualify as a CFTC Regulated Instrument. A delay of more than 28 days between the agreement to purchase a token and its delivery to the purchaser may increase this risk.

» **Focus communications on the value of using the digital token:** While a Token Sponsor will want users of its digital token to understand and appreciate the potential value of the token's project, the Token Sponsor should seek to be clear that the digital token is not intended to provide a passive investment opportunity for its holders. This may be aided by the Token Sponsor emphasizing the benefits of using or consuming the digital token and emphasizing any ways in which token holders and other network participants will contribute to the token's potential value.

» **For financial and accounting purposes, treat the digital token consistently with its use:** When permitted by generally accepted accounting principles, tax regulations, and similar rules, the treatment and discussion of the digital token in the Token Sponsor's financial statements, reports and analyses should be consistent with its use in the related systems or applications. Characterizing the digital token as an investment, security, or CFTC Regulated Instrument for tax and accounting purposes could influence its regulatory treatment by the SEC or CFTC. This is not to suggest, however, that the use of a term mandated by tax or accounting rules, such as "forward contract" for example, would be considered dispositive as to the character of a digital token or contract relating to the token for purposes of SEC or CFTC regulations – only that it may give the appearance of inconsistent treatment.

- **Tokens should be designed so that holders do not expect profits from the token's project:** Projects should not entail equity rights and should not result in the periodic distribution of funds (whether fiat or crypto-currency) to digital token holders, or the expectation of such distributions. Likewise, a Token Sponsor should not design or market digital tokens with any emphasis on price-appreciation or profit delivery to token holders. In particular:
  - A Token Sponsor should try to avoid hallmarks of a traditional security, such as (1) a stake of ownership or control in a company or venture behind a digital token project (including a decentralized autonomous organization), or (2) the sharing of any of a Token Sponsor's profits with other token holders through distributions, dividends, interest, or other payments.
  - A Token Sponsor should be wary of features in the digital token that would be reasonably expected by a prospective purchaser to cause the token to appreciate in price or otherwise provide passive returns to the token holders.
  - A Token Sponsor should be cautious in using the digital tokens as financial incentives for employees or others, so as to avoid the appearance that these recipients reasonably expect the token to appreciate in price.

Distributions of a digital token before the underlying project for the token is complete can be at risk of creating investment contracts even if the token would not be subject to federal securities laws once the project is fully completed. Selling tokens at a discount to a projected public sale price or to raise funds for the project may contribute to this risk. In order to successfully conduct a pre-sale, a Token Sponsor may need to ensure compliance with the registration requirements or an exemption from registration under the Securities Act and delay delivery of the token until the project is constructed and fully functional.

When practical, a Token Sponsor may choose to fully comply with an applicable exemption from registration, including limiting the type of persons (such as accredited investors or eligible contract participants) to which its token is sold or the jurisdictions in which an offering is conducted, rather than rely on arguments for why the token should fail the *Howey* Test. Compliance with such an exemption should not prevent a Token Sponsor from subsequently concluding that its digital token does not qualify as an investment contract and permitting the digital token to be transferred without compliance with the exemption.

III. WHAT ARE THE STEPS FROM INCEPTION TO COMPLETION OF A DIGITAL TOKEN DISTRIBUTION?

A Token Sponsor should follow the steps set forth below, as applicable, when launching a digital token that is intended to be neither a security nor a CFTC Regulated Instrument. Following the order of the steps below is important, as any action taken out of order may compromise the regulatory standing of the token:

Concept and technology development: A Token Sponsor should fully develop its conception of its underlying system(s) and application(s) employing the digital token. This primarily includes the development of clear frameworks related to: (i) how the system will enable the provision of any applications, products, and/or services to which the token will provide access, (ii) the design and construction of any related external facing applications, and (iii) the writing and testing of code.

White paper and other materials: A Token Sponsor should draft a complete and accurate white paper, which should be reviewed by expert legal counsel before publication (including posting on a website or social media). Please refer to Section D of these Principles and Guidelines for Token Sponsors for more information on what, at a minimum, should be included (and excluded) from a white paper. It is recommended that, when appropriate, separate materials should be prepared to address how the token will be offered and distributed to users.

Regulatory review: The Token Sponsor, with counsel, should review its token project, its accompanying white paper, and any related applications, services, or marketing materials for issues related to state and federal money transmitter laws, import and export regulations, AML/OFAC compliance obligations, federal and state securities laws, commodity laws, and any other potential legal or regulatory considerations related to the sponsor's specific business. In particular, they should consider:

- The application of the *Howey* Test and other aspects of the definition of a "security" to the digital token;
- Whether a Token Sponsor's digital token involves a CFTC Regulated Instrument like a swap or retail commodity transaction;
- Tax and related reporting requirements that may arise from the creation and distribution of the token and the operation of the applications related to the token;
- Whether to register with FinCEN as a "money services business";
- Whether to conduct appropriate "know your customer" activities in relation to the distribution of the token to comply with any applicable money laundering, OFAC, and/or import/export laws; and
- Whether to consult with legal counsel in other jurisdictions.

Corporate review (*if appropriate for the token*): The Token Sponsor should establish all necessary corporate or other legal entities (which may include the drafting of corporate governance documents, board resolutions, etc.), register intellectual property, draft privacy policies and user terms, and prepare external communications strategies. The Token Sponsor should seek counsel to work on any transactions to raise capital for the project apart from a potential pre-sale.

Pre-utility sale (if appropriate for the token): A Token Sponsor may need to sell (but not deliver) digital tokens in advance of completion of the associated system(s) or application(s). This may require the Token Sponsor to sell the digital tokens in compliance with an exemption from the Securities Act and the CEA, even though the Token Sponsor does not anticipate that its digital tokens will qualify as securities or CFTC Regulated Instruments after the system(s) and application(s) are completed. The Token Sponsor should seek expert legal counsel to assess whether the sale requires an exemption and, if so, what exemptions would be available. If an exemption is required, legal counsel should assist the Token Sponsor in developing and executing a legal and regulatory compliance program relating to the pre-utility sale.

Public distribution: The Token Sponsor should develop and complete a token distribution closing checklist designed to ensure compliance with applicable laws and regulations. Also, if the Token Sponsor's planned token distribution so requires, counsel should assist the Token Sponsor in drafting appropriate terms and conditions, including representations and warranties, as well as any agreement that will govern the distribution.

IV. WHAT MINIMUM INFORMATION SHOULD BE INCLUDED IN A DIGITAL TOKEN'S MATERIALS?

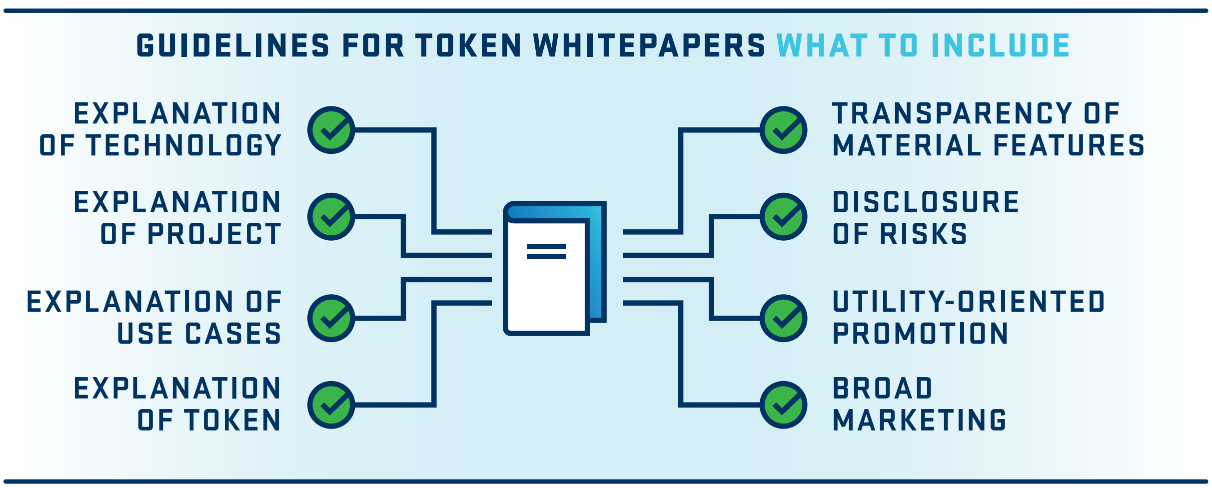
Digital tokens generally have accompanying materials such as a white paper and marketing materials. A Token Sponsor that intends to generate and distribute a digital token should draft a clear and complete white paper explaining the relevant facts related to the token project, its utility and value proposition as well as any problem(s) it seeks to solve, any related products and/or services, and how the token is intended to operate as an integral part of the project. Additionally, marketing materials themselves can come in many forms, both written and spoken. Marketing materials in any form should be crafted carefully. A clear division of labor can be helpful, with the white paper and certain other information focused on how people can use the token and other materials focused on how and why people should acquire tokens.

SPONSORS SHOULD MARKET A PRODUCT RATHER THAN AN INVESTMENT

Marketing materials should focus on the benefits of using the token for its intended application and be addressed to those likely to use the token in this manner. For example, if a token could only be used by members of a network, purchasers should be required to join the network before receiving their tokens. Marketing efforts should not be directed at those known to be in the business of or making a practice of recommending or purchasing tokens as investments.

INFORMATION THAT SHOULD BE INCLUDED IN A WHITE PAPER

A Token Sponsor's white paper is a critical document. A white paper provides background on a Sponsor's token project, as well as specifics on the project's technological application, any related products or services, and how the digital tokens will operate. If the tokens are designed to monetize the value of such products or services, it may be appropriate to explain the business model underlying the project. A white paper is not a business plan, marketing materials, offering memorandum, or prospectus – it is a factual description of how the token will operate as part of a system or within an application. The white paper will often form the objective basis for evaluating the regulatory implications of the projects, including the distribution of the tokens and the offer of any products, applications, and services. Thus, Token Sponsors should carefully consider what should and should not be included in their white papers.

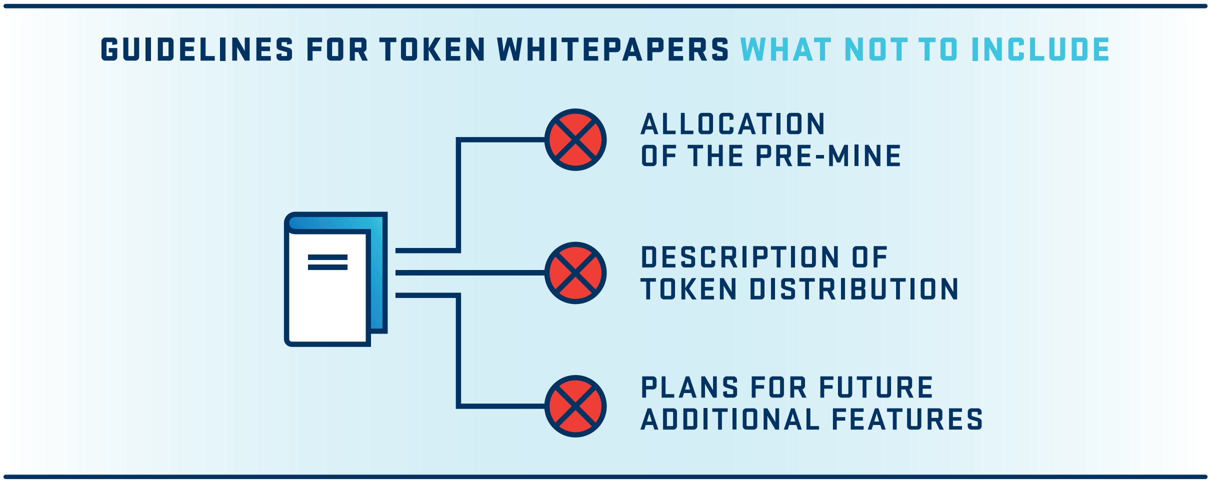


» **Explanation of Technology:** A Token Sponsor's white paper should explain the technology underlying the token project's token and affiliated system(s) and/or application(s). It might include such matters as a description of the underlying code, how an application interacts with the platform, why a blockchain-based product or service is critical to solving the problem(s) that the token project aims to address, and the operation of the token network. Any means by which the token's protocol enables control of, changes to, or corrections of the token's protocol should be discussed. Depending on the intended token recipient, the Token Sponsor should carefully separate hyper-technical or dense discussions of the technology from plain-language discussions of the technology to enable the widest possible audience to understand the project and its central components. While technical discussions of the technology may be very important, a Token Sponsor should consider including them as appendices to, or separate documents from, the project's white paper.

- **Explanation of Project:** A Token Sponsor's white paper should explain the utility of the token project and include a description of how the project seeks to achieve its intended purpose as well as how the token will be used for this purpose.
  - **Services and Products:** A white paper should describe system(s) or application(s) that may be acquired or utilized with the token.
  - **Use of Smart Contracts:** If the Token Sponsor's project uses smart contracts, the white paper should describe how the smart contracts are intended to be used, what purposes they are intended to serve within the application, and how the smart contracts are intended to operate, including how they self-execute in the context of the application.
- **Explanation of Use Cases:** A Token Sponsor's white paper should consider providing current use cases for the project's products and/or services and specifically the digital token. The explanation can include descriptive or illustrative case studies of the application to provide the reader an understanding of how the project's application and token will work in practice within the blockchain application.
- **Explanation of Token:** A Token Sponsor's white paper should provide a comprehensive description of a token that is imbedded in the product and/or service. The description should include the form of the token (*e.g.*, ERC20, etc.), and any rights of, or benefits to, and obligations of, token holders.
- **Transparency of Material Features:** A Token Sponsor, through published material or statements (such as a white paper and distribution terms), should transparently disclose the material features of its digital token and of the token's distribution, including information pertaining to pricing, structure, allocation, and utility.
- **Disclosure of Risks:** A white paper should disclose any foreseeable conditions that could disrupt or impair use of the tokens' application(s) or system(s). If the Token Sponsor has devised plans to mitigate certain risks, it should disclose the material details of such plans.
- **Utility-Oriented Promotion:** Promotion of the system or application for a Token Sponsor's digital token should not encourage interest in acquiring the token based solely on investment expectations or a fear of missing out on an investment. Depending on other facts, such promotion could affect the token's characterization as a security. The Token Sponsor should not link to or reference material the content of which is not in its control.
- **Broad Marketing:** The dissemination of a Token Sponsor's white paper should be focused towards the population who would most likely use or benefit from the Token Sponsor's product, service, or token. The marketing of a white paper should not be targeted toward general populations with an interest in investing, particularly those who speculatively invest in digital tokens, or who buy with the sole intention of selling for increased returns.

INFORMATION THAT SHOULD NOT BE INCLUDED IN A TOKEN SPONSOR'S WHITE PAPER

- **Allocation of the pre-mine:** A Token Sponsor's white paper should avoid discussion of any allocation of tokens for investors, developers, founders, or employees. Such discussions would appear to be more relevant to a potential investor in the project than a user of the application.
- **Plans for future additional features:** A Token Sponsor's white paper should not discuss any plans that the Token Sponsor may have for expanding the features or scope of the project's products, services or applications, or other proposed enhancements to the token's use after the launch of its token. Emphasis on plans for future development by the Token Sponsor may negatively affect a digital token's security analysis under the *Howey* Test.



- **Description of the distribution of tokens:** If a Token Sponsor's digital token will be distributed in private sales, a limited public sale or auction, airdrop, or a similarly limited event, it may be more appropriate to describe the event in separate materials that can be superseded when the event is completed, rather than in the Token Sponsor's white paper. Such materials may include details that would only be of interest to participants in the event. This may help keep readers from improperly regarding a Token Sponsor's white paper as marketing the token rather than describing its operation.

Of course, a Token Sponsor's white paper generally should discuss any means its system(s) or application(s) employ to distribute tokens as part of its regular operations. Such systemic distributions might include rewards for work done in generating or verifying new blocks and rewards for other work done to operate the system(s) or application(s).

INFORMATION THAT SHOULD NOT BE INCLUDED IN A TOKEN SPONSOR'S PROMOTIONAL AND MARKETING MATERIALS GENERALLY

- **Intentional misrepresentations or misleading statements:** A Token Sponsor should not make any misrepresentations, misleading statements, or omit any material facts that could be deemed important information for someone using or acquiring its digital token.
- **Promises of financial returns:** A Token Sponsor should take care that materials relating to its digital token not make statements that characterize the token as a passive investment opportunity or imply that the token holders will earn financial gains as a result of business activities of the Token Sponsor unrelated to the underlying utility of the tokens' system(s) and application(s). Examples of such statements are those made in the *Munchee* Order regarding how the "ecosystem" had been designed to cause the token to appreciate or, as discussed in more detail in Section 2, the prospects for a secondary market. Token Sponsors should avoid making promissory statements.
- **Discussion of matters that might primarily interest investors:** A Token Sponsor's materials should not make any statements that would be relevant to an investor but not to a user of the application(s) or system(s) relating to the digital token. Quantitative statements regarding current or potential markets for such application(s) or system(s) should be carefully considered. The user of a digital token to obtain a service, for example, may find the number of customers or the number of times the service is accessed more relevant than the dollar amount spent on the service. Sponsors should especially avoid projecting the project's takeover of market share or the token's future secondary market price.
- **Discussions of prior investments or major projects completed by the development team and its advisors or consultants:** In the *Munchee* Order, the SEC criticized statements highlighting "its founders had worked at prominent technology companies" and "their skills running businesses and creating software." This suggests a Token Sponsor should be cautious about discussing the management and entrepreneurial skills and records of those involved with its token project in the context of a token's future financial performance or in such a way that creates an expectation that their efforts will help the price of the relevant digital token appreciate.

CONCLUSION

Following these *Principles and Guidelines for Token Sponsors* provides no guarantee that a federal or state regulator will not take issue with the digital token issuance, sale, or other distribution. Rather, these principles and guidelines are intended to provide an overview to assist a Token Sponsor when thinking through critical issues related to its digital token issuance, sale and distribution. These *Principles and Guidelines for Token Sponsors* should be read in concert with the *Token Alliance's Principles and Guidelines for Token Trading Platforms*.

SECTION 2 - PRINCIPLES AND GUIDELINES FOR TOKEN TRADING PLATFORMS

This Section provides introductory principles and guidelines for entities that allow the trading of digital tokens on their platforms and for Token Sponsors seeking to have their tokens traded on such platforms. This Section only addresses platforms (collectively, "Token Trading Platforms")[201] through which market participants can convert virtual currency, fiat currency, or other digital tokens into other virtual currency, fiat currency, or other digital tokens that are not:

» Registered with the SEC pursuant to the Exchange Act as a "national securities exchange" or an "alternative trading system;" or

» Registered with the CFTC pursuant to the CEA as a "registered entity."

TOKEN TRADING PLATFORM

Any entity that hosts customer-oriented spot markets and is neither (a) registered with the SEC pursuant to the Exhange Act as a "national securities exchange" or an "alternative trading system" nor (b) registered with the CFTC pursuant to the CEA as a "registered entity".

Token Trading Platforms and other secondary markets for digital tokens play a critical role in the establishment of secure networks, enhance token utility, and promote the general adoption of cryptocurrency and blockchain technology. They provide an important mechanism for price discovery, which in turn allows systems that incentivize blockchain validation—such as proof of work—to function efficiently. They also expand opportunities for the general public (*e.g.*, the unbanked) to acquire and benefit from blockchain applications, and to purchase and sell tokens as their demands for particular token functionalities change and evolve and as new and improved tokens are developed.

But secondary markets may also create securities law-related concerns. In the words of SEC Chairman Jay Clayton, a secondary market is a "key hallmark" of securities and of securities offerings.[202] As explained in the United States Regulatory Overview provided in Part 1, Section 1, facilitating the trading of digital tokens may subject a platform to regulation by the SEC or the CFTC if the tokens are found to be securities or CFTC Regulated Instruments. The uncertainty surrounding the application of "facts and circumstances" legal tests to new and evolving blockchain technology makes compliance with those regulatory definitions challenging.

201 These Principles and Guidelines assume that the Token Sponsor is independent of the Token Trading Platform. Although a Token Trading Platform may make a market in a token for which it is the Sponsor, this reduces the need for formal reviews and agreements.
202 SEC *supra* note 49; CLAYTON *supra* note 45.

Of course, responsible Token Trading Platforms should do more than merely avoid regulation by the SEC or the CFTC. They should voluntarily conduct business in a manner that protects token consumers, protects the integrity of secondary markets, and builds public confidence in the broader blockchain industry. These broader concerns, although important, are beyond the scope of this chapter, as are the following non-exhaustive list of other legal and regulatory issues that Token Trading Platforms should address:

- cyber security;
- whether their activities constitute money transmission under the relevant federal and state statutes and regulations;
- privacy and data transfer issues for international users;
- AML/KYC and OFAC procedures, including transparency surrounding such procedures so that users understand why they must provide their information;
- reserving the right to remove users from the exchange;
- reserving the right not to conduct cross-chain recoveries when people deposit the wrong tokens in exchange wallets; and
- how the exchange will treat victims of external phishing schemes or theft of tokens.

Rather, this Section will focus on how Token Trading Platforms may manage the risk that a regulator or a court may contend that a digital token trading on the platform is a security or CFTC Regulated Instrument notwithstanding the Token Sponsor's claims to the contrary. This is an important threshold concern for any Token Trading Platform because allowing even one security or CFTC Regulated Instrument to trade on the platform would require the Token Trading Platform to registered with either the SEC or CFTC, respectively.

I. IMPORTANT CONSIDERATIONS FOR VETTING TOKENS FOR ACCEPTANCE ONTO A TOKEN TRADING PLATFORM

- ✓ Before it establishes a market for any digital token, a Token Trading Platform should examine the token to determine the risk that it might be deemed to be a security or CFTC Regulated Instrument and, consequently, that the Token Trading Platform might fall within the requirements of the Exchange Act or CEA. No token should be exempt from this examination. Digital tokens for which markets were established before a Token Trading Platform adopted written procedures as described below should be reviewed retroactively.
- ✓ The compliance officer or other senior managers of the Token Trading Platform should establish written procedures ("Procedures"), containing factors used to evaluate digital tokens for approval for trading on the platform, as well as standards for ongoing review of tokens to assess if they will no longer be permitted to trade. The Procedures should include:
    - a review the token's present utility, based on the Token Sponsor's white paper and other documents, information, or demonstrations provided by the Token Sponsor;

- a review of promotional statements (and any subsequent disclaimers) made by the Token Sponsor or agents on its behalf on public-facing media;
- a current written analysis prepared by the Token Sponsor's counsel or by the Token Sponsor in consultation with its counsel explaining why the digital token is not a security or CFTC Regulated Instrument, which analysis should be reviewed by counsel for the Token Trading Platform; and
- a requirement that digital tokens are reviewed periodically to ensure that they remain compliant with existing law and regulatory expectations relevant to Exchange Act or CEA requirements.

✓ The same criteria should be used to close a market for a digital token as are used to deny a request to establish a market for a prospective token.

✓ A Token Trading Platform should memorialize the results of a token's examination and any re-examination and store them for no less than five years.

✓ A Token Trading Platform should not permit trading of any derivative instruments, including but not limited to any CFTC Regulated Instruments.

✓ A Token Trading Platform should carefully consider whether to permit trading of digital tokens on a leveraged, margined, or financed basis. If a Token Trading Platform were to permit trading of tokens in these ways, it should only do so where it has implemented appropriate measures to ensure such trading is in accordance with applicable CEA requirements.

✓ As illustrated by the *Munchee Order*, promises by a Token Sponsor to establish secondary trading markets for its digital token, or even publicized efforts by the Token Sponsor to do so, may be a negative factor under the *Howey* Test. In light of this, a Token Trading Platform should consider its policies around (a) confidentiality of requests to establish a market and communications relating to such requests and (b) publicity regarding its decision to establish, to not establish, or to close a market for a digital token. The Token Trading Platform should take appropriate steps to inform applicants of and require applicants to abide by these policies.

✓ Adopt policies and procedures to ensure that a Token Trading Platform's directors, officers, employees, and affiliated third parties do not use nonpublic material information obtained through their work with the Token Trading Platform to engage in digital token transactions that could give the appearance of trading on material non-public information.[203]

✓ Have procedures for promptly investigating any reports of market manipulation.

✓ Establish criteria and procedures for suspending trading of a token suspected of being involved in manipulative trading activity.

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203 Sections 6(c) and 9(a) of the CEA, CFTC Regulation 180, and associated guidance and case law may be relevant to such policies and procedures.

✓ Involvement of a Token Trading Platform in the offering and distribution of a digital token may become a factor in determining whether a digital token qualifies as an investment contract under the *Howey* test. A Token Trading Platform may want to assess this risk with the Token Sponsor before becoming involved. Even after a market is established, a Token Trading Platform should avoid appearing to endorse as an investment any digital token that is trading on its platform and should make appropriate disclosures and disclaimers when necessary to counter any such appearance. This guidance is not meant to discourage communication between Token Sponsors and Token Trading Platforms for the purpose of clarifying or enhancing legal compliance or collaboration relating to technological issues associated with potential or continued inclusion of the digital token on the Token Trading Platform.

II. CONSIDERATIONS FOR TOKEN SPONSORS DEALING WITH TOKEN TRADING PLATFORMS

» A Token Sponsor should keep in mind that no Token Trading Platform is obligated to maintain a market for its digital token and should be prepared to work with the Token Trading Platform to answer all reasonable questions that the Token Trading Platform asks of it.

» A Token Sponsor should consider whether any financial dealings with a Token Trading Platform or its affiliates could create a reasonable impression that the Token Sponsor is "buying" the digital tokens' way onto the platform.

» A Token Sponsor that deals with Token Trading Platforms should have policies and procedures to prevent its affiliates and employees from trading based on non-public information regarding the token's status on the platform, such as a decision to open or close a market for the token.

» While a Token Sponsor may publicize that its token can be purchased or sold on a Token Trading Platform, once a market for the token is opened, the Token Sponsor should refrain from discussing the token's potential for price appreciation.

CONCLUSION

Following these Principles and Guidelines for Token Trading Platforms provides no guarantee that a federal or state regulator will not take issue with the trading of particular tokens on its Token Trading Platform. Rather, these principles and guidelines are intended to provide an overview to assist a Token Trading Platform when thinking through important considerations before establishing a market for digital tokens. These Principles and Guidelines for Token Trading Platforms should be read in concert with the Token Alliance's Principles and Guidelines for Token Sponsors.

VI. PART 3: TOKEN ECONOMIC LANDSCAPE

TRENDS IN TOKEN PROJECT FUNDRAISING EVENTS: 2013-PRESENT

I. METHODOLOGY

Measuring digital token project[204] size is difficult. To do so, throughout this part, the term "digital token projects" or "token projects" includes all digital token fundraising events that (i) entailed over $25,000 being raised from project participants; and (ii) did not return these raised funds. Amounts raised are valued according to average daily exchange rates on the date the fundraising event closed. Also, for purposes of this part, fundraising events for digital tokens are defined to take place regardless of whether tokens are distributed immediately or are promised to be delivered to project participants in the future (and have yet-to-be created, like Filecoin). Thus the scope of analyses in this part includes all "presales," "private sales," "pre-ICOs", and so-called "Initial Coin Offerings" or "ICOs," as well as both meta-tokens on Ethereum (most of which are based on the ERC-20 standard), meta-tokens on other blockchains, and base tokens in fundamental protocols. Analyses set forth below also include 'temporary tokens' that are intended to be redeemable for future tokens. Some data may be missing or subject to future revision, and fundraising events occurring more than 30 days apart are treated as separate.

II. INTRODUCTION

The scale of token project fundraising events over the past several quarters has been a defining feature of the industry, and has prompted significant attention by regulators, financial institutions, and retail market participants alike. Yet as Figure 1 shows, token project fundraising events vary immensely, and as subsequent analyses below indicate, are quite diverse in how such events have been conducted, the types of tokens that have actually been distributed, and in what jurisdictions token projects have taken place. This part will characterize the overall evolution and makeup of recent token projects, but the reader should keep in mind the diversity of actual token projects, and their fundraising and token distribution methods. No one anecdote is indicative of all or most token project fundraising.

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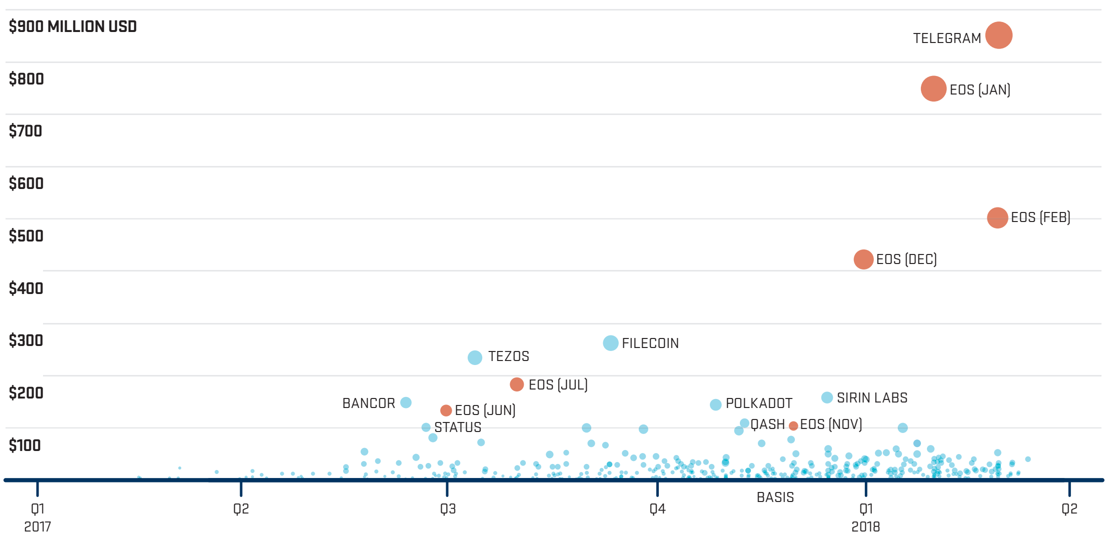
204 For a definition of digital token, *see* page 12.

FIGURE 1

TOKEN PROJECT FUNDRAISING LANDSCAPE, 2017 - 2018



Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. EOS's ongoing fundraising events are valued according to the total raised during each period and grouped into monthly amounts, with each month being treated as a separate "fundraising event," and thus are highlighted in a different color. Some data may be missing or subject to future revision.

Figure 1 also illustrates that the industry's growth and evolution during the 2017-2018 period reveals distinct periods for the digital token ecosystem, despite its relatively young age. Subsequent analyses set forth below further highlight this reality, as well as central features and underappreciated aspects of the evolution of digital token markets.

Beyond considering the fundraising event numbers, this report also explores how evaluating different 'tiers' or bands of funds raised can help clarify the full range and scale of projects coming to market. Thinking geographically also continues to yield novel insights into the market, and is a useful approach given the different regulatory realities found around the world in addition to the unique regional projects, audiences, and fundraising patterns that have emerged.

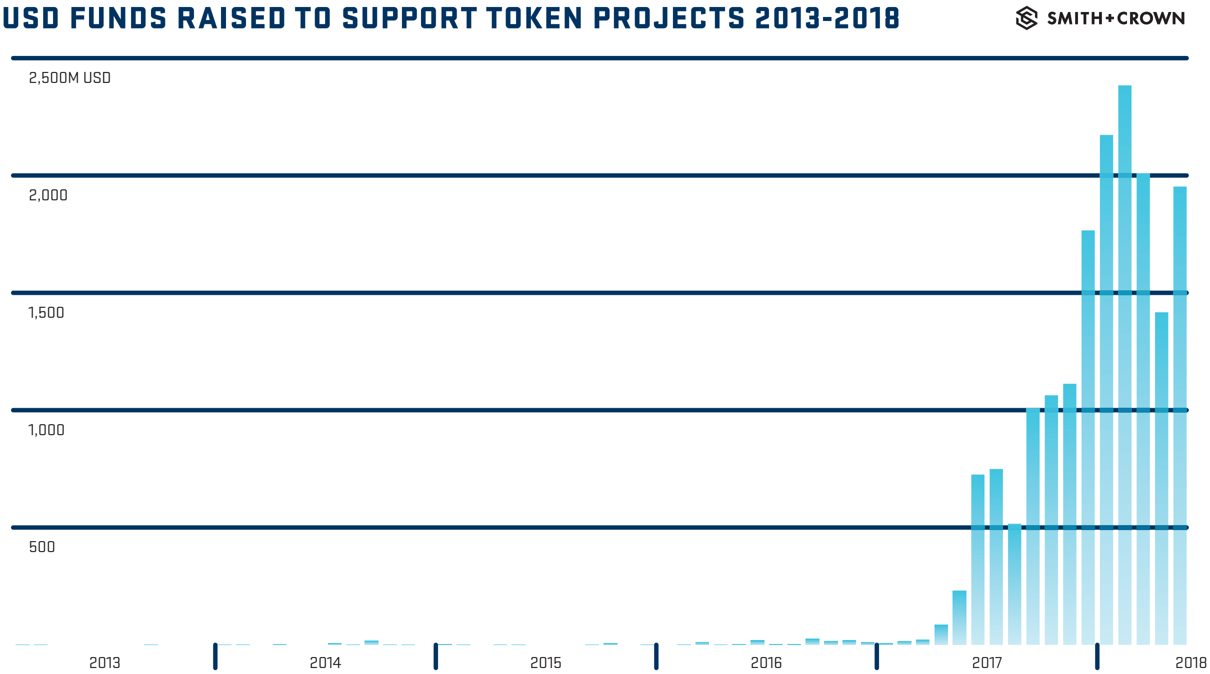
Finally, examining the different industries present within the space, and how their component sectors typically function can yield additional insights into how the technology is being applied.

III. TOTAL AMOUNTS RAISED IN TOKEN PROJECT FUNDRAISING EVENTS

As Figure 2 illustrates, in 2016, over $100 million was raised for token projects (not including funds raised through the DAO and returned). At the time, this number surprised many in the industry. However, few token projects generated over $5 million from project participants during this period, and many projects raised approximately $1 million. Amongst token projects that raised funds from 2013 - 2016, many functional platforms have become enduring pieces of the blockchain industry today, including Ethereum. Notably, as the chart below illustrates, the total dollar-volume of this and other noteworthy token project fundraising events was quite small relative to those that took place in 2017 and the first quarter of 2018.

FIGURE 2

USD FUNDS RAISED TO SUPPORT TOKEN PROJECTS 2013-2018



Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

2017 represented a new chapter in the history of token project fundraising, with $7.3 billion raised from well more than 550 completed token project fundraising events. Underappreciated is how 2017 was marked by a series of distinct stages that somehow also managed to fit within a single calendar year. These periods also coincided relatively closely with 2017's calendar quarters, and are profiled below.

FIGURE 3: QUARTERLY TOKEN PROJECT TRENDS FOR 2017-2018

YEAR	QUARTER	TOKEN SALES	RAISE AMOUNT	AVERAGE RAISE
2017	Q1	20+	~ $44 million	~ $1.8 million
2017	Q2	60+	~ $1.04 billion	~ $16 million
2017	Q3	150+	~ $2.25 billion	~ $15 million
2017	Q4	300+	~ $3.90 billion	~ $13 million
2018	Q1	220+	~ $6.56 billion	~ $30 million

Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

As Figure 3 shows, the scope and scale of digital token fundraising events changed dramatically in 2017. Each distinct quarter is profiled on the following page:

» Q1 2017 effectively extended 2016's pattern of a limited number of modest raises. This was illustrated by the quarter's average token fundraising amount of $1.8 million, which was virtually identical to averages from the four preceding quarters.

» Q2 2017 represented a sharp break from earlier patterns. Completed fundraising events tripled, and with the average digital token fundraising event amount increasing tenfold, total dollar-volume increased twenty-fold from the Q1 total. While several token projects began to engage in large dollar-volume fundraising events for ambitious undertakings, a much larger number of projects continued to operate at smaller-scale in line with average volumes that marked the 2013-2016 period.

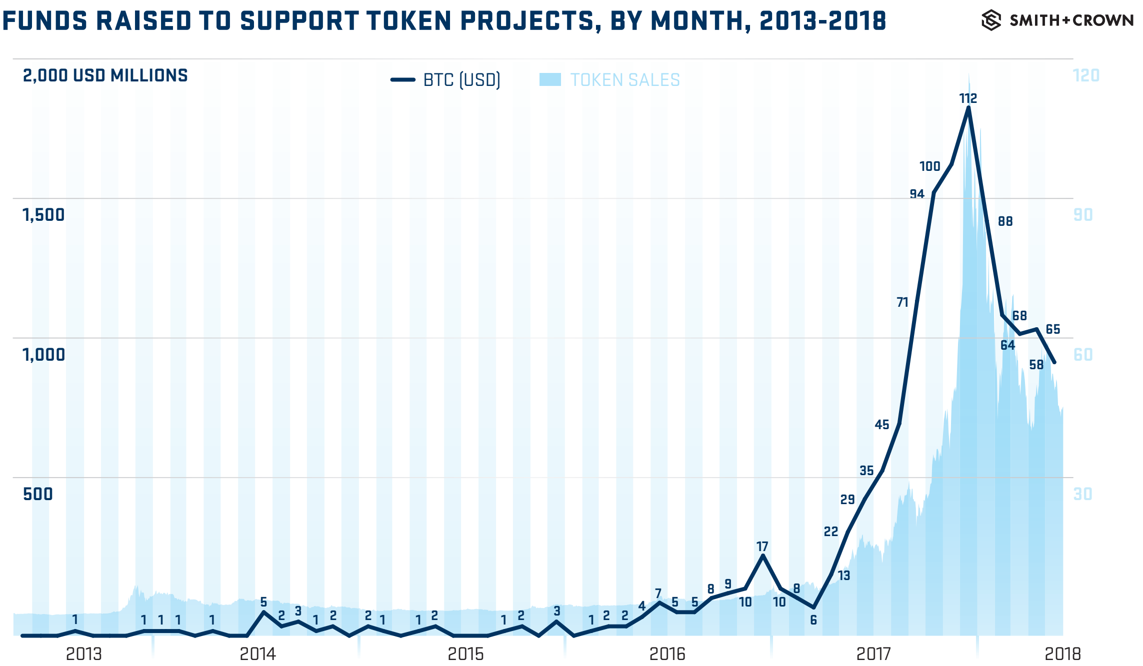
» Q3 2017 brought about a doubling of Q2's token project fundraising events and amounts raised. The trend of very large token projects that began in Q2 continued in Q3, with both Tezos and Filecoin each raising more than $200 million. Equally significant was the broad group of projects raising more than $5 million each, a different but equally compelling measure of the market's strength. Average fundraise amounts declined slightly relative to Q2.

» Q4 2017 brought about another doubling of total token project fundraising events, with a virtual doubling of dollar-amounts even as average sale amounts declined modestly.

Continuing into 2018, the pattern of each quarter having a unique characterization continued apace:

FIGURE 4

FUNDS RAISED TO SUPPORT TOKEN PROJECTS, BY MONTH, 2013-2018



Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

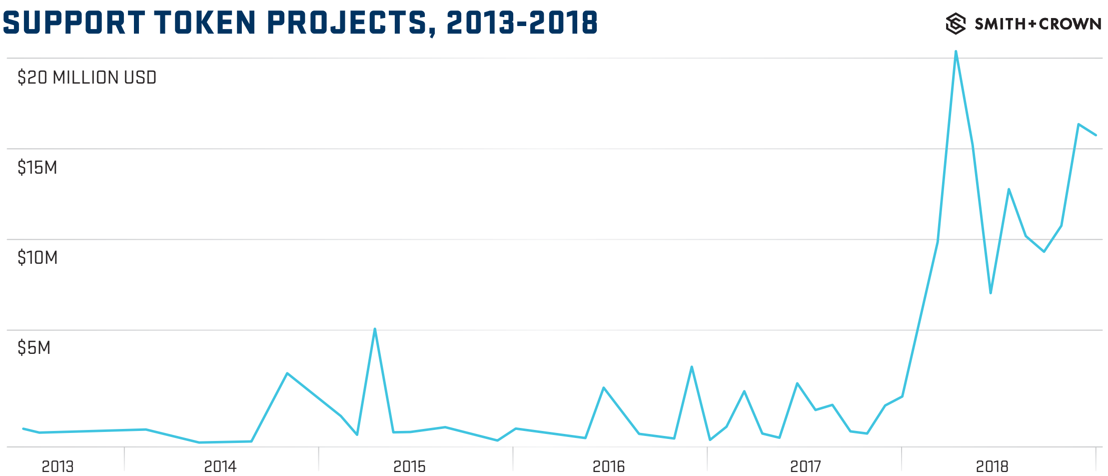
» Q1 2018 saw a break in the trend of increasing token sales events, with a decline from over 300 to around 220, yet the amount raised continued to increase, to over $6.5 billion for the quarter, a more than 50% increase from Q4 2017, yet a slowing rate of increase hinting at a potential slowing in the trend. As would be expected by the above, the average sale amount increased from around $13 million to close to $30 million.

IV. TOKEN PROJECT AVERAGE FUNDRAISING AMOUNT

A long-running debate within the digital token ecosystem concerns the question of how much projects should seek to raise? As noted, prior to 2017, many digital token projects sought around $500,000 to $2 million, with plenty slightly below and above. In 2017, however, the dollar-volume of fundraising events for many token projects began consistently growing. Debates over the appropriate size of token projects reflect the reality that if only a small amount of money is sought via the fundraising event, then only a few project participants can enjoy the project's value upon its commencement. Some token projects have sold all available tokens in less than 60 seconds, despite much larger demand.

FIGURE 5

AVERAGE FUNDS RAISED TO SUPPORT TOKEN PROJECTS, 2013-2018



NOTE THAT EOS AND TELEGRAM ARE EXCLUDED FROM THE DATA UPON WHICH THESE CALCULATIONS ARE DERIVED

Conversely, larger-sized fundraising events allow more people to participate in a token project. However, large fundraising events can result in projects accumulating tens or hundreds of millions of dollars. This is a complex topic, with tradeoffs that the digital token community actively discusses. Figure 5 clearly illustrates, however, that 2017 and early 2018 have been marked by a trend towards larger dollar-volume token project fundraising events. Some attribute greed as the primary factor driving increased project size, but as the discussion set forth above suggests, there are multiple dynamics that drive token project size, including pricing, a token's underlying utility, project type, market optimism, and market fairness.

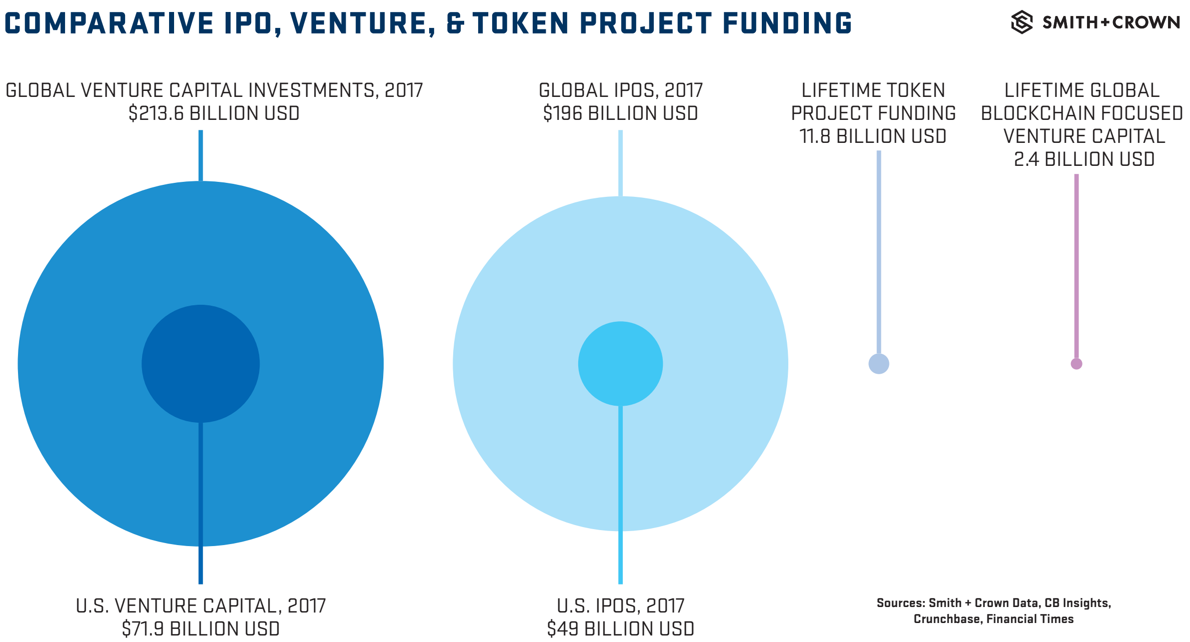
How the market evolves in the years ahead will be telling. The twin dynamics of uncertainty over potential regulatory steps and related issues concerning the treatment by some major regulators of certain digital tokens as securities will likely shape the near-term trajectory of the markets.

V. THE RELATIVE SIZE OF TOKEN PROJECT FUNDRAISING ACTIVITY

Impressive 2017 growth aside, token project fundraising and blockchain investments remain small relative to IPOs or venture capital investments (which are not mutually exclusive categories), as Figure 6 illustrates.

FIGURE 6

COMPARATIVE IPO, VENTURE, & TOKEN PROJECT FUNDING



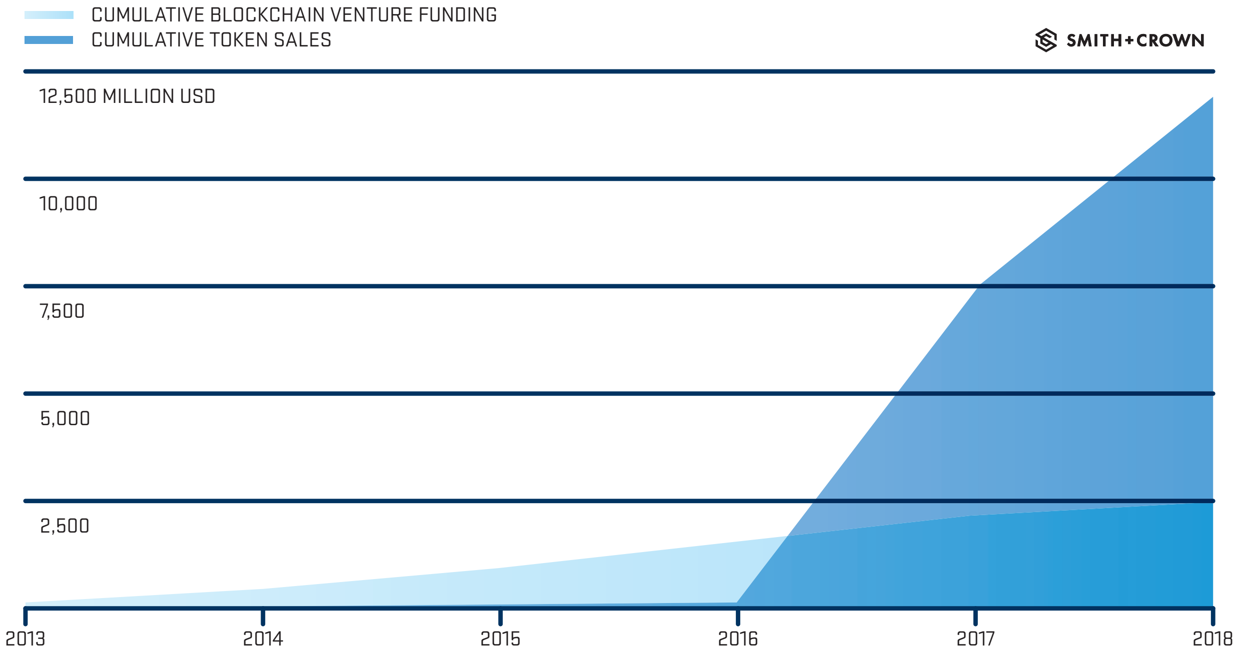
Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

This comparison is not meant to suggest that IPOs or VC investments are similar in mechanics or purpose to most or many digital token projects. Indeed, that is not the case, in part because as Part 1 explains, many digital tokens are viewed as commodities rather than securities in the eyes of regulators.

As explained above and illustrated by Figure 7 on the following page, larger token project fundraising events have enabled increased market access to innovative projects and services directly via these events, relative to traditional, capital markets-oriented fundraising methods that are also focused on blockchain-based projects.

FIGURE 7

CUMULATIVE BLOCKCHAIN-FOCUSED VENTURE CAPITAL & TOKEN PROJECT FUNDRAISING ACTIVITY 2013-2018



Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

VI. DISTRIBUTION OF TOKEN PROJECTS BY DOLLAR-VOLUME SIZE

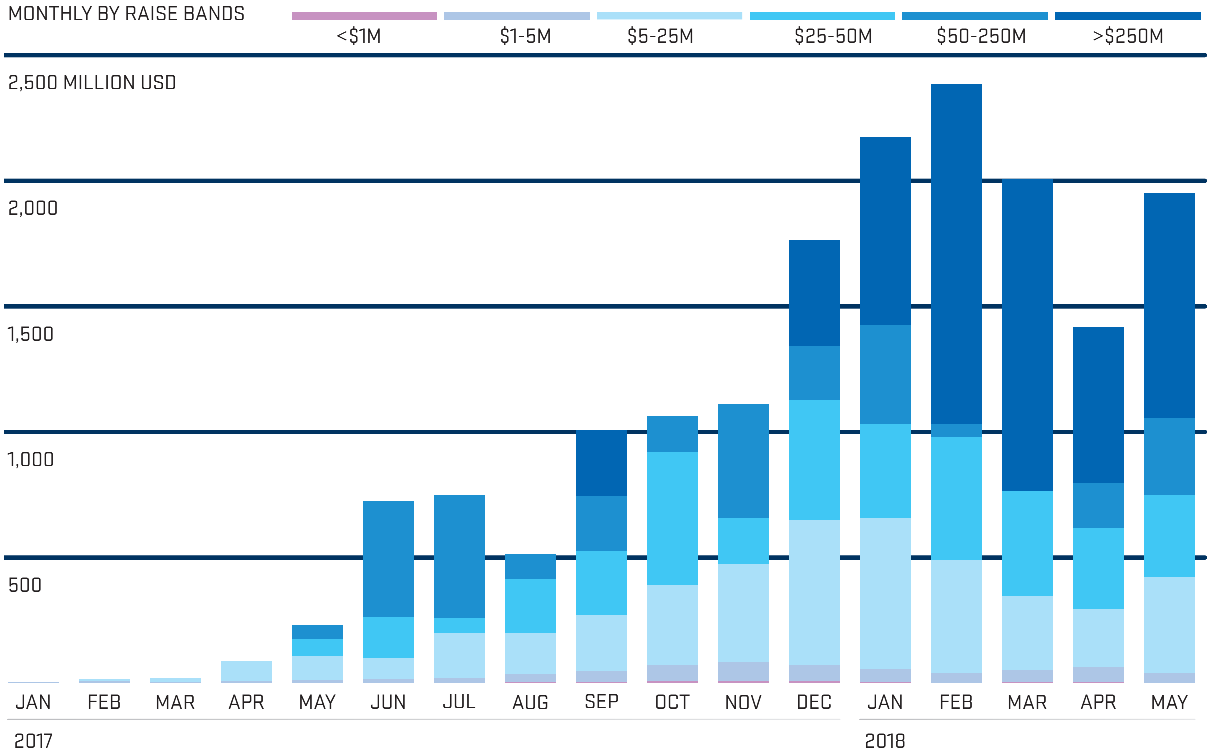
As discussed above, the diversity of token project size and type is often underappreciated. Figure 8 below divides 2017-18 token projects into different categories based on the size of accompanying fundraising events.[205] In doing so, it clearly illustrates how token project growth was driven by the extensive, broad-based activity within tiers of less widely publicized digital token projects. While large projects persisted throughout 2017, a thick middle band of projects gradually increased their contributions to the overall industry raise amounts. Whether this trend will persist throughout 2018 bears careful observation. Regardless, this metric will provide unique insight into the general health of the industry.

205 The rationale for segmenting token project fundraising activity in this way is a mix of analyzing the distribution of the data and benchmarking it against capital raise activity in other markets. It is one way of understanding the diversity of projects, though noted that projects themselves seek to raise different amounts and as noted above, what was seen as an acceptable amount to raise changed considerably throughout the year.

FIGURE 8

TOKEN PROJECT FUNDRAISING AMOUNTS 2017-2018

SMITH+CROWN



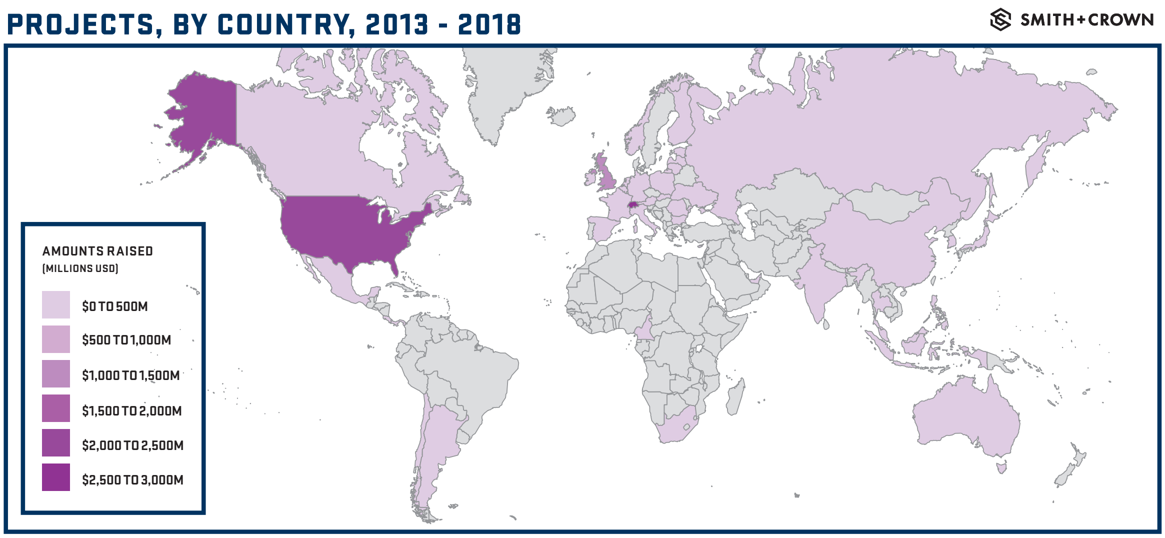
Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

VII. GEOGRAPHY OF TOKEN SALES

Figure 9 illustrates both the relative concentrations and also the geographic diversity of amounts raised by token projects globally since 2013. The United States, Switzerland, and Singapore are recognized blockchain hubs and stand out as leaders, but many other jurisdictions have been hosting token projects and token project fundraising.

FIGURE 9

FUNDS RAISED TO SUPPORT TOKEN PROJECTS, BY COUNTRY, 2013 - 2018

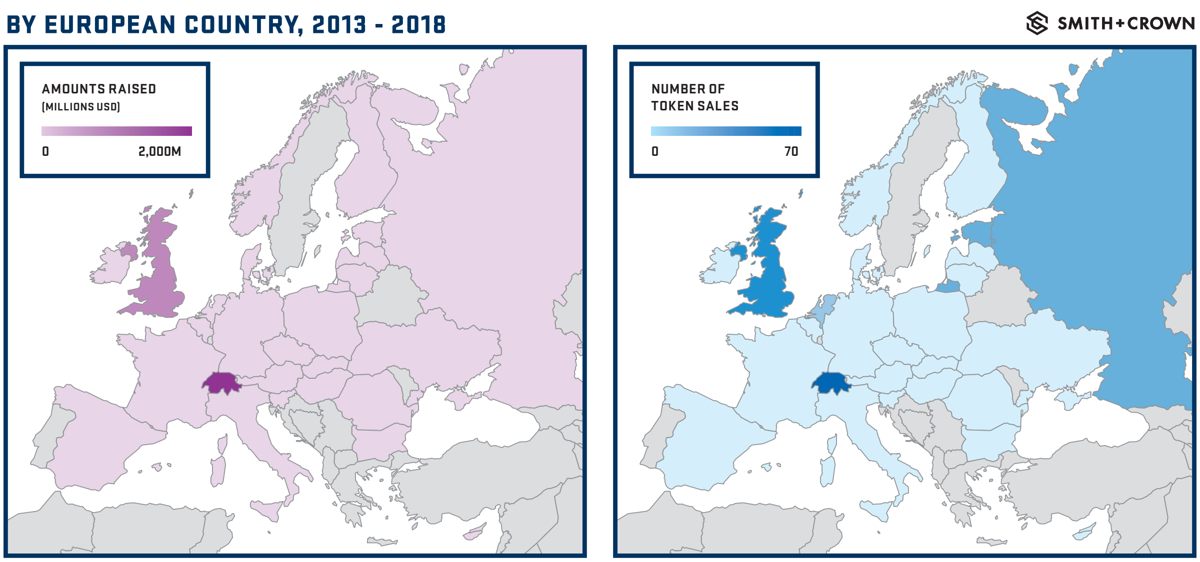


Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

European maps in Figure 10 yield a number of additional insights, including the extent of activity in the United Kingdom, Estonia, and Russia.

FIGURE 10

FUNDS RAISED TO SUPPORT TOKEN PROJECTS BY EUROPEAN COUNTRY, 2013 - 2018



Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

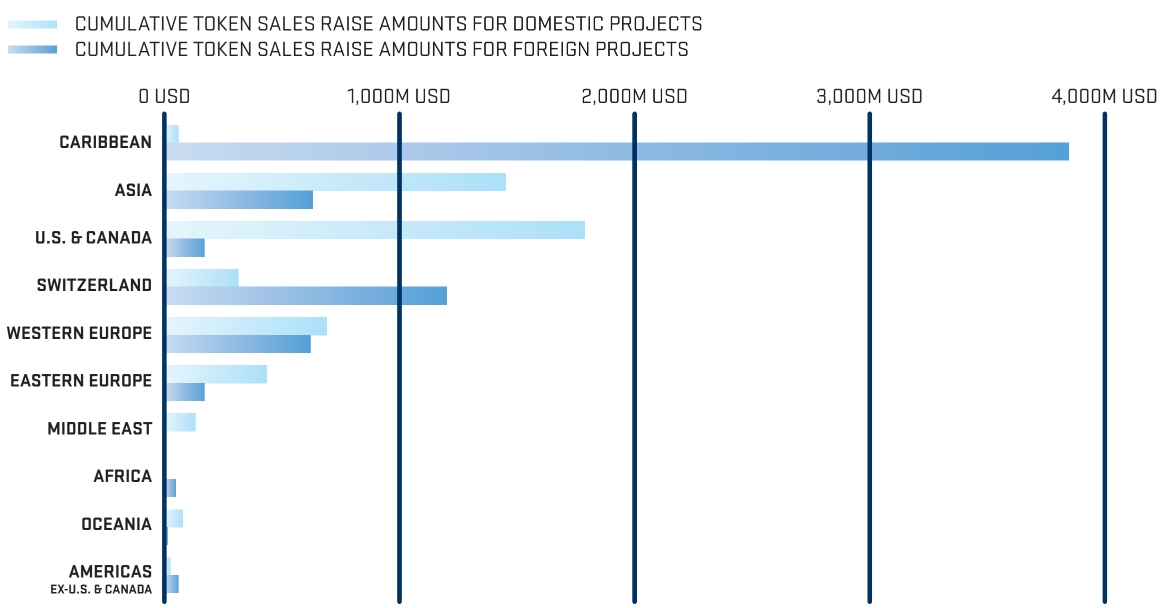
In the broadest sense, Figures 9 and 10 illustrate the community's global nature, and the broad, diverse origins of many emerging projects. Monitoring evolving trends in token fundraisings' geographic patterns will be revealing as the industry continues to evolve.

A rarely considered yet particularly interesting manner of examining the geography of token project fundraising is exploring the issue of fundraising domicile (where funds are raised) relative to the location of a project's headquarters – as measured by the location of a project's main office or the core leadership team's primary working location. While data can be imprecise, as the industry includes a number of genuinely distributed teams and organizations, the domiciles of virtually all leading projects in the space (those representing more than 95 percent of all token fundraising events by dollar amount) can nevertheless be identified.

Figure 11 below takes a regional look at the question of fundraising compared to that of working domiciles on a regional basis. Switzerland is broken out from Western Europe because its own activity is larger than the entire surrounding region. What emerges is a clear appreciation of the Caribbean's role as a fundraising center. Despite nearly $4 billion in capital raises in the Caribbean, virtually none of the projects were locally-based. While the United States and Canada appear to be the leading center of working activity, their fundraising is often occurring elsewhere. Yet the Caribbean is also serving as a fundraising center for more than just the United States, since its raise amounts exceed amounts cited as working within the United States. Switzerland supports a community of local projects, and also acts as a major fundraising center for global projects.

FIGURE 11

TOKEN PROJECT FUNDRAISING DOMICILES, 2013 - 2018



Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

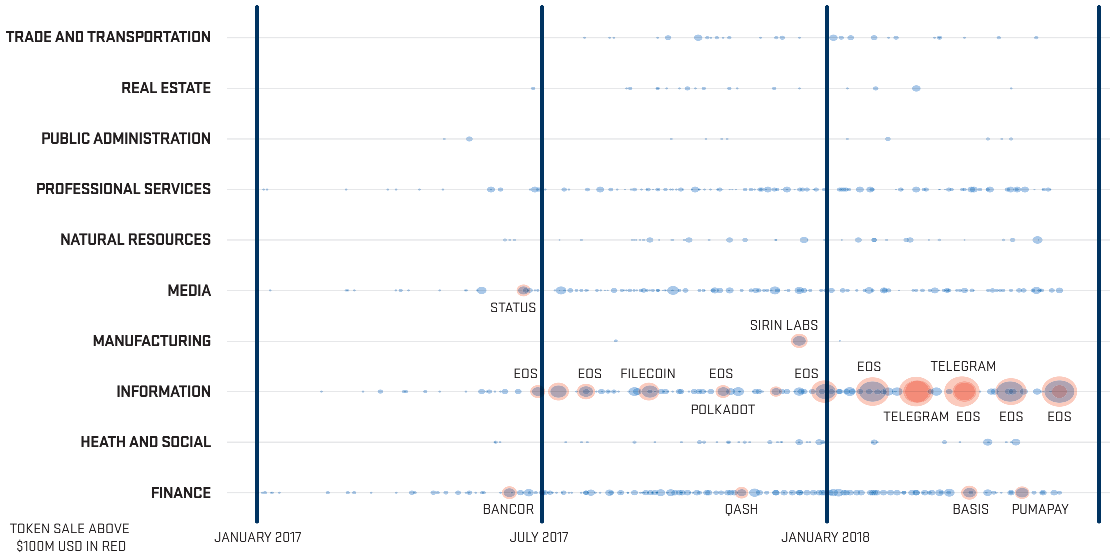
VIII. INDUSTRY ANALYSIS

In an effort to keep up with the dramatic increase in breadth, diversity, and, as a result, complexity of the token space in 2017, Smith + Crown created a classification system for industries and component sectors. Looking across these classifications offers significant insight into the industry's evolution.[206]

FIGURE 12

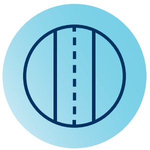
TOKEN PROJECT FUNDRAISING BY INDUSTRY 2017-2018

SMITH+CROWN



Note: Token project fundraising includes all token projects that raised over $25,000 and did not return funds raised to participants. Amounts raised are valued according to average daily exchange rates on the date the fundraising closed. EOS's ongoing raise is valued according to the total raised during each auction period and grouped into monthly amounts. Rounds for the same project that are separated by more than 30 days are treated as separate fundraising events. Some data may be missing or subject to future revision.

Unsurprisingly, finance and information technology dominated the landscape until now. Blockchain technology is a unique way of storing data and representing tradable value. The expansion of projects beyond this core showed how entrepreneurs are imagining new ways blockchain technology can be applied. The different industries are briefly described below:



Trade & Transportation - Personal transportation services, supply chain management, and transportation of goods.

Real Estate - Commercial, residential, property management, and real estate investment funds.

206 Smith + Crown has considered this issue carefully in developing an estimation of blockchain-related activity across a range of industries and sectors and have implemented the following approach to industry classification. Projects are classified according to their target market, that is, whichever industry in which they are hoping to compete or which they are trying to disrupt. If the project's market is industry agnostic, classify according to the product. For example, if it is a general purpose payment system, it operates in payment processing sector. In addition, there are several new sectors that are specific to the blockchain industry, including smart contract platforms and prediction markets that projects can be classified by. Finally, the NAICS code industry system is used as a master category system for industries and newly emerging sectors.

Public Administration - Voting mechanisms, record keeping, and governance platforms.

Professional Services - Advertising/marketing, accounting, identity management, legal services, and loyalty rewards.

Natural Resources - Energy, agriculture, and precious metals.

Media - Gaming, messaging, entertainment, and social networks.

Manufacturing - Hardware devices and other manufacturing enterprises.

Information - Smart contract platforms, distributed computing, data storage, and data analytics.

Health & Social - Medical services, non-profits, social services, and education.

Finance - Payments systems, distributed trading platforms, and distributed prediction markets

IX. CONCLUSION

Overall, token projects are both diverse and constantly evolving. Their accompanying fundraising events are global in nature, and the patchwork of conflicting regulations around the world has likely contributed to many diverse projects. As this part illustrates, there is more complexity to the digital token ecosystem than one might be led to believe; its scope and diversity can be appreciated through the unique and insightful analyses set forth above. Many high-quality projects have been able to occur through well-managed fundraising events, and future digital token projects will likely feature unexplored designs, use cases, and accompanying network models.

VII. LOOKING AHEAD

The concept of digital tokens is complex. As Hester Pierce recently said, she used to know what a token was. Now it's not so clear. "A thing might seemingly have one form but in fact support many functions, each requiring a different regulatory regime." In many ways we are in that universe, unpacking tokens, whether they represent money, property, a security, or a commodity – or sometimes multiple characteristics at the same time. As she also noted, "…we must not let our lack of familiarity with new technology breed anxiety and therefore bad regulation." Digital tokens based on blockchain technology are another innovation in technology that should be embraced; however, we realize that much work lies before us to ensure that regulators and policy makers understand what tokens are, what they can be, what promises may as yet be unknown, and how to allow that to flourish while protecting markets, purchasers, and investors.

This report represents the first installment in what is anticipated to be multiple parts in the crusade to open the doors to creative thinking and understanding in the token ecosystem. This report addresses digital tokens that are not intended to be securities or Regulated Commodities Instruments. Subsequent work could include: unique considerations for cybersecurity; AML/KYC potential regulatory adjustments; promoting the concept of a "utility token" among policymakers; considering potential regulatory adjustments for tokens with security characteristics; compliance challenges for security tokens that may be unique to a digital security that may change form (for example, no longer be considered a security – so-called "hybrid" tokens); and how the industry might play a role in self-regulation.

We look forward to working with the industry and key stakeholders to promote careful stewardship of a token ecosystem.

TOKEN ALLIANCE

CHAMBER OF DIGITAL COMMERCE

UNDERSTANDING DIGITAL TOKENS:
Market Overviews and Proposed Guidelines
for Policymakers and Practitioners