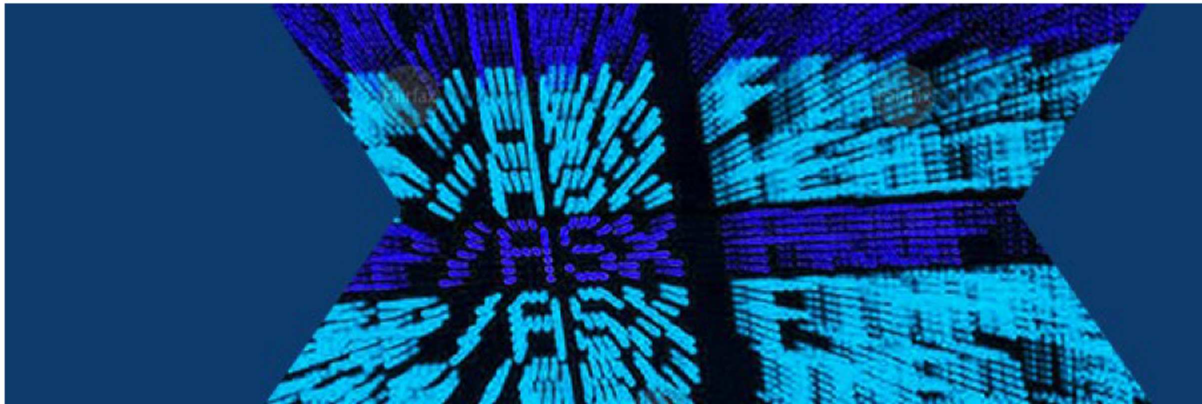
ASX

Compliance Updates



Listed@ASX

Compliance Update 1 August 2019
Update no 06/19

1. Cryptocurrency-related activities

Over the course of this year, ASX has observed an increase in enquiries and announcements by listed entities proposing to engage in cryptocurrency-related activities. These activities include:

- conducting an initial coin offering ('ICO') where investors are offered 'tokens' in return for a payment of money or cryptocurrency;
- issuing tokens and listing them on a cryptocurrency exchange with the intention of selling them to investors/speculators as demand emerges (often referred to as an 'initial exchange offering' or 'IEO');
- providing advisory, introductory, facilitation or marketing services to an entity in relation to an ICO or IEO;
- trading or making markets in cryptocurrencies or tokens;
- building and/or operating exchanges that trade cryptocurrencies or tokens;
- building and/or operating platforms that facilitate payments in, or exchanges of, cryptocurrencies or tokens;
- mining cryptocurrencies;
- developing or acquiring the technology needed to engage in the activities above and licensing it to parties wishing to engage in those activities;
- establishing an investment fund to invest in cryptocurrencies and/or tokens; or
- acquiring or investing in entities or businesses engaged in, or proposing to engage

in, any of the above activities.

ASX's concerns about cryptocurrency-related activities

ASX has previously advised the market of its concerns about cryptocurrency-related activities in Listed@ASX Compliance Updates no 09/17 dated 30 October 2017 and no 01/18 dated 16 February 2018.

As noted in those updates, cryptocurrency-related activities raise significant legal, regulatory and public policy issues and their regulatory status in a number of overseas jurisdictions remains subject to considerable uncertainty and rapid change.

ASX's concerns regarding cryptocurrency-related activities have been reinforced and amplified by:

- the UK Financial Conduct Authority's consultation paper entitled 'CP19/3: Guidance on Cryptoassets' issued in January 2019, which observes that:

  > *'Fraudulent activity is likely to exist across the range of cryptoassets, but evidence suggests there are significant risks associated with ICOs, particularly around high failure rates, or fraudulent ICOs. Recent research looked at listed tokens in 2017 with data provided for those ICOs with over $50 million in market capitalisation and found that 78% of these listed tokens were scams.'*

- the United States Commodity Futures Trading Commission's customer advisory entitled 'Use Caution When Buying Digital Coins or Tokens' issued on 16 July 2018, which notes that:

  > ***'Many Initial Coin Offerings End in Fraud or Failure***
  > *Several studies and news reports indicate that a large number of Initial Coin Offerings (ICOs) are fraudulent or the underlying products or services fail to live up to their promises. Estimates of fraud range from 5 percent to more than 80 percent of ICOs. One report also identified nearly 300 offers that contained plagiarized investment documents, promises of guaranteed returns or fake executive teams.*
  > *Another report indicates that after one year from their ICO, nearly half of the projects or companies have failed or shut down.'*

- the list of cryptocurrency-related enforcement actions being undertaken by the US SEC, details of which can be found on the following webpage under the heading 'Digital Assets/Initial Coin Offerings': https://www.sec.gov/spotlight/cybersecurity-enforcement-actions
- the decisions of the Chinese and South Korean governments to ban ICOs; and
- the decisions of a number of prominent social media sites to ban the advertisement of ICOs on their sites.

ASX is also aware of commentary suggesting that 95% of trading on cryptocurrency exchanges is fake and/or manipulative.

In light of the above, ASX is publishing this guidance so that listed entities involved in

cryptocurrency-related activities have a clear understanding of ASX's position on the issues those activities raise under the listing rules.

The original purpose of ICOs and IEOs

ICOs were created as a mechanism to fund the development of start-up technology companies, where the company was not yet mature enough to pursue an initial public offering ('IPO') of its securities. In an ICO, a company wanting to develop a particular technology sells a quantity of tokens (or 'coins') to investors/speculators in exchange for money or cryptocurrencies such as Bitcoin or Ethereum. The tokens confer entitlements to use the technology once it has been developed, or some other 'utility' related to the technology. The company is supposed to use the funds raised to build the technology so that the tokens then have value.

IEOs sprang up as an alternative to ICOs when the Bitcoin bubble of 2017 burst in December of that year and the prices of Bitcoin and other cryptocurrencies dropped dramatically, resulting in fewer investors/speculators wanting to participate in ICOs.

Proponents of ICOs and IEOs argue that the tokens offered to investors are not 'securities' and therefore the fund raising undertaken through the issue of such tokens is not regulated by securities laws. In a number of cases, that argument has been ruled to be incorrect by regulators and an offer of tokens has been found to breach securities laws. Nevertheless, the (sometimes mistaken) belief that offers of tokens are largely unregulated and the speculative fervour triggered by periods of rapid growth in the price of Bitcoin and other cryptocurrencies have attracted scammers and fraudsters into this space.

ICOs and IEOs raise particular issues when they are undertaken by a listed entity that has already conducted an IPO. As mentioned previously, ICOs and IEOs were developed as a funding mechanism for start-up technology companies that were not yet mature enough to undertake an IPO. An entity that has already conducted an IPO will have a reasonable number of existing security holders who have subscribed capital on the basis of its prospectus and who expect to make a return on that capital. The rights conferred on token holders will typically result in a shift of value from the entity's security holders to its token holders.

To illustrate, some developers of computer games seek to fund their development by an ICO of tokens that confer a right to play a given number of games, once it has been developed. The number of tokens offered can run into the millions. This means that there will be millions of instances where the game developer potentially will receive little or no revenue from users playing the game.

It is not uncommon for a listed entity proposing an ICO or IEO to be seeking to raise funds that are substantially higher than the amount raised in its IPO and/or its current market capitalisation. That brings the question of value shifting from the entity's security holders to its token holders into sharp focus.

ASIC INFO 225

On 30 May 2019, ASIC published updated guidance regarding ICOs and crypto-related activities in Information Sheet 225 entitled 'Initial coin offerings and crypto-assets' (INFO 225).

ASX strongly encourages listed entities proposing to engage in any cryptocurrency-

related activities in Australia, including in particular those proposing to undertake an ICO or IEO, to read INFO 225 and seek legal advice from a reputable Australian law firm on how it might apply to the entity's activities.

ASX is aware of some Australian law firms providing advice that tokens issued in an ICO or IEO are not a financial product for the purposes of the Corporations Act and therefore are not regulated by that Act. The examples ASX has seen of such advice do not appear to have considered all of the issues involved in this complex question, including in particular whether or not the ICO or IEO involves an offer of an interest in a managed investment scheme.

On ASX's understanding of the law, there is a reasonable likelihood that many of the tokens offered to investors in Australia as part of an ICO or IEO constitute an interest in a managed investment scheme and the offer of those tokens is therefore regulated by chapters 5C and 7 of the Corporations Act.

There is also a reasonable possibility that entities carrying on a business of providing advisory, introductory, facilitation or marketing services in relation to ICOs or IEOs in Australia are in the business of promoting these types of managed investment schemes and therefore each scheme they promote must be registered under section 601ED(1)(b) of the Corporations Act, regardless of the number of Australian investors who participate in the ICO/IEO.

Listing rule 11.1

In many cases, a proposal by a listed entity to engage in cryptocurrency-related activities will involve a significant change in the nature or scale of the entity's activities and therefore need to be notified to ASX under listing rule 11.1.

Where ASX forms the view that a proposal by a listed entity to engage in cryptocurrency-related activities will be a significant change to the nature or scale of the entity's activities, given the issues above, ASX is likely to exercise its discretion under listing rules 11.1.2 and 11.1.3 to require the entity to seek security holder approval for the change and to re-comply with the admission requirements in chapters 1 and 2 of the listing rules.

Listing rule 12.5

Listed entities have an ongoing obligation under listing rule 12.5 to have a structure and operations appropriate for a listed entity. A breach of that obligation can result in the entity's securities being suspended from quotation under listing rule 17.3.1 or the entity's admission to the official list being terminated under listing rule 17.12.

If a listed entity engaging in cryptocurrency-related activities is found to be involved in a fraud or scam or is breaching applicable laws by engaging in those activities, ASX will regard that as a breach of listing rule 12.5 and give serious consideration to whether it should terminate the entity's admission to the official list.

Under listing rule 18.7, ASX may require an entity to give ASX any information, document or explanation that ASX asks for to enable it to be satisfied that the entity is, and has been, complying with listing rule 12.5. For the avoidance of doubt, this includes providing to ASX (not for release to the market) a copy of any legal advice obtained by the entity confirming that its cryptocurrency-related activities do not breach applicable laws.

Listing rule 3.1

ASX has observed that listed entities are making announcements about proposed cryptocurrency-related activities prematurely and without an appropriate level of detail to meet the entity's disclosure obligations under the listing rules.

Generally speaking (and subject to its obligation to make disclosure earlier if information has leaked or there is a false market in its securities), a listed entity proposing to engage in a cryptocurrency-related activity should not make an announcement about the proposed activity until the proposal is reasonably well developed and the entity is in a position to provide a reasonable amount of detail about the proposal. This includes in the case of an ICO or IEO:

- the proposed timetable for the ICO or IEO;
- the number of tokens to be offered in the ICO or IEO;
- the price at which the tokens will be offered;
- the purposes for which the funds (including cryptocurrencies) raised by the ICO or IEO will be used;
- the protections in place (if any) to ensure that the proceeds of the ICO or IEO will be used for those purposes and those purposes only;
- the specific rights that the tokens will confer on their holders;
- the type of investors (retail or wholesale) who will be offered tokens;
- the jurisdictions in which the tokens are to be offered;
- confirmation that the entity has legal advice that the ICO or IEO is lawful in those jurisdictions and that the entity has all of the licences, registrations, authorisations and approvals necessary to conduct the ICO or IEO;
- confirmation that the entity has received tax advice on the tax treatment of the ICO or IEO and disclosed any material tax issues the ICO or IEO will involve;
- confirmation that the entity has received accounting advice on the accounting treatment of the ICO or IEO and disclosed any material accounting issues the ICO or IEO will involve;
- details of any agreements the entity has entered into with parties providing advisory, introductory, facilitation or marketing services in relation to the ICO or IEO, including a detailed description of those services and the fees and perquisites (including free or discounted tokens) those parties are to receive for providing those services;
- whether the tokens are intended to be listed on cryptocurrency exchanges and, if so, which exchanges;
- whether any party providing advisory, introductory, facilitation or marketing services in relation to the ICO or IEO has an interest or involvement in a cryptocurrency exchange on which the tokens are intended to be listed and, if so, the nature of that interest or involvement and how the conflicts this creates will be managed.

An entity that makes an announcement of its intention to conduct an ICO or IEO without

a reasonable amount of detail about the ICO or IEO will likely find itself suspended until it is able to provide that detail.

This includes, in particular, disclosing the specific rights that the tokens will confer on their holders. Without that information, investors are not in a positon to assess the impact of the ICO or IEO on the price or value of the entity's securities.

Claims that cryptocurrency-related activities are regulated or have been approved by ASX

ASX has seen claims in announcements, on websites, or in other materials published by listed entities engaging in cryptocurrency-related activities that their activities are 'regulated by', or have been 'approved by', ASX. Generally, the context in which these claims have been made shows that they are intended to convey an impression to the reader that the activity in question is less risky than other cryptocurrency-related activities because of ASX's oversight.

ASX only regulates cryptocurrency-related activities to the extent they raise issues under the listing rules.

If ASX becomes aware that a listed entity has published materials claiming that the entity's cryptocurrency-related activities are 'regulated by', or have been 'approved by', ASX or something similar, ASX will immediately suspend trading in its securities. The suspension will continue until the entity publishes an announcement acceptable to ASX retracting the claim.

For the avoidance of doubt, the fact that ASX may decide that listing rule 11.1 or 12.5 does not apply to a particular cryptocurrency-related activity is not an approval by ASX of that activity.

Claims that cryptocurrency-related activities are regulated by AUSTRAC

ASX has also seen claims in announcements, on websites, or in other materials published by parties engaging in cryptocurrency-related activities that their activities are 'regulated by' AUSTRAC. Again, the context in which these claims have been made shows that they are intended to convey an impression to the reader that the activity in question is less risky than other cryptocurrency-related activities because of AUSTRAC's oversight.

AUSTRAC only regulates cryptocurrency-related activities to the extent they raise issues under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 ('AMLCTF Act').

In this regard, some entities engaged in cryptocurrency-related activities are required to enrol or register with AUSTRAC as a digital currency exchange provider or a remittance service provider in accordance with the AMLCTF Act. Those entities are also subject to 'know your client' and other obligations under the AMLCTF Act. It is acceptable for a listed entity that is enrolled or registered with AUSTRAC and subject to obligations under the AMLCTF Act to disclose that information in a market announcement or elsewhere.

However, ASX will regard any published materials claiming that a listed entity's cryptocurrency-related activities are more widely regulated by AUSTRAC as misleading and will require the entity to publish an announcement to clarify the claim.

Simple Agreements for Future Equity (SAFEs) and Simple Agreements for Future Tokens (SAFTs)

ASX has recently seen instances of listed entities issuing SAFEs or SAFTs in conjunction with, or as a precursor to, an ICO or IEO.

A SAFE is an agreement between an investor and a company where the company promises to give the investor a future equity stake in the company if it undertakes an IPO or certain other trigger events occur. SAFEs were developed in Silicon Valley as a way for venture capital investors to quickly invest in a 'hot' start-up without burdening the start-up with the more laboured negotiations an equity offering may entail.

A SAFT is an agreement between an investor and a company where the company promises to give the investor tokens issued by the company if it undertakes an ICO or certain other trigger events occur.

A SAFE will generally be an equity security for the purposes of the listing rules. Among other things, this means that any SAFE issued by a listed entity must satisfy the requirement in listing rule 6.1 that the terms of the SAFE are, in ASX's opinion, appropriate and equitable. Issuing a SAFE may also trigger a requirement for the entity to obtain shareholder approval under listing rule 7.1 if the entity does not have the available placement capacity to issue the SAFE or under listing rule 10.11 if the SAFE is issued to a person in a position of influence.

A SAFT may also be an equity security for the purposes of the listing rules if the underlying tokens are an interest in a managed investment product. If they are, this will raise the issues discussed in the previous paragraph.

A SAFE or SAFT may also raise issues under listing rule 12.5, in terms of whether the entity has an appropriate structure for a listed entity.

Consultation with ASX

In light of the above, ASX would strongly encourage listed entities proposing to pursue cryptocurrency-related activities to consult with ASX before they do so and, in particular, before they make any announcement to the market concerning such activities.

ASX would also strongly encourage listed entities proposing to issue SAFEs or SAFTs to consult with ASX on the listing rule ramifications before they do so. This applies not only where the listed entity itself is proposing to issue the SAFEs or SAFTs but also where a child entity is proposing to do so.

New listings and quotations

The guidance in Listed@ASX Compliance Update no 01/18 dated 16 February 2018 regarding entities involved in cryptocurrency-related activities applying for admission to the ASX official list or for quotation on the AQUA market still holds good.

An applicant seeking to list a cryptocurrency-related business will need to satisfy ASX not only that it has a structure and operations appropriate for a listed entity (listing rule 1.1 condition 1), but also that its business is bona fide, that it will comply with all applicable legal requirements in Australia and in all jurisdictions where it is proposes to carry on business, and that proper disclosure has been made to investors of the risks (including emerging regulatory risks) involved. This will include satisfying ASX that it has

considered, where applicable, the legal and regulatory issues outlined in INFO 225 and that it has taken legal advice on those issues and any applicable overseas legal and regulatory requirements.

Applicants wishing to list a new LIC, LIT or ETF investing in cryptocurrencies or cryptocurrency derivatives will also need to satisfy ASX about:

- their proposed investment strategy, including how and when they will provide a return to investors and, if applicable, how they will hedge the risks in the underlying investments and any related currency risks;
- if they intend to invest in cryptocurrencies directly, their understanding of the market volatility and liquidity risks associated with cryptocurrencies and how will they manage those risks;
- if they intend to invest in, or hedge using, cryptocurrency derivatives, their understanding of the margin risks associated with cryptocurrency derivatives and how they will manage those risks (including in particular what liquidity lines they will have available to meet margin calls);
- the names of the individual fund managers who will be making their investment decisions and otherwise managing their portfolio and:
  - a copy of their CVs;
  - how, and for how long, have their services been secured;
  - their specific knowledge of and experience in cryptocurrencies;
  - if the applicant intends to invest in cryptocurrencies directly, their experience in managing highly volatile asset portfolios;
  - if the applicant intends to invest in, or hedge using, cryptocurrency derivatives, their experience in managing highly volatile derivative portfolios; and
  - why they consider their LIC/LIT/ETF is a suitable investment for retail investors.

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