

ANALYSIS OF FOREIGN EXPERIENCE IN THE REGULATORY FRAMEWORK OF DISTRIBUTED LEDGERS AND ICO (INITIAL COIN OFFERING) WITHIN INNOVATIVE ECONOMY

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Abstract

Purpose: The article analyzes the content of economic and legal mechanisms of state control over the emerging market of ICO (Initial Coin Offering).

Methodology: This was analytical-logical research based on content analysis.

Result: Regarding the considered areas of legal regulation, it is worth noting that in regulating the protection of intellectual rights, counteracting legalization and laundering of money obtained by criminal means, as well as in regulating the protection of personal data, most states use the current legislation without any changes.

Applications: This research can be used for universities, teachers, and students.

Novelty/Originality: In this research, the model of the analysis of foreign experience in the regulatory framework of distributed ledgers and ICO (initial coin offering) within innovative economy is presented in a comprehensive and complete manner.

Keywords: *crypto industry, tokens (digital coupons), blockchain, smart contracts, cryptocurrency.*

INTRODUCTION

From the point of view of civil law, ICO is a proposal to conclude a preliminary contract for the sale and purchase of assets of a binding nature at the stage of the formation of a legal entity. Tokens (or digital coupons) are used here as securities. They are released on the blockchain, which guarantees the irrevocability and transparency of transactions, as well as the accuracy of the execution of agreements through the use of smart contracts ([Young, G. 2008](#); [Bornstein, B.H., Schwartz, S.L. 2009](#); [Kane, A. W., Dvoskin, J. A. 2011](#)).

According to Autonomous NEXT, since 2014, the yield of the initial investors averaged 123%, and the investments were distributed in the following sectors: cryptocurrency, service blockchain, cloud investments, and payments. In addition, although in 2017, the share of other areas of investment through ICO (media, computer games, Internet of things, etc.) significantly increased, areas with high economic and criminological risks (cryptocurrency and payment solutions for the crypto market) remain the most popular.

According to Chainalysis estimates, in 2017 alone, about 1.6 billion US dollars were attracted to ICO. At the same time, already 10% of the projects were considered fraudulent. So, according to Bloomberg, the number of victims of cybercriminals in ICO this year is about 30 thousand. Each of the victims lost an average of \$7.500. Specifically, the calculations were based solely on phishing fraud, when the withdrawal of investors' funds is carried out through the transfer of money to fake addresses. If we start from the intentional non-fulfillment by startups of obligations to investors, then the number of fraudulent projects will increase at least five times ([Poser, S., Bornstein, B.H., & McGorty, E. K. 2003](#); [Zavos, H. 2009](#); [Smith, D. 2007](#); [Watanabe, N. 2019](#)).

High fraud risk now forces states to look for optimal controls over the ICO market.

In general, we can underline the formation of three main strategies for the legal regulation of the primary token allocation.

THE ANGLO-SAXON MODEL: EQUATING TOKENS TO SECURITIES

The formation of this model was initiated by the investigation of the US Securities and Exchange Commission (SEC) (hereinafter referred to as the Commission) against the German company [Slock](#), which created the DAO for the purpose of making a profit by creating and obtaining assets by selling DAO tokens to investors, whose funds were used would be to finance a project.

DAO token holders could monetize their investments in DAO tokens by reselling them on several web platforms that supported secondary trading in DAO tokens. After the sale of tokens, but before the start of project financing, the criminals

took advantage of the lack of an electronic DAO code and stole approximately one-third of DAO assets. In fact, investors remained unprotected, and the company was not responsible for the loss of assets.

The losses incurred by investors forced the US authorities to assess the possibilities of protecting the interests of ICO members by extending securities laws to tokens.

As the SEC officially announced, the tokens sold by the DAO, a virtual organization created by Slock.it, were securities and were subject to federal laws. In addition, all companies that issue assets based on blockchain technology must register transactions under the rules on the placement of securities. In case of violation of these rules, participants of unregistered transactions should be liable for the violation of the legislation on securities.

Thus, in the US, an attempt was made to bring the ICO regulation under the provisions of securities laws with the corresponding regulation of exchanges, exchange sites, and investors' rights.

This step was ambiguously met in the financial market. So, in particular, David Moskowitz, founder, and CEO of cryptocurrency firm Attores endorsed an important distinction between conventional virtual currencies and tokens similar to securities, indicating that in this case the SEC will not affect the development of cryptocurrency innovations. Others, on the contrary, considered that the Commission's decision could slow down the development of innovations in the blockchain sector, however, society would overcome this.

The decision of the US to regulate individual ICO projects with the promise of profits under the securities laws became a kind of trigger for launching a similar strategy in Singapore and Canada.

The Monetary Authority of Singapore (MAS) announced on August 1, 2017, that if tokens have the properties of securities, they are subject to regulation, like shares placed on stock exchanges.

It is important to emphasize that MAS has delimited digital tokens and virtual currencies. Under digital tokens, it was proposed to understand cryptographically protected evidence of the holder's right to receive income or to perform certain actions, and under virtual currencies - digital tokens, usually used as means of payment, measure of value and means of cost-saving. Thus, for the first time, at the sub-legal level, real and obligatory rights in the field of crypto technologies were delimited ([Emam, S. S., & Shajari, H. 2013](#); [Suleri, J., & Cavagnaro, E. 2016](#); [Mollaei, B., Gorji, Y., & Rezaei, F. 2014](#); [Manapov, K. B. 2018](#));

The MAS competence does not apply to all types of tokens, but only to those that fall under the provisions of the Securities and Futures Act (Cap. 289), and the Financial Advisers Act (Cap. 110)). The result of this approach may be the separation of Singapore exchange enterprises into licensed and non-licensed.

Canada became the third country to equate tokens with promises of dividends to securities.

On August 24, the CSA (Canadian Securities Administrators) issued a special act Staff Notice 46-307 Cryptocurrency Offerings, in which it determined that tokens are subject to the provisions of the Securities Act if investors or businesses are located in the country ([Venegas, P. \(2017\)](#)).

However, proper registration should be carried out only if the properties of the tokens correspond to the characteristics of the securities. Tokens are subject to relevant legislation if they comply with 4 parameters: investing money, the presence of a corporation, the expectation of profit, and making a profit through the actions of third parties. It is interesting that not every token is recognized as a security, but only one that will be recognized as such by a specific decision of the Commission. It mentioned among the signs of ICO: a large number of investors, the use of the Internet to reach a larger audience, attending public events to advertise their tokens, collecting funds from a large number of investors.

Sale of shares can be carried out only upon receipt of a permit from the relevant regulatory authority.

If any platform exchanges tokens, the properties of which allow them to consider them as securities, it must be registered.

Of interest is the regulation of ICO in the United Arab Emirates. If the project falls under the jurisdiction of the FSMR (Financial Services and Markets Regulation), it will be evaluated by the FSRA for safety in any case. For this purpose, if the tokens in ICO have the properties of security, the FSRA may consider the tokens as securities in accordance with Section 58 (2) (b) 2 of Article 58 of the FSMR "Securities". Therefore, an issuer seeking to launch ICO in or out of an ADGM (Abu Dhabi Global Market) should contact the FSRA as soon as possible.

The issuer of the securities will be obliged to comply with the requirements of sections 58-71 of the FSMR and chapter 4 of the Regulations for Market Activity (MKT). When the Issuer wishes to publicly offer securities on behalf of Abu Dhabi Global Market (ADGM), these requirements include, for example, the obligation to publish a Prospectus in accordance with section 61 of the FSMR.

A person may make a public offer of securities without a prospectus if one of the conditions is fulfilled: the offer is directed to professional clients, or to less than 50 people during any 12-month period; or when the remuneration payable by a person for the purchase of securities is at least \$US 100,000.

In addition, all intermediaries and operators of the primary and secondary securities market, working with tokens-securities, must obtain a license or be approved by the FSRA as holders of a license for the provision of financial services.

In the case when tokens do not have characteristics and properties of securities, such a proposal cannot be an offer of securities, therefore trade in such tokens will not fall under the regulation of FSMR. However, in unregulated ICO investors cannot use the guarantees that accompany the regulated offer of securities. In this case, investors are advised to exercise caution ([Dostov, V., Shust, P., Leonova, A., & Krivoruchko, S. \(2019\).](#)).

If funds for ICO are collected for existing companies and projects, they need to disclose information about products, tokens and business plans.

The document also invites enterprises and businesses that would voluntarily help develop standards for conducting such unregulated ICO to create a new legal fund-raising method.

Thus, in the United States, Singapore, Canada and other countries, the regulation of ICO projects followed the path of setting them under the provisions of securities legislation, which, on the one hand, made it possible to view the nature of tokens from the usual perspective of securities regulation, and on the other, ensured the protection of investors against possible abuses by ICO organizers.

EAST ASIAN TEMPORARY BAN MODEL

This model is based on a temporary restriction and even a ban on ICOs and the circulation of cryptocurrency until the government adopts laws regulating this sphere, with the creation of an appropriate cryptographic infrastructure.

It is down this path that the People's Bank of the People's Republic of China went on September 4, 2017, banning ICO in the country.

Now, ICO projects are actually equated with crimes related to the illegal sale of tokens, tickets, illegal issuance of securities, financing of fraud, as well as the organization of financial pyramids, etc.

The Central Bank of China also stressed that virtual currencies are outside the legal field and cannot be considered as the equivalent of fiat currency.

Companies, involved in ICO, should close the website, access to the data warehouse (to delete frames), as well as cancel the license to do business. Financial institutions and non-bank payment institutions cannot carry out business related to transactions and financing of tokens.

Such an adamant position was met by a fall in cryptocurrency by 32% during the week, which gave grounds for individual analysts to talk about the beginning of a crypto-economic crisis.

However, the subsequent statement by the People's Bank about creating a research group, whose task is to study the possibility of "digitizing" the yuan, made it possible to talk about a possible return of China to a crypto economy, but under fundamentally new conditions for centralizing the financial system and stricter ICO requirements.

OFFSHORE REGULATION MODEL

At present, it is only beginning to take shape in regions interested in attracting financial resources.

In particular, in Gibraltar a set of documents was prepared, defining the future regulation of cryptocurrency and ICO.

The Gibraltar Financial Services Commission (GFSC) has noted an increase in the use of tokens based on distributed ledger technology (DLT) as a means of raising funds, especially in the early stages. The blockchain regulation law must be signed at the beginning of 2018. It defines the ICO as "an unregulated way of raising funds within an enterprise or project, usually at an early stage, and often when products and services have not been specifically designed, formed or tested, not to mention the possibility of obtaining income from them ([Momtaz, P. P. \(2019\).](#))"

Tokens differ in structure and purpose. In some cases, tokens are securities, such as company stocks, and their promotion and sale are regulated as such.

Anyone who is considering investing in tokens through an ICO is advised to contact the regulatory authority, the financial compensation system or the ombudsman to clarify the status of the token. In addition, they should warn investors about the token price volatility, in some cases the impossibility of its sale as well as high risks of attracting investments in the early stages of the company's activities.

In general, states using the offshore model consider ICO as raising funds on the basis of voluntary acceptance by the parties of all the criminological risks associated with its conduct. The state reserves only the obligation to inform market participants of these risks, and to ensure the protection of investors only in cases of gross violation by the company of the requirements of not taking preventive measures.

Against the background of the discreteness of the protective legislation in terms of fraud prevention, it seems even more attractive to establish a simplified procedure for registering companies and providing tax incentives.

According to estimates by the Center for the Digital Economy and Financial Innovations of MGIMO Russia, the introduction of an offshore model will allow small states to attract at least \$ 500 million in foreign investments, which, in the case of Gibraltar, is one-fourth of the country's GDP.

Consideration of these models is important in determining the strategy for the development of the crypto-economics of Russia. The Central Bank of the Russian Federation in the information "On the use of "virtual currencies", in particular, Bitcoin, when making transactions" on January 27, 2014, indicated that there is no security for "virtual currencies" and there are no legally obliged subjects for them. Operations are speculative in nature, carried out on the so-called "virtual exchanges" and carry a high risk of losing value ([Martins, V. F., Sampaio, P. N. M., Cordeiro, A. J. A., & Viana, B. F. \(2018\)](#)).

The Central Bank of the Russian Federation confirmed its wary position in a letter issued on September 4, 2017 "On the use of private "virtual currencies"(cryptocurrency)", which warned of high risks when using and investing in cryptocurrencies. The letter noted that most operations are carried out outside the legal regulation of both Russia and most other states. Cryptocurrencies are not guaranteed and are not provided by the Central Bank. In this regard, the attention of citizens and all participants of the financial market is drawn to increased risks when using and investing in cryptocurrency. Operations with cryptocurrencies carry high risks both during exchange operations, including due to sharp fluctuations in the exchange rate and in the case of raising funds through the ICO ([Iurina, A. \(2017\).](#)).

Among the main risks, the Central Bank of the Russian Federation sees the technical danger of abuse during the issue and circulation of tokens, as well as criminological risks in the event of a cryptocurrency exchange for fiat currency, but this message is mainly of a warning nature and does not entail serious legal consequences for market participants. Thus, in modern law, there is a tendency of "moderation" of the ICO in the direction of their recognition as legal securities and the convergence of the ICO mechanism with the procedure of initial public offering of shares.

In continuation of defining approaches to legal regulation, Fintech will conduct a comparative analysis of foreign laws.

When conducting a comparative analysis of legislation in the field of creation and use of financial technologies in foreign countries, the national legislation of 20 countries that are most susceptible to the introduction of financial technologies was studied. Six most sensitive areas of the considered sphere were chosen:

- 1) Content of the concept of "financial technology";
- 2) Financial technology development policy;
- 3) Regulation of certain types of financial technologies;
- 4) Intellectual property rights protection;
- 5) Personal data protection when using financial technologies;
- 6) Counteraction to legalization and laundering of money obtained by criminal means in this area.

CONCLUSION

In accordance with the analysis of legislation in the field of financial technologies in foreign countries, the following basic conceptual approaches of countries to the legal regulation of the latest financial technologies can be distinguished:

- 1) regulation of the creation and use of financial technologies is based on current legislation without its changes (for example, Australia, China, Spain, USA, Canada, Japan, Singapore, Malaysia, Russia, Germany, Estonia, Isle of Man, New Zealand, etc.);
- 2) regulation of the creation and use of financial technologies is based on the current legislation without its changes, while the state has regulatory guidelines in the development of fintech (Australia, Spain, Hong Kong, Malaysia, etc.);
- 3) states that make changes to existing legislation (Hong Kong, Japan, Singapore, UAE, Netherlands, United Kingdom, Korea, Australia, Canada, Switzerland, Malaysia, etc.);
- 4) regulation of the creation and use of financial technologies is accompanied by the introduction of new regulation of certain types of financial technologies (for example, the United Kingdom, Hong Kong, the United Arab Emirates, etc.).

At the same time, the state may fall into several categories of classification.

The main ways of regulating the creation and use of financial technologies are explanations, regulations and information letters of regulators or the expansion of the range of subjects of the current legislation.

Regarding the considered areas of legal regulation, it is worth noting that in regulating the protection of intellectual rights, counteracting legalization and laundering of money obtained by criminal means, as well as in regulating the protection of personal data, most states use the current legislation without any changes.

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