



K&L GATES

2018 INVESTMENT MANAGEMENT CONFERENCE
CHICAGO

Trading and Investing in Bitcoin, Ether, Cryptocurrencies and Initial Coin Offerings

Edward Dartley, New York
Rick Giovannelli, Charlotte
Clifford C. Histed, Chicago
Peter J. Shea, New York

OVERVIEW OF PRESENTATION

- Cryptocurrencies
 - Definitions
 - Developments
- Cryptocurrency Derivatives
- Initial Coin Offerings and Tokens
 - Regulatory issues



FINTECH ~~WILL DISRUPT~~ IS DISRUPTING IM

The New York Times Magazine

THE WORK ISSUE: REIMAGINING THE OFFICE

01 How to Build a Perfect Team

02 The War on Me

The Robots Are Coming for Wall Street

Hundreds of financial analysts are being replaced with software. What office jobs are next?

By NATHANIEL POPPER
Photographs by JONNO RATTMAN

FEB. 25, 2016




U.S. News & World Report Money

INVESTING / THE SMARTER INVESTOR

Fintech Will Change the Way You Invest

A mix of finance and technology, fintech is set to explode on Wall Street.

By Jason Raznick, Contributor | April 25, 2016, at 10:59 a.m.



3 WAYS THAT AI WILL IMPACT MUTUAL FUNDS AND ASSET MANAGEMENT

AUG 10, 2017

Disruptive technologies have been in the news a lot lately. And with good reason: they are transforming the way entire industries operate. Mutual funds and asset management firms are not immune.



IM IS ALSO COMPETING WITH FINTECH

Acorns to launch new retirement accounts after buying Portland fintech startup, Vault

Posted Nov 7, 2017 by Jonathan Shieber (@jshieber)



Update: This post has been updated to indicate that Manning Field is the company's chief commercial officer, not chief financial officer as was originally reported.

Micro-investment service, [Acorns](#), which automatically invests small amounts from its customers' bank accounts into investment funds, has bought [Vault](#), a Portland-based developer of retirement fund investment services.

SEI to Expand Reach With \$80M Fintech Buy

The financial services company says the acquisition of Archway Technology Partners represents a slight shift from its insistence on organic growth.

by **FABIOLA CINEAS** • 7/6/2017, 10:16 a.m.



Al West, chairman and CEO of SEI Investments.

On Wednesday, Oaks-based financial services company **SEI Investments** announced that it has acquired Indianapolis-based tech firm **Archway Technology Partners**, a company that provides operating technology and services to the family office industry.

IM FINTECH INCLUDES “ROBOADVISERS” ...



Enterprising Investor

Practical analysis for investment professionals

31 May 2017



Artificial Intelligence for Investing

By Andrew Dassori

BARRON'S

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FOCUS ON FUNDS

Legg Mason Takes Majority Stake in Robo Shop Financial Guard

By Chris Dieterich • July 7, 2016 11:26 a.m. ET

Baltimore-based asset manager Legg Mason (LM) on Thursday announced that it has taken a majority investment robo-advisor platform Financial Guard.

Invesco acquires robo-adviser Jemstep

The deal will bolster automated advice, investment management services

Jan 12, 2016 @ 9:59 am
By Alessandra Malito

283 Shares

Investment management firm **Invesco Ltd.** has acquired **Jemstep**, one of the first online automated investment platforms in the financial services industry, in the latest bid to offer more robo-technology to traditional advisers.

... BUT ALSO MANY OTHER TECHNOLOGIES...

How does Finomial work?



INVESTOR COMPLIANCE

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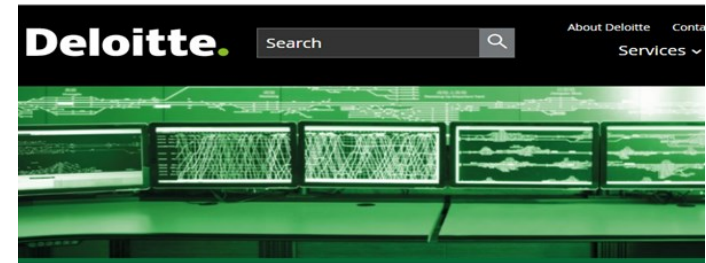
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Article

How can Fintech facilitate fund distribution?



Fintech is more than a buzz word. It is a game changer in the operating model of asset managers, distribution intermediaries, and service providers. New investor behaviors are the driver of change. The investment management ecosystem has to further increase efficiency and provide a better customer experience. Luxembourg asset servicing firms have a major opportunity to help asset managers and distribution intermediaries to succeed in the change.

Executive summary

Industries are permanently evolving, but incremental changes are hardly noticed. Sometimes however, industrial sectors undergo radical changes, where the process of incremental evolution is significantly disrupted by outside technological, demographic, regulatory, or economic forces.

In this ALFI report produced by Deloitte Luxembourg, we seek to describe the impact of Fintech on the distribution model of the asset management industry and the strategies to be adopted by incumbent actors.

Today the Fintech surge is starting to reshape the financial sector on a global scale with a flourish of new actors attracting significant attention from markets, customers,



PDF file - 1.22MB

Download our Whitepaper regarding "How can Fintech facilitate fund distribution?"



... INCLUDING REGTECH, TRADING ...

Let's Talk Payments
LTP FINTECH INSIGHTS CONTRIBUTE MEDICI TOP 21

26 FinTech Companies Powering Institutional Investments and Trading

February 26, 2016 By: Sofia



EquityZen is a marketplace for private secondary investments in companies worth more than \$50 million.

The **RidgeWorth Funds** provides investors with a range of equity funds, bond funds and asset allocation funds.

Correlix (acquired by TS-Associates) offers its real-time Latency Intelligence monitoring software to capital markets firms to identify and manage latency impediments to trade opportunities and discover ways to efficiently optimize their transaction infrastructure.



REG TECH MARKET MAP

FINANCIAL SERVICES

- ENTERPRISE RISK MANAGEMENT:** ArgosRisk, FINOMIAL, Cloud9, QUMRAM, fenergo.
- TAX MANAGEMENT:** Avalara, canopy, taxometry, VATBOX, exactor.
- REPORTING:** Confirmation.com, AQMETRICS, CERTENT, Global Debt Registry, intix, GOVERNANCED, PLIA.
- PORTFOLIO RISK MANAGEMENT:** Credit Benchmark, kyriba, QuanTemplate, loanlogics, riskalyze, CreditPoint, Limina, ncino.
- AML/KYC:** CONTEGO, ComplyAdvantage, trunomi, FORTRESS.
- OPERATIONS RISK MANAGEMENT:** CORLYTICS, R-sam, NetGuardians, ASCENT.
- BLOCKCHAIN/BITCOIN:** Skry, Oelliptic, CHAINALYSIS.

HEALTHCARE: greenlight.guru, InvisALERT, Qualtrix.

VENDOR RISK MANAGEMENT: venminder, Enterprise Risk Control, CERTRAX, CBANC, PREVALENT.

IDENTIFICATION / BACKGROUND CHECK: Trulioo, onfido, ThisIsMe, trooly, CLi, verato, now we comply, SOCURE, Checkr.

CANNABIS: BiolrackTHC, MJ FREEWAY, Hypur, K.N.D., payQwick, HELIX TCS, CBINSIGHTS.

GOVERNMENT / LEGISLATION: TrackBill, LOGICGATE, FiscalNote.

ENVIRONMENT, HEALTH, SAFETY, & QUALITY: Assent, rizepoint, ICIX, INTELEX, effective SOFTWARE, OnRule.

INFORMATION SECURITY / CYBERSECURITY: REDOWL, CloudPassage, CORE SECURITY, EiQ, HYTRUST, RISKIQ, onapsis, LogRhythm, dataphy, QUARRI, Lumeta, CLOUD RAXAK, druva, radar, cloudcover, skyhigh, Ever-Compliant.

GENERAL COMPLIANCE MANAGEMENT: ME WE, AgeCheq, CONNUS, Contiguity, Oversight, Jewel Paymentech, convercent, Simpliance, Zlien, ComplyGlobal, flexeye, SocialSafeGuars, GAN, INTILITY.

TRADE MONITORING: OpenGamma, DROIT, ANCOA, ComplySci.

QUANTITATIVE ANALYTICS: FINCAD, AYASDI.



... AND OF COURSE BLOCKCHAIN

Forbes / Investing / #MarketMoves

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SEP 27, 2017 @ 01:31 PM 2,100

The Little Black Book of Billionaire Secrets

NASDAQ Collaborates In SEB's Blockchain Investment For Mutual Funds Market



Roger Aitken, CONTRIBUTOR
FULL BIO

Opinions expressed by Forbes Contributors are their own.

Leading Nordic financial services group SEB, with a presence in around twenty countries including the Baltic states, Denmark and Germany with total assets of SEK2,777 billion (c.\$341bn), and Nasdaq have announced a joint project to test a “developed prototype” for a mutual fund trading platform based on blockchain technology.

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REUTERS



#TECHNOLOGY NEWS NOVEMBER 6, 2017 / 5:08 AM / 21 DAYS AGO

BP, Shell lead plan for blockchain-based platform for energy trading

Reuters Staff

2 MIN READ



(Reuters) - A consortium including energy companies BP and Royal Dutch Shell will develop a blockchain-based digital platform for energy commodities trading expected to start by end-2018, t

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Blockchain Gets a Wall Street Win: 'We Know the Thing Works Now'

By **Matthew Leising**
November 20, 2017, 5:00 AM EST

- Test of tracking equity swaps with blockchain deemed a success
- Firms including Goldman Sachs, JPMorgan did a six-month trial

IM IS BUYING FINTECH COMPANIES (MOSTLY ROBOS SO FAR)...

TIAA acquires business-to-business robo-adviser MyVest

The deal follows a collaboration the two companies established in 2009 to provide clients with investment and tax management services



Jun 30, 2016 @ 12:25 pm

83 Shares

By Alessandra Malito



TIAA, a financial services firm focused on the educational sector, has acquired business-to-business robo-adviser MyVest.

#BUSINESS NEWS
JUNE 19, 2017 / 7:12 PM / 5 MONTHS AGO

BlackRock takes Scalable Capital stake in Europe 'robo-advisor' push

Simon Jessop, Trevor Hunnicutt

LONDON/NEW YORK (Reuters) - BlackRock (BLK.N), the world's biggest asset manager made its first push into Europe's "robo-advice" market on Tuesday after taking a stake Anglo-German digital investment manager Scalable Capital.



Invesco acquires robo-adviser Jemstep

The deal will bolster automated advice, investment management services



Jan 12, 2016 @ 9:59 am

283 Shares

By Alessandra Malito



Investment management firm Invesco Ltd. has acquired Jemstep, one of the first online automated investment platforms in the financial services industry, in the latest bid to offer more robo-technology to traditional advisers.



... IM IS ALSO INVESTING IN FINTECH

Forbes / Entrepreneurs



MAY 6, 2015 @ 05:00 AM 19,111

The Little Black Book of Billionaire Secrets

HR Startup Zenefits Raises \$500 Million At \$4.5 Billion Valuation



Brian Solomon, FORBES STAFF
FULL BIO

Zenefits was already the hottest startup of 2014. Now it's making a case to grab the same title in 2015.

The HR startup announced on Wednesday morning that it raised a blowout \$500 million in Series C funding in a round led by Fidelity and TPG. The new investment values Zenefits at a \$4.5 billion valuation, hurdling the \$1 billion mark to make it one of the top 20 most highly valued venture-backed tech startups in the world.



Northwestern Mutual launches \$50 million fintech venture fund

Anna Irrera



(Reuters) - **Northwestern Mutual Life Insurance Co [NMLIC.UL] has set up a \$50 million corporate venture fund to invest in fintech startups**, in a bid to expand its digital offering and capabilities.

The initiative makes Northwestern Mutual the latest established financial institution to set up a venture arm dedicated to backing fintech companies, as large firms seek to keep up with a wave of digital transformation impacting their sector.



[Back to Blog](#)

T. Rowe Price, Fidelity Lead \$130 Million Investment in Twilio

By David Penn Posted on August 3, 2015

Share:



An investment of \$130 million has boosted the total capital of cloud communication innovator Twilio to more than \$233 million. The Series E round was led by T. Rowe Price and Fidelity Investments, and included participation from Salesforce Ventures, Draper Fisher Jurvetson (DFJ), Arrowpoint Partners, Amazon.com, and Altimeter Capital.



NOT ALL DEALS HAVE GONE WELL....

Bloomberg
Technology

TPG, Fidelity Get Retroactive Discount After Zenefits Fiasco

By **Eric Newcomer**

June 30, 2016, 7:00 PM EDT

Updated on June 30, 2016, 8:12 PM EDT

- Zenefits valuation falls to \$2 billion from \$4.5 billion
- Common shareholders, including founders, see 20% dilution

Zenefits is effectively cutting the value of its most recent funding round to \$2 billion from \$4.5 billion so the reeling San Francisco-based startup can give some investors a larger ownership share of the company, after laying off hundreds of employees.

11/27/2017

Mutual Fund Investments in Startups and the Valuation Challenge | Lets Talk P

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Mutual Fund Investments in Startups and the Valuation Challenge

May 13, 2016 By: LTP Team

140 Shares

It is a common perception that mutual funds are interested in investing their money in publicly traded companies, but they are increasingly showing a keen interest in startups. **In 2014, mutual fund firms such as Blackrock, Fidelity Investments, T. Rowe Price and Wellington Management completed between 6-16 US startup investment deals. T. Rowe Price doubled its private tech deals into venture-backed startups in 2014.**

According to PitchBook's 2015 Unicorn Report, **T. Rowe Price owns stakes in 14 tech startups, Wellington Management has been involved in funding 12 tech startups while Fidelity has been involved in eight such capital raises.**

This helps mutual fund companies to invest early in a promising startup – and by looking at a startup business, the portfolio manager also gains insights about the market. It also provides him an idea on what this startup disruption means to publicly traded rivals. These advantages come with some risks for mutual fund firms where they face the challenge of valuing a startup and there are also liquidity issues to consider.

Recently in March 2016, we saw **mutual funds companies such as Fidelity, Blackrock and other giants cut value of their stakes at an increased pace making few new investments.** According to a securities filing analyzed by the *Wall Street Journal* in March, Fidelity Investments, T. Rowe Price Group Inc. and Wellington Management – which manage or advise mutual funds that own shares in at least 40 closely – held startups valued at \$1 billion or more apiece. Out of this 40, for 13 of the startups, at least one mutual fund companies values its investment at less than what is paid.

When we look at examples of some mutual fund investments in FinTech, **Fidelity injected at least \$106 million into Zenefits in May 2015 as lead investor in** a funding round that increased the San Francisco company's valuation to \$4.5 billion. In September 2015, Fidelity marked down stake by 48% to \$7.74 a share from \$14.90. According to the *San Francisco Business Times*, in March 2016, the valuation of Zenefits was less than \$2 billion or 65% less than the May 2015 valuation.

The above recent examples reiterate the point that it is quite a challenge for a mutual fund firm to do the valuation exercise of a startup without the data and reporting requirements that publicly traded companies are subject to. As most of these startups are not public, a massive amount of educated guesswork is needed which may not always be scientific.

The Obligatory Commercial ...

K&L GATES

FINTECH REPRESENTATIVE CLIENTS AND MATTERS

REGULATED INVESTOR INVESTMENT

Represented affiliates of leading national banks, including Bank of America, Goldman Sachs, PNC, TIAA and Wells Fargo in more than 100 BHCA-compliant strategic equity investments, including:

OTHER GROWTH EQUITY, VENTURE CAPITAL AND SIMILAR FINANCINGS

Represented investors and their portfolio companies in a variety of capital-raising transactions ranging from formation and Series Seed financings through multiple rounds of preferred equity, debt and other financings through IPOs, including:

M&A AND OTHER STRATEGIC TRANSACTIONS

Represented fintech companies and their equity owners in a variety of M&A and other strategic transactions, including:



CRYPTOCURRENCY - BITCOIN

Increase in Bitcoin from 01/26/2017 – 01/26-2018

\$10,980.57

BITCOIN PRICE

+\$10,074.07

SINCE LAST YEAR (USD)

+1101.5%

SINCE LAST YEAR (%)



Source: Coinbase. Please note that there are multiple cryptocurrency exchanges that have multiple values for a cryptocurrency at any given time.

CRYPTOCURRENCY - BITCOIN

Increase in Bitcoin Cash from 06/30/2017 – 01/25/2018

\$1,572.26

BITCOIN CASH PRICE

+\$1,135.08

SINCE LAST YEAR (USD)

+258.4%

SINCE LAST YEAR (%)



Source: Coinbase. Please note that there are multiple cryptocurrency exchanges that have multiple values for a cryptocurrency at any given time.

CRYPTOCURRENCY - ETHER

Increase in Ether from 01/26/2017 – 01/25/2018

\$1,041.01

ETHEREUM PRICE

+\$1,031.10

SINCE LAST YEAR (USD)

+9764.2%

SINCE LAST YEAR (%)



Source: Coinbase. Please note that there are multiple cryptocurrency exchanges that have multiple values for a cryptocurrency at any given time.

DISTRIBUTED LEDGER/BLOCKCHAIN

- What is Distributed Ledger / Blockchain?
 - “A distributed ledger is a database that is ***consensually shared and synchronized*** across network spread across multiple sites, institutions or geographies. It allows transactions to have public ‘witnesses,’ thereby making a cyberattack more difficult. The participant at each node of the network can access the recordings shared across that network and can own an identical copy of it. Further, any changes or additions made to the ledger are reflected and copied to all participants in a matter of seconds or minutes. Underlying the distributed ledger technology is the blockchain, which is the technology that underlies bitcoin.” See Investopedia Definition of “Distributed Ledger”.
- Core principles of trust, verifiability, immutability and transparency.
- Distributed ledger as a technology will have multiple uses for multiple industries.
- Cryptocurrencies are just one aspect of the uses for blockchain.

DISTRIBUTED LEDGER/BLOCKCHAIN

- Bitcoin is a single purpose blockchain; it's purpose is limited to creation of Bitcoins.
- Ethereum is a distributed ledger separate and apart from Bitcoin. Currency of denomination for Ethereum is Ether.
- Ethereum is an application blockchain; it provides for the ability to create “smart contracts” on a distributed ledger. These smart contracts enable the issuance of separate digital tokens in exchange for a contribution of Ether or other cryptocurrencies or fiat currency to the sponsor.
- Ethereum has spawned a proliferation of over 350 cryptocurrencies that are based on smart contracts.
- These cryptocurrencies are the digital tokens that are typically offered in ICOs.

HOW DO YOU TRADE PHYSICAL CRYPTO?

Spot or physical exchanges such as:

- Bitstamp
- Coinbase/GDAX
- itBit
- Kraken
- Gemini

PHYSICAL CRYPTO TRADING CONCERNS

- Hacking/security breaches/DDoS attacks
 - The NORKs
 - Mt. Gox
 - Bitfinex
 - Bitstamp
 - Coinbase/GDAX
 - ItBit
 - Kraken
- Manipulation/spoofing – plenty of press about “SPOOFY” on Bitfinex
- Slow execution and confirmation
- Random / frequent government interventions

CRYPTOCURRENCIES AND FUNDS

- January 18, 2018 Letter (the “Blass Letter”) from Dalia Blass, Director of SEC Division of Investment Management, to Securities Industry and Financial Markets Association (SIFMA) and Investment Company Institute (ICI)
 - Asks for comments from anyone concerning SEC staff issues associated with 1940 Act-registered investment company investment in cryptocurrencies.
 - Issues raised should be seriously addressed by any fund manager – private or registered fund – commonality of issues.
 - “A number of significant investor protection issues that need to be examined before sponsors begin offering these funds to retail investors.”
 - “[S]ignificant outstanding questions concerning how funds holding substantial amounts of cryptocurrencies and related products would satisfy the requirements of the 1940 Act and its rules.”

The Blass Letter Concerns

- **Valuation:** Adequacy of information necessary to . . . value cryptocurrencies or cryptocurrency-related products - given *volatility, fragmentation, lack of regulation, and nascent state and current trading volume in the cryptocurrency futures markets.*
- **Liquidity:** Open-end funds.
- **Custody:** Safeguarding assets
 - 1940 Act custodian or self-custody
 - Validate existence, ownership and software functionality of private cryptocurrency keys
 - Physical settlement of futures

The Blass Letter Concerns

- **Arbitrage for ETFs: Feasibility.**
- **Potential Manipulation & Other Risks:**
 - “a number of recent media reports have highlighted a range of possible vectors for potential manipulation of cryptocurrency markets.”
 - “the pricing, volatility and resiliency of these derivative markets generally would be expected to be strongly influenced by the underlying markets.”
- **Stop Order Threat:** Rule 485(a) amendments to allow investment in substantial amounts of cryptocurrencies viewed with extreme disfavor.

Other SEC Actions

- **Withdrawal of Cryptocurrency Fund Registration Statements:**
 - 1940 Act-Registered Funds.
 - Direct Investment
 - Derivatives Exposures
- **Securities Act-Only Registrations – Need for Listing Rules:**
 - Delays and Rejections.
- **OTC – Dealer Quoted, not exchange traded.**

IS CRYPTO A “COMMODITY” UNDER THE COMMODITY EXCHANGE ACT?

The term “commodity” means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Irish potatoes, wool, wool tops, fats and oils ..., cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions ... and motion picture box office receipts ... and all services, rights, and interests ... in which contracts for future delivery are presently or in the future dealt in.

7 U.S.C. Sec. 1(a)(9)

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7 U.S.C. Sec. 1(a)(9)

WHAT HAS THE CFTC SAID AND DONE?

- Chairman Massad testified “derivative contracts based on virtual currency” are an area within the CFTC’s “responsibility” (December 2014)
- The CFTC’s jurisdiction is implicated when a virtual currency is used in a derivatives contract, or if there is fraud or manipulation involving a virtual currency traded in interstate commerce
- Beyond instances of fraud or manipulation, the CFTC generally does not oversee spot or cash market exchanges and transactions involving virtual currencies that do not utilize margin, leverage or financing

WHAT HAS THE CFTC SAID AND DONE?

- *Coinflip* settlement (September 2015) – allegedly offered bitcoin options without registering as a swap execution facility (SEF) or as an exchange
- *Bitfinex* settlement (June 2016) – Hong Kong-based spot exchange offered “financed” trading to retail investors, and therefore allegedly offered unlawful off-exchange futures, and operated as an unregistered FCM
- *Gelfman* and *Gelfman Blueprint* federal court action (September 2017) – “No jurisdiction” argument made by *pro se* defendant
- LabCFTC Primer on Virtual Currencies (October 2017)

WHAT HAS THE CFTC SAID AND DONE?

- CFTC Backgrounder on Self-Certified Contracts for Bitcoin Products (December 2017)
- Three new injunctive cases filed in federal court in Boston and New York (January 2018)
- Wall Street Journal January 23, 2018 – CFTC Chairman Giancarlo and SEC Chairman Clayton
- CFTC Market Risk Advisory Committee Meeting discussing the self-certification process for new and novel futures contracts – taking place as we speak

BITCOIN DERIVATIVES - LedgerX

- In July 2017, the CFTC approved LedgerX as a SEF and a derivatives clearing organization
- Offers options and day-ahead swaps
- Eligible contract participants only – no retail participation
- Contracts are physically-settled – traders post or receive actual bitcoins

BITCOIN DERIVATIVES - LedgerX

- LedgerX is critical of cash-settled futures contracts – see “The easy way and the right way” published at LedgerX.com on November 30, 2017
- Points out the frequent outages suffered by the spot exchanges upon which Cboe and CME base settlement prices
- Argues that if spot exchanges go down, and a hypothetical futures exchange had to look to other pricing sources, they would have to “rely on known-bad, unregulated, un-surveilled overseas data, or make it up. There is no other option.”

BITCOIN FUTURES CONTRACTS - Cboe

- Cboe Futures Exchange launched its contract on Dec 10
- Contract is cash-settled based on the Gemini Exchange auction price for bitcoin in U.S. dollars (not based on an average or index price)
- Temporary Cboe website crash on Day One did not appear to seriously affect trading
- Two trading halts on Day One due to price movement
- Predictions of new ability to short bitcoin resulting in a bubble burst – and what happened?
- Because of concerns about volatility, and concern over settlement mechanism, the regulators are watching this market very closely

BITCOIN FUTURES CONTRACTS - CME





















- September 26, 2017 - “I really feel that bitcoin is very nascent right now. I really don’t see us going forward with a futures contract in the very near future.”
- October 31, 2017 - "Given increasing client interest in the evolving cryptocurrency markets, we have decided to introduce a bitcoin futures contract."
- December 1, 2017 – CME issues news release with contract details

BITCOIN FUTURES CONTRACTS - CME

- CME launched its contract on December 18
- Contract is cash-settled based on a proprietary Bitcoin Reference Rate which aggregates the trade flow of these bitcoin spot exchanges:
 - Bitstamp
 - Coinbase/GDAX
 - itBit
 - Kraken
- Concerns that these exchange are unregulated, and some are not even available to U.S. traders
- Again, the regulators are watching closely

INITIAL COIN OFFERING LANDSCAPE

- ICO “boom” heard ‘round the world – Perceived as a fast way to raise significant funds
- Gap between what happened from 2016-2017 and the current legal landscape
<https://www.tokendata.io/>

	Tezos	Completed	\$230,498,884.00	Jul 2017				
	EOS	Active	\$200,000,000.00	Jun 2018				
	Filecoin	Completed	\$200,000,000.00	Sep 2017				
	MobileGo	Completed	\$53,069,235.00	May 2017	\$0.758	\$0.519	0.68x	
	Centra	Completed	\$49,696,100.00	Sep 2017	\$0.731	\$1.135	1.55x	
	Kyber Network	Completed	\$49,304,000.00	Sep 2017	\$0.357	\$1.713	4.79x	
	Enigma Catalyst	Completed	\$45,000,000.00	Sep 2017				
	Monetha	Completed	\$36,388,800.00	Aug 2017	\$0.181	\$0.129	0.71x	
	Basic Attention Token	Completed	\$36,000,000.00	May 2017	\$0.036	\$0.214	5.96x	
	SONM	Completed	\$35,000,000.00	Jun 2017	\$0.106	\$0.155	1.47x	

U.S. AND GLOBAL REGULATOR SCRUTINY

- Regulators from the following countries have increased their focus on ICOs.
 - United States
 - Canada
 - Peoples Republic of China
 - Republic of Korea
 - Russian Federation
 - Hong Kong
 - United Kingdom
 - Singapore
 - Malaysia
 - Thailand
 - Dubai
 - Many others

GLOBAL REGULATOR CONCERNS

- Criminality / Money Laundering
- Tax Evasion
- Cybersecurity
- Cross-border enforcement and extraterritoriality
- Money Transmission Laws – federal and state
- Fraud/manipulation of cryptocurrency markets
- Fund industry retail investor protection
- Securities law implications

INITIAL COIN OFFERINGS

- Digital tokens should be distinguished from primary cryptocurrencies.
 - Often issued pursuant to creation of a smart contract formed on Ethereum distributed ledger. Other ledgers, like Tezos, also provide this flexibility.
 - Many different purposes for tokens and can implicate various regulatory frameworks.
 - Often trade off-market. Not all cryptocurrency exchanges accept them.
- Digital tokens often have the following features alone or in combination:
 - Equity like features (e.g., voting rights and rights to distributions).
 - Debt like features (e.g., right to receive fixed additional tokens or revenue from mining or other activities).
 - Consumptive use tokens (e.g., prepayment of right to use services on the platform).

WHEN ARE COINS/TOKENS SECURITIES?

- On July 25, 2017, the U.S. Securities and Exchange Commission issued its report concluding that the tokens issued by the DAO constituted securities (found [here](#)).
- The DAO - acronym for “decentralized autonomous organization,” i.e., a virtual organization embodied in computer code and executed on a distributed ledger or blockchain.
- Investors contributed Ether in exchange for DAO Tokens.
- DAO Tokens had limited voting and ownership rights.
- The DAO intended to earn profits by funding projects that would provide DAO Token holders a return on investment.
- No limit on number of DAO Tokens offered or on the number or accreditation status of purchasers
- Capital raise equivalent to US\$150 million.

WHEN ARE TOKENS SECURITIES?

- SEC applied the US Supreme Court's *Howey* test to determine whether DAO Tokens constituted an “investment contract” (and thus a security) under Section 2(a)(1) of the U.S. Securities Act of 1933 and Section 3(a)(1) of the U.S. Securities Exchange Act of 1934.
- Pursuant to the *Howey* test a transaction is an “investment contract” if all of these features exist:
 - (1) an investment of money
 - (2) in a common enterprise
 - (3) with a reasonable expectation of profits
 - (4) to be derived from the entrepreneurial or managerial efforts of others.

SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946)

WHEN ARE TOKENS SECURITIES?

- Utility tokens – i.e., those with a consumptive use -- might not be securities because of their consumptive or redemptive qualities.
“[W]hen a purchaser is motivated by a desire to use or consume the item purchased – ‘to occupy the land or to develop it themselves,’ as the Howey Court put it, - the securities laws do not apply. . . .” *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975).
- Securities regulatory characterization may depend on the nature of the smart contract, features of the token, accounting treatment, the use of proceeds and the extent and nature of presale or build-out activities.
- The SEC will look closely at facts and circumstances and whether a token represents consumptive value or an investment contract. An important consideration may be whether the consumptive use is immediately available.

WHEN ARE TOKENS SECURITIES?

- ICO sponsors and intermediaries need to keep in mind that *Howey* might not be the only test that could be applied.
- The application of a particular test may depend in part on whether the token has debt or equity features as discussed in a prior section
 - *Risk Capital Test*. *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811 (1961).
 - *Family Resemblance Test*. *Reves v. Ernst & Young*, 494 U.S. 56, 66-67 (1990).
 - (1) “the motivations that would prompt a reasonable seller and buyer to enter into [the transaction]”;
 - (2) “the ‘plan of distribution’ of the instrument,” including an assessment of whether “there is common trading” of the instrument “for speculation or investment”;
 - (3) “the reasonable expectations of the investing public”;
 - and (4) “whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the investment, thereby rendering application of the Securities Acts unnecessary.”
- Application of state laws.
- Accounting treatment can guide regulatory analysis.

FRAUD RISKS

The SEC Filed Fraud Charges Against 2 'Initial Coin Offerings'

<http://fortune.com/2017/10/01/sec-ico-fraud-charges/>

October 1, 2017

Securities and Exchange Commission announces prosecution of the creator of two stock-like “ICOs,” or Initial Coin Offerings, which it alleges were sold on the basis of fraudulent claims.

...

The two ICOs in question were marketed as “REcoin” and “DRC,” and both were run by Maksim Zaslavskiy. REcoin was advertised as “The First Ever Cryptocurrency Backed by Real Estate,” while DRC, or Diamond Reserve Club, claimed to be backed by investments in diamonds. . . . [N]either scheme had “any real operations.” They made no investments on behalf of token buyers, and misrepresented their total level of investment.

...

“don’t really exist,” . . . weren’t even really ICOs.

FRAUD RISKS

- What to look for:
 - Is there a real underlying business?
 - Does the business have assets, expertise, staff?
 - Who is behind the operations?
 - Marketing over-promising?
 - Too good to be true?

SEC CHAIRMAN CLAYTON SPEAKS

Statement on December 11, 2017:

- “By and large, the structures of initial coin offerings that I have seen promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws.”
- “Merely calling a token a ‘utility’ token or structuring it to provide some utility does not prevent the token from being a security.”
- “[W]hile there are cryptocurrencies that do not appear to be securities. . . ., [b]efore launching a cryptocurrency or a product with its value tied to one or more cryptocurrencies, its promoters must either (1) be able to demonstrate that the currency or product is not a security or (2) comply with applicable registration and other requirements under our securities laws.”

SEC CHAIRMAN CLAYTON SPEAKS

Statement on December 11, 2017:

- “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.”



SEC CHAIRMAN CLAYTON SPEAKS

[Statement on January 22, 2018:](#)

- “Market professionals, especially gatekeepers, need to act responsibly and hold themselves to high standards. To be blunt, from what I have seen recently, particularly in the initial coin offering (“ICO”) space, they can do better.”
- “I have instructed the SEC staff to be on high alert for approaches to ICOs that may be contrary to the spirit of our securities laws and the professional obligations of the U.S. securities bar.”

GENERAL

If tokens are securities they may be offered in the United States or to US investors only in compliance with the registration requirements of the Securities Act or pursuant to an exclusion or exemption from those requirements

OPTION ONE – OFFSHORE SALES ONLY

SAMPLE: Representation and Warranties of Contributor

Purchaser is not:

- a citizen of
- resident or domiciled in,
- making a contribution from,
- incorporated, established or registered in the United States of America or

Purchasing of Tokens for or on behalf of any such person or entity;

Query: How effective are these restrictions?

OPTION 2 – PRIVATE PLACEMENT/REG D

- Private placement (or non-public offering) is a private offering, mostly to a small number of chosen investors. PIPE (Private Investment in Public Equity) deals are one type of private placement.
- Rule 506 of Regulation D is considered a "safe harbor" for the private offering exemption of Section 4(a)(2) of the Securities Act. Can raise an unlimited amount of money from accredited investors.
- A Private Placement Memorandum ("PPM") is a securities disclosure document used in a private offering of securities by a company or investment fund.

OPTION 2 – PRIVATE PLACEMENT/REG D

Reg D on the Rise? Investor-Grade ICO Products Are Coming – and Soon

<https://www.coindesk.com/reg-d-on-the-rise-investor-grade-ico-products-are-coming-and-soon/>

Innovators in the initial coin offering (ICO) sector appear to be stepping up efforts to target an increasingly interested institutional market.

Strategy pioneered with the launch of the first token designed specifically as a security, VC firm Blockchain Capital's pioneering BCAP token, is showing signs of further adoption.

OPTION 3 – REGULATION A OFFERING

Regulation A unregistered offerings to retail investors subject to conditions that may make it unsuitable for large offerings but may be useful for small ones

- Amended in 2015 pursuant to the JOBS Act to be more practically useful
- Annual volume limitation (\$50 million or \$20 million with sublimits for sales by selling security-holders) depending on whether the issuer is a tier 1 issuer or a tier 2 issuer as defined in Regulation A.
- As with a registered offering, Regulation A requires that the issuer provide specified disclosures to investors and file an offering statement with the SEC, and it provides the SEC with power to issue stop orders.
- Tier 2 issuers are also subject to additional disclosure and ongoing reporting requirements, including enhanced blue sky requirements

ISSUES FOR U.S. FUND MANAGERS

- Trading issues and illiquidity
- Custody, regulatory rules and internal controls
- Valuation - lack of established valuation protocols; reliability and fairness with extreme price movements
- Accounting, verification and audit
- Suitability of asset class for retail and other investors
- Heightened regulatory scrutiny and enforcement risk
 - Jan 8, 2018 NFA announcement requiring immediate notice of any virtual currency trading by a CPO or CTA
 - SEC Chairman and Staff statements and warnings