ICO Utility Tokens and the Relevance of Securities Law

By Syren Johnstone

Abraham Lincoln famously posited that if one calls a tail a leg it doesn't mean that a dog has five legs. Similarly, a blockchain-based token offered in an initial coin offering ('ICO') may, irrespective of how it is called, be a security subject to securities laws applicable to the primary market as well as secondary market activities. ICOs are an example of how new technology is changing the way the public capital market is accessed by businesses, typically start-ups, in need of capital.

The legal treatment of tokens remains unclear in many jurisdictions, which is increasingly problematic as ICO activity has ballooned from around US$300 million during 2013 to 2016 to well in excess of US$5 billion in 2017. As Hong Kong is now considering its potential status as an ICO hub, it is essential that regulatory agencies and market professionals come to grips with a better understanding of how tokens are, or may be, regulated.

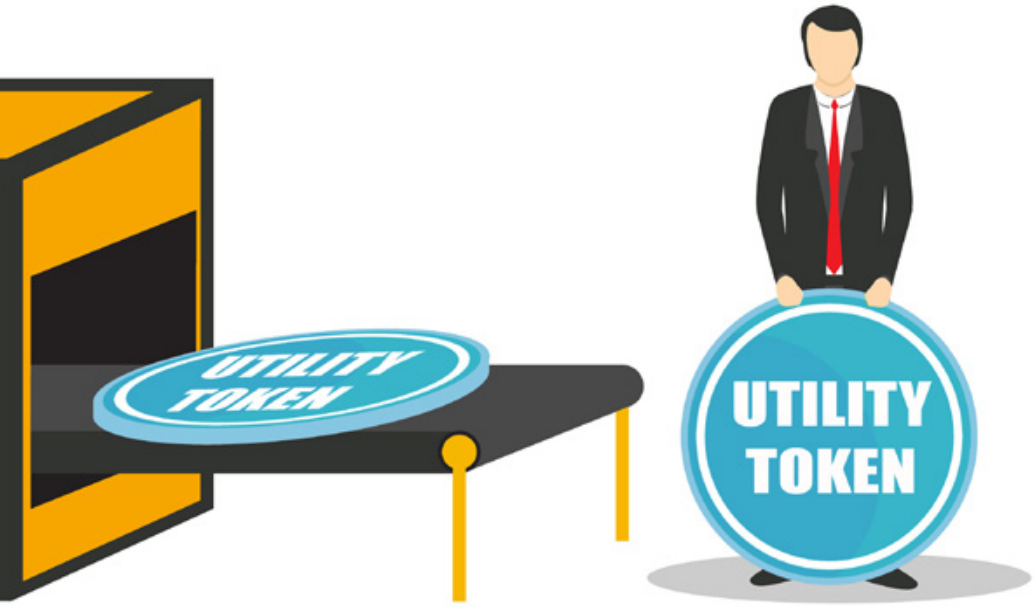
A focus of this article is "utility tokens". Unlike tokens that clearly operate like equity or debt (via payments, voting rights, etc), utility tokens present problems as regards their legal characterisation. The nature of a utility token is to permit the holder to access a service provided by the issuer's platform. This is typically a pre-sale made by a start-up seeking capital to develop the promised service. While token-holder rights bear resemblances to, for example, licensees, franchisees, or club memberships, utility tokens may have other features that lend securities-like properties to them.

Regulatory attitudes

Regulatory and practice attitudes (in markets that have not banned ICOs) have evolved with the ICO market and roughly fall into three phases.

Around the end of 2016, ICOs were generally considered to be undesirable owing to the risk of mis-disclosure and fraud, risks magnified by the speed and ease at which money was able to be raised – eight figure US dollar sums were able to be raised in a matter of minutes or hours with no regulatory oversight. The origin and subsequent use of funds being transacted also raise money laundering and terrorist financing concerns.

By this time it had already been widely understood that blockchain technology is important to future economic development. Tokens are important in this context because they collectively facilitate a blockchain-based ecosystem that provides operational functionality – imagine that one had train carriages but no train tracks. Going into 2017 regulators were adopting a more cautionary watching role, reluctant to inhibit evolution.



That began to change with the rapid growth of offerings in 2017 and following the "21(a) Report" issued by the U.S. Securities and Exchange Commission ('U.S. SEC') in July 2017. The 21(a) Report concluded that a token known as "*Slock.it*" was a security, although it had not been promoted as such. The U.S. Sec and the Hong Kong Securities and Futures Commission ('SFC')) have recently gone on the offensive to warn issuers and market professionals not to put form over substance when structuring tokens as a means of seeking to circumvent securities laws that serve to protect investors, and are accordingly applying greater scrutiny to ICOs.

What is a "security"?

In consequence of the foregoing, there has been a more profound examination of what are the features of a utility token that might render it to be regarded as a security.

The law applying to the offering of securities and their marketing in Hong Kong, as set out in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) and the Securities and Futures Ordinance ('SFO') (Cap. 571), is in general consistent with best international practices that prohibit accessing public capital unless registration or authorisation requirements are complied with or a relevant exemption applies. Tokens that are securities may also be subject to laws concerning regulated activities and the operation of exchanges and automated trading services. However, whether a specific token is a security will require careful consideration.

The SFO's definition of "security" provides little assistance in relation to tokens that do not clearly fall into pre-established categories, such as shares or debentures. The definition of "collective investment scheme" ('CIS'), which is one form of security, is widely drafted and remains open to interpretation in its application. Hong Kong is absent of case law that provides useful guidance on either of these defined terms. The report of the UK's Financial Markets Law Committee (July 2008) has acknowledged that the definition of CIS in s. 253 of the UK Financial Services and Markets Act 2000, which the SFO's definition reflects, is very wide and subject to legal uncertainties. There have been a handful of cases in the UK that provide some limited assistance to understanding the CIS term, though less so regarding the particular characteristics of tokens.

The scope of the term "security" has been more extensively explored in the U.S. and the ICO community has long been well aware of the relevance of the test established by the U.S. Supreme Court in *SEC v. W.J. Howey Co.* (328 U.S. 293 1946) ('*Howey*'). *Howey* established that an "investment contract", which is one type of security as defined by the Securities Act of 1933, means "a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party" (*Howey*, 2). *Howey* is of interest here for two reasons.

First, because *Howey* has been applied to tokens by the U.S. SEC. First in the 21(a) Report to the *Slock.it* ICO and most recently (December 2017) to the "*Munchee*" ICO. *Slock.it* unsuccessfully sought to take its tokens outside of the securities legislation via a distributed autonomous organisation ('DAO') that tried to remove the concept of a third party's efforts. "*Munchee*" actively promoted that its tokens could be traded and investors could expect to profit from the increase in the value of the tokens as a result of the efforts of its promoters, ie a purchaser of the tokens could expect profits from the efforts of another. Both of these cases are relatively clear cut, and that may not always be the case.

Second, because of potential similarities to elements in the definition of CIS that align with, though are not identical to, the concept in *Howey* of a common enterprise in which the efforts of another are key. The "purpose or effect" requirement under the CIS definition is possibly wider than *Howey* because that phrase may encompass expectation, and the notion of "profit" in *Howey* is easily encompassed by the CIS concept of profits, income, payments or "other returns".

However, applying existing law to tokens is inherently problematic because blockchain has enabled fundamental changes in the ease and manner of accessing public capital, the cost and timing of doing so, the willingness of the public to purchase tokens and the ease of trading them. Moreover, the ICO market, and the new digital economy it represents, is global and borderless in a way never before encountered. These new realities make it difficult to continue with oversimplified analogies to user licenses, franchises or memberships that have traditionally not amounted to capital raising exercises from a large and anonymous public market.

Hong Kong practitioners will therefore need to exercise some caution when advising on the nature of a proposed token issuance and how it is undertaken.

Best practices

The increasing awareness that tokens can be subject to securities laws that possess uncertainties in their potential scope of application has had an impact on practices in the industry. This has led to the emergence of best practices such as Coinbase's "A Securities Law Framework for Blockchain Tokens" (December 2016) and the "Best Practices for Token Sales" issued by the Fintech Association of Hong Kong (December 2017). A core principle of both is that an ICO should be, inter alia, transparent as to its legal structure and regulatory treatment.

While best practices have been developed to promote self-regulation of the industry, they have not always been observed in practice. As already noted, the form of a token may be given precedence over its substance in an attempt to remove them from securities laws. This has led to stern warning language from the Chairman of the U.S. SEC as regards semantic gymnastics or elaborate structuring exercises (before the Senate Committee on Banking, Housing and Urban Affairs, 6 February 2018). Two days later, the SFC issued a circular stating that "ICO issuers are *typically assisted* by market professionals such as lawyers, accountants and consultants for advice to structure the offering as utility tokens to fall outside the purview of the SFO *and to circumvent the scrutiny of the SFC*" (emphasis added).

Legal practitioners will be well aware that avoidance and evasion are quite different matters. Professional advisers often structure transactions to avoid or minimise various legal ramifications, and are under no responsibility, moral, legal or otherwise, to bring a matter under consideration within any particular law or regulatory scrutiny. There is a significant difference between that role and engaging in professional misconduct by advising issuers to engage in (or cooperating in) evasion of the law through, for example, window dressing that mischaracterises the real nature of the token. Doing so may be tantamount to conspiracy to defraud.

While that distinction may be clear-cut in principle, the characteristics of a utility token that might cause it to be regarded as a security are less clear. Where a relevant grey area is in play, advice may fall into the difficult territory of avoision. Here it will be essential that advice is based on a thorough understanding of the token's functionality and the other circumstances of the offering, is appropriately qualified to recognise potential uncertainties and attendant risks, and that full and fair disclosures are made in connection with the ICO.

Solicitors in Hong Kong should also be cognisant of Law Society's Practice Direction P (Guidelines on Anti-Money Laundering and Counter Terrorist Financing).

The purpose of securities laws

The overarching purpose of securities laws is to regulate investments, irrespective of the form or name they assume. Accordingly, the development of securities laws and the definition of "security" were intended to be adaptable, not to create fixed and unchangeable categories. Flexibility is the foundation on which the Financial Secretary has the power under s. 392 of the SFO to specify interests, rights or property as securities.

One might point to the development of structured product regulation as a lesson in the failure of looking at how a product fits into a pre-existing set of categories, rather than considering its function in the market. A product structured as a debenture that bears no relationship to the usual commercial purposes of a debenture is a debenture in name only. Similarly, there is a risk that bisecting utility tokens into "securities" or "not securities" based on established categories fails to identify and regulate how tokens are interacting with the public capital market.

New challenges may require regulatory agencies to interpret the law with one eye firmly fixed on regulatory intent. The *Howey* test and the definition of securities in the SFO with its broadly drafted definition of CIS, both permit considerable latitude. The recent comment of the Chairman of the U.S. SEC that "by and large, the structures of ICOs that I have seen involve the offer and sale of securities and directly implicate the ... investor protection provisions of our federal securities laws" (made in his personal capacity

to the U.S. Senate Committee on Banking, Housing, and Urban Affairs, 6 February 2018) may indicate a leaning toward a broader purposive approach, but purposive approaches can present risks.

Care needs to be taken that purposive flexibility is not applied by regulators in a way that creates uncertainty. The Swiss financial regulator, FINMA, faced with an absence of ICO-specific law, issued guidelines in February 2018 on how it intends to treat ICOs under Swiss law. It may treat a utility token as a security if it functions solely or partially as an investment in economic terms. One might ask whether this could risk subjecting token issuers to ex post facto regulation because, unlike traditional markets, an issuer may not be involved in an exchange's decision to list its tokens – this will depend on the exchange's perception of demand – and it is quite possible that the listing will itself promote demand that makes the token function like an investment in economic terms. This poses a conundrum where the issuer has taken no steps to promote secondary market activity.

Returning to Abraham Lincoln, he was wrong semantically. If a tail is called a leg then it can be said that a dog has five legs. And if utility token issuances put public capital at risk, expose consumers to fraud, and behaves similarly to an investment in established classes of securities, then perhaps that is enough to render it a security within the original intent of the legislature. Practitioners call it "the smell test". Indeed, the SFO provides that "interests, rights or property ... commonly known as securities" are to be regarded as securities. On the other hand, calling a security a utility token does not change its nature. ■

ICO功能型代幣以及與證券法的關聯性

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瑞士伯拉罕林肯有一句名言，就是：假如人們將尾巴稱為腿，這不能說狗便是有五條腿。同樣地，發行人如果為其以區塊鏈作基礎的代幣進行「首次代幣發行」（initial coin offering，以下簡稱ICO），那麼不論這些代幣是以甚麼名稱來表示，它都有可能會被視作證券的一種，須受適用於一級市場及次級市場活動的證券法所監管。對於有資金需求的企業（一般是指初創企業）而言，ICO是一種新技術，改變它們以往進入公開資本市場的做法。

法律上如何處理代幣問題，許多司法管轄區對此的態度有欠明確。然而，由於ICO活動所涉及的金額，已從2013年至2016年期間的大約3億美元，激增至2017年的超過50億美元，代幣問題亦因此而日益受到關注。香港正在考慮是否有可能發展成為一個ICO中心，因此讓監管機構和市場專業人員能夠更有效地掌握和了解如何（或可以如何）對代幣進行監管，實在是至關重要。

本文將重點放在討論「功能型代幣」（utility tokens）方面。功能型代幣有別於該等有如股權或債權般運作的代幣（通過支付和表決權等方式），因為前者在法律的識別上仍然有欠明確。功能型代幣的性質，是讓代幣持有者能夠享用到代幣提供者的平台所提供的服務。因此，這基本上是等同一項預售，由該等在設法尋求資本，以發展其所承諾的服務的初創公司所提供。儘管代幣持有者的權利，與例如獲許可人、特許經營者、俱樂部會員等相類似，但功能型代幣也可能具有其他與證券相類似的特性。

監管態度

社會對ICO的監管和實際運作所抱持的態度（在並無禁止進行ICO的市場中），隨著ICO市場的發展而有所改變，並可大致分為三個階段。

在2016年底以前，ICO一般而言並不受市場所歡迎，因為它存在不實披露和欺詐等方面的風險，亦存在因資金籌集的速度與便利程度的提升所增加的風險－發行人可在數分鐘或數小時之內，募得八位數字的美元金額，而不須接受任何監管和監督。此外，交易金額的來源及其後續使用，也引起當局對清洗黑錢和恐怖主義融資的關注。

此時，人們已普遍認識到區塊鏈技術對未來經濟發展的重要性，而代幣在這方面扮演非常重要的角色，因它們在整體上促成了一個運用區塊鏈技術，從而發揮運作功能的生態系統－試想想：要是只有火車廂，但沒有建造火車軌，這些

火車廂還可以起甚麼作用？踏入2017年，監管機構所扮演的，是一個給予市場告誡的監察者角色，而不會隨意干預這領域的發展。

隨著該等代幣的發行量在2017年大幅攀升，以及美國證券交易委員會在2017年7月所發表的《21(a)報告書》，情況開始逐漸發生變化。該《21(a)報告書》所下的結論是：該等稱為"*Slock.it*"的代幣，其性質實際上是證券，儘管它並沒有以此作招徠。美國證券交易委員會（以下簡稱「美國證交會」）與香港證券及期貨事務監察委員會（以下簡稱「香港證監會」）近期主動表態，告誡發行人和市場專業人員不要只強調形式而忽視實質，將代幣構建成為一種規避法律監管的手段，企圖讓它不受保障投資者的證券法所監管，並因而對ICO採取了更嚴格的審查。

何謂「證券」？

基於上述情況，人們對功能型代幣的特質乃進行更深入的研究，以了解在甚麼情況下，它們有可能會被視作證券。

一般而言，香港的與證券發行和營銷有關的法規（例如是《公司（清盤及雜項條文）條例》（第32章）和《證券及期貨條例》（第571章）所載的條文）與最佳國際常規一致，而該等常規訂明，除非發行人遵守相關的註冊或認可規定，又或是適用相關的豁免，否則不得取用公開資本，而在性質上屬於證券的代幣，也許亦須遵守與受監管活動、交易所運作、自動交易服務等有關的法律。然而，某一特定代幣其在性質上是否屬於證券，仍需詳加對其作出審視。

《證券及期貨條例》對「證券」所下的定義，對於該等未被明確涵蓋在先前所確立的類別（例如股份或債權證類別）的代幣而言，未能起太大的參考作用。「集體投資計劃」（作為證券的其中一種）一詞的定義所涵蓋的範圍相當廣，其適用情況仍有待給予進一步的闡明，而香港現行的判例法，並未能對該兩個被界定的用詞所具的含義提供有用指引。英國金融市場法律委員會的報告書（2008年7月）確認，《2000年英國金融服務及市場法》第253條中所載的關於「集體投資計劃」的定義（其內容顯示於《證券及期貨條例》所載的定義），其含義非常廣泛，並受法律上的不明確因素所影響。英國有若干案例在某程度上，有助我們了解「集體投資計劃」一詞的含義，但關於代幣的特性為何，則未見對此有所說明。

美國對「證券」一詞的適用範圍作出了更為廣泛的探討，而ICO社群亦早已明確知悉美國最高法院在*SEC v. W.J. Howey Co.*（328 U.S. 293 1946）一案（以下稱'*Howey*案'）中所確立的測試之關聯程度。*Howey*案確認「投資合約」是《1933年證券法》所界定的其中一種證券，意思是指「一項合同、交易或計劃，任何人可透過它將資金投放於一個共同企業，並預期可單憑發起人或第三方所付出的努力而獲得收益」(*Howey, 2*)。*Howey*案是基於下述兩項原因而與這方面相關。

首項原因是，美國證交會已將*Howey*案適用於涉及代幣的情況。《21(a)報告書》首先談及*Slock.it* ICO的情況，並於最近期（2017年12月）談及「*Munchee*」ICO的情況。*Slock.it*試圖通過一個分布式自主組織 (distributed autonomous organisation) 而將第三方努力的概念移除，使其所發行的代幣不受證券法的規管，然而它的此舉並不成功。"*Munchee*"強調它的代幣可進行買賣交易，而投資者可期望通過發起人的努力，使代幣的價值上升，從而獲得收益；亦即是說，購買代幣的人可期望透過其他人的努力而獲得收益。雖然這兩個案例較為清晰，但情況並非經常如此。

第二項原因是，由於與「集體投資計劃」的定義中的元素存在相類似之處（儘管不盡相同），該定義亦與*Howey*案中的共同企業概念一致，而在當中，其他人的努力是至為關鍵的因素。「集體投資計劃」的定義所述的「目的」，可能比*Howey*案的涵蓋範圍更廣，因為「目的」可以包含期望；而且，由於*Howey*案中所述的「收益」概念，可以包含在「集體投資計劃」的定義所設想的各種回報中，當中包括來自購買、持有、管理或處置有關財產的回報。

然而，將現行法律適用於代幣，事實上是存在本質上的問題，因為區塊鏈技術促使以下各種情況產生了根本變化：獲取公開資本的便捷程度和方式、所需的成本和時間、公眾購買代幣的意願、以及進行代幣交易的便利性等各方面。此外，ICO市場（以及其所代表的新數碼經濟）是全球性的，並無任何疆界，此等情況實屬前所未有。新現實情況的出現，讓人們不能繼續以過於簡化的形式，將其與用戶許可、特許經營權、會員資格等來進行類比，而事實上一直以來，它們都並不存在於大規模和不具名的公開市場所進行的集資活動。

因此，香港的法律執業者如果須就某項擬議的代幣發行之性質，以及應該如何將其付諸實行等問題提供意見，便務須格外審慎行事。

最佳常規

如果代幣發行須受證券法的規管，而有關法例的潛在適用範圍卻存在不確定性，那麼該產業的運作亦可能會因此受到一定程度的影響。此等情況乃促使最佳常規的出現，例如：Coinbase的「區塊鏈代幣的證券法框架」（2016年12月）；香港金融科技協會發表的「代幣銷售最佳常規」（2017年12月），而它們的核心原則皆為：ICO的法律架構和監管處理都應當具透明度。

儘管當局已制定最佳常規，促進行業的自我監管，但在實際運作上，該等常規並沒有經常被遵守。正如所指出的情況那樣，發行人若試圖將代幣置於證券法的規管範圍以外，便可能會特別強調它的形式，多於它的實質內容。此舉促使美國證交會主席就代幣發行方面所運用的語義技巧和複雜建構操作，發出了措辭嚴厲的警告（2018年2月6日在美國參

議院的銀行業、住房和城市事務委員會的席前）。兩天後，香港證監會亦發出了通告，指出「ICO發行人一般會徵詢律師、會計師及顧問等市場專業人士的意見，並在他們的協助下，將所發售的加密貨幣建構為功能型代幣，藉此繞過《證券及期貨條例》的監管範圍和規避證監會的監管」（斜體字以示強調）。

法律執業者明確知悉，迴避與逃避是截然不同的兩回事。專業顧問經常會將有關的交易建構起來，使其得以迴避或盡量減輕各種可能的法律後果，而無需承擔該等須將某一事宜置於特定法律或監管審查之下的責任（不論是道德、法律，還是其他方面的責任）。這一職能，與作出專業不當行為有著明顯的差異，因為後者是建議發行人通過櫥窗粉飾，就所發行的代幣之真實性質，作出（或與他人共同作出）與事實不符的描述。此等作為屬於逃避法律規管的行徑，有可能等同於串謀欺詐。

儘管該等區分在原則上也許是明確的，但使功能型代幣會被視為證券的該等特徵，卻並非如此清晰明確。假如當中存在灰色地帶，那麼顧問所提供的意見，便也許會陷入迴避與逃避之間 (avoision) 的困難境地。這兒最重要的一點是，顧問所提供的意見，必須建基於對該代幣的功能，以及對該發行所涉及的其他情況具有透徹的了解；具備適當的資格來識別潛在的不確定性和當中伴隨的風險；並且針對有關的ICO作出全面和公平的信息披露。

此外，香港的律師亦須充分明瞭香港律師會所發出的《實務指示P》（《打擊洗錢及恐怖分子資金籌集指引》）。

證券法的目的

證券法的首要目的，是對各項投資進行監管，不論該等投資是以甚麼形式或名稱來呈現。因此，證券法的發展以及對「證券」所下的定義，必須對環境的轉變具有適應能力，從而不致囿於各個固定和不可變更的類別中。故此，靈活性是其基礎，而財政司司長在這一基礎上，有權根據《證券及期貨條例》第392條指明權益、權利或財產為證券。

有人或會指出，結構性產品監管的加強，是由於業界未能正視如何將產品適當地置於先前確立的各個類別中（即並非只考慮該產品在市場上的功能），而從中吸取的一個教訓。一項被建構成為債權證的產品，如果其本身與債權證的一般商業目的並無任何關連，那麼它只能說是名義上的債權證。同樣地，假如根據既定的類別而將功能型代幣區分為「證券」或「非證券」，那麼當中所存在的風險將會是：它可能對於該等代幣與公開資本市場如何進行互動，無法作出識別和監管。

基於現時所面臨的各種新挑戰，監管機構在解釋有關法例時，可能需要將部分注意力牢牢地放在監管機構的意圖上。*Howey* 案中的測試與《證券及期貨條例》對證券所下的定義，連同法例給「集體投資計劃」一詞所下的寬泛定義，均顯示法例允許享有相當的自由度。美國證交會主席近期發表評論稱：「大體而言，我所見到的ICO結構都涉及證券的發行和銷售，並直接涉及……美國聯邦證券法的投資者保障條款」（該等評論是他以個人身份，於2018年2月6日向美國參議院的銀行業、住房和城市事務委員會作出），這也許顯示，美國現時傾向採納一個範圍更廣，並且以目的為本的做法。然而，以目的為本的做法亦有可能會帶來風險。

需要注意的是，監管機構所採取的該等以目的為本的靈活做法，並不會因此帶來不確定性。瑞士的金融監管機構FINMA面對本國缺乏ICO方面的法律，遂於2018年2月發出了相關指引，就其擬如何根據瑞士法律來處理ICO作出了相關說明。如果其所發揮的功能，是完全或部分地有如在經濟上的一種投資，則該機構可能會將該功能型代幣視為一種證券。有人可能會問，此舉是否會導致代幣發行人須面對事後的監管，因為此等發行有別於傳統市場的做法，而有關的發行人也許並無機會參與交易所批准其代幣上市的決定－這將會取決於該交易所對需求的認知－而相當可能出現的情況是，該項上市本身會促進需求，而此等需求會促使該等代幣發揮有如經濟上的投資功能。如果發行人並沒有採取適當措施，促進在次級市場方面的活動，這將會導致複雜問題的出現。

現在回到亞伯拉罕林肯於上面所說的一番話。林肯的說法，可以說是在語義上犯錯。如果我們將尾巴稱為腿，那麼我們的確可以說：狗有五條腿。如果發行功能型代幣，會導致公開資本被置於風險之下，消費者可能會面對欺詐風險，而該等代幣的表現，如果又與已確立的證券類別中的投資項目相類似，這也許足以使該等代幣發行，等同於立法機構原來所指的證券。對此，法律執業者稱之為「嗅覺檢定法」。事實上，《證券及期貨條例》訂明：「通常被稱為證券的權益、權利或財產」，將被視為證券；而另一方面，即使我們將證券稱為功能型代幣，這亦不會改變其原來性質。 ■