

## Lexology- Initial Coin Offering and its legal framework

- Background-What is ICO

Financing tools alternative to bank financing have been on the rise in the past years. Commonly used methods are finding angel investors, launching an initial public offering or crowd funding. Coin offering is a recent trend on alternative financing methods.

Initial coin offering (ICO) is an investment instrument using the blockchain technology. After booming of the Bitcoin – one type of cryptocurrency-, ICO became popular and dangerous. Lack of regulation on the matter increases risk of fraud. Since virtual or crypto currencies have no legal and binding definition, governments have different approaches on the issuance and trading of such virtual currencies.

Japan accepts virtual money as money and has a set of rules applicable for ICO. USA on the other hand, classifies cryptocurrencies under commodity/funds, or as a type of “digital asset securities” regulated by Securities and Exchange Commission (SEC). ICO is restricted by China in its territory in order to prevent fraud and anti- money laundering. On the opposite side, ICO is supported by Malta. Maltese government announced that Malta will provide ICO investors with incentives and tax advantages. Additionally the government announced that crypto exchange market will be safe since the offshore accounts are not allowed within the territory of Malta Island.

Another ICO supportive country is Switzerland that established crypto-valley. At the same time, due to positive approach of Swiss government, Swiss Financial Market Supervisory Authority (FINMA) published a guideline on cryptocurrencies and ICO. With the said guideline, diversification on types of tokens is made as follows;

-Asset tokens which are called as security token according to SEC. Token, which take a place under this class, provides access to the goods and services that the project will launch in the future. Additionally, this category may be used for discount or premium access to the goods and services. In other words, security tokens represent fixed assets of same kind for example a house or a share in a company.

- Payment tokens are called as crypto-currency according to SEC. This category provides purchase, sale and other financial transaction opportunity to its owner.

- Utility Tokens are classified under the same name in SEC as well. A utility token is a more liquid medium of exchange that gives one access to the value created by a blockchain network. Utility tokens really represent access to a service delivered by a blockchain based ecosystem. Utility tokens represent the service delivered by a network and are quantified units of services that can be accessed within a given network.

Depending on the type of token, investors and participant of an ICO have different rights and responsibilities. For example, while payment and utility tokens are not deemed to be a security; security/ asset tokens can be deemed as a security. Only payment tokens may be considered as a means of payment under anti-money laundering legislations.

In last 5 years, investors and participants made approximately 11 billion dollar investment as per the research on ICOs<sup>1</sup>; and triple of such amount is expected until 2025. All in all, since the cryptocurrency is being used as a payment instrument and it will be using more legal regulation especially on taxation area will be critical for the government.

- ICO projects

Since the tokens have a price, they can be issued and sold at the inception of a new network to fund its development, some steps have to be followed by the investors in order to present their project as an ICO project.

For a simple ICO project below listed items are required;

- blockchain technology
- tokenization
- preparation of a white paper which means proper business plan

- -Turkish legal framework

Since Turkish law does not recognise or regulate cryptocurrencies; coin offering also remains unanswered. There are not any whitepaper or guideline issued by the government regulating cryptocurrencies or blockchain. CMB is the regulator of the capital markets in Turkey and announced on 27 September 2018<sup>2</sup> that it will issue secondary legislation to regulate crowd funding.

On 25 November 2013<sup>3</sup>, the Banking Regulation and Supervision Agency, which is the regulator of the banking market and the payment systems, announced that cryptocurrencies cannot be considered as e-money in Turkey. E-money is defined by the Law No. 6493 on Payment and Security Settlement Systems, Payment Services and Electronic Money as the "the monetary value issued against a fund accepted by the issuing institution, stored electronically, used for carrying out the payment transactions defined by this Law, and accepted as a payment instrument by the real and legal entities other than the institutions issuing electronic money".

Additionally, in its guideline of suspicious transactions, Financial Crimes Investigation Council (MASAK) has listed money transfers for the purpose of purchasing bitcoin to intermediary institutions which sell bitcoin from the accounts of their customers as a type of suspicious transaction.

#### ICO projects in aspect of Crowd Funding

Turkish crowd funding regulation set under the Capital Markets Law No. 6362 ("Law"). Article 3 of the Law defines such concept as " fundraising through funding platforms in an attempt to provide a project or entrepreneurs with the required funding within the principles set forth by the Board, without being subject to provisions related to investor compensation of the Law." As per the Law, the Turkish Capital Markets Board ("Board" or "CMB") is authorized to regulate crowd funding and issue license to crowd funding platforms.

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<sup>1</sup> [https://www.ey.com/Publication/vwLUAssets/ey-research-initial-coin-offerings-icos/\\$File/ey-research-initial-coin-offerings-icos.pdf](https://www.ey.com/Publication/vwLUAssets/ey-research-initial-coin-offerings-icos/$File/ey-research-initial-coin-offerings-icos.pdf)

<sup>2</sup> <http://www.spk.gov.tr/Bulten/Goster?year=2018&no=42>

<sup>3</sup> [http://www.bddk.org.tr/ContentBddk/dokuman/duyuru\\_0512\\_01.pdf](http://www.bddk.org.tr/ContentBddk/dokuman/duyuru_0512_01.pdf)

Crowd funding is a way of raising money for projects and enables fund owners to collect money from a large number of investors via online platforms like ICO.

Main crowd funding criteria are (i) having license for platforms and (ii) following the rules and procedures. As per the Law, in contradictory with ICO, the Board is entitled to determine above-mentioned rules and procedures on establishment, shareholders, share transfers, maximum funding limits of these platforms and fund collection for one project. Thus, as the regulator, the CMB has the authority to supervise crowd funding activities in Turkey as well.

As a comparison, in ICO projects rules and principles are not determined by any of the authority. Additionally, except for USA, licensing issue is not regulated as well. Therefore, there is not any clear guidance issued by the Board as to whether ICO will fall within the scope of the regulatory jurisdiction/authority of the Board. We see that various countries take their regulatory positions and issuing guidance by taking into account the structure and characteristics of, including the rights attached to, a digital coin in determining if the digital coin is a type of capital markets instruments under their respective laws. Thus it can be expected that the CMB will also need to assess these issues and publicize its regulatory position sooner or later.

Thus, on 27 November 2017, CMB announced that bitcoin or cryptocurrencies shall not be used as an underlying asset for derivative instruments and thus investment institutions shall not provide any investment service and activities for trade of any spot and derivative transactions based on such cryptocurrencies. By a resolution dated 27 September 2018, CMB has announced that all necessary administrative and pecuniary measures will be applied to unauthorized activities which can be presented to investors as a crowd-funding before the secondary regulations in relation to crowd-funding are entered into force.

Last but not least, on 3 January 2019, CMB has announced a Draft Communiqué on Equity-Based Crowd-Funding. The draft Communiqué generally aims to regulate, among others, the principles and procedure of equity-based crowd funding activities and establishment, authorisation and activities of crowd funding platforms.

#### ICO vs IPO

Under the Law, public offering is defined as *“a general call made through any means for the purchase of capital market instruments and the sale realised after this call”*. Such concept is regulated with strict rules to be followed by companies. For example, in order to initiate an IPO, among others, the issuer shall apply to the CMB for the approval of a prospectus together with other documents.

Cryptocurrencies are not defined under the Law and its secondary legislation as a capital market instrument, thus there is not any explicit regulatory guidance issued by the CMB yet as to whether the initial public offering rules can be applicable to ICOs. However, it should be noted that the CMB has an obvious authority to prescribe any other new product as a capital markets instrument as per the Law.

- Conclusion

There is not any piece of legislation or any other regulatory framework under Turkish law yet which explicitly recognizes or prohibits cryptocurrency and ICO concepts. Further, there is not any express regulatory guidance issued by the CMB yet as to whether the initial public offering rules can be

applicable to ICOs. However, it should be noted that the CMB has an obvious authority to prescribe any new product as a capital markets instrument as per the Law. In order to avoid any potential issue which may be caused by any fraudulent or money laundering offences, it is advisable that investors should be careful and diligent while making any investment in cryptocurrencies or ICOs.