

## Introduction

Token sales (also known as token generating events (TGE) or initial coin offerings (ICOs)) are becoming an increasingly popular method for blockchain and cryptocurrency startups from around the world to raise funds. In 2017, ICOs have raised more than a billion dollars for early stage startups.

Hong Kong, Singapore and Switzerland have emerged as popular jurisdictions for ICOs, due to friendly regulatory environment and government support for fintech and blockchain technology development.

## What Is an ICO?

Despite the nomenclature, ICOs can be very different from initial public offerings (IPOs). IPOs involve the sale of shares in a company to investors and are subject to well-defined (but exacting) regulatory processes. IPOs are more suitable for established businesses (with a track record) and not feasible for startups.

An ICO is the sale of a type of digital asset (a token) which is based on blockchain technology. It is an alternative means of fundraising for blockchain technology projects outside of the traditional fundraising methods, such as venture capital funding and angel funding.

Some of the most important questions that token issuers have to consider at the outset of the project is the purpose, function and the rights attached to the tokens. The purpose and function of the digital tokens are defined by the token issuer.

The characteristics and rights attached to the digital tokens sold will impact the regulatory and compliance treatment and requirements for the token sale.

There are many different types of digital tokens. Some examples are tokens that represent or constitute:

- An ownership interest in a company or an interest in a physical asset
- A voucher or right to use the service or function on the platform
- A loyalty or incentive point



## ICO Process

Broadly speaking, there are four main stages of an ICO, namely: (1) pre-announcement; (2) ICO marketing; (3) ICO launch funding; and (4) end of ICO.

At the pre-announcement stage, the issuer typically prepares a white paper, road map, and terms and conditions of the ICO.

- The white paper sets out key aspects of the underlying project, such as the issuer's business model, the technical aspects of the product, the problems the product intends to solve and how it is going to solve them and a description of the token. For certain ICOs, a technical paper may also be prepared.
- The road map outlines defined and realistically achievable goals of the project, and the intended timeframes.
- The terms and conditions of the ICO would cover risk factors and other key legal terms such as the terms and conditions of the sale, project life cycle and timeline, investors' rights, and the amount of funding it is seeking.

These documents are published on the issuer's website and prospective investors may actively discuss the merits of the project through platforms such as Reddit, Bitcointalk, Slack and Telegram.

Depending on the issuer's funding needs, the ICO may conduct a pre-sale prior to its main crowdsale.

Some of the sale mechanics/terms which issuers will need to consider are:

- Whether pre-registration of interested buyers is required for KYC purposes
- Whether there is a minimum amount targeted to be raised and whether funds will be refunded if the target is not met
- What is the soft and/or hard cap
- Token pricing and distribution methodology
- Length of the offering
- Timing of release of tokens
- Whether (due to regulatory and AML/CFT reasons) there are blackout jurisdictions that will not be permitted to participate in the crowdsale

Issuers should be mindful not to oversell the prospects of its ICO or encourage speculation in its tokens.

## How Can Issuers Benefit From ICOs?

For issuers, ICOs offer several advantages:

- ICOs are currently less regulated and, therefore, can be brought to market more quickly.
- The transaction costs incurred are likely to be lower. Issuers do not have to hire investment bankers to underwrite the transaction.
- The marketing of ICOs can be primarily done online. ICOs, therefore, have potential to reach large audiences within a short span of time.

However, ICOs still require a significant amount of effort, expenditure and risk. Therefore, before embarking on an ICO, it is important to consider very carefully if a token sale is right for a project, by considering the project's business case and funding requirements, whether the project needs to be built on a blockchain and the need for the token.

## Regulatory Aspects of ICOs

With the growth of the ICO market, various governments are scrutinizing the developments of such offers, while considering numerous regulatory issues.

The responses from governments have so far been varied – ranging from a ban of ICOs in China (although China later clarified that the ban could be temporary pending regulations being implemented), a signal of potential increased regulations (and enforcement) in the US to clarifications that ICOs are permitted but must comply with existing securities laws (e.g., Singapore).

In Singapore, the Monetary Authority of Singapore (MAS) published its "Guide to Digital Token Offerings" on November 14, 2017. The guide states that some coins or tokens offered through an ICO may be considered securities. If so, those ICOs would then be required to comply with requirements for an offering of securities under various securities laws, specifically the Securities and Futures Act of Singapore (Cap. 289) (SFA) and the Financial Advisers Act (Cap. 110). In other words, ICOs distributing securities tokens will be treated the same as if they were issuing publicly traded stocks. For example, under the SFA, a prospectus is required for any offer of securities that is not an excluded or exempted offer under the SFA. Furthermore, these rules extend to non-residents and foreign entities so long as they engage in activities intended to induce the Singaporean public.

MAS provided examples to illustrate how they might distinguish securities tokens from non-securities tokens (commonly referred to as utilities tokens). MAS confirmed the following:

- A token that gives holders the right to access and use the issuer's platform **is not** a security
- A token that gives holders a share in the issuer's profits **is** a security
- A token enabling holders to receive profits from the issuer's investment portfolio **is** a security

In addition, intermediaries or exchange operators dealing in tokens that constitute securities will need to obtain the necessary licenses and comply with existing rules on anti-money laundering and countering terrorism financing.

## Looking Ahead

We expect the ICO market to continue to grow and mature in the months to come with greater understanding and development on best practices for the industry and increased clarity on regulatory requirements and treatment.

We support transparent, secure and legally compliant token sales with long-term oriented and sustainable goals and economics which are fair and in the interests of its participants and the digital asset community.

## How We Can Help

- Incorporation
- Advise on legal structure
- Advise on token model (legal issues) and regulatory compliance
- Review white paper for legal compliance and issues
- Draft and review token sale terms and conditions
- Advise on AML/CTF compliance
- Advise on privacy and confidentiality obligations
- Draft and review website terms of use and privacy policy
- Draft and review shareholders agreement and/or subscription agreement
- Draft and review employment agreement and advise on employment issues

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