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The Regulation of Initial Coin Offerings in South Africa

by

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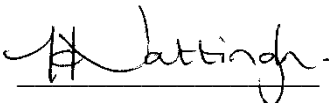
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Soli Deo Gloria

LIST OF ABBREVIATIONS

| | | |
|-----------|---|---|
| AML/CFT | - | Anti-Money Laundering/Combating the Financing of Terrorism |
| DLT | - | Distributed Ledger Technology |
| dApp | - | Decentralised application |
| FATF | - | Financial Action Task Force |
| ICO | - | Initial Coin Offering |
| CASP | - | Crypto Asset Service Provider |
| CATP | - | Crypto Asset Trading Platform |
| CARWG | - | Crypto Asset Regulatory Working Group |
| IFWG | - | Intergovernmental Fintech Working Group |
| NT | - | National Treasury |
| FAIS Act | - | Financial Advisory and Intermediary Services Act 37 of 2002 |
| FSCA | - | Financial Sector Conduct Authority |
| FIC | - | Financial Intelligence Centre |
| FIC Act | - | Financial Intelligence Centre Act 38 of 2001 |
| FSR Act | - | Financial Sector Regulation Act 9 of 2017 |
| SARB | - | South African Reserve Bank |
| P2P | - | Peer to peer |
| VASP | - | Virtual Asset Service Provider |
| CoFI Bill | - | Conduct of Financial Institutions Bill |
| FMA | - | Financial Markets Act 91 of 2012 |

SUMMARY

Emergent and creative uses of virtual or crypto currencies (or assets) have made enormous regulatory waves over the past few years. Many international jurisdictions, including South Africa have taken some steps towards a regulatory approach, however the regulation of crypto assets still remains murky, dubious and is far from clear cut.

A specific emergent and creative use for crypto assets are to raise funds from the public to finance a project / business venture by means of an Initial Coin Offering (ICO) or so-called token launch/offering/generation. An investor in an ICO will pay with fiat currency (or legally recognised money i.e. South African Rands), to finance the project, in exchange for a crypto token of a sort which may be connected with the right to receive some value in return. This value may take various forms, such as access to a network, distribution of the earnings generated by the project, or voting rights. ICOs are currently primarily used by start-ups to bypass the regulatory red-tape of “traditional” capital and fundraising methods through banks or venture capitalists. Countries world-wide grapple with how ICOs should be regulated and so does South Africa.

The CARWG under the auspices of the IFWG issued a comprehensive position paper on crypto assets in April of 2020. An updated version of the position paper has been issued on 11 June 2021. This position paper indicates a proposed policy position of, and makes regulatory recommendations pertaining to, ICOs in South Africa. This mini-dissertation examines these recommendations and policy position through analysing the background of ICOs, the full nature and characteristics of an ICO, as well as the benefits and the risks to ICO issuers and investors, in order to establish a clear understanding of what South Africa’s current regulatory approach pertaining to ICOs is and to identify any potential shortfalls in order to make appropriate recommendations.

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CHAPTER 1: INTRODUCTION

Innovative and creative alternative uses for virtual or crypto currencies (or crypto assets¹) have emerged since the launch of its pioneer Bitcoin, in 2008, that sought to provide a digital peer to peer cash system that runs on decentralised protocols.² As a result, enormous regulatory waves have been made over the past few years. Many international jurisdictions, including South Africa have taken some steps towards a regulatory approach for crypto assets, however the regulation thereof remains murky, dubious and is far from clear cut.

A specific emerging innovative and creative use for crypto assets are to raise capital from the public to finance a project, business venture or crypto asset start-up through launching an Initial Coin Offering (ICO) or so-called token launch/offering/generation.³ An investor could pay with either fiat currency (legally recognised money i.e. South African Rands), or another popular crypto asset, to finance the project, in exchange for another crypto asset (or ICO token) – a crypto asset of the new start-up or business venture.⁴ This crypto asset may be connected with the right to receive some value in return. This value may take various forms, such as access to a network, distribution of the earnings generated by the venture, or voting rights, to name a few. ICO's are primarily used by start-ups to bypass the regulatory red-tape of "traditional" capital and fundraising methods through banks, private equity firms or venture capitalists.⁵

The crypto asset start-ups Ripple and Ethereum were the pioneers of the ICO phenomenon as they utilised ICOs as a vehicle to acquire start-up capital to ultimately fund and launch their crypto asset start-ups. In 2013, Ripple raised \$5 million (USD fiat

¹ See 2.4.4. in Chapter 2 below.

² Nakamoto 'Bitcoin: A Peer-to-Peer Electronic Cash System' [online] available at <https://bitcoin.org/bitcoin.pdf> ; accessed 2 October 2021 at 1.

³ Debler "Foreign Initial Coin Offering Issuers Beware: The Securities and Exchange Commission Is Watching" 2018 *Cornell International Law Journal* at 251.

⁴ Goforth "The Lawyer 's Cryptionary: A Resource for Talking to Clients About Crypto-Transactions" 2019 *Campbell Law* at 39.

⁵ IFWG Crypto Assets Regulatory Working Group Position Paper on Crypto Assets April 2021 (hereafter the "CARWG Updated Position Paper 2021") at 19.

currency plus Bitcoin) in exchange for one billion of its XRP crypto tokens.⁶ In 2014, the Ethereum ICO raised nearly a whopping \$18 million (USD fiat currency plus Bitcoin) in exchange for its Ether crypto tokens.⁷ In 2017 ICOs gained significant global traction.⁸ By the end of 2017 nearly \$1,8 billion (USD) was raised through ICOs that were run in the United States, European Union member states, Russia, Singapore, China and Hong Kong.⁹ By the end of 2019 it has been officially reported that over \$26 billion (USD) has been raised through ICOs worldwide.¹⁰ Just over a staggering \$58 million (USD) has been raised through ICOs from June 2020 to August 2021.¹¹ These statistics indicate that ICOs as a vehicle to raise capital is both extremely useful and substantially growing due to constant demand. Some describe this “ICO bonanza as a new gold rush.”¹²

MacNiven writes that:

“The sudden and substantial growth of ICOs has captured the attention of countries all over the world. Without a proven regulatory scheme, nations are grappling with how to handle this new technology. Some have banned the technology, some have modified their laws to adapt and others seem to still be figuring out how to adjust.”¹³

In light of the above, the question this study seeks to answer is how South African regulators and policy makers are grappling with this new technology phenomenon called an ICO. Plainly put, how is ICOs currently regulated in South Africa?

This question will be explored and answered through three (3) substantive chapters. Chapter 2 will provide insight to the background of so-called crypto assets and other key concepts that are fundamental to this study. In Chapter 3 the ICO phenomenon will be

⁶ Goforth (note 4 above) at 39.

⁷ Goforth (note 4 above) at 39.; and see Frankenfield “Initial Coin Offering (ICO)” [online] available at <https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp> ; accessed 9 September 2021.

⁸ Maume & Fromberger "Regulations of Initial Coin Offerings: Reconciling U.S. and E.U. Securities Laws." 2019 *Chicago Journal of International Law* at 561.

⁹ Maume (note 8 above) at 561.

¹⁰ ICO Bench “ICO Market Monthly Analysis November 2019” [online] available at https://icobench.com/reports/ICObench_ICO_Market_Analysis_November_2019.pdf ; accessed 7 October 2021 at 7.

¹¹ ICO Bench “Stats and Facts” [online] <https://icobench.com/stats> [online] ; accessed 20 October 2021.

¹² Maume and Fromberger (note 8 above) at 548.

¹³ MacNiven "Initial Coin Offerings: Striking a Balance between Protecting Investors and Fostering Growth." 2019 *Rutgers Business Law Review* at 5.

scrutinised through a study of its nature, characteristics, process, benefits and risks. And finally, Chapter 4 will discuss the current policy and regulatory stance of ICOs in South Africa with succinct considerations of criticism and accompanying submissions, as to whether the policy position and regulatory recommendations are sufficient for laying the regulatory foundation for ICO regulation.

CHAPTER 2: BACKGROUND AND KEY CONCEPTS

2.1. Introduction

Cryptography, Distributed Ledger Technology (DLT), blockchain, cryptocurrency, crypto assets and crypto tokens are all phenomena and terminology that have formed (and still forms) the foundation for the birth of Initial Coin Offerings (ICOs) as we know it today. In order to apprehend the true nature of an ICO it is quintessential to understand where it comes from and what brought ICOs to what it is known as today.

These foundational phenomena and terms are defined and discussed below.

2.2. Cryptography

Many adults today would still carry fond childhood memories of how they have sent a letter conveying a secret message written in a self-invented alphabet with special characters, symbols and letters to one of their friends sitting on the other side of the classroom. Only the friend, or perhaps even a select group of friends, would be able to decipher this message due to their knowledge or understanding of the self-invented alphabet. If the teacher would catch this letter being sent around, s/he would have no clue what the message states unless s/he had the key (or ultimately the 'crack-code') to decipher the special characters, symbols and letters. This childhood memory can be held out as an example of one of the most basic forms of cryptography.

People wanting to send secret or confidential messages to others through a method of securing or protecting the information or data contained in the message is as old as mankind itself.¹⁴ However, the inception and development of personal use digital computers and computer hardware throughout the twentieth century (the Digital Revolution),¹⁵ together with the birth (and boom) of the internet in between the late

¹⁴ Dixit "Conceptualising interaction between cryptography and law" 2018 *NUJS Law Review* at 328.

¹⁵ Mühleisen "The Long and Short of The Digital Revolution" 2018 International Monetary Fund Finance & Development at 6 [online] available at <https://www.imf.org/external/pubs/ft/fandd/2018/06/impact-of-digital-technology-on-economic-growth/muhleisen.htm> ; accessed on 27 October 2021.

1980s¹⁶ and the early 1990s¹⁷ has made it possible to access, send and receive virtually any information or data much easier and quicker. The access, sending and transferring of money or funds has also become utterly quick, easy and convenient with the advent of electronic and online banking as well as a multitude of electronic payment methods. However, the rise of easy access and sharing of data inevitably raised massive data security and protection concerns. Cryptography was (and still is) the method with the proverbial superhero cape that was harnessed to address the digital security conundrum and consequently made it possible for people and businesses to freely and securely engage in online banking, e-commerce, and communicate via emails, text messages, and voice communications.¹⁸

The word “cryptography” is derived from the Greek words *kryptos* (hidden) and *logos* (word) which refers to “the science and art of code-making and code-breaking.”¹⁹ Cryptography can thus be theoretically defined as the process in terms of which ordinary plain text is converted to unintelligible or incomprehensible text (code) or vice-versa as a secure method of encryption through which data or information can either be stored and/or transferred to an intended recipient for reading and processing.²⁰ Cryptography consequently protects data or information from being altered or stolen by an unintended recipient and ensures that the data shared between the sender and the recipient is kept secret.²¹ Cryptography can also be used as a means of user authentication.²²

Modern day cryptography practices use mathematical and computer science to protect the confidentiality, integrity, and authenticity of data or information stored or transferred

¹⁶ Murphy “From dial-up to 5G: a complete guide to logging on to the internet” 2019 *Quartz* [online] available at <https://qz.com/1705375/a-complete-guide-to-the-evolution-of-the-internet/> ; accessed 27 October 2021.

¹⁷ Dixit (note 14 above) at 328.

¹⁸ Dixit (note 14 above) at 332.

¹⁹ Dixit (note 14 above) at 327.

²⁰ The Economic Times *Definition of 'cryptography'*, [Online] available from <https://economictimes.indiatimes.com/definition/cryptography> ; accessed 13 September 2021.

²¹ Dixit (note 14 above) at 327.

²² The Economic Times (note 20 above).

as well as to ensure the non-repudiation²³ thereof.²⁴ Basic day-to-day applications of cryptography include the passwords used to access a computer, Automated Teller Machine (ATM) and online services, One Time Pins (OTP's), CAPTCHA²⁵ tests and so forth.

There are three types of general cryptographic techniques used namely (i) symmetric-key cryptography, also known as conventional cryptography, (ii) asymmetric-key cryptography, also known as public-key cryptography ('PKC') and (iii) hash functions.²⁶

Symmetric-key cryptography is a method where the sender encrypts the data with a key and the receiver decrypts the data with the exact same key.²⁷ Thus, the sender and receiver share the same single private key to encrypt and decrypt data. It is analogous to a bank account password.²⁸

In terms of asymmetric-key cryptography the sender encrypts the data with a public key, which is basically publicly known, and the receiver can then only decrypt the data with a private key, known only by the receiver.²⁹ A public key is roughly akin to a bank account number or the number on a plastic bank card. - it is public-facing.³⁰ However, to access the bank account with that particular number or in order to use the plastic bank card, a private key (the password) known only to the receiver (or bank account owner) is necessary.

Typical hash functions are a type of algorithm that converts any length of plain text input (letters, numbers and characters) into a secure fixed-length random output that is unreadable unless the receiver has a key to decrypt the output.³¹ What makes hash

²³ Meaning that at a later stage the sender of the data or information cannot renounce nor deny his/her *initial* intention to transfer or share the data or information. See The Economic Times (note 20 above).

²⁴ Note 23 above.

²⁵ CAPTCHA is an abbreviation for Completely Automated Public Turing test to tell Computers and Humans Apart.

²⁶ Note 23 above.

²⁷ Dixit (note 14 above) at 330.

²⁸ Evans "Cryptokitties, cryptography, and copyright" 2019 *AIPLA Quarterly Journal* 219 at 235.

²⁹ Dixit (note 14 above) at 331.

³⁰ Evans (note 28 above) at 235.

³¹ Frankenfield "Cryptographic Hash Functions" 2021 *Investopedia* [online] available at <https://www.investopedia.com/news/cryptographic-hash-functions/>; accessed 12 September 2021.

functions so useful and secure is that *any* small change to an input will cause a drastic change in the output - basically, an entirely different hash output.³² Consequently, integrity verification of data is made easy and fool-proof through hashing data. The hash is also called the “unique identifier [...] or a digital fingerprint of the source data that cannot be altered.”³³ Hash functions are predominantly used for password verification, electronic signature generation and verification as well as verification of the integrity of files and messages.³⁴

Typical hash functions can also be paired with enhanced security and cryptographic features in order to modify hashed data in such a way to make it absolutely unintelligible or unreadable making it extremely difficult to detect identifying information about the senders and receivers or about the contents of a file or message.³⁵ This phenomenon is known as cryptographic hashing.

An example of cryptographic hashing is the patented SHA-256³⁶ software algorithm that converts any length of input into a random output value that is 256 bits long.³⁷ Bitcoin, the original and largest ‘cryptocurrency’ in the world,³⁸ uses the SHA-256 cryptographic hash function in its algorithm, to pass transaction information anonymously.³⁹

Thus, putting it plainly, cryptographic hashing empowers the sender of data to publicly post a cryptographic hash (the unintelligible and extremely difficult – almost impossible without massive computing power - to crack, code and digital fingerprint of the source data) as method of verification, so that any receiver can personally verify whether they possess the original data without the sender revealing their identity or any part of the contents of the data.

³² Garner “Merkle Tree Hashing: How Blockchain Verification Works” 2018 *Coincentral* [online] available at <https://coincentral.com/merkle-tree-hashing-blockchain/> ; accessed 29 September 2021.

³³ Evans (note 28 above) at 239.

³⁴ Frankenfield (note 31 above).

³⁵ Frankenfield (note 31 above); N-able “SHA-256 Algorithm Overview” 2019 *N-able* [online] available at <https://www.n-able.com/blog/sha-256-encryption> ; accessed 13 September 2021.

³⁶ “Secure Hash Algorithm 256”.

³⁷ N-able (note 35 above).

³⁸ See explanation on Bitcoin below in 2.4.1.

³⁹ Frankenfield (note 31 above).

2.3. Distributed Ledger Technology (DLT) and the blockchain

DLT and the blockchain, albeit often used interchangeably, are two completely separate technological phenomenon's that operate together to create a very secure means of storing, protecting and validating information or data.

DLT is a type of technology protocol that basically enables a set of data to be stored, updated, validated and shared as a synchronised record (or ledger) on different technological locations,⁴⁰ decentralised and distributed, in a peer to peer (P2P) network of computers. It is simply as if multiple original copies of a conventional database were to be kept and updated at different physical locations in order to avoid one single central location thereof. However, DLT utilises technology, through P2P computers – commonly referred to as network nodes⁴¹ - to decentralise the storing, validating, updating and sharing of the database – a distributed ledger of data – rather than storing one original copy in one central location (like a bank or on cloud storage Dropbox, Google Drive or OneDrive).⁴²

Blockchain, on the other hand, is the software program (like Microsoft on a computer) that “runs” or operates on DLT protocol to operate a synchronised but decentralised database. Blockchain software was originally researched as an alternative method to timestamp digital documents that would prevent backdating or tampering.⁴³ Blockchain technology combines the internet, cryptography (through public or private key encryption with digital signatures) and DLT via P2P networks as a means of securely structuring and storing an original record/ledger of data.⁴⁴ The blockchain software collects information or data and stores it in sets/blocks with a predetermined capacity or with certain data requirements. Once the block has been filled to its capacity, or with what is required, it is chained to a previously filled block. These blocks of data, chained together, forms the so-called

⁴⁰ Vessio 'Chapter 40: Virtual Currencies' (May 2021) *Banking Law and Practice LexisNexis Butterworths* at 40.2.1.

⁴¹ Any electronic device or computer that is capable of transmitting or receiving information over a blockchain network constitutes a node. Goforth (note 4 above) at 89.

⁴² Evans (note 28 above) at 234 - 235.

⁴³ Haber & Stornetta “How to time-stamp a digital document” 1991 *Journal of Cryptology* 99–111.

⁴⁴ Evans (note xxx above) at 235.

“blockchain”,⁴⁵ and once the data is recorded on the blockchain, it is extremely difficult – almost impossible – to tamper with it.⁴⁶

Blockchain software establishes and maintains a distributed ledger/record that is publicly available on the internet. Each block in a blockchain holds three things, namely the data, its own cryptographic hash and the cryptographic hash of the previous block chained to it. The data held in the block also depends on what is required by the specific type of blockchain software used as different blockchain software requires different data input.⁴⁷ The cryptographic hash (as explained above) is the unique digital fingerprint of the source data⁴⁸ but, also serves to identify a block and all that is held within it.⁴⁹ The cryptographic hash is first generated and then calculated once a block has been created. Any alteration of the contents of the block will precipitate a change in the cryptographic hash, causing a new and different block than the original block.⁵⁰ Apart from the first block in a blockchain, known as the ‘Genesis block’, each new block is chained to the next block through the cryptographic hash of the previous block.⁵¹ Thus, each new block has its reference and existence due to the previous block’s cryptographic hash being chained to it. Consequently, any alteration to the contents of a block, that precipitates a change to its cryptographic hash, will also cause all the following blocks in the chain to be invalid.⁵² Albeit cryptographic hashing makes the detection of any data alterations quick, easy and infallible, it does not eliminate the possibility to successfully tamper with the contents of the block. This is because computers can be easily harnessed to calculate the cryptographic hash of a block, as well as the hashes of the subsequent blocks, in a matter of seconds. To reduce the possibility of tampering, modern blockchain software utilises a Proof-of-Work (POW) mechanism through which it slows the time of the creation of new

⁴⁵ Conway “Blockchain Explained” 2021 *Investopedia* [online] available at <https://www.investopedia.com/terms/b/blockchain.asp> ; accessed 14 September 2021.

⁴⁶ Conway (note 45 above).

⁴⁷ Goforth (note 4 above) at 61.

⁴⁸ Evans (note 28 above) at 239.

⁴⁹ Iansiti & Lakhani “The Truth About Blockchain” 2017 *Harvard Business Review* [online] available at <https://hbr.org/2017/01/the-truth-about-blockchain> ; accessed 14 September 2021.

⁵⁰ Iansiti & Lakhani (note 49 above).

⁵¹ <https://www.investopedia.com/terms/b/bitcoin.asp>

⁵² Iansiti & Lakhani (note 49 above).

blocks down.⁵³ This mechanism requires the nodes in a P2P network to “solve cryptographic hashing puzzles based on the transactions in a proposed new block on the blockchain” that takes a prolonged amount of time.⁵⁴ Thus, if a block is tampered with, the POW puzzle will need to be solved for each and every block on the blockchain. What makes blockchain software so significant, is finally the use of the distributed P2P network of nodes that are harnessed as a method to create consensus. Any person (with their computer) may join a P2P network of nodes and will receive a complete copy of the particular blockchain.⁵⁵ A new block, based on the solution of the POW cryptographic hash puzzle, will only be broadcasted across the P2P network, once the puzzle has been solved.⁵⁶ All the other nodes in the P2P network will verify the validity of the block and will then only add the new block to their blockchain, otherwise the block will be rejected.⁵⁷ This creates consensus throughout the entire P2P network of computers, making modern blockchain software a secure method of sharing, distributing, updating and storing data.

2.4. The origin and background of cryptocurrency, its definitional development and its uses

2.4.1. Bitcoin and altcoins

In 2008 a mysterious nine-page white paper titled “Bitcoin: A Peer-to-Peer Electronic Cash System” under the pseudonymous Satoshi Nakamoto was published.⁵⁸ This spawned the development of so-called cryptocurrency that is “a purely peer-to-peer version of electronic cash [that] ... allow online payments to be sent directly from one party to another without going through a financial institution [or intermediary].”⁵⁹ Bitcoin utilises blockchain technology (as explained above) to create and operate a secure digital, decentralised, peer-to-peer currency that can be used similarly to cash.⁶⁰ The Bitcoin blockchain’s approach to the POW mechanism is known as ‘Bitcoin mining’ and is

⁵³ Werbach & Cornell “Contracts Ex Machina” 2017 *Duke Law Journal* at 328.

⁵⁴ Werbach & Cornell (note 53 above) at 328.

⁵⁵ Iansiti & Lakhani (note 49 above).

⁵⁶ Werbach & Cornell (note 53 above) at 328.

⁵⁷ Werbach & Cornell (note 53 above) at 328.

⁵⁸ Werbach & Cornell (note 53 above) at 324.

⁵⁹ Nakamoto (note 2 above) at 1.

⁶⁰ Werbach & Cornell (note 53 above) 327.

underpinned by an incentive structure that gives the P2P network of computers “a reason to follow the legitimate consensus rather than behave dishonestly.”⁶¹ The Bitcoin POW cryptographic hash puzzles range in their levels of difficulty, ensuring that a random Bitcoin network node finds the solution roughly every ten minutes.⁶² The blockchain software will release new Bitcoins – as a financial reward – to the network node that finds the hash puzzle solution, proposes the new block to the blockchain and after it has been successfully validated by the other nodes in the network.⁶³ This process is known as ‘Bitcoin mining’ and is the only way in which new Bitcoins can be created and released into circulation.⁶⁴

The first official Bitcoin (Genesis) block, ‘Block 0’ was mined and released in January 2009⁶⁵ containing 50 Bitcoins.⁶⁶ All the other blocks mined for approximately four years after the release of the Block 0 also contained 50 Bitcoins.⁶⁷ However, Bitcoin is a limited resource and there will “ultimately be no more than approximately 21 million Bitcoins ever created.”⁶⁸ Thus, the Bitcoin mining reward is halved every four years.⁶⁹ Three Bitcoin halving events have taken place to date and a Bitcoin block now only contains 6,25 Bitcoins.⁷⁰ To date 18 853 668 out of the approximately 21 million Bitcoins have already been mined and released into circulation.⁷¹

With so many Bitcoins available for circulation a person need not acquire Bitcoins through mining only but, can also purchase Bitcoins with or trade fiat currency⁷² for it, either from

⁶¹ Werbach & Cornell (note 53 above) 328.

⁶² Werbach & Cornell (note 53 above) 328.

⁶³ Werbach & Cornell (note 53 above) 329.

⁶⁴ Werbach & Cornell (note 53 above) at 329.

⁶⁵ Frankenfield “Bitcoin Definition” 2021 *Investopedia* [online] available at <https://www.investopedia.com/terms/b/bitcoin.asp> ; accesses 18 September 2021.

⁶⁶ Conway “Bitcoin Halving” 2021 *Investopedia* [online] available at <https://www.investopedia.com/bitcoin-halving-4843769> ; accessed 18 September 2021.

⁶⁷ Werbach & Cornell (note 53 above) at 329.

⁶⁸ Werbach & Cornell (note 53 above) at 329

⁶⁹ Conway (note 66 above).

⁷⁰ Conway (note 66 above).

⁷¹ CoinMarketCap “Today’s Cryptocurrency Prices by Market Cap” 2021 [online] available at <https://coinmarketcap.com/> ; accessed 18 October 2021.

⁷² Also known as “real currency,” “real money,” or “national currency” which is the paper and coin money of country for example Rand, Cents, Dollars, Euros and so forth, which is issued and designated as its legal tender and is customarily accepted as a medium of exchange. See the Financial Action Task Force (FATF)

a current Bitcoin owner or from Bitcoin.com. The owner of the Bitcoin can then use their Bitcoin to directly and digitally transact with another person, as if it was cash, albeit electronic, and consequently bypass any intermediaries (like banks) to complete the transaction, in a secured and verified manner.

Bitcoin was the first technological platform to utilise blockchain technology to create a secure digital, decentralised, peer-to-peer currency that can be used similarly to money.⁷³ However, since Bitcoin's launch in 2008, "an entire ecosystem of developers, entrepreneurs, investors, traders, and analysts [jumped on the same band wagon] toward the vision of technologically enabled economic and social transformation."⁷⁴ Consequently two things happened. Firstly, major corporations like Microsoft, Dell Computer, Time Inc. and thousands of others started accepting Bitcoin-denominated transactions,⁷⁵ and secondly, developers, entrepreneurs and traders started developing alternative cryptocurrencies (known as "altcoins") that serve the same, a similar and/or enhanced purpose than Bitcoin. Examples of altcoins are Namecoin (the first altcoin),⁷⁶ Ether, Litecoin, Cardano, Polkadot, Bitcoin Cash, Stellar, Chainlink, Tether and Monero⁷⁷ to name a few. However, there are over 12 000 (and counting) different 'cryptocurrencies' available as of October 2021.⁷⁸

2.4.2. The Financial Action Task Force (FATF) definitional response

Cryptocurrencies operate on a global level as peer-to-peer computer networks span across the world. Consequently, regulators internationally grapple with not only how cryptocurrency should be regulated or supervised (in their own jurisdiction and abroad) but ultimately also, as a first step, how it should be defined in order to develop sufficient

Report: Virtual Currencies Key Definitions and Potential AML/CFT Risks, June 2014 at 4 (hereafter the "FATF 2014 Report").

⁷³ Debler (note 3 above) at 246.

⁷⁴ Werbach & Cornell (note 53 above) at 324.

⁷⁵ Werbach & Cornell (note 53 above) at 324.

⁷⁶ Frankenfield "Namecoin" 2021 *Investopedia* [online] available at <https://www.investopedia.com/terms/n/namecoin.asp> ; accessed 20 October 2021.

⁷⁷ Conway "The 10 Most Important Cryptocurrencies Other Than Bitcoin" 2021 *Investopedia* [online] available at <https://www.investopedia.com/tech/most-important-cryptocurrencies-other-than-bitcoin/> ; accessed 20 October 2021.

⁷⁸ Frankenfield "What Investors Need to Know About Altcoins" 2021 *Investopedia* [online] available at <https://www.investopedia.com/terms/a/altcoin.asp> ; accessed 20 October 2021.

regulatory responses. In 2014 the global money laundering and terrorist financing watchdog - the independent inter-governmental Financial Action Task Force (FATF) - that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction,⁷⁹ published a report on so-called “Virtual Currencies”.⁸⁰ The term virtual currency is used synonymously to cryptocurrency and refers to non-fiat currencies.⁸¹ The FATF defines virtual currency as:

“a digital representation of value that can be digitally traded and functions as (1) a medium of exchange; and/or (2) a unit of account; and/or (3) a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued nor guaranteed by any jurisdiction, and fulfils the above functions only by agreement within the community of users of the virtual currency. Virtual currency (...) [should be] distinguished from fiat currency [as well as] (...) e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency.”

Consequently, the FATF attributed three generic characteristics to virtual currencies, namely that it is a medium of exchange and/or a unit of account and/or a store of value. The problem with the three generic characteristics of virtual currencies are however that, according to the European Central Bank (ECB), it can be attributed to all money regardless of its shape or form.⁸²

In October 2018, following the report of the UK Cryptoasset Taskforce (see 2.4.3. below) the FATF included the term “virtual asset” as a new and updated term for virtual currency to their glossary.⁸³ The FATF now defines a “virtual asset” as:

“a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat

⁷⁹ See the FATF ‘About’ section on <https://www.fatf-gafi.org/about/>.

⁸⁰ The FATF 2014 Report (note 72 above).

⁸¹ See note 72 above for an explanation of fiat currency. The FATF 2014 Report (note 72 above) at 4.

⁸² Vessio (note 40 above) at 40.2.2.

⁸³ Financial Action Task Force (FATF) Report: Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers, June 2019 at 4 (hereafter the “FATF 2019 Report”).

currencies, securities, and other financial assets that are already covered elsewhere in the FATF Recommendations.”⁸⁴

2.4.3. The UK Cryptoasset Taskforce definitional response

The UK Cryptoasset Taskforce issued a report in 2018 presupposing that the term “cryptoassets” be used for virtual currencies as they assert that cryptoassets are not to be considered currency or money although it can be used as a means of exchange as if it were currency.⁸⁵ The taskforce further asserted that cryptoassets are too volatile to be a good store of value, are not widely-accepted as means of exchange, and are not used as a unit of account.⁸⁶ Alternatively the taskforce has identified three *typical uses* for cryptoassets, namely:

- (i) A *means of exchange* that enables the buying and selling of goods and services through functioning as a decentralised tool; and
- (ii) For *investment* purposes through holding and trading cryptoassets as financial instruments; and
- (iii) To *support capital raising* and/or the creation of decentralised networks *through Initial Coin Offerings (ICOs)*.⁸⁷

2.4.4. The South African definitional response and the Crypto Asset Regulatory Working Group (CARWG)

In South Africa, no legislatively enacted definition for crypto assets (or virtual currencies) have been adopted yet. In 2014 the South African Reserve Bank issued a Position Paper on Virtual Currencies⁸⁸ in which the FATF definition of virtual currencies was used. However, the Crypto Asset Regulatory Working Group (CARWG) under the auspices Intergovernmental Fintech Working Group (IFWG) was established in the beginning of

⁸⁴ The FATF 2019 Report (note 83 above) at 13.

⁸⁵ Cryptoassets Taskforce: Final Report Financial Conduct Authority, Bank of England and HM Treasury October 2018 at 12 (referred hereafter as the "UK Taskforce Report 2018").

⁸⁶ UK Taskforce Report 2018 (note 85 above) at 12.

⁸⁷ UK Taskforce Report 2018 (note 83 above) at 11 - 12.

⁸⁸ SARB National Payment System Department: Position Paper on Virtual Currencies (2014) at 2.

2018.⁸⁹ Their mandate is to review the position on crypto assets in South Africa and abroad in order to formulate a coherent and comprehensive policy stance.⁹⁰ After the CARWG issued an initial consultation paper for response and comment to industry participants in 2019, they issued a comprehensive position paper on crypto assets on 14 April 2020.⁹¹ In this Position Paper the CARWG provided its first and official definition of crypto assets.⁹² On 11 June 2021 the CARWG issued an updated Position Paper⁹³ and consequently also an updated and extended definition of crypto assets as a foundation for developing a comprehensive policy stance and regulatory recommendations. The CARWG currently defines crypto assets as follows:

“A crypto asset is a digital representation of value that is not issued by a central bank, but is capable of being traded, transferred or stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility; applies cryptographic techniques and uses distributed ledger technology.”⁹⁴

The phrases “capable of being” and “uses distributed ledger technology” in the definition above, have been included additionally in the 2021 Position Paper definition of crypto assets from the initial 2020 Position Paper definition.

It is critical to note that the definition for crypto assets specified by the CARWG does not include any digital representations of any sovereign currencies whatsoever, because crypto assets are not regarded as valid legal tender, fiat currency or public money⁹⁵ in South Africa as it is not issued by the government nor by its central bank.⁹⁶

⁸⁹ IFWG Crypto Assets Regulatory Working Group Position Paper on Crypto Assets April 2020 (hereafter the “CARWG Position Paper 2020”) at 4.

⁹⁰ Note 89 above.

⁹¹ Note 89 above.

⁹² The CARWG Position Paper 2020 at 9 defined a ‘crypto asset’ as: “a digital representation of value that is not issued by a central bank, but is traded, transferred and stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility, and applies cryptography techniques in the underlying technology.”

⁹³ CARWG Updated Position Paper 2021.

⁹⁴ CARWG Updated Position Paper 2021 at 16.

⁹⁵ CARWG Updated Position Paper 2021 at 16 and 35.

⁹⁶ Central banks globally are looking at issuing so-called ‘Central Bank Digital Currency’ too but for purposes of this study it will not be addressed.

Internationally, central banks in particular, also stray from referring to the crypto phenomenon as ‘currency’ exactly for the latter reasons. Yet, this may start to vary from jurisdiction to jurisdiction as El Salvador bestowed Bitcoin with legal tender status as real currency to be accepted in its transactions on the 6th of September 2021.⁹⁷

What makes defining and developing regulatory and policy responses to crypto assets so complex is that, what started out as an alternative (but electronic) cash payment method, can now be used for more than just that. Crypto assets now have various functions and can be used in different ways just as the UK Cryptoasset Taskforce identified in their 2018 report (see explanation above). The CARWG identified *five* different ‘use cases’ for crypto assets in their quest to regulatory response and policy development. This stems from the fact that crypto assets can “perform certain functions similar to those of ‘traditional’ currencies, securities or financial products and commodities.”⁹⁸ These five use cases are:

- (i) buying and/or selling of crypto assets by individual consumers and legal persons;
- (ii) using crypto assets to pay for goods and services (payments);
- (iii) capital raising through ICOs;⁹⁹
- (iv) crypto asset funds and derivatives; and
- (v) crypto assets market support services.¹⁰⁰

Since the birth of Bitcoin, and the boom of both Bitcoin and altcoins, the various terminology that have been applied to describe the crypto phenomenon spanned from ‘cryptocurrency’, to ‘digital currency’¹⁰¹ or ‘virtual currency’ and to ‘digital tokens’ or ‘crypto tokens’, to ‘digital assets’ and finally ‘crypto assets’.¹⁰² All of them are essentially correct

⁹⁷ CoinMarketCap “Countries Which Allow Cryptocurrency as Legal Tender” 2021 [online] available at <https://coinmarketcap.com/legal-tender-countries>; accessed 18 October 2021.

⁹⁸ CARWG Position Paper 2020 at 8.

⁹⁹ See Chapter 3.

¹⁰⁰ CARWG Position Paper 2020 at 8; and CARWG Updated Position Paper 2021 at 14.

¹⁰¹ ‘Digital currency’ can mean a digital representation of either non-fiat virtual currency or fiat e-money and is often used interchangeably with the term ‘virtual currency’. See the FATF 2014 Report (note 72 above) at 4.

¹⁰² CARWG Updated Position Paper 2021 at 15.

and synonymous however as stated earlier, it is globally argued the term ‘currency’ should be avoided when referring to the crypto phenomenon, as it is not legal tender nor fiat currency. Thus, both internationally and in South Africa, regulatory bodies prefer the term ‘crypto assets’ or ‘virtual assets’¹⁰³ “as it encapsulates and extends”¹⁰⁴ to all the various functions and uses thereof.¹⁰⁵

For purposes of this study the term ‘crypto asset’ will be used to eliminate confusion and reference will be made to alternative, essentially synonymous, terms only if it is necessary to do so.

2.5. Crypto tokens

The phenomenon of crypto tokens spawned from two things, namely the rise of alternative uses for crypto assets (not just as electronic coins for alternative cash as presented by Satoshi Nakamoto) as well as the birth of the Ethereum programming platform that made it possible for altcoin developers to encode a smart contract¹⁰⁶ in the blocks of the decentralised blockchain.¹⁰⁷ The encoded smart contract will, upon the occurrence of a certain event, automatically disburse a new crypto asset in exchange for Ether (the crypto asset of Ethereum)¹⁰⁸ or any other major crypto asset or even fiat currency.¹⁰⁹ The automatically disbursed crypto asset is referred to as a crypto token. These crypto tokens are generally distributed, sold, and circulated through an initial coin offering (ICO), which involves a process of capital raising to fund the project development of a crypto asset start-up.¹¹⁰ It is important to note that these altcoin crypto tokens are predeveloped/pre-created or developed/created through the encoded smart contract that resides in the

¹⁰³ As preferred by the FATF, as international standard setting body. See the FATF 2014 Report (note 72 above).

¹⁰⁴ CARWG Updated Position Paper 2021 at 15.

¹⁰⁵ CARWG Updated Position Paper 2021 at 15.

¹⁰⁶ A smart contract is computer protocol that can be programmed to be self-executing in that upon the occurrence of a specific event the smart contract will automatically trigger contractual performance, for example changes in ownership or financial flows. See CARWG Updated Position Paper 2021 at 18 and Evans (note 28 above) at 244.

¹⁰⁷ Essaghoolian "Initial Coin Offerings: Emerging Technology's Fundraising Innovation" 2019 *UCLA Law Review* at 310.

¹⁰⁸ Essaghoolian (note 107 above).

¹⁰⁹ Goforth (note 4 above) at 84 – 85.

¹¹⁰ Frankenfield "Crypto Tokens" 2021 *Investopedia* [online] available at <https://www.investopedia.com/terms/c/crypto-token.asp> ; accessed 18 October 2021.

block. Thus, these altcoins are *initially not* mined. This phenomenon is also referred to as a ‘premine’¹¹¹ or ‘presale’.¹¹² This is different from how the original crypto asset, Bitcoin, were initially created and released through the mining process.

Consequently, crypto tokens, does not only represent the crypto tokens released through smart contract developed/predeveloped tokens based on a decentralised platform like Ethereum – the premined tokens. However, crypto tokens also represent the original fungible and tradable crypto assets or utilities that reside on their own blockchains¹¹³ like Bitcoin or Litecoin – the mined tokens. Plainly put, Bitcoin for example, is a crypto asset, but Bitcoin has over 18 million¹¹⁴ mined and issued crypto tokens (the commonly referenced ‘Bitcoins’) that represent the fungible and tradable crypto assets of Bitcoin.

There are, from a programming perspective actually a difference between premined and mined crypto tokens,¹¹⁵ but from a regulatory perspective, both internationally and as indicated by the CARWG, the term crypto token is preferred as a reference to both and to describe how crypto assets are denominated.¹¹⁶ The term ‘crypto assets’ are viewed as an umbrella term for all the different crypto tokens.¹¹⁷

In terms of current international standards¹¹⁸ and the CARWG,¹¹⁹ there are generally three broad classifications of crypto tokens, namely:

(i) *Exchange or payment tokens* which is designed to be used as a means of exchange or payment for purchasing goods and services *like* electronic cash. It is also sometimes utilised for investment purposes.¹²⁰ They are commonly referred to as ‘cryptocurrency’

¹¹¹ Hayes “Premining” 2021 *Investopedia* [online] available at <https://www.investopedia.com/terms/p/premining.asp> ; accessed 18 October 2021.

¹¹² Essaghoorian (note 107 above).

¹¹³ Frankenfield (note 110 above).

¹¹⁴ CoinMarketCap “Today’s Cryptocurrency Prices by Market Cap” 2021 [online] available at <https://coinmarketcap.com/> ; accessed 18 October 2021.

¹¹⁵ Goforth (note 4 above) at 97.

¹¹⁶ Frankenfield (note 110 above).

¹¹⁷ CARWG Updated Position Paper 2021 at 15.

¹¹⁸ UK Taskforce Report 2018 (note 85 above) at 11.

¹¹⁹ CARWG Updated Position Paper 2021 at 15.

¹²⁰ CARWG Updated Position Paper 2021 at 15.

like Bitcoin, Dash, Litecoin and similar.¹²¹ They are not issued by a central bank or any other central body nor do they provide certain rights to users as with security or utility tokens. They either reside on their own blockchain or utilise the platform of an alternative DLT protocol, like Ethereum.

(ii) *Security tokens* provide certain rights such as ownership, the repayment of a specific sum of money, or entitlement to a share in future profits.¹²²

(iii) *Utility tokens* can be redeemed for access to a specific product or service that is typically provided using alternative DLT protocol, like Ethereum, as their platform.¹²³

2.6. Conclusion

It is trite that crypto assets, since it was first pioneered by Bitcoin in 2008, have developed tremendously. International and local regulatory bodies have started responding to these developments by developing a definitional framework for the crypto asset phenomenon and identifying its various uses. These definitions and identifications are essential and foundational knowledge to understand any further creative, innovate uses that may be built on the crypto asset phenomenon.

¹²¹ Goforth (note 4 above) at 97.

¹²² CARWG Updated Position Paper 2021 at 15; and UK Taskforce Report 2018 (note 85 above) at 11.

¹²³ CARWG Updated Position Paper 2021 at 15; and UK Taskforce Report 2018 (note 122 above).

CHAPTER 3: INITIAL COIN OFFERINGS (ICOs)

3.1. Introduction

As indicated in Chapter 2, both the UK Cryptoasset Task Force and CARWG has identified the raising of capital through Initial Coin Offerings (ICOs) a specific use case for crypto assets. It is important to scrutinise the ICO phenomenon in order to understand the full extent of the regulatory approach and policy stances that have already been adopted, that should be adopted and are also recommended. This is also necessary to alternatively identify shortfalls in and suggest appropriate submission to any regulatory and policy recommendations pertaining to ICOs.

Through the lens of the nature and characteristics, the process and the benefits and risks to investors and issuers, a comprehensive look will be taken at the ICO phenomenon in this chapter.

It is important to note that the nature, characteristics, process, benefits and risks of an ICO as it is known today can be ascribed to global practices, custom and also its development since its first appearance through the altcoin Ripple's capital raising process in 2013.¹²⁴ No formally regulated definition and/or process for ICOs have been legislatively adopted in South Africa or abroad.

3.2. Nature and characteristics

The common nature and characteristics of an ICO can be described as follows:

i) Businesses or start-ups use ICOs to raise capital

ICOs are primarily used as a vehicle to acquire start-up capital to fund and launch the crypto asset start-ups of altcoin developers.¹²⁵ Crypto tokens are issued to early backers in exchange for either fiat currency or other popular and in-demand crypto asset tokens

¹²⁴ Goforth (note 4 above) at 39.

¹²⁵ Dell'Erba "Initial Coin Offerings: The Response of Regulatory Authorities" 2018 *New York University Journal of Law and Business* at 1111.

like Bitcoin or Ether for example.¹²⁶ The funds from these ICO tokens are then used to finance the start-up project.

It is important to note that ICOs are not necessarily utilised to fund crypto start-ups only but can also be utilised to fund the projects or ventures of any start-up.¹²⁷ For example, if an entrepreneur wishes to open a drive through movie theatre, she can launch an ICO to fund this project through issuing crypto tokens.

ii) An ICO are also known as an initial token offering (ITO), token launch, token generation, software presale token or premine

As explained in Chapter 2, crypto asset tokens need not only be mined through the POW mechanism as the sole and primary method of releasing tokens¹²⁸ into the public and onto the blockchain anymore. Through the use of ICOs, crypto tokens can now either be predeveloped and sold to investors,¹²⁹ or developed through an application that are pre-programmed or encoded with a smart contract that will disburse a brand new token upon the occurrence of a certain event, like the payment of a certain amount of money or the exchange of a certain other crypto asset.¹³⁰ An ICO will thus cause a start-up to release its very own crypto tokens into the public and onto its blockchain for the very first time.¹³¹ These tokens are thus 'premined', launched and/or generated to fund or create capital inflow for a start-up, albeit a crypto-asset start-up or any other business venture. In the event that an ICO is utilised either to fund a full crypto asset start-up project or the completion thereof, the ICO will usually be conducted prior to the proposed network software being finalised and ready for use.¹³² Thus, the tokens issued to early investors are sometimes also called software presale tokens.¹³³

iii) ICO tokens are created through specifically designed distributed ledger (DLT) protocol

¹²⁶ Goforth (note 4 above) at 29.

¹²⁷ Maume & Fromberger (note 8 above) at 562.

¹²⁸ As is the case with Bitcoin.

¹²⁹ MacNiven (note 13 above) at 2.

¹³⁰ Essaghoolian (note 107 above) at 310

¹³¹ Dell'Erba (note 125 above) at 1110.

¹³² Essaghoolian (note 129 above).

¹³³ Dell'Erba (note 125 above) at 1110.

The ICO tokens of a start-up are created, whether predeveloped or developed though full performance in terms of an encoded smart contract, by way of DLT protocol that is specifically designed for this purpose.¹³⁴ Examples of such protocols are Ethereum Counterparty or Openledger.

A start-up will use either of these protocols to build a so-called dApp (decentralised application), that would affect the creation and release of its own brand-new tokens through an ICO. These protocols also operate through the exchange of their own internal tokens (known as dApp, user or utility tokens).¹³⁵ Plainly put, building, operating and even hosting a dApp on a particular DLT protocol cost fees, but these fees are only payable through dApp tokens. For example, Ethereum as a DLT protocol, has an internal token known as Ether (or ETH), which should be acquired by the start-up venturer/ICO host/dApp builder to be able to operate its ICO through the dApp.¹³⁶ However, the prospective investors would usually also need to acquire a dApp token to be able to acquire brand-new ICO token. But sometimes the DLT protocol would allow an investor to exchange fiat currency for a brand-new ICO token too.

iv) The different tokens issued through an ICO may serve different functions

Crypto tokens that are issued through an ICO are usually connected with a right to receive some future value in return.¹³⁷ This future value may range from being a place holder for a promise of being of value in the future when the project is finished, a future product or a service, having access to a network, sharing in the distribution of earnings generated by the project, voting or proprietary rights.¹³⁸ Thus, crypto tokens, in whichever of the latter shapes or forms, will represent some sort of a financial stake in the start-up.¹³⁹ ICOs are consequently not crowdfunding campaigns,¹⁴⁰ that are essentially donations, at all.

¹³⁴ Dell'Erba (note 125 above) at 1111.

¹³⁵ Crosser "Initial Coin Offerings as Investment Contracts: Are Blockchain Utility Tokens Securities" 2018 *University of Kansas Law Review* at 392.

¹³⁶ Ethereum "Ethereum-powered tools and services" 2021 [online] available at <https://ethereum.org/en/dapps/>; accessed 30 October 2021.

¹³⁷ CARWG Updated Position Paper 2021 at 18.

¹³⁸ CARWG Updated Position Paper 2021 at 18 and Dell'Erba (note 125 above) at 1112.

¹³⁹ Dell'Erba (note 138 above).

¹⁴⁰ Excluding equity crowdfunding campaigns.

Some of the mentioned kinds of future value that can be received through a crypto token is akin to what is received through investing in company securities. (Like voting and proprietary rights and sharing in future profits.) As a result, legal scholars by definition now distinguish between essentially two broad types of crypto tokens namely, security type tokens (crypto tokens with securities features) and non-security type tokens (crypto tokens without such features).¹⁴¹

However, in their mandate to develop regulatory recommendations, the CARWG identified that crypto tokens issued through an ICO generally have four overarching types of functions, identified through their characteristics, which reflects how they could be treated from a legal perspective.¹⁴² These crypto tokens are as follows:

- a) *Security tokens*: It goes without saying that these crypto tokens feature security like characteristics such as equity, debt or derivatives accompanied by an income-generating component, price fluctuations, rights vis-à-vis the issuer, and participatory (like voting and sharing in profits) and proprietary rights vis-à-vis the investor.¹⁴³
- b) *Digital assets or transactional instruments*: These crypto tokens will embody an attributed value for exchange or transactional purposes once the start-up project is finished. These tokens will have use as a store of value, an asset and/or a unit of account.¹⁴⁴ This is just like the general payment or exchange tokens as identified and defined in chapter 2. Therefore, these tokens may be acquired to keep as a digital asset that will appreciate in value or as an alternative type of cash in digital format (commonly referred to as a 'crypto currency').
- c) *Asset-backed tokens*: These crypto tokens provide underlying exposure to assets for example commodities like gold, oil, diamonds or even to securities, cash or real-estate.¹⁴⁵

¹⁴¹ Song "The Future of Korean Regulation on Initial Coin Offerings" 2021 *George Mason International Law Journal* at 4.

¹⁴² CARWG Updated Position Paper 2021 at 19.

¹⁴³ Note 142 above.

¹⁴⁴ Note 142 above.

¹⁴⁵ Note 142 above.

d) *Utility tokens*: These crypto tokens have dual overarching functions namely that they can either hold consumptive use value or serve a commercial purpose.¹⁴⁶ Utility tokens are also “not fundamentally intended to be relied on as a passive investment vehicle”¹⁴⁷ at all.

Utility tokens with consumptive use value are utilised as an internal currency harnessed to run supporting services or functionalities on a DLT protocol¹⁴⁸ platform on which dApps are built (see above).¹⁴⁹ They are, as previously explained also known as dApp or user tokens. These tokens are the fuel that enable the running of honest and consensual behaviour on the DLT protocol.¹⁵⁰ These utility tokens’ existence is essential to the proper functioning of the dApp.¹⁵¹

Commercial purpose tokens on the other hand can be used to engage transactions and earn rewards.¹⁵² These utility tokens need however not necessarily be used to for dApp specific transactions or rewards. These rewards can be earned and transactions clinched for other monetary reasons. For example, going back to the instance where an entrepreneur ventures to open a drive through movie theatre, a utility token can represent a voucher for a movie ticket with a popcorn and a drink when the theatre eventually opens.

Utility tokens have been compared to tradable gift cards or vouchers, gambling chips, franchise agreements, (pre-sold) software licenses, sporting event tickets and many more.¹⁵³

A start-up can issue different kinds of tokens when running an ICO. For example, where an entrepreneur ventures to open a petrol station, she may issue a number of security tokens that may represent participatory interest or voting rights in the business, a number of digital asset tokens that are investments for the investors, a number of asset-backed

¹⁴⁶ Crosser (note 135 above) at 393.

¹⁴⁷ Note 146 above.

¹⁴⁸ Note 142 above.

¹⁴⁹ Frankenfield “Decentralized Applications (dApps)” 2021 *Investopedia* [online] available at <https://www.investopedia.com/terms/d/decentralized-applications-dapps.asp> ; accessed 30 October 2021.

¹⁵⁰ Note 146 above.

¹⁵¹ Note 146 above.

¹⁵² Note 146 above.

¹⁵³ Note 146 above.

tokens (also an investment however more secure) and a number of utility tokens that may represent a voucher for a full tank of petrol once the petrol station opens.

v) ICOs are inherently risky

ICOs are without doubt inherently risky due to its encrypted and decentralised nature.¹⁵⁴ This is because the identity of the person behind the ICO and transaction information are hidden through cryptographic hashing and is consequently difficult to track down. Therefore, ICO participants are exposed to fraud, theft and money laundering risks.

But apart from that, ICOs are also inherently risky because, as a general rule, ICOs are launched prior to the development (or coding) of the software that will utilise the particular crypto token,¹⁵⁵ or before the business venture or project is developed or built. The crypto asset start-up *might* showcase a proof of concept or so-called ‘alpha version’ of the software to prospective investors prior to the crypto token sale to build some investor confidence.¹⁵⁶ The developers might even be able to present investors with a beta version.¹⁵⁷ However, the investment in crypto tokens through an ICO is purely speculative as there is no guarantee that the start-up nor its software will be successful.¹⁵⁸

vi) Usually only a single round of capital raising is conducted

ICOs are launched with the premise to raise capital to finance the development or completion of the software of the crypto asset start-up or of a business venture. Consequently, ICOs are ran prior to the commencement of the start-up. The tokens released through an ICO are usually also offered to the public at a discount,¹⁵⁹ as it is the first time that these tokens hit the market. ICO tokens are usually available for resale on the secondary market, either immediately after it has been acquired through an ICO or later on (which may yield great profits).¹⁶⁰ Either a predefined number of crypto tokens

¹⁵⁴ Debler (note 3 above) at 252.

¹⁵⁵ Dell'Erba (note 125 above) at 1112.

¹⁵⁶ Note 155 above.

¹⁵⁷ Note 155 above.

¹⁵⁸ Dell'Erba (note 125 above) at 1111.

¹⁵⁹ Note 158 above.

¹⁶⁰ Song (note 141 above) at 3.

are sold through an ICO¹⁶¹ or an ICO is launched to raise a set target capital amount.¹⁶² Apart from that, ICOs only run for a specified period of time.¹⁶³ In instances where a target amount of capital needs to be raised, and that target has not been met, the funds may be returned to the initial investors and the ICO will be deemed unsuccessful.¹⁶⁴ It is precisely for all the latter reasons that ICOs run a single round of capital raising . This and also to incite early investor participation.

vii) ICOs are quick, efficient and mostly unregulated

The Ethereum ICO raised a whopping near \$18 million (USD fiat currency plus Bitcoin) in just 42 days (from 22 July to 30 August 2014).¹⁶⁵ Approximately \$2.2 million of this near \$18 million start-up capital was raised in the first 12 hours of the ICO launch.¹⁶⁶ More than 50 million Ether tokens was issued throughout the run of the ICO and the Ethereum platform was eventually launched on 30 July 2015.¹⁶⁷ Some of the most successful ICOs were conducted in a matter of minutes and even seconds. In April 2017, it took the start-up Gnosis, an innovative decentralized prediction platform, 12 minutes to sell out all its ICO tokens. They raised \$12,5 million (USD).¹⁶⁸ In May 2017, it took the start-up Blood, 2 minutes to raise \$5,5 million (USD).¹⁶⁹ And in the same month, it took the start-up Brave, developers of a new web browser, 30 seconds to raise \$35,5 million (USD).¹⁷⁰

ICO's are currently mostly unregulated¹⁷¹ especially when it comes to tokens other than security tokens – non-security tokens. Thus, ICOs are primarily preferred by start-ups as

¹⁶¹ CARWG Updated Position Paper 2021 at 18.

¹⁶² Note 142 above.

¹⁶³ Frankenfield “Initial Coin Offering (ICO)” 2020 *Investopedia* [online] available at <https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp> ; accessed 17 June 2021.

¹⁶⁴ Note 142 above.

¹⁶⁵ Goforth (note 4 above) at 39 and see Frankenfield (note 163 above).

¹⁶⁶ Cryptopedia “Ethereum and the ICO Boom” 2021 [online] available at <https://www.gemini.com/cryptopedia/initial-coin-offering-explained-ethereum-ico#section-ethereums-role-in-the-ico-boom> ; accessed 18 October 2021.

¹⁶⁷ Note 166 above.

¹⁶⁸ Dell'Erba (note 125 above) at 1113.

¹⁶⁹ Note 168 above.

¹⁷⁰ Note 166 and note 168 above.

¹⁷¹ However, China has banned all crypto-related transactions in September 2021 and the Securities and Exchange Commission (SEC) in the United States declared all tokens issued through an ICO securities that are subject to registration and SEC regulation. See 3.5.1 below.

a bypass of the regulatory red-rape of “traditional” capital and fundraising methods through private equity firms, banks or venture capitalists.¹⁷²

viii) ICOs are announced and launched on crypto asset forums

Upcoming ICOs are announced and advertised on corporate websites or on crypto asset forums¹⁷³ like CoinMarketCap, Cryptocointalk, Bitcoin Talk or Reddit.¹⁷⁴ CoinMarketCap runs a full and complete ICO Calendar on its website and at the time of this study there were six ICOs in progress and 29 upcoming ICOs.¹⁷⁵

ICOs are not announced, promoted nor launched on social media platforms. In 2018 Facebook, Instagram, Twitter and Google (that includes all Google-owned platforms like YouTube too) has banned the advertising of crypto assets and ICOs as it can constitute ‘deceptive promotional practices’.¹⁷⁶ Mid 2019 Facebook partially lifted its ban on crypto asset related advertisements, requiring prospective advertisers to submit an application to an internal team.¹⁷⁷ This team holds list of pre-approved advertisers and would require specific details relating to the product including whether it has obtained any licenses or has been listed on a public stock exchange.¹⁷⁸

ix) ICOs are marketed through a so-called ‘white paper’

When an ICO is announced on a crypto asset forum, the start-up’s business or project plan, called a white paper, is accompanied by the announcement as the marketing tool to lure and convince prospective investors to participate in the issuance of the new tokens.¹⁷⁹

¹⁷² Note 142 above.

¹⁷³ Note 142 above.

¹⁷⁴ Note 155 above.

¹⁷⁵ CoinMarketCap “In Full - The Complete ICO Calendar” [online] available at <https://coinmarketcap.com/ico-calendar/>; accessed 19 October 2021.

¹⁷⁶ O’Neal “Big Tech are Banning Crypto and ICO Ads - Is There a Reason to Panic?” 2018 *Cointelegraph* [online] available at <https://cointelegraph.com/news/big-tech-are-banning-crypto-and-ico-ads-is-there-a-reason-to-panic>; accessed 19 October 2021.

¹⁷⁷ Sharma “Facebook Partially Lifts Ban On ICO Ads” 2019 *Investopedia* [online] available at <https://www.investopedia.com/news/facebook-partially-lifts-ban-ico-ads/>; accessed 19 October 2021.

¹⁷⁸ Note 177 above.

¹⁷⁹ Note 142 above.

Technological, commercial, and financial information of the new token is usually included in the white paper. Other information that may be included in a white paper is; a technical report of the problems, solutions and notable features of the project; the prospects for success; a detailed report of the DLT protocol or blockchain platform on which the idea will be executed; a timeline through which the project will be executed and progress may be tracked; when the start-up should commence; detailed description of how the raised capital will be managed; an explanation of how investors' profits will be generated and rewards distributed (that might be accompanied by a calculation to that effect); the credentials and history of the team of experts; the team of professional advisors with legal and financial expertise;¹⁸⁰ any other relevant and necessary information.

3.3. The process

Through the explanation of the nature and characteristics of an ICO it is apparent that the process of launching an ICO is quite simple.

As a first step an ICO should be announced on a crypto asset forum and should be accompanied by a white paper indicating the prospective ICO tokens that will be available including how these tokens could be acquired, as well as the time and date of the launch. Secondly the ICO is launched for either a specified period of time or with a target capital raising amount or both. Thirdly, the investors are issued with their brand-new ICO tokens, upon exchanging their dApp tokens, other popular crypto token or fiat currency (whichever is required through specification in the white paper or on the crypto asset forum) through automatically executing smart contract. As a fourth and final step, the ICO is either deemed successful - if the issuer's target amount were met or if they acquired enough capital throughout the launch days - or, the ICO is deemed unsuccessful and the money of the prospective investors are returned.

In instances where an ICO is utilised to raise capital for a crypto asset start-up, an additional step may be placed between the first and the second step. If the ICO issuers wishes to garner more interest in their start-up and build additional investor confidence,

¹⁸⁰ Note 142 above.

the issuers may launch a proof of concept or alpha version of their crypto asset software.¹⁸¹ Or they may produce a more advanced or beta version¹⁸² and possibly even make the project code publicly available and invite peer-reviews.¹⁸³

3.4. Benefits

ICOs hold many benefits to investors and issuers either solely or simultaneously.

3.4.1. Benefits to investors

Firstly, ICOs have the potential for significantly high returns.¹⁸⁴ This is due to the fact that ICOs are launched in the early stages of a start-up (and tokens are often issued at a discounted premium) and usually without any entry threshold.¹⁸⁵ Thus, average or first-time investors may invest small amounts of money and yield great profits.¹⁸⁶ Where with the classic public fundraising model, an Initial Public Offering (IPO), most of the investment value would be reaped up by venture capitalists and the ordinary Jane and Joe would have to pay a premium to even participate.¹⁸⁷ Thus, any investor, from local to international and first-time to experienced, could participate in the issuance through an ICO. This wide inclusion of investors is described by scholars as the “democratisation of capital markets”.¹⁸⁸

Secondly, a unique advantage to ICO tokens is that investors can in many cases immediately trade it on the secondary market.¹⁸⁹ Thus, investors can yield profits soon after the launch of the start-up without waiting years for a return of investment, as with a venture capital investment.¹⁹⁰ This also creates great transparency to the secondary

¹⁸¹ Note 168 above.

¹⁸² Note 168 above.

¹⁸³ Essaghoolian (note 107 above) at 311.

¹⁸⁴ Note 129 above.

¹⁸⁵ Note 129 above.

¹⁸⁶ Note 129 above.

¹⁸⁷ MacNiven (note 13 above) at 3.

¹⁸⁸ Rohr & Wright "Blockchain-based Token Sales, Initial Coin Offerings, and the Democratization of Public Capital Markets" 2019 *Hastings Law Journal* at 479.

¹⁸⁹ Note 187 above.

¹⁹⁰ Note 187 above.

market for the ICO tokens, as “investors can get real-time pricing based on the progress of the company.”¹⁹¹

3.4.2. Benefits to issuers

Firstly, the technology on which ICOs are exclusively built and launched, (the DLT protocol like Ethereum, Counterparty or Openledger) is designed to be fairly simple, straightforward, user friendly and accessible.¹⁹² For example, a standardised Ethereum smart contract (the ERC20 Token Standard), allows for the release of an ICO token through 93 lines of smart contract code, that is demonstrated Ethereum’s website, in a step by step tutorial.¹⁹³ Market entry for ICO issuers are thus facilitated, but are subscribed through much lower barriers of entry.¹⁹⁴ Which is again, another democratisation of the capital markets.¹⁹⁵ Plainly put, a business that, due to its nature, are unable to enter the capital markets through being listed on a stock exchange, like a personal liability companies or partnership, can now do so.¹⁹⁶

Secondly, a global audience can be attracted by ICO offering through ICO forums being readily available on the internet.¹⁹⁷ Thus again, any investor, from local to international and first-time to experienced, could participate in the issuance – a further democratisation to the capital markets. This would that an ICO could raise much money than any classic fundraising method, like an IPO that is bound to a specific stock exchange, or other fintech model, like equity crowdfunding.¹⁹⁸ It would also mean that start-ups that are unattractive to venture capitalists, would now have avenue to access funding.¹⁹⁹

¹⁹¹ Note 187 above.

¹⁹² Note 8 above.

¹⁹³ Ethereum “Understand the ERC-20 Token Smart Contract” 2020 [online] available at <https://ethereum.org/en/developers/tutorials/understand-the-erc-20-token-smart-contract/> ; accessed 30 October 2021.

¹⁹⁴ Note 8 above.

¹⁹⁵ Note 188 above.

¹⁹⁶ Note 188 above.

¹⁹⁷ Note 8 above.

¹⁹⁸ Note 8 above.

¹⁹⁹ Note 187 above.

Third, all capital that have been raised through an ICO may be kept by the issuer, unlike with venture capitalism.²⁰⁰

Lastly, ICOs are currently not regulated by any central body nor government, thus taxes are bypassed.²⁰¹

3.4.3. Benefits to both

Firstly, typical intermediaries like banks, private equity firms, brokers and stock exchanges are bypassed as ICOs are marketed directly to the client.²⁰² Secondly, albeit a significant risk to the investor too, ICOs currently operate mostly outside of any financial market regulation, meaning that there is no reporting, disclosure or even prospectus requirements that need to be adhered to. Consequentially, both the latter two advantages increase the speed of the ICO process and reduces additional capital costs (that may be attributed to costly paperwork, compliance procedures and commissions)²⁰³ tremendously.²⁰⁴

3.5. Risks

The advantages of ICOs could sound extremely promising, but ICOs undoubtedly also pose exponential risks to both investors and issuers too. However, the risks for investors are far greater than for issuers. This has also become apparent through the research of the CARWG who identified seven risks to capital raising through ICOs in their 2021 Position Paper that quests for suitable and adequate regulatory and policy recommendations.²⁰⁵ At least five out of the seven risks would have the investor bow at the mercy of the issuer²⁰⁶ where the other two risks pertain to both the investor and issuer.²⁰⁷

²⁰⁰ Note 187 above.

²⁰¹ Note 187 above.

²⁰² Maume & Fromberger (note 8 above) at 560.

²⁰³ Note 187 above.

²⁰⁴ Note 202 above.

²⁰⁵ CARWG Updated Position Paper 2021 at 25 – 26.

²⁰⁶ Risks 1, 2, 4, 5 and 7 as mentioned in CARWG Updated Position Paper 2021 at 25 – 26.

²⁰⁷ Risks 3 and 6 as mentioned CARWG Updated Position Paper 2021 at 25 – 26.

3.5.1. Risks to investors

Firstly, the greatest risk that ICO investors are currently faced with pertains to money laundering and terrorist financing.²⁰⁸ It is general international practice as prescribed by the FATF, that any and all financial services should be regulated and held accountable for Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT). However, regulators worldwide are working tirelessly to mitigate this risk. The FATF has updated their International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation in June 2021 to include Virtual Asset Service Provider's (VASPs) under "New Technologies" in Recommendation 15, and consequently paves a road for regulation to mitigate AML/CFT risks not only pertaining to ICOs but also to the crypto asset industry as a whole.²⁰⁹

Secondly, as stated above, albeit a benefit to both issuer and investor too, ICOs currently operate mostly outside of any financial market regulation, meaning that there are no reporting, disclosure or even prospectus requirements that need to be adhered to. The CARWG identified this a risk that are the fuel for current fraudulent ICOs.²¹⁰ Globally no clear legal framework pertaining to ICOs exist. For example, China has outright banned all crypto-related transactions in September 2021 and stated that it is considered illicit financial activity.²¹¹ The Securities and Exchange Commission (SEC) in the United States declared that *all* tokens issued through an ICO are considered securities thus they should be registered with the SEC and are subject to SEC regulation.²¹² The CARWG explains that issuers who conduct illegal activities, and wilfully so too, move their ICO activities to

²⁰⁸ Risk 1 as mentioned in the CARWG Updated Position Paper 2021 at 25.

²⁰⁹ Financial Action Task Force Report: International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, updated October 2021 (hereafter the "FATF AML/CFT Standards").

²¹⁰ Risk 4 pertaining to ICOs. See CARWG Updated Position Paper 2021 at 26.

²¹¹ Bloomberg "China bans Bitcoin transactions" 2021 *MyBroadband* [online] available at <https://mybroadband.co.za/news/cryptocurrency/415750-china-bans-bitcoin-transactions.html?fbclid=IwAR0qWDQWbeLssWgnsarkIRxRJ34IWNNRnyiiT94cNBli4fdR2nxHDXPhlow> ; accessed 15 October 2021.

²¹² Rooney "SEC chief says agency won't change securities laws to cater to cryptocurrencies" 2018 *CNBC* [online] available at <https://www.cnbc.com/amp/2018/06/06/sec-chairman-clayton-says-agency-wont-change-definition-of-a-security.html> ; accessed 14 September 2021.

jurisdictions where ICOs are either completely unregulated or where regulators take “a ‘light touch approach’ towards ICOs.”²¹³

The third risk for investors follows from the second relating to the regulatory void or inconsistencies within which ICOs operate. This is that investors who fall victim to ICO fraud or theft, have very limited recovery avenues at their disposal.²¹⁴ As ICOs are a cross-border phenomenon, without a central body, it is difficult to track the flow of money or pursue remedial action.²¹⁵ This risk will eventually be mitigated through the FATF recommendation that regulators internationally should require VASPs to be licensed with a central body in their jurisdiction for AML/CFT reasons.²¹⁶

Fourthly, incomplete, inaccurate or incomprehensible disclosure of ICO information to investors also pose a great risk.²¹⁷ If the ICO issuer is a crypto asset start-up, it is easy to fool the average investor with sugar-coated technical information that may sound promising, but in actual fact deceives or misleads the investor about the true nature of the investment.²¹⁸ Inaccurate information about ICOs can also be pushed through a so-called ‘pump and dump’ scheme.²¹⁹ This means that fraudsters push false and misleading information through various mediums, causing the ICO investment value to inflate – the so called ‘pump’. At the peak of the inflated price – the ‘pump’ – the fraudsters sell their ICO investment – the ‘dump’. Consequently, the ICO investment price plummets and the investors lose their money.²²⁰

A fifth risk to investors is the fact that, although ICO tokens are usually almost immediately available for trade on the secondary market, this is not always the case. Thus, investors may be unable to trade their ICO tokens or exchange them for fiat currencies. This means that there might be limited exit opportunities for investors.²²¹

²¹³ Note 210 above.

²¹⁴ Note 187.

²¹⁵ Note 187.

²¹⁶ FATF AML/CFT Standards (note 209 above) at 76, interpretive note to recommendation 15.

²¹⁷ Risk 7 pertaining to ICOs. See CARWG Updated Position Paper 2021 at 26.

²¹⁸ Note 217 above.

²¹⁹ Note 187 above.

²²⁰ Note 187 above.

²²¹ Risk 2 pertaining to ICOs. See CARWG Updated Position Paper 2021 at 25.

The final risk to investors is the lack of a fiscal framework for ICOs particularly. As no specific legal classification for ICOs have been made yet, no tax authority has taken official steps to this effect too. Although in South Africa, the Revenue Services (SARS) have taken steps to tax crypto assets specifically. In South Africa all crypto assets are taxed as a financial instrument. And a buyer will be taxed on the basis of their intention (either being a scheme of profit-making, or investment for long-term gains) behind acquiring a crypto asset.²²² From a risk perspective, this means that an ICO investor would probably be required to pay taxes on ICO tokens at some point in time and would not be able to benefit from ICO investments without paying taxes anymore.

3.5.2. Risks to issuers

It is submitted that the only sole risk to ICO issuers is the myriad of risks that investors are confronted with when deciding whether they wish to participate in an ICO or not. These risks might deter even some risk prone investors from participating in an ICO, which might, as a turn of the table, leave the (honest and disruptive) ICO issuers to bow at the mercy of the ICO investors. These heavily weighing investor risks might impede the ICO frenzy,²²³ leaving ICO issuers without capital.

3.5.3. Risks to both

As mentioned earlier, ICOs are highly speculative and inherently risky as it cannot be guaranteed that the start-up would be successful. Thus, investors are firstly confronted with this high-risk investment, but as a parallel, issuers are also confronted with the concomitant risks (like not raising enough capital due to the nature of the investment) of this high-risk investment.²²⁴

Another risk to both issuer and investor is cybersecurity.²²⁵ High volume transactions is a target that usually lure criminals to attack. As ICOs raise funds in the form of crypto assets

²²² Vermeulen "Cryptocurrency tax in South Africa" 2021 *MyBroadband* [online] available at <https://mybroadband.co.za/news/cryptocurrency/396579-cryptocurrency-tax-in-south-africa.html> ; accessed 17 September 2021.

²²³ MacNiven (note 13 above) at 4.

²²⁴ Risk 3 pertaining to ICOs. See CARWG Updated Position Paper 2021 at 25.

²²⁵ Risk 6 pertaining to ICOs. See CARWG Updated Position Paper 2021 at 25.

(like Bitcoin or Ether) or fiat currency, cyber-attacks are an inevitable threat.²²⁶ The lack of proper cybersecurity controls poses a significant threat to both ends of the ICO tail.

3.6. Conclusion

It is clear that the ICO phenomenon holds a very specific nature with accompanying characteristics. The process of an ICO is also uncomplicated. Some of the benefits as well as some risks of an ICO is analogous to its nature and characteristics. However, some of the advantages are misused and abused causing enormous risks to investors and honest and disruptive start-ups that utilise and ICO to raise capital to fund their ventures. These risks need to be mitigated and managed through policy and regulation to garner fintech innovation on the one hand but to also wit investor protection, investor confidence and market efficiency²²⁷ on the other hand.

²²⁶ Note 225 above.

²²⁷ Labuschagne “Chapter 4 Offer Regulation under the 2008 Companies Act” 2014 *University of Pretoria* LLD thesis at 33.

CHAPTER 4: SOUTH AFRICA'S REGULATORY RESPONSE TO INITIAL COIN OFFERINGS

4.1. Introduction

South Africa has not adopted any formal regulatory responses pertaining to ICOs yet. However, the Crypto Asset Regulatory Working Group (CARWG) under the auspices of the Intergovernmental Fintech Working Group (IFWG) issued a comprehensive position paper on crypto assets in April of 2020 (hereafter the CARWG Position Paper 2020).²²⁸ An updated version of the position paper has been issued on 11 June 2021 (hereafter the CARWG Updated Position Paper 2021).²²⁹ This position paper, typified as a living document,²³⁰ indicates a proposed policy position of, and makes regulatory recommendations pertaining to, Initial Coin Offerings (ICOs) in South Africa (amongst the other crypto asset use cases).²³¹ This chapter discusses the policy position and regulatory recommendations pertaining to ICOs, but also provides succinct criticism and submissions regarding the current recommendations.

4.2. Background to the CARWG policy positions, recommendations and crypto asset service providers (CASPs)

The first CARWG Position Paper 2020 made 30 recommendations pertaining to the appropriate regulation and policy stances that should be considered and adopted by the relevant South African authorities regarding the regulation of crypto assets and related activities.²³² These recommendations were based on the response and comment of industry participants after a consultation paper on crypto assets were issued by the CARWG in 2019. The new, refined and updated version of this position paper, the CARWG Updated Position Paper 2021, now sets out 25 recommendations for a revised South African policy, legal and regulatory position on crypto assets and related

²²⁸ CARWG Position Paper 2020.

²²⁹ CARWG Updated Position Paper 2021. See 2.4.4. in Chapter 2, above.

²³⁰ CARWG Updated Position Paper 2021 at 2.

²³¹ CARWG Updated Position Paper 2021 at 38.

²³² CARWG Position Paper 2020.

activities.²³³ These recommendations addresses three overarching and crucial financial sector branches namely, the implementation of an Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework, a framework for monitoring cross-border financial flows and the application of financial sector laws.²³⁴ Apart from that, the CARWG Updated Position Paper 2021 also provides a roadmap and timelines for implementing a framework for regulating, so-called crypto asset service providers (CASPs) in South Africa.²³⁵

The fact that crypto assets are not regarded as valid legal tender or 'money'²³⁶ consequentially exclude crypto assets from the definition of 'money' in terms of the National Payment System Act,²³⁷ as well as from any existing associated South African legislation.²³⁸ The latter challenges regulatory authorities to come up with a brand-new approach for regulating crypto assets and their related activities. The IGFW requires that the approach devised by a particular regulator should "achieve regulatory and legal certainty in the most appropriate and responsible manner possible."²³⁹

An appropriate and responsible manner or plan for the draft of the regulatory recommendations and policy positions regarding the regulation of crypto assets and their related activities, was devised by the CARWG through typifying and defining so-called CASPs – 'Crypto Asset Service Providers'. This plan stems from the FATF that initiated the typification and definition of so-called VASPs – Virtual Asset Service Providers – as they refer to crypto assets as virtual assets.²⁴⁰

The CARWG asserts that the various use cases of crypto assets (as discussed in Chapter 2) are operated and administered by CASPs. These CASPs are responsible for the crypto asset activities that flow from the five particular crypto asset use cases as identified by

²³³ Note 230 above.

²³⁴ CARWG Updated Position Paper 2021 at 3 - 4.

²³⁵ Note 230 above.

²³⁶ As explained in 2.4.4. above.

²³⁷ Section 1(v) of the National Payment System Act 78 of 1998.

²³⁸ Note 230 above.

²³⁹ Note 230 above.

²⁴⁰ As explained in 2.4.2. above and the FATF 2019 Report (note 83 above) at 4 & 13.

the CARWG. The CARWG Position Papers provide extensive and in-depth descriptions of and definitions for what CASPs are and what falls under the umbrella thereof. But generally, CASPs are all crypto asset trading platforms (known as CATPs) that provide a myriad of services such as: intermediary services pertaining to the buying and selling of crypto assets; the trading, conversion or exchange of fiat currency or other value into crypto assets or vice versa; the trading, conversion or exchange of crypto assets into other crypto assets; remittance services using crypto assets as a means of facilitating credit transfers; and providing advice in relation to crypto assets.²⁴¹ However, there are other specific crypto asset service providers that also fall under the umbrella of CASPs too, for example crypto asset token issuers (see 4.3. below), crypto asset fund or derivative service, crypto asset digital wallet providers, crypto asset vending machine and crypto asset safe custody service providers.²⁴² The CARWG Updated Position Paper 2021 provides extensive explanations on these service providers and the services that they offer.²⁴³

As stated earlier, the CARWG requires that all CASPs should be regulated, and appropriately so too.²⁴⁴ This requirement is the first of six principles that guided the CARWG's approach for recommending the regulation of CASPs in South Africa. These principles were acceded by the IFWG as well. The second principle are that of 'same activity, same risk, same regulations', meaning that an activities-based perspective must be maintained and should inform the devise of a regulatory approach. Third, a risk-based approach to crypto asset regulation must apply. Fourth, a truly collaborative and joint approach (by financial sector market regulators and participants) to crypto asset regulation must be maintained. Fifth, the dynamic development of the crypto assets market, including maintaining knowledge on emerging international best practices (through standard-setting bodies) should be proactively monitored. And as a sixth

²⁴¹ CARWG Updated Position Paper 2021 at 31.

²⁴² CARWG Updated Position Paper 2021 at 31 – 32.

²⁴³ Note 242 above.

²⁴⁴ CARWG Updated Position Paper 2021 at 7.

principle, the digital literacy and digital financial literacy levels amongst the consumers and potential consumers of crypto assets must be increased.²⁴⁵

In applying these principles, the CARWG undertook that their policy positions and recommendations will ensure that:

“[t]he [relevant] South African authorities (...) [will] aim to enable responsible innovation by regulating CASPs through an appropriate regulatory framework that proportionately balances the potential benefits against the risks that may be introduced into the financial system, while ensuring a level playing field is maintained by not unduly advantaging or disadvantaging either the incumbent role players or new fintech entrants.”²⁴⁶

4.3. ICO issuers to be regulated as CASPs

As explained above, there are specific service providers of crypto assets that have been identified and that fall under the umbrella of CASPs. A specific service provider included under the regulatory umbrella of CASPs are any crypto asset token issuer that conduct the issuance of crypto asset tokens through ICOs.

It is interesting to note however, that the FATF does not oblige any and all crypto asset token issuers to adhere to the policy and recommendations pertaining to CASPs (or VASPs as the FATF calls it),²⁴⁷ they do however oblige any person who provides financial services in respect of an ICO to adhere thereto. This is because they argue that, where a company is formed and has an initial public share offer (initial public offering – or IPO), the company issuing the shares is not an obliged entity, but the bank that underwrites the offering or offers credit to people who take up the public offer, is an obliged entity.²⁴⁸ However, the CARWG states that the position in South Africa is different and that *all* crypto asset token issuers (ICO issuers), whether they are registered as a company or not, will have to subscribe to *all* the requirements, policy positions and recommendations imposed on CASPs as detailed in their Position Papers.²⁴⁹

²⁴⁵ CARWG Updated Position Paper 2021 at 8.

²⁴⁶ CARWG Updated Position Paper 2021 at 6.

²⁴⁷ The FATF 2019 Report (note 83 above) at 4 & 13.

²⁴⁸ Note 241 above.

²⁴⁹ Note 241 above.

The CARWG made eight overall recommendations for the regulation of all crypto assets and related activities in South Africa. Recommendations 1 to 8 in the CARWG Updated Position Paper 2021 lists these overall recommendations. These eight overall recommendations were already made in the CARWG Position Paper 2020, but were just refined and updated in the CARWG Updated Position Paper 2021. However, only overall Recommendations 1 to 5 are of relevance for the proposed regulation of ICOs although these recommendations are also applicable to every and any CASP irrespective of the service they provide. Thus, any crypto asset token issuer that issues tokens through an ICO will be subject to certain overall recommendations when they are brought into law.

Recommendation 1, as a catch-all recommendation, presupposes that all entities that provide crypto asset services be considered a CASP as defined by the CARWG (see 4.2. above).²⁵⁰ For regulatory purposes, a CASP is categorised through the specific activity it performs and/or service it provides and not the underlying technology it utilises.²⁵¹ These activities and services of CASPs would consequently require them to be licensed by or registered with a specific regulatory authority in South Africa. Recommendation 1 proposes the various regulatory authorities that the various defined CASPs should be registered with or licensed by. The CARWG recommends that an ICO crypto asset token issuer (as a CASP) in South Africa will have to register with or be licensed by three possible regulatory authorities namely:²⁵²

- (a) The SARB Financial Surveillance Department: Where ICO token issuers would have to register as a CATP and/or money remitter in terms of the Exchange Control Regulations of South Africa.
- (b) The Financial Intelligence Centre (FIC) of South Africa: Where ICO token issuers would have to register as an “accountable institution” in terms of the Financial Intelligence Centre Act 38 of 2001 (FIC Act). This will be in so far as the ICO token issuer’s activity is in respect of the participation in, and provision of, financial services

²⁵⁰ CARWG Updated Position Paper 2021 at 30.

²⁵¹ Note 250 above.

²⁵² Note 250 above.

related to an issuer's offer or sale of crypto asset tokens. (See Recommendation 2 below.)

- (c) The Financial Sector Conduct Authority (FSCA): Where ICO token issuers would have to be licensed as a crypto asset intermediary, subject to the Conduct of Financial Institutions (CoFI) Bill in the future. The CoFI Bill is the second phase following the commencement of the Financial Sector Regulation Act 9 of 2017 (FSR Act) that introduced the transition to a Twin Peaks model for regulating the financial sector in South Africa in April 2018. The CoFI Bill will primarily legislate the general market conduct of financial institutions as well as principles for "treating customers fairly". Upon promulgation, the CoFI Bill will also repeal various financial sectoral laws like the Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS Act). It is suggested by the CARWG that CASPs will be defined and their conduct be regulated under the CoFI Bill.²⁵³ The FSCA (the one twin of the two peaks)²⁵⁴ will then become the responsible authority (once the CoFI Bill commences) for the licensing of the various crypto asset services provided by CASPs as defined. (See 4.5.2. below.)

Recommendation 2 requires that Schedule 1 to the FIC Act be amended to include all CASPs in the list of 'accountable institutions' that should register with the FIC of South Africa.²⁵⁵ This is to address the great risks to South Africa's AML/CFT system that are associated with crypto asset related services and activities. As Recommendation 2 was already part of the CARWG Position Paper 2020, the implementation of this recommendation is already well under way. The National Treasury (NT) issued a consultation paper on proposed amendments to schedules to FIC Act on 19 June 2020.²⁵⁶ As soon as this amendment is signed into law, all ICO issuers in South Africa will have to register with the FIC.

²⁵³ Recommendation 10 of the CARWG Updated Position Paper 2021 at 36.

²⁵⁴ The other peak being the Prudential Authority (PA).

²⁵⁵ CARWG Updated Position Paper 2021 at 33.

²⁵⁶ National Treasury: Proposed amendments to schedules to Financial Intelligence Centre Act, 2001 (Government Gazette 43447 of 19 June 2020).

Recommendation 3 proposes that the FIC will then also supervise all CASPs to ensure compliance with the FIC Act and may consequently impose administrative penalties upon non-compliance.²⁵⁷ Thus, ICO issuers who do not comply with the FIC Act will be issued with penalties.

In terms of Recommendation 4, the CARWG will continue to monitor the crypto asset ecosystem, with apt mindfulness of the risks to financial stability posed by crypto asset activities and will track the implementation of the recommendations.²⁵⁸ This includes the monitoring of cross-border financial flows through ICO launches in South Africa.

In terms of Recommendation 5, crypto assets (i.e. tokens issued through an ICO irrespective of their nature) are to remain without legal tender status and will not be recognised as a form of electronic money.²⁵⁹

As explained in 4.2. above, all the recommendations of the CARWG are accompanied by a timeline for their implementation. The implementation of Recommendations 1 to 5, as explained above, are marked as a short-term objective that should be implemented within 12 months after publication of the recommendations.²⁶⁰ Thus, as the CARWG Updated Position Paper 2021 were released by the IFWG on 11 June 2021, the process of implementing Recommendations 1 to 5 should be completed by June 2022. Consequently, by mid-2022 all ICO crypto asset token issuers should evidently be regulated as CASPs as the first step to the regulation of ICOs in South Africa.

4.4. Policy position pertaining to ICOs

The CARWG Updated Position Paper 2021 cites a succinct policy position (but with broad interpretation) pertaining to ICOs in particular. The policy position is two pronged in that the CARWG recognises that, on the one hand, ICOs are used as a means to raise capital, and that ICOs should consequently be regulated within the current regulatory framework for start-up firms to raise capital. On the other hand, a specific regulatory framework is

²⁵⁷ CARWG Updated Position Paper 2021 at 34.

²⁵⁸ Note 257 above.

²⁵⁹ CARWG Updated Position Paper 2021 at 35.

²⁶⁰ CARWG Updated Position Paper 2021 at 41.

necessary to ensure that this alternative means of capital raising takes place within a defined framework.²⁶¹

4.5. Regulatory recommendations pertaining to ICOs

4.5.1. Regulatory recommendations regarding: Security token offerings (Recommendation 20)

The CARWG made a specific regulatory recommendation regarding the issuing of security tokens through an ICO. This is the 20th recommendation of the CARWG and the roadmap for implementation marked this recommendation as a medium-term objective to be achieved within 12 to 24 months from the date that the IFWG issued the CARWG Updated Position Paper 2021 to the public, which was 11 June 2021.²⁶²

The CARWG recommends that the National Treasury (NT) and the FSCA should consider aligning, as far as possible, the issue of security tokens through ICOs to the regulation applicable to issuers of securities or 'over-the-counter' financial instruments.²⁶³ The CARWG consequently recommends that the regulation of security tokens issued through ICOs be considered for regulation under the Financial Markets Act 91 of 2012 (FMA).²⁶⁴

The roadmap for implementation is also set out in Recommendation 20, namely that the regulation of security token offerings under the FMA should be subject to consultation with the Companies and Intellectual Property Commission (CIPC) and alignment with the Companies Act 71 of 2008 to the fullest extent possible and appropriate.²⁶⁵ Further to the implementation roadmap, the CARWG recommends that the NT and the FSCA (in particular) take the appropriate action to consider the appropriateness of the FMA for giving effect to Recommendation 20.²⁶⁶

²⁶¹ CARWG Updated Position Paper 2021 at 38.

²⁶² CARWG Updated Position Paper 2021 at 46.

²⁶³ Note 261 above.

²⁶⁴ Note 261 above.

²⁶⁵ Note 262 above.

²⁶⁶ Note 262 above.

4.5.2. Regulatory recommendation regarding: Payment or exchange and utility token offerings (Recommendation 21)

Distinct from security tokens issued through an ICO, the CARWG made specific regulatory recommendations pertaining to the issue of payment or exchange and utility tokens through an ICO. This is the 21st recommendation of the CARWG and the roadmap for implementation marked this recommendation as a parallel medium-term objective to be achieved within 12 to 24 months as well.²⁶⁷

The CARWG recommends that the issuing of payment or exchange and utility token offerings through ICOs should be appropriately accommodated in the licensing activities under the CoFI Bill and as a 'financial service' under section 3(1) of the FSR Act.²⁶⁸ These CoFI Bill licensing requirements, including some specific conduct standards, should still be developed by the NT. The CARWG suggests that these standards should ensure that ICO issuers (of payment or exchange and utility token offerings) are required to prepare a detailed prospectus, which would be the equivalent of a white paper²⁶⁹ that is generally part of the ICO process. The prospectus should set out specific requirements and details on disclosures about the company, a governance plan, any agreement(s) between the customers and ICO issuers, comprehensive independent audits, and specific reports (to be confirmed) to regulators.²⁷⁰

As an urgent and interim measure to address the regulation of payment or exchange and utility tokens, not just pertaining ICOs as a use case of the CARWG, but also pertaining to the use case of buying and/or selling crypto assets, the FSCA issued a draft Declaration to declare crypto assets as a 'financial product' in terms of paragraph (h) of section 1 of the FAIS Act, on 20 November 2020.²⁷¹ In the statement in support of the draft Declaration, the FSCA explains that it is of the view that declaring a crypto asset as a 'financial product' under the FAIS Act would address the same immediate consumer risks,

²⁶⁷ Note 262 above.

²⁶⁸ Note 262 above.

²⁶⁹ Note 262 above.

²⁷⁰ Note 262 above.

²⁷¹ Draft Declaration of Crypto Assets as a Financial Product (20 November 2020).

but it would happen expeditiously as appose to the proposed accommodation of such crypto asset tokens as a “financial service” under section 3(1) of the FSR Act.²⁷² The FSCA further explains that the effect of declaring crypto assets as a financial product under the FAIS Act would require that:

- (a) any person furnishing ‘advice’ or rendering ‘intermediary services’ (as defined under the FAIS Act) in relation to crypto assets must accordingly be authorised as a financial services provider (FSP) under the FAIS Act; and
- (b) any person so authorised, including its representatives, must consequently comply with the applicable FAIS requirements, such as the requirements of the General Code of Conduct for Authorised Financial Services Providers and Representatives, 2003 (General Code), and the Determination of Fit and Proper Requirements, 2017 (F&P Requirements).²⁷³

This draft Declaration would only be applicable to the ambit of advice and intermediary services pertaining to crypto assets. The FSCA has done this intentionally so as to exclude the full scope of potential CASP activities as, in consultation with the CARWG Position Paper, such a process would take quite some time.²⁷⁴

It is noteworthy that security crypto asset tokens are considered as already falling within the definition of ‘financial product’ under the FAIS Act.²⁷⁵ Plainly put, the same effect as stated above would be relevant (but are actually already relevant as ‘securities’ are included in the scope of the definition of ‘financial product’ under the current FAIS Act) to security tokens issued through an ICO on the basis of ‘advice’ or as an ‘intermediary service’ as defined in the FIAS Act.

At the time of this study, this draft Declaration has not been signed into law yet. However, the reason why the position pertaining to payment or exchange and utility tokens has

²⁷² Statement in Support of the Draft Declaration of Crypto Assets as a Financial Product under the Financial Advisory and Intermediary Services Act (20 November 2020).

²⁷³ Note 272 above at 3.6.

²⁷⁴ Note 272 above at 3.7.

²⁷⁵ Note 271 above at 2.

already been considered by the FSCA, is because the roadmap for implementation pertaining to the regulatory recommendations for the use case of buying and/or selling crypto assets,²⁷⁶ are marked as a short-term objective (within 12 months from the 11 June 2021)²⁷⁷ and it also overlaps with the regulatory recommendations regarding payment or exchange and utility tokens issued through an ICO.

4.6. Criticism and submissions regarding the regulatory recommendations and policy stance

4.6.1. Security token offerings

The CARWG recommends that security token offerings issued through ICOs should be considered for regulation under the FMA.

The FMA was primarily promulgated in 2012 to create a licensing regime for new security exchanges, to create a legislative framework for unlisted securities, to address market abuse, such as insider trading, and to bring South Africa's regulation pertaining to financial markets on par with the best in the world.²⁷⁸

The FMA further regulates the formal (that is, regulated) financial market.²⁷⁹ A benefit of security tokens issued through an ICO, as discussed in 3.4.1. above, is the fact that investors can almost immediately trade such tokens on the secondary market. The secondary market is an informal market and subsequently not regulated by the FMA.²⁸⁰ This means that if ICO security tokens are subjected to regulation under the FMA as it currently stands, the whole secondary market for ICO security tokens will be excluded from the ambit of FMA regulation. The informal market is regulated under Chapter 4 the Companies Act 71 of 2008 (Companies Act) as well as the common law.²⁸¹ Thus, it is submitted that Chapter 4 of the Companies Act pertaining to company securities be

²⁷⁶ Recommendation 9 and 10 as stipulated in the CARWG Updated Position Paper 2021 at 35 - 36.

²⁷⁷ CARWG Updated Position Paper 2021 at 43.

²⁷⁸ Financial Markets Act 19 of 2012 Review: Building Competitive Financial Markets for Innovation and Growth - A Work Programme for Structural Reforms to South Africa's Financial Markets (27 February 2019) at 1.

²⁷⁹ Labuschagne (note 227 above) at 170.

²⁸⁰ Labuschagne (note 227 above) at 170.

²⁸¹ Labuschagne (note 227 above) at 170.

thoroughly consulted in order to formulate a new and comprehensive regulatory approach pertaining to security tokens issued through an ICO so as to address both the formal and informal markets relevant to ICO token issuances and token trading. It is additionally submitted that ICO security tokens cannot be subjected to Chapter 4 of the Companies Act as a blanket approach to ensure regulation of security tokens in the informal market. This is because a clear benefit for ICO issuers (see 3.4.2 above), is that irrespective of their business nature or structure,²⁸² they can make use of an ICO to raise capital for their businesses. Thus, an ICO issuer of security tokens (that are, for example, accompanied by ownership or voting rights) need not necessarily be a company, but can also be another business structure.

4.6.2. Payment or exchange and utility token offerings

Until a defined framework for the regulation of ICOs are legislated, and the FSR Act has been amended to include payment or utility and exchange tokens under section 3(1) as a 'financial service' and until the NT has developed specific conduct standards and licensing requirements for ICO issuers, it would be sufficient to regulate the issuance of these tokens as a 'financial product' under the FAIS Act.

However, when recommending that a detailed prospectus be required by an ICO token issuer, the CARWG makes specific reference to that ICO token issuer being a company (see 4.5.2. above). It is again submitted (as pertaining to security token offerings above) that the NT should not limit the business structure of an ICO to that of a company alone. An ICO issuer (see 3.4.2 above) of any nature and structure can utilise and ICO as a means of capital raising. Thus, it is additionally submitted that an ICO issuer, irrespective of its business structure, should be required to issue a prospectus or so-called white paper.

4.6.3. Recommendatory void in relation to the ICO process

An ICO is a process whereby a start-up or business looking to acquire capital can do so by means of utilising DLT protocol technology to generate or launch crypto asset tokens

²⁸² For example, a personal liability company or partnership or even a sole trader.

that have attached to them a certain value or can fulfil a specific function (see Chapter 2 above). The crypto asset tokens issued through an ICO can either be security, payment, exchange or utility tokens. The tokens issued through an ICO are the first (or initial) tokens of a start-up. Thus, an ICO is usually launched for a single round of capital raising (see 3.2 above). That being said, an ICO is a process of capital raising and it is submitted that this process should be appropriately and comprehensively regulated so as to safeguard investors on the one hand but to also create an opportunity for technological innovation pertaining to capital raising on the other hand. It is consequently also submitted that the regulation of the various types of ICO tokens only, as is currently recommended, is inadequate to address the full might and innovative functionality of an ICO.

4.6.4. ICO policy position

It is submitted that the ICO policy proposition is sufficient to provide for broad interpretations and recommendations in designing a future regulatory framework for the innovative fintech approach to capital raising. In relation to finding application for ICOs in South Africa's current regulatory framework for raising capital, it is a final submission that the NT should head against a piecemeal approach to regulating ICOs. Such an approach would lead to uncertainty, inconsistencies in the way regulations are applied and may result in deterring investors from participating in and ICO, or worse, fuel fraudulent ICO activities. Thus, as stated in the second prong of the policy proposition pertaining to ICOs, it might be invaluable to develop a defined and specific regulatory framework for ICOs. This framework need not be long or intricate and might as well be included in the CoFI Bill. It need only address the full nature and all the characteristics of an ICO.

4.7. Conclusion

South Africa has responded to the creative fintech use of crypto assets for acquiring capital through ICOs in the CARWG Position Papers on crypto assets issued in 2020 and updated in 2021, respectively. The CARWG requires that all ICO crypto asset token issuers fall under the umbrella of CASPs and should consequently subscribe to certain regulations that are recommended to be applicable to all CASPs overall. Further to the ICOs in particular, the CARWG presupposes a policy position that is open to broad

interpretation but that is accompanied by only two regulatory recommendations: one pertaining to security token offerings and the other pertaining to payment or exchange and utility tokens. These two regulatory recommendations are scant and do not encapsulate the full extent of an ICO as it is known by investors, industry participants and researchers, today. There are much room, but already a well-established recommendatory foundation, for developing a comprehensive regulatory approach for ICOs in South Africa.

CHAPTER 5: CONCLUSION

The regulation of ICOs in South Africa is not even in its infancy; it has just recently been conceived. The CARWG made a broad policy statement pertaining to the recognition and proposed regulation of ICOs in its CARWG Updated Position Paper 2021. This broad policy position acknowledges ICOs as a method to raise capital by start-ups and suggests that ICOs consequently be regulated under the current laws in South Africa that regulate capital raising of start-ups (see 4.4. above). Apart from the latter, the CARWG made another broad policy statement regarding a proposal for this alternative means of fundraising to take place within a defined framework.²⁸³ In addition to the policy position, the CARWG made regulatory recommendations pertaining to security tokens and payment or exchange and utility tokens issued by ICO issuers, respectively. These recommendations fall short of addressing and encapsulating the full nature and characteristics of an ICO through proportionately balancing the potential benefits against the risks that may be introduced into the financial system.²⁸⁴ However, token regulation is a critical first step in the regulation of ICOs as “token regulation is also an issue of systemic stability”.²⁸⁵ Maume and Fromberger explain that the absence of token regulation may result in the emergence of an unregulated parallel market for securities-like tokens, for example, and “the burst of a bubble could have catastrophic consequences”.²⁸⁶

The CARWG also suggests certain overall regulations pertaining to ICO token issuers as CASPs. This includes that ICO token issuers falling under its definition and scope of a CASP as defined by the CARWG, would need to be licensed by or registered with a specific regulatory authority in South Africa. A further overall requirement would be that ICO token issuers (as CASPs) should register with the FIC as an ‘accountable institution’ in the quest to address the great risks to South Africa’s AML/CFT system that are associated with crypto asset related services and activities. Non-compliance with the

²⁸³ CARWG Updated Position Paper at 38.

²⁸⁴ CARWG Updated Position Paper 2021 at 6.

²⁸⁵ Maume & Fromberger (note 8 above) at 562.

²⁸⁶ Maume & Fromberger (note 8 above) at 563.

latter requirement by ICO token issuers, would result in the imposition of administrative penalties (see 4.3. above). Issued ICO tokens will also have (and remain to have) no legal tender status at all. The CARWG will also monitor cross-border financial flows through ICO launches in South Africa.

The use of ICOs as a capital raising vehicle is growing tremendously. Just over a staggering \$58 million (USD) has been raised through ICOs from June 2020 to August 2021.²⁸⁷ Vessio rightly urges “that this exponential growth demands that regulatory regimes be put in place as opposed to discussions on whether they should be”.²⁸⁸

As submitted in Chapter 4, fragmented and piecemeal regulation of ICOs might stifle innovation due to the wake of uncertainty for both the issuer and the investor. This may culminate in either the abuse of ICOs for fraudulent purposes or a complete lack of participation in this innovative fintech development.

It is consequently paramount that a defined framework for ICO regulation in South Africa be developed to garner the development and growth of this great and emergent fintech innovation but to also ensure investor protection, investor confidence (and certainty), market efficiency²⁸⁹ and financial stability.

[13 757 words]

²⁸⁷ Note 11 above.

²⁸⁸ Vessio (note 40 above) at 40.1.

²⁸⁹ Note 227 above.

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