PROGRAM MATERIALS
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Being Secure About Your Security Token Offering and Other Crypto-Observations

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Being Secure About Your Security Token Offering & Other Crypto-Observations

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Speakers

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Barry Seeman is the Managing Partner of Bear Run Partners, LLC, a specialized consultancy firm, working with both buy-side and sell-side financial services industry firms, in the critical analysis and/or development of: Crypto-Currencies, Blockchain, and Capital Markets solutions. Previously, Barry was the Head of Global Derivatives and Hedging for AEGON / Transamerica. He has over 30 years experience running major Sell-Side and Buy-Side divisions. Barry has a Bachelor of Science and Masters in Electrical Engineering and a MBA from Cornell University, in Ithaca New York.

CLE Materials

Doc 1 - Being Secure about your Security Token Offering / Barry Seeman & Susan Joseph	https://medium.com/altcoin-magazine/https-medium-com-barry-seeman-being-secure-about-your-security-token-offering-cd1ae6aa7be0
Doc 2 - Being Smart about your Smart Contract / Barry Seeman & Susan Joseph	https://medium.com/altcoin-magazine/being-smart-about-your-smart-contract-follow-up-to-being-secure-about-your-security-token-9d9ae19b2b30
Doc 3 - SEC.gov | Framework for "Investment Contract" Analysis of Digital Assets	https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets
Doc 4 - SECURITIES AND EXCHANGE COMMISSION v. W. J. HOWEY CO. et al. | US Law | LII / Legal Information Institute	https://www.law.cornell.edu/supremecourt/text/328/293
Doc 5 - Blockstack PBC offering-circular-20190711	https://stackstoken.com/static/offering-circular-20190711.pdf
Doc 6 - SEC.gov | Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities	https://www.sec.gov/news/public-statement/joint-staff-statement-broker-dealer-custody-digital-asset-securities
Doc 7 - TurnKey Jet, Inc./ No Action, Interpretive and/or Exemptive Letter of April 3, 2019	https://www.sec.gov/divisions/corpfin/cf-noaction/2019/turnkey-jet-040219-2a1.htm
Doc 8 - SEC.gov | Pocketful of Quarters, Inc.	https://www.sec.gov/corpfin/pocketful-quarters-inc-072519-2a1
Doc 9 - Letter from the Financial Stability Board 13Oct19	https://www.fsb.org/wp-content/uploads/P131019.pdf
Doc 10 - Diversity in Blockchain's Initial Review of Facebook's Project Libra 24Jun19	https://diversityinblockchain.com/news/2019/7/17/project-libra-and-diversity-in-blockchain
Doc 11 - SEC.gov | Leaders of CFTC, FinCEN, and SEC Issue Joint Statement on Activities Involving Digital Assets	https://www.sec.gov/news/public-statement/cftc-fincen-secjointstatementdigitalassets
Doc 12 - 2016-10567 Dept of Treasury - FINCEN - Customer Due Diligence Requirements for Financial Institutions	https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf
Doc 13 - IRS Notice 2014-21 n-14-21	https://www.irs.gov/pub/irs-drop/n-14-21.pdf
Doc 14 - FAFT - VIRTUAL ASSETS AND VIRTUAL ASSET SERVICE PROVIDERS	https://www.fatf-gafi.org/media/fatf/documents/recommendations/RBA-VA-VASPs.pdf
Doc 15 - The Care and Feeding of the Crypto Ecosystem/ New State Licensing Is a Win - TabbFORUM	https://medium.com/@SusanJoseph1786/the-care-and-feeding-of-the-crypto-ecosystem-new-state-licensing-is-a-win-30441c8197a8
Doc 16 - Privacy Rights and Self-Sovereign Identity in a Data-Driven World Dec 2019	https://medium.com/@SusanJoseph1786/paradise-is-not-lost-the-win-win-of-privacy-rights-and-self-sovereign-identity-in-a-data-driven-dc01d400201d

Embarking Upon the Security Token Journey

- We are witness to the rise of digital, tokenized assets attempting to break out of the confines of stock exchanges and illiquid private investments, and creating the potential for a more flexible investment environment.
- **Security Tokens**, the focus of this presentation, are a **third category** of tokenization, each of which carry their own regulatory concerns:
  - **Crypto-Currencies** (Bitcoin, Ethereum, etc.)
  - **Utility Tokens** (certain gaming and reward tokens or tokens that stay within a closed network).
  - **Security Tokens** are digital assets which represent fractional ownership in a potentially broad range of financial investments or hard assets.
- ***Imagine the ability to create digital investments with programmable transparency, reporting, liquidity and risk control.***
  - The technological enablement of these digital investments must be respectful of the overall regulatory regime. While a coder might technically be able to engineer non-compliant investment products, regulators will not look past deficiencies in the product for the sake of technology.
- If you are a lawyer working with a client on a Security Token Offering, there are regulations and risks that fall outside of the technology realm that we will discuss in this presentation.

Quote(s) of the Month(s)!

- "A Security Token does not need to follow any regulatory rules, because it is not a security."
- "We are raising money through crowd funding, Therefore token holders will know what they are buying from the website."
- "The technology takes care of KFC, oops KYC and AML."
- "Can I advertise the token offering?"
- "Fractionalization and Democratization mean I can sell these tokens to any type of investor, as long as they have a wallet."
- Voicemail: "Hi Barry, this is xxxx xxxxxx. I'm calling from (Insert Blockchain Developer). We have a real estate tokenized offering, known as a Security Token Offering, that we wanted to discuss with you. If you could give me a call back, when you get a chance at…. "
- "Why do I need a Broker Dealer to sell a Token?"
- "I am funding operations with my Token Offering, so it is not a security."
- "I am creating a token for an existing music platform and business, and will sell it to customers and in bulk to others who are not interested in supporting the platform but are contributing to gain the token appreciation."
- "The technology offers a transparent look at the investment, so regulations are complied with by that alone."

Question 1: What are you SELLING?

- The "Nature of the Investment" **defines** the Legal Construct of the Security Token Offering.
- "Sound" legal structuring takes into account various aspects of jurisdictional regulations and compliance, taxes and other attributes of the offering.
- Regulatory Burdens do not *disappear* because of the "Token", they actually become more onerous!
  - The technology and coding of the Token must be consistent with the offering and any applicable regulations.

- Security Tokens can reflect an investment in any of the following possibilities (and numerous other assets):
  - Equity ownership in a company
  - Limited partnership interest in a private equity fund
  - Shares of a Cayman Feeder into a REIT for U.S.-domiciled real estate holdings
  - Portfolio of bonds
  - Equity ownership in hard assets, such as mineral rights
  - Equity ownership in other types of income streams.

Why do Digital Assets Attract the Attention of the SEC?

- The SEC uses a principles-based method to determine regulation, and has, from time to time, issued guidance as to how to apply those principles.
- On April 3, 2019, the **Securities and Exchange Commission's Strategic Hub for Innovation and Financial Technology**, known as the **FinHub**, published a digital assets framework to help entities determine whether a digital asset is offered and sold as an investment contract, and, therefore, must follow the regulatory landscape as a security.
- While the framework does not have the binding effect of law and is not legal advice, it is significant because it contains staff views and guidance and signals how the SEC will approach these types of analyses.
- Whether or not the offering requires Registration, other activities may implicate regulations and include:
  - offering, selling, or distributing the digital asset
  - marketing or promoting the offering
  - buying, selling, or trading
  - facilitating exchanges
  - holding or storing
  - offering financial services such as management or advice
  - other professional services
- All should undertake their own evaluation, engage their own professional advice and specifically review all the materials published on SEC's FinHub. The SEC further offers an open door and to reach out to Staff if there are questions after applying the framework to the potential offering.

The Howey Test and the Investment Contract

- ***Does the digital asset offering have the characteristics of an investment contract?***
- The leading case from which many progeny have followed that refine that ruling is SEC v. Howey Co., 328 U.S. 293 (1946). In that case and case law following, the law set out has been to look to whether an investment contract exists – using a four-pronged approach to analyze the facts and circumstances of each proposed offering, The four prongs commonly known as the *Howey* Test include:
  - A. whether there is an investment of money;
  - B. whether there is a common enterprise that the investment of money is applied to;
  - C. whether there is an expectation of money from the investment;
  - D. whether that person is led to expect profits which come from the efforts of a promoter or third party.
- All four prongs of this test do not need to be satisfied for an offering to be considered as a security and fall within the purview of the SEC.
- In analyzing the potential offering in a principles-based environment, the investment underlying the offering should be evaluated in addition to the surrounding facts and circumstances of the proposed transaction. This leads to an individual approach when looking and advising on any particular transaction or investment.

The Howey Test and the Investment Contract (cont.)

- The *Howey* case looked at contracts for the purchase of orange groves, associated service contracts, and whether these contracts constituted investment contracts. While the underlying groves are not securities themselves, (and at some level, might be viewed as a commodity), the contracts surrounding them were determined to be a security.
- The case derived the Howey Test. which asks whether the value of a transaction for one of its participants is dependent upon the other's work. Specifically, the Howey Test determines that a transaction represents an investment contract if "a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party,"

This same test can be applied today in connection with digital tokens.

- Some practitioners have attempted to circumvent Securities Regulations, by believing that the token is a digital token, and therefore is not a security. The SEC does not care what you call the offering but will view the Howey Test as the determining factor on their oversight. Failure to do so may result in an enforcement action that may include among other things a fine, disgorgement, or a ”cease and desist” action.
- Those engaged in all aspects of the marketing, offer, sale, resale, or distribution of any digital asset will need to determine if they fall within the federal securities law regime (‘33 and ‘34 Acts).
- Securities can either be registered or qualify for an exemption from registration (i.e. Reg D). Regardless of the registration status, disclosures of terms and conditions, risks, conflicts of interest, tax treatments, etc. are still required for review by potential investors through offering documentations.

The Howey Test as Applied to Digital Assets

A. The Investment of Money

- Is there an offer and sale of a digital asset?
- Was the digital asset purchased or otherwise acquired in exchange for value, whether in the form of fiat, digital currency, another digital asset, or other type of consideration?
- Does the purchaser have a reasonable expectation that it will receive a security or security interest?

B. Common Enterprise

- Fluctuation in the value of the common asset owned does not by itself equate to a "common enterprise" under *Howey,* but it might be a contributing fact in combination with other analyses.
- The SEC does not per se view the "common enterprise" prong of *Howey* as a distinct element of an investment contract. It is, however, a factor. Since judicial decisions have not trended to ask whether this prong is relevant or necessary, it is prudent to include this type of analysis.

C. Reasonable Expectation of Profits

- This prong of the *Howey* test focuses directly on the underlying transaction and asks, "does the purchaser reasonably expect to gain a return on their invested capital?"
- Gains may be in the form of distributions, appreciation realization, (i.e. sell at a gain on a secondary market) or gains resulting from a third party's efforts.,

The Howey Test as Applied to Digital Assets continued

D. Efforts of Others

- Are efforts of others necessary to the generation of the return on the investment?”
- Types of activities might be management related or when a promoter, sponsor, or other third party provides essential managerial efforts that affect the endeavor’s success and investors reasonably expect a resulting profit.
- Who are the Active Participants? The SEC views them as the “promoters, sponsors or other third parties or affiliates. Are these parties driving the expectation of return? It is significant to point out that in this SEC Guidance, the concept of the Active Participant is directly applied to a digital asset context. And, it is equally significant to point out that this is a subjective determination that is going to depend on the individual circumstances of a potential investment.
- The SEC focus on the “efforts of others” analyses would point to a broader view of this aspect of the *Howey* test going forward as applied to digital assets. This is noteworthy in the context of digital assets that may purport or intend to be decentralized in nature. Is the platform itself an enterprise subject to regulation? Is the token only subject to regulation? The analyses of who those “others” are and whether their responsibilities might fall under the purview of the SEC, if any, are critical to undertake and there are no bright lines. This is an evolving area of the law.
- Always key to the analysis is the question of whether the efforts are “active and deliberate” as opposed to “passive” in nature.

The SEC Speaks

- This past year, the In addition to the SEC Digital Asset Guidance, the SEC approved the first crypto token Reg D offering and issued two no-action letters that applied to tokens in different projects.
- **Blockstack: Reg D Offering is approved.**
- On July 11 and 12, 2019. the SEC qualified the Regulation A token offerings of Blockstack PBC. Blockstack, an enterprise building a decentralized network was authorized to offer 28mm worth of crypto tokens. Blockstack's goal was to give all potential investors, not just the accredited class, the opportunity to participate. This offering aligns with Blockstack's philosophy of creating an open, fair, un-siloed, user-controlled internet.
- The SEC Reg A qualification was heralded as a step forward and potential path to finance the development of blockchain networks and the distribution of digital assets. However,, there is a lengthy timeline and hefty expense with this type of offering. Blockstack disclosed it undertook an expense of 2.8mm with a 10-month timeline to approval. It should be noted that there will also be ongoing reporting obligations.
- Further, Blockstack pointed out that there may be no market to trade these tokens. The SEC and the Financial Industry Regulatory Authority (FINRA) released a joint statement on July 8, 2019, identifying issues such as custody of digital assets by broker-dealers operating a registered exchange or ATS and intermediation of digital asset transactions. This statement was a summary rather than guidance, and the industry is awaiting true guidance on these issues. Until then, it will be a difficult and uncertain environment for FINRA broker-dealer applicants and ATS platforms to launch and begin to support trading in digital securities.

The SEC Speaks continued

- Two specific no-action letters issued this year are of interest as they are the first to address cryptocurrencies/digital assets directly: TurnKey Jet, a private jet charter company in existence since 2012 in a regulated industry and Quarters, a start-up headed by a twelve-year old CEO and his father aiming to create a universal gaming token to be used across video game platforms.
- **TurnKey Jet's Token:**
- TurnKeyJet was cleared to create and sell a custom cryptocurrency to raise money. Per the No-action letter, the tokens will be immediately useful, they will remain at a fixed price of one U.S. dollar, can only be used for air charter services, and repurchases will only be made at a discount to the token. Importantly, TurnKey Jet will not represent the tokens as having profit potential.
- The token is anticipated to be used to sell to to to help them book travel on private jets which enables the company to be more flexible and accommodate spur of the moment plans not subject to banking hours as traditional banking rails can take too long.
- Many have commented that this type of token interior to a platform looks very similar to a laundromat token.
- **Quarters Token:**
- The Quarters token cannot be resold or transferred outside of the closed platform and cannot be traded between players. It is a separate from the additionally issued platform token which is a security and may entitle holders to platform profits. The tokens will be available to gamers in unlimited quantities at a fixed price, with price appreciation unlikely. Additionally, the token will be immediately available for use on 30 or more games.
- Quarters, goes further and is more permissive than TurnKey Jet because the token is transferable to third-party developers who build on the Quarters platform. This characteristic provides an incentive for developers to create a robust economy for the platform. As such, it might have some interesting applications for networks in the enterprise world. Developers still need to undergo know-your-customer and anti-money laundering checks before onboarding.
- This type of crypto-network economy for enterprise has not yet been explored, but one could easily see loyalty and other similar applications develop and further cement a platform's prominence..

Example: Tokenization of Real Estate

- Fractional Ownership Vehicles already exist and include Real Estate Investment Trusts (REITs), Real Estate Cooperatives, Limited Partnerships, Limited Corporations and Time Shares.

- So what does Tokenization give the investor?
  - Liquidity?
  - Broader Market Appeal and Distribution?
  - Distributed Ledger Technology?
  - Easy, Efficient and Fast Execution?
  - Transparency?

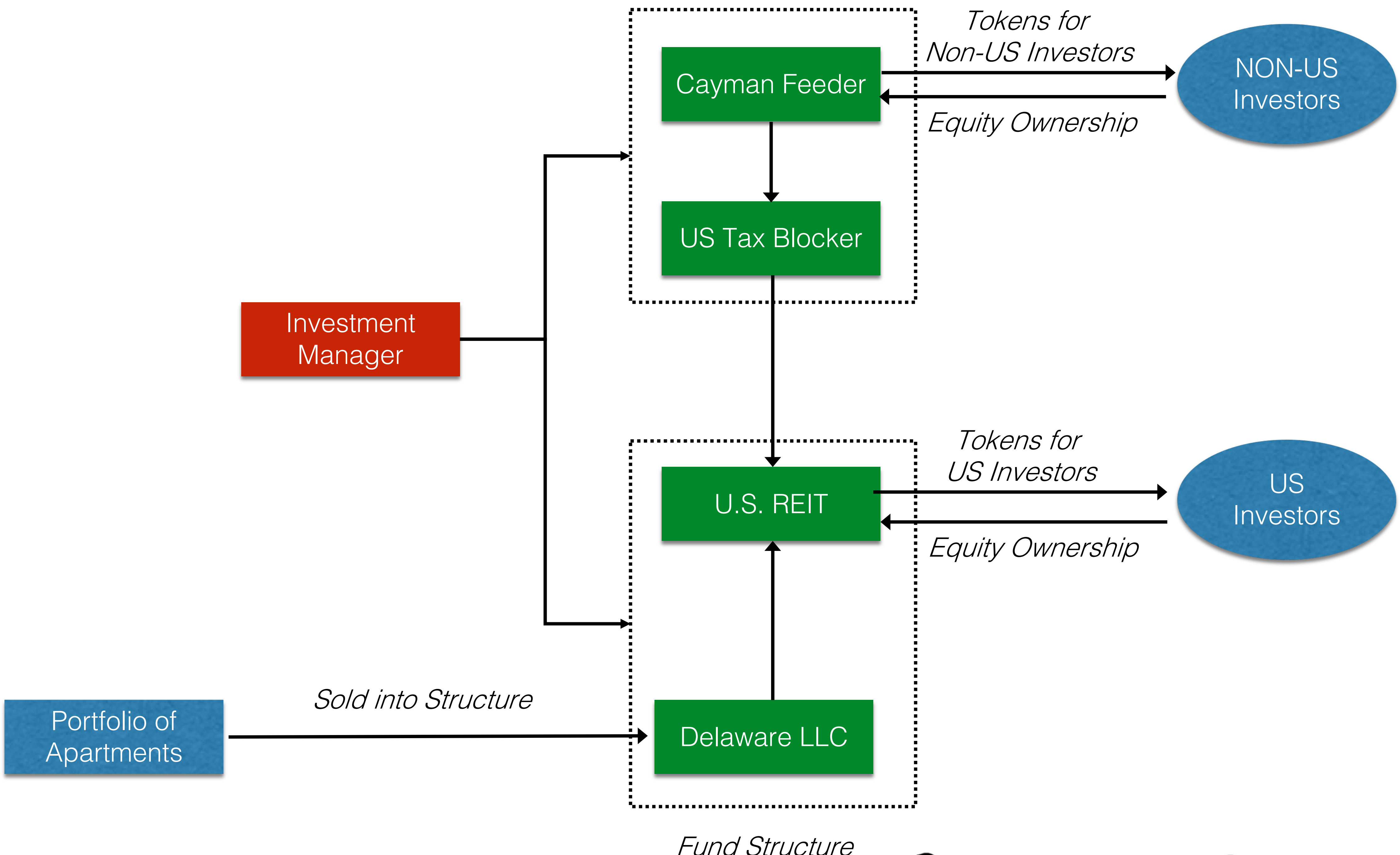
- Why can't we Tokenize a Single Apartment?
  - How many fractional owners can you put in the Title Registry?
  - Who makes any decisions regarding the leasing, upkeep, accounting, tax payments and eventual sale of the properties?
  - What happens if any one of the fractional owners/token holders disappears or cannot be reached regarding decisions involving the property? Does this impact the quality and transferability of property title?
  - Who decide when to sell and for how much?

Question 2: Who are the Target Purchasers?

- “Where’s the Money?!?”
- Are you selling an Investment or a Token?
    - The Security Token is the “whip cream on the dessert”
- Where are the Purchasers located? What markets are available for money raising?
- Are the Token Purchasers interested in the Income Distribution?
- How is Income Accrued within the Token?
- Is it interest, dividend, sale proceeds, or capital gains/losses?
- Are there tax issues (i.e. Withholding Taxes) pertaining to the Underlying Investment for the Purchaser?

Example: Tokenization of Real Estate

- Simplistic Real Estate Investment Trust (REIT) Example



Question 3: How do you intend to raise the funds?

- Know the Regulations / Domiciliation:
  - SEC (https://www.sec.gov/ICO),
  - FCA (https://www.fca.org.uk/firms/cryptoassets),
  - AMF (https://www.amf-france.org/en_US/Reglementation/Dossiers-thematiques/Fintech/Vers-un-nouveau-regime-pour-les-crypto-actifs-en-France)
  - Various State Regulatory Bodies (i.e. NYDFS and similar entities across other states)
- Is your money raise is going to be solely targeting Token investors, or accepting investments from non-token investors, as well?
- How is your platform (enterprise) that issues the tokens set up? Decentralized? Centralized? Foundation? Some other form?
- Can I just list all the great attributes on a web site?
- Do I really need offering documents?
- What size minimum investment? What size net worth of investor?
- Is this a retail or private placement?
- What is Rule 144A?
- Can I use a placement agent?
- Do I really need to “Know My Customer”, since we met online?

Question 4: Who are the other Service Providers you should consider?

- Legal Counsel
- Fund Administrator, Transfer Agent and Custodian
- Audit Firm
- Governance Firm (Independent Directors)
- Accounting Firm/Tax Advisor
- Alternative Trading System (ATS)
- Placement Agents / Broker Dealers
- PR Agencies
- Will the Service Provider be scared off by the Security Token?

Challenges:

- Will the Service Provider be scared off by the Security Token?
- Does the Service Provider have experience with these types of offerings?
- Is the Service Provider's experience Proof of Concept oriented or Marketplace Product Proven?

Other Crypto-Observations

- **Statement 1: "Potential financial stability issues from global stablecoins." - FSB Chair's letter to G20 Finance Ministers and Central Bank Governors - October 13, 2019**
- On October 13th, 2019, the Chairman of the Financial Stability Board (FSB) sent an alarming letter to G20 Finance Ministers and Central Bank Governors discussing Stablecoins.
- It states: *"the introduction of "global stablecoins" could pose a host of challenges to the regulatory community, not least because they have the potential to become systemically important, including through the substitution of domestic currencies.* ***These include challenges for financial stability; consumer and investor protection; data privacy and protection; financial integrity including AML/CFT and know-your-customer compliance; mitigation of tax evasion; fair competition and anti-trust policy; market integrity; sound and efficient governance; cyber security and operational risks; and an appropriate legal basis.****"*
- *"Stablecoin projects of potentially global reach and magnitude* ***must meet the highest regulatory standards and be subject to prudential supervision and oversight****. Possible regulatory gaps should be assessed and addressed as a matter of priority… The FSB is assessing how the existing regulatory framework applies to "global stablecoins" and whether any regulatory gaps need to be filled.* ***In any case, it is essential to apply the principle of 'same activity – same rules', independent of the underlying technology****."*

Other Crypto-Observations

- **Statement 2: Leaders of CFTC, FinCEN, and SEC Issue Joint Statement on Activities Involving Digital Assets**
- This joint statement of major U.S. Regulators was released from Heath Tarbert, Chairman, U.S. Commodity Futures Trading Commission (CFTC); Kenneth A. Blanco, Director, Financial Crimes Enforcement Network (FinCEN); and Jay Clayton, Chairman, U.S. Securities and Exchange Commission (SEC) on October 11, 2019.
- It states: "*to remind persons engaged in activities involving digital assets of their* ***anti-money laundering and countering the financing of terrorism (AML/CFT) obligations under the Bank Secrecy Act (BSA)****.*"
- This statement calls out the fact that *"that market participants refer to digital assets using many different labels. The label or terminology used to describe a digital asset or a person engaging in or providing financial activities or services involving a digital asset, however, may not necessarily align with how that asset, activity or service is defined under the BSA, or under the laws and rules administered by the CFTC and the SEC."*

Other Crypto-Observations

- **Statement 3: IRS issues additional guidance on tax treatment and reminds taxpayers of reporting obligations**
- On October 9th, 2019, the U.S. Internal Revenue Service (IRS) announced *"As part of a wider effort to assist taxpayers and to enforce the tax laws in a rapidly changing area, the Internal Revenue Service today issued two new pieces of guidance for taxpayers who engage in transactions involving virtual currency."*
- They also gave clarification on hard fork events, when a "*crypto-currency undergoes a protocol change resulting in a permanent diversion from the legacy distributed ledger. This may result in the creation of a new crypto-currency on a new distributed ledger in addition to the legacy crypto-currency on the legacy distributed ledger. If your crypto-currency went through a hard fork, but you did not receive any new crypto-currency, whether through an airdrop (a distribution of crypto-currency to multiple taxpayers' distributed ledger addresses) or some other kind of transfer, you don't have taxable income*." Whew!
- Most importantly, the IRS left us with a message to ponder, regarding the reporting of the above mentioned activities: ***"The IRS is aware that some taxpayers with virtual currency transactions may have failed to report income and pay the resulting tax or did not report their transactions properly. The IRS is actively addressing potential non-compliance in this area through a variety of efforts, ranging from taxpayer education to audits to criminal investigations."*** We believe the IRS adding crypto disclosure to its tax form shows the inroads crypto and digital assets have made to the general public.

Other Cypto Observations

- **Statement 4: FATF Virtual Asset Guidance was issued to globally coordinate a risk-based approach to working with Digital Assets and Virtual Asset Service Providers ("VASP").**
- "In June 2019, the FATF adopted an Interpretive Note to Recommendation 15 to further clarify how the FATF requirements should apply in relation to VAs and VASPs, in particular with regard to the application of the risk-based approach (RBA) to VA activities or operations and VASPs; supervision or monitoring of VASPs for AML/CFT purposes; licensing or registration; preventive measures, such as customer due diligence, recordkeeping, and suspicious transaction reporting, among others; sanctions and other enforcement measures; and international co-operation."
- This is colloquially known as "the Travel Rule." This rule require regulators and Virtual Asset Service Providers (VASPs) — which include exchanges from various countries worldwide — to collect and share personal data during transactions. The identity follows the transaction, and the recommendation imposes banking grade standards on the cryptocurrency sector.
- Currently, many digital wallet providers and exchanges already ask for customer information to verify identity. But some do not. There have been no real standards or uniformity in the information gathering.

Other Cypto Observations

- **Statement 4: FATF Virtual Asset Guidance was issued to globally coordinate a risk-based approach to working with Digital Assets and Virtual Asset Service Providers (“VASP”).**
- Further, those using specific privacy or anonymous currencies do not reveal personal data in the course of their transactions. It is uncertain how these privacy cryptocurrencies will fare under the Travel Rule, but we already see some exchanges de-listing these types of coins. Some argue the privacy features make the coins fully fungible and able to mimic cash as a true bearer instrument with no identity attached.
- Though these guidelines are not “binding”, participants have one year to comply or they risk being shut out of valuable trading markets. As a result, most exchanges are working to put rules in place that comply.
- FATF guidelines could bring about a more standardized approach to compliance among exchanges and help the industry become further adopted by mainstream participants.

Q&A

Thank You.

TABB FORUM
WHERE CAPITAL MARKETS SPEAK

October 09, 2019

Being Secure About Your Security Token Offering

Barry Seeman

Susan Joseph

Many experts have declared that the Security Token Offering is less onerous and less expensive than traditional capital raising. But issuing a STO requires more than writing smart contract code. For issuers contemplating a Security Token Offering, there are risks that fall outside of the technology realm. As global regulatory scrutiny intensifies, potential issuers need to understand the business/legal framework to formulate a sound game plan. Here are four questions every potential issuer should ask before jumping into the STO arena.

Preparing for the Evolving World of Digital Assets

Over the past several years, we have witnessed the rise of digital, tokenized assets attempting to break out of the confines of stock exchanges and illiquid private investments.

Security Tokens are a third category of tokenization, different than Crypto-Currencies (Bitcoin, Ethereum, etc.) and Utility Tokens, in which the tokens represent fractional ownership in a potentially broad range of financial investments or hard assets. The marketplace has been slow to fully embrace this new paradigm in investing, but the tides are changing. More frequent announcements of asset tokenization are being released, while sizable pools of investors become educated and embrace the potential of these digital investments.

Imagine the ability to create digital investments with programmable transparency, reporting, liquidity and risk control. These promises, that blockchain technology offers, are being realized as the improvements above are now becoming standardized protocols. Blockchain brings forth the use of determinative code (known as "smart contracts") in order to create programmable structuring and risk control, unique methods of exchange, and security issuance that can be more automated than currently exist. It is for these reasons that Security Tokens have attracted the attention from individuals to institutional investors, all seeking the beneficial attributes tied to attractive investment opportunities.

[Related: "Will Libra Catalyze a Token Revolution in Finance? (https://tabbforum.com/opinions/will-libra-catalyze-a-token-revolution-in-finance/)"]

If you are an issuer contemplating a Security Token Offering (STO), there are risks that fall outside of the technology realm that we want to discuss in this article. This rapidly evolving technology and investment ecosystem is being scrutinized by regulators across the globe, along with highly specialized attorneys, consultants, and investment professionals. It is against this backdrop that it is worth looking at Security Tokens, a particular type of offering made possible through the adoption of certain blockchain technology.

This article is based upon the experiences and observations of an experienced financial professional, Barry Seeman, and a crypto-seasoned attorney, Susan Joseph. Both contact details are found at the end of the article.

A reader should view this article as a good thought-process outline to follow, if you are contemplating a STO. As you may consider some of the issues raised within, you can formulate a sound game plan for your STO, keeping developments on time and within budget. Additionally, this article will not dwell upon the technology underlying various specific distributed ledgers that support Security Tokens but will focus upon a business/legal framework in order to keep you "*Secure About Your Security Token Offering*."

The Security Token Revolution Is an Evolution

The revolutionary goal of Security Tokens, secured digital assets issued and managed in the form of tokens through distributed ledgers, is to create a global marketplace of overwhelming investment opportunities, while significantly improving the manner in which security investments are offered.

Terms like “democratization,” “digital shares” and “liquidity” are often attributed to these offerings and promoted within the offerings’ white papers. While on their own, these concepts do not offer direct revolutionary impact, collectively they do reflect an evolutionary improvement over our current arcane investment environment by providing programmable logic embedded within the security and adding in additional compliance and transparency capabilities through blockchain-based record and message transfer systems. If you are currently working on or considering a Security Token Offering (“STO”), then this article will give you more fundamental background concepts, observations and concerns to consider and address in the launch of your offering.

As with all articles like this one, we must disclose that we are not providing legal advice, are not your attorney nor your accountant, and therefore, this article is for informational purposes only and not for the purpose of providing legal and/or accounting advice. You should contact your own legal counsel and/or accountant to obtain advice with respect to any particular issue or problem raised in this paper. Furthermore, all services providers acknowledged or highlighted in this paper are there for discussion purposes and should not be construed as an explicit endorsement of their services. Any service provider should be engaged solely after you have performed and resolved adequate due diligence and have agreed to contracted services.

Even though many Security Token advocates have declared the STO to be a less onerous and less expensive process to a private fund or corporate offering, we find this is not exactly the case today. Issuing a STO requires more than writing smart contract code. While certain reconciliation and administration steps in the life of an investment are anticipated to be less onerous if they are maintained by well-functioning smart contract computer code, many of the steps to issue a STO are still similar to a traditional private offering.

We often suggest taking a “belt and suspenders” approach to all aspects of the offering, since STOs are still relatively new territory for investors, regulators, exchanges, and issuers. As the evolution of digital investments proceeds and more STOs become commonplace as capital raising investment vehicles, there will be a compression of launch time and costs compared to the environment today. Those who have mastered the STO process early on will be well positioned to move more quickly and efficiently as the marketplace advances.

When Jumping into the STO Arena, Four Questions You Should Ask:

Question 1: What is the nature of the investment that is being sold through the proposed Security Token?

We need to first discuss the nature of the investment and the legal construct of the Security Token Offering. If a Security Token is simply a digital security, then we must act to ensure that the underlying legal structure provides a sound vehicle for investors. The determination of a “sound” legal structure takes into account various aspects of jurisdictional regulations and compliance, taxes and other attributes of the offering. Digital Asset regulatory burdens do not disappear merely because the investment is now created as a digital security. This remains one of the key misconceptions of the crypto-investment space – that you can avoid regulatory compliance because you issue a “token.”

A “typical” Security Token (quoted because we are not certain there are any typical security tokens) reflects an investment in any of the following possibilities:

- Equity ownership in a company
- Limited partnership interest in a private equity fund
- Shares of a Cayman Feeder into a REIT for U.S.-domiciled real estate holdings
- Portfolio of bonds
- Equity ownership in hard assets, such as mineral rights
- Equity ownership in other types of income streams

Anything with a legal ownership structure is possible as the underlying asset of a Security Token. It is for this critical reason that the token does not circumvent rules and regulations of the host country’s regulatory and tax environment. You must strongly consider the investment vehicle structuring and look to work with astute legal counsel along with tax counsel, to address both regulatory rules for asset ownership and many of the investment objectives of your token holders.

A great example of a STO is the concept of tokenization of real estate. Over the past several years, there have been a number of highly touted articles describing the use of security tokens in order to allow for fractional ownership of property. There have been a number of STOs that have approached various forms of real estate. In theory, STOs make perfect sense and are simply an extension of vehicles that already exist in order to promote fractional ownership of real estate.

Such existing vehicles include Real Estate Investment Trusts (REITs), Real Estate Cooperatives, Limited Partnerships, Limited Corporations and Time Shares. Each one of these legal structures can hold real estate as the underlying asset and offer fractional ownership units, but each exists to serve different purposes to the end investor. These types of vehicles are candidates for Security Token Offerings that, once implemented, should be easier to track, trade, and reconcile as compared to the current paper or legacy technology-bound systems. It is important to note that “should” is a relative word, as STOs are still new types of offerings that are being tested both as products themselves and as powered by emerging blockchain technologies.

More important, financial regulatory authorities across the globe are beginning to pass rules pertaining to the issuance and sale of Security Tokens. These rules will evolve over time as the digital shares become more accepted. But you must be conscious of what security laws and tax laws are applicable to your investment and your investors and seek the appropriate advice from engaged counsel. Here are some important resources:

- SEC (https://www.sec.gov/ICO (https://www.sec.gov/ICO))
- FCA (https://www.fca.org.uk/firms/cryptoassets (https://www.fca.org.uk/firms/cryptoassets))
- AMF (https://www.amf-france.org/en_US/Reglementation/Dossiers-thematiques/Fintech/Vers-un-nouveau-regime-pour-les-crypto-actifs-en-France (https://www.amf-france.org/en_US/Reglementation/Dossiers-thematiques/Fintech/Vers-un-nouveau-regime-pour-les-crypto-actifs-en-France))

This highlights the important point, that a *Security Token represents an investment made by an investor, who has the expectation of an increase in the value of said investment*. Therefore, most securities regulators consider Security Tokens to fall under their purview and will require issuers to adhere to the regulatory ruleset that applies to whatever underlies the Security Token and how it is being sold.

Which leads us to the next question …

Question 2: Who are the target purchasers of the proposed Security Tokens?

This is the nice way of saying: “Where is the money?!?” Are you interested in raising money in the United States? Can you source investors in Asia? Can you offer this Security Token in Europe? There is a litany of issues that come to light, once you determine where your potential investors reside and how you intend to conduct your money raise.

Over the past several years, there has been a big push to offer Security Tokens giving investors access to many different opportunities. While it is exciting to see cutting-edge products on the market, these early crowdfunding money raises focused on the notoriety of the Token, while diminishing the message surrounding the true nature of the investment. Some of these earlier issued Tokens may have been Security Tokens whose issuers did not follow investment rules and compliance. As a result, today regulators are in the midst of sorting out past offerings through various enforcement actions.

What can we learn from this? If you are offering an investment, get proper professional advice! We must take the approach that the underlying investment is the most important component of the offering, and the Security Token is the “whip cream on the dessert.” We cannot emphasize enough that the underlying investment is the main attraction and the digital security is an enhancement component that brings other attributes to the offering.

It should be noted that even if STOs evolve past digital securities as enhancements to become brand-new types of digitally native investments, STOs will still fundamentally be investments that will have to fit within regulatory regimes, and appropriate compliance must be observed.

Other concerns should be addressed in connection with any offering. You should also determine the potential sensitivities that your investors may have. Are they individuals who may be sensitive to certain tax triggers in the investment, or are they institutional investors looking for a specific yield in the payouts? These answers will help you understand any nuances that should be introduced into the structuring. Once you have answered the money raising questions, you have the basic information to begin discussions with your legal counsel.

Let's Look at a Practical Example:

We will return to the real estate example to explain why understanding and respecting the underlying asset is critical. Imagine we have several single-family homes in the United States that we want to tokenize as a package for investors. On a base level, can we sell fractional ownership in these homes? The answer is "of course." But what about the following:

- How do you handle the title registry of factional owners on individual properties?
- Who makes any decisions regarding the leasing, upkeep, accounting, tax payments and eventual sale of the properties?
- How do you decide what to do if you do not have unanimous agreement among token holders – i.e., in the sale of a property?
- What happens if any one of the fractional owners/token holders disappears or cannot be reached regarding decisions involving the property? Does this impact the quality and transferability of property title?
- What is the basis for distribution of any earnings?
- How do you handle the fractional responsibility for property taxes?
- These questions bring about other questions and we realize this list is by no means exhaustive.

Suddenly, we begin to realize that there are a number of structural and legal hurdles to overcome when tokenizing assets. Today, these types of hurdles can be more easily addressed in traditional investment vehicles teamed up with tokens that represent the shareholder units. And, so, these hurdles typically force the issuer to revert back to standard fund and corporate entity issuances, as you would see in non-tokenized deals, with the anticipation of marginal gains to be made through tokenization on top.

In this same real estate tokenization proposal, consider the following:

- We transfer the single-family homes into an investment vehicle known as a Real Estate Investment Trust, or “REIT.” We choose this structure because the properties have the potential to generate rental income, and we want to minimize the tax impact at the vehicle level.
- Because it is a REIT, we must distribute at least 90% of the net taxable income to the unit holders, with certain tax benefits also passed onto the unit holders (distribution of 100% of the net taxable income will eliminate an entity-level C-Corp. tax).
- We must have a designated Investment Manager, which will be paid a management fee from the REIT’s activities for its role in managing the investments.
- We will also need to address the number of shareholders rule for REITs.
- If we have non-US unit holders, then they are subject to withholding tax on both the net income and the proceeds from the sale of underlying properties (FIRPTA withholding). This is because the single-family homes are US domiciled.
- In order to simplify and minimize certain tax impacts to non-US unit holders, we create a Cayman-Island feeder, associated with “tax-blockers.” These blockers do not eliminate the tax, but rather minimize some of the impact and simplify the tax filing.
- We must engage the services of a fund administrator, audit firm and other service providers in the management of the investment vehicles.

This is not the complete structure, nor the complete picture. We still have not even mentioned the addition of the token overlay on top, which will add another level of complexity. You can see from the structure above that we are attempting to deal with different tax issues faced by US and non-US investors in the same underlying assets.

Once you add in the prospect of offering tokens, you also need to decide if you will offer separate tokens for US investors and non-US investors, and whether having two tokens confuses or dilutes your money-raising efforts.

If you do choose the two-token approach, then the US token can represent direct ownership interest into the REIT, while the non-US token would represent ownership interest into the Cayman Feeder. Your money-raising activities would need to ensure that the appropriate investors would purchase the appropriate tokens, and that you disclose the potential for different returns in the two different tokens.

This example is meant to highlight some of the complexities faced in the formation of one type of STO, a REIT Security Token Offering. Other STOs have their own quirks specific to the type of underlying investment contemplated. It is critical to have the legal and investment structure worked out before coding the token begins. What is coded in the contract must be a technological match to the offering documents. For this reason, we strongly stress the engagement of solid and well-respected legal and tax counsel.

Besides advising on the general legal structure for the offering, you also rely upon your counsel for drafting the offering documents, registering the appropriate entities with regulatory bodies, and drafting all the associated service agreements within the structure. They will give you advice on the Anti-Money Laundering (AML) and Know Your Customer (KYC) protocols you need to follow in your offering. You will use them to review your marketing materials and white papers, so that you do not cross the regulatory line into dangerous territory. You may want to ask for a review of the smart contract protocols built into the technology of the tokens, in order to reconcile the offering documentation with the workings of the Security Token.

Many law firms have built out expertise in Cryptocurrencies, Tokenization and Blockchain. When considering a law firm and/or a consultant, take into account that you will need expertise in the underlying asset issues, the security and/or fund structuring, and the technology and tokenization itself. Smart contract technology audits are newer services being offered by law firms, technologists and other practitioners. Security Token Offerings are quickly becoming a cutting-edge practice. Be sure to ask whether your engaged expert practitioners have specific expertise in these areas of cryptocurrencies, tokenization and blockchain technologies. In addition to the structuring and issuance of Security Tokens, your legal counsel will be able to assist in the protection of intellectual property associated with the tokens.

Multi-national firms such as Clifford Chance (www.cliffordchance.com (http://www.cliffordchance.com)), Baker & McKenzie (www.bakermckenzie.com (http://www.bakermckenzie.com)), Shearman & Sterling (www.shearman.com (http://www.shearman.com)), Katten Muchin Rosenman (www.katten.com (http://www.katten.com)) and Skadden, Arps, Slate, Meagher & Flom (www.skadden.com (http://www.skadden.com)) are all increasing their capabilities in the blockchain and cryptocurrency space.

Other, smaller firms, such as DlxLaw (www.dlxlaw.com (http://www.dlxlaw.com)), formed by prior big-law partners with experience in blockchain and cryptocurrency, exhibit deep bench strength and capabilities that can be beneficial in a STO. All in all, several hundred attorneys list blockchain or cryptocurrency as part of their expertise, and the number of attorneys practicing in this area is rapidly increasing. *Please note, this is not an exhaustive list of law firms engaging in this type of practice.*

Which leads to the third question …

Question 3: How do you intend to raise the funds for the Security Token Offering?

There was a time very recently, like in many "hot" markets, when you could simply announce the launch of a new token and expect a groundswell of interest and the formation of numerous wallets for investments. We believe we have evolved from that euphoric state to come back to earth for a more traditional and rational approach to money raising. Investors must be compelled to invest because of the economic potential of the underlying business or assets.

The Security Token adds both complexity and notoriety to your offering, and you must decide if your money raise is going to be solely targeting token investors, or accepting investments from non-token investors, as well. In either case, you must examine your approach to raising money and follow the proper rules and regulations of the domiciliation of the investor source. Security regulators take this very seriously and, as mentioned earlier, they are beginning to scrutinize the marketing and money-raising approaches of recent crypto-coins and Security Tokens.

In the United States, regardless of the nature of the investment offering, if any minutia of the investment is offered or sold to US investors, all activities associated with the money raise must comply with the Securities Act of 1933 and other Federal and State rules regarding the sale of security interests. For this reason, many Security Token Offerings are structured and distributed as private placement offerings, thus avoiding many of the rules and requirements for a public/retail offering.

As much as we may believe a website and crowdfunding approach will raise ample funds, you must be careful not to cross the line into a public offering without the supporting compliance in the marketing materials and offering to all of the regulatory requirements. Additionally, some cryptocurrencies may also fall within money transmitter regulations. More than one regulatory scheme may impact a particular investment. Again, advice of counsel is recommended.

How you intend to raise the funds for the Security Token Offering will determine a number of next steps. Your legal counsel will not only document the offering to reflect the approach but will also give you guidance on selection of brokers and/or placement agents that will ensure compliance with the regulations.

In the US, a private placement offering will restrict investors to only those that meet the SEC's "Accredited Investor" thresholds. This approach impacts the dynamics of every step of the money raising process. Obviously, it impacts the type of investor you are targeting, but a subscription into the private placement should only occur after a "Know Your Customer" due diligence process, which will include the disclosure and paper trail of the investor's personal information, a cross check by a reputable shareholder service or fund administrator, and lastly that the source of funds are also known to cover your requirements under Anti-Money Laundering (AML) rules and sound protocols.

Furthermore, these investors will be subject to Rule 144 and will be required to hold the investment for a period of one year. So, actual token liquidity cannot be achieved until a year after issuance. This should be emphasized, as often we hear claims that the issuance of security tokens will automatically make the market more liquid. While this ultimately may become the case, the initial holding period applies to tokens, and automatic liquidity is not expected.

Let's return to the environment of increased scrutiny that the SEC has placed upon the sale of Security Tokens to investors. It is critical that you take a conservative approach, meaning that if you hire placement agents or broker dealers, these entities must be registered as a broker-dealer, with the Form BD credentials to sell private placements. Their agents must be registered representatives with the broker-dealer or an affiliated one. Furthermore, Blue Sky Laws in the US typically require the broker-dealer to be registered in the states where it is raising investment capital. You can conduct much of your own due diligence on FINRA's broker check website: https://brokercheck.finra.org/ (https://brokercheck.finra.org/).

Some broker-dealers to consider that have embraced the Security Token Offering market are US Capital Global (www.uscapglobal.com (http://www.uscapglobal.com)), Entoro Capital (www.entoro.com (http://www.entoro.com)), Boustead Securities (www.boustead1828.com (http://www.boustead1828.com)), Harbor Platform (www.harbor.com (http://www.harbor.com)), and Amerx (www.amerx.com (http://www.amerx.com)). There are many broker-dealers moving into this space, so conduct your own due diligence, and certain crypto-exchanges such as Gemini (www.gemini.com (http://www.gemini.com)) have applied for an ATS license. Suffice to say this is a rapidly evolving arena.

Which leads us to our final question …

Question 4: Who are the other Service Providers you should consider in this Security Token Offering?

This section is going to drop some names, but it does not imply that these are the best or only service providers in the marketplace. You will need to understand, in excruciating detail, the extent of the services offered, and the costs for said services.

Since aspects of Security Token Offerings are still new, some service providers will require a bit more hand holding in understanding the nuances of the offering. Certain service providers are not interested in participating in Security Token Offerings until more rules and regulations are in place, giving them more comfort about their liability risks associated with the provision of services.

You may require the services of a Fund Administrator or a Transfer Agent and Custodian. Many of these service providers, such as SS&C GlobeOp (www.ssctech.com (http://www.ssctech.com)) and MG Stover (www.mgstover.com (http://www.mgstover.com)), provide a broad range of services. Some firms, such as PrimeTrust (www.primetrust.com (http://www.primetrust.com)), provide compliance/transfer agent/custodial services strictly affiliated with token issuances. These firms may also insist that all investors are subject to their own internal KYC/AML checks, even if your tech team has built all the protocols into the token blockchain structure. The firms will be responsible for accepting investment funds, calculating Net Asset Values (NAVs), calculating and wiring dividend payments, and coordinating annual audits.

In providing good governance and oversight for your investors, consider a strong representation from a board of directors, of which at least half are independent in nature. There are excellent firms, such as DMS Governance (www.dmsgovernance.com (http://www.dmsgovernance.com)), that supply directors to funds and other corporate structures.

Your Security Token investor will also be looking for a strong audit firm to conduct annual audits. Your investor may even ask for assurance opinions. Major firms, such as PWC (www.pwc.com (http://www.pwc.com)), Deloitte (www2.deloitte.com (http://www2.deloitte.com)), EY (www.ey.com (http://www.ey.com)) and KPMG (www.kpmg.com (http://www.kpmg.com)), have all been increasing their abilities to handle Security Token Offerings. Given the size of many token offerings, you might consider a mid-to-large size firm, as an alternative to a major firm, for its level of service and a potentially lower cost structure, such as EisnerAmper (www.eisneramper.com (http://www.eisneramper.com)), Richey May & Co. (www.richeymay.com (http://www.richeymay.com)), BDO (www.bdo.com (http://www.bdo.com)), Marcum (www.marcumllp.com (http://www.marcumllp.com)) and Friedman LLP (www.friedmanllp.com (http://www.friedmanllp.com)).

Lastly (at least for this article), we briefly discuss the technology build and platform support for the Security Token itself. Many of the up-and-coming Alternative Trading System (ATS) platforms are also interested in creating the coding for the token, such as Openfinance (www.openfinance.io (http://www.openfinance.io)), tZERO (www.tzero.com (http://www.tzero.com)) and, most recently, Harbor Platform, mentioned above. New platforms with experienced coders are also being approved on an ongoing basis, and this is an area with a lot of activity. Leaseum Services (www.leaseumservices.com (http://www.leaseumservices.com)), a platform to which the author is affiliated, is building out tools and processes to assist companies in accessing investment solutions on the blockchain.

Certain non-platform smart contract providers are looking at creating standard offering documents. You need to determine the best approach here, because there are a number of firms that sit outside of the ATS platforms that can build the token. And, since these smart contracts should be audited, there are a small number of firms that specialize in that service.

We leave you with this: Security Tokens, as a widely accepted investment vehicle, will evolve and grow in the coming years. We may be on the precipice of an explosion of offerings. There are many companies, asset managers and investment product providers looking at this space and its growth potential. When contemplating an offering, do consider many of the factors, issues and potential solutions discussed herein. Do your homework! Choose excellent counsel and service providers. Make the Security Token all about the investment and not about the Security Token, and you will be on the path to a successful launch.

This article appeared on Medium.com (https://medium.com/@barry.seeman/https-medium-com-barry-seeman-being-secure-about-your-security-token-offering-cd1ae6aa7be0), on Oct. 2, 2019. For more information on these subjects, please contact:

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WHERE CAPITAL MARKETS SPEAK

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Being Smart About Your Smart Contract

Barry Seeman
Susan Joseph

Now is the time for the digital asset and cryptocurrency space to work with global regulators to widely adopt this emerging technology and ecosystem. We need only look at the regulatory activity to see that a robust digital asset and cryptocurrency world is being established; it is far better to work with than against the regulators so that innovation can be realized.

Work With, Not Against, Your Regulators!

Timing is everything! And now is the time for the digital asset and cryptocurrency space to work with global regulators to widely adopt this emerging technology and ecosystem. Regulators have issued a number of new statements and cautions, and taken actions, since we published our article on Oct. 2, 2019, "Being Secure About Your Security Token Offering (https://tabbforum.com/opinions/being-secure-about-your-security-token-offering/)."

In this article, we are bringing forward some additional information, observations and suggestions to the digital asset space, focusing on some of the recent statements and actions taken by U.S. and global regulators. In particular, we will discuss aspects of perceived financial markets stability, Know Your Customer (KYC) protocols, Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) protocols, and Tax Reporting. These issues are critical to understand and act upon, whether designing your first Security Token or opening your first crypto wallet.

This article is based upon the experiences and observations of an experienced financial professional, Barry Seeman, and a crypto-seasoned attorney, Susan Joseph. Contact details for both are found at the end of the article.

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Regulating the Known and the Unknown

Since the beginning of October 2019, there have been a number of guidance statements from global regulators that should give cryptopreneurs, investors, lawyers, enterprise managers, executives and blockchain programmers pause. Some industry participants have argued that regulators have been slow to exhibit a deep understanding of digital or crypto assets, and as such, have created an uncertain regulatory environment that leaves innovators with no clear path forward. But we would argue that those times are behind us.

We need only to look at the regulatory activity to see that a robust digital asset and cryptocurrency world is being established, and it is far better to work with than against the regulators so that innovation can be realized. All security/banking/markets regulators are tasked with understanding the potential systemic risks associated with an activity or product, and issue rules that can act to reduce or eliminate those risks to global markets. Global regulators have been prudent and diligent in education of their staff and the constituents or marketplaces that they serve. Some have set rules specific to digital assets and cryptocurrency. Many have offered "sandboxes" or "local office hours" as outreach and to encourage innovation. These statements, offerings, and ultimate rules are meant to create a level playing field, while also acting to set the bar describing certain illegal or frowned upon activities.

In our last article ("Being Secure About Your Security Token Offering (https://tabbforum.com/opinions/being-secure-about-your-security-token-offering/)"), we highlighted foundational considerations when issuing a new Security Token (a particular class of crypto-asset). Specifically, we stated:

> *"Financial regulatory authorities across the globe are beginning to pass rules pertaining to the issuance and sale of Security Tokens. These rules will evolve over time as the digital shares become more accepted. But you must be conscious of what security laws and tax laws are applicable to your investment and your investors and seek the appropriate advice from engaged counsel. … This highlights the important point that a Security*

Token represents an investment made by an investor, with the expectation of an increase in the value of said investment. Therefore, most securities regulators consider Security Tokens to fall under their purview and will require issuers to adhere to the regulatory rule-set that applies to whatever underlies the Security Token and how it is being sold."

It is now coming to pass that regulators are issuing statements and rulings to curtail certain activities that crypto-assets may afford. We recommend, as we did in the previous article, that you become equally sophisticated in the expressed concerns of regulators and act to remedy the structure and operations of your digital asset, protect your operation from restricted investors and money laundering possibilities, and take that "belt and suspenders" approach of "Being Smart About Your Smart Contract."

STATEMENT 1: "Potential financial stability issues from global stablecoins," FSB Chair's letter to G20 Finance Ministers and Central Bank Governors (https://www.fsb.org/wp-content/uploads/P131019.pdf), Oct. 13, 2019.

OK, this wasn't a text from your kid brother, telling you that Mom and Dad are watching the clock because your about to break curfew.

On Oct. 13, 2019, the Chairman of the Financial Stability Board (FSB) sent an alarming letter to G20 Finance Ministers and Central Bank Governors discussing stablecoins.

As a reminder, the FSB was formed through a mandate by the Group of 20 in April 2009, post-Financial Crisis. Its charter is to propose and guide "the development of critical reform initiatives in a number of areas" and work with "international standard-setting bodies and international organizations to build a more resilient financial system, addressing the fault lines that caused the global financial crisis." (*source:* FSB Chair's Letter to G20 Finance Ministers and Central Bank Governors). The sole decision-making body of the FSB is the Plenary consisting of representatives of all central banks and monetary authorities of the Member Countries. The current Plenary has 59 representative members from 25 jurisdictions, six representatives from four international financial institutions and eight representatives from six international standard-setting, regulatory, supervisory and central bank bodies. (https://www.fsb.org/organisation-and-governance/ (https://www.fsb.org/organisation-and-governance/))

The Chairman's letter did not pass judgement upon all crypto-assets, but rather singled out the potential for stablecoins to be a source of instability to global markets. It states:

"The introduction of 'global stablecoins' could pose a host of challenges to the regulatory community, not least because they have the potential to become systemically important, including through the substitution of domestic currencies. These include challenges for financial stability; consumer and investor protection; data privacy and protection; financial integrity including AML/CFT and know-your-customer compliance; mitigation of tax evasion; fair competition and anti-trust policy; market integrity; sound and efficient governance; cyber security and operational risks; and an appropriate legal basis."

On the surface, this appears to be a direct assault on the potential development and release of the Libra Stablecoin, Facebook's attempt to revolutionize global payments and money accounts. Libra's mission is (https://libra.org/en-US/) to be "A simple global currency and financial infrastructure that empowers billions of people. Reinvent money. Transform the global economy. So people everywhere can live better lives." Reserve assets backing this stablecoin will be the U.S. Dollar, Euro, Japanese Yen, British Pound and Singapore Dollar.

It certainly sounds like an altruistic approach to creating value for the underserved, and yet Mark Zuckerberg's planned upcoming testimony in front of the U.S. House Financial Services Committee (on Oct. 23) may further sway lawmakers and regulators away from expressing support for this endeavor. Randal Quarles, FSB Chairman, states in the letter:

"Stablecoin projects of potentially global reach and magnitude must meet the highest regulatory standards and be subject to prudential supervision and oversight. Possible regulatory gaps should be assessed and addressed as a matter of priority. … The FSB is assessing how the existing regulatory framework applies to 'global stablecoins' and whether any regulatory gaps need to be filled. In any case, it is essential to apply the principle of 'same activity – same rules', independent of the underlying technology."

We note that Libra publicly and consistently says it wants to work with regulators and will not launch prior to receiving regulatory approval in Europe and the USA. Both David Marcus, the Facebook/Calibra leader, and newly elected Libra board member, and Dante Disparte, head of policy and communications at Libra, have specifically and repeatedly stated this position:

- "Facebook admits digital currency doubts as regulatory hurdles loom (https://www.ft.com/content/be6a7756-eea2-11e9-ad1e-4367d8281195)," Financial Times, Oct. 14, 2019
- Hearing Before the United States Senate Committee on Banking, Housing, And Urban Affairs (https://www.banking.senate.gov/imo/media/doc/Marcus%20Testimony%207-16-19.pdf), July 16, 2019

For an in-depth analysis of the Libra Stablecoin, please refer to a report, authored by Susan Joseph, Executive Director of Diversity in Blockchain, and her co-founders, Anna Ashurov, Michelle Gitliz, Shawnna Hoffman, and Josh Klayman, which can be found at: https://diversityinblockchain.com/news/2019/7/17/project-libra-and-diversity-in-blockchain (https://diversityinblockchain.com/news/2019/7/17/project-libra-and-diversity-in-blockchain). This report is also available on the Congressional Record.

In essence, the ground rules have been laid, meaning that Libra, and any other stablecoin, will need to meet and follow the same regulatory regime of the US Dollar, Euro, etc. This includes all aspects of money transfer restrictions, regulatory reporting, sanction adherences, anti-money laundering protocols, etc. The phrase, "Subject to prudential supervision and oversight," signifies that regulatory bodies will need to move quickly in order to instill rules into the use and trading of Libra. And the phrase, "same activity – same rules," points to the premise that digital assets, coins and tokens must follow the same ruleset established for underlying assets, currencies or services they are attempting to disrupt.

[Related: "Will Libra Catalyze a Token Revolution in Finance (https://tabbforum.com/opinions/will-libra-catalyze-a-token-revolution-in-finance/)?"]

Over the past several weeks, we have witnessed the departures of key supporters from the Libra Association, such as PayPal, EBay, Stripe, Mastercard and Visa. It is unclear if this was a move in concert, or as a result of governmental pressure on these large corporate players in payment transfer and technology. There were letters of deep concern (https://www.schatz.senate.gov/imo/media/doc/Signed%20Letters%20re%20Libra%20to%20Patrick%20Collison,%20Ajaypal%20Banga,%20and%20Alfred sent by Senators Sherrod Brown and Brian Schatz to Stripe, Mastercard and Visa.

Either way, there is a substantial amount of scrutiny and oversight which will ultimately impact the development of Libra and other potential stablecoins.

STATEMENT 2: Leaders of CFTC, FinCEN, and SEC Issue Joint Statement (https://www.cftc.gov/PressRoom/SpeechesTestimony/cftcfincensecjointstatement101119) on Activities Involving Digital Assets

This joint statement of major U.S. Regulators was released from Heath Tarbert, Chairman, U.S. Commodity Futures Trading Commission (CFTC); Kenneth A. Blanco, Director, Financial Crimes Enforcement Network (FinCEN); and Jay Clayton, Chairman, U.S. Securities and Exchange Commission (SEC), on Oct. 11.

Once again, this wasn't a little tweet or a postcard in the mail. Regulators are paying attention to this business sector and you should be paying attention to the regulators. We have received a significant warning from key U.S. regulators, who are concerned and together acted "to remind persons engaged in activities involving digital assets of their anti-money laundering and countering the financing of terrorism (AML/CFT) obligations under the Bank Secrecy Act (BSA)."

Consider the following:

1. If you are working on, or considering an investment in cryptocurrency, such as Bitcoin, you likely fall under the purview of the CFTC, because of its prudential oversight of market contracts like futures and certain currency trading;
2. If you are working on, or considering an investment in a Security Token, or some other crypto-asset, you likely fall under the purview of the SEC, because of its prudential oversight of the securities and investments markets; and,
3. Regardless of whether you are working on a cryptocurrency or crypto-asset, you likely are under the purview of the FinCEN!
4. While we are not specifically tackling state regulations in this article, state regulatory schemes may be implicated as well. Yes, you can be governed by more than one regulator at the same time.

TAKE HEED! The Financial Crimes Enforcement Network is becoming a powerful voice in the rulemaking and oversight of the digital asset world. We highlight that this agency has not been a typical voice that is often quoted in the financial press, and when presented in the joint statement with the CFTC and the SEC, it must be taken with more emphasis. So we will reiterate: TAKE HEED! Regulatory bodies are resolving much of the rule ambiguity covering digital assets, and the fear that crypto-assets are ripe for abuses of money laundering and other nefarious activities is forcing a vocal focus from FinCEN.

Early adopters and investors in digital assets may have unwittingly believed that these investable or tradable tokens were not subject to rules of regulators, because of the altered terminology enjoined to the characteristics and operations of the tokens. This statement calls out the fact that:

> *"Market participants refer to digital assets using many different labels. The label or terminology used to describe a digital asset or a person engaging in or providing financial activities or services involving a digital asset, however, may not necessarily align with how that asset, activity or service is defined under the BSA, or under the laws and rules administered by the CFTC and the SEC."*

Do not be misled with a false understanding that regulators will give you a pass on activities and products such as “crowdfunding” and “utility tokens.” The CFTC, FinCEN and SEC just gave the world the overt “if it quacks like a duck” warning. Crypto-assets, ryptocurrencies and stablecoins will all fall under some rules and regulations of these and other governmental bodies across the globe. We emphasize that developers, issuers, lawyers, enterprise managers, executives, and investors must be aware of the regulations pertaining to their activities in their domiciliation.

Let’s return to the message of the statement, reminding participants that they are subject to “anti-money laundering and countering the financing of terrorism (AML/CFT) obligations under the Bank Secrecy Act (BSA).” The BSA was enacted (https://occ.treas.gov/topics/supervision-and-examination/bsa/index-bsa.html) to deter and detect money laundering, terrorist financing, other criminal activities, and the misuse of U.S. financial institutions. This is a wide-ranging mandate which gives FinCEN the ability to scrutinize the full breadth of crypto activities.

Crypto-assets may present substantial innovation opportunities and represent the great democratizer of financial and security activities, allowing for instantaneous and trusted transactions, fractional ownership and various other blockchain miracles. They may allow for more transparency! All true. We welcome, support and are encouraged by the innovation that is both at the door and on the horizon. But we recognize that blockchain technology creates an environment which can circumvent all the safeguards legislated for KYC/AML/CFT obligations. To successfully mainstream innovation and encourage digital asset sector growth, all activities must remain compliant. And so, we support compliant innovation. Let’s discuss various aspects of these obligations.

Under Know Your Customer, or KYC, U.S. financial institutions must adhere to rules set forth by FinCEN, entitled “Customer Due Diligence Requirements for Financial Institutions (https://www.govinfo.gov/content/pkg/FR-2016-05-11/pdf/2016-10567.pdf),” or the CDD Rule. Let’s break down the rule into four musts:

1. Identify and verify the identity of any customer or investor;
2. If the customer or investor is a company, then identify and verify the identity of the beneficial owner of the company;
3. Understand the nature of the customer or investor relationship in order to develop a customer risk profile; and
4. Continuously monitor customers for suspicious activities and/or transactions.

Many smart contracts today have built into the coding the capabilities to capture the required information from the contract holder or investor. This includes obvious fields such as name, address, Social Security number, and other attributes required under the CDD Rule. But capturing the information is only one aspect of the protocol, and many contracts seem to fall short of the verification step, as well as the constant monitoring. If all aspects could be captured and implemented, such automation may make compliance easier and less costly, which would certainly be an improvement over some of today’s processes.

The irony is that the majority of token networks are built upon “trusted” blockchain networks; however, the network has not necessarily been populated with trusted information. Therefore, smart contracts must verify collected owner or investor data with external vendors that specialize in KYC-compliant background checks, such as LexisNexis Risk Solutions (http://www.risk.lexisnexis.com/) and service provider in the crypto-space, PrimeTrust (http://www.primetrust.com/).

Regulators have feared from the inception of blockchain token technology that these networks would be a gathering place for undesirable participants – i.e., criminals, terrorists and tax evaders. Therefore, adherence to the KYC protocols will require more than just safekeeping of key data. It will also require the belt-and-suspenders approach to utilizing external service providers to process and verify the information, provide verification of identify, flag and restrict problematic participants, and continuously monitor these components.

Further, the statement also emphasized the need to be diligent against money laundering and the financing of terrorism. Indeed, much of this approach starts with the KYC protocols, but you must realize that the flexibility and automation of smart contracts can also be a source of tainted funds or funds to be used for nefarious purposes.

The benefits of cryptocurrencies can also represent the greatest threats to their use. This is often the case with innovative products and processes. Thus, innovation that complies with regulation offers the best chance of taking root and flourishing. For example, it is possible to establish an anonymous wallet for holding cryptocurrencies and STOs. Generally, most wallets are not considered completely anonymous because they contain a private and a public key; a public key can typically be traced back to a specific server, which could identify the user. However, the problem is that it is entirely possible to set up an entirely anonymous wallet by taking some low-tech steps: 1) use a TOR browser (browser for maintaining anonymity) in order to set up a software wallet, and 2) use a burner email (temporary and fake email account) in order to finalize the wallet setup. You now have a public key which is not affiliated with an identifiable email or server. How does that entirely anonymous wallet square with the regulatory environment? And how does that cryptocurrency capability encourage adoption when it acts as its own worst regulatory enemy?

You can also transact in a clandestine fashion by avoiding the popular coin exchanges and purchasing cryptocurrencies directly from a holder in a private transaction, or even through bitcoin ATMs! If you have set up several anonymous wallets, you can proceed to mix coins across several accounts, which will break the informational capture of sender and receiver of the coins despite the FATF “travel rule” recommendations (https://www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-rba-virtual-assets.html) earlier this year, which requires exchanges to collect, share, and store personal information about transactions. Certain aspects of the technology as applied can now make the actual transaction harder and harder to trace.

With this reality, Anti-Money Laundering protocols become difficult to execute. Wallets can be maintained away from the scrutiny of compliance staff at financial institutions. Money/coin transfers can happen with little traceability. All of a sudden, you do not know the true source of the cryptocurrency that you have in your wallet.

It begs a sensible next question that should be considered if you're involved in any Security Token Offering or other transaction where you are preparing to accept cryptocurrencies: Should you accept an investment/subscription payment in Bitcoin or Ether, and/or pay dividends in the same? We would argue that hesitation in this space is warranted. We have typically advised Security Tokens to be offered in U.S. Dollars, and for dividends/distributions to be paid in U.S. Dollars, thus avoiding the possibility of transacting in tainted cryptocurrencies. The statement from the three regulators puts the onus for enacting and maintaining AML safeguards on the STO issuers and associated service providers. Belt and suspenders again!

[Related video: "Cryptocurrencies' Messy Legal Framework Might Surprise You: Katherine Cooper, Murphy & McGonigle (https://tabbforum.com/videos/cryptocurrencies-messy-legal-framework-might-surprise-you-katherine-cooper-murphy-mcgonigle/)"]

<u>STATEMENT 3: IRS issues additional guidance (https://www.irs.gov/newsroom/virtual-currency-irs-issues-additional-guidance-on-tax-treatment-and-reminds-taxpayers-of-reporting-obligations) on tax treatment and reminds taxpayers of reporting obligations</u>

If we trade in virtual currencies, do we need to report and pay virtual taxes? We're just asking …

On Oct. 9, 2019, the U.S. Internal Revenue Service (IRS) announced: *"As part of a wider effort to assist taxpayers and to enforce the tax laws in a rapidly changing area, the Internal Revenue Service today issued two new pieces of guidance for taxpayers who engage in transactions involving virtual currency."*

In particular, the IRS stated that cryptocurrencies are treated as property, and therefore, general tax principles applicable to property transactions apply accordingly. Well, this seems to make sense, and it involves the tax impact upon realization of gains and/or losses, with a conversion back into U.S. Dollars.

Furthermore, they specify that if you are paid in cryptocurrencies, then income is income. And it is a burden of the recipient to calculate the fair market value of cryptocurrency paid as wages, measured in U.S. dollars at the date of receipt.

They also gave clarification on hard fork events, when a:

> *"crypto-currency undergoes a protocol change resulting in a permanent diversion from the legacy distributed ledger. This may result in the creation of a new crypto-currency on a new distributed ledger in addition to the legacy crypto-currency on the legacy distributed ledger. If your crypto-currency went through a hard fork, but you did not receive any new crypto-currency, whether through an airdrop (a distribution of crypto-currency to multiple taxpayers' distributed ledger addresses) or some other kind of transfer, you don't have taxable income."*

Whew!

If you do receive new crypto-currencies as a result of a hard fork (regardless of an airdrop or not), then the IRS considers that you have two distinct assets, which requires you to recognize a closing transaction on the first cryptocurrency, thus generating a gain or a loss.

Most important, the IRS left us with a message to ponder, regarding the reporting of the above mentioned activities:

> *"The IRS is aware that some taxpayers with virtual currency transactions may have failed to report income and pay the resulting tax or did not report their transactions properly. The IRS is actively addressing potential non-compliance in this area through a variety of efforts, ranging from taxpayer education to audits to criminal investigations."*

We believe the IRS adding crypto disclosure to its tax form shows the inroads crypto and digital assets have made to the general public.

Finally …

We do not believe that the crypto-asset world is finished seeing new rules and statements from regulators. It is critical to stay on top of these developments and become adaptive to the changing landscape. Whether we are addressing anti-money laundering protocols or addressing the need for tighter controls around investor solicitations, we promote the “belt and suspenders” approach of “Being Smart About Your Smart Contract.”

This article previously appeared on Medium.com (https://medium.com/altcoin-magazine/being-smart-about-your-smart-contract-follow-up-to-being-secure-about-your-security-token-9d9ae19b2b30). For more information on these subjects, please contact:

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The Care and Feeding of the Crypto Ecosystem: New State Licensing Is a Win

Susan Joseph

Barry Seeman

Many believe that regulators have stood in the way of blockchain and cryptocurrency industry development. While there is frustration that the industry is not developing as quickly as many had anticipated, however, blaming regulators for impeding development makes little sense. Both federal and state regulators are striving to understand the issues surrounding cryptocurrencies and digital assets and enact rules and guidelines in order to nurture innovation.

Regulators Are Nurturing Innovation

Like many immature markets, the crypto marketplace witnessed a roller coaster of engagement for cryptocurrencies and digital assets. They have cycled from red hot to a crypto-winter and are now fighting back for a legitimate place at the investment table. As both a potential inhibitor to growth and an enhancer to the structure, cryptocurrencies and digital assets fall under the purview of numerous government regulators. Some of these regulators are a part of Federal oversight, while others are specific to acting on behalf of their states. The current overriding truth is that both federal and state regulators are actively engaged, and most are striving to understand the issues surrounding these assets and enact rules and guidelines in order to nurture innovation.

Many believe that regulators have stood in the way of blockchain and cryptocurrency industry development, as they have been slow, and sometimes obscure, in their release of rules pertaining to the formation and trading of these assets. This is far from the truth, and an unfair view. The reality is, there is frustration that the industry is not developing as quickly as many had anticipated, and blaming regulators for impeding development makes little sense. The technology itself is emerging, and it will take time for it to fully develop. And with all emerging technologies, the regulators need to be educated on these developments before making any assertive ruling in the space. Their engagement in the development of markets is critical for the promotion of a sound marketplace. One need only to look at the activities of the CFTC, SEC, FinCEN, etc., on the federal level and certain states such as New York and Wyoming to see the level of engagement.

Growth pains will abound as the technology matures and finds its way. During this exciting and uncertain period of trial and error, consumers and industry alike need reasonable protections that can be enforced and evolve as the sector develops. Regulators recognize this and are meeting this challenge by crafting appropriate rules that enable an innovation environment to best serve its citizens. Let’s look specifically at Wyoming and New York State to see how regulators have addressed innovation.

[Related: "Regulating Innovation Without Killing It (https://tabbforum.com/opinions/a-practical-guide-to-regulating-innovation-without-killing-it/)"]

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This article is based upon the experiences and observations of a crypto-seasoned attorney, Susan Joseph, and an experienced financial professional, Barry Seeman. Both contact details are found at the end of the article.

The Wyoming SPDI

Recently, Wyoming announced banking rules effective Oct. 1, 2019, that create a new banking category called Special Purpose Depository Institutions ("SPDI") (http://wyomingbankingdivision.wyo.gov/home/areas-of-regulation/laws-and-regulation/special-purpose-depository-institution). SPDIs are non-lending banks that can accept deposits, provide payment services and custody, and apply to become a member bank of the Federal Reserve system, among other things (Chapter 12, 13-13-103(b) (i)-(f) (http://wyomingbankingdivision.wyo.gov/home/areas-of-regulation/laws-and-regulation/special-purpose-depository-institution)). The SPDI was created with crypto/digital asset businesses in mind. Enhanced Digital Custody regulations that apply to the SPDIs were just released the week of Nov. 4, 2019 (Chapter 19 (https://drive.google.com/file/d/1U7gIrVwpWElz3C10bC92-33zAKQnS-8E/view)). These new regulations are critical rules that can potentially help the industry innovate.

How Can the Wyoming SPDI Help the Cryptocurrency and Digital Asset Industry?

Virtual currency transmission businesses are governed by both FinCEN and state money transmitter or equivalent law. These types of businesses must register under federal rules and be licensed under state money transmitter laws (if applicable) in each state that they operate. States may require costs, bonding, minimum net worth, and certain disclosures ranging from financial reporting and experience, audited financial statements, and litigation and bankruptcy proceedings, to background checks and fingerprinting.

The practical result is that virtual currency businesses will need to obtain licenses under a patchwork of different state regimes. With 50 states, this can be a confusing and complicated process. Moreover, sometimes the state licenses may be difficult to obtain. Meeting regulatory requirements can be onerous, time consuming and expensive, and may be downright prohibitive. A more streamlined approach would be very helpful.

How does a business "scale" in this regulatory environment? One solution may be to create a Wyoming SPDI that can be recognized across nearly all states. A Wyoming SPDI is a state-chartered bank, which relies on a long history of legal precedent pertaining to interstate banking laws. In practical terms, it is anticipated that a business will be able to obtain an SPDI license and then have that SPDI entity approved in approximately 42 states without additional licensure, and in the remaining states it may need to apply to the state regulator to open a branch or obtain a money transmitter license.

Due to banking parity rules, it is believed that an institution with this type of banking license is likely to be recognized in nearly all states. Each state still maintains its ability to approve and control what comes into its borders, subject to interstate banking rules and multi-state compacts. It is important to point out that these institutions must meet and maintain certain capital requirements and bank-grade compliance practices. This type of regulation offers strong consumer and institution protection. As contemplated, it creates a streamlined approach and may allow nearly national footprints to be established, thus potentially offering a business the ability to regulatorily scale.

The SPDI Is an Innovation Created by Regulators

Reasonable innovation is occurring through new laws. It takes time to be thoughtful and get it right. Let me say this again in all CAPS AND BOLD:

THE SPDI IS A NEW SOLUTION WITH REASONABLE RULES OF THE ROAD THAT MIGHT ENABLE THE INDUSTRY TO BETTER OPERATE BECAUSE IT ENABLES REGULATORY SCALE. THIS SOLUTION WAS INVENTED BY REGULATORS WITH TECHNOLOGISTS AND INDUSTRY INPUT.

<u>The NY BitLicense</u>

The New York Department of Financial Services (“NYDFS”) took the bull by the horns in 2015 and pioneered the BitLicense (https://www.dfs.ny.gov/apps_and_licensing/virtual_currency_businesses) that allows cryptocurrency businesses to operate within New York State or to engage with New York residents. The application check list can be found here (https://nationwidelicensingsystem.org/slr/PublishedStateDocuments/NY_Virtual_Currency_New_Application_Checklist.pdf). Before the BitLicense was implemented, much public input and debate was sought. An article written by Davis Polk (https://www.davispolk.com/files/2015-06-05_New_Yorks_Final_BitLicense_Rule.pdf) summarizes some of this discussion.

NYDFS Innovated by Creating the BitLicense

Whether you like the BitLicense or not, NYDFS stepped up to the plate to put a framework together so businesses dealing in and with virtual currencies could operate with certainty and consumers could be protected. NY regulators acted at the outset of this industry to help move it forward.

There have been plenty of articles complaining (https://fortune.com/2018/05/25/bitcoin-cryptocurrency-new-york-bitlicense/) about the difficulty of obtaining a BitLicense. Approximately 18 businesses have been licensed (https://finance.yahoo.com/news/york-financial-regulator-reviewing-controversial-174532125.html) under this regime to date. Businesses have left New York State, claiming the BitLicense process is too time consuming, requires too much disclosure and is onerous. Not all agree. Firms such as Gemini (https://gemini.com/) have chosen to operate in New York. They understand that meeting these tough regulations might make them a clear winner for both consumers and institutions in the battle of which crypto exchange to choose. To that end, earlier this year, Gemini advertised with slogans on taxis and New York City subways that said “crypto needs rules. (https://cointelegraph.com/news/crypto-needs-rules-says-new-gemini-ad-campaign)”

NYDFS Continues to Evaluate its Approach to the Blockchain Sector

New York State regulators have actively listened to the crypto and blockchain industry. Recently, NYDFS Superintendent Linda Lacewell said the agency was looking into the BitLicense (https://finance.yahoo.com/news/york-financial-regulator-reviewing-controversial-174532125.html). As proof of this, a new Research and Innovation Division was created in July (https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1907231) to oversee internal transformation and market innovation. It will, among other things, house the division for licensing and supervising virtual currencies. Further, a task force (https://www.coindesk.com/new-york-forms-blockchain-study-task-force-hints-at-bitlicense-update) composed of technologists, consumers, institutional and retail investors, representatives of enterprises, and academics was formed that will evaluate if/how the law serves New York individuals and businesses located in the state. Reports will be issued by Dec. 15, 2020 (https://legislation.nysenate.gov/pdf/bills/2017/S9013), that will include an industry overview and proposals on how the state may best regulate, define or use cryptocurrencies. It may be that tweaks will be made to the process. The report will also look at mining costs and energy impact, taxation, and cryptocurrency trading activities.

Blockchain technology in general has broad applications and it is good to see regulators looking at it holistically. It is clear that New York State is taking this sector seriously and continues to commit to serve it.

Wyoming and NY Regulators Support This Business Sector

Comments have been made that the Wyoming SPDI may be a backdoor to operate in New York State without obtaining a BitLicense, if the SPDI obtains NYDFS permission to open a branch in New York. This may be true. Some of these articles are careful to point out that NYDFS still has the ultimate authority to approve SPDI branches within the state (https://www.coindesk.com/wyomings-new-crypto-banking-law-could-defang-new-yorks-bitlicense).

States are charged with and need to reasonably protect their citizens via regulations regarding cryptocurrencies. Tussles between states seeking to entice businesses to find a home within their borders and protect their citizens is nothing new. Consumers and businesses win when there is competition and choice in a market. There is no need to create a “rock ’em sock ’em robots” atmosphere. Too often this sector is its own worst enemy. New and creative ways to accomplish goals to further the industry should be applauded.

Conclusion

Both New York State and Wyoming regulators are actively engaged to help support the blockchain industry. Early on New York State licensed this industry to protect consumers and spur responsible industry growth. Wyoming created a framework that hopefully will allow this sector to flourish. The point of these regulations is to make this sector safe for consumers, promote responsible innovation, and create accountability and a framework from which entities may operate. Recognition should go to the regulators for stepping up to innovate while protecting their constituencies. With Thanksgiving coming, let us all say, “thank you.”

This article previously was published on Medium (https://medium.com/@SusanJoseph1786/the-care-and-feeding-of-the-crypto-ecosystem-new-state-licensing-is-a-win-30441c8197a8). For more information on these subjects, please contact:

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