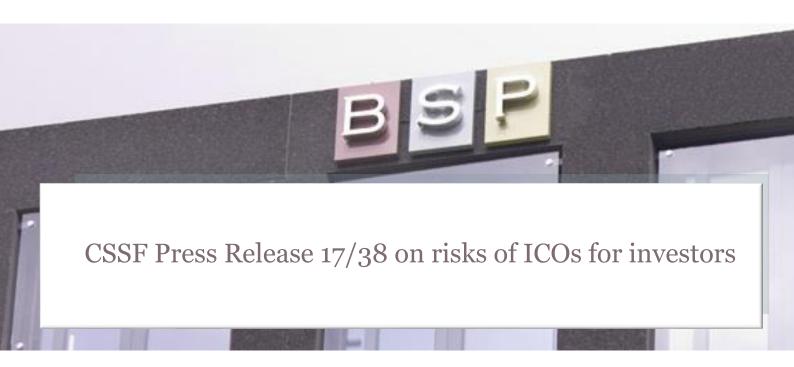
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Avocats



WHAT?

An ICO is an unregulated and innovative way of public fund raising, by selling coins or tokens. By launching an ICO, a company (the Issuer) (startup and/or fintech company) or an individual, issue coins or tokens for sale in exchange of virtual currencies, such as Bitcoin. Sometimes, ICOs may as well involve traditional currencies. The aim of launching an ICO is to circumvent traditional rigorous and regulated capital-raising process, by allowing Issuers to raise money in a fast manner and start rapidly their activities.

That being said, the non-regulated nature of ICOs represents a risk for investors, who are not protected and Issuers conduct their activities without any applicable legal framework. In such a context and in order to protect investors and investments, European Securities and Markets Authority (ESMA) has published recommendations on which the Commission de Surveillance du Secteur Financier (CSSF) relies on.

Such a publication follows the position of the US Securities and Exchange Commission dated July 25th 2017¹ which stated in particular that:

"The Securities and Exchange Commission issued an investigative report today cautioning market participants that offers and sales of digital assets by "virtual" organizations are subject to the requirements of the federal securities laws. Such offers and sales, conducted by organizations using distributed ledger or blockchain technology, have been referred to, among other things, as "Initial Coin Offerings" or "Token Sales". Whether a particular investment transaction involves the offer or sale of a security – regardless of the terminology or technology used – will depend on the facts and circumstances, including the economic realities of the transaction."

Furthermore, please note that on September 4th 2017, Chinese regulator has banned and deemed illegal the practice of raising funds through launches of token-based digital currencies, targeting ICOs.

WHEN?

On November 16th 2017, the CSSF has published information², whereby the CSSF informs investors and other market participants that ESMA has issued a statement on ICOs setting out risks of so-called ICOs for investors. That being emphasised, for the time being such information cannot be considered as a concrete position statement from the CSSF on ICOs in Luxembourg.

HOW?

Considering that ICOs are highly speculative investments, depending on how ICOs are

¹ https://www.sec.gov/news/press-release/2017-131

²http://www.cssf.lu/en/documentation/publicatio ns/press-releases/news-cat/548/



structured, they may fall outside of regulated legal framework, in which case investors do not benefit from any protection. Therefore, in order to guarantee investors' protection, ESMA has determined that depending on ICOs' structure, different UE financial regulations may apply (and their corresponding national laws) such as (i) the Prospectus Directive, (ii) the Markets in Financial Instruments Directive, (iii) the Alternative Investment Fund Managers Directive, (iv) the Market Abuse Regulation, (v) the Fourth Anti-Money Laundering Directive, etc.

Besides, other national rules or regulations may also apply in addition to the aforementioned UE legislation, depending on the ICO's structure, which must be examined on a case-by-case basis.

ESMA also emphasises that investors should realise that when investing in ICOs and depending on the ICO's structure, investors are exposed to certain risks, as follows:

- unregulated space, vulnerable to fraud or illicit activities: ICO may fall outside any applicable legal framework and therefore may be used for fraudulent or activities, such as laundering purposes. In the case where an ICO does not fall under the scope of EU laws and regulations, investors cannot benefit from the protection that these laws and regulations provide;
- high risk of losing all of the invested capital: absence of guarantee that the services/products proposed by the Issuer will be successfully developed and, even assuming that the project is successful, any eventual benefit may be

- extremely low relative to the invested capital;
- lack of exit options and extreme price volatility: investors may not be able to trade their coins or tokens or to exchange them for traditional currencies and the price of virtual currencies may be extremely volatile, which could lead to market price manipulation and fraudulent activities. Investors may be exposed to the lack of exit options or not be able to redeem their coin or token for a prolonged period;
- **Inadequate** information: unaudited, incomplete and unbalanced information made available to investors in white papers. Lack of information regarding investments risks in the white papers. Investors may therefore not understand the risks that they are taking and make investments that are not appropriate to their needs; and
- flaws in the technology: the blockchain technology that supports the coins or tokens is still experimental. There may be flaws in the code or programs that are used to create, transfer or store the coins or tokens and thus investors may have difficulties to access or control their coins or tokens, or the coins or tokens may be stolen (hack): clear lack of security for investors regarding the tokens or coins.

As a consequence, ESMA "reminds" Issuers to give careful consideration as to whether their ICOs and their activities thereof constitute regulated activities. In such a case, Issuers have to comply with the relevant EU or national legislation and any failure to comply with the



applicable rules would constitute a violation of such rules and regulations.

Therefore, the main question for Issuer is to determine whether the coins or tokens shall be qualified as financial instruments. In such a case, it is likely that the Issuer conduct regulated investment activities that could fall under the scope of UE financial regulations (and their corresponding national laws).

As a conclusion, Issuers themselves have a duty to analyse the regulatory framework, seeking the necessary permissions and meeting the applicable requirements when conducting their activities and in particular when contemplating launching an ICO.



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