

## 'Digital Assets' May Need To Be Registered, SEC Warns

By Jack Newsham

*Law360, New York (July 25, 2017, 9:13 PM EDT)* -- The U.S. Securities and Exchange Commission said on Tuesday that “initial coin offerings” that issue digital tokens in exchange for money or digital currency may be subject to regulation under federal securities laws, warning that its approach to enforcement would be guided by “economic realities” instead of the labels businesses use.

The agency’s guidance took the form of a report on a German group known as The DAO, for decentralized autonomous organization that used blockchain technology to raise about \$150 million last year. Although the SEC said it would not take any enforcement action against The DAO, it said the group’s tokens — which were sold online to U.S. investors — legally qualified as securities and urged entrepreneurs and investors to act with caution.

“The federal securities laws apply to those who offer and sell securities in the United States, regardless whether the issuing entity is a traditional company or a decentralized autonomous organization, regardless whether those securities are purchased using U.S. dollars or virtual currencies, and regardless whether they are distributed in certificated form or through distributed ledger technology,” the SEC said.

According to the SEC, The DAO issued digital scrip, or tokens, that would entitle its holders to vote on projects that would be undertaken with the capital they raised. The group was closely linked to a German tech company called Slock.it UG, whose co-founders deployed the code that guided The DAO’s operation, vouched for its security and created an informational website.

The agency only reached legal conclusions about The DAO’s tokens, and said it would evaluate each coin offering based on the “facts and circumstances” of each case. But it laid down several broad principles and explained its reasons in ways that attorneys told Law360 they found helpful.

Josh Klayman, who leads Morrison & Foerster LLP’s Blockchain and Smart Contracts Group, said many lawyers had been waiting for the SEC to “break its relative silence” on coin offerings and said the guidance was similar to what she expected.

The DAO’s process was ultimately marred by a heist of nearly a third of the \$150 million worth of digital currency that it raised, but it has spurred a broader interest in coin offerings. Klayman said her firm’s statistics show that more than \$700 million in cryptocurrency and cash has been raised in such offerings so far this year, nearly triple last year’s total.

SEC Chair Jay Clayton stressed in a statement that although the government supported innovation, its top priority was keeping investors and markets protected. Top officials with the regulator's divisions of corporate finance and enforcement made similar points, saying in a joint statement that a broad variety of investment arrangements involving the exchange of things of value could legally be viewed as securities.

Emma Channing, the general counsel and interim CEO at the financial technology firm Argon Group, told Law360 the SEC's stance is similar to what "responsible attorneys" had been saying. She said the agency seemed to emphasize two characteristics of DAO tokens — that owning one was like owning a security, and that they produced income — in reaching its conclusions.

She added that the SEC's guidance could have "very significant consequences" for digital asset trading platforms, which may be required to register as national securities exchanges and be subject to new regulations as a result.

Slock.it didn't immediately respond to a request for comment after German business hours.

The SEC said its investigation was conducted by Pamela Sawhney, Daphna A. Waxman, Valerie A. Szczepanik and Lara Shalov Mehraban.

--Editing by Brian Baresch.

*Clarification: This story has been updated to reflect that the SEC only evaluated one coin offering, but did so in a way that could have broader applicability.*