



Initial Coin Offerings (ICO) Capability Statement

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Tiang & Partners
程偉賓律師事務所

Initial Coin Offerings

ICO market snapshot



2017 witnessed the emergence of Initial Coin Offerings (ICOs) as a new capital-raising phenomenon with exponential investment volumes.



A recent PwC study suggests that almost US\$2.9 billion was raised in 2017 across global ICOs.



We believe in helping clients to embrace the new digital world – with a constant focus on regulatory compliance, quality and professionalism.

What is an ICO?

An **ICO** (or a token launch or sale) describes a limited period in which a project raises finance by offering digital tokens in exchange for a cryptocurrency (e.g. Bitcoin, Ethereum, etc.) or, in some cases, fiat currency (e.g. cash). The constitution of the parties involved, the project structure and the offer process all vary, but this is the basic model.

The tokens (or “coins”) typically entitle the “token-holders” to benefit from rights linked to the underlying business model (which itself commonly leverages distributed ledger technology – blockchain as its platform). Such rights may include:

- Right to access and interact with the underlying platform or community conceived by the funds;
- An ability to play a development role in the platform; and/or
- Right to share the profit generated by the arrangement.

What are the legal and regulatory considerations?

There is sometimes a perception that the legal analysis begins and ends with consideration of relevant securities laws. It does not. It’s certainly at the heart of any sensible regulatory analysis (and which securities laws apply is a related issue) but a host of other legal issues need to be addressed.

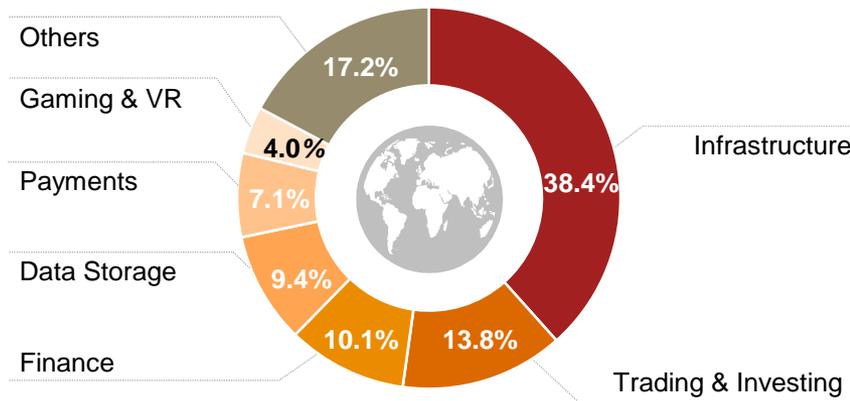
This is a rapidly developing area of law with the regulatory framework surrounding ICOs evolving regularly. Founders, investors and participants should exercise caution before proceeding with a token sale and obtain specific legal advice on the potential regulatory challenges.

Due to the inherent “borderless” nature in which ICOs are typically conducted, careful consideration of a variety of issues is needed, across the multiple jurisdictions involved, including:

- What rights are attached to the tokens? Are they properly characterised as a utility, security, debenture, financial product, investment scheme, etc. for the purposes of local legislation?
- Where will the issuer operate and where is the likely participant population?
- How are tokens redeemed or transferred by participants?
- Can the tokens be “purchased back” by the ICO issuing party?
- Do the tokens maintain a “stored-value”? Can further value be uploaded at a later date?
- Will it be backed by, or considered an interest, in certain assets?
- How and where will the sale be marketed? What representations are made to interested parties?
- How is any bounty program being handled?
- Will there be added functionality, or token sales, in future?

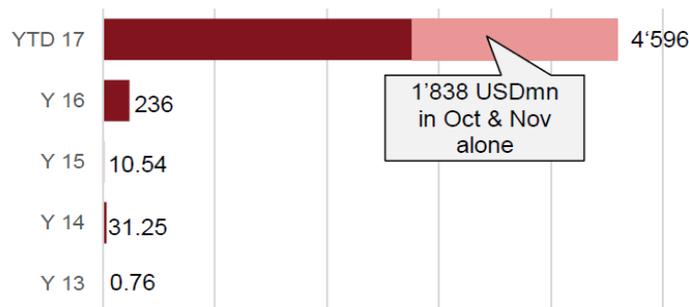
Explosion of ICOs in 2017 – a year in review

ICO market distribution by industry, 2017



Source: Coinschedule

Global ICO volume (USDmn)



Source: PwC's Introduction to Token Sales (ICO) Best Practices

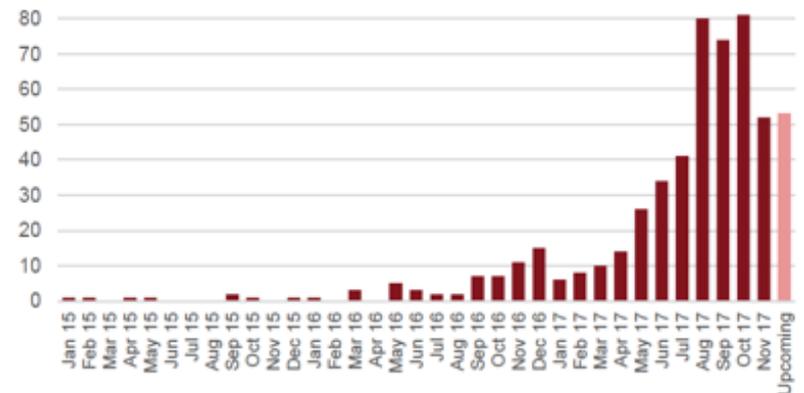
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Average ICO characteristics

Year	Ø duration / ICO (days)	Ø volume / ICO (USDk)*	# ICOs
2013	41	381	2
2014	68	3'814	8
2015	33	1'101	9
2016	41	4'816	57
YTD 2017	30	11'726	438**
All	32	10'114	514**

Source: PwC's Introduction to Token Sales (ICO) Best Practices

Number of ICOs globally (per month)



Source: PwC's Introduction to Token Sales (ICO) Best Practices

Areas of focus – legal and regulatory



Legal and regulatory

Each ICO requires careful preparation and review of the suite of legal documentation (and marketing material) in light of a host of legal and other considerations. The legal documents (ranging from the whitepaper to the token sales agreement – and everything in between) can vary in content, length and style. But together they must describe the dynamics of the ICO, including the nature of the digital token, cap metrics, token pricing mechanics, pre-retail ICO stages if any, how to subscribe, what the issuer's rights and obligations comprise and so on. Disclosure and transparency is key, including being entirely upfront about the risks. If *you* were interested in the project, what would *you* want to know?



Incorporation and drafting Articles of Association



Token sale/ offer documents



SFC regulatory advisory and Legal Opinion



White paper review



Terms and conditions of token sale



Overseas legal advice



Social media, marketing language and privacy review



Inter-company, employee/consultancy arrangements



Intellectual property and licensing arrangements

Regulatory challenges for ICOs

Security vs. Utility tokens

Digital tokens can exhibit different characteristics, which inform their likely categorization as either a “security” or “utility” under applicable securities legislation. The true nature of the rights and the overall structure, not merely the name given to them, is what matters. The varieties and forms are evolving all the time; however, ICOs generally tend to adopt one of the following four structures in their token sales (or a combination of them).

Security token



Tokens with security characteristics (e.g., shares, debentures) with income generating components and potential rights vis-à-vis the issuer, e.g., control, participation, ownership

Digital currency



Tokens with an attributed value for exchange/transactions, asset/value storage and/or unit of account

Asset-backed token



Tokens providing underlying exposure to real world assets (e.g. gold, diamond, securities, cash, real estate, etc.)

Utility token



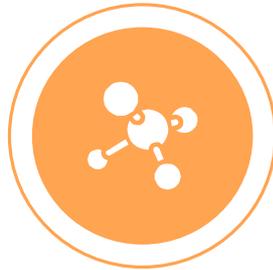
Tokens used for supporting services/ functionalities on blockchain-based platforms

Some advantages of pursuing an ICO

Whilst many token sale/ICO projects could raise funds via the traditional angel or venture capital route, there are certain advantages in pursuing a token sale. Indeed, sometimes a combination of VC and ICO funding can be a powerful statement of intent.



An effective and synergistic way to raise capital for blockchain-based projects



Removes some of the perceived drawbacks present in the traditional equity capital raising process



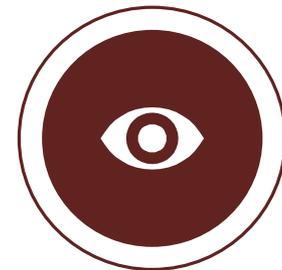
Projects receive funding without diluting equity or control



Often allows a talented team to be assembled quickly



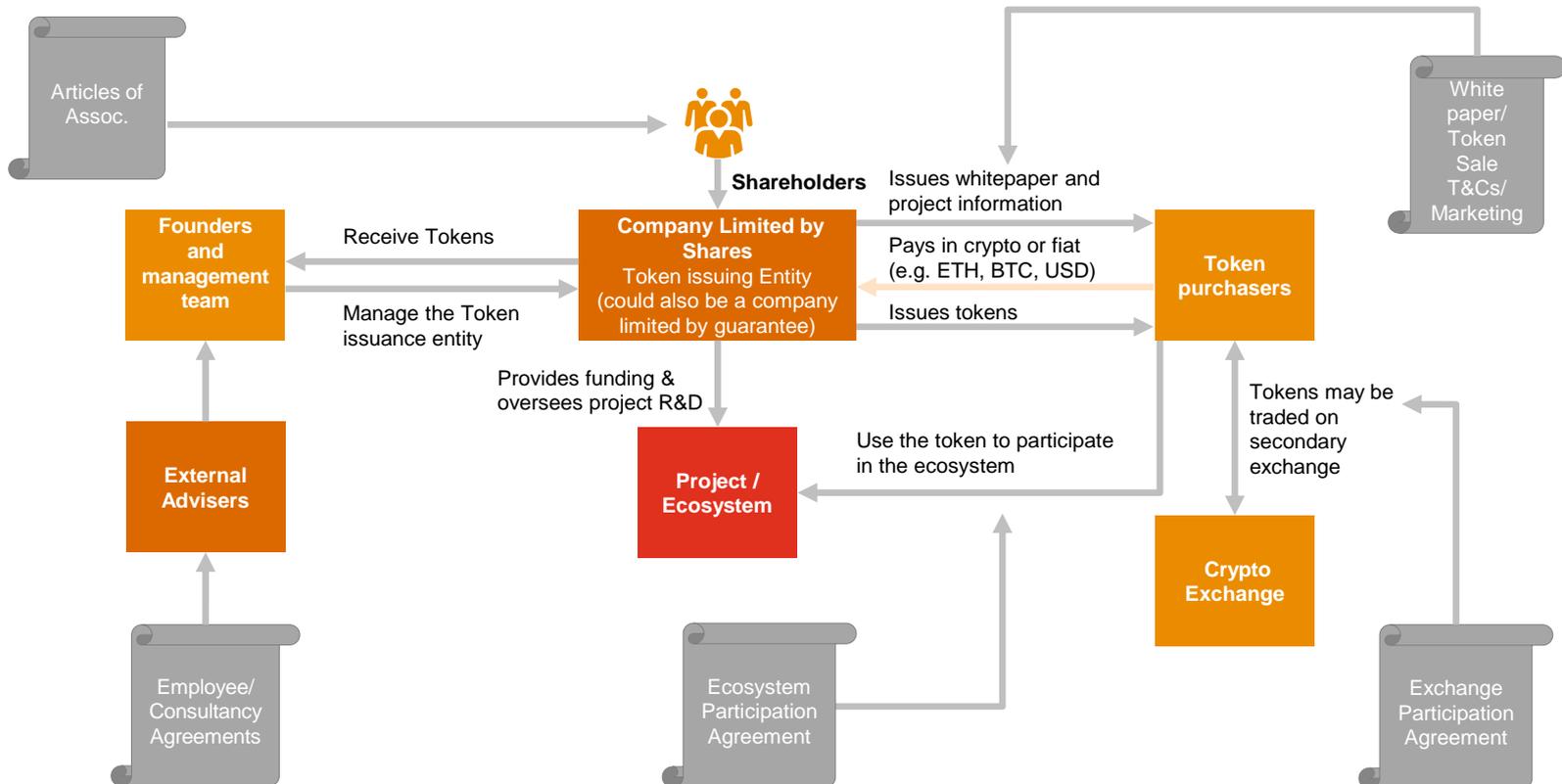
Expedites the setup of an ecosystem/community



Provides optimal market visibility

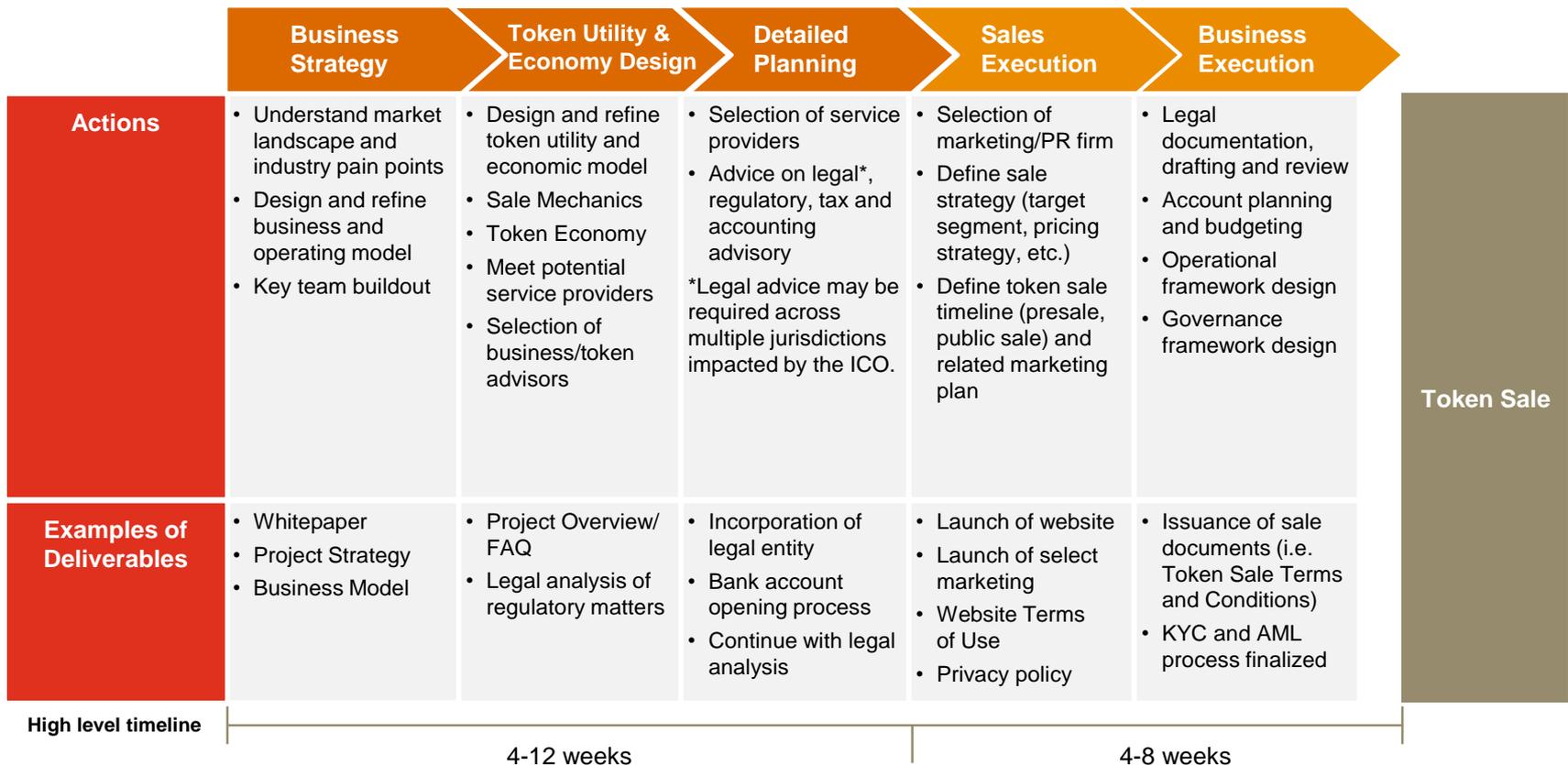
How to conduct an ICO

Whilst there are many varieties of token sale structures, the below graphic depicts a fairly typical structure adopted by a “for profit entity”. The complexity and entities involved can vary greatly, as can the territories involved (which is relevant to any prudent legal analysis). Note that Foundation models are also often seen.



High level ICO timeline

Launching a token sale/ICO needs to be handled with care and requires project management and planning at each step. Some of the main workstreams, involving different professionals, are described below.



How Tiang & Partners can help

Our Hong Kong legal practice has a core team of corporate, capital markets and TMT lawyers who are passionate about the opportunities that an ICO (and other cryptocurrency-related projects) can provide to a new digital marketplace. We believe in the benefits available to both start-ups and established businesses and are committed to helping our clients take full advantage of this new ecosystem whilst navigating (and complying with) the surrounding regulatory environment.

Every cryptocurrency mandate is different, but many will typically include the following legal workstreams:

- Regulatory analysis of the token sale, both from a local and overseas territory perspective;
- Entity set-ups, corporate structuring and governance;
- Arrangements involving cryptocurrency exchanges;
- Advice in relation to deposit taking activities/stored value legislation;
- IP licensing and inter-company arrangements;
- Local licensing and securities-related arrangements; and
- Advice on and preparation of data privacy policies and relevant consumer legislation applicable to token holders.

There is no “one size fits all approach” in structuring and executing an ICO. We assist our clients in evaluating and implementing the appropriate structure for their business model, from a true utility token, all the way to a regulated security offering.

Tiang & Partners is part of an integrated team of ICO professionals

In our experience, preparing our clients for their ICO requires expertise from a market-leading, integrated team.

Accordingly, we frequently work closely with PwC subject matter professionals in tax, transfer pricing, accounting, AML, strategy, governance and cyber-security, to provide seamless and coordinated professional advice. Further, with our connections to the world’s most extensive legal network, we also help guide our clients across multiple jurisdictions impacted by the ICO.

Key Hong Kong legal contacts



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