

ICOs and the Evolving role of the Regulator

Overview

Initial Coin Offerings (ICOs) as an alternative means of fund raising have gained substantial growth globally in the last two years driven by the increasing popularity of distributed ledger technology and cryptocurrencies such as the Bitcoin and Ethereum. All-time cumulative ICO funding has exploded from US\$0.30b as at 31 December 2016 to US\$19.26b as at 31 December 2017¹

ICOs though are not without some risks due to their speculative nature, cybersecurity and fraud risk around the underlying cryptocurrencies and their largely unregulated status across the world. The most recent comment from the Guernsey Financial Services Commission ("GFSC") states that whilst the Commission has a policy of encouraging innovation and has worked with firms using the underlying technology, Blockchain, they are still cautious about approving applications for ICOs and the establishment of a digital currency exchange in Guernsey. However, many regulators are now shifting towards a more active approach. The jurisdictions of choice seem to be those whose regulators acknowledge the complex nature of ICOs as well as the need to protect investors while at the same time allowing an environment that drives innovation. Jersey is one of such jurisdictions, as demonstrated by the recent Guidance Note issued by the Jersey Financial Services Commission ("JFSC") on the application process for Issuers of ICOs in Jersey. To access the full Guidance Note, click [here](#)

This article takes an indicative look at how the regulatory landscape has evolved over the last two years, considering selected jurisdictions based on publicly available information. It also highlights key matters from the JFSC's Guidance Note. It should not be considered as an exhaustive list of regulations or advice on regulatory changes.



2017

- **USA: (July)** Following the hacking of a controversial ICO, the Securities and Exchange Commission issued an investor warning on the risks associated with ICOs and stated separately that relevant federal security laws apply to tokens which have the same characteristics as securities
- **Singapore: (August)** the Monetary Authority of Singapore warned consumers of potential risks of digital token and virtual currency-related investment schemes. It also effectively brought the issue or offer of digital tokens under regulation if they constituted products regulated under the Securities and Future Acts
- **China: (August)** the People's Bank of China declared the raising of funds through ICOs illegal and demanded that any funds raised through China-based ICOs be returned to investors
- **Canada: (August)** the Canadian Securities Administrators (CSA) highlighted some of the risks associated with ICOs, how they might involve the sale of securities, the obligations of FinTech businesses under securities laws, and how the CSA Regulatory sandbox could help them comply
- **United Kingdom: (September)** the Financial Conduct Authority issued a consumer warning on the risk of ICOs
- **Hong Kong: (September)** the Securities and Futures Commission issued a statement explaining that depending on the facts of each case, digital tokens may be "securities" as defined in the Securities and Futures Ordinance and subject to relevant securities laws. It also warned investors of the inherent risks
- **Switzerland: (September)** the Swiss Financial Market Supervisory Authority outlined its position on ICOs, areas in which existing financial market regulation might be applicable, matters to consider when launching ICOs and warning to investors on the potential risks.
- **Gibraltar: (September)** the Gibraltar Financial Services Commission issued a statement on ICOs, highlighting matters for potential investors to consider and hinting that a regulatory framework will be introduced in 2018
- **Guernsey: (September)** the GFSC issued an advisory notice regarding ICOs highlighting recent warnings by other financial services regulators, and that no schemes have been noted to have been launched in Guernsey.
- **European Securities and Markets Authority: (November)** an alert was issued to investors warning of the risk of ICOs and another alert to firms involved in ICOs of the need to consider relevant regulatory requirements
- **Jersey: (November)** the JFSC issued a statement explaining what ICOs are and warned investors about the potential risk associated with them
- **Isle of Man: (December)** the Financial Services Authority issued a series of questions and answers on ICOs, what they mean, how they operate, and other matters for investors to be aware of. The FSA also pointed out that whilst ICO businesses are not regulated, as virtual currency businesses, they might be caught under the Designated Businesses (Registration and Oversight) Act 2015 and therefore, required to comply with the Anti-Money Laundering and Countering the Financing of Terrorism legislation

Note: (1) Sourced from [CoinDesk ICO tracker](#)

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2018

- **Switzerland: (February)** the Swiss Financial Market Supervisory Authority issued guidelines on how relevant financial market legislation will be applied in handling enquiries from ICO organisers, the minimum information required to respond to such queries and the principles on which such responses will be based
- **Gibraltar: (February)** the Gibraltar Financial Services Commission announced that legislation is being developed in relation to ICOs. The legislation, which is planned for 2018 is expected to establish minimum disclosure and marketing rules and measures to detect and money laundering and terrorist financing
- **Guernsey: (February)** the GFSC issued a general comment that they would continue to encourage firms or individuals to use their Innovation Sandbox to discuss potential applications for ICOs.
- **Cayman: (April)** the Cayman Islands Monetary Authority issued advice on the potential risks of investments in Initial Coin Offerings (ICOs) and all forms of virtual currency. There are suggestions that a guideline will be issued in the near future.
- **Malta: (April)** the Virtual Financial Assets Act was tabled to parliament in April 2018 and is expected to be passed into law in 2018. As one of the components of the Act, an issuer of an ICO looking to issue tokens, which can later be exchanged or traded on a cryptocurrency exchange, will require a license by the Malta Financial Services Authority. The Act also covers matters such as marketing and advertisement, and the potential liability resulting from ICO activity, minimum content of a whitepaper, the use of funds and due diligence on promoters of the entity raising funds
- **Jersey:**
 - o **(April)** the JFSC issued a statement refuting all claims that ICOs are regulated by the Commission. The JFSC also stated that a Jersey company issuing digital coins or tokens from Jersey would need to obtain a consent under the Control of Borrowing (Jersey) Order 1958 (COBO) from the JFSC, just like any other Jersey company raising capital through the issuance of shares. The statement also touched briefly on the grounds for granting such consent.
 - o **(July)** the JFSC issued a guidance note on the application process for the Issuers of ICOs. Prior applications for consent under COBO were considered on a case-by-case basis but the guidance note provides a consistent framework for subsequent applications
- **Bermuda: (July)** Bermuda has issued legislation² in relation to ICOs. The legislation applies to companies issuing ICOs and imposes certain legal requirements, which a company must comply with, including publishing an offering document or white paper with minimum disclosures. The legislation also brings ICOs within the scope of restricted business activities and therefore any company wishing to launch an ICO will require the consent of the Minister of Finance.

The JFSC's Guidance Note

Some matters arising from the JFSC's Guidance Note are highlighted below:

- The Guidance Note does not preclude the JFSC's earlier investor warning on the potential risks associated with ICOs. In our opinion, the warning should not be considered as only relevant to potential investors and the public. The risks highlighted represent very important matters, which ICO issuers and similar digital businesses should consider in their risk assessments and as a foundation for designing controls.
- The guidance note addresses one of the common questions across many jurisdictions – "Is the digital token by its nature similar to a security?" The JFSC has, however, taken a more consistent approach by stating that the requirements will apply to all ICO issuers irrespective of the nature of the token. The JFSC will decide where exemptions are deemed necessary for non-security tokens and whether to regulate an ICO issuer for conduct, prudential and AML/CFT purposes where the structure of the ICO necessitates this. Issuers therefore need to pay attention to these details and seek appropriate advice.
- The general requirements as stated in the Guidance Notes cover key matters such as incorporation, regulatory consents, AML/CFT requirements, governance, audit, risk management and ongoing reporting to the JFSC etc. which ICO issuers should incorporate into their compliance frameworks.

If you would like to discuss the implementation of any aspect of the regulatory requirements, please contact any of our Regulatory Compliance advisers. Our global network also means we are able to connect with you with appropriate colleagues in other jurisdictions, where multijurisdictional support is required. We are also constantly monitoring the regulatory horizons to identify the impact of regulatory changes and key matters for consideration.

Note: (2) Companies and Limited Liability Company (Initial Coin Offering) Amendment Act 2018 which came into effect on 9 July, 2018 and the Companies (Initial Coin Offering) Regulations 2018 and Limited Liability Company (Initial Coin Offering) Regulations 2018 which came into effect on 10 July, 2018



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