

LT in Focus

Overview of ICO regulations: changes in key jurisdictions

Regulators around the world have been increasingly active in expressing their positions about tokens and ICOs, warning investors of potential risks related to cryptocurrencies. Read on for an overview of recent regulatory changes in key jurisdictions.

[China](#)

[Hong Kong](#)

[Canada](#)

[Singapore](#)

[USA](#)

[Man Island](#)

[Malaysia](#)

[Israel](#)

China

Seven key China's regulators outlawed initial coin offerings (ICOs) in a [joint statement](#). The statement followed an investigation by the country's central bank, which found that over 90 percent of reviewed ICO projects raise funds illegally and with fraudulent intent.

According to the statement, the companies exchanging tokens for fiat money and cryptocurrencies in ICOs must stop their operations. The ban applies to crowdfunding projects and cryptocurrency exchanges, too. Supposedly, both Chinese and foreign companies, operating in China or targeting the Chinese markets, fall within the scope of restrictions.

Organisations and individuals that raised funds through ICOs should make arrangements to return funds to investors.

Starting from 4 September, the Chinese central bank will be reporting the companies that start or continue raising funds by selling cryptocurrencies or refuse to return the raised funds to investors to the competent authorities to initiate civil and/or criminal proceedings.

The Chinese regulator is committed to closing the above-mentioned projects and restricting their access to electronic platforms (websites and mobile apps). The restrictions might also apply to non-compliant foreign companies, targeting the Chinese consumer market.

Banks and financial institutions were prohibited from doing any business with the companies engaged in ICOs.

This means that the Chinese regulator targets not only the current or upcoming ICOs, but also the closed transactions. Many platforms have suspended their operations to assess the risks. Those that stopped trading tokens continue to operate online.

Furthermore, according to the [latest media releases](#), China is planning to ban commercial trading of all cryptocurrencies, not only tokens. However, China's top exchanges have not received any official notices from the regulators so far.

Taking into account all of the above, the companies planning ICOs or conversion of cryptocurrencies to tokens, other cryptocurrencies, or fiat money are recommended:

- i. To legally restrict access of Chinese nationals to their services
- ii. To technically disable the use of the company's services in China
- iii. To cease any marketing campaigns in China or targeting Chinese audiences
- iv. If possible, to negotiate the future of tokens with the Chinese exchanges.

September 2016

[China \(a statement\)](#)

[Hong Kong \(a statement\)](#)

[Canada \(a notice\)](#)

[Singapore \(a risk map\)](#)

[USA \(a warning\)](#)

Hong Kong

The day after the joint statement of the Chinese regulators was released, the Hong Kong's Securities and Futures Commission (SFC) issued its own [statement](#).

The SFC chose a more liberal approach, consistent with the positions earlier expressed by Singapore and the USA. The SFC said that, depending on the facts and circumstances of an ICO, digital tokens may be treated as investment instruments.

The following features of tokens can be taken into account:

- Tokens represent equity or ownership interests
- Tokens are considered debentures

- Tokens by their nature are interest in a collective investment scheme.

Any transactions in tokens constitute regulated activities. Parties engaging in a 'regulated activity' are required to hold the relevant licence(s) and/or permits.

SFC claimed jurisdiction over any company that conducts regulated financial activities targeting Hong Kong's market, irrespective of where it is domiciled.

The secondary investment tokens market is also regulated by the SFC. Exchange of tokens for fiat currencies or cryptocurrencies may require the SFC's licences and permits.

Canada

The Canadian Securities Administrators (CSA) has released a [CSA Staff Notice](#), advising of potential applicability of the Canadian securities laws to initial coin offerings ("ICOs") under certain circumstances.

The CSA specifically underlined that even if marketed as software products, tokens remain securities by their nature.

In determining whether or not an investment contract exists, the CSA businesses should apply the following four-prong test, similar to the US Howey test. The CSA pointed out to the following factors as important in determining whether a person or company is trading in securities for a business purpose:

- Soliciting a broad base of investors, including retail

investors

- Attending public events, including conferences and meetups, to actively advertise the sale of coins/tokens; and
- Raising a significant amount of capital from a large number of investors.

Fintech companies can use the CSA Regulatory Sandbox initiative to obtain exemptive relief from the requirements of the securities regulations.

The CSA covered cryptocurrency exchanges in its notice, too. The regulator requires due diligence, procedures for identity verification, anti-money laundering, counter-terrorist financing and recordkeeping.

Singapore

After it voiced its [position](#) on tokens, the Monetary Authority of Singapore (the "MAS"), joined by the Consumer Advisory of Investment Schemes, released a [map of ICO risks](#) the consumers should be aware of, to name but a few: (i) Risks relating to foreign and online operators; (ii) Risks relating to sellers without a proven track record; (iii) Risks relating to insufficient secondary

market liquidity; (iv) Risks relating to investments promising high returns; (v) Risks of money laundering and terrorism financing.

The MAS urges investors to mitigate risks and consult the MAS to check on ICO projects.

USA

To implement the measures announced in its recent report alongside the [regulatory position](#) on sale of tokens to the public, the SEC started fighting the companies engaged in crypto-economy, as their activities, in SEC's opinion, are illegal. Thus, the SEC recently suspended trading in the common stock of certain issuers, including First Bitcoin

Capital Corp., CIAO Group, Strategic Global, and Sunshine Capital.

Furthermore, the regulator [warned](#) investors about the potential market manipulation schemes, such as "pump-and-dump", a stock fraud banned on the US stock market.

Isle of Man

Amid the pessimistic ICO market outlooks, the Isle of Man's government [reaffirmed](#) its commitment to opening its doors to entrepreneurs looking to launch initial coin offerings and announced the creation of a regulatory

framework that would eventually legalise tokens. The Isle of Man is one of the first jurisdictions that legalised ICOs subject to compliance with the AML and KYC requirements and obtaining of necessary permits.

Malaysia

The Securities Commission of Malaysia (SC) issued a [media release](#) to caution investors against participating in ICOs and reminded that the securities laws may potentially apply to cryptocurrency transactions.

The regulator urges investors to be mindful of the potential risks involved in ICOs, noting that trading in digital tokens in the secondary market may give rise to the risks of insufficient liquidity or volatile and opaque pricing. The regulator warns that ICO investors might be limited in their legal protection and recourse against the scheme operators. As the terms and features of ICOs may differ from project to project, investors who wish to engage or

invest in ICO projects are reminded to seek legal or other professional advice if there are doubts as to the legitimacy of the projects. Therefore, the SC admits the possible unlawful use of ICOs, although it was very reserved in commenting on the wide use of ICOs in fraudulent schemes.

The media release does not offer an overview of any changes in the ICO regulatory environment, announcing no tightening of the law enforcement practices, which makes the release rather ICO-neutral. Nevertheless, the SC is prepared to apply the securities laws, whenever there are sufficient reasons to do so.

Israel

The head of the Israeli Securities Authority (ISA) has announced the establishment of a committee to evaluate the need for regulating the ICOs and related technologies.

The committee needs to:

- 1) Identify the financial meaning of the distributed ledger technology and the transactions recorded in it and decide on the future regulatory scope
- 2) Analyse the global cryptocurrency- and ICO-related regulatory practices
- 3) Assess the readiness of the existing securities legislation to regulate ICOs and blockchain solutions and prepare recommendations on the necessary amendments.

The report is expected by December 2017.

Taking note of the rising global interest toward cryptocurrencies and blockchain technologies and the broadening use of ICOs to raise financing, the regulator chose a neutral, but constructive position calling for the legalisation of ICOs and the development of investor protection mechanisms.



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"Predictably, many jurisdictions have followed the trend established by the USA and are monitoring the ICO market more intensely. The ban imposed by China's People's Bank has shut the Chinese market for private currency issuers. Even though the Chinese regulator differentiates between tokens and cryptocurrencies, Chinese regulators are unanimous about going hard on the cryptoeconomy. Still, there are jurisdictions that are welcoming the new trend, which is important. We expect that many players will be channeling their projects to these 'safe harbours', even though certain restrictions exist there, too".

We hope that you will find this newsletter interesting and informative. Please feel welcome to contact us for more information on the topics covered.

Best regards,

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