

UPDATE

# ICO boom slowed by recent regulatory decisions

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Most people will by now have at least heard of blockchain – a distributed ledger or decentralised database of digital transactions grouped together in a cryptographically protected 'block' with other transactions that have occurred within a similar timeframe and circulated to the entire network. The most famous blockchain is probably Bitcoin – the first of the cryptocurrencies.

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Those who have gone deeper down the blockchain rabbit hole may have also heard mention of ICOs – or initial coin offerings (also known as ITOs, or initial token offerings). An ICO is an alternative means of raising funds – think of it as crypto-crowdfunding (typically accessible only by investors using cryptocurrencies). A start-up strikes upon a novel and unique product or service, but needs significant capital to develop that service or product. Rather than turning to the traditional debt or equity markets, or to venture capital, these new start-ups have developed the ICO. Investors (typically via a 'white paper' on the company's website) will be invited to invest, in exchange for tokens (as opposed to shares, as in a traditional IPO).

These tokens do not constitute a traditional equity or ownership interest in the underlying company, but rather can be considered (bluntly) as akin to an IOU – the investor can, once the underlying company is up and running and its product or service operational, exchange the tokens for that service or product. If the service or product proves sufficiently popular there may even be a secondary market for the trading of tokens.

Whilst ICOs are in many ways similar to the traditional IPO, the fundamental difference is of course that the investor receives a token, rather than a share. As a result, the vast majority of ICOs have been completed without regard to securities legislation or regulation, seemingly on the basis that a 'token' is not a 'security'. Indeed, the Financial Times has referred to ICOs as 'unregulated issuances of crypto coins'. ICOs have therefore become a quick, cheap and easy alternative to more traditional fund raisings.

The popularity of ICOs has exploded in 2017 with some staggering fundraising results. It is estimated that around 20 ICOs are introduced every month, and in the first half of 2017 alone some \$1.3 billion was raised through ICOs (up from a mere \$26 million in 2014).

The Basic Attention Token, from the owners of the Brave Browser, raised \$36m in just 30 seconds. Another project, Bancor Foundation, raised \$153m in just three hours.

## The turning of the tide?

As with all bubbles, however, recent events have led to suggestions that the ICO bubble may be about to burst.

The US Securities and Exchange Commission (in an Investor Bulletin published on 25 July 2017) stated that tokens issued via an ICO may be considered to be securities and therefore subject to federal securities laws. The guidance included a stark warning to fund-raisers to take care in the design of their ICOs to ensure compliance where applicable. Hong Kong and Singapore have made similar noises. China has gone

one step further, banning and deeming illegal the practice of raising funds through ICOs, directing that any funds raised via an ICO based in China be returned to investors.

By contrast, the Canadian (Quebec) financial regulator has adopted perhaps a more pragmatic approach. Whilst it determined that a token sale by Impak Finance, a platform for investing in socially responsible enterprises, is indeed a security, it accepted the company into its regulatory sandbox (a consortium of provincial securities regulators, formed to jumpstart fintech projects that do not easily fit within the existing legal framework). As a consequence, Impak Coin will become the first regulated ICO based in Canada. The Canadian regulator has seemingly been willing to apply a lighter touch to the offering, including allowing Impak to avoid complying fully with requirements that issuers would normally be subjected to for investor protection purposes.

The Isle of Man has also taken an accommodating approach, having identified a significant opportunity for early movers in providing environments which accommodate compliant ICO organisers. The dependency has recently announced the creation of a regulatory framework which will allow token sales to be compliant with AML and KYC regulations.

## Conclusion

It is clear that global regulators are now catching up with the ICO trend. They are taking a keener interest in this new technology, and actively examining the structures to determine how they should be treated (and indeed regulated) in their respective jurisdictions.

Given the popularity and potential of ICOs to be a real game-changer in the context of fundraising (even for use across non-tech industries), it seems unlikely to us that the coin, or token, offering will disappear in the face of this re-energised regulation. The ICO bubble will not burst, but rather evolve and take new shape. We expect ICO 2.0 will be a compliant, regulator-friendly model, which should then provide a truly viable alternative to the traditional debt and equity markets.

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