

Client Alert

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The Rise of ICOs, Digital Tokens and Virtual Currencies - Do Securities Regulations Apply?

Background

On 10 August 2017, the Monetary Authority of Singapore ("MAS") and Commercial Affairs Department ("CAD") issued a joint statement, advising consumers on the risks associated with digital token and virtual currency related investment schemes¹. This follows on from an earlier public release by MAS on 1 August 2017, clarifying the regulatory position on the offer of digital tokens in Singapore².

Globally, there is an emergence of initial coin (or token) offerings ("ICOs") as a source of funding for startups and technology companies latching onto the digital token trends. The Business Times reported that based on information obtained from Tokendata.io, there were 34 ICO projects raising USD 665 million in July 2017 alone. Singapore has also seen its fair share of ICOs and digital tokens offering, ranging from property backed tokens to crowdfunding platforms for entrepreneurs to raise funds by issuing tokens sold for virtual currencies.

So, do securities regulations apply to ICOs?

Are the laws changing?

In Singapore, there has been no public indication yet that the laws will be changing or that the MAS will start regulating all ICOs and digital tokens. The statements made are, however, a timely reminder to companies looking to raise funds and intermediaries who facilitate or have a part to play in the process, that existing securities regulations do need to be considered carefully, before determining that the activities are not subject to any securities law or regulations. This is similar to the approach taken by the U.S. Securities and Exchange Commission who recently asserted jurisdiction over digital tokens and concluded that the DAO Tokens were securities under U.S. federal securities law³.

¹ <http://www.mas.gov.sg/News-and-Publications/Media-Releases/2017/Consumer-Advisory-on-Investment-Schemes-Involving-Digital-Tokens.aspx>

² <http://www.mas.gov.sg/News-and-Publications/Media-Releases/2017/MAS-clarifies-regulatory-position-on-the-offer-of-digital-tokens-in-Singapore.aspx>

³ In April and May of 2016, The DAO offered and sold approximately \$1.15 billion DAO Tokens in exchange for about \$12 million Ether. The total offering raised approximately \$150 million. A DAO Token provided the holder with both voting rights and a profit participation. Additionally, the DAO Tokens were freely transferable and were traded on various electronic platforms. In its

Securities or utility tokens?

The fundamental consideration should be the nature of the digital tokens and the rights attached to it. Just because a token is not labelled as a share or debt security does not mean it is not a "security" under the Securities and Futures Act, Cap 289 ("SFA") or not tantamount to one.

Traditionally, tokens are issued to give buyers access rights to the creators' technology or to utilise certain functionalities or applications, i.e. it serves as a token for payments. However, ICO projects have evolved such that token holders may be given rights that go beyond merely using the creator's systems or functionalities.

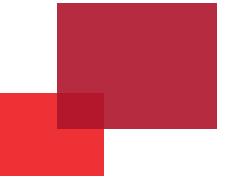
For example, token holders may be given a right to vote on the affairs of the issuer or receive a profit share from the business operations. This may result in the token being a share or the arrangement being a collective investment scheme under the SFA. In other instances, issuers may promise to redeem the tokens in future at a predetermined price or formula, which makes the token tantamount to a "debenture" under the SFA if it effectively amounts to an obligation to return the principal (i.e. the cash or virtual currencies originally funded by the token holders) with an interest portion.

Ultimately, one needs to look at the substance of the tokens and the rights attached to them, and determine if the tokens purely function as tokens for payments, whether investors expect an investment return out of the tokens, or both. There is, however, a fine line to be drawn given that in most instances, investors who decide to buy the tokens would hope that the tokens will become more valuable over time as the issuer's business proposition, functionality or software takes off.

What securities regulations apply to financial intermediaries and token issuers?

Where the tokens amount to shares, debentures or collective investment scheme units, the ICO may be subject to prospectus registration requirements under the SFA, unless the offering falls within one of the safe harbor rules (e.g. offers made only to institutional and accredited

Report, the SEC noted that, from May to September 2016, one platform executed more than 550,000 spot transactions in DAO Tokens by more than 15,000 U.S. and non-U.S. customers. A copy of Securities and Exchange Commission investigation report can be assessed via the following link: <https://www.sec.gov/litigation/investreport/34-81207.pdf>



investors, or small offers where the total amount raised within any 12-month period does not exceed SGD 5 million). An issuer seeking to rely on one of the safe harbor rules will need to ensure that conditions attached to the parameters of the safe harbor are met. For example, token resale restrictions may need to be imposed. Where the ICO amounts to a collective investment scheme and are offered to accredited investors, the scheme may need to be registered with the MAS as a restricted scheme.

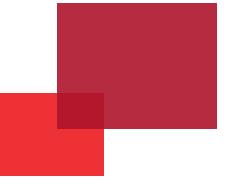
Intermediaries who facilitate ICOs or crowdfunding platforms that seek to provide market access to entrepreneurs may need to hold a licence for dealing in securities or marketing collective investment schemes.

Platforms or exchanges which provide secondary markets for digital tokens that constitute "securities" under the SFA may amount to a "securities market", which will require approval or recognition from the MAS.

Are there any other regulations that financial intermediaries should be mindful of?

Even if the tokens fall outside the regulation of the SFA, they may be regarded as stored value facilities where they function as tokens for payments. Any entity which is responsible for holding the underlying funds will need to consider if it is a multi-purpose stored value facility holder. Approval from the MAS is required where the aggregated stored value exceeds SGD 30 million.

Finally, financial intermediaries should be mindful of potential fraud and money laundering issues. While many unregulated ICOs are backed by legitimate business propositions and requests for funding, the absence of regulations in many cases, the nascent stage at which investors get involved, and the online distribution model make such crowdfunding exercises susceptible to fraud. Banks and other regulated financial institutions who are involved in the process (whether through the facilitation of the ICO or providing bank accounts to token issuers) will need to conduct robust AML/KYC checks as required under the applicable MAS Notices on Prevention of Money Laundering and Countering the Financing of Terrorism. Regulated financial institutions also have a positive obligation to report any suspicious transactions and incidents of fraud to the regulators.



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