

Australian regulators have finally made a move on initial coin offerings

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Initial coin offerings have taken off this year Shutterstock

The Australian Securities and Investment Commission (ASIC) has finally issued [guidance](#) to [explain](#) how “[initial coin offerings](#)” (ICOs) will be regulated.

ICOs are a form of crowdfunding, with companies raising funds by selling tokens or cryptocurrencies to investors with promises of a [social good](#) or [financial benefit](#). ICOs have exploded this year, with [one estimate](#) that more than US\$2.2 billion has been raised so far.

But ICOs are also risky. They are mostly created by anonymous entities, are currently unregulated, and may not always refund money upon request or allow the resale of tokens. Investors are often left in the dark with respect to their entitlements, rights, and benefits. ICOs typically confer no ownership rights in the company and, unlike bonds, investors in ICOs do not receive interest payments.

Until recently regulators around the world have been scrambling to figure out how to deal with this new phenomenon.

ICOs are popular because the promoter or operator does not have to apply for registration or a licence, and there is no delay in waiting for regulatory approval. The cost of setting up and releasing an ICO is very low. For investors, the popularity is driven by the expectation that the price of the cryptotoken will increase in value. However, this is risky because when a currency is the subject of intense speculation, its [price will be volatile](#).

Adding to the risk for investors, the cryptocurrencies that promise the highest returns in the

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shortest time are the ones with the lowest market capitalisation, and they are also the most volatile. For example, Dent's market cap is just over US\$5 million (compared with Bitcoin's US\$67 billion) and the [fluctuations in Dent's price](#) in the past week alone reads like a seismogram during a major earthquake.

Regulators are catching up

Australia's new approach is markedly different than the path of regulators in other countries. The Chinese government recently decided to outlaw all ICOs, with seven regulators in China issuing a [joint decree](#). ICOs were declared an unauthorised public financing activity, involving illegal fundraising, financial fraud, and pyramid schemes.

In response to the Chinese ban, many blockchain projects refunded all of the money they had raised. The ban [sent the value of bitcoin](#) (in which many ICOs are denominated) into freefall. Meanwhile, the market capitalisation of [Ethereum](#) [declined by a staggering US\\$6 billion](#) within 24 hours of the announcement.

But China is not the only country to take steps to reign in ICOs.

In July the US Securities and Exchange Commission (SEC) issued a [warning](#) that US securities laws apply to ICOs. It stipulated that no matter what terminology or technology was being used, the sale of digital coins may be regulated as "securities". The effect of this ruling is that ICO operators must [comply with reporting and consumer protection legislation](#), including keeping a register of "investors" and filing annual returns.

The Australian approach

ASIC's information sheet sets out clear guidelines for how to operate within Australia's regulatory framework, while encouraging innovation and the development of new financial business models. Australia's approach is an amalgam of a suite of regulations that might apply to public and private companies when they launch an initial public offering (IPO), raise funds from existing shareholders, or offer financial services.

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The many ways that ICOs stage the release of tokens remains organic. Some pre-empt the process by raising venture capital and most publish a white paper to anticipate the launch. Recently, some ICOs have started imposing a lock-up period of 3-12 months, during which time the investors cannot sell their tokens. Making sense of the projects and the rules imposed on the token sales can make it harder for investors to make an informed decision.

Importantly, if an ICO is operating as a [Managed Investment Scheme](#) (MIS) with people brought together to contribute money in a collective investment to get an interest in the scheme (like a cash management trust or a property trust), the operator will need to comply with a range of disclosure, registration, and licensing obligations under the

[Corporations Act](#)

. An MIS arises when the contributor obtains an interest in the scheme, where the contributors' assets are pooled together, and where that pool of assets is controlled by the operator of the scheme.

According to ASIC, an ICO could also be an offer of shares. In this case the company must keep a [register](#) of all the shares they have issued. This is similar to the way that public companies (that is, companies with more than 50 non-employee shareholders) issue securities. The register must have information about the company's members (or shareholders) and the number of shares in the company. The register must also contain key identification information about each member, as well as the number and types of shares held by each member. Importantly, this sort of offering must be accompanied by a disclosure document.

The [disclosure document](#) must be lodged with ASIC before the launch. Only when a company is issuing shares to fewer than 20 people and raising less than A\$2 million in the first 12 months will it be [exempt](#) from providing that disclosure.

If the ICO is an offer of a derivative (for example, an option or a future), then the company will need to be licensed. In Australia, companies will need a [financial services licence](#) if, as part of their business, they provide financial product advice to clients, deal in a financial product, make a market for a financial product, operate a registered scheme, provide a custodial or depository service, or provide traditional trustee company services.

As well as this detailed guidance for ICO operators, ASIC is directing potential investors to its [MoneySmart](#) website. This provides guidance about the risks of investing in an ICO. It warns that the value of

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crypto-tokens is volatile, that the tokens may be stolen, and that many ICOs are scams.

Buyer beware

Even with this new guidance, the challenge for the investors remains to separate the schemes from the scams. ASIC's media release and information sheet should not be regarded as a general stamp of approval. The regulator is by no means suggesting that they are fit for general consumption.

ASIC recommends that anyone intending to contribute to an ICO check first whether the issuer is a company registered in Australia and whether it has a licence to operate an ICO. If the company is not registered and does not have a licence in Australia, investors will have little protection if things go wrong.

While China is regulating the use of ICOs by banning them (for now), Australia is taking a more supportive approach by encouraging operators to play by the rules. Meanwhile, for consumers the message is clear: when it comes to ICOs, investor beware.

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