BLOCKING THE CHAIN: REGULATING THE INITIAL COIN OFFERING

Alexander Fong*

I. INTRODUCTION

TODAY, the issuance of equity and debt securities are governed by regulatory regimes which aim to promote freedom of information and are designed to sift out fraudulent activity, for the purposes of ensuring financial stability, market efficiency and investor protection.[1] Regulatory systems which fail to inhibit fraudulent behaviour have done so to their detriment.[2]

A. A HISTORY OF FINANCE

In A.D. 424, a man named Ochus was summoned by his half-brother, King Sogdianus, to the Persian capital of Susa. The new king wished to consolidate his power, so the purpose of the summons was manifest: fratricide. Ochus lived comfortably in Babylon, enjoying the company and support of wealthy landowners. Ochus' backers knew that standing with a future king might favour their fortunes, yet their investment in Ochus required that they stomach a substantial amount of risk. Asset-rich but cash-poor, they collectively mortgaged substantial portions of land to a clan of financiers—the Murašu family—and hired a private army. With their help, Ochus marched to Susa, killed his brother, and took the throne as King Darius II. Bereft of aid and forgotten by the

* B.A. (Law) (*Cantab*) (Candidate). I would like to thank Astron Douglas for his support and Alessandro Forzani for feedback on an earlier draft. Gratitude to the editors of *De Lege Feranda* cannot be understated. All errors are mine.

1 See, generally: Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, OUP 2014). For specific comment on the objectives of financial markets regulation, 48ff.

2 Bernard Black, 'The Legal and Institutional Preconditions for Strong Securities Markets (2001) 48 UCLA LR 781.

usurper, many of Ochus' backers defaulted on their mortgage payments and went into foreclosure. Darius II had left them behind.[3]

The arrangement between Ochus' backers and the Murašu clan must seem familiar to the modern eye.[4] In this case, Ochus was a mere beneficiary. His backers were issuers of the asset, and the Murašu clan their investors. Then, such acts of financing were unregulated, or at least not in the sense we understand it today. No structure existed to regulate the disclosure of risks of complex debt obligations,[5] and so whether the Murašu clan were aware of precisely the enterprise which Ochus undertook remain a mystery.[6]

B. Structure of analysis

The rapid development and application of blockchain technology has created a realm of both unparalleled innovation and incalculable risk,[7] not least in the form of Initial Coin Offerings (ICOs) as a form of financing. Regulation has taken some shape, among others in the form of anti-money-laundering controls,[8] and different jurisdictions have adopted different approaches in the service of ensuring financial stability and investor protection. We will consider regulation chiefly in the context of the UK, but compare where necessary the effect of regulation in other jurisdictions.

In this paper, I first set out the main objectives of financial regulation as it exists in the UK,[9] and the key regulatory requirements relating to corporate governance and disclosure.[10] I then consider the procedural problems arising out of superimposition of pre-existing securities regulation onto ICOs (the "recycle approach").[11] I argue that this may (a) produce over regulation; (b) produce legal uncertainty by allowing regulatory authorities the discretion to under- or over-regulate; or (c) lead to over-complication in the regulatory framework and practical uncertainty.[12] Finally, I consider the substantive problems in equating ICOs with other investment products,

[3] William N. Goetzmann, *Money Changes Everything: How Finance Made Civilisation Possible* (Princeton 2016) 64.
[4] Michael Simkovic, 'Competition and Crisis in Mortgage Securitization' (2013) Indiana LJ 88, 213.
[5] Black (n 2).
[6] For the effect that imperial policy had on encouraging risk, see: Tenney Frank, 'The Financial Crisis of 33 AD' (1935) 56(4) American Journal of Philology 336.
[7] Clare Dickinson, 'US exchange giant launches cryptocurrency data feed' *Financial News* (London, 18 January 2018).
[8] Council Directive (EU) 2018/843 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing [2018] OJ L 156/43.
[9] See below, II.B.
[10] See below, II.C.
[11] See below, III.
[12] See, below, III.A–III.C.

especially securities.[13] I argue that there is merit in producing bespoke ICO regulations which acknowledge ICOs as a unique class of products (the "bespoke approach").[14] This approach does not envision the creation of regulatory mechanisms alien to the law as it stands. It merely proposes a consolidation of certain key mechanisms which ICO promoters should comply with, namely the implementation of a) rules relating to corporate governance through a scheme of registration, and b) mandatory prospectus requirements. These measures would better contribute to the fulfilment of the Financial Conduct Authority's (FCA) objectives, reduce the legal uncertainty attaching to the superimposition of securities regulation, and allow blockchain technology to thrive.

II. Financial Regulation in the UK

A. Background

It suffices to note briefly that the regulatory regime in the UK has, understandably, undergone quite significant a metamorphosis from the enactment of the Financial Services Act 1986 (FS Act 1986) to the post-2008 reforms which have led to the regulatory regime today.[15] The general trend of regulation has been, after 2008, toward increasing interventionism.[16]

The UK has two primary regulatory bodies. The Prudential Regulatory Authority (PRA) deals primarily—though not exclusively—with prudential regulation and the maintenance of capital and liquidity requirements. The functions of supervision of conduct and enforcement of specific rules relating to financial activity and assets are divested into another body. In this respect, the Financial Services Authority (FSA) was known for its adoption of a "principle-based regulation" approach to supervising such conduct.[17] This approach rewarded firms which exhibited a "high degree of cooperation… with the FSA supervisors",[18] by providing them with

[13] See below, IV.

[14] See below, IV.C.

[15] For a comprehensive overview of the evolution of the regulatory regime in the UK, see Julia Black, 'Regulatory Styles & Supervisory Strategies' in Niamh Moloney, Ellis Ferran and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* (OUP 2015).

[16] ibid 238f.

[17] ibid 230f.

[18] Financial Services Authority, *The Failure of the Royal Bank of Scotland* (Board Report 2011) 242.

regulatory "holidays" in the form of, *inter alia*, fewer risk assessments.[19] However, the UK's current approach as the Financial *Conduct* Authority[20] has been one of more intense scrutiny.[21]

B. OBJECTIVES OF REGULATION

In light of this background, the objectives of financial regulation, as set out by the FCA in a 2017 Discussion Paper, are: (a) the protection of investors; (b) the protection of financial markets; and (c) the promotion of competition.[22] All three are mirrored in Section 1 of the Financial Services and Markets Act 2000 (FSMA) as the *consumer protection objective*, the *integrity* objective, and the *competition* objective respectively.[23]

(i) The Consumer Protection Objective

According to Section 1C(1) of the FSMA,[24] the consumer protection objective is defined as 'securing an appropriate degree of protection for consumers.'[25] Section 1C(2) then considers the factors the FCA must have regard to in considering what is "appropriate": *inter alia*, the degrees of risk in investing,[26] the differing expertise[27] and expectations of investors,[28] general principles of investor responsibility on one hand,[29] and issuer responsibility on the other.[30]

The manner in which the consumer protection objective is drafted underscores the inimitable role financial regulation plays in correcting asymmetries of information between investors in, and issuers of, investment products.[31] This particular objective is salient in relation to ICOs, primarily because most investors in speculative ICOs are members of the public-at-large.[32]

[19] For a comprehensive self-assessment undertaken by the FSA in 2009, after the 2008 crisis, see generally: Financial Services Authority, 'The Turner Review: A regulatory response to the global banking crisis' (Review 2009).
[20] The FSA was abolished by the Financial Services Act 2012 and replaced by the FCA and the Prudential Regulation Authority of the Bank of England.
[21] Black (n 15) 239.
[22] Financial Conduct Authority, Distributed Ledger Technology: Discussion Paper on distributed ledger technology (Discussion Paper, DP17/03 2017).
[23] Financial Services Act 2012, Pt 1A, Ch. 1B–1E.
[24] As amended by the Financial Services Act 2012.
[25] Financial Services and Markets Act 2000, as amended by the Financial Services Act 2012, s 1C(1).
[26] ibid s 1C(2)(a).
[27] ibid s 1C(2)(b).
[28] ibid s 1C(2)(f).
[29] ibid s 1C(2)(d).
[30] ibid s 1C(2)(e).
[31] ibid s 1C(2)(c).
[32] Thus benefitting from Council Directive 2004/39/EC on markets in financial instruments [2004] OJ L 145/1.

(ii) The Integrity Objective

Section 1D(1) of the FSMA defines the integrity objective as "protecting and enhancing the integrity of the UK financial system".[33] The word "integrity" is defined by s 1D(2) which reads: (2) The "integrity" of the UK financial system includes—(a) its soundness, stability and resilience, (b) its not being used for a purpose connected with financial crime, (c) its not being affected by behaviour which amounts to market abuse, (d) the orderly operation of the financial markets, and the transparency of the price formation process in those markets.

The market for ICOs has proven a hotbed for frustrated investors.[34] In November 2017, a "smart contract" technology firm called Confido carried out an ICO to raise funds in the service of its blockchain. It managed to raise nearly USD $375,000, before the firm, and all traces of it, disappeared.[35] The ICO tokens were traded on certain online venues, most notably TokenLot, which could do naught but notify the authorities in the aftermath. The case of Confido shows how regulations which are not targeted towards the prevention of financial crime or market abuse, *per* the integrity objective as set out in the FSMA, might fail to preserve the integrity of a financial market.

(iii) The Competition Objective

This objective raises issues of competition law which lie outside the scope of this article. The precise achievement of this objective, therefore, will not be analysed in relation to the regulatory mechanisms purporting to govern ICOs.

[33] Financial Services and Markets Act 2000, s 1D(1), as amended by the Financial Services Act 2012.
[34] Saheli Roy Choudhury, 'Many ICOs are fraudulent, say men behind two top bitcoin rivals' *CNBC* (New Jersey, 17 November 2017), <https://www.cnbc.com/2017/11/17/many-icos-are-fraud-according-to-ethereum-co-founder-and-ripple-ceo.html> accessed 22 January 2018; see also: Nikhilesh De, 'New Class-Action Suit Filed Against Tezos Founders' (Coindesk, 18 December 2017), <https://www.coindesk.com/new-class-action-suit-filed-tezos-founders/> accessed 22 January 2018.
[35] Arjun Kharpal, 'Cryptocurrency start-up Confido disappears with $375,000 from an ICO, and nobody can find the founders' *CNBC* (New Jersey, 21 November 2017), <https://www.cnbc.com/2017/11/21/confido-ico-exit-scam-founders-run-away-with-375k.html> accessed 23 January 2018.

C. MECHANISMS OF REGULATION

Issuers and investors in the UK are, at least in theory, subject to the regime created primarily by the FSMA and its corresponding amendments,[36] the 2005 Prospectus Regulations (PR 2005),[37] and the FCA's Handbook.[38] The final mechanism contains an assortment of rules which relate to disclosure guidance and transparency requirements, as well as rules relating to venues for the trading of assets.

We will chiefly consider how (a) listing requirements; and (b) mandatory disclosure requirements, aid in the fulfilment of the consumer protection objective and integrity objective.

(i) Listing Requirements

The regime of rules relating to securities' and investments extend past the regulation of the assets themselves,[39] to the regulation of the venues at which such assets are traded.[40]

To ensure the efficacy of these rules and regulations, ICO promoters must be identifiable and accountable to investors.[41] This is because the regime of corporate governance regulation works to the benefit of the consumer if issuers and promoters are responsible per s 1C(2)(e) FSMA.[42] It works to the benefit of the market if financial crime is not only *attributable to an individual* but *prosecutable* according to s 1D(2) FSMA.[43]

Yet it appears from the outset that the most onerous of listing requirements relating to offerings of securities will not apply to the majority of ICOs. First, ICOs rarely, if ever, are admitted for trading on regulated markets such as the London Stock Exchange (LSE). Such an admission might distinguish the ICO as a high-quality investment product, but it would not be in

[36] See, generally: Financial Services Act 2012.

[37] Financial Services and Markets: The Prospectus Regulations 2004, SI 2005/1433, enacted pursuant to Council Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L 345/64.

[38] The regulatory environment in the UK must also be appreciated amidst the EU's wider regulatory regime. See Council Directive 2004/109/EC on the harmonisation of transparency requirements [2004] OJ L 390/38 (the "Transparency Directive"), Council Directive 2011/61/EU on Alternative Investment Fund Managers [2011] OJ L 174/1; and Council Directive (EU) 2015/849 on money laundering or terrorist financing [2015] OJ L 141/73, the Council Regulation (EU) 596/2014 on market abuse (market abuse regulation) [2014] OJ L 173/1.

[39] See the definition of a 'specified investment', Article 76 of the Regulated Activities Order 2000.

[40] For an overview of the framework, see, generally: Barber & Allen, The ICSA Corporate Governance Handbook (4th ed) (ICSA Publishing Ltd 2007).

[41] For discussion on issues relating to the novel issues of accountability presented by ICOs, see Chohan, 'Initial Coin Offerings (ICOs): Risks, Regulation, and Accountability' in *Discussion Paper Series: Notes on the 21st Century* (UNSW 2017)

[42] As amended by the Financial Services Act 2012.

[43] As amended by the Financial Services Act 2012.

the ICO promoter's interest to do so voluntarily; compliance with these conditions are time-consuming and expensive.[44] ICOs trade, by and large, through online exchanges such as TokenLot, which describes itself as an ICO "superstore".[45] Although it is common for such exchanges to conduct "Know-Your-Customer" disclosures,[46] such measures fall short of ensuring that ICO promoters are held fully accountable, as they would be if admitted to the LSE, for the process and product of their ICOs. Reference to the Confido scam suffices to make this point.[47]

(ii) Disclosure Requirements

The imposition of disclosure requirements is generally conceded to benefit both investors and issuers.[48] A key component of the disclosure regime relates to the publishing of a prospectus relating to the financial instrument–or security, as the case may be–being offered to the public, and this mechanism is governed by FSMA, s 85(1). If ICO promoters are subject to a disclosure regime, the consumer protection objective is achieved when investors are able to, by consulting the document issued by the ICO promoter, according to s 87A of the FSMA, "make an informed assessment of (a) the assets and liabilities, financial position, profits and losses, and prospects of the [promoter]… and (b) the rights attaching to the transferable [assets]".[49] In the vein of accountability and in the service of the integrity objective, the details of the promoter must also be disclosed, together with a detailed assessment of the tokens to be offered.[50]

The provision of a disclosure document in the form of a prospectus also offers consumers *evidential* protection through the law. A prospectus, reduced to its core, is a series of representations made by the company regarding the product it offers, upon which investors rely in making a decision. Although, strictly speaking, there is a distinction between misrepresentation and prospectus liability, what in effect occurs remains a misrepresentation which the law is actively seized against through s 90 FSMA,[51] which allows investors to make a claim in respect of an error

[44] For more on 'signalling' and the hypothesis on 'lemons', see, generally: George Akerlof, 'Market for lemons: Quantitative Uncertainty and the Market Mechanism' (1970) 222 Quarterly Journal of Economics 488.
[45] TokenLot <https://www.tokenlot.com> accessed 5 February 2018.
[46] ibid, see also 'Singapore MAS-licensed P2P lender Crowd Genie launches ICO' *Digital News Asia* (Malaysia, 4 February 2018) <https://www.digitalnewsasia.com/business/singapore-mas-licensed-p2p-lender-crowd-genie-launches-ico> accessed 5 February 2018.
[47] See above, II.B.(ii)
[48] For a discussion which concludes the contrary see Omri Ben-Shahar and Carl Schneider, 'The Failure of Mandated Disclosure' (2011) 159 University of Pennsylvania Law Review 647.
[49] In relation to issuers and securities, see Financial Services and Markets Act 2000 s 87A(2).
[50] See below, IV.B, 'A unique class of product'.
[51] A stance which has been held for centuries; see *Derry v Peek* (1889) 14 App Cas 337.

on the prospectus which distorts the market price. The importance of this section is that, although some reliance must be shown, reliance on the prospectus itself need not be proven. In effect, the statute enables actions to be brought to preserve the "soundness, stability and resilience" of the market; in other words, its *integrity*.[52]

A prospectus may also play a part in 'signalling' that the security is being offered by a reputable promoter.[53] The process of compiling a prospectus often requires consultation of analysts, auditors and other financial intermediaries known as "gatekeepers".[54] The function of these intermediaries is meted out: as an impartial third party, an auditor has little incentive to misinform potential investors in the product which they find themselves auditing.[55]

Currently, it is customary for ICO promoters to issue a "white-paper" which sets out the complexities of its product and its operation and application of blockchain technology.[56] But such a paper would not be in compliance with traditional prospectus requirements, which prioritise ease of reading and accessibility to investors.[57]

III. PROCEDURAL PROBLEMS OF THE 'RECYCLE APPROACH'

Having briefly disposed of the objectives which underpin financial regulation in the UK, and the various regulatory mechanisms which exist, the efficacy of these mechanisms in achieving these objectives in relation to ICOs falls to be considered. The "recycle approach" entails the application of pre-existing securities regulation to ICOs. But the procedural mechanism–namely, the use of the definition of 'security'–which determines whether or not ICOs fall within these regimes, I argue, is deficient. I compare the approaches of the US and Singapore to that of the UK, and argue that not all ICOs are so capable of such conclusive definitions.

[52] Financial Services and Markets Act 2000 s 1D(2)(a), as amended by the Financial Services Act 2012.
[53] Akerlof (n 44).
[54] Jennifer Payne, 'The Role of Gatekeepers' in Moloney, Ferran and Payne (n 15).
[55] Zohar Goshen and Gideon Parchomovsky, 'The Essential Role of Securities Regulation' (2006) 55 Duke LJ 711, 711.
[56] See, below, the discussion of the Decentralised Autonomous Organization in III.A: Danger of over-regulation–the United States.
[57] Prospectus Directive art 5(1), as implemented by Financial Services and Markets Act 2000 s 87A(3).

A. DANGER OF OVER-REGULATION – THE UNITED STATES

In 2016, Christoph and Simon Jentzsch wrote a code for an enterprise called the Decentralised Autonomous Organization (DAO).[58] The code was scripted to allocate investor capital to experimental digital technology. Investors obtained rights to vote on the technology they wanted by buying DAO tokens in an ICO, in other words, "investing" in the DAO.[59]

The fund raised approximately USD$150 million worth of the cryptocurrency Ethereum, after which the code was attacked by an unknown entity.[60] Approximately USD$50 million was directed to a subsidiary account.[61] The episode prompted a regulatory scramble by the Securities and Exchange Commission (SEC), its findings culminating in the release of an investigative report.[62] The SEC Report stated that certain ICOs would be subject to securities regulation on a case-by-case basis "depending on the particular facts and circumstances, without regard to the form of the organization or technology used to effectuate a particular offer or sale".[63] The finding was based on a factual application of securities laws to DAO tokens. It was made on the grounds that investors in the DAO "[invested] money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others".[64]

The SEC's approach proves ineffective because of the overtly broad nature of its securities regulations. The *Howey* test–or US securities regulation in general[65]–provides a 'catch-all' form of regulation which cuts into the innovation so important to the block-chain space. There is much to be said for protecting investors from a legal perspective[66] and an economic one,[67] but there is also a balance to be struck with the need to preserve the vibrancy of the market.

[58] Richard Waters, 'Automated company raises equivalent of $120m in digital currency' *CNBC* (New Jersey, 17 May 2016) <https://www.cnbc.com/2016/05/17/automated-company-raises-equivalent-of-120-million-in-digital-currency.html> accessed 5 February 2018.
[59] Although these voting rights were limited, see the United States (US) Securities Exchange Commission, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The DAO (Release No. 81207, 25 July 2017) (the SEC report).
[60] See, generally: ibid.
[61] Investors were made whole by the 'forking' of the Ethereum blockchain, which had tremendous ramifications on holders of the cryptocurrency Ethereum as a whole: see Rachel O'Leary, 'Upgrade Complete? Ethereum's New Software Isn't Quite Stable Yet' (Coindesk, 18 October 2017), <https://www.coindesk.com/update-complete-no-ethereums-new-software-isnt-stable-just-yet/> accessed 22 January 2018.
[62] The SEC Report (n 59).
[63] ibid 10.
[64] ibid 11ff, per the US Securities Act s 2(a)(1) and the US Exchange Act s 3(a)(10). Also see the 'Howey' test for what concerns a security: *Securities and Exchange Commission v W J Howey Co* (1946) 328 US 293.
[65] Per the US Securities Act s 2(a)(1) and the US Exchange Act s 3(a)(10).
[66] William Douglas, 'Protecting the Investor' (1934) 23 Yale LJ 521.
[67] Roberta Romano, 'Empowering Investors: A Market Approach to Securities Regulation' (1998) 107 Yale LJ 2359.

B. TOO MUCH DISCRETION – SINGAPORE

In November 2017, the Monetary Authority of Singapore (MAS) published a guide stating that "if a digital token constitutes a product regulated under the securities laws administered by MAS, the offer or issue of digital tokens must comply with the applicable securities laws".[68]

But although such a statement might *prima facie* appear quite similar to the approach taken by the SEC, no 'witch-hunt' of the sort undertaken in the USA has been carried out in Singapore. This is despite the regulation of "collective investment schemes", a definitional category ostensibly capable of being encompass all ICOs.[69]

What does this suggest? I propose that it exposes another problem with relying on definition as the controlling mechanism for regulating ICOs: unfettered discretion and legal uncertainty.

It is true that case studies offered by the MAS Guide contemplate cases in which ICOs will not fall under the regulatory regime under the SFA. But the odds of these cases proving problematic in real-life scenarios are slim. The following is one such case: Company A plans to set up a platform to enable sharing and rental of computing power amongst the users of the platform. Company A intends to offer digital tokens (hereinafter, "Token A") in Singapore to raise funds to develop the platform. Token A will give token holders access rights to use Company A's platform. The token can be used to pay for renting computing power provided by other platform users. Token A will not have any other rights or functions attached to it.[70]

In such an example, it is hard to see what the value is in embodying access rights in a digital token. Access rights are customarily restricted on online webpages by registration fees. Further, the use of the token in payment for 'renting computer power' appears to resemble more a credit for use on an online site–the type of which is already existent.[71] It is difficult to countenance that such a case study would apply to a more than negligible number of ICO companies.

It may be said that the MAS may ultimately hesitate to apply the regulatory regime too wantonly and oppressively as a matter of public policy.[72] But although it may serve an adequate *ex post* measure to allow innovation, this kind of 'discretionary' regulation does little to alleviate worries of legal uncertainty, especially in a market already so dynamic and volatile.

[68] Monetary Authority of Singapore, A Guide to Digital Token Offerings (2017) (the MAS Guide) 2ff.
[69] Securities and Futures Act 2001 (SFA) s 2(1).
[70] MAS Guide (n 69) 8.
[71] For example, 'Amazon Reward Points' obtained for utilising an Amazon credit card, see: Amazon Platinum Mastercard, <amazon.co.uk/gp/cobrandcard/marketing.html> accessed 22 January 2018.
[72] Jamie Lee, 'Singapore embraces FinTech to stay ahead' *Business Times* (Singapore, 13 November 2017).

C. UNDER-REGULATION, OVER-COMPLICATION–UNITED KINGDOM

In April 2017, the FCA released a discussion paper[73] which focused on the innovation and corresponding risks of adopting "distributed ledger technology" (DLT). In September 2017, the FCA released a consumer alert on ICOs and emphasised the highly speculative nature of the investment, and the lack of regulatory coverage for investors.[74] It specifically stated that most ICOs would not fall *within* the regulatory framework which governed securities, but those which did would be regulated as such.[75] It followed that those falling *without*, would unfortunately leave their investors bereft of a claim s 90 of the FSMA.

The FCA's Feedback Statement[76] was a novel opportunity to go further, and to propose bespoke regulations with regard to ICOs, but it proposed a recycle approach which injected even more uncertainty in relation to the classification of ICO tokens. The FCA considered a class of ICO tokens which might *not* amount to 'specified investment[s]'[77] subject to requirements under the FCA Handbook's Conduct of Business Sourcebook (COBS) and the FCA's Principles for Business.[78] These requirements take the form of lighter regulations concerning corporate governance and other governance strategies.[79] It then reiterated its position regarding the classification of certain ICOs as 'transferable securities' within the meaning of the Markets in Financial Instruments Directive (MiFID) II[80] and the prospectus requirements which follow. The stratification of these different regulatory classifications—ICO tokens as securities, "regulated activities", and "specified investments"—introduces scope for even more definitional difficulties for ICO promoters, not least for the FCA itself.

This is not to say that such a regime would be incapable of regulating ICOs—under or over-regulation are still forms of regulation. But it does mean that the FCA, like the MAS, has much discretion, sometimes very arbitrary discretion, in relation to which ICOs it regulates.

[73] FCA Discussion Paper (n 22).

[74] Financial Conduct Authority, 'Consumer warning about the risks of Initial Coin Offerings (ICOs)' (Financial Conduct Authority, 12 September 2017) <https://www.fca.org.uk/news/statements/initial-coin-offerings> accessed 22 January 2018.

[75] ibid.

[76] Financial Conduct Authority, Distributed Ledger Technology: Feedback Statement on Discussion Paper 17/03 (Feedback Statement, FS17/04 2018), 28f.

[77] ibid 2.

[78] ibid 3.

[79] See, above, II.C.(i).

[80] Council Directive 2014/65/EU on markets in financial instruments [2014] OJ L 173/349, effective 2018.

IV. Substantive Problems and The 'Bespoke Approach'

A. Fact-dependence and subjectivity

The problems found in Part III, with regard to the *manner* in which ICOs have been regulated, stem almost completely from the difference in *substance* between ICOs and securities. What precisely constitutes an ICO token is a matter of immense subjectivity. ICO tokens are digital assets which confer on investors certain rights which may be enforced. Depending on the ICO and the objectives of each issuer, these rights may differ. They may confer voting rights in respect of a distributed ledger network,[81] or they may confer rights to acquire the issuer's cryptocurrency at a later date. But because ICO tokens as a class of products vary so greatly in the manner in which they are constituted—and the purpose for which they are envisioned to be used–they cannot be properly equated with securities in all instances.

B. A unique class of product

There must be some merit in calling a spade a spade. First, the definition of a security, which determines which products fall within the regulatory regime in the first place, does not survive an application to ICOs, which may differ greatly in how they are constituted. But although the current law may find that a BAT token does indeed constitute a security, or at least a 'specified investment' under the RAO 2001, it also offers tremendous latitude for a finding to the contrary. I submit that there is no reason this should be the case. There is nothing intrinsically different about the BAT ICO insofar as its proceeds provided the resources with which to finance the running of the platform.[82] The recycle approach provides a false sense of assurance that regulation exists, while failing to offer a principled basis upon which regulation is based. It is true that the FCA has not stated categorically that utility tokens would not be subject to at least some form of regulation.[83] But as we have seen, without the requirement of a prospectus, or with piecemeal regulation relating to the corporate governance of the ICO promoter, no concrete assessment of the token, whether

[81] SEC Report (n 59) 13f.

[82] The BAT ICO raised USD $ 35 million in 30 seconds: Ameer Rosic, "ICO Pros & Cons: Cutting through the Noise" *Huffington Post* (New York, 2 June 2017).

[83] Specifically, Art. 4.1.44 MiFID II: 'transferable securities' are classes of securities which are negotiable on the capital market, such as: "(a) shares in companies and other securities equivalent to shares… (b) bonds or other forms of securitised debt… (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities [inter alia]."

it be utility or asset-backed, exists for the investor to make an informed decision regarding her investment.[84]

C. THE BESPOKE APPROACH

I argue that the preferred mechanism for reform would be through the implementation of ICO-specific rules in the FCA Handbook. In particular, the following regulations should be considered.

(i) A Scheme of Registration

I argue first that all ICOs promoters should be registered with the FCA, and all registered promoters should be subject to the listing requirements found in the Listing Rules (LR) of the FCA's Handbook.[85] ICO promoters should be incorporated,[86] and should furnish details of the details of their company and directors. Such a requirement would give body to the FCA's language of 'authorisation' in their Feedback Statement[87] and would be tremendously effective in ensuring accountability and the fulfilment of the consumer protection objective and integrity objective.

(ii) Incorporating a Definitional Test

Of course, requiring ICO promoters to register with the FCA merely shifts the definitional question forward; which promoters will be required to register, and how will they know that they must do so? It is the author's view that the answer should focus on the subjective intentions of the promoters, and the manner in which the digital token is meant to be used in the promoters' entrepreneurial activities.

Accordingly, I argue that the following test be adopted: a digital token should be regulated if, in selling the relevant digital token: (a) the promoter intends to confer rights in favour of investors; (b) the promoter intends to induce investors' reliance; and (c) the promoter purports to affect the value of the digital token by way of his managerial efforts.

It will be immediately apparent that the above test incorporates elements of the *Howey* test, but does away with the legal fiction that such assets are necessarily securities. Instead, it focuses

[84] For the relationship between legal regulation and economics, see, generally: Anthony I. Ogus, *Regulation: Legal Forms and Economic Theory* (Hart Publishing 2004).
[85] Specifically, Listing Rules 1–3.
[86] Listing Rules R 2.2.1.
[87] FCA Feedback Statement (n 76) Annex 1, para 2.

on the subjective intention of the promoter, which, if made out, establishes a justifiable ground for sanction.

(iii) Mandatory Disclosure Requirements

Perhaps more controversially, I argue that all ICOs be subject to mandatory disclosure requirements in the form of the release of a prospectus. It suffices briefly to reiterate the main benefits of imposing disclosure requirements onto ICO promoters. The first relates to the benefit derived by investors. In accordance with the consumer protection objective and integrity objective as articulated by the FCA,[88] the imposition of disclosure requirements would be instrumental in ensuring that investors receive the information they require to make informed decisions regarding their investments.[89] Second, it allows them a concrete document on which they can rely, and on which they might advance a private claim arising out of the negligent[90] or fraudulent misrepresentation resulting therefrom.[91] Third, the benefit to the ICO promoter is that a disclosure document signals the quality of the product, if compiled with reputable gatekeepers, and creates an incentive for the ICO promoter to disclose accurate information.[92]

It is important, however, to be aware that too onerous a set of disclosure requirements might prove to be counter-productive and might stifle innovation in blockchain technology.[93] But I contend that in the realm of such nascent technology, it pays to be cautious. The imposition of disclosure requirements may result in a marked decrease in the amount of ICOs from the time of its implementation, but such a decrease may perhaps be attributable to a decrease in the number of *fraudulent* ICOs, as opposed to indicating stifled innovation.

[88] See above, II.B.
[89] Ogus (n 84).
[90] The law on negligent misstatements is found in *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.
[91] Governed by the MAR, the Criminal Justice Act 1993, and the Insolvency Act 1986. For the law on misrepresentation consult Derry v Peek, n 52; and for excellent and exhaustive treatment of the subject in the law of contract: Neil Andrews, Contract Law (CUP, 2nd edn, 2015), 218ff.
[92] Akerlof (n 44).
[93] Ben-Shahar and Schneider (n 48).

IV. CONCLUSION

I have argued that ICO tokens represent a unique class of products which is incapable of being defined with the language in respect of securities. Concomitantly, I have proposed that a discrete set of regulations be enacted to deal directly with ICOs, which in my assessment will add uniformity, clarity and certainty to this developing area of law. Such regulation necessarily comes at the cost of inhibiting some degree of innovation–but I hold still that it serves more to constrain fraudulent activity, primarily because of the high incidence of fraud which exists in the current ICO market.

But whether one decides to recycle the cloth of regulation or tailor it bespoke is perhaps a question which suits the lawyer alone. For the rest of the world it remains apparent that the end of the initial coin offering lies far over the wine-dark sea.[94]

[94] Homeric epithet. A.T. Murray (trs), *Homer, The Odyssey* (Heinemann 1919) book 1, line 180: "And now have I put in here, as thou seest, with ship and crew, while sailing over the wine-dark sea to men of strange speech, on my way to Temese for copper. And I bear with me shining iron."