As anyone who is active in the blockchain space is very well aware, 2017 saw an enormous increase in the number of "Initial Coin Offerings" (ICOs) that have been arranged. Over US$5.68 billion was said to have been raised in 2017, with over 1.4 billion in December 2017 alone, for example.

The key advantages of ICOs for fund raisings have been:

- speed;
- lack of bureaucratic "red tape";
- interest generated by offerings; and/or
- low cost of the process.

In recent months, there has been an increased regulatory focus on ICOs. Just to recap in very basic terms – the regulations we are dealing with differ between the various jurisdictions, but all are directed at the same policy objectives, namely investor protection from abuses that were rampant around the world before regulation was introduced. So, for example, persons offering securities (e.g. an equity investment opportunity in a business) are required (subject to exemptions) to issue a prospectus that fully and fairly describes the business, the risks and the management, etc., so that investors can make properly informed decisions, with liability for misstatement. Post-investment share dealing by the pre-Initial Public Offering (IPO) shareholders may be restricted. This is, of course, a gross over-simplification of a significant area of law that keeps many thousands of lawyers very busy the world over.

Many in the blockchain space have exulted in the ability of the distributed technology to confound boring old world restrictions and set free the power of bold, forward thinking visionaries and their followers, and the ability of the little guy to get in on the ground floor, ahead even of venture capital.

Regulators have generally been slower than many expected to make their positions known. Possible contributing factors to the slowness to address these questions publically by regulators:

- a number of jurisdictions have an eye on encouraging innovation, hoping to become or maintain early leadership as hubs for fintech business;
- the difficulty in balancing questions of how to further such economic ambition with regulation to protect consumers;
although ICOs have raised large sums, there has been relatively little mainstream penetration; and/or

general uncertainty as to how to distinguish between ICOs with and without investment characteristics.

Lawyers have been watching carefully for indications from regulators around the world, recognising that, although ICOs may take an outwardly unusual form, many of them undoubtedly look, walk, and talk like securities.

Here we review developments in certain key jurisdictions since the United States (US) Securities and Exchange Commission (SEC) made an announcement on 25 July 2017.

United States

Perhaps not surprisingly, the US moved first. On 25 July 2017, the SEC’s Enforcement Division announced its conclusions about whether The Decentralised Autonomous Organisation (The DAO) that had issued The DAO tokens in an ICO on the Ethereum blockchain in 2016, broke securities regulations. The SEC decided that The DAO tokens were securities and their offering and sale violated securities laws as it was not registered with the SEC and did not qualify for any of the permitted exemptions from registration (although it decided not to pursue enforcement action).

The release is useful in that it lays out a brief history of The DAO and then analyses that against the US Securities Act and the case law.

One line is, we think, of interest to all proponents of a token sale:

"The touchstone of an investment contract [Note: an investment contract is a kind of security, and the SEC concluded that The DAO was an example of an investment contract] is the presence of an investment in a common venture premised upon a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."

Lest we think that this is an invitation to devise an ICO that evades one or more of these descriptions so as to take it outside the definition, the SEC further goes on to quote the seminal case of SEC v. W.J. Howey Co. (328 U.S. 293 at 299) which calls the definition a "flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits".

Those words do convey perhaps a slightly darker view of the endless ways in which hopeful investors can be parted from their hard-earned money than many blockchain enthusiasts will feel is appropriate for this new world of technology-enabled early-stage participation, but let us see.

Emphatically, the SEC supports looking at substance rather than form and went on to consider whether what was invested was money, whether there was a reasonable expectation of profit and whether this was to be derived from the managerial efforts of others (in which analysis the role of the founders and the "curators" in The DAO were important).
The SEC also held that the platforms that traded The DAO tokens satisfied the definition of an "exchange" and were therefore required to have been either registered or to have been exempted from such registration – neither of which requirements were met.

The SEC went on to lay out who can have liability in an unregistered offer of securities that is not exempted: "Those who have a necessary role in the transaction are held liable as participants". So, for example, it will be illegal for a broker, dealer, or exchange to effect any transaction in a token which is a security unless the offering and sale of the security and the relevant exchange it is traded on are either registered or exempted from registration.

The SEC’s final word:

"Those who offer and sell securities in the United States must comply with the federal securities laws, including the requirement to register with the Commission or to qualify for an exemption from the registration requirements of the federal securities laws. The registration requirements are designed to provide investors with procedural protections and material information necessary to make informed investment decisions. These requirements apply to those who offer and sell securities in the United States, regardless whether the issuing entity is a traditional company or a decentralized autonomous organization, regardless whether those securities are purchased using U.S. dollars or virtual currencies, and regardless whether they are distributed in certificated form or through distributed ledger technology [Note: blockchain is a particular type of distributed ledger technology (DLT)].

In addition, any entity or person engaging in the activities of an exchange, such as bringing together the orders for securities of multiple buyers and sellers using established nondiscretionary methods under which such orders interact with each other and buyers and sellers entering such orders agree upon the terms of the trade, must register as a national securities exchange or operate pursuant to an exemption from such registration."

Reference:


Developments since:

- The SEC announced the formation of a new cyber unit within its enforcement division that will also investigate "violations involving distributed ledger technology and initial coin offerings". https://www.sec.gov/news/press-release/2017-176

- The SEC warned investors that some companies may have been publicly announcing ICOs (or related events) to affect the price of the company’s shares. Specific warnings include companies claiming that their ICOs are "SEC compliant" without specifying how they are compliant, or companies describing their ICOs in "vague or nonsensical terms" or using unexplained technical jargon. https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_icorelatedclaims
The SEC charged a businessman and two companies with fraud in connection with two ICOs purportedly backed by diamonds and real estate. The pitch claimed that the offerors had a "team of lawyers... and accountants" when in fact, says the SEC, none had been retained. 

The SEC’s newly created cyber unit filed its first charges against an ICO alleging that a company called PlexCorps and its top officials had defrauded investors. The SEC has also obtained an emergency asset freeze in relation to this ICO. 

The SEC issued a cease-and-desist order against Munchee from its ICO, stating that the tokens to be issued were "investment contracts" with the token purchaser having "a reasonable expectation of obtaining a future profit based on Munchee's efforts". The tokens were therefore securities, and Munchee violated the law by offering and selling the tokens without having obtained relevant approvals or exemptions. 

The SEC filed a complaint against AriseBank (a cryptocurrency banking firm that claims to offer several banking products related to cryptocurrency) and its founders, alleging amongst others, that its ICO was an illegal offering of securities as there was no relevant registration or exemption from registration. The SEC stated that the ICO was "a general solicitation that uses statements posted on the Internet and distributed throughout the world – including the United States", and "was not limited by size, geography, number of investors, or investor accreditation status". The SEC also noted that AriseBank ICO's website "does not prohibit investments from U.S. citizens or make any assessment of an investor's accreditation". 

The Chairman of the SEC issued a statement on cryptocurrencies and ICOs. 

- the SEC recognises that ICOs may be "effective ways for entrepreneurs and others to raise funding", and "[t]he technology on which cryptocurrencies and ICOs are based may prove to be disruptive, transformative and efficiency enhancing";
- however, any activity that involves an offering of securities must be accompanied by disclosures, processes and other investor protections required by law;
- the statement made clear that not all digital tokens are securities:

"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";
• however, the SEC will look at substance over form:

"... a blockchain entry on a distributed ledger may change the form of the transaction, but it does not change the substance... merely calling a token a "utility" token or structuring it to provide some utility does not prevent the token from being a security. Tokens and offerings that incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others continue to contain the hallmarks of a security under U.S. law ... simply calling something a "currency" or a currency-based product does not mean that it is not a security";

• "market participants should treat payments and other transactions made in cryptocurrency as if cash were being handed from one party to the other", and shall ensure that their cryptocurrency activities are not undermining anti-money laundering (AML) and know-your-customer (KYC) obligations; and

• market participants and their advisers should thoughtfully consider legal implications, including the principles-based U.S. securities law framework and to engage with the SEC staff to aid in their analysis.

• The Chairmen of the SEC and the Commodity Futures Trading Commission (CFTC) testified before members of the Senate Banking, Housing and Urban Affairs Committee on 6 February 2018. In relation to ICOs, the key messages from the written testimony and the hearing were:

  • various regulators need to "come together" in crafting a coordinated plan, and put in place sound regulatory frameworks;
  • additional legislations and/or powers may be needed for effective regulation;
  • to date no ICOs have been registered with the SEC, with the SEC Chairman declaring that "I believe every ICO I have seen is a security"; and
  • the SEC will continue to "police these markets vigorously and recommend enforcement actions against those who conduct ICOs or engage in other actions relating to cryptocurrencies in of the federal securities laws".

Written testimonies of the Chairmen of the SEC and the CFTC:
https://www.banking.senate.gov/public/_cache/files/a5e72ac6-4f8a-473f-9c9c-e2894573d57d/BF62433A09A9B95A269A29E1FF13D2BA.clayton-testimony-2-6-18.pdf; and
https://www.banking.senate.gov/public/_cache/files/d6c0f0b6-757d-4916-80fd-a43315228060/A2A6C1D8DDBB7AD33EBE63254D80E9E3.giancarlo-testimony-2-6-18b.pdf

Recording of the hearing:
United Kingdom

To date, the United Kingdom’s (UK) Financial Conduct Authority (FCA) has provided little guidance on ICOs, and whether they fall within the regulated sphere. This is unsurprising given that the UK’s regulated activities and financial promotions regimes were not originally drafted with ICOs in mind. Nonetheless, there are some useful points to take from what the FCA has said so far. Indeed, it is evident that, whereas other countries have gone as far as banning ICOs, the FCA has instead warned issuers that ICOs may fall within the existing regimes and be subject to regulation.

In April 2017, the FCA published a discussion paper on DLT (DP 17/3), which stated that "depending on how [ICOs] are structured, they may...fall into the regulatory perimeter". Elaborating on this, the FCA drew parallels between ICOs and initial public offerings, private placement of securities and crowd sales – providing the first indication that where ICOs are similarly structured, the businesses involved may be carrying out regulated activities or may need to be authorised by the FCA.

On 12 September 2017, the FCA issued a consumer warning on ICOs, describing them as "very high risk speculative investments", subject to price volatility, vulnerable to fraud and often lacking adequate documentation. The FCA acknowledged that most ICOs are not regulated by the FCA, but this can only be decided on a case by case basis. Again, the FCA stressed that whether an ICO is subject to regulation very much depends on how it is structured and reiterated the parallels drawn in its April 2017 discussion paper. It also drew further parallels between ICOs and collective investment schemes.

In light of the FCA’s view that some tokens may constitute transferable securities and therefore fall within the prospectus regime, the FCA has advised that businesses involved with ICOs should carefully consider if their activities amount to arranging, dealing or advising on regulated financial investments. Additionally, digital currency exchanges that facilitate the exchange of certain tokens should consider if they need to be authorised by the FCA to be able to deliver their services.

The FCA is clearly alive to the risks posed by ICOs but has not yet provided any indication that changes need to be made to existing regulatory structures in order to ensure the suitable regulation of ICOs and protection of consumers. Nonetheless, the FCA is in the process of considering the responses to its April 2017 discussion paper and any follow up publication will hopefully shed further light on the FCA’s approach to ICOs going forward.

The UK Treasury has also recently intimated that it would be taking steps to ensure that cryptocurrencies are appropriately regulated. Whilst the approach which the Treasury intends to adopt is presently unclear, a Treasury spokesman has explained:

"We are working to address concerns about the use of cryptocurrencies, by negotiating to bring virtual currency exchange platforms and some wallet providers within Anti-Money Laundering and Counter-Terrorist Financing regulation".
European Union

Until recently, the European Securities and Markets Authority (ESMA) has been largely silent on its position with regards ICOs. On 13 November 2017, however, the ESMA published two statements on ICOs: one alerting investors to the risks involved in investing in ICOs; and the other alerting firms involved in ICOs of the need to meet regulatory requirements. Taking each of these in turn:

Alert to investors

In a similar vein to the FCA, the ESMA described ICOs as "highly speculative investments" and warned investors of the possibility of losing the entirety of their investment due to the risks involved and lack of protection available to them in instances where ICOs are unregulated. The ESMA warned that:

- investing in ICOs exposes investors to the high risk of losing all their invested capital due to the inherently risky nature of ICOs;
- investing in ICOs leaves investors vulnerable to, and potentially unprotected against, fraud or illicit activities;
- ICOs offer few exit options and expose investors to extreme price volatility;
- the information that is made available to investors in relation to an ICO is, in most cases, unaudited, incomplete, unbalanced and even misleading; and
- the technology underpinning the coins or tokens is still largely untested and potentially flawed.

The ESMA urged investors to bear such risks in mind if they are considering investing in ICOs or have already done so.
Alert to firms

In its warning to firms involved in ICOs, the ESMA expressed its concern that firms involved in ICOs may be conducting their activities without complying with relevant applicable European Union (EU) legislation and that such firms need to give careful consideration to whether their activities are in fact regulated.

Similar to the FCA's warning, the ESMA stressed that whether an ICO falls within the regulated sphere very much depends on how it is structured. Helpfully, the ESMA said that where coins or tokens qualify as financial instruments, it is likely that the firms involved in ICOs will be conducting regulated investment activities. Moreover, they may be involved in offering transferable securities to the public. Such financial instruments may fall within a range of EU regulatory regimes and the ESMA identified the Prospectus Directive, the Markets in Financial Instruments Directive (MiFID), the Alternative Investment Fund Managers Directive (AIFMD) and the Fourth Anti-Money Laundering Directive (MLD4) as examples.

However, the ESMA has not provided guidance as to what characteristics would result in a token falling under the definition of a financial instrument. Furthermore, it is ultimately for the national regulators of the EU member states to determine whether a token constitutes a financial instrument; each of whom may well adopt different approaches (and indeed reach different outcomes) when making an assessment. Nonetheless, financial instruments are defined in Annex 1 Section C of MiFID to include, amongst other things, transferable securities, money-market instruments, units in collective investment undertakings and a range of derivatives. If tokens share similar characteristics with these financial instruments, they too are likely to be considered financial instruments and fall within the scope of EU regulation:

Reference:


France

Given the lack of regulatory framework governing all new cryptocurrency and blockchain technology-based fundraising activity, the French Autorité des Marchés Financiers (AMF) launched a programme called UNICORN (for "Universal Node to ICO’s Research & Network") in October 2017 to gather the views and suggestions of market players, issuers, advisers and investors, on the legal responses to questions raised by this new funding method.

Before the launch of UNICORN, at least four ICOs had already taken place in France, and several other proposed ICOs had been brought to the AMF's attention. The total amount raised by these
four ICOs is estimated at approximately €80 million. The secondary market capitalisation of the associated tokens stood at approximately €350 million.

The AMF has issued guidelines targeted to investors warning about risks inherent to such investments. In particular, the AMF has laid strong emphasis on the fact that the purchase of tokens requires a good understanding of the nature of these projects, the underlying technology, associated risks, and the fact that this type of fundraising is by nature intended for a technology-oriented and informed public. The tokens issued during these transactions have different characteristics which are specific to each transaction, and it is essential to be informed about the nature of the tokens issued, what it represents for the enterprise that issues it, and the related risks and benefits.

According to the AMF, ICOs involve high risks related to:

- the absence of specific regulation;
- information documents;
- loss of capital;
- volatility or the lack of a market;
- money-laundering and scams; and
- the projects financed.

As part of its actions and follow-up in terms of innovation, the AMF has carried out a first high-level study of these transactions and their legal implications. This first assessment indicates that while some of the ICOs identified may be covered by existing legal provisions (regulation applicable to intermediaries in miscellaneous assets, to the public offering of financial securities, or, in particular, to managers of alternative investment funds), most of these issues would fall, in the current state of the law, outside of any regulation for which the AMF ensures compliance.

In the AMF's consultation document, three options for supervising ICOs are envisaged:

- promoting best practices without changing existing legislation;
- extending the scope of existing texts to treat ICOs as public offerings of securities; and
- proposing *ad hoc* legislation adapted to ICOs.

The AMF, considering that certain forms of ICOs may in the future constitute an alternative mode of financing for a segment of the DLT or blockchain technology economy, is launching a digital-asset fundraising accompaniment and research programme. This programme, UNICORN, in parallel with the reflection on possible ways forward for regulation, aims to offer initiators of these projects a framework allowing for development of their transactions, and to ensure the protection of players and purchasers wishing to participate.

The AMF encourages academic research on this subject and intends to publish a first impact analysis of these new forms of financing in a year’s time.
At the date hereof, France has adopted an Ordinance n° 2017-1674 dated 8 December 2017 (the Ordinance) – expected to be enter into force at the latest by 1 July 2018 – in application of the law dated 9 December 2016 on transparency, anti-corruption and modernization of economic life (Sapin II) in view of adapting French legislation to allow for representation and transmission, through a DLT, of certain financial securities. Such financial securities will include negotiable debt securities, shares of collective investment funds, capital securities issued by companies limited by shares and debt instruments other than marketable debt instruments, provided that they are not traded on a trading platform.

The Ordinance will confer to the registration of an issue or transfer of financial securities in a blockchain the same effects as those provided by registration of financial securities in an account. Thus, a new paragraph 2 to be added to Article L. 211-3, para. 2 of the French Financial and Monetary Code will set forth that "Registration in a shared electronic registration system is deemed to be registration in an account". Other provisions of the French Financial and Monetary Code and the French Commercial Code will be amended to allow for the use of the DLT.

Further, the Ordinance will allow financial securities held through a DLT to be pledged in a similar manner as for financial securities held in a financial account.

Since the Ordinance only sets out key principles, a decree from the French Council of State (Conseil d'Etat) will be adopted to provide for the application conditions of registration of financial securities in a DLT, and the pledge of financial securities registered in a DLT. The expected decree will determine, to a large extent, the DLT system concerning financial securities.

The Ordinance must enter into force on the date of publication of the decree of application and, at the latest, by 1 July 2018.

Singapore

Singapore has an enviable track record of creating the conditions for industry hubs to develop and prosper. This is usually based upon careful examination of the requirements for a particular industry, and painstaking calibration of policy and regulation, as well as incentives, to set in motion a virtuous cycle, gaining a network effect and growing into a successful hub, persisting over time and successively refined to achieve the desired results. Singapore is not alone in being desirous of attracting fintech entrepreneurs to choose Singapore as a base for their global/regional business – a number of other cities have the same ambition.

The relevant authority in Singapore, the Monetary Authority of Singapore (MAS), has been looking carefully at the very same issues. As long ago as March 2014, the MAS had famously published its view that virtual currencies in and of themselves are not regulated in Singapore (which statement attracted a lot of attention in the crypto space) – but that virtual currency intermediaries would be regulated for money laundering and terrorist financing risks. The enormous upsurge in capital raising via token sales however was not contemplated by that 2014 position – and the MAS observes that tokens may "represent ownership or a security interest over an issuer’s assets or property" or may represent debt owed by the issuer and be consider a debenture. The Singapore analysis is whether or not ICOs or token sales represent an offer of securities (shares, units in
shares, debentures or units in a collective investment schemes, etc.) under the Singapore Securities and Futures Act (SFA).

Not long after the SEC’s release on The DAO, the MAS posted a release on its website (see link below). The MAS release was positioned as a clarification as to how ICOs and token sales would stand in relation to Singapore securities law.

Recently, the MAS issued "A Guide to Digital Token Offerings" in Singapore (MAS Guide), which provided insights into the application of Singapore security laws to ICOs. Interestingly, the MAS Guide included a number of non-exhaustive case studies of various types of cryptocurrencies in the blockchain and/or ICO space (e.g. utility tokens, tokens in relation to portfolios, etc.).

In summary, the MAS clarified that, depending upon their characteristics, tokens may be securities – the consequences (unless relevant exemptions apply) being:

- a need for a prospectus registered with the MAS;
- issuers/intermediaries be subject to licensing under the SFA and Financial Advisers Act;
- the AML/CFT rules observed; and
- exchanges facilitating the securities needing to be approved or recognised under the SFA.

The MAS stated that a person intending to have an ICO in Singapore or operate a platform involving digital tokens in Singapore is encouraged to seek professional advice from qualified legal practitioners to ensure compliance with all applicable laws, rules and regulations in Singapore.

The MAS also stated in the MAS Guide that it intends to establish a new payments services framework relating to the dealing or exchange of virtual currencies for fiat or other virtual currencies. The MAS noted that such intermediaries will be required to put in place policies, procedures and controls to address such risks. These will include requirements to conduct customer due diligence, monitor transactions, perform screening, report suspicious transactions and keep adequate records.

On a relevant note, the MAS recently issued a second consultation on its proposed regulatory framework for payment services (MAS Consultation Paper). The MAS Consultation Paper interestingly noted the distinction between virtual currencies and e-money, and noted that virtual currency transactions, given their anonymous nature, may be particularly vulnerable to money laundering and terrorism financing risks.

In relation to ICOs, the MAS Consultation Paper remarked that:

"Virtual currency exchanges that meet the funds possession criteria will need to hold a payment services licence. These include exchanges that originate from initial coin offerings ... where the ICO issuer provides virtual currency services."
Prior to the release of the MAS Guide and the MAS Consultation Paper, the MAS also issued a joint consumer advisory release with the Commercial Affairs Department (which deals with fraud) identifying token sale risks for investors. Amongst those risks identified were:

- heightened risk of fraud where operators are located outside Singapore;
- token sellers’ possible lack of experience and credibility;
- possible lack of secondary market liquidity; and/or
- possibility that the venture is highly speculative.

Singapore’s position as an Asian leader in fintech start-ups and regulatory policy makes this a very significant step in Asia.

This section is contributed by Sheetal Sandhu, senior associate, Virtus Law LLP (a member of the Stephenson Harwood (Singapore) Alliance).

Reference:

- The MAS release:  

- The MAS Guide:  

- The MAS advisories:  

- The MAS Consultation Paper:  

**China**

As is widely known, a great deal of the interest in cryptocurrencies, and in ICOs, has come (amongst other places) from China. Periodically, the cryptocurrency world and cryptocurrency prices are sent into a tailspin by an announcement by the Chinese authorities.
On 4 September 2017, a notice from the China's central bank (PBC) announced an immediate ban on ICOs in China, and that 60 exchanges have been identified for inspection and/or reporting. The committee expressed concern that some ICOs were scams and/or pyramid schemes.

ICOs were referred to as "unauthorized and illegal public fundraising". Given the definition, ICO activities may trigger criminal charges such as illegal selling of tokens, illegal issuance of securities, illegal fundraising, financial fraud and pyramid schemes.

In addition, the announcement indicated that "any individuals or organizations that have completed fundraising through coin offering shall make arrangements to return the funds raised". This of course raised an enormous number of questions, including whether only investors in China were eligible, how to deal if only a fraction the money raised were available, and how to deal with secondary market trading, where the original investors who had divested, no longer control the tokens.

The PBC also promised to "strictly investigate" the "illegal activities in the projects that had completed fundraising" – a standing threat to completed ICOs.

There is also a ban on platforms that provide trading and exchange services for ICOs. It was reported that the PBC was preparing a package of measures with other regulators in relation to further restricting ICOs and would implement them when the "conditions are ripe". Such measures will likely include blocking websites that offer ICOs or cryptocurrency trading services.

Another point we would like to mention is, according to the PBC notice, financial institutions and non-bank payment institutions are prohibited from conducting activities in connection with ICOs and related trading. Financial institutions and non-bank payment institutions are also banned in participating bitcoin trading according to a notice issued by PBC in 2013. The consistency of two notices demonstrates that the Chinese government strictly separates virtual currencies industry from the financial industry and monetary system.

The relative delicacy of the approach to this subject elsewhere reflects a desire on the part of many jurisdictions to become attractive destinations or hubs for fintech businesses. New York, London, Singapore and Hong Kong, in particular, have considerable experience in creating major hubs for regional and world businesses, and so the desire to ensure modern standards of investor protection is balanced with the desire not to stifle innovation and force investors/innovators to base themselves elsewhere. It seems fairly clear that there is likely to be a deal of convergence on basic principle. It is also clear that KYC and AML issues will remain high on the agenda.

Reference:
- The PBC's publication:
- China prepares fresh ICO rules:
• Chinese authorities plan to block ICO websites:  
• PBC ordered banks to stop financing cryptocurrencies:  

**South Korea (a significant market participant)**

In early September 2017, the Financial Services Commission (FSC) made a press release that it had held a "joint task force meeting" with "digital currency-related institutions and regulators", namely the Korea Fair Trade Commission (KFTC) and the National Tax Service (NTS).

Some themes appear to emerge from the press release:

- there were concerns over "illegal fund-raising impersonating digital currency investment";
- ICOs being used to solicit investments without complying with securities laws – the article stated that the South Korean financial authorities "will punish initial coin offering (ICO) that raises funds in the form of stock issuance using digital currencies permitted in some countries, including Switzerland, for violating the Capital Market Act". In other words, South Korea appears to be taking the same line as the US, and Singapore (amongst others) on tokens being sold to investors within the South Korean jurisdiction that upon proper analysis are in fact securities;
- laws relating to AML and its interaction with digital currency trading, as well as, the loss of consumer data through hacking will be examined;
- "severe disciplinary action for violations"; and
- there is a very direct statement of intent in relation to digital exchanges: there is a plan "to examine the current conditions of digital currency traders and establish joint inspection systems with the KFTC, prosecution, police and NTS". Exchanges will be encouraged to adopt consumer protection measures, including "deposits for consumer assets" – this may be a reference to having strong escrow arrangements for fiat deposits.

It notes South Korea’s desire to examine the approach of other countries on issues such as "the character of digital currency traders, permission and taxation" and "fully discussing them".

The nod to learning from other jurisdictions is interesting – it is not clear if this is formulaic or serious, but in any event, there is plenty to consider for digital exchanges in Korea or with customers in Korea.

Following up in late September 2017, the FSC has reportedly followed China by banning all forms of ICOs "regardless of using a certain technology or a certain name."
During the inter-agency gathering held on 4 December 2017, South Korea's government established a new task force to regulate cryptocurrencies. This is the second task force set up by the South Korean government. Taking over the effort from financial regulators, the South Korean Ministry of Justice was put in charge of the task force to establish and implement cryptocurrency regulations. This task has now been taken over by Office for Government Policy Coordination.

Since then, the South Korean regulators have implemented fresh measures to regulate cryptocurrency exchanges, including a ban on opening anonymous cryptocurrency accounts, and a complete ban on foreigners and minors from trading through cryptocurrency accounts. Both measures took effect from 30 January 2018. Although it was previously reported that the FSC would treat non-compliant cryptocurrency exchanges as organising unauthorised fundraising, it is currently unclear whether this position remains the status quo.

Stephenson Harwood LLP (Seoul Office) is not permitted under the existing law of the Republic of Korea (Korean law) to advise on Korean law. The information presented above is our summary of the latest developments in South Korea and does not constitute legal advice.

Reference:

- The FSC's press release (Korean language):
- Articles on the ICO ban:
  http://english.yonhapnews.co.kr/news/2017/09/29/0200000000AEN20170929005300320.html; and
  (Korean language)
- Article on the FSC drawing up regulations for cryptocurrency exchanges:
- Article on the FSS' view on cryptocurrency trading:
- Article on the second task force:
- Articles on the new measures to curb transactions of cryptocurrencies:
  http://english.yonhapnews.co.kr/news/2018/01/02/0200000000AEN20180102003000320.html; and
Hong Kong

The Securities and Futures Commission of Hong Kong (SFC), in line with other jurisdictions, takes the view that ICOs may be regulated securities or futures contracts, depending upon their terms and features:

- where tokens "represent" shares or ownership in a corporation, they may be regarded as shares – for example if a token gives "the right to receive dividends or the right to participate in the distribution of the corporation’s surplus assets upon winding up";
- where tokens represent debt, they may be regarded as debentures – for example an issuer "may repay token holders the principal of their investment on a fixed date or upon redemption, with interest paid to token holders";
- where the token funds are managed collectively by the issuer to invest in a project with a return to token holders, this may be a collective investment scheme; and
- where ICO or token futures contracts are traded on certain exchanges, they may be futures contracts.

It is important to note that these are fairly obvious examples – there will doubtless be tokens whose "terms and features" would be more difficult to characterise with such certainty.

The notices stated the consequences of a token being a security or futures contracts being marketed to the Hong Kong public (whether or not the issuer or any intermediary is located in Hong Kong). For instance, an ICO scheme operator may require a licence issued by the SFC for carrying on regulated activities, and the scheme itself may need to be authorised by the SFC. The operator may require type 1 (dealing in securities), type 2 (dealing in futures contracts), type 4 (advising on securities), type 5 (advising on futures contracts) and/or type 9 (asset management) licence.

The SFC also underlined the AML requirements in Hong Kong and noted the potential for fraud and investor loss in relation to digital tokens.

On 9 February 2018, the SFC issued an announcement that:

- it has taken regulatory action against a number of cryptocurrency exchanges and issuers of ICOs in breach of licensing and authorisation requirement;
- it has sent letters to cryptocurrency exchanges in Hong Kong or with connections to Hong Kong warning them that they should not trade cryptocurrencies which are "securities" without relevant licenses;
- it has also sent letters to several ICO issuers, and "will continue to closely monitor ICOs, and will not tolerate any violations of the securities laws of Hong Kong"; and
- it "may take further action where appropriate", in particular against non-compliant cryptocurrency exchanges and/or those which are repeat offenders.
Reference:

- The SFC's statements on ICOs:
  
  

- The SFC's announcement on 9 February 2018:
  

**Summary**

This is a rapidly developing area. With the regulators keeping a close watch on ICOs and cryptocurrencies in general, the "wild west" days may soon be over. Those active in this area should carefully consider the impact of the legislation and the announcement, and if desired, seek professional advice to assist in navigating the labyrinth of regulations across the various jurisdictions.
INITIAL COIN OFFERINGS AND REGULATION - A REVIEW OF SIGNIFICANT JURISDICTIONS

Get in touch

Kehua Zhang  
Partner, Guangzhou  
Wei Tu Law Firm  
T: +86 20 8388 0590  
E: kehua.zhang@shlegalworld.com

Jonathan Chu  
Partner, Hong Kong  
T: +852 3166 6925  
E: jonathan.chu@shlegal.com

Katherine Liu  
Senior associate, Hong Kong  
T: +852 2533 2717  
E: katherine.liu@shlegal.com

Jonathan Chu  
Partner, Hong Kong  
T: +852 3166 6925  
E: jonathan.chu@shlegal.com

Katherine Liu  
Senior associate, Hong Kong  
T: +852 2533 2717  
E: katherine.liu@shlegal.com

Joel Shen  
Foreign counsel, Jakarta  
Christian Teo & Partners  
T: +62 21 515 0280  
E: jshen@cteolaw.com

Jonathan Kirasop  
Partner, London  
T: +44 20 7809 2121  
E: jonathan.kirasop@shlegal.com

Sam Gray  
Partner, London  
T: +44 20 7809 2293  
E: sam.gray@shlegal.com

Indranee Dursun  
Senior associate, Paris  
T: +33 1 4415 8005  
E: indranee.dursun@shlegal.com

Yewon Han  
Associate, Seoul  
T: +82 2 6138 4878  
E: yewon.han@shlegal.com

Martin Green  
Partner, Singapore  
T: +65 6226 1600  
E: martin.green@shlegal.com

Sheetal Sandhu  
Senior associate, Singapore  
Virtus Law LLP  
T: +65 6661 6523  
E: sheetal.sandhu@shlegalworld.com

Kyaw Zin Htet  
Associate, Singapore  
T: +65 6622 9670  
E: kyaw.zinhtet@shlegal.com

Stephenson Harwood is a law firm with over 1000 people worldwide, including more than 150 partners. Our people are committed to achieving the goals of our clients - listed and private companies, institutions and individuals.

We assemble teams of bright thinkers to match our clients' needs and give the right advice from the right person at the right time. Dedicating the highest calibre of legal talent to overcome the most complex issues, we deliver pragmatic, expert advice that is set squarely in the real world.

Our headquarters are in London, with ten offices across Asia, Europe and the Middle East. In addition, we have forged close ties with other high quality law firms. This diverse mix of expertise and culture results in a combination of deep local insight and the capability to provide a seamless international service.

Stephenson Harwood LLP Foreign Legal Consultant Office is not permitted under the existing law of the Republic of Korea (Korean law) to advise on Korean law.

Virtus Law LLP and Stephenson Harwood LLP are registered as a Formal Law Alliance in Singapore under the name Stephenson Harwood (Singapore) Alliance. Both firms are registered in Singapore under the Limited Liability Partnership Act (Chapter 163A) with limited liability. The Alliance enables us to offer clients an integrated service in multi-jurisdictional matters involving permitted areas of Singapore law. The term “partner” is used to refer to a member in one of the constituent law firms.

Information contained in this note should not be applied to any particular set of facts without seeking legal advice.