DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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INITIAL COIN OFFERINGS – ARE THEY JUST GETTING STARTED OR COMING TO A HALT?

The rise of cryptocurrencies has created a new method to raise capital, the initial coin offering ("ICO"). An ICO is a process used mainly by private tech startups from the digital sector, where a company creates a new virtual coin or token ("coin") and offers it for public sale. ICOs are raising amounts of money comparable to the amount of money raised by venture capital fundraising. In the third quarter of 2017, ICOs reportedly raised $1.32 billion and early-stage tech companies using venture capital fundraising raised $1.41 billion. ICOs are on pace to top 2017's total of $6.5 billion raised in coin offerings, with $1.66 billion raised through February 2018.

To buy a coin from an ICO, an investor typically needs either Ether or Bitcoin and a digital wallet*. Usually, an investor will send the digital currency directly to the wallet of the company offering the ICO. The coins being sold usually do not confer any ownership rights in the company selling them. Instead, the coin is meant to be used within an online service or to buy the company's product or service, if it is ever launched. Individual investors are not the only people buying coins launched from ICOs. Wealth management firms and hedge funds are actively trading cryptocurrencies.

The volatility of the cryptocurrency market recently has been extreme and it is likely that some of the volatility is related to the regulatory uncertainty surrounding cryptocurrency regulation and the ICO market. See our prior ALERTS of February 20, 2015 and January 18, 2018.

Most recently, the Securities and Exchange Commission ("SEC") launched a cryptocurrency probe in late February, issuing subpoenas and information requests to technology companies. The SEC is reportedly focused in part on simple agreements for future tokens ("SAFTs"). SAFTs allow big investors and well-off individuals to buy rights to coins ahead of their sale. The SEC is concerned SAFTs are potentially being used to trade like securities without conforming to strict securities' rules.

The Department of the Treasury ("Treasury") also released a letter March 6, dated February 13, that states virtual currency exchanges and administrators, including ICO issuers, have been subject to the Bank Secrecy Act's ("BSA") money transmitter requirements since 2011. The Treasury considers virtual currency exchangers and administrators money transmitters, and requires each must comply with the BSA and its implementing regulations, which include registering with the Financial Crime Enforcement Network ("FinCEN") as a money service business. The Treasury takes the view that generally, a developer that sells convertible virtual currency, including in the form of ICO coins or tokens, in exchange for another type of value that substitutes for currency is a money transmitter and must comply with anti-money laundering requirements. Issuers of ICOs must also be wary of varying state money transmitter licensing requirements and the New York BitLicense.

ICO arrangements vary and participants could fall under the authority of the SEC or Commodities Futures Trading Commission, depending on the offering.

Notwithstanding the federal uncertainty, ICO issuers may soon find some relief on the state level in Wyoming. Wyoming's state legislature passed H.B. 70, which is headed to Governor Matt Mead for signature. H.B. 70 exempts tokens offered in Wyoming via an ICO from needing to be registered as a security, so long as the tokens conform to the purposes outlined in the statute. If the bill is signed into law, it will be the first time an elected body defines a utility token as being something other than a security. The Wyoming House has also unanimously passed H.B. 19, a bill that exempts cryptocurrencies from the state's money transmission laws.

ICO markets arguably create value and give small start-ups business opportunities to arrange funding that traditional funding methods fail to offer. State and federal regulators continue to struggle with the characterization and classification of cryptocurrencies as non-traditional assets that do not neatly fit within existing regulatory regimes. Answers to cryptocurrency regulation may affect more traditional assets, stores of value and the use of cryptocurrency as a payment method**.

On the state level, the first few months of 2018 have seen heightened attention to the ICO and cryptocurrency market. We will continue to monitor this nascent and rapidly evolving area. ❑

✧ *Mike Tomkies and Lindsay Valentine*

NOTES

* Bitcoin was the first global cryptocurrency introduced and it was created as an alternative medium of payment and store of value. Bitcoin has a hard

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limit on the eventual number of Bitcoins and requires "miners" to find a solution to create a Bitcoin. Ether is the currency vehicle for Ethereum. Ethereum is a blockchain technology platform which facilitates peer-to-peer contracts and applications via Ether. Ethereum standardized the coding for creating a coin and can be credited for the boom of ICOs.

** At least 13 major retailers and services currently accept Bitcoin, including Overstock, Expedia, Dish Network, small businesses using Intuit's PayByCoin service and Microsoft. Amazon registered three domain names related to cryptocurrencies in November 2017.