

Initial coin offering

April 2018

We set out below an overview of the steps involved in establishing an initial coin/token offering ("ICO") vehicle (an "ICO Vehicle") in the Cayman Islands, from formation to coin/token offering, as well as the key issues which may arise.

Regulatory Environment

We believe that the Cayman Islands financial regulator, the Cayman Islands Monetary Authority ("CIMA") is keen to take a very practical and commercial approach to ICOs, in order to maintain Cayman's reputation as a leading finance centre. CIMA has not, as yet, issued any formal guidelines on ICOs. We understand that CIMA may issue guidance in the future, which will be based on consultations with players in the blockchain industry, in order to develop an effective and business-friendly ICO landscape which also aligns with international standards as they continue to develop.

The global regulatory landscape with respect to ICOs and cryptocurrencies is in a state of constant (daily) flux and the current Cayman position should always be checked with one of Collas Crill's technology teams.

Currently, all ICO founders should consider each of the following questions in order to determine what, if any, regulatory issues may apply to them and/or the ICO Vehicle:

Is the ICO Vehicle issuing a security?

- Under the Securities and Investment Business Law ("SIBL"), a person shall not carry on or purport to carry on securities investment business unless that person holds a license granted under SIBL or is exempt from holding a license. Amongst other things, "securities investment business" is defined as "dealing in securities".
- Under SIBL, securities are defined, broadly, as shares, partnership interests, debt instruments, warrants, options, futures and contracts for difference. Digital tokens, coins or crypto currencies are not specifically captured within this definition, although they may exhibit characteristics which may bring them into the definition of securities. The Cayman Islands does not have an equivalent to the U.S. concept of an 'investment contract' and the corresponding 'Howey Test' used to determine what a security is for U.S. law purposes.
- Our view is that if the ICO Vehicle is issuing a "utility coin/token" which is not linked to any underlying securities, then the ICO and/or the ICO founder is not carrying out securities investment business and does not need to be regulated under SIBL. If the ICO Vehicle is issuing a security, or a security-linked coin/token, then the ICO Vehicle may be carrying out securities investment business and a licence / licence exemption under SIBL must be sought for the ICO Vehicle. Collas Crill can advise on applications for licences or relevant exemptions.

Is the ICO Vehicle issuing an equity?

- Under the Mutual Funds Law an equity is defined as a share or unit which gives the holder an entitlement to participate in the profits or gains of the issuer and which is redeemable at the option of the holder.

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- If the ICO Vehicle issues equities as defined above, it may be deemed a mutual fund, and may need to be structured as a mutual fund. Cayman Islands mutual funds must be registered with CIMA, unless they are issuing equities to 15 investors or less, a majority of which are capable of appointing or removing the operator of the fund.
- An ICO Vehicle which issues utility coins/tokens, which are not linked to the equity of the ICO Vehicle and which are not redeemable, will not need to be regulated under the Mutual Funds Law. Collas Crill can advise on all matters to do with mutual funds.

What Anti Money Laundering procedures should be put in place?

- The Cayman Islands Anti Money Laundering laws (which consist of the Proceeds of Crime Law, the Anti Money Laundering Regulations and related guidance notes (together, the "**AML Laws**")) apply to entities which carry out "relevant financial business", as defined in the AML Laws. To summarise, "relevant financial business" means regulated businesses, such as banking, trust, insurance, securities investment business, and regulated or non regulated funds business. It also includes trading securities for a businesses' own account or for the account of customers.
- Whilst there may be a technical argument that the AML Laws are not applicable to ICO Vehicles which solely issue utility coins/tokens, which are not linked to any equity or security, market and best practice dictate that it is prudent to ensure that full due diligence documentation is collected on all purchasers of utility coins/tokens, both in the pre sale and public sale stage of an ICO.
- It should also be borne in mind that the establishment of effective AML policies may make it easier for an ICO Vehicle to engage third party service providers (including banks) to act for the ICO Vehicle.
- Typically ICO Vehicles will incorporate AML procedures into their on-line ICO application process and specialist service providers continue to develop and refine the process.

Is the ICO Vehicle engaged in a "money services business"?

- The founder should consider whether the principal business of the ICO is the provision of "money services" which, under the Money Services Law, include the provision of money transmission (such as money transfer services or payment instruments) and currency exchange services.
- If the founder determines that the ICO Vehicle will be principally engaged in the provision of money services, then it will need to apply to CIMA for licencing under the Money Services Law.
- Our view is that if the ICO Vehicle is solely issuing utility coins/tokens, and will not be providing fiat currency exchange, then the Money Services Law is unlikely to apply. That said, each ICO should be evaluated on its own facts and it is advisable to consider whether any licensing requirements apply where investors are granted express permission to deal with or exchange utility coins/tokens in any manner other than in relation to the ICO Vehicle's platform/services.

Will purchase documentation be executed electronically?

- If so, consideration will need to be given to the Electronic Transactions Law (the "**ETL**"). The ETL provides a framework whereby contracts may be executed electronically and deemed enforceable, as long as the electronic signature provided is "reliable".

- Distinction should be drawn where purchase documentation requires physical signature to signify agreement, as opposed to a "click-through" type agreement. While the general requirement of a "reliable" electronic signature will apply to both forms of agreement, the ICO Vehicle should be aware of any specific requirements to ensure valid electronic execution and enforceability of each.
- To meet the reliability requirement, an electronic signature must satisfy the following elements: (i) the manner in which the electronic signature is created is linked to the signatory and only the signatory; (ii) at the time of signature, the signatory was the only person who had control of the way to create the electronic signature; (iii) the ICO Vehicle must be able to detect if there has been any alteration to the electronic signature after it was made; and (iv) where the signature is provided as a legal requirement and as assurance of the integrity of the information in the document, the ICO Vehicle must be able to detect if that information has been altered after the document has been signed.
- The ICO Vehicle should establish a methodology for determining whether an electronic signature is "reliable" (i.e. fulfils the above requirements) under the Electronic Transactions Law. A good way of doing this would be to set out, within the applicable purchase document itself, the type of electronic signatures which would be acceptable, the validity of any "click-through" acceptance and any certification required from the signatory to prove the authenticity of such signature.

Road Map from Establishment to Coin Offering

Below we have set out the key steps to be taken in order to successfully launch an ICO in the Cayman Islands.

Establishment of Vehicle:

- The most appropriate structure for an ICO Vehicle is an exempted company with limited liability. Collas Crill, in conjunction with our affiliated registered office provider, Collas Crill Corporate Services Limited ("**CCCS**"), can incorporate an exempted company within 1 business day of receipt of all necessary items (as set out below) from a founder.
- In order for us to incorporate an exempted company which will constitute the ICO Vehicle, we and CCCS will need the following:
 - a completed checklist, which should include an explanation of the ICO Vehicle's purpose and its source of funding;
 - due diligence documentation on each of the proposed directors and shareholders of the ICO Vehicle. In summary, the due diligence required is as follows:
 - certified true copy of each person's passport;
 - confirmation of each person's residential address through a certified true copy of a utility bill;
 - verification of that same residential address through a second certified true copy of a utility bill or a reference letter as per the pro forma which we will send you;
if any individual holds a US or UK passport we would require a self certification form, which we will send you;
 - we will also require due diligence on any individual or corporate entity who owns more than 10% of a corporate director or a shareholder of the ICO Vehicle. In respect of a corporate entity we require:
 - certified true copy of its corporate documents;
 - certified true copy of its structure chart;

- due diligence documents for all individuals within that corporate entity;
- certification should be by a "respected professional" such as an attorney or accountant. The certificate should include their contact details and the date of signing.
- once the above items have been received, CCCS will issue an invoice for the appropriate incorporation costs. As soon as payment has been remitted, CCCS will go ahead and incorporate the company which, as mentioned, may be done in as little as 1 business day.
- We will incorporate the ICO Vehicle with our "plain vanilla" set of Memorandum and Articles of Association. It may be necessary for the ICO Vehicle to then adopt a bespoke set of Articles. This will depend on the business purpose and / or internal operations of the ICO Vehicle. We can advise on this and draft the bespoke Articles, as required.
- We would be happy to make introductions to Cayman Island service providers who can provide independent directors for the ICO Vehicle, if this is considered appropriate.

Bank Account Opening:

- Finding a bank to open a bank account for an ICO Vehicle is a key consideration which may impact timing.
- Currently Cayman Islands banks are reluctant to provide banking services for ICO Issuers. However this is a constantly changing landscape.
- We may be able to make introductions to banks which we believe are currently comfortable with engaging clients who operate in the crypto-currency and blockchain space, although it should be noted that these banks are not currently operating in the Cayman Islands. Note that there is no restriction on any Cayman Islands entity having foreign bank accounts.

Pre-Sale:

- In circumstances where the ICO Vehicle wishes to raise funds prior to the public sale of the ICO, current market practice is for ICO Vehicles to enter into a Simple Agreement for Future Tokens ("**SAFT**") with a purchaser. Pursuant to the SAFT the purchaser will purchase a right to the coins/tokens which will be distributed following the public sale.
- With input from the founder, we will draft a SAFT along with a Prospectus which will set out a summary of the terms and conditions of the coin/token offering, the risk factors, information on the ICO Vehicle and its principals, and the coins/tokens and the network to which they relate.
- The SAFT and the Prospectus, together with the full terms and conditions which effectively also operate as a purchase agreement (the "**Terms and Conditions**") may be published on the founder's website. This will enable the SAFT and the Prospectus and Terms and Conditions to be executed electronically (subject to the ELT mentioned above), and to be updated periodically as needed.
- Unlike in the USA, a SAFT is not considered to be a security under Cayman Islands law, provided that the coins/tokens which are ultimately being offered under the SAFT are utility coins/tokens, and are not securities themselves. In these circumstances, we will ensure that the SAFT is drafted in such a way that makes it absolutely clear that it is not a security.

IP Transfer Agreement:

Depending on the circumstances of the ICO, prior to the public sale an agreement may need to be entered into between the ICO Vehicle and any person or entity which owns intellectual property connected to the ICO Vehicle, in order to transfer that intellectual property to the ICO Vehicle, such that it can properly utilise that IP in order to produce the coins/tokens and offer them for sale. We can assist in drafting this, as necessary.

Third Party Agreements:

- It is likely that the ICO Vehicle will wish to engage various external service providers such as (amongst others):
 - an administrator;
 - a custodian;
 - a marketing agency;
 - an IT specialist; and
 - developers.
- We can assist by reviewing every third party service provider agreement and ensuring that they comply with Cayman Islands law.

Public Sale:

- As discussed, provided that the coins/tokens being offered by the ICO Vehicle are clearly utility coins/tokens, then the public sale is unlikely to fall within the parameters of Cayman Islands law or regulations restricting the sales of securities or the mutual fund legislation.
- The public sale of the coins/tokens should be documented by way of a Prospectus (which can be the same as the pre-sale prospectus) and the Terms and Conditions, which Collas Crill can draft.
- As with the SAFT, the Terms and Conditions may be published on the founder's website and executed electronically, once the ELT is complied with.

Physical Presence in Cayman - Optional:

- If it is determined that a substantive physical presence in the Cayman Islands is necessary, the ICO Vehicle can be incorporated or converted into a "Special Economic Zone Company" and establish a physical presence in Cayman Enterprise City. This may only occur if the ICO Vehicle falls firmly outside of the Cayman regulatory space, and fundamentally is not doing business in the Cayman Islands outside of the Special Economic Zone.
- If a physical presence is required, we can introduce you to our contacts in Cayman Enterprise City.

Each of the above points, and any related discussions which we may have with you are based on the understanding that you have obtained relevant legal advice, including tax advice, in all applicable jurisdictions.

This memorandum is subject to any legislation, regulation, guidelines or notifications which the Cayman Islands Government may issue from time to time.