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## Blockchain, Tokens, and Mutual Funds—We’re Not There Yet

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Recent buzz around cryptocurrency, initial coin offerings (ICOs), and blockchain technology has sowed confusion among many market participants about the impact of this new technology on the asset management industry. This article discusses the current regulatory state of play and how this innovative technology is likely to play out in the registered funds space. In particular, it discusses the current barriers to investment in cryptocurrencies, tokens, and ICOs by registered investment companies. It also addresses several of the questions posed by regulators as they seek to wrestle this rapidly innovating and disruptive technology into conformity with existing law. At the current time, none of these instruments are viable investments for registered investment companies. The underlying technology, however, has been used by some fund families and will likely continue to be adopted across the industry.

### A Quick Primer on Blockchain and Tokens<sup>1</sup>

Numerous recent articles have described blockchain and its underlying technology.<sup>2</sup> It is perhaps best understood as a means of exchanging and tracking value. A blockchain itself is simply a shared, immutable ledger that records the history of transactions in separate but linked blocks of data. Others

have described it as a database that operates through consensus on transactions between participants without the need for an intermediary. A blockchain can be permissioned (in which case only certain users may validate the transactions on the blockchain) or permissionless (in which case anyone may enter and validate transactions on the blockchain), and it may have various degrees of autonomy—from systems that are still in development to private blockchains to systems that once created function entirely based on the instructions embedded in the software, with no centralized authority. Currently, developers of blockchain projects will either use existing blockchain protocols—for example, the Ethereum protocols—or develop a custom protocol on which their platforms or applications will operate.

Tokens are not little round objects but typically 30 lines of code. They can exist on base protocols, separate networks, platforms built on protocols, and applications that have both a mix of on-chain and off-chain elements. For example, the Bitcoin network is the host platform for Bitcoin, and the Ethereum network is the host platform for Ether. Although the industry is still trying to classify the different types of tokens,<sup>3</sup> they may be roughly categorized into native tokens and tokens that enable various functions. In this sense, it is important to understand that because blockchain is intended to

be decentralized, it must use a form of game theory to incentive participants to participate cooperatively so that the distributed system operates as intended. Tokens, and their design, play a key role in this, insofar as they may incentivize participants to produce (or mine) more tokens, use the platform, or otherwise perform tasks of value to the network.

A native token operates directly on the blockchain. Bitcoin and Ether are both native tokens, although Bitcoin must be mined and Ether has been pre-mined.<sup>4</sup> Functional tokens may enable transactions on a blockchain, permit the holder to gain access to services, pay for services, run applications, or be linked to particular assets. Asset-based tokens, for example, are functional tokens that may be linked to gold or a particular diamond that can be tracked from its mining to an engagement ring—and entitle the holder to the asset. App (short for application) tokens can be issued on the application layer of the Ethereum blockchain through smart contracts. Overall, tokens serve as a kind of fuel that is required for and rewards participants for accessing and performing services on the network.

In the current state of play, as discussed below, a critical issue for regulatory analysis is whether a protocol, platform, or application has reached a stage of development where the token can actually be used for its intended purpose. The intended purpose of a token is essentially static from a functional perspective, that is, if a token's programming calls for it to do a certain thing, then that is the thing that it does. What can change is whether the ecosystem is sufficiently developed for the token to actually do that thing. Once the token can actually be used for its intended purpose, it is said to have utility. As discussed below, this concept of utility is key to current discussions on the regulatory status of the token.

Within this general ecosystem there are multiple variations, and given that this is a rapidly evolving technology it is likely that there are many variations still to come. For purposes of this discussion, it is important to distinguish among three different concepts—cryptocurrency, tokens and related ICOs,

and blockchain technology itself—and to understand their interrelationship. At this stage in the development of the technology, all the plumbing is out in the open. If blockchain continues to develop and thrive, however, within a few short years, it is likely that much of this technical infrastructure will become invisible. Just as one no longer types in code to perform tasks on a computer, but instead can swipe or speak to effectuate the desired action, it is likely that the underlying blockchain transactions will become invisible to most users employing the technology. It is possible that in the world of the future, while millions of people will regularly effect transactions using cryptocurrency, Bitcoin will be as antiquated as Pong.

## Cryptocurrencies, ICOs, and Blockchain

### Cryptocurrencies

In October 2008, the Bitcoin whitepaper introduced a new currency based on distributed ledger technology, also known as the Bitcoin Blockchain. Several years after Bitcoin first burst onto the scene, the US Commodity Futures Trading Commission (CFTC) concluded that Bitcoin should be treated as a commodity trading in a spot market.<sup>5</sup> Currently, Bitcoin and other cryptocurrencies are tradeable on the peer-to-peer networks or exchanges. As the price of these cryptocurrencies has exploded, even relatively unsavvy investors became familiar with the terms “wallets” and “keys.” Cryptocurrencies are fungible tokens that have no other marketed functionality than use as a medium of exchange or stored value. There continues to be uncertainty as to whether tokens functioning as currencies should all benefit from the CFTC's original determination with respect to Bitcoin.<sup>6</sup>

### ICOs

In 2012, a young technologist, enamored with Bitcoin, but not interested in giving up control to venture capitalists, had the ingenious idea that a

software developer, interested in developing a new protocol on the Bitcoin Blockchain, could simply ask people to send Bitcoins to a wallet in exchange for an interest in the protocol. His idea led to the first ICO in 2013, Mastercoin, but it took a while for the concept to really get going. By 2017, however, ICOs had raised \$5.6 billion in capital in a runaway speculative rush that knocked regulators on their heels and left securities lawyers trying to explain the significance of a 1946 case on orange groves to twenty-something software developers in a big rush to launch their own ICOs.

Most of these software developers were initially unaware that an innovation as interesting as blockchain fell squarely in the middle of one of the most regulated sectors of the US and global economies. They modelled their early sales on the crowdfunding used by funding sites such as Kickstarter.

Relatively quickly, however, it was apparent to all concerned that most of the tokens being sold in ICOs met the definition of an “investment contract” and hence were a security within the meaning of Section 2(a)(1) of the Securities Act of 1933, as amended (the Securities Act).<sup>7</sup> In *SEC v. W. J. Howey Co.*<sup>8</sup> and its progeny, the US Securities and Exchange Commission (the SEC) and the courts have laid out the characteristics of an “investment contract.” After some initial delay, the SEC released the so-called DAO Report<sup>9</sup> in July 2017, which laid to rest any idea that tokens were something different or new that fell outside the federal securities laws. In strong language, the Report stated:

The Commission deems it appropriate and in the public interest to issue this report of investigation (“Report”) pursuant to Section 21(a) of the Exchange Act to advise those who would use a Decentralized Autonomous Organization (“DAO Entity”), or other distributed ledger or blockchain-enabled means for capital raising, to take appropriate steps to ensure compliance with the U.S. federal securities

laws. All securities offered and sold in the United States must be registered with the Commission or must qualify for an exemption from the registration requirements . . . .

This Report reiterates these fundamental principles of the U.S. federal securities laws and describes their applicability to a new paradigm—virtual organizations or capital raising entities that use distributed ledger or blockchain technology to facilitate capital raising and/or investment and the related offer and sale of securities. The automation of certain functions through this technology, “smart contracts,” or computer code, does not remove conduct from the purview of the U.S. federal securities laws. [Citations Omitted.]

The DAO report thus established that tokens and ICOs fell squarely within the ambit of the federal securities laws. It did not, however, stem the tide of ICOs. While a certain percentage of the ICO markets likely involves fraudulent enterprises,<sup>10</sup> the fundraising model has continued to be used. Similarly, blockchain developers have used other methods, such as airdrops,<sup>11</sup> to place tokens in the hands of potential users as a way to jumpstart a community. While ICOs face many regulatory hurdles, as discussed below, they can increase transparency in the projects and technology through the publication of so-called White Papers that describe the technology and use case and offer the possibility of an effective financing mechanism for bona fide blockchain projects.

As discussed in detail below, however, and as with cryptocurrency, for practical purposes, registered mutual funds are currently unable to invest in these token offerings.

### Blockchain Technology

One of the best use cases for blockchain technology is the financial services industry. Blockchains

can be very slow, but they can offer several significant advantages over traditional settlement systems, in particular, immutability and elimination of an intermediary. Many asset managers are actively exploring the use of the technology in their business lines. To take just a few examples:

- IBM has introduced blockchain banking solutions that reduce settlement times and lower costs for global payments.<sup>12</sup>
- Fidelity Investments has been researching and experimenting with blockchain technology since 2014. In 2014, Fidelity started using its internal research and development department, Fidelity Labs, to look into blockchain technologies. In 2015, Fidelity established the Fidelity Blockchain Incubator, which dedicated a team to experiment with blockchain technologies and a number of digital currencies. Also in 2015, Fidelity Labs created Fidelity's Bits and Blocks Club to be an internal learning program for all Fidelity employees. Since 2014, Fidelity has entered into various collaboration relationships with Ideo Co-Lab, the Institute for the Future, Harvard University, University College London, the MIT Media Lab, and IC3. In addition, Fidelity Labs has built pilot programs around the blockchain. For instance, Fidelity built a protocol to accept Bitcoin in its employee cafeteria. It also allowed for donors to its charitable fund, Fidelity Charitable, to contribute Bitcoin or Ether. Finally, Fidelity has taken steps to integrate its products with existing products in the blockchain space, such as its integration with Coinbase.<sup>13</sup>
- In December 2017, Vanguard announced a pilot program to use blockchain technology for sharing and using index data. In a partnership with the Center for Research in Security Prices (CRSP<sup>®</sup>) and Symbiont, Inc., Vanguard's pilot program uses index data from CRSP<sup>®</sup> and Symbiont's blockchain technology to allow investment managers to instantly distribute,

receive, and process index data. The Vanguard pilot program aims to improve benchmark tracking, automate workflows with smart contracts, and eliminate the need for manual updates.<sup>14</sup>

- T. Rowe Price announced a pilot program that uses "Bankchain," a post-trade settlement platform powered by blockchain. The Bankchain system has the potential to streamline the post-trade process.<sup>15</sup>
- Fidelity, Putnam Investments, Schroders, and SEI have created "incubation" programs for start-up companies. These arrangements can include a mix of physical workspace, access to executives, working with in-house tech teams, and financial support. For instance, SEI uses its "Codify" incubator to focus on companies developing technologies to support compliance or regulatory reporting.<sup>16</sup>
- Several asset management firms in addition to Fidelity have established labs. In February 2018, BlackRock announced that it had created an innovation lab focused on artificial intelligence, similar to RBC Global Asset Management, which had previously announced its own lab. In 2015, State Street created its own lab to explore blockchain technology.<sup>17</sup>
- Although the project itself has stalled, Eaton Vance, AB, KKR, and Credit Suisse had previously collaborated to create a blockchain-based tool to streamline the operations requirements to trade syndicated loans.<sup>18</sup>

In the coming years, it is very likely that blockchain technology and applications will be used increasingly by financial institutions.<sup>19</sup>

## Tokens and Cryptocurrencies in Mutual Funds—Regulatory Roadblocks

Currently, regulators from the SEC to the CFTC to the Office of the Comptroller of the Currency (OCC) to regulators around the globe are trying to come to terms with how to regulate cryptocurrency

and token sales. A threshold question that regulators are seeking to address is the status of tokens under the US securities laws. The ultimate determination of the regulatory status of tokens will affect every element of how this technology will fit into the US securities markets: Can tokens be offered and sold to the public? Can tokens be traded on an exchange? What information must be publicly available? And, for purposes of this discussion, could tokens and cryptocurrencies become viable assets in which registered investment companies may invest?

For now, that answer appears to be “not yet.” In January 2018, Dalia Blass, the Director of the Division of Investment Management of the SEC issued a public letter that concluded, among other things, “[W]e have, at this time, significant outstanding questions concerning how funds holding substantial amounts of cryptocurrencies and related products would satisfy the requirements of the 1940 Act and its rules.”<sup>20</sup>

Blass posed a series of questions touching on the following topics: valuation, liquidity, custody, arbitrage (for exchange traded funds), and potential market manipulation. Blass and other regulators, including SEC Chairman Jay Clayton, have also raised key issues with respect to accounting, audit, reporting, and general concerns over asymmetry of information between investors and the developers and founders of tokens and blockchain tokens. A fuller discussion of overcoming certain of those regulatory hurdles is below.

### ICOs and Tokens

As alluded to above, the SEC and state regulators<sup>21</sup> have made it abundantly clear that state and federal securities laws apply to token offerings. As SEC Chairman Clayton recently stated, “When investors are offered and sold securities, whether through traditional channels or through an ICO on a sales-oriented website, state and federal securities laws apply. These laws have applied to our securities markets for over 80 years. At their core, these laws require full and fair disclosures of material

information about both the securities and the venture being funded. Unfortunately, some market participants seem to believe that the use of new technology provides a basis for ignoring the core principles of our securities laws.”<sup>22</sup> Thus, the fact that the securities laws apply is settled. The application of those laws, however, remains unsettled on several critical points.

Most legal professionals and industry participants agree that, based on application of the *Howey* test, in the early stages, most tokens should be considered to be securities and hence subject to all of the requirements of state and federal securities laws.<sup>23</sup> The question arises not on that easy case but on a much harder question that occurs later in the development stage. At a certain point in time, a token becomes functional on the base protocols, separate networks, platforms built on protocols, or applications for which it is designed. So, while initially tokens may be sold as a means of financing the growth of the blockchain project for which they are designed, at some point, their value ceases to rely “on the efforts of others” and becomes a function of the value of the service that they perform. At that juncture, not only would *Howey* no longer seem to apply, but it would be impractical to seek to impose security-type restrictions on the transfer of the tokens. Practitioners refer to tokens at this stage as “utility” tokens and have sought to advance an argument that, following utility, the tokens should cease to be treated as securities.

If a token is a security prior to utility, its offer and sale is very difficult to effectuate in a manner that complies with federal and state securities laws. For a variety of reasons, registration of token offerings has not been pursued in the market. Available exemptions generally require that the token be legended and that its offer and sale be restricted for the applicable period of time.<sup>24</sup> The peer-to-peer networks on which tokens trade and other features of the market make legending and imposition of lock-ups impractical, if not impossible. As

a result, the industry migrated to use of a variation on an instrument commonly used for early stage companies called a Simple Agreement for Future Equity and created a new instrument referred to as a Simple Agreement for Future Tokens or SAFT.<sup>25</sup> SAFTs are acknowledged to be securities and sold in offerings generally complying with Regulation D or other available exemptions. SAFTs allow for legending and lock-ups as required under the applicable exemptions. While the offering and sale of the SAFTs comply with federal securities law, they pose two distinct issues. First, as securities, they typically are sold only to accredited investors, who likely are purchasing as investments, not with the intention to use the tokens as intended at the time of utility. Thus, this early token distribution may not put tokens in the hands of those who are mostly likely to use them.<sup>26</sup> More importantly, the SEC has not endorsed the view that a token delivered in connection with a SAFT, at the time that the token reaches utility, would be freely transferable. While strong arguments exist in support of the mutability of the token,<sup>27</sup> supporting a position that it could change its regulatory status, at this time there is no clear resolution of the issue.<sup>28</sup> An additional problem is how to define a level of utility sufficient to conclude that the value of the token would no longer depend upon the “efforts of others.” While some token sellers have released the tokens “at utility,” other have not, in consideration of the regulatory risk, resulting in a chokepoint where early capital may be indefinitely locked up. This is an important issue that may require some form of no-action or other regulatory relief to resolve. Regulators have also pursued regulatory actions against some participants in these offerings. Resolution of those actions may also provide some insight into the problem, although overriding issues of fraud in those cases may cloud the other legal issues.

### Custody

The greatest current impediment to mutual funds interested in participating in the investment

opportunities presented by blockchain technology is the paucity of options to custody tokens and cryptocurrencies in a manner that complies with the Investment Company Act of 1940, as amended (the 1940 Act). Currently, purchasers of tokens must open an account on one of the various wallet services that is accessed through a personal code, referred to as a key. A common practice is to print the code to ensure its safekeeping and to remove it from computers or other internet-connected devices to avoid hacking.<sup>29</sup> For mutual funds to invest in tokens or cryptocurrencies, they must be able to custody the tokens in a manner that is far more robust than existing wallet services.

Section 17(f) of the 1940 Act provides that a registered fund must “maintain its securities and similar investments in the custody of [, among certain other kinds of entities,] a bank or banks having the qualifications prescribed in [Section 26(a)(1) of the 1940 Act].”<sup>30</sup> Various market participants are working toward establishing a financial institution able to meet this definition and with internal operations able to hold blockchain assets. One promising option is a state-chartered trust company. The 1940 Act defines “bank” in a manner that incorporates both federal and state concepts. As defined in Section 2(a)(5) of the 1940 Act, a “bank” includes, among other things, any “trust company, whether incorporated or not, doing business under the laws of any State or of the United States, a substantial portion of the business which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks under the authority of the Comptroller of the Currency, and which is supervised and examined by state or federal authority having supervision over banks or savings associations, and which is not operated for the purpose of evading the provisions of this title . . . .”<sup>31</sup> In assessing whether a trust company could qualify as a custodian,<sup>32</sup> therefore, it is necessary to consider whether the trust company exercises fiduciary powers similar to national banks under the authority of the OCC.

That particular analysis requires a review of federal banking law and regulation that turns on the meaning of “fiduciary powers” and the interplay between state and federal regulation with respect to what states consider to be a fiduciary power for purposes of the state’s banking oversight function.

In New York State, a New York State-chartered limited purpose trust company would appear to exercise fiduciary powers. Consistent with that interpretation, NYDFS has publicly stated that it intends that any limited purpose trust company charter that it grants should be for “the sole purpose of exercising fiduciary powers.”<sup>33</sup> That suggests that all or virtually all powers exercised by a New York State-chartered limited purpose trust company would be considered fiduciary powers, whether expressly enumerated under state law or not. Further among the powers that New York state law expressly includes in the term “fiduciary powers” are “custodial services.”<sup>34</sup> Of note, to be a “bank,” a trust company may not operate for the purpose of evading the purposes of the 1940 Act. A trust company seeking to custody crypto assets would have to be established for purposes wholly unrelated to evading the purposes of the 1940 Act. Instead, it would seek to facilitate investment companies’ compliance with the full requirements of Section 17(f) and the rules thereunder.

### Market Manipulation

A frequently expressed concern of SEC officials relates to the asymmetry of information that may exist in a token market. Whereas the federal securities laws have established robust procedures to ensure fair markets, through a disclosure-based system and limitations on trading while in possession of material non-public information, the application of all elements of this regime are not apparent in the crypto markets. For example, under certain blockchain protocols, founders retain substantial amounts of the tokens, with various methodologies for releasing the tokens at later points into the ecosystem. It is not hard to imagine how this could affect price, especially where a speculative market exists. What is

harder is to take the steps needed to develop a system to limit opportunities for manipulation. In addition to adopting traditional disclosure regimes (possibly using as models streamlined reporting options), such a system could be built into the programming or could lever the generally higher degree of transparency available over a blockchain. Without resolution of this issue, the SEC may be unwilling to proceed with providing no-action or other regulatory relief to address other pressing issues.

### Valuation

Mutual funds holding crypto assets must be able to value them in accordance with the requirements of the 1940 Act. This raises numerous questions, but may be one of the easier issues to solve, because to some degree the problem is similar to issues that arose in valuing dot.com stocks during the early years of the internet and valuing privately held companies in today’s world of unicorns where companies with substantial market floats do not trade publicly. The combination of the availability of trading markets for many tokens and fair valuation options, should allow for the development of viable and robust valuation methodologies.

### Conclusion

In sum—blockchain represents an explosive and disruptive technology—the technology has moved as fast as the iPhone, which was developed at about the same time, in a regulatory space that moves much more slowly. Blockchain itself continues to transform and develop, even as regulators and lawyers seek to refine their understandings and analysis. Mutual funds, with their many investor safeguards, could become an important vehicle for investors to benefit from likely capital appreciation in this market, once the regulatory hurdles are overcome.

At the same time, blockchain has gripped the popular imagination and taken on a life far beyond what is actually possible. Its ultimate role in the industry may be more as a mundane processing method than the road to riches.

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#### NOTES

- <sup>1</sup> In this article, we use the term “token.” Tokens and coins in blockchain vernacular are interchangeable.
- <sup>2</sup> See, e.g., Jesse P. Kanach, Andrew P. Cross, & Mary C. Moynihan, *As Fintech Platforms Grow Up, Investment Management Firms Face the ‘Problems of Tomorrow’*, *The Investment Lawyer*, Mar. 2017; see also Joel S. Telpner & Thomas M. Ahmadifar, *ICOs, The DAO, and the Investment Company Act of 1940*, *The Investment Lawyer*, Nov. 2017.
- <sup>3</sup> Smith + Crown, *Smith + Crown’s Industry and Sector Classification* (Dec. 13, 2017), <https://www.smithandcrown.com/introducing-smith-crown-industry-classifications/>.
- <sup>4</sup> Noelle Acheson, *How Bitcoin Mining Works*, Coindesk (Jan. 29, 2018), <https://www.coindesk.com/information/how-bitcoin-mining-works/> (explaining how bitcoin mining works); Alyssa Hertig, *How Ethereum Mining Works*, Coindesk (last visited May 24, 2018), <https://www.coindesk.com/information/ethereum-mining-works/> (explaining how Ethereum mining works).
- <sup>5</sup> See *CFTC v. McDonnell*, No. 18-CV-361, slip op. at 19 (E.D.N.Y. Mar. 6, 2018) (quoting *In re Coinflip, Inc.*, Dkt. No. 15-29 (CFTC Sept. 17, 2015) (“Bitcoin and other virtual currencies are encompassed in the definition and properly defined as commodities.”), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfcoindroporder030618.pdf>.
- <sup>6</sup> See, e.g., Gary Gensler, Fmr. Chairman, Commodity Futures Trading Comm’n, Remarks at the MIT Business of Blockchain Event (Apr. 23, 2018) (“When investing in any form of financing, whether an ICO, or in traditional forms, such as stocks or bonds, the public benefits from full and fair disclosure.”), available at <https://www.media.mit.edu/posts/remarks-at-blockchain-event/>.
- <sup>7</sup> 15 U.S.C. § 77b(a)(1) (2016).
- <sup>8</sup> 328 U.S. 293 (1946) (hereinafter, *Howey*).
- <sup>9</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 (Exchange Act Rel. No. 81207) (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf> (hereinafter the DAO Report).
- <sup>10</sup> Shane Shifflett & Coulter Jones, *Buyer Beware: Hundreds of Bitcoin Wannabes Show Hallmarks of Fraud*, *Wall St. J.* (May 17, 2018 12:05 P.M.), <https://www.wsj.com/articles/buyer-beware-hundreds-of-bitcoin-wannabes-show-hallmarks-of-fraud-1526573115?mod=searchresults&page=1&pos=2>.
- <sup>11</sup> In an airdrop, a project creator takes a snapshot of a public blockchain, such as Bitcoin’s or Ethereum’s, and distributes tokens to all wallet addresses based on some pre-existing criteria. See Brady Dale, *So Long ICOs, Hello Airdrops: The Free Token Giveaway Craze is Here*, Coindesk (updated Mar. 17, 2018 5:41 A.M.), <https://www.coindesk.com/long-icos-hello-airdrops-free-token-giveaway-craze/> (explaining the practice of airdrops).
- <sup>12</sup> Press Release, IBM, *IBM Announces Major Blockchain Solution to Speed Global Payments* (Oct. 16, 2017), available at <https://www-03.ibm.com/press/us/en/pressrelease/53290.wss>.
- <sup>13</sup> Hadley Stern, *Fidelity’s Proof of Work: Our Bitcoin and Blockchain Journey*, *Medium* (Feb 16, 2018), <https://medium.com/@hadleystern/fidelitys-proof-of-work-our-bitcoin-and-blockchain-journey-5aa94d6a787a>; Fidelity Labs (last visited May 24, 2018), <https://www.fidelitylabs.com/>. More recently, it has been reported that Fidelity is exploring the development of in-house custody solutions and development of a crypto exchange. *Fidelity, a household name in American investing is plotting a big move into cryptocurrency trading*, *Business Insider* (June 6, 2018), <http://www.businessinsider.com/fidelity-a-household-name-in-american->



*investing-is-plotting-a-big-move-into-cryptocurrency-trading-2018-6.*

- <sup>14</sup> Press Release, Vanguard, Vanguard Using Blockchain Technology to Improve Index Data Distribution (Dec. 12, 2017), available at <https://pressroom.vanguard.com/news/Press-Release-Vanguard-Using-Blockchain-Technology-To-Improve-Index-Data-Distribution-121217.html>.
- <sup>15</sup> Christopher Dillon & Matthew Ko, *Looking Beyond Bitcoin's Hype to Blockchain's Potential*, T. Rowe Price (Feb. 2018), [https://www4.troweprice.com/gis/content/dam/fail/Collections/MarketScene/Blockchain\\_Technology/Blockchain\\_Technology.pdf](https://www4.troweprice.com/gis/content/dam/fail/Collections/MarketScene/Blockchain_Technology/Blockchain_Technology.pdf); see also Bankchain (last visited May 24, 2018), <http://www.bankchaintech.com/>.
- <sup>16</sup> Jackie Noblett, *Fund Shops to Fintech Start-Ups: Come Live with Us*, Ignites (May 2, 2018), [http://www.ignites.com/c/1944264/228664/funds\\_shops\\_fintech\\_start\\_come\\_live\\_with?referrer\\_module=emailMorningNews&module\\_order=0](http://www.ignites.com/c/1944264/228664/funds_shops_fintech_start_come_live_with?referrer_module=emailMorningNews&module_order=0).
- <sup>17</sup> *Id.*
- <sup>18</sup> Richard Henderson, *How Blockchain Will Transform Asset Mgmt: Report*, FundFire (Apr. 6, 2018), [http://fundfire.com/c/1928874/226664?referrer\\_module=SearchSubFromIG&highlight=%22blockchain%22](http://fundfire.com/c/1928874/226664?referrer_module=SearchSubFromIG&highlight=%22blockchain%22).
- <sup>19</sup> Some of the major patent holders in blockchain technology are Fidelity and Banc of America.
- <sup>20</sup> Letter from Dalia Blass, Dir., Securities & Exchange Commission Division of Investment Management, to Paul Schott Stevens, Pres. & CEO, Investment Company Institute & Timothy W. Cameron, Asset Mgmt. Grp.-Head, Securities Industry & Financial Markets Association (Jan. 18, 2018), available at <https://www.sec.gov/divisions/investment/noaction/2018/cryptocurrency-011818.htm>.
- <sup>21</sup> Press Release, NASAA, State and Provincial Securities Regulators Conduct Coordinated International Crypto Crackdown (May 21, 2018), available at <http://www.nasaa.org/45121/state-and-provincial-securities-regulators-conduct-coordinated-international-crypto-crackdown-2/>.
- <sup>22</sup> Jay Clayton, Chairman, Sec. & Exch. Comm'n, Statement on NASAA's Announcement of

Enforcement Sweep Targeting Fraudulent ICOs and Crypto-asset Investment Products (May 22, 2018), available at <https://www.sec.gov/news/public-statement/statement-nasaa-announcement-enforcement-sweep-targeting-fraudulent-icos-and>.

- <sup>23</sup> This discussion is obviously based on blockchain activities in the United States. While it may be possible to conduct an offering outside of the United States, it appears to be very difficult to restrict these activities to non-US persons.
- <sup>24</sup> See 17 C.F.R. §§ 230.500 *et seq.* (2017); see also Sec. & Exch. Comm'n, Regulation D Offerings (last visited May 24, 2018), <https://www.sec.gov/fast-answers/answers-regdhtm.html>.
- <sup>25</sup> In light of the regulatory uncertainty around SAFTs, some practitioners have changed the name of a functionally similar arrangement to express that they are merely sale agreements prior to utility or to provide the option to receive equity in lieu of tokens.
- <sup>26</sup> See *In re Munchee Inc.*, Securities Act Release No. 10445 (Dec. 11, 2017) (finding that one reason an ICO token was a security under the Securities Act was that it was marketed towards people interested in purchasing tokens rather than to people who might have wanted to use the expected utility of the token), available at <https://www.sec.gov/litigation/admin/2017/33-10445.pdf>.
- <sup>27</sup> At its simplest, the argument asserts that it is possible to have an investment contract that is separate from the underlying object of the contract, which may not itself be a security. The case law is replete with products that provide the basis for an investment contract without qualifying as securities themselves. See, Stephen G. Christianson, *What is "Investment Contract" within Meaning of § 2(1) of Securities Act of 1933 (15 U.S.C.A. § 77b(1)) and § 3(a)(10) of Securities Exchange Act of 1934 (15 U.S.C.A. § 78c(a)(10))*, Both Defining Term "Security" as Including Investment Contract, 134 A.L.R. Fed. 289 (1996), §10[b] (citing cases involving dental care products, foxes, beavers and master tapes) and §14[a] (citing cases involving whisky, personal and home care products, oil, chinchillas and earthworms).

<sup>28</sup> Gabriel T. Rubin and Dave Michaels, “Silicon Valley Is Into Bitcoin. It Wants to Keep Washington Out.,” *Wall St. J.* (April 19, 2018 5:30 A.M.), <https://www.wsj.com/articles/cryptocurrency-firms-investors-see-exemption-from-sec-oversight-1524130200>. Public statements of SEC Staff and commissioners have also questioned an over-reliance on “utility”—a concept that has only had limited application in securities laws to date. See, e.g., Nikhilesh De & Mahishan Gnanaseharan, *SEC Chief Touts Benefits of Crypto Regulation*, CoinDesk (updated Apr. 6, 2018), <https://www.coindesk.com/sec-chief-not-icos-bad/> (reporting that in a speech by Chairman Jay Clayton at Princeton University on April 5, 2018, Chairman Clayton discussed the issue of “utility tokens” and those that think labeling them as such releases the token from being regulated as a security); Public Statement, Jay Clayton, Chairman, Sec. & Exch. Comm’n, Statement on Cryptocurrencies and Initial Coin Offerings (Dec. 11, 2017) (“Merely calling a token a “utility” token or structuring it to provide some utility does not

prevent the token from being a security.”), available at <https://www.sec.gov/news/public-statement/statement-clayton-2017-12-11>.

<sup>29</sup> See Ernst & Young, EY Research: Initial Coin Offerings 32 (2017) (reporting that hackers steal up to \$1.5 million in ICO proceeds per month), available at [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>30</sup> 15 U.S.C. § 80a-17(f)(1); see also *id.* § 80a-26(a)(1).

<sup>31</sup> *Id.* § 80a-2(a)(5)(C).

<sup>32</sup> This analysis would also apply to a definition of a “qualified custodian” for purposes of the Investment Advisers Act of 1940, as amended. See 17 C.F.R. § 275.206(4)-2(a) (requiring the use of a qualified custodian for the safekeeping of client funds).

<sup>33</sup> New York State Department of Financial Services, Information and Procedure for the Organization of a Trust Company for the Limited Purpose of Exercising Fiduciary Powers (last visited May 24, 2018), <https://www.dfs.ny.gov/banking/iaus1b.htm>.

<sup>34</sup> *Id.*

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