

# **THE SPAGHETTI EFFECT OF ICO REGULATIONS: AN INTRODUCTION TO THE DEVELOPING REGULATORY FRAMEWORKS OF INITIAL COIN OFFERINGS AROUND THE WORLD**

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## **INTRODUCTION**

This Commentary provides an overview of initial coin offerings (ICOs) regulations. First, it addresses the definitional challenge caused by the rapid development of the crypto-industry and different terms used by regulators. Secondly, it compares ICOs to initial public offerings (IPOs), and explains some of the benefits and harms of ICOs. Finally, it charts a spectrum of ICO regulation in different jurisdictions that moves from a complete ban to experimental “sand-box” regimes. This Commentary aims to help all players, including issuers, investors and consumers, and regulators in the crypto-industry better understand the interwinding ICO regulations as well as risk and opportunities.

### **I. THE DEFINITIONAL CHALLENGE OF INITIAL COIN OFFERINGS**

There are many factors that make it difficult to draft and understand regulations on crypto-assets. This Commentary will focus on one in particular: the lack of clear terminology regarding crypto-assets across regulating bodies, particularly as it relates to initial coin offerings (ICOs). Without common terms, academic studies and government regulations risk being inefficient and confusing.<sup>1</sup> Regulators and the public face uncertainty not just for the future of the crypto innovations, but also for the consequences triggered by violating statutes and regulations pertaining to the industry.<sup>2</sup>

Take for example the term for virtual tokens: the chart below shows how inconsistent verbiage across regulatory agencies can be.<sup>3</sup>

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<sup>1</sup> See Blandin, *infra* note 3, at 34–35.

<sup>2</sup> See IMF, Fintech: The Experience So Far, Policy Paper No. 19/024 at 28 (Jun. 27, 2019) (“These initiatives illustrate that key to crafting legal rules that provide legal clarity . . . is effective and ongoing dialogue between national authorities and a diversity of stakeholders”) [hereinafter IMF Fintech Policy Paper].

<sup>3</sup> See Apolline Blandin, et al., The Global Cryptoasset Regulatory Landscape Study, U. Cambridge Faculty Res. Paper No. 23/2019, 34–36.

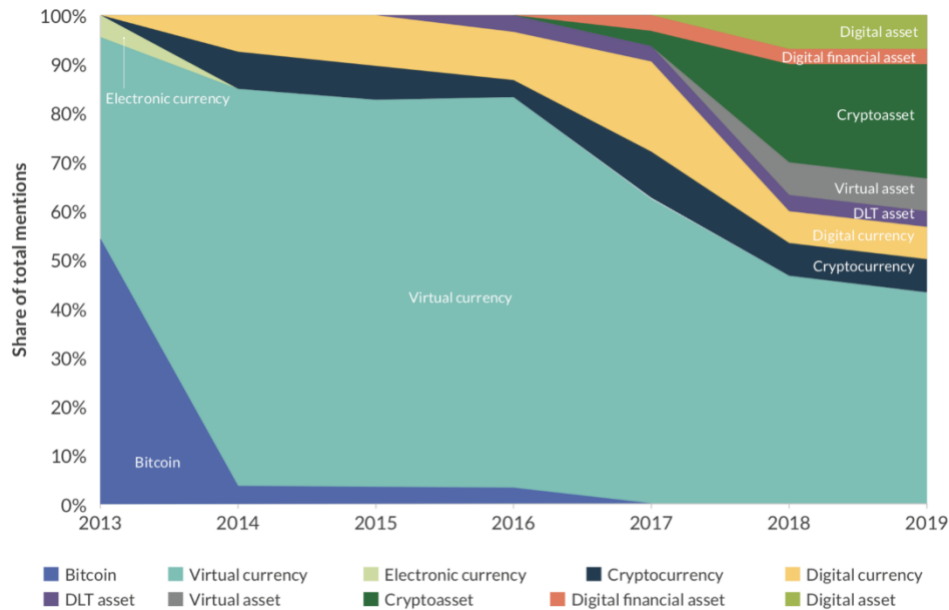


Chart 1: Terminology used by different agencies and jurisdictions<sup>4</sup>

To clarify these critical terms, it is helpful to begin with a practical explanation of ICOs. ICOs<sup>5</sup> mimic initial public offerings, or “IPOs”.<sup>6</sup> A project funded by an ICO typically develops in four stages. It begins with a pre-sale phase, when an announcement is made about the project to drum up interest from investors.<sup>7</sup> The second phase is the actual offering; the ICO begins the public distribution of tokens.<sup>8</sup> Distributed tokens are then used in the operation phase, where they are traded or redeemed under specific

<sup>4</sup> *Id.* at 35 fig.5.

<sup>5</sup> *ICO*, MERRIAM-WEBSTER ONLINE DICTIONARY (last visited Sept. 26, 2020).

<sup>6</sup> *Initial Public Offerings*, BLACK’S LAW DICTIONARY (10th ed. 2014) (“public sale of stock; the first offering of an issuer’s equity securities to the public through a registration statement”). ICOs may, however, go beyond the purpose of fundraising. *Id.*

<sup>7</sup> Blockchain Development, *ICO Development: The Four Stages of Launching a Successful ICO*, YOUR STORY (Feb. 4, 2019), <https://yourstory.com/mystory/ico-development-the-four-stages-of-launching-a-suc-095p54g2wu>.

<sup>8</sup> Crypto bounty programs are incentive programs used to promote various activities within an ICO. Jake Frankenfield, *Bounty Programs (ICO)*, INVESTOPEDIA (Jul. 2, 2018), <https://www.investopedia.com/terms/b/bounty-programs-ico.asp>. This could include sale, “airdrops,”<sup>8</sup> and/or “bounty programs.” *Id.*

terms of use.<sup>9</sup> Finally, the entity that launched begins maintenance to keep the project going, or completes one project and establishes another.

Turning to the technical definition, ICOs are “a *blockchain-based* sale or distribution of *crypto-assets* to the public.”<sup>10</sup> The basis of an ICO is the *crypto-asset* that is offered in exchange for an investment. For ease, this Commentary adopts the broad definition of “crypto-assets” found in *The Global Cryptoasset Regulatory Landscape Study*: “any digital token issued and transferred via any type of DLT system[.]”<sup>11</sup> DLT, or *distributed ledger technology*, is a data storage mechanism using cryptographical algorithms,<sup>12</sup> and is the technology behind *blockchain*.

Blockchain can be simplified as follows: it is a series of blocks, where each block stores a series of unique transaction data.<sup>13</sup> Blocks are bound together by a chain that comprises cryptographic hashes, which gives sequential order among blocks and is meant to guard against data tampering.<sup>14</sup> Since every member of the blockchain network receives a copy of this ledger (hence the term “distributed”), tampering would require amending all copies of the ledger; in most instances, this is simply impossible. This feature is

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<sup>9</sup> Blockchain Development, *ICO Development: The Four Stages of Launching a Successful ICO*, YOUR STORY (Feb. 4, 2019), <https://yourstory.com/mystory/ico-development-the-four-stages-of-launching-a-suc-095p54g2wu>. The token might have some use in the product or service offered by the company, or it might simply signify a stake in the project or issuer. Jake Frankenfield, *Initial Coin Offering (ICO)*, INVESTOPEDIA (Nov. 4, 2019), <https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp>.

<sup>10</sup> See REPORT WITH ADVICE FOR THE EUROPEAN COMMISSION: ON CRYPTO-ASSETS, EUR. BANKING AUTHORITY 29 (Jan. 9, 2019), <https://eba.europa.eu/documents/10180/2545547/EBA+Report+on+crypto+asset+s.pdf> (“The use of crypto-assets . . . has evolved rapidly in recent years and is anticipated to continue to do so”) [hereinafter EBA REPORT], at 6. See generally Howell et al., *Initial Coin Offerings: Financing Growth with Cryptocurrency Token Sales* (Nat’l Bureau Econ. Res., Working Paper No. 24774, 2018) (on file with author).

<sup>11</sup> Blandin et al., *supra* note 3, at 17.

<sup>12</sup> See Sir Mark Walport, *Distributed Ledger Technology: Beyond Block Chain*, GOV’T OFF. SCI. (Jan. 19, 2016), [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/492972/gs-16-1-distributed-ledger-technology.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/492972/gs-16-1-distributed-ledger-technology.pdf); see also ECB Crypto-Assets Task Force, *Crypto-Assets: Implications for Financial Stability, Monetary Policy, and Payments and Market Infrastructures*, EUR. CENT. BANK (May 2019), <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op223~3ce14e986c.en.pdf>.

<sup>13</sup> Ameer Rosic, *What is Blockchain Technology? A Step-by-Step Guide for Beginners*, BLOCKGEEKS (2016), <https://blockgeeks.com/guides/what-is-blockchain-technology/>.

<sup>14</sup> *Id.*

what has made DLT particularly attractive to the financial services sector where fraud is traditionally attempted often.

The next step is to classify crypto tokens. Several governments and researchers categorize crypto-assets based on their functionality:<sup>15</sup> payment tokens,<sup>16</sup> utility tokens,<sup>17</sup> and security tokens.<sup>18</sup> This approach has an obvious disadvantage: multi-functional tokens (sometimes called hybrid tokens) do not sit easily in a single class and there is no clear guidance as to how these tokens will be regulated.

However, this taxonomy offers an easy framework when comparing different government regulations. Governments tend to regulate security tokens in the ICO launching process, but do not necessarily regulate payment or utility tokens.<sup>19</sup> While the ICO process offers a new and efficient method for raising money, it also provides an avenue for increased risk of fraud and manipulation.<sup>20</sup> In most jurisdictions, securities laws are in place to protect investors; the more a crypto-asset looks like a traditional security, the more protection a regulator will want to offer to those investing in these projects.

## II. ICO: EVERYONE’S IPO, OR A MODERN PONZI TOOL?

As mentioned above, the term ICO comes from the concept of the IPO, or initial public offering. Admittedly, there are some similarities between IPOs and ICOs—both can be used for raising capital, and both are risky due to the uncertain futures of the activities that are being funded. However, there are also clear differences between them: first, launching an IPO requires

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<sup>15</sup> See, e.g., IMF Fintech Policy Paper, *supra* note 2, at 23; *Guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICOs)*, SWISS FIN. MKT. SUPERVISORY AUTHORITY FINMA (Feb. 16, 2018), <https://www.finma.ch/en/~media/finma/dokumente/dokumentencenter/myfinma/1bewilligung/fintech/wegleitung-ico.pdf?la=en> [hereinafter *Finma Guidelines*].

<sup>16</sup> *Finma Guidelines*, *supra* note 15, at 3 (“Payment tokens...are tokens which are intended to be used, now or in the future, as a means of payment for acquiring goods or services or as a means of money or value transfer”).

<sup>17</sup> *Id.* (“Utility tokens are tokens which are intended to provide access digitally to an application or service by means of a blockchain-based infrastructure”).

<sup>18</sup> *Id.* (“Asset tokens represent assets such as a debt or equity claim on the issuer”).

<sup>19</sup> See, e.g., ADVICE: INITIAL COIN OFFERINGS AND CRYPTO-ASSETS, EUR. SEC. & MKTS. AUTHORITY (Jan. 9, 2019), [https://www.esma.europa.eu/sites/default/files/library/esma50-157-](https://www.esma.europa.eu/sites/default/files/library/esma50-157-1391_crypto_advice.pdf)

1391\_crypto\_advice.pdf (“The prospectus rules should apply to crypto-assets offered to the public, including through ICO, where the instruments qualify as transferable securities. It will therefore not apply to those crypto-assets that do not qualify as transferable securities, in which case disclosure requirements will depend on national law”) [hereinafter *ESMA ADVICE*].

<sup>20</sup> See, e.g., SEC, *Spotlight on Initial Coin Offerings (ICOs)*, <https://www.sec.gov/ICO>

professional and regulated intermediaries like dealers, brokers, and underwriters, whereas launching ICOs can be completed directly by the issuers.<sup>21</sup> Second, given that there are fewer or no compliance requirements in launching an ICO, the cost to do so is often lower than that of launching IPOs.<sup>22</sup> This theoretically means that even an individual can launch one's own token to raise funds.<sup>23</sup> Similarly, that individual can potentially game the crypto-asset system.<sup>24</sup> This Section will explore these and other potential benefits and harms related to the proliferation of ICOs.

A. *The Potential Benefits of ICOs*

One of the potential benefits of ICOs that is often overlooked is financial inclusion. Because DLT reduces reliance on intermediaries,<sup>25</sup> the cost for investors and issuers in ICOs has the potential to be significantly lower than that for traditional fundraising.<sup>26</sup> While opportunities for IPOs and venture capitals are generally only accessible by accredited investors, ICOs may be accessible to main-street investors.<sup>27</sup> One recent example comes from NBA player Spencer Dinwiddie, who in January 2020 tokenized his three-year contract with the Brooklyn Nets so that other investors could share profits and risk from his athletic career.<sup>28</sup> Dinwiddie successfully launched his unique bond despite NBA

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<sup>21</sup> See, e.g., *Capital Market, Timeline: Initial Public Offering Transaction*, BLOOMBERG L. (2019) (“The [i]ssuer typically hires an investment bank to serve as the lead or managing underwriter of the offering”).

<sup>22</sup> Caitlin Long, *ICOs Were 45% Of IPOs In Q2 2018, as Cryptos Disrupt Investment Banks*, FORBES (Jul. 22, 2018, 9:36 PM), <https://www.forbes.com/sites/caitlinlong/2018/07/22/icos-were-45-of-ipos-in-q2-2018-as-cryptos-disrupt-investment-banks/#78382461794c>.

<sup>23</sup> See, e.g., Vladislav Burirov, *Regulation of Crypto Tokens and Initial Coin Offerings in the EU*, EUR. J. COMP. L. & GOVERNANCE 146–86 (2019).

<sup>24</sup> There is some evidence suggesting that most crypto-asset transactions are actually generated artificially by cryptocurrency exchanges. Paul Vigna, *Most Bitcoin Trading Faked by Unregulated Exchanges, Study Finds*, WSJ (Mar. 22, 2019, 9:00 AM), <https://www.wsj.com/articles/most-bitcoin-trading-faked-by-unregulated-exchanges-study-finds-11553259600?shareToken=ste90e80f8d18f47cb896491914f06cea3> [hereinafter Vigna, *Bitcoin Trading Faked*].

A recent study by Bitwise Asset Management shows that many unregulated crypto exchanges have low website-access volume, but a large number of transactions, implying that the high volume of transactions may be artificially inflated by the exchange. *Id.*

<sup>25</sup> CRYPTOASSETS TASKFORCE: FINAL REPORT, HM TREASURY 32 (Oct. 29, 2018), <https://www.gov.uk/government/publications/cryptoassets-taskforce>.

<sup>26</sup> *Id.*

<sup>27</sup> See generally IMF Fintech Policy Paper, *supra* note 2, at 48 (“Several countries are focusing on development of digital financial services as part of their National Financial Inclusion Strategies”).

<sup>28</sup> Kai Sedgwick, *NBA Star Spencer Dinwiddie Just Tokenized His Own Contract*, BITCOIN.COM (Jan. 13, 2020), <https://news.bitcoin.com/nba-star-spencer-dinwiddie-just-tokenized-his-own-contract/>.

officials' protests.<sup>29</sup> As of July 2020, however, Dinwiddie's offering concluded, only reaching 10 percent of its target sale of shares.<sup>30</sup> But if a similar tokenization is successful, it may lead to more athletes following suit, and paving the way for the average person to do the same.

Another potential benefit is that traditional banking fees are often too high to serve the unbanked.<sup>31</sup> Since ICOs utilize DLT, theoretically, they can provide some banking services to a wider population.<sup>32</sup> As Don Tapscott, Executive Chairman of the Blockchain Research Institute, writes:

[B]lockchain could be the solution. By lowering barriers to financial inclusion and enabling new models of entrepreneurship, the tonic of the market could be brought to bear on the dreams and ideas of billions of the unbanked.<sup>33</sup>

Government and international organizations may also encourage or welcome ICO development because it could benefit people in developing countries where banking is not easily accessible. By incentivizing issuers of ICOs, governments could attract investments, increase government revenue, and support small and medium-sized enterprises (SMEs).<sup>34</sup>

Additionally, both consumers and issuers can benefit from using tokens because using utility tokens as a pre-sale has the potential lower transactional costs.<sup>35</sup> Issuers can launch a pre-sale campaign at a lower price than that of conventional vouchers or pre-

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<sup>29</sup> *Id.*

<sup>30</sup> Samuel Haig, *NBA Star Sells Just 10% of Tokenized Contract*, COINTELEGRAPH (Jul. 23, 2020), <https://cointelegraph.com/news/nba-star-sells-just-10-of-tokenized-contract>.

<sup>31</sup> See, e.g., Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System*, BITCOIN (2008), <https://bitcoin.org/bitcoin.pdf> (“The cost of mediation increases transaction costs, limiting the minimum practical transaction size and cutting off the possibility for small casual transactions, and there is a broader cost in the loss of ability to make non-reversible payments for nonreversible services”).

<sup>32</sup> *Id.*

<sup>33</sup> Alice Merry, *Women Worldwide Struggle to Access Banking Services. Bitcoin is Only Making that Worse*, TIME (Oct. 29, 2018, 1:22 P.M.), <https://time.com/5431809/blockchain-financial-inclusion-gender-gap/>.

<sup>34</sup> Iota Kaousar Nassr & Mamiko Yokoi-Arai, *Initial Coin Offerings (ICOs) for SME Financing*, OECD 30–32 (2019), <http://www.oecd.org/finance/ICOs-for-SME-Financing.pdf>.

<sup>35</sup> Sabrina T. Howell et al., *Initial Coin Offerings: Financing Growth with Cryptocurrency Token Sales*, (revised Sept. 2019) (Nat'l Bureau of Econ. Res., Working Paper No. 24774, 2019) (“[Blockchains] with native tokens permit disintermediation of Internet-based marketplaces .... In the blockchain-token model, platform management is decentralized, and value accrues to token holders”).

sale crowdfunding,<sup>36</sup> and consumers can not only buy the goods or services at a lower price,<sup>37</sup> but also have better privacy protection when such tokens are anonymous or pseudo-anonymous.<sup>38</sup>

### B. *The Potential Harm of ICOs*

Despite the potential benefits from ICOs, there are serious concerns and possible harms that must also be considered. First, ICOs might cause financial and economic instability. There is a risk that non-sophisticated investors might be attracted to ICOs for the promise (actual or perceived) of high and quick returns, without appreciating the economic risks involved in the transaction.<sup>39</sup> Most of the tokens' values are highly volatile and risky,<sup>40</sup> and the crypto-assets market is vulnerable to manipulation and insider trading due to the current vacuum of regulations on crypto dealings.<sup>41</sup> Furthermore, customers and investors may be vulnerable to frauds without enforceable or available legal remedies.<sup>42</sup> The SEC's Office of Investor Education and Advocacy has released an investor alert regarding Ponzi schemes that use virtual currencies or crypto tokens, cautioning that:

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<sup>36</sup> Instead of obtaining the equity right, utility token owners can use it as a voucher for future service or goods. For example, Filecoin token owners can use their token in exchange of online storage service in the future when the network is completed. Deloitte, *Are Token Assets Securities of Tomorrow*, <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/technology/lu-are-token-assets-the-securities-tomorrow.pdf>; Filecoin website, <https://filecoin.io/>

<sup>37</sup> *Id.*

<sup>38</sup> See, e.g., *Cryptocurrencies and Blockchain—Legal Context and Implications for Financial Crime, Money Laundering and Tax Evasion*, EUR. PARL. at 45–46, 51 (Jul. 2018), <http://www.europarl.europa.eu/cmsdata/150761/TAX3%20Study%20on%20cryptocurrencies%20and%20blockchain.pdf> (“Monero has been specifically developed to allow its users to execute transactions in full anonymity. It is said to be cryptographically private by default”).

<sup>39</sup> See, e.g., REVEALING REALITY, *How and why consumers buy cryptoassets: A report for the FCA* (Oct. 2018), [https://www.revealingreality.co.uk/wp-content/uploads/2019/04/RR\\_FCA-cryptoassets.pdf](https://www.revealingreality.co.uk/wp-content/uploads/2019/04/RR_FCA-cryptoassets.pdf); Paul Kiernan, *Fed's Powell Says Facebook's Libra Raises 'Serious Concerns'*, WSJ (Jul. 11, 2019, 8:52 PM), <https://www.wsj.com/articles/feds-jerome-powell-faces-senators-after-rate-cut-signal-11562837403>.

<sup>40</sup> See, e.g., IMF Fintech Policy Paper, *supra* note 2, at 37 (“Digital currencies currently pose little challenge to fiat currencies at present as they are too volatile, risky, and not yet scalable”).

<sup>41</sup> Vigna, *Bitcoin Trading Faked*, *supra* note 24.

<sup>42</sup> See, e.g., LAW LIB. CONG., REGULATION OF CRYPTOCURRENCY AROUND THE WORLD 1 (June 2018), <https://www.loc.gov/law/help/cryptocurrency/cryptocurrency-world-survey.pdf> (“Most [jurisdictions] also note that citizens who invest in cryptocurrencies do so at their own personal risk and that no legal recourse is available to them in the event of loss”).

[T]he rising use of virtual currencies in the global marketplace may entice fraudsters to lure investors into Ponzi and other schemes in which these currencies are used to facilitate fraudulent, or simply fabricated, investments or transactions. The fraud may also involve an unregistered offering or trading platform. These schemes often promise high returns for getting in on the ground floor of a growing Internet phenomenon.<sup>43</sup>

The SEC has even prosecuted such a case. In *SEC v. Shavers*, the head of an alleged Ponzi scheme launched a Bitcoin “investment opportunity” in an online forum, where potential investors were said to be promised 7 percent interest per week.<sup>44</sup> Invested funds were to be used in Bitcoin arbitrage activities to produce returns, but the Bitcoins instead were (allegedly) either used to pay existing investors or converted to U.S. dollars for the purpose of paying off the organizer’s personal expenses.<sup>45</sup> The operation raised at least 700,000 Bitcoin, or more than \$4.5 million at the time.<sup>46</sup>

Secondly, while the lack of intermediary *could* make the crypto-industry an attractive investment option for the unbanked, it may actually create a more exclusive than inclusive environment. As reported in 2018, there are 1.7 billion unbanked adults around the world, with a higher incidence in developing countries.<sup>47</sup> Inclusive financial services must be able to serve large populations, and the transactions they foster must be reliable and low-cost.<sup>48</sup> But, as Alice Merry, a financial inclusion expert, notes, “[b]lockchain and cryptocurrencies cannot offer [low-cost, reliable transactions to the masses] because they were simply not built for scale. Whereas it is estimated that Bitcoin can process just three to seven transactions per second, Visa can process 24,000 transactions in a second.”<sup>49</sup> She

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<sup>43</sup> Press Release, SEC, Investor Alert: *Ponzi Schemes Using Virtual Currencies* (Jul. 23, 2013), <https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-alerts/investor-7>.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> Press Release, SEC, *SEC Charges Texas Man With Running Bitcoin-Denominated Ponzi Scheme*, <https://www.sec.gov/news/press-release/2013-132#.Ue6yZODmp-I>. Today, that total would amount to more than \$60 million.

<sup>47</sup> Merry, *supra* note 33.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.* The low bitcoin transaction speed is called “Bitcoin scalability problem”, where the bitcoin blockchain can only record at a relatively small size and low frequency. *See also, Visa, Fact Sheet* <https://usa.visa.com/dam/VCOM/download/corporate/media/visanet-technology/aboutvisafactsheet.pdf>. (last visited Aug. 25, 2020). Visa claims it has the capacity to process up to 65,000 transactions per second. *But see* Colin LeMahieu, *Nano: A Feeless Distributed Cryptocurrency*



continues that the volatility of the crypto market is “completely inappropriate” for the typical transactions needed by low-income individuals, like bill payments, money transfers, and savings and loans requests.<sup>50</sup>

There is also potential exposure to indirect harm through criminal activities like money laundering, drug transactions, or even violence.<sup>51</sup> Cryptocurrencies seem to have become the preferred currency for drug dealers and extortionists.<sup>52</sup> In fact, “[m]any cybercriminals and online criminal markets find the anonymity and security of virtual currency extremely attractive and opt for virtual currencies.”<sup>53</sup> The head of Europol estimates that approximately 3 to 4 percent of Europe’s annual criminal takings may be laundered through the crypto-industry.<sup>54</sup> While that may seem like a small amount, in reality, it equates to somewhere between £3 to 4 billion (or \$4.2 to 5.6 billion).<sup>55</sup>

These potential harms that may result from unregulated use and distribution of crypto-assets demonstrate that it is important to untangle the tactics used across the world to stop and prevent harms. The next Part offers an overview of the approaches to regulation implemented across the globe.

### III. A TASTE OF ICO SPAGHETTI REGULATIONS

Even if the scope of this Commentary is relatively narrow, it is still possible to highlight the “spaghetti effect” ICO regulations.<sup>56</sup>

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*Network* (last visited Aug. 25, 2020), [https://content.nano.org/whitepaper/Nano\\_Whitepaper\\_en.pdf](https://content.nano.org/whitepaper/Nano_Whitepaper_en.pdf). Some alternative tokens aim to solve this Bitcoin scalability problem, such as Nano, which may process over 10,000 transactions per second.

<sup>50</sup> Merry, *supra* note 47.

<sup>51</sup> FCA, CONSULTATION PAPER: GUIDANCE ON CRYPTOASSETS, CP19/3 12 (Jan. 2019) (“Recent research looked at listed tokens in 2017 with data provided for those ICOs with over \$50 million in market capitalisation and found that 78% of these listed tokens were scams”); Sessa Kethineni & Ying Cao, *The Rise in Popularity of Cryptocurrency and Associated Criminal Activity*, INT’L CRIM. JUST. REV. ONLINE 11–12 (“[For] example, the kidnapping of a South African citizen for ransom, holding a Russian tourist hostage demanding transfer of BTCs, demanding of ransom attempt to murder a BTC miner in Taiwan, the kidnapping and extortion of cryptocurrency [sic] exchange (EXMO) executive in Ukraine, and the robbery of two British BTC traders in the UK”).

<sup>52</sup> See Kethineni & Cao, *supra* note 51, at 1.

<sup>53</sup> *Id.* at 2.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> See, e.g., Jagdish Bhagwati, *US Trade Policy: The Infatuation with FTAs, in THE DANGEROUS DRIFT TO PREFERENTIAL TRADE AGREEMENTS* (1995); Guy Lewis Steele Jr., *Macaroni Is Better than Spaghetti, in PROCEEDINGS OF THE 1977 SYMPOSIUM ON ARTIFICIAL INTELLIGENCE AND PROGRAMMING LANGUAGES* 60-66 (1977).

In meteorology, the spaghetti model represents a messy tangle of the myriad predicted pathways for hurricanes.<sup>57</sup> In trade, the spaghetti bowl effect is the drafting and stacking of free trade agreements (FTAs), which supplant multilateral World Trade Organization negotiations and creates jumbled landscape of rules, tariffs, and institutional arrangements.<sup>58</sup> Here, we use it to represent the almost innumerable different ways in which countries choose to approach ICO regulations. Often, FTAs among different countries cause international trade systems to be extremely complex. Similarly, ICO regulations have a similar spaghetti effect—no uniform international framework currently exists, and domestic regulations vary from jurisdiction to jurisdiction, making the regulations look like they cannot be untangled. To ease the spaghetti effect, the next Section discusses some common features of these regulations, and then distinguishes their differences based on individual governments’ paramount policy goals.

A. *Common features in the ICO regulations*

Two common regulatory features exist in most jurisdictions: warning requirements aimed to investors and consumers, and due diligence requirements. Because of speculation and high risk in ICOs, most governments, as well as international organizations, have issued warnings to the public.<sup>59</sup> For example, the European Securities and Markets Authority (ESMA) issued two statements in 2017 and 2018 calling for public awareness of high risk in crypto-assets.<sup>60</sup> In October 2017, the Japanese Financial Service Agency (FSA) also explicitly warned the public that “potential fraud” and “price volatility” are two high risks in ICOs of which consumers should be cautious.<sup>61</sup>

Secondly, to reduce consumer and investor risk, and increase accountability, ICO regulations require service providers or intermediaries to comply with due diligence standards—including know your customer (KYC) policies, as well as other anti-money laundering laws—which mainly require service providers to identify and verify token users so that their crypto-assets and transactions

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<sup>57</sup> *Hurricane Spaghetti Models*, CYCLOCANE, <https://www.cyclocane.com/spaghetti-models/#details> (last visited May 14, 2020).

<sup>58</sup> *See, e.g.*, Bhagwati, *supra* note 56.

<sup>59</sup> *See, e.g.*, LAW LIB. CONG., *supra* note 42; ESMA ADVICE, *supra* note 19, at 7.

<sup>60</sup> ESMA ADVICE, *supra* note 19, at 7.

<sup>61</sup> FSA, *Initial Coin Offerings (ICOs): User and business operator warning about the risks of ICOs* (Oct. 27, 2017) (“the price of a token may become worthless suddenly”).

remain traceable and accountable.<sup>62</sup> This transparency will inevitably lead to higher costs, which would diminish one the greatest advantages of launching an ICO.

### B. *ICO Regulations Distinguished*

The two common features noted above often signify where the similarities end among countries engaging in crypto-industry regulation. This Section offers an overview of the different approaches taken by various regulating jurisdictions.

#### i. *Complete ban to preserve market stability and protect consumers*

Some countries, like China and South Korea, have taken action against all forms of ICOs.<sup>63</sup> This complete ban on all types of ICOs has a clear impact on the market: the number of ICOs and the amount of funds raised in ICOs have plummeted in these countries because issuers and investors simply choose alternatives— withdrawing from the market or launching their tokens in other jurisdictions.<sup>64</sup> Shortly after the Chinese government announced “all ICOs are illegal financing” in September 2017,<sup>65</sup> South Korea followed suit.<sup>66</sup> After its three-month investigation, the South

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<sup>62</sup> Fedor Poskriakov et al., *Cryptocurrency Compliance and Risks: A European KYC/AML Perspective*, in BLOCKCHAIN & CRYPTOCURRENCY REGULATION 2019 164 (Josias Dewey ed., 1st ed. 2019).

<sup>63</sup> People’s Bank of China, Statement, Public Notice of the PBC, CAC, MIIT, SAIC, CBRC, CSRC and CIRC on Preventing Risks of Fundraising through Coin Offering (Sept. 8, 2017), <http://www.pbc.gov.cn/en/3688110/3688181/3712144/index.html> [hereinafter PBC Ban Notice]; Financial Services Commission (FSC), Statement, 가상통화 투기근절을 위한 특별대책, 금융부문 대책 시행 [Special Measures for the Elimination of Virtual Currency Speculation, Enforcement of Financial Sector Measures (Dec. 28, 2017)], at 3–4 (Jan. 23, 2018), <http://www.korea.kr/common/download.do?tblKey=GMN&fileId=185832583>.

See generally LAW LIB. CONG., REGULATION OF CRYPTOCURRENCY IN SELECTED JURISDICTIONS (Jun. 2018), <https://www.loc.gov/law/help/cryptocurrency/regulation-of-cryptocurrency.pdf> [hereinafter CRYPTOCURRENCY IN SELECTED JURISDICTIONS].

<sup>64</sup> *China: Government Indicates All Virtual Currency Platforms Have Withdrawn from Market*, GLOBAL LEGAL MONITOR, (Jul. 12, 2018) <https://www.loc.gov/law/foreign-news/article/china-government-indicates-all-virtual-currency-platforms-have-withdrawn-from-market/> (“Chinese yuan used to account for over 90% of the global trading in Bitcoin. ... [S]ince September 2017, Bitcoin traded with Chinese yuan has dropped to under 1% of global Bitcoin trading”).

<sup>65</sup> See Chao Deng, *China Bans Fundraising via Cryptocurrencies, Known as ICOs*, WSJ (Sept. 4, 2017 7:55 AM), <https://www.wsj.com/articles/chinas-ico-ban-brings-bitcoin-back-to-earth-1504526144>.

<sup>66</sup> Gregor Stuart Hunter, *South Korea Joins Cryptocurrency Crackdown*, WSJ (Sept. 29, 2017 1:26 AM), <https://www.wsj.com/articles/south-korea-joins-cryptocurrency-crackdown-1506661702>.

Korean government asserted that ICOs are highly risky because “[important] investment information [regarding ICOs is] missing, such as company introduction, business plans and financial statements ... [e]specially, there was no disclosure on how those funds were used and most of [the issuing companies] refused to answer the financial authorities’ request.”<sup>67</sup>

However, because not all ICOs fall within the security-token category, such a complete ban may be over-inclusive. Thus, the ban in South Korea faced a constitutional challenge.<sup>68</sup> In addition to the constitutional challenge, the government investigation showed that the country’s ban on ICOs led to South Korean ICOs being launched overseas to circumvent the ban.<sup>69</sup> Though the Chinese government is also aware of some Chinese ICOs launched overseas to circumvent regulations, it currently would rather prioritize financial-market stability by stringently striking down all ICOs in China, and those launched overseas targeting Chinese citizens.<sup>70</sup>

More recently, South Korea has reevaluated its stance on cryptocurrency. On March 5, 2020, the National Assembly—the South Korean parliament—voted in favor of an amendment to the Special Financial Transactions Information Act.<sup>71</sup> The aim of the Act and its amendment is to create a framework for the crypto-industry in South Korea, incorporating existing guidelines, and providing a mechanism for taxation.<sup>72</sup> Initial reactions to this news were positive; however, shortly after the announcement, concerns were made by those who feared that regulatory policing would make South Korean crypto-asset exchanges “restrictive” and “inflexible.”<sup>73</sup> Industry insiders, even more pessimistically, suggested that the law will actually shrink the cryptocurrency

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<sup>67</sup> Kevin Helms, *South Korea Updates ICO Stance After 3-Month Investigation*, BITCOIN NEWS (Feb. 1, 2019), <https://news.bitcoin.com/south-korea-updates-ico-policy/>.

<sup>68</sup> Kevin Helms, *Korean Court Case Alleges ICO Ban is Unconstitutional*, BITCOIN.COM (Dec. 8, 2018), <https://news.bitcoin.com/korean-court-governments-ico-ban-unconstitutional/>.

<sup>69</sup> *Id.*

<sup>70</sup> 新報網, 央行上海總部: 持續防范 ICO 和虛擬貨幣交易風險 [Central Bank Shanghai Headquarters: Continuously Preventing ICO and Virtual Currency Trading Risks], BEIJING NEWS (Sept. 18, 2018), <http://www.bjnews.com.cn/finance/2018/09/18/505995.html>.

<sup>71</sup> Tim Alper, “Game On!” *South Korean Parliament Passes “Landmark” Crypto Bill*, CRYPTONEWS (Mar. 5, 2020), <https://cryptonews.com/news/breaking-south-korean-parliament-passes-landmark-crypto-bill-5948.htm> [hereinafter Alper, *Game On*].

<sup>72</sup> *Id.*

<sup>73</sup> Tim Alper, *South Koreans Welcome New Crypto Laws—But There’s a Word of Warning*, CRYPTONEWS (Mar. 6, 2020), <https://cryptonews.com/news/south-koreans-welcome-new-crypto-laws-but-there-s-a-word-of-5963.htm>.

market further. The new law will take effect in March 2021,<sup>74</sup> so what changes will occur in said market remain to be seen.

*ii. Sit-on-the-fence approach for the balance of stability and innovation*

A majority of jurisdictions in the world adopt the sit-on-the-fence, or wait-and-see, approach to regulate ICOs:<sup>75</sup> under pre-existing financial frameworks, regulators demand that token issuers follow specific compliance requirements without completely banning ICOs. The advantage of this approach is the balancing of innovation while protecting investors and consumers.

*a. The United States*

The U.S. is currently the largest ICO market in the world.<sup>76</sup> The market is regulated by the Securities and Exchange Commission (SEC), which applies its pre-existing securities framework to ICOs, while explicitly remaining ambiguous and flexible in its policies.<sup>77</sup> Specifically, the SEC applies securities law, including the principles from the *Howey* case, to determine whether an ICO meets the elements of an “investment contract,” and thus should be bound by relevant securities laws.<sup>78</sup>

Under the Securities Act and the Securities Exchange Act, the term “security” is broadly defined. The definition in the Securities Exchange Act of 1934 reads, in relevant part, “[t]he term ‘security’ means any note, stock, ... bond, ... [or] investment contract ... .”<sup>79</sup> This definition, though broad, is important: if a certain investment is considered to be a security, it will be subject to specific registration requirements.<sup>80</sup> The decision in *Howey* has

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<sup>74</sup> Alper, *Game On*, *supra* note 71.

<sup>75</sup> LAW LIB. CONG., *supra* note 42, at 24.

<sup>76</sup> *Stats and Facts: Top Countries and ICOs*, ICOBENCH.COM (last visited Oct. 10, 2019), <https://icobench.com/stats>.

<sup>77</sup> Hester M. Peirce, Comm’r, SEC, Remarks at Protecting the Public While Fostering Innovation and Entrepreneurship: First Principles of Optimal Regulation (Feb. 8, 2019), <https://www.sec.gov/news/speech/peirce-regulation-view-inside-machine> (acknowledging that “[a]mbiguity [in SEC policy] is not all bad .... Delay in drawing clear lines may actually allow more freedom for the technology to come into its own”).

<sup>78</sup> See Securities Act of 1933, 15 U.S.C. § 77; SEC v. Edwards, 540 U.S. 389, 393 (2004); SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946); SEC, REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: THE DAO (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf> [hereinafter SEC SECTION 21(A) REPORT].

<sup>79</sup> Securities Exchange Act of 1934, 73 P.L. 291, 48 Stat. 881 (1934).

<sup>80</sup> *What is the Howey Test?*, FINDLAW (May 17, 2018), <https://consumer.findlaw.com/securities-law/what-is-the-howey-test.html>

given the SEC a test on how to determine whether or not an agreement falls into the investment contract category.

In the case, the Supreme Court was asked to decide whether a leaseback agreement was actually an investment contract. Two corporate defendants sold tracts of land with citrus groves to several buyers, and then offered the buyers the option of leasing the land back to the defendants.<sup>81</sup> The defendants, in turn, would take care of the land, the harvest, and the marketing of the citrus.<sup>82</sup> The SEC sued the defendants, claiming these leaseback agreements were securities and, therefore, should be registered as such.<sup>83</sup> The Supreme Court agreed, and developed the test used by the SEC today. Under *Howey*, a transaction is considered to be an investment contract “comprises ‘(1) the investment of money (2) in a common enterprise (3) with an expectation of profits to be derived solely from the efforts of the promoter or a third party.’”<sup>84</sup> Subsequent cases have expanded the term “money” to include investments of other assets as well.

On April 3, 2019, the SEC’s Strategic Hub for Innovation and Financial Technology published non-binding guidance (“the Framework”)<sup>85</sup> and a No-Action Letter,<sup>86</sup> both of which provide a comprehensive but non-exhaustive application of the *Howey* test<sup>87</sup> to determine ICOs’ legality. The Framework briefly concludes that the first two prongs of the *Howey* test, “investment of money” and “common enterprise,” typically exist in ICOs, because the investment of money is not limited to monetary consideration.<sup>88</sup> As for the third prong, the Framework provides approximately thirty questions to show the SEC’s analysis of whether there is “reliance on the efforts of others” and “reasonable expectations of profits.”<sup>89</sup>

The No-Action Letter provides even more specific legal and factual questions as an interpretative exemplar of when the SEC legal division decided *not* to bring a lawsuit against an issuer.<sup>90</sup> These critical facts include whether funding from token sales is used for developing the ICO platform; whether tokens can be

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<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

<sup>83</sup> *Id.*

<sup>84</sup> SEC. v. SG Ltd., 265 F.3d 42, 46 (1st Cir. 2001) (citing *Howey*, 328 U.S. at 298–99).

<sup>85</sup> SEC, FRAMEWORK FOR “INVESTMENT CONTRACT” ANALYSIS OF DIGITAL ASSETS 12 (Apr. 2019), <https://www.sec.gov/files/dlt-framework.pdf> [hereinafter SEC FRAMEWORK].

<sup>86</sup> TurnKey Jet, Inc., SEC No-Action Letter, 2019 WL 1471132 (Apr. 3, 2019) [hereinafter TurnKey No-Action Letter].

<sup>87</sup> See generally SEC FRAMEWORK, *supra* note 85; TurnKey No-Action Letter, *supra* note 86.

<sup>88</sup> SEC FRAMEWORK, *supra* note 85, at 12 n.9.

<sup>89</sup> *Id.* at 6–10.

<sup>90</sup> TurnKey No Action Letter, *supra* note 86.

immediately used for their designated functionality once they are sold; whether tokens are transferable only within the provider’s wallets; and whether the sale price is at most one U.S. dollar per token.<sup>91</sup> Marketing methods should focus on tokens’ functionality, not their potential growth of value, for an ICO to avoid SEC action.<sup>92</sup>

*b. The U.K. and two E.U. members states*

The U.K., a global financial hub, is another country taking a similar approach to ICOs by applying its pre-existing financial framework to regulate security tokens.<sup>93</sup> In its most-recent guidance, the Financial Conduct Authority (FCA) determined that crypto-assets that meet the “Specified Investment” definition in the Regulated Activity Order (RAO)—including financial instruments under MiFID<sup>94</sup>—will be regulated.<sup>95</sup> Similar to the SEC’s Framework and No-Action Letter, the FCA offered some guidance in the RAO on how it will decide whether crypto-assets fall within “Specified Investment.”<sup>96</sup> Two reports published by the FCA offer several non-exhaustive questions guiding the assessment of whether a token is a Specified Investment,<sup>97</sup> such as “the contractual rights and obligations the token-holder has by virtue of holding or owning that crypto-asset,” “any contractual entitlement to profit-share,” or ownership, including voting rights conferred to token holders.<sup>98</sup>

Within the E.U., Cyprus and Estonia are renowned for their active roles in regulating the crypto-industry.<sup>99</sup> The Cyprian government has decided that only firms involved in ICOs are subject to the government’s pre-existing framework; other activities related to crypto-assets that are performed by individuals are not

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<sup>91</sup> If an issuer decides to buy back these tokens, the buy-back price cannot be higher than one USD per token, unless a U.S. court orders otherwise.

<sup>92</sup> See, e.g., TurnKey No Action Letter, *supra* note 86.

<sup>93</sup> See LAW LIB. CONG., *supra* note 42, at 58–59.

<sup>94</sup> Directive 2014/65/EU, of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, 2014 O.J. (L 173) 349

<sup>95</sup> See generally FIN. CONDUCT AUTHORITY, GUIDANCE ON CRYPTOASSETS FEEDBACK AND FINAL GUIDANCE TO CP 19/3 at 16 (Jul. 2019), <https://www.fca.org.uk/publication/policy/ps19-22.pdf>.

<sup>96</sup> *Id.* at 20.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> See, e.g., Adrian Zmudzinski, *Cyprus’ Finance Minister: Blockchain Draft Bill to be Ready This Year*, COINTELEGRAPH (Jul. 4, 2019), <https://cointelegraph.com/news/cyprus-finance-minister-blockchain-draft-bill-to-be-ready-this-year>; Daniel Diemers et al., *Initial Coin Offerings—A strategic perspective*, PWC (Jun. 2018), [https://cryptovalley.swiss/wp-content/uploads/20180628\\_PwC-S-CVA-ICO-Report\\_EN.pdf](https://cryptovalley.swiss/wp-content/uploads/20180628_PwC-S-CVA-ICO-Report_EN.pdf) (Estonia ranked in the top ICO countries). See generally *10 World countries with the most vibrant ICO scene*, HACKERNOON (Oct. 14, 2019), <https://hackernoon.com/10-world-countries-with-the-most-vibrant-ico-scene-44273900701a>.

regulated.<sup>100</sup> Individuals or investors should be aware of the high risk in ICO activities, and that there is no specific remedy or protection for their loss.<sup>101</sup> The Estonian Financial Supervisory Authority (EFSA), on the other hand, published its unofficial guidelines similar to the *Howey* test: security tokens “[granting] reasonable expectation for profit or governance rights” are subject to its securities law, and non-security tokens—including utility tokens, charity tokens, and payment tokens<sup>102</sup>—are subject to other regulations.<sup>103</sup> Even though the Estonian government has not create a new framework, it has expanded its pre-existing framework by providing clear and comprehensive guidance.

### c. *Hong Kong and Singapore*

On the other side of the world, some jurisdictions have shown a highly supportive attitude toward the crypto-industry, despite their high-level regulations. For example, under its Securities and Futures Ordinance, the Hong Kong government regulates the security tokens to which securities law applies when the tokens are “digital representations of ownership of assets ([e.g.], gold or real estate) or economic rights ([e.g.], a share of profits or revenue) utilizing blockchain technology.”<sup>104</sup> On November 6, 2019, the Securities and Futures Commission, the authority in Hong Kong, published its position paper to provide a new framework for “virtual asset trading platform[s]” dealing with non-securities tokens.<sup>105</sup> This policy paper provides a comprehensive list of requirements that these platforms should comply with in order to apply for a license to trade security-tokens.<sup>106</sup> Likewise, the Monetary Authority of Singapore (MAS) issued guidance that specifies that “[d]igital

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<sup>100</sup> *Cryptocurrencies and ICOs News Briefing Technical Alert*, INST. CERTIFIED PUB. ACCTS CYPRUS (Oct. 31, 2018), [https://www.icpac.org.cy/zePortal/WebFiles/SELK/WebDocuments/Announcements/2018/Cryptocurrencies%20and%20ICOs%20News%20Briefing/TA%20\\_2018%20Cryptocurrencies%20and%20ICOs%20News%20Briefing.pdf](https://www.icpac.org.cy/zePortal/WebFiles/SELK/WebDocuments/Announcements/2018/Cryptocurrencies%20and%20ICOs%20News%20Briefing/TA%20_2018%20Cryptocurrencies%20and%20ICOs%20News%20Briefing.pdf); ESMA Highlights ICO Risks for Investors and Firms, EUR. SEC. & MKTS. AUTHORITY (Nov. 13, 2017), <https://www.esma.europa.eu/press-news/esma-news/esma-highlights-ico-risks-investors-and-firms>.

<sup>101</sup> See LAW LIB. CONG., *supra* note 42.

<sup>102</sup> Priit Lätt & Carel Kivimaa, *Blockchain & Cryptocurrency Regulation 2019*, in BLOCKCHAIN & CRYPTOCURRENCY REGULATION 2019 273–77 (Josias Dewey ed., 1st ed. 2018).

<sup>103</sup> *Id.*

<sup>104</sup> *Statement on Security Token Offerings*, SEC. & FUTURES COMMISSION (Mar. 28, 2019), <https://www.sfc.hk/web/EN/news-and-announcements/policy-statements-and-announcements/statement-on-security-token-offerings.html>.

<sup>105</sup> *Regulation of virtual asset trading platforms*, SEC. & FUTURES COMMISSION (Nov. 6, 2019), [https://www.sfc.hk/web/EN/files/ER/PDF/20191106%20Position%20Paper%20and%20Appendix%20to%20Position%20Paper%20\(Eng\).pdf](https://www.sfc.hk/web/EN/files/ER/PDF/20191106%20Position%20Paper%20and%20Appendix%20to%20Position%20Paper%20(Eng).pdf).

<sup>106</sup> *Id.*



tokens which constitute capital markets products” would therefore be considered identical to capital markets products, and thus issuers should obey all relevant regulations.<sup>107</sup>

These models, while still attempting to regulate the crypto-industry, allow flexibility for issuers. Although a case-by-case approach is likely not to stifle innovation, it can cause ambiguities.<sup>108</sup> These regulators have wider discretion in determining whether a token falls within the ambit of the securities laws. Presumably because these authorities have long established their reputation on the global financial stage, they still attract worldwide investors and ICO issuers. Though uncertainty in regulation can lead to ambiguities, it does not seem to have stopped investment in ICOs: the amount of the capital raised within the U.S., the U.K., Singapore, and Hong Kong combined possess roughly half of worldwide funds raised by all ICOs in the first quarter of 2019.<sup>109</sup> The implication of this approach, either encouraging Fintech innovation or being cautious about ICO risk, may also establish a paradigm that affects other jurisdictions.

*iii. New regimes for the crypto-industry and its ecosystem*

At the other end of the spectrum, some countries have formed new and supportive frameworks for ICOs and the crypto-industry. The French government plans to take the leading role in developing the E.U.’s framework of the crypto-industry.<sup>110</sup> Specifically, in addition to providing the whitelist and blacklist of ICO issuers,<sup>111</sup> the French authority (AMF) has not only published specific conditions on which it would approve ICOs, but also emphasized that without approval, ICOs may still be legal, though

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<sup>107</sup> MONETARY AUTHORITY OF SINGAPORE, *A Guide to Digital Token Offerings*, (Apr. 2019), <https://www.mas.gov.sg/-/media/MAS/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Guide-to-Digital-Tokens-Offering-last-updated-on-5-April-2019.pdf>.

<sup>108</sup> See, e.g., *Coinbase’s Written Testimony for the Subcommittee on Capital Markets, Securities, and Investment*, COINBASE BLOG (Mar. 13, 2018), <https://blog.coinbase.com/coinbases-written-testimony-for-the-subcommittee-on-capital-markets-securities-and-investment-47f8a260ce41> (arguing that the absence of legal certainty “[harms] healthy innovation in the U.S.” because tokens users would leave the US market).

<sup>109</sup> *ICO Market Quarterly Analysis Q1 2019*, ICOBENCH [https://icobench.com/reports/ICO\\_Market\\_Quarterly\\_Analysis\\_Q1\\_2019.pdf](https://icobench.com/reports/ICO_Market_Quarterly_Analysis_Q1_2019.pdf).

<sup>110</sup> See CRYPTOCURRENCY IN SELECTED JURISDICTIONS, *supra* note 63, at 34–39 (June 2018), <https://www.loc.gov/law/help/cryptocurrency/regulation-of-cryptocurrency.pdf>.

<sup>111</sup> The French government publishes the whitelist and the blacklist to increase transparency of tokens to the public. See *Listed companies & corporate financing: Initial Coin Offering (ICO)*, AMF (last visited Oct. 25, 2019), [https://www.amf-france.org/en\\_US/Acteurs-et-produits/Societes-cotees-et-operations-financieres/Offres-au-public-de-jetons-ICO](https://www.amf-france.org/en_US/Acteurs-et-produits/Societes-cotees-et-operations-financieres/Offres-au-public-de-jetons-ICO).

issuers without approvals cannot market their ICOs directly to the public in France.<sup>112</sup>

Likewise, Malta has been supporting crypto-industry development. The Maltese government has published the Guidance to Financial Instrument Test (FI Test),<sup>113</sup> providing a comprehensive framework to determine “whether a DLT Asset qualifies as (i) Electronic Money ... (ii) a Financial Instrument ... [or] (iii) a Virtual Financial Asset or a Virtual Token.”<sup>114</sup> The FI test has three stages, each of which requires token users to complete specific details about their tokens in the online system, and the system eventually determines the category in which the token falls. This Guidance and the online platform provide an efficient and specific mechanism for token users: the Guidance provides a rationale for determining the crypto-asset category as well as a step-by-step manual for token users.

*iv. A few outliers and “sandboxes”*

There are also a few jurisdictions adopting even more innovative frameworks. For example, originally the Japanese government had a strict regulatory requirement for service providers in the crypto-industry, while it created a new framework for crypto-assets.<sup>115</sup> As of May 1, 2020, new crypto regulations have been adopted through amendments to the Payment Services Act (PSA) and the Financial Instruments and Exchange Act (FEIA). Previously, most crypto-assets in Japan were not securities under the statute.<sup>116</sup> Instead of regulating conduct based on the tokens’ function like most jurisdictions, the Japanese government required all virtual currency service providers in the crypto-industry to register and obtain licenses.<sup>117</sup> The amendments in force as of May 1, 2020 made significant changes to crypto-asset regulation, including requiring unlicensed crypto trading platforms not to market to Japanese users

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<sup>112</sup> *Id.*; see also Christophe Perchet, Juliette Loget & Stéphane Daniel, *France*, in BLOCKCHAIN & CRYPTOCURRENCY REGULATION 2019 283–85 (Josias Dewey ed., 1st ed. 2019).

<sup>113</sup> MALTA FIN. SERV. AUTHORITY (MFSA), *Financial Instrument Test Guidelines*, (Apr. 2019), [https://www.mfsa.mt/wp-content/uploads/2019/05/VFAG\\_FITest\\_1.02.pdf](https://www.mfsa.mt/wp-content/uploads/2019/05/VFAG_FITest_1.02.pdf).

<sup>114</sup> *Id.*

<sup>115</sup> Katsuhiko Fujihira & Seth M. Graham, *FSA Proposes Bill to Amend Japanese Laws Regulating Cryptocurrency-Related Businesses*, MOFO BLOG (Apr. 9, 2019), <https://www.mofo.com/resources/publications/190409-japanese-cryptocurrency.html>.

<sup>116</sup> Taro Awataguchi, Anderson Mōri & Tomotsune, *Japan*, in BLOCKCHAIN & CRYPTOCURRENCY REGULATION 2019 349–58 (Josias Dewey ed., 1st ed. 2018).

<sup>117</sup> *Id.*

and residents.<sup>118</sup> Additionally, the regulations introduced two self-regulatory organizations for the crypto-industry: the Japan STO Association, and the Japan Virtual and Crypto Assets Exchange Association (JVCEA).<sup>119</sup>

It is noteworthy that these categories of approaches are dynamic and not mutually exclusive to each other. Several governments provide the “regulatory sandbox” at the boundary of their pre-existing framework.<sup>120</sup> For example, the FCA of the U.K. approved twenty-nine businesses to operate at a small, short-term scale for certain tokenized and banking projects from July 2018 to February 2019,<sup>121</sup> while maintaining its current framework mentioned in the sitting-on-the-fence approach. Similarly, Taiwan's Financial Supervisory Commission, which for the most part maintains its pre-existing framework, also announced two tracks for ICO security tokens based on the amount of the capital raised: the issuers of ICOs raising capital below NTD 30 million (approximately USD 1 million) can apply for the exemption track—which enables non-listed companies to raise funds from accredited investors<sup>122</sup>—whereas those above NTD 30 million are required to obtain approval under the Financial Technology Development and Innovative Experimentation Act in advance of their issue.<sup>123</sup>

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<sup>118</sup> Kevin Helms, *Japan Implements Significant Changes to Cryptocurrency Regulation Today*, BITCOIN.COM (Apr. 30, 2020), <https://news.bitcoin.com/japan-changes-cryptocurrency-regulation/>.

<sup>119</sup> *Id.*

<sup>120</sup> See, e.g., *Advice to ESMA: Own Initiative Report on Initial Coin Offerings and Crypto-Assets, Annex 2 – Regulatory Sandboxes and Innovation Hubs*, SEC. & MKTS. STAKEHOLDER GROUP (Oct 19, 2018) (“In August 2018, 12 financial regulators . . . announced the creation of the Global Financial Innovation Network (GFIN) . . . ‘to provide a more efficient way for innovative firms to interact with regulators, helping them navigate between countries as they look to scale new ideas’”).

<sup>121</sup> *Regulatory Sandbox—Cohort 4*, FIN. CONDUCT AUTHORITY (last updated Feb. 20, 2019), <https://www.fca.org.uk/firms/regulatory-sandbox/regulatory-sandbox-cohort-4-businesses>.

<sup>122</sup> 金融監督管理委員會，金管會對「證券型代幣發行(*Security Token Offering, STO*) 相關規範」之說明 [Explanation of the FSC on "Security Token Offering (STO) Related Specifications"], FIN. SUPERVISORY COMMISSION R.O.C. (TAIWAN) (Jun. 27, 2019), [https://www.fsc.gov.tw/ch/home.jsp?id=96&parentpath=0,2&mcustomize=news\\_view.jsp&dataserno=201906270004&aplistdn=ou=news,ou=multisite,ou=chinese,ou=ap\\_root,o=fsc,c=tw&dtable=News](https://www.fsc.gov.tw/ch/home.jsp?id=96&parentpath=0,2&mcustomize=news_view.jsp&dataserno=201906270004&aplistdn=ou=news,ou=multisite,ou=chinese,ou=ap_root,o=fsc,c=tw&dtable=News).

<sup>123</sup> See generally *Jin Rong Ke Ji Fa Zhan Yu Chuang Xin Shi Yan Tiao Li* (金融科技發展與創新實驗條例) [Financial Technology Development and Innovative Experimentation Act] (passed by Legislative Yuan, Dec. 29, 2017, and promulgated by the President, Jan. 31, 2018), R.O.C. (TAIWAN).

#### **IV. CONCLUSION AND TAKEAWAYS**

The rapid development of the crypto-industry creates opportunities and challenges to the financial industry as well as regulators. This Commentary aimed to explain the terminology and implication of the blockchain technology in the crypto-industry.

In addition to charting some of the core terminological challenges, this Commentary showed that, despite having the same purpose for fundraising, ICOs are still quite different from IPOs, and governments around the world have been experimenting with regulations in various ways—from a complete ban, to case-by-case analysis, to new frameworks incentivizing small and medium-sized enterprises (SMEs) to utilize ICOs. While it is too early to tell whether an international regime is appropriate for ICOs and crypto-industry regulations, without international cooperation, the issuers of ICOs will likely choose a jurisdiction that favors the crypto-industry.

Regulators and the public alike have to balance the benefits and costs when they decide whether to regulate ICOs, and what policy goals are to be served by such regulations. Issuers of ICOs should beware of their offering's legal implications before launching one, especially in a jurisdiction without a clear regulatory framework, whereas consumers and investors should remain alert that few legal remedies are currently available or enforceable when disputes over the crypto-assets transactions occur.