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A Global View of Token Regulation

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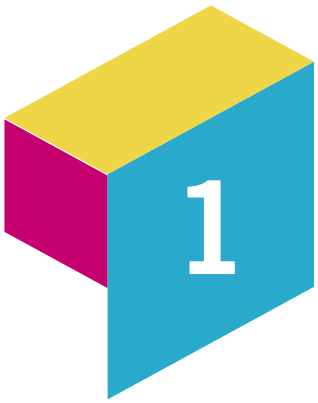
Over $2bn is reported[1] to have been raised this year by way of token offerings[2]. By that measure alone, token offerings have arguably become an important means of fundraising. The legal and regulatory treatment is, however, often complex and unclear. Since token offerings generally involve multiple jurisdictions, that complexity is compounded by the number of jurisdictions involved.

What does that mean for those seeking to raise funds this way? Simply put, for many token offerings, advice in multiple jurisdictions will be needed. This note considers the main questions raised, in several key jurisdictions: Germany, Hong Kong, the People's Republic of China (**PRC**)[3], Singapore, the United Kingdom (**UK**) and the United States (**US**).

At present, there is little international convergence of regulation in relation to token offerings. It is far too early in the development of this market to predict what the settled or common regulatory approach will be. However, in the current environment of heightened regulatory concern and scrutiny, issuers and advisors of token offerings need to consider the regulatory requirements, and risks of non-compliance, across multiple jurisdictions.

This note is not exhaustive of all relevant legal or regulatory issues that may arise in the context of a token offering. Without limitation, this note does not consider matters related to tax.



Where should the entity issuing or generating the tokens be established?

A number of token offerings to date have involved an entity incorporated or established in the Cayman Islands, Gibraltar, Singapore, Switzerland, the UK or the US. There are many factors that drive the choice of jurisdiction, which vary on a case-by-case basis. A question frequently asked, however, is whether any law other than that of the jurisdiction of incorporation of the entity generating or offering the tokens needs to be considered in relation to a token offering.

The short answer is yes. In addition to the laws of the jurisdiction in which the entity issuing or generating the tokens is incorporated or established, the laws of each jurisdiction within which the tokens could be considered to be offered or sold, or in which a regulated activity may be deemed to be carried out, will also be relevant. Most jurisdictions regulate the conditions under which certain investments may be offered (if at all) within that jurisdiction. There are also generally restrictions on the ability of certain persons to carry out certain (regulated) activities in relation to such investments, or submit the carrying out of such activities to conditions (such as licencing or authorisation requirements).

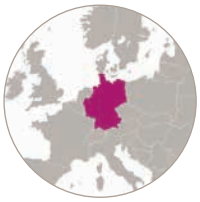
1 https://www.coindesk.com/ico-tracker/. Coindesk reports an "all-time cumulative ICO funding" amount of $2.69 billion as at 13 October 2017.
2 Also referred to as initial coin offerings (ICOs), token generation events, token sales and a number of other descriptors.
3 Refer to Part 6 for a brief overview of the regulatory considerations relating to the PRC.

2

Are tokens regulated investments?

Each token and token offering is different: there is currently no generally accepted, standardised model. Thus, the regulatory analysis must be conducted on a case-by-case basis.

Furthermore, what it means to be a "regulated" investment or instrument differs from one jurisdiction to another. In addition, the terms "security token" and "utility token", although frequently used in the context of token offerings, are not recognised legal or regulatory concepts or categories. It is also important to recognise that whether tokens are "securities" is not the only relevant question: there may be other regulatory consequences, even if the tokens themselves are not "securities".



2.1 Germany

Carrying out a regulated activity in Germany is generally prohibited, unless the relevant person is licensed or exempt. Many activities which involve "financial instruments"[4] are regulated activities. Depending on the circumstances, tokens may qualify as some form of "financial instrument".

Whether an activity relating to "financial instruments" is regulated depends on the activity. The sale and purchase of tokens that are "financial instruments" will likely qualify as a regulated activity, although certain exemptions[5] apply. Furthermore, the mere mining of, or payment with tokens should not constitute regulated activities.

Where, however, the sale and purchase of tokens takes place through a platform, authorisation requirements could be triggered for the platform. This would be the case, for example, where the platform carried out some form of brokering activity or placing business. Depending on the precise circumstances, the platform could also be regarded as a multilateral trading facility.

Furthermore, the marketing of "financial instruments" to the German market is also restricted and the issue of any advertisement, invitation or document which contains an invitation to the German market to buy or subscribe for "financial instruments" will need to be duly authorised by the relevant regulator unless an exemption applies.

2.2 Hong Kong

Carrying out a regulated activity in Hong Kong is generally prohibited, unless the relevant person is licensed or exempt. Many activities which involve "securities", including inducing others to trade, are regulated activities.

Furthermore, the marketing of "securities" to the Hong Kong public is also restricted and the issue of any advertisement, invitation or document which contains an invitation to the public in Hong Kong to buy or subscribe for "securities" will need to be duly authorised by the relevant regulator unless an exemption applies.

Many tokens will be "securities" for these purposes. Packaging something that would otherwise be "securities" in the form of a token will not generally change the regulatory outcome. For example, tokens that grant the holder some or all of the rights that would typically be enjoyed by:

2.2.1 a shareholder (for example, entitlements to dividends declared, profits or the proceeds of the assets of an insolvent company);

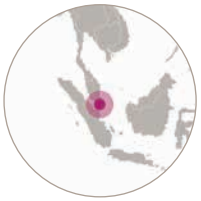
2.2.2 a bondholder (for example, a right to the repayment of a sum of money); or

2.2.3 a participant in a fund (for example, to profits or income from the acquisition, holding, management or disposal of the fund property),

are likely to be considered "securities". Tokens that have characteristics of structured products are also likely to fall within the regulatory perimeter.

4 Financial instruments are broadly defined and cover not only securities but also units of account (*Rechnungseinheiten*). The German regulator (*BaFin*) has repeatedly stated that virtual currencies (e.g. Bitcoin) are to be treated as units of accounts and hence, are "financial instruments".

5 For example, although the sale and purchase of tokens that are financial instruments will likely constitute proprietary trading, an entity that does not carry on any other regulated activity or belong to a group of institutions, a financial holding group, or a financial conglomerate that includes a credit institution pursuant to the Capital Requirements Regulation (European Union Regulation (EU) No. 575/2013), will not generally require authorisation by reason of that buying and selling alone.



2.3 Singapore

Carrying out a regulated activity in Singapore generally requires compliance with licensing and marketing rules, unless the relevant person is exempt. An activity is a regulated activity if it relates to the offer of an investment product such as securities (including shares, debentures or collective investment schemes).

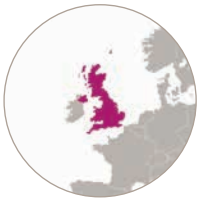
Whether (and if so, how) a token would be regulated needs to be considered on a case-by-case basis. For example, if:

2.3.1 the token grants any legal, equity or other security interests in an entity;

2.3.2 the token grants any right of repayment of the amount (whether in part or full) paid by holders to acquire the token or any right to interest payments over such amount; or

2.3.3 the value of the token is related in any way to the value of any underlying property, or holders of the token can participate in or receive returns arising from (whether directly or indirectly) any property or rights relating to any property,

the token is more likely to be regulated.



2.4 UK

Carrying out a regulated activity in the UK is generally prohibited, unless the relevant person is authorised or exempt. An activity is a "regulated" activity if, amongst other things, it relates to a "specified investment". Furthermore, communicating in the course of a business an invitation or inducement to engage in investment activity is also generally prohibited, unless the relevant person is authorised or the communication is approved by an authorised person. Again, an activity is an "investment" activity for this purpose if (amongst other things) it relates to "specified investments" (or a specified class of investment).

Some tokens will be "specified investments". Packaging something that would otherwise be a "specified investment" in the form of a token will not generally change the regulatory outcome. For example, tokens that grant a holder some or all of the rights that would typically be enjoyed by:

2.4.1 a shareholder (for example, entitlements to dividends declared, profits or the proceeds of the assets of an insolvent company);

2.4.2 a bondholder[6] (for example, a right to the repayment of a sum of money); or

2.4.3 a participant in a fund (for example, to profits or income from the acquisition, holding, management or disposal of the fund property),

are likely to be considered "specified investments". Tokens that give rights to other tokens or to other "specified investments", or that have characteristics of derivatives (e.g. futures, options or contract for differences) are also likely to fall within the regulatory perimeter. The UK Financial Conduct Authority (**FCA**), has, however, indicated that "many ICOs will fall outside the regulated space"[7]. Depending on the precise structure and the function of the tokens, it may therefore be the case that the tokens do not fall within the regulatory perimeter as "specified investments". This could be the case, for example, if no legal rights attach to the tokens. Even if that is so, however, it remains the case that agreements or instruments (including other tokens) that refer to or give rights to such unregulated tokens may themselves amount to "specified investments".

6 Or the holder of any other instrument creating or acknowledging indebtedness.

7 FCA Consumer Warning about the risks of ICOs, published 12 September 2017 (accessed 27 October 2017). The warning can be found at: https://www.fca.org.uk/news/statements/initial-coin-offerings.

2.5 US

Whether (and how) a token will be regulated in the United States depends in large part upon whether it is classified as a security (called an **investment contract**) under US securities law. This determination depends primarily on the test set out under *SEC v. W.J. Howey Co.*, (the **Howey Test**) and subsequent case law.[8] The Howey Test holds that an arrangement is an investment contract (notwithstanding the fact that it is not a traditional equity or debt security) if four key elements are satisfied.[9]

In regards to the capital-raising entities that use distributed ledger or blockchain technology to facilitate capital raising and investment, the United States Securities and Exchange Commission (the **SEC**) recently analysed the applicability of both registration and exchange trading requirements in SEC Release No. 81270 (the **DAO Report**).[10] In analysing the tokens at issue in the DAO Report, the SEC focused primarily on the last prong of the Howey Test, i.e., whether investors in the DAO tokens had an "expectation of profit, solely from the efforts of others" before ultimately concluding that the DAO tokens were securities. Given the novelty of the technology, it seems reasonable to assume that many tokens will have ongoing involvement with their sponsors throughout their lifecycles. Therefore, it is possible for the SEC to construe investment in tokens as speculative activity seeking capital appreciation from resale on a secondary market which would make them securities, as they did in the DAO Report.

To the extent that tokens are deemed to be securities offered and sold in the United States, then under the US Securities Act of 1933 (the **US Securities Act**) they must either be registered with the SEC or qualify for an exemption from registration. The basic dichotomy is that the token offering has characteristics of a public offering, but can only be carried out under a non-public offering exemption. This creates potential issues around compliance with the various requirements of these private offering exemptions.

In addition, any entity or person engaging in the activities of an exchange must register as a national securities exchange or operate pursuant to an exemption from such registration. Therefore, for any trading of tokens to occur following issuance, a registered venue must be identified. One frequently-used exemption is available for an alternative trading system (**ATS**) which, although technically an exchange, is regulated as a broker-dealer, and must be registered as such with the SEC. However, as of this writing, no exchange or ATS is available for this purpose.

Finally, while it is expected that tokens that are solely utility tokens[11] should not be securities, it is incorrect to assume that this would mean that they are not subject to US regulation. Others which may apply are US state securities laws, commodities laws, state and federal money transmitter and consumer protection laws, and US federal income tax laws. Even if a token-based platform is fully developed and the tokens are widely used commercially on that platform, the tokens may be subject to US regulations.

8 SEC v. W.J. Howey Co., 328 U.S 293, 298-299 (1946).

9 The Howey Test for determining whether an investment contract exists is broken down as follows: (1) whether there is an investment of money; (2) in a common enterprise; (3) where the investor is led to expect profits; and (4) solely from the efforts of others.

10 The Report can be found at: https://www.sec.gov/litigation/investreport/34-81270.pdf.

11 There is no definition of this term, but it is commonly used to indicate an instrument that gives a contractual entitlement to some goods or services that can be used or consumed by the token holder.

3

Are pre-sale arrangements themselves regulated investments?

Pre-sale arrangements (if any) vary significantly from one token offering to another. In some cases, a separate instrument is intentionally created (which may or may not itself be a token), which gives rights to, or is convertible into, the main token, once created. In others, the pre-sale is intended to amount to no more than a sale of property that will come into existence at a future date (the tokens). As for tokens generally, the variety in structures therefore requires any pre-sale arrangements to be considered on a case-by-case basis.

Broadly speaking, for most jurisdictions (e.g. Germany, Hong Kong, Singapore and the UK):

3.1.1 if the main token is itself a regulated investment, security or other regulated product, pre-sale arrangements that amount to an instrument, certificate or agreement giving rights to the main token will generally amount to a separate regulated investment; and

3.1.2 even if the main token is not itself a regulated investment, security or other regulated product, pre-sale arrangements that have characteristics of a derivative, structured product or other financial instrument may nevertheless amount to a separate regulated investment.

For the US, pre-sale arrangements generally will be deemed securities because their value will be primarily dependent upon the sponsor of the tokens developing and marketing the tokens and the platform on which the tokens will be used. This is a classic example of "efforts of others" which, if coupled with an expectation of profit, will fall squarely within the definition of investment contract laid out in the Howey Test.

One of the more prominent attempts to create a legal framework for compliance with US securities law is the "simple agreement for future tokens" (the **SAFT**). The idea is that the parties will assume that the SAFT is an investment contract (and therefore a security under the Howey Test) and as such the token sponsor will structure the token sale in order to ensure that it can rely on an exemption from registration under the US Securities Act, such as limiting availability of the token to investors to those who qualify as "accredited investors"[12].

As the authors of the SAFT acknowledge, their argument hinges on ensuring that the tokens (once issued) are not securities. However, this may not be possible to determine at the outset, as it may be possible that the value of the token continues to depend significantly on the efforts of the token sponsor or third parties. If this turns out to be the case, the fact that the tokens were purchased on a delayed basis through a SAFT does not particularly affect the analysis.

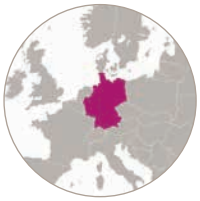
12 Pursuant to Section 4(a)(2) of the US Securities Act and Regulation D thereunder, sales of securities in a non-public offering to certain types of investors (accredited investors) are exempt from the registration requirements of the US Securities Act.

4

Is a prospectus (or other offering document) required?

Certain jurisdictions mandate that an offering document be made available before certain investments or instruments may be offered to certain classes of investors (such as retail investors). In the context of token offerings, this may apply, depending upon the structure, to either or both of the main token and any pre-sale arrangements that amount to such an investment or instrument.

It is important to note, however, that even if an offering document is not strictly required from a legal perspective (for example, because an exemption applies), it will generally be advisable, with a view to limiting potential future disputes (amongst other things), in most cases to prepare documentation that clearly describes, for example, the tokens, any right(s) attaching to the tokens, the relevant platform, the principal legal relationships, the terms of the token offering (including selling restrictions) and relevant disclaimers (including risk factors).



4.1 Germany

An approved prospectus will be required if the tokens are "transferable securities"[13] (*übertragbare Wertpapiere*) or certain kinds of capital investments (*Vermögensanlagen*) and the intention is to offer them to the public in Germany (or if they are admitted to trading on an organised market), unless an exemption applies. This also applies to pre-sale arrangements that give rights to tokens that are "transferable securities".

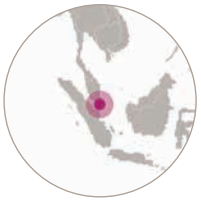
Even if the tokens are not "transferable securities", an approved prospectus may still be required to offer tokens to the public in Germany under the German Investment Act (*Vermögensanlagegesetz*) as it applies broadly to capture products[14] which fall outside the securities prospectus regime.

4.2 Hong Kong

A prospectus may only be issued, circulated or distributed in Hong Kong to offer any shares in, or debentures of, a company (whether incorporated in Hong Kong or elsewhere) to the public in Hong Kong for subscription or purchase or to invite offers by the public in Hong Kong to subscribe such shares or debentures if it meets the relevant regulatory and registration requirements, unless an exemption applies. Whether a particular token will be a "share" or "debenture" will depend on the specific characteristics of the token.

13 The relevant criteria for determining whether an instrument qualifies as "transferable securities" are: (i) fungibility (ii) free transferability, (iii) transfer pursuant to the law applicable to moveables, and (iv) rights reflected in a negotiable instrument.

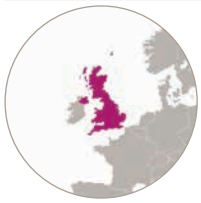
14 Broadly, any instrument which gives rise to a right, or an option, to receive cash, interest or payments of any nature.



4.3 Singapore

In Singapore, prospectus requirements apply when an offer of "securities" is made to persons in Singapore, unless an exemption applies. Accordingly, where tokens constitute securities, an offer of the tokens to persons in Singapore will require a prospectus to be registered with the Monetary Authority of Singapore (**MAS**) unless a prospectus exemption applies. Exemptions are available for (among others) offers to "institutional investors", subject to certain conditions such as advertising and resale restrictions.

Even if a prospectus is not required, it is advisable to prepare documentation which clearly outlines the key terms and conditions attached to the tokens, including the key risks involved, as the provision of such disclosures to investors (even if not strictly required) would be in line with the regulatory expectation of the MAS.



4.4 UK

An approved prospectus will be required if the tokens are "transferable securities" offered to the public in the UK (or for which admission to trading on a regulated market will be requested), unless an exemption applies. This may also apply to pre-sale arrangements, for example, that give rights to tokens that are "transferable securities" or are themselves "transferable securities".

The definition of "transferable securities" refers to "those classes of securities which are negotiable on the capital market".[15] There is uncertainty as to whether (or when) the market for tokens could be said to amount to a "capital market". If the market for tokens amounts, wholly or partly, to a "capital market", a prospectus would generally be required (unless an exemption applies) for those tokens amounting to securities transferable on that capital market. The term "security" for these purposes is not defined, but (following pronouncements from the European Commission) would arguably capture those tokens capable of being traded on an exchange.

4.5 US

To the extent that a token is deemed to be a security for US purposes, the registration provisions of the US securities laws require that the offer or sale of securities to the public must be accompanied by the "full and fair disclosure" afforded by registration with the SEC and delivery of a statutory prospectus containing information necessary to enable prospective purchasers to make an informed investment decision.

Registration entails disclosure of detailed information about the issuer's financial condition, the identity and background of management, and the price and amount of securities to be offered.

These same laws also provide that, unless a registration statement is in effect as to a security, it is unlawful for any person, directly or indirectly, to engage in the offer or sale of securities.

If an exemption to registration under the US Securities Act is being used, US securities laws impose a standard to which the disclosure must be prepared by the issuer and provides a private right of action by an investor to enforce that standard. The disclosure must not make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.[16]

15 Instruments of payment are excluded.
16 Rule 10b-5 under the US Securities Exchange Act of 1934.

If the tokens are not regulated investments, do other potential regulatory issues arise?

While important, laws relating to the regulation of investment products and services are not the only potentially relevant regulatory issues. Some important examples are set out below.[17]

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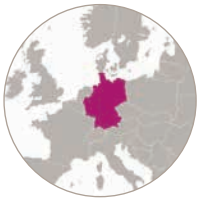


5.1 Germany

Payment services. Where tokens are offered against legal tender, an intermediate platform through which tokens are acquired or sold may carry out regulated payment services and will thus require an authorisation under the German payment services regime.

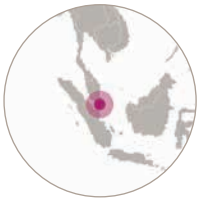
5.2 Hong Kong

5.2.1 **Stored value facility**. A person may not provide a "stored value facility" in Hong Kong unless the person is authorised to do so. A "stored value facility" is, broadly, a facility which may be used for storing the value of an amount of money that is paid into the facility from time to time and may be stored on the facility under the rules of the facility. Such facility may then be used as a means of making payments for goods or services. Depending upon the precise structure, the wallet associated with a token offering may involve a stored value facility where fiat currency is accepted in exchange for the tokens.

5.2.2 **Consumer protection**. Certain consumer protection legislation may apply in certain cases to protect subscribers to a token offering, such as protection against false trade descriptions, unfair trade practices and restrictions relating to certain clauses (such as exemption clauses).

5.2.3 **Other licensing concerns**. Depending on the precise structure, consideration may need to be given to whether other licensing concerns may be relevant, including deposit-taking or money services related requirements.

17 These example are not exhaustive of all potential regulatory issues that may arise.



5.3 Singapore

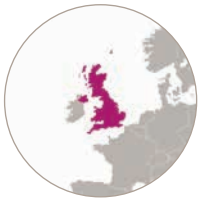
5.3.1 **Licensing and anti-money laundering**. The MAS has proposed[18] a new payments regulatory framework which would mean that virtual currency intermediaries that buy, sell or facilitate the exchange of virtual currencies (e.g. Bitcoin or digital tokens), or which provides a platform to allow persons to exchange virtual currencies, could require a new type of licence and be subject to anti-money laundering regulations.

5.3.2 **Stored value facility**. A token may constitute a "stored value facility" if it could be purchased by a holder with fiat currency being used as a means of making payment for goods or services, and such payment is to be made by the issuer of the tokens. If the token is a stored value facility, an issuer will need to comply with certain requirements, including anti-money laundering regulations. Approval of the MAS is also required if the aggregated stored value held by the issuer exceeds SGD 30 million (currently, about USD 22 million), subject to conditions.

5.3.3 **Data protection**. Token issuers must comply with the obligations imposed under the Singapore Personal Data Protection Act relating to the use and disclosure of personal data of buyers and sellers of the tokens, and subscribers of the token offerings.

5.3.4 **Consumer protection**. Singapore has "light touch" consumer protection regulations that apply generally to the sale or advertisement of products to consumers. Issuers must not undertake "unfair practices" when transacting with consumers, such as taking advantage of consumers who are not in a position to protect their own interests. Aggrieved consumers are able to take a civil action against such issuers. Advertising requirements under the Singapore Code of Advertising Practice should also be considered.

5.3.5 **Other licensing requirements**. Depending on the specific structure, other licensing requirements may apply, such as those relating to deposit taking, payment services and money-changing and remittance business.



5.4 UK

5.4.1 **Payment services**. A person may not provide a "payment service" in the UK, or purport to do so, unless the person is authorised to do so. "Payment services", broadly, relate to money or "funds" (which includes banknotes or coins, scriptural currency or electronic money). Depending upon the precise structure, a token offering may involve the provision of payment services (particularly where fiat currency is accepted in exchange for the tokens). Recent regulatory pronouncements from the European Commission have suggested that the scope of payment services regulation may be extended to certain cryptocurrency exchanges and wallet providers.

5.4.2 **Regulation of exchanges and custody services**. Where tokens are financial instruments for the purposes of MiFID[19] (which includes most "specified" (i.e. regulated investments)), operating an exchange that allows for trading in such tokens will generally be a regulated activity if conducted in the UK. Equally, safeguarding or administering tokens that are "specified" (i.e. regulated) investments in the UK will generally also be a regulated activity.

5.4.3 **Supply of digital content**. Specific consumer protection legislation applies in relation to the supply of "digital content" (i.e. data which is produced and supplied in digital form). Tokens may arguably amount to, or involve, digital content, and therefore trigger protections where consumers are involved in the token offering. These protections involve certain terms being implied as to the digital content being of satisfactory quality, fit for purpose and as described. The terms of consumer contracts are also subject to "fairness" test, which could apply to the relevant subscription documentation in the context of a token offering. Consumers may also be entitled to enforce rights to a rebate or refund in certain circumstances.

5.4.4 **Unfair commercial practices**. Protections from unfair commercial practices may also apply where consumers are involved in a token offering. These prohibit unfair commercial practices, misleading actions or omissions, aggressive practices and blacklisted practices. A breach of the prohibition may entitle consumers to pursue certain civil remedies (including rights to a discount, damages or to unwind the relevant contract), and may attract criminal sanctions in certain circumstances.

18 The public consultation has closed and the MAS is expected to respond to industry feedback in November 2017.
19 Markets in Financial Instruments Directive (Directive 2004/39/EC of the European Parliament and of the Council), and subsequent amendments.

5.5 US

5.5.1 **Money services regulations**. US federal law makes it illegal to knowingly conduct, control, manage, supervise, direct, or own all or part of a money transmitting business which is not licensed under state and federal law. FinCEN, a bureau within the US Department of the Treasury, has published guidance to clarify whether a person dealing in cryptocurrency would fall under the definition of a "money transmitter". In its guidance, FinCEN has stated that those who issue and redeem cryptocurrency and those who accept and exchange cryptocurrency for either fiat or other cryptocurrency as a business would be deemed money transmitters. Consequently, it is possible that a token sponsor (or the entity which handles the exchange of cryptocurrency) would be deemed to be engaging in an unlicensed money transmission business in violation of US law.

5.5.2 **Regulation of exchanges**. The SEC has made it clear that any entity or person engaging in the activities of an exchange, such as bringing together orders for securities and entering such orders pursuant to agreed terms of the trade, must register as a national securities exchange or operate pursuant to an exemption, such as an ATS. To the extent tokens are deemed securities, a qualified venue must be registered with the SEC in order to facilitate trading in the secondary market.

Can tokens be offered into the People's Republic of China (PRC)?

A circular was issued jointly by seven regulatory authorities in the PRC on 4 September 2017, which, amongst other things, demanded that all token offerings cease immediately and any completed offerings be unwound (i.e. any proceeds raised should be returned to investors). In addition, cryptocurrency exchanges could no longer provide any trading services (between fiat and cryptocurrencies, or between cryptocurrencies) or pricing/quote services.

The circular does not specifically address whether it is only targeted at domestic token offerings, although insofar as it relates to cryptocurrency exchanges, the penalties stated suggest that it is focusing only on exchanges operating in China.

It is difficult to gauge at this stage whether and how the Chinese regulators would seek to enforce against cross-border token offerings. It is expected that new regulations will be introduced to prohibit illegal fundraising activities (which may include token offerings) in the near future.

What are some of the most significant practical issues currently faced in relation to token offerings?

7.1.1 **Security and token holdings**. A significant issue in the context of token offerings has been whether and how tokens can be held in a secure way. In particular, it is generally unclear, both as a practical and legal matter, whether or how a claim to tokens that have been lost (for example, because the relevant wallet provider was hacked, or due to fraud) can be enforced.

7.1.2 **Bankability**. Token issuers have faced difficulties in banking fiat currencies converted from cryptocurrency proceeds received from token offerings.

Banks typically view token offerings as presenting a high risk for money laundering, which means that banks would be obliged to undertake enhanced customer due diligence and enhanced monitoring of business relations to comply with their "know-your-client" (**KYC**) and money laundering obligations.

A key practical issue is that banks generally require the source of funds to be established, which necessarily involves identifying:

(i) the institution or investor from which the funds originate; and

(ii) the activity that generated the funds.

It may be difficult to ascertain the source of funds in relation to token offerings, given the generally anonymous nature of cryptocurrency proceeds, particularly where conversion takes place on a cryptocurrency exchange. Globally, a number of banks are reported to have closed bank accounts of companies offering cryptocurrency services.

At present, there does not appear to be a clearly identified practical solution to the "bankability" problem.

7.1.3 **Clearing and settlement**. The legal basis of transfers, clearing and settlement of transactions in tokens and other cryptocurrencies or assets is unclear. For example, in certain jurisdictions, it is unclear whether (or how) the holder of a token could successfully enforce a "proprietary" claim to the token against a third party (for example, in the case of theft or misappropriation). Mechanics applicable to other types of investments such as bonds or shares are not applicable or easily adaptable to tokens.

7.1.4 **Ability to exchange for fiat currency**. Many tokens are not directly exchangeable for fiat currency or, even if they are, they are not exchangeable easily. The ease with which a new token will be able to be transferred and exchanged will depend on whether they are accepted for trading by a cryptocurrency exchange platform. While more popular tokens and existing cryptocurrencies will be traded across multiple platforms, new tokens may not be accepted by exchange operators and therefore liquidity will be negatively impacted. Without easy access to a market price for any new token, it could be difficult to exchange the token for fiat currency.

7.1.5 **Regulatory status**. As noted above, in many jurisdictions tokens and token offerings can be subject to multiple classifications, each with their own regulatory requirements. One recent example of this was highlighted by the U.S. Commodity Futures and Trading Commission (**CFTC**) in its recently published Primer on Virtual Currencies[20]. In its primer, the CFTC stated that tokens issued in connection with token offering may be both a "commodity" for purposes of the U.S. Commodity Exchange Act and a security for purposes of the securities laws, while emphasising that it will look beyond the form to the actual substance and purpose of an activity when applying CFTC regulations. To the extent that a token is a CFTC commodity it could become subject to a host of regulatory requirements which are substantially different to those imposed on securities (e.g. trading and clearing requirements, transaction reporting and position limits). Therefore, as the regulators in each of the discussed jurisdictions develop their views on the status of tokens and token offerings, any issuer, advisor or purchaser should be aware that the terms of the transaction will determine the financial regulations to which they are subject and that the securities analysis, while critical, is not the end of the discussion.

20 The Primer on Virtual Currencies can be found at: http://www.cftc.gov/idc/groups/public/documents/file/labcftc_primercurrencies100417.pdf.

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