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Initial Coin Offerings Regulatory Environment



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Introduction

This short note has been written for entrepreneurs and companies who are curious about ICOs, legal advisors, and regulators. It assumes a basic understanding of ICOs so as to avoid the usual layman's intro most legal publications include.

This does not purport to be a comprehensive guide or render legal advice. The position is as at 17 January 2018.

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1. Background

In 2017 over 1 billion USD were raised through initial coin offerings (ICOs). Companies or organisations using blockchain technology are increasingly looking to access financing by selling proprietary tokens.

Regulators around the world have expressed concern at these practices and some have gone as far as banning ICOs altogether such as China and South Korea.

Other countries have applied their current regulatory regime to ICOs on a case by case basis such as the US Securities and Exchange Commission (SEC) which published advice on Section 21(a) and blocked the ICO of [] with a cease and desist order.

The UK Financial Conduct Authority (FCA) has said little to date ICOs except that they will be looked at on a case by case basis.



2. Will my ICO be regulated?

This rather complex question can only be addressed once a lawyer has a full understanding of the tokens you are planning to offer for sale as well as the marketing material you have put together to promote the sale or pre-sale.

An ERC20 token could still be regulated depending on the way it is marketed and the functions it will fulfil within your company or organisation.

The statutes that govern whether or not a token will qualify as a “security” in the US or a “specified investment” in the UK offer different tests to determine the likelihood of a regulator finding that an ICO will fall under its purview.

There are different ways in which a regulator can decide that your ICO should be regulated from determining that you are managing an exchange market, a currency (less likely), selling shares, debt instruments, derivatives or a mixture of each one.



3. Token Classification

Token classification offered to date has been made by developers and is not quite satisfactory from a legal and regulatory point of view.

The distinction between work and usage or utility tokens offers limited clarity and should not be relied on when establishing whether your tokens will be regulated.

Many tokens execute complex functions which will usually make them a work / usage hybrid at best.

When analysing a token your lawyer will need to look at each function it performs in isolation as well as in conjunction with the other functions.



4. Tokens Characteristics to Avoid

This is not an exhaustive list and does not necessarily mean that a token will be regulated you will need to consult a financial or payment systems lawyer with knowledge of the particular jurisdiction you are looking launch your ICO in.

1. Tokens that convey any semblance of ownership rights in the organisation they relate to
2. Tokens that give the holder voting rights in the governance or management of the organisation
3. Tokens that act as an IOU between the organisation and the holder of the tokens
4. Tokens that give the holder an option to purchase further assets or tokens
5. Tokens that give the holder a future contract to purchase further assets or tokens
6. Tokens that incorporate functions similar to those of an insurance



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