



# ICOs and Regulations: An Impossible Match?

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[University of Financial Technology]



# Setting the scene

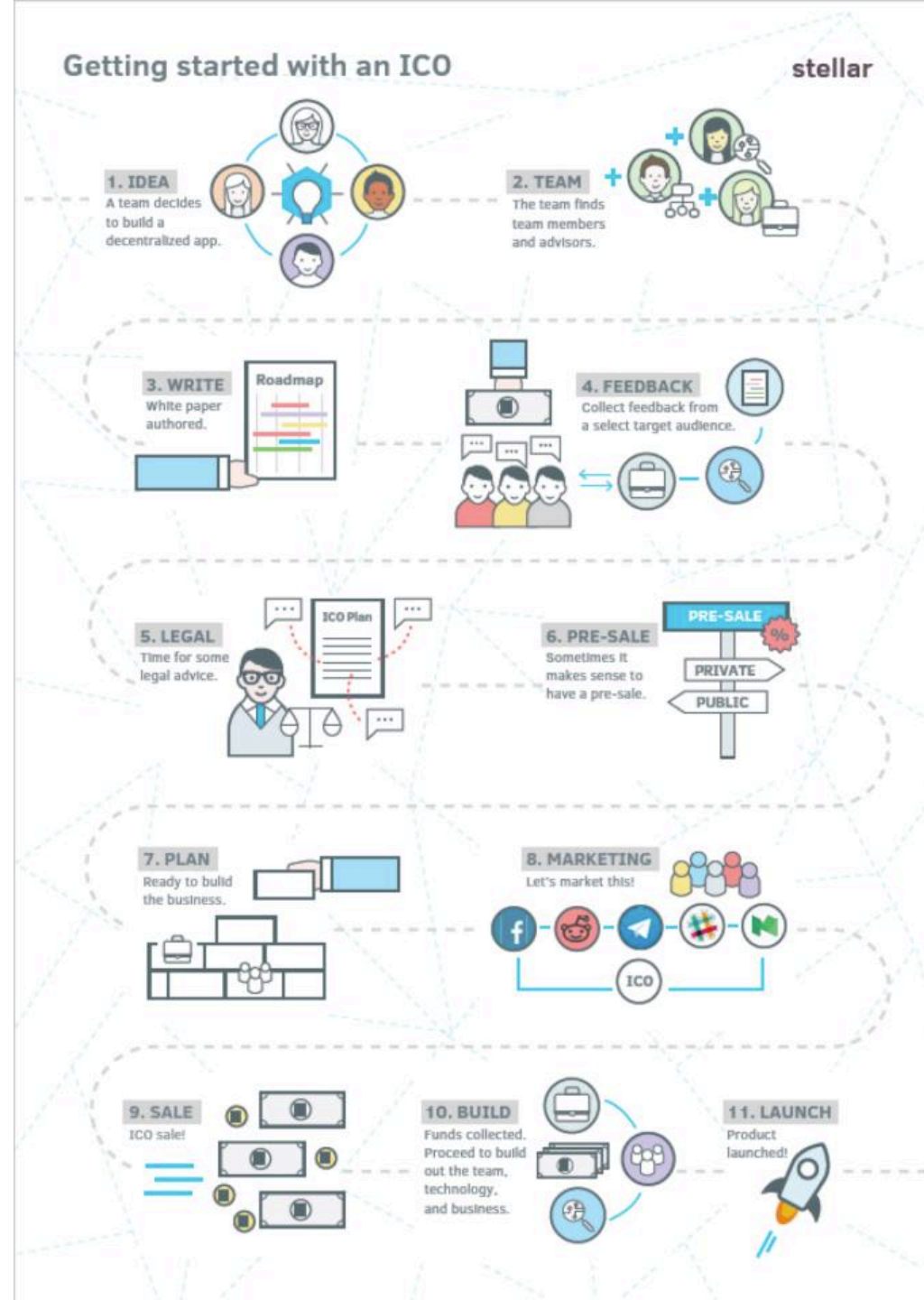
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# The path to an ICO

- ICO: Initial Coin Offering
- First ICO: 2014
- 2016: 50 ICOs or \$98.64 million
- 2017: 370 ICOs or \$6.23 billion
- 2018: 829 ICOs and already more than \$20.65 billion





# TYPE OF TOKENS

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## USAGE

Access  
Use product or  
service  
Similar to gift cards  
or loyalty programs



## EQUITY

Entitle the holder to  
equity-like benefits  
(profit sharing,  
voting rights)



## ASSET

Backed by real-life  
asset



## COMMUNITY

Ability to enact  
monetary policy

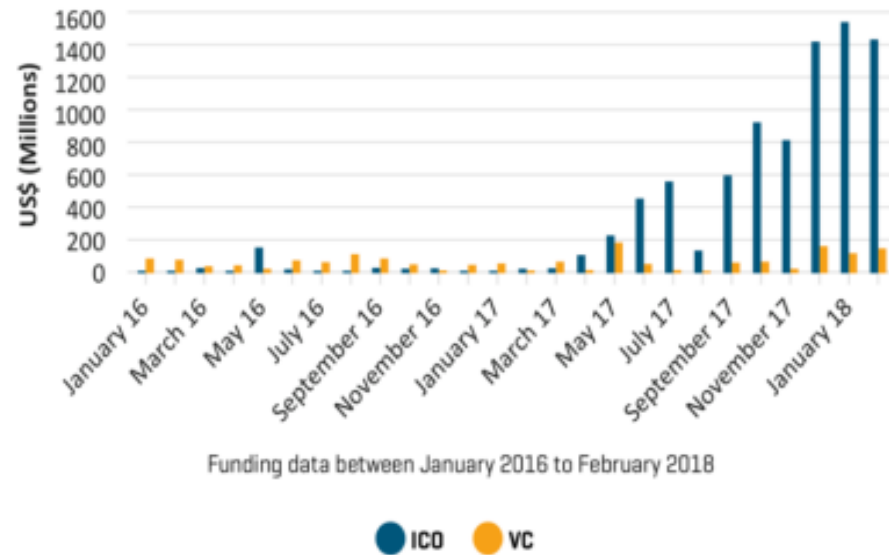


AUGUR

## WORK

Contribution to  
organization and  
earn revenue in  
exchange

# ICOs to complement or replace VCs fundings?



Funding data between January 2016 to February 2018

Figure 18: Monthly blockchain funding (ICO vs VC); data sourced from [99]



# What are the benefits and risks of ICOs?

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# BENEFITS OF ICOs (Organizations issuing)

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01

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**CUSTOMER BASE:**  
Rally customer base prior to official launch

02

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**POSITIVE NETWORK EFFECTS:**  
Incentivizing of the users

03

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**NEW FINANCING MODEL:**  
Encourage innovative projects

04

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**INVESTOR OUTREACH:**  
Global investors can participate.  
Non-discriminatory

05

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**FAST AND EASY:**  
Open to anyone. Easily generated.  
Lower transaction costs. Marketing tool.

06

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**RETAIL INVESTORS:**  
Enthusiasm from retail investors. Pricing reflects liquidity more than rights associated

# BENEFITS OF ICOs (Investors)

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01

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**TRANSFERABLE:**  
Easy, frictionless transfer

02

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**LIQUIDITY:**  
Up to \$100 million in 24-hour volume

03

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**NETWORK EFFECT:**  
Encourage innovative projects

04

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**DEMOCRATIZATION:**  
Global investors can participate.  
Non-discrimnatory

05

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**GAIN:**  
Quick appreciation. Quest to find next bitcoin



# RISKS OF ICOs: CONSUMER PROTECTION

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## DUE DILIGENCE

- ✓ No auditing of firms performing ICOs
- ✓ No assurance that technology described can effectively be developed
- ✓ Flaws can be discovered late in the development stage



## TOKEN VALUATION

- ✓ Not necessarily based upon fundamental value
- ✓ Often valued based on expected resale profits



## KEYS

- ✓ Private keys cannot be regenerated
- ✓ Possibility to lose control of tokens if cryptographic keys are lost or not properly managed

# RISKS OF ICOs: MARKET RISKS

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## HIGH PRICE VOLATILITY

43 out of the largest 100 cryptocurrencies (by market capitalization) had a 7-day price change of greater than 5%

(source: Historical snapshot – 30 September 2018, Cryptocurrency Market Capitalizations.

<https://coinmarketcap.com/historical/20180930/>)



## MARKET MANIPULATION

- ✓ “Whales”
- ✓ Pumping and dumping
- ✓ Spoofing

Whale: ETH Flash crash where the price of ETH dropped from \$320 to \$0.10 on GDAX within seconds



## NETWORK LAG

Large ICOs can slow down the the transaction validation speed of the network



# Regulatory framework

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# LUXEMBOURG REGULATORY CONSIDERATION

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## LEGAL OPINION

- ✓ Legal analysis of the ICO
- ✓ Identify type of token
- ✓ Reference to law applicable



## WHITE PAPER

- ✓ Identification of team
- ✓ Token characteristics
- ✓ Development roadmap
- ✓ Considered similarly to a prospectus



## INVESTMENT FUNDS

- ✓ Leading investment fund center in Europe
- ✓ Requests to create investment funds investing in:
  - Cryptocurrencies
  - ICOs

# LUXEMBOURG REGULATORY CONSIDERATION

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Application of the law depends on the token features



## MiFID

- ✓ Legal uncertainty surrounding tokens
- ✓ Broad Notions of “financial instrument” and “transferable security”
- ✓ Not clear which features make a token as a “transferable security”
- ✓ Which tokens transactions are to be considered part of the “capital market”



## Prospectus Law

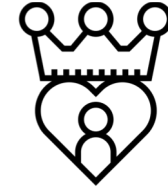
### **If token qualifies as securities:**

- ✓ Limited possibilities to benefit from exemptions

### **Potential for clarification:**

- ✓ Issue amount (expressed in cryptoassets or cryptocurrency)
- OR
- ✓ Number of residents of each Member State able to subscribe

Will need to see additional prospectus rules adapted to the needs of ICOs



## Consumer Law Protections

- ✓ If purchaser qualifies as consumer the law applies
- ✓ White paper is essential
- ✓ Information contained should not mislead the consumer
- ✓ the law and must be drafted not to mislead the consumer.
- ✓ Set a standard for ICOs actors regarding minimum content



# BENEFICIAL REGULATORY MEASURES

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01

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ASSESSMENT MATRIX

02

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AUDITORS SPECIALIZED IN ICOs

03

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CONSUMER EDUCATION

04

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REGULATORY CERTAINTY  
REGARDING INVESTMENT FUNDS

05

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INTERFACE FOR GOVERNMENT  
MONITORING

06

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OPEN COMMUNICATION  
CHANNELS WITH INDUSTRY  
STAKEHOLDERS

## MALTA

### **Virtual Financial Assets (VFA) Act**

- ✓ Applicable to the legal authorisation and regulation of Initial Coin Offerings (ICO) and Crypto Currency Exchanges
- ✓ Specifies what information a white paper must contain and what requirements must be met for it to be approved and published.
- ✓ Defines terms such as virtual financial assets, smart contracts or VFA agents

### **Malta Digital Innovation Authority Act**

- ✓ Legal provisions to establish the Malta Digital Innovation Authority (MDIA),
- ✓ Will act as the regulatory authority for the
- ✓ create binding and appropriate rules that promote and support the establishment of the blockchain scene

### **Innovative Technology Arrangements and Services (ITASA)**

- ✓ Bill details requirements and procedures for registering and certifying technology vendors and technology arrangements in Malta.
- ✓ Focus in particular on the area of crypto currency exchanges.



## SINGAPORE

- ✓ Warning for Digital Token Exchanges and ICO issuer on May 24, 2018
- ✓ Need to obtain preliminary authorization from the MAS for digital tokens considered as securities

# OUTSIDE OF LUXEMBOURG



## SWITZERLAND

- ✓ Favorable regulatory environment
- ✓ Plans to introduce an innovation-friendly financial technology license by 2018
- ✓ Published ICO guidelines on February 16, 2018, providing information needed to deal with enquiries related to ICOs:
- ✓ Each case must be decided on its individual merits;
- ✓ Focus on the function and transferability of tokens (Payment tokens, utility tokens, asset tokens);
- ✓ Focus on AML and securities regulation (Payment ICOs, Utility ICOs, Asset ICOs);
- ✓ Information to investors concerning risks related to ICOs.



# What about Best Practices?

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# BEST PRACTICES

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01

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TRANSPARENCY

02

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DISCLOSURES

03

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ICO MECHANISMS

04

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TECHNOLOGY

05

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FOUNDERS & EMPLOYEES

06

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LEGAL & REGULATORY

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