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## **SEC RELEASES PROPOSED RULES ON INITIAL COIN OFFERINGS**

The Securities and Exchange Commission has released, **for public comment**, the proposed rules to govern the registration of initial coin offerings (ICOs).

**Initial Coin Offerings** refer to distributed ledger technology fundraising operations involving the issuance of tokens in return for cash, other cryptocurrencies or other assets. They involve coins (or tokens) being issued in order to raise money from the general public. Once the project reaches a certain stage, benefits to tokenholders may include but is not limited to any of the following: (a) Gains through profits or increase in the value of tokens which can be sold if the project is successful; (b) Voting or governance rights; or (c) Usage rights.

**Coin** is a unit of value employed as a means of exchange within the blockchain to incentivize the network of participants to use blockchain. It has functions limited to exchange of value.

**Token** refers to virtual currency created through a smart contract with functions beyond an exchange of value and can represent assets or functionally desired by the developer.

Under the draft rules, the tokens issued by the startups or companies conducting the ICO may follow the nature of a security under Section 3.1 of the Securities Regulation Code, and therefore, these should be registered with the Commission and necessary disclosures need to be made for the protection of the investing public.

Nevertheless, despite being analogous to securities, the present registration process for initial public offering (IPO) may not be tailor fit for initial coin offering. Hence, the proposed rules have been formulated for the **registration of security tokens** offered through initial coin offerings.

The **salient points** of the proposed rules are as follows:

1. The proposed rules shall cover the conduct of ICOs wherein convertible security tokens are issued by start-ups and/or registered corporations organized in the Philippines, and start-ups and/or corporations conducting ICOs targeting Filipinos, through online platforms;

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2. The proposed rules shall involve a two-pronged assessment of the ICOs: (a) initial assessment and (b) registration proper;
3. All ICOs conducted within the Philippines or by Philippine startups or corporations shall be required to undergo an initial assessment by submission of initial assessment request and attached documents (including the proposed whitepaper) wherein said startup or corporation shall have the burden to prove **that the tokens are not security tokens**;
4. The SEC shall have 20 days upon receipt of complete documents for initial assessment to determine whether the tokens are security tokens or not.

If it finds that the tokens are indeed **security tokens**, and unless the ICO falls under the exemptions from registration provided under the rules or conducted exclusively through crowdfunding portals under the proposed rules for crowdfunding, the **issuer must register the security tokens** (registration proper) before the start of the pre-sale;

5. Startups who will conduct ICOs of security tokens shall be **required to incorporate**; and in the case of foreign corporations, required to **maintain a branch office** in the Philippines;
6. SEC has the power to require the amendment to the Whitepaper/proposed whitepaper to conform to the documents submitted with the Commission and/or to include all the information required under the proposed rules;
7. The members of the team and the advisors of the ICO project should possess all the qualifications and none of the disqualifications provided under the proposed rules;
8. The Issuer of the security tokens are required to submit, among the other documents, as exhibits to the registration statement a **code audit report** issued by an independent code auditor, including but not limited to testing of the source code, KYC/AML framework, technology risks and security protocols. Regular code audit reports shall also be required to be submitted for monitoring of the project, in addition to other continuing reports specified under the proposed rules
9. SEC or its duly authorized representatives shall conduct an ocular inspection of the Philippine office of the Issuer and system walkthrough of the operating system before the approval of any registration for a security token ICO;

10. The proposed rules define the allowable means of advertising and prohibited advertising practices (including deceptive advertising);
11. Entities that conducted an ICO prior to the implementation of the proposed rules are given 3 months to submit the initial assessment request to the Commission; and,
12. The issuer of a security token ICO is required to **keep the proceeds under escrow** with a reputable independent escrow agent. The Escrow Agreement should be submitted as part of the exhibits attached to the registration statement and should provide, among others, (1) that the said proceeds shall be withdrawn only upon the presentation of the Issuer's work progress report, and (2) that the Escrow Agent will return the said proceeds to the investors in case the soft cap of the project is not reached or in a pro rata basis in case the project is abandoned by the issuer before completion.

Study of the whitepapers of various ICOs that have been conducted within the Philippines shows that **the proponents of such ICOs claim that the tokens** being issued are **not securities** and therefore not under the jurisdiction of the SEC. **Allowing this practice is proven dangerous to the investing public** who are left with no clear recourse once the said ICOs are proven to be scams.

Therefore, the SEC will put the burden of proving that the tokens issued through an ICO in the hands of the proponents by presuming that the tokens are securities unless proven otherwise.

The proposed rules are benchmarked from the rules in various jurisdictions and markets.

The draft SEC Memorandum Circular may be accessed via this link:

*<http://www.sec.gov.ph/wp-content/uploads/2018/08/MC-Rules-for-ICOs.pdf>*

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