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The Current & Future of Cryptocurrencies and ICO's

1 EXECUTIVE SUMMARY

1.1 On 1 February 2018, the International Business Structuring Association (IBSA) held a panel discussion on the current and future uses of blockchain technology, cryptocurrencies and Initial Coin Offerings ("ICOs"), hosted at the offices of global law firm Squire Patton Boggs (UK) LLP.

1.2 The panel was chaired by fintech and regtech expert Hazem Danny Al-Nakib, a board member of Securrency, and featured international tax partner Dmitry Zapol of IFS Consultants, Financial Services Partner Paul Anderson of Squire Patton Boggs, Founding Director Stan Stalnaker of Hub Culture, Co-Founder Grant Blaisdell of Coinfirm and Senior Associate Jay Gomez of Triay & Triay. A lively discussion focused on distributed ledger technology and blockchain, applications of these technologies in various industries across the public and private sector, the state of cryptocurrencies as an asset class, and the current regulatory and legal challenges facing the nascent industry.

1.3 Over the past two years, cryptocurrencies have firmly entered the public conscience and mainstream media. Millions of people became involved in the booming market in various 'coins' and the so-called token sales via ICOs have raised approximately US$20 billion. By the end of 2017, as many as 30 initial offerings would take place every day. The current market capitalization of the global cryptocurrency market is some US$450 billion, spread across more than 1,513 individual cryptocurrencies.

2 DISTRIBUTED LEDGER TECHNOLOGY AND BLOCKCHAIN

2.1 About a decade ago, the public (or to be precise a small group of Internet enthusiasts who at the time bothered to take notice) learnt about a new protocol for a peer-to-peer electronic cash system using a cryptocurrency called bitcoin. The protocol established a set of rules that involved numerous independent participants forming a global distributed computation network. The end result would ensure the integrity of the data exchanged amongst these devices without the need to rely on a single trusted third party. The protocol became the foundation of a growing number of global distributed ledgers called blockchains that have the advantages of speed, lower cost, security, fewer errors and the elimination of central points of attack and failure.

2.2 The advantage of the blockchain is that at any given moment the data it contains is 'resolute' whereby all of the data is 'resolutely' known within the blockchain, requiring vast amounts of

computing power and energy – it provides certainty and in the absence of a central database, the system is less prone to hacking. Also, most blockchains are public and reside on the network, which means that anyone can view them at any time, and they are heavily encrypted.

2.3 Periodically, over fixed time intervals, all the transactions in the blockchain are verified by the devices forming the network, cleared and stored in a block, which is linked to the preceding block thus forming a chain. Each block must refer to the preceding block to be valid. This structure permanently time-stamps and stores exchanges of value, preventing anyone from altering the ledger.

2.4 The bitcoin network is one example of a public blockchain technology which provides the means to send money directly and safely without going through a bank or a credit card company. However, since its inception, the technology has branched out into several different strands:

(a) Virtual currencies, such as those used in online computer games;
(b) Digital currencies, such as AmEx rewards points, schemes via PayPal, etc.;
(c) Other cryptocurrencies, such as Ethereum or Litecoin; and
(d) Various types of tokens ranging from utility, usage, work, asset-backed, and share-like.

2.5 Besides payment systems, the use of distributed ledger technology (DLT) and the blockchain has a great range of applicability – such as health care records, land titles, financial services. Indeed, there are many industries where these central tenets of the DLT, such as immutability and transparency are valued, and a central distributed database is essential. The so-called ‘protocol’, which connects the public blockchain to the developers, a language of connection, allows certain utility and functionality.

2.6 This leads to the concepts of cryptocurrencies and ICOs.

3 DISTRIBUTED LEDGER TECHNOLOGY AND BLOCKCHAIN

3.1 The analysis of cryptocurrencies or ‘coins’ and “tokens”, differs widely around the world. Ultimately, it comes down as to whether these are considered an asset-based currency, such as a security. Should these be considered a security, there comes a number of regulatory hurdles and existing securities regulations. In addition, it appears there is an increased push to characterise some as a commodity as well. Within the UK, there’s also some consideration being given to the extent to which there is some collective investment scheme. However, this is also not without difficulty, considering the sheer number of cryptocurrencies traded on big exchanges.

3.2 With regards to ICOs, a large question remains over how many of the token sales are following a proper approach with regards to regulatory framework, KYC and financial institution integration. Given the sheer number of ICOs, the legal concerns are mainly concentrated on KYC and anti-money laundering legislation compliance issues, whereby the monies raised in ICOs must be verified as to its origin, in order to use the funds raised by the ICO and convert them to traditional “fiat” currencies.

3.3 Increasingly, large financial institutions and banks are becoming 'picky' with providing services and collaborating with ICO-participating businesses and individuals, mainly due to KYC/AML issues. Despite the lack of flexibility that often stems from the little self-regulation undertaken by the businesses seeking to use the bank's services, the bottom line remains that in the instance that a business or individual does not comply with the current KYC requirements, the use of the traditional financial services will remain difficult to access.

3.4 In the future, ICOs will likely become 'more real' in respect of the token's actual true utility and functionality, not just a form of payment or a token traded on an exchange, but an actual use and sustainability of the platform it derives from. More token sales will also be equity-based, whereby they will be a genuine fundraising route for companies to obtain funds to expand and develop. Lastly, large institutional, 'brick and mortar' companies will begin using ICOs/ITOs/token sales in order to raise funds, much like the current, substantially smaller individual businesses and companies do.

4 REGULATING CRYPTOCURRENCIES

4.1 Naturally, the regulation of cryptocurrencies currently poses a large number of issues. To serve as an example, one of the first issuances of Bitcoin-based pre-paid cards some eight years ago in Gibraltar was received with great suspicion, mostly due to the reputation Bitcoin had at the time. Ultimately, what regulators should be doing is to work closely with persons and businesses at the forefront of the blockchain industry to adequately deal with the developing industry. Overregulating can easily 'kill' the industry, as it is a fine balance – to serve as an example, New York passed the 'Bit-licence' a little too early, a little too fast, which drove the entire industry out of the state into Nevada, California and off-shore, to Bermuda, and so on.

4.2 Three major groups of regulatory approaches have developed across the world regarding securities regulation. The first group is centred on the offshore jurisdictions, which have largely adopted a laissez-faire policy of acceptance and providing entry to both businesses and currencies. The second group include countries such as the UK and the US, where the FCA and the SEC are mature, robust regulatory institutions, which are likely to tentatively approach the blockchain-enabled industry towards a more regulated market applying existing regulation. The third group feature jurisdictions which actively stepped out to stop the spread of the cryptocurrency industry within the jurisdiction completely.

5 FUTURE USE OF BLOCKCHAIN

5.1 Bermuda, the Canton of Zug in Switzerland, Luxembourg and Singapore are all currently either implementing, or considering implementing, some form of blockchain/DLT technology. This includes capabilities in healthcare, IFPF distributed file storage, title deeds and so on.

5.2 In Bermuda, this is being brought a step forward by the implementation of the so-called Bermuda Standard, whereby all of the Bermudan government's files and forms, such as aircraft registry, ship registries, beneficial titles, human identity are digitised and stored in the blockchain. This

technology is also being exported over to other states, such as Singapore, Estonia or Dubai, where an infrastructure layer is to be developed between the citizen and the state, where compliance can be done via a blockchain network. By 2020, Dubai aims to put all of its government services offered via the blockchain.

5.3 This has potentially wide-ranging application to personal ownership, such as digital vaults and storage, asset management and ownership which is likely to become an increasingly lucrative market in the coming decade.

6 GOING FORWARD

6.1 Predictions are that by the end of 2018, the global blockchain-technology enabled market will be over US$1tn, as more institutional money, including hedge funds, will allow for a more regulated, mature form of cryptocurrency-based assets entering the market. The applications of a 'resolute' share trading mechanism or the trading of commodities using digital assets will also likely become increasingly popular.

6.2 The technology is currently moving forward too quickly that attempts at drafting and implementing a comprehensive regulatory framework have so far been unsuccessful and mostly avoided. Moreover, given the ongoing threat of overregulation, whereby the industry will be 'scared off' to a more liberal, lenient jurisdiction where less stringent regulations apply, most governments are 'keeping their powder dry' and waiting for the market to consolidate before undertaking further steps. Given that the regulators' powers derive directly from the government, any principles-based solutions are difficult to put into place now when the market is so fluid and fast-paced.

6.3 Bringing stakeholders together, understanding the technology involved, and the categorization, similarities and differences between tokens, coins, securities, in the traditional markets and in the new blockchain space is crucial, especially in an environment that maintains certain standards of KYC and AML so that there is synergy and sustainability.

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This summary was written by Michael Zamecnik of Squire Patton Boggs, taken from an event organised by the IBSA, a not-for-profit Association dedicated to sharing knowledge, collaboration and networking. We would like to thank Hazem Danny Al-Nakib of Securrency, Paul Anderson of Squire Patton Boggs, Grant Blaisdell of Coinfirm, Stan Stalnaker of Hub Culture and Jay Gomez of Triay & Triay.

In describing the nature of the Blockchain and cryptocurrency assets, reference has been made from the book 'Blockchain Revolution: How the Technology Behind Bitcoin Is Changing Money, Business and the World' by Don Tapscott.