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RUSSIAN APPROACH TO ICO REGULATION

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Abstract: Initial coin offering (ICO) is a mechanism allowing to attract investments all over the world via Internet exchanges trading digital tokens of different nature. The Decree of Russian President pointed that legal framework should be adopted till 2018. Despite high importance of this sphere, in Russia it is yet unregulated. In 2019 the Russian State Duma started the process of adoption of the draft law. The Russian draft law ‘’On Digital Financial Assets’’ aims to create legal framework for ICO which has a lot of similarities with the IPO rules. The paper studies the suitability of draft law provisions to capture digital financial assets. It is proved that proposed legal framework is inconsistent with tokenised financial instruments. Basing on the experience of Singapore it is argued that Russia shall use its approach to regulate all digital tokens constituting different financial products not only company’s shares.

Keywords: investments, digitalisation, ICO, tokens, securities, digital economy, financial assets, Singapore

1. INTRODUCTION

Digitalization is one of the key drivers of a modern economy and it is highly connected with virtual currencies and digital tokens [11], which opened up a new era for investments as well for investors. Digital technologies made it possible to use initial offering of coins (ICO), which is a mechanism used by new ventures to raise capital by selling tokens to a crowd of investors [4]. A new method of attracting investments is based on the idea that security coins are similar to stock in that they are purchased for investment and represent an interest in the company [10]. Meanwhile, some states were not prepared to face with challenges raised from rapid development of digital technologies [1] and their usage in the sphere of financial market. Russia is

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among them. Today, Russia is only at the first stage of creating legislation on investments providing by digital technologies, there is not law regulating ICO, cryptocurrencies, etc.

In 2017 Russian President adopted the Decree "On the Strategy for the Development of the Information Society in the Russian Federation for 2017-2030".[2] This Decree highlighted the main tracks for development of Russian legislation in the sphere of digitalization: e-commerce, big data, crowdfunding, virtual tokens. In accordance with it in 2018 the draft law ''On Digital Financial Assets'' was elaborated, but still it is not adopted. The main scope of the draft law is to fix the legal basis for the implementation of new types of financial activities, which include the creation cryptocurrency and ICO, the procedure for their accounting and transfer, requirements for the operator of the information system, as well as activities to confirm the validity of digital records in the distributed digital transaction registry. The analysis of the draft law ''On Digital Financial Assets'' shows that Russian legislator does not have an opinion about the legal status of tokens, including investment tokens, as well the draft law contains many inaccuracy and loop holes. Therefore, there is a need to elaborate and establish legal framework allowing to regulate initial coin offering in Russia. The legislator should basing on the foreign experience continue study the phenomenon of ICO and cryptocurrencies in order to find the most effective ways of legal regulation. Thus, the purpose of this paper is to answer the question does Russian choose the right approach in ICO regulation.

2. METHODS

For the purposes of this paper, methods of analysis, synthesis, induction, deduction, as well as formal legal and hermeneutic methods were used. Comparative study of Russian draft law and Singaporean legislation aims to find the more appropriate approach of ICOs legal regulation.

3. NATURE OF ICO UNDER RUSSIAN DRAFT LAW ''ON DIGITAL FINANCIAL ASSETS''

[2] URL: http://www.consultant.ru/document/cons_doc_LAW_216363/

According to the art.1 of the Russian draft law ‘’On Digital Financial Assets’’ digital financial assets are digital rights, including commitments and other rights, including monetary claims, the ability to exercise rights on equity securities, the right to demand the transfer of equity securities, which are stipulated in the decision to issue digital financial assets in the manner established by Federal Law, the issue, accounting and circulation of which is possible only by making (changing) entries in the information system based on a distributed registry. This definition shows that draft law don’t divide digital tokens on utility and security coins, but it has provisions establishing application of the Law on Securities Market if tokens guarantee right of their user on the share in a company. In fact the main idea of the draft law is to set the rules allowing to decrease risks of investors buying security tokens. At the same time, it does not fix any features connected with tokens as futures contracts, so the advisability of unifying all digital financial assets under one definition and establishing common legal framework for them does not solve issues that may arise in connection with the transfer of security and utility tokens, and cryptocurrency. Notably, the first edition of the draft law was based on the concept of difference of security tokens and other digital assets.

The art.3 of the Russian draft law ‘’On Digital Financial Assets’’ demonstrates that decision on ICO conduct shall include in fact the same information as a prospectus of securities offering. Meanwhile, the practice of the ICO shows that it is difficult for startups to foresee everything in advance with absolute accuracy. The law obliges young companies not only to write their decision too verbatim, but also to follow it steadily. Another important issue connected with ICO is that it is conducted under control of the Central Bank. Thus, ICO is directly affects the activities of state bodies; this contradicts the idea of ICO as a simpler, more convenient and faster way to attract financial assets to a project, without involving a state regulator.

The Russian draft law “On Digital Financial Assets” sets strict rules for the operator of the information system that records rights to shares of non-public joint-stock companies issued in the form of tokens. Named operators shall to be licensed as professional

participants of securities market, such requirements are not fixed when it comes to other digital financial assets. Moreover, according to the draft law only banks are allowed to engage in tokens exchange business. However no license is required when the person is engaged in consulting services on ICO.

In art. 5 of the draft law "On Digital Financial Assets" are also settled requirements for a place of incorporation of information system operator. The operator of the information system may be a legal entity whose personal law is Russian law only. The feasibility of such a provision is justified and will allow the Bank of Russia to establish control over such a sphere of activity, at the same time, foreign platforms for ICO will be outlaw in Russia. Meanwhile, the draft law says about legal liability for the operator of the information system but it does not establish liability for other persons. The rights and obligations of owners of digital financial assets, exchange operators of digital financial assets are repeatedly mentioned, however, it is unclear what punishment these persons will incur.

Analysis of the Russian draft law ''On Digital Financial Assets'' shows that ICO in fact is equal to IPO under its provisions. Of course, "by subjecting the issuance of security tokens to securities regulation, the regulator will provide a greater level of protection to the purchasers of security tokens" [8]. However, measures proposed by the draft law seem to be insufficient. Of course digital tokens can be deemed shares, but, researchers marked out a large variety of tokens [3] and they all have different issuing goals [2]. Therefore, it is impossible to limit regulatory framework of ICO only by tokens that have only securities nature, so 'categorizing features of tokens and investigate them case by case looks better solution rather than make regulations in general' [7].

4. THE CASE OF SINGAPORE

Singapore is the world leading state in the sphere of digitalization [5]. The sales of digital tokens registered in this state in 2018 raised more than 1.6 billion US dollars [6]. Despite of the Chinese experience[3], we believe that it is

[3] See Announcement of the People's Bank of China, the Office of the Central Leading Group for Cyberspace Affairs, the Ministry of Industry and Information Technology and Other Departments on Preventing the Financing Risks of Initial Coin Offerings

impossible to ban ICO because of it internet nature. Therefore, methods which are used by Singapore to regulate ICO deserve attention and should be analysed in the context of creation Russian draft law.

Despite of success in attracting investments via ICO Singapore does not have special legislation on ICO. The Securities and Futures Act (Cap. 289)[4] and Financial Advisers Act (Cap. 110)[5] and guidelines issued by Monetary Authority of Singapore (MOS)[6] constitute the legal basis for ICO regulation in Singapore. The par. 2 (1) of the Securities and Futures Act reads as follows: capital markets products means any securities, units in a collective investment scheme, derivatives contracts, spot foreign exchange contracts for the purposes of leveraged foreign exchange trading, and such other products as the Authority may prescribe as capital markets products. It means that ICO is under the scope of the MOS and legislation on securities and futures should be applied and there is no direct regulation under the SFA unless the currency is linked to an ownership or security interest in the issuers assets or property [9,12]. Notably, this approach allows regulate as ICO of security coins, but also cryptocurrency futures. In comparison, the Russian draft law "On Digital Financial Assets" contains provisions only about ICO of non public companies shares and does not fix any features associated with tokens - futures contracts.

If the ICO is supposed to be public, then under the Singaporean law it means that the issuer needs to prepare and register an issue prospectus, and disclose information about the person who seeks financing in this way. If the ICO falls under criteria of small offer pointed in the paragraph 272A of the Law on Securities and Futures an issuer need not prepare a prospectus that is registered by the Monetary Authority of Singapore. These provisions look like similar to the rules proposed by the Russian State Duma in the draft law.

There are special requirements to organizers of ICO in Singapore which are equal to the organizers of IPO on the traditional securities market. In its information the MAS pointed out that if

[4] URL: https://sso.agc.gov.sg/Act/SFA2001
[5] URL: https://sso.agc.gov.sg/Act/FAA2001

[6] A Guide to Digital Token Offerings 2017. URL: https://www.mas.gov.sg/regulation/explainers/a-guide-to-digital-token-offerings

the digital tokens constitute securities or futures contracts, the exchanges must immediately cease the trading of such digital tokens until they have been authorised as an approved exchange or recognised market operator by MAS. The issuer has ceased the offer and has taken remedial actions to comply with MAS' regulations. It has also returned all funds received from Singapore-based investors.[7] Thus, according to the provisions of the Securities and Futures Act and Financial Advisers Act ICO issuer shall obtain a license. Requirements for an application for obtaining these licenses are the same which are imposed to "traditional" participation of the financial market activities. They are submitted in accordance with the Guidelines on Criteria for the Grant of a Financial Adviser's Licence[8] and the Guidelines on Licence Applications, Representative Notification and Payment of Fees.[9] Moreover, if the issuer will consult investors on security or other financial products, he will be also required a license of a financial adviser.

Analysis of Singaporean legislation shows that ICO is regulated like traditional activity on the financial market if the tokens have a nature of securities or futures. This approach is more complicated than stipulated in the Russian draft law and allows to regulate crypto futures and other digital financial assets.

5. CONCLUSIONS

From the Russian draft law it is clear that Russia is going to treat digital financial assets as securities, and will regulate ICO only when tokens are deemed as shares. It means that a variety of other tokens, including those which are financial products, will be unregulated. Therefore, the draft law on Digital Financial Assets shall include provisions concerning all financial products: bonds, investment pies etc. Singaporean experience shows that it is real. Moreover, ICO operators and exchanges shall be treated the same way as participants of securities market, without extra requirements to their

[7] MAS warns Digital Token Exchanges and ICO Issuer [электронный ресурс]. URL: https://www.mas.gov.sg/news/media-releases/2018/mas-warns-digital-token-exchanges-and-ico-issuer

[8] Guidelines on Criteria for the Grant of a Financial Adviser's Licence (Guideline No. FAA-G01).

[9] Guidelines on Licence Applications, Representative Notification and Payment of Fees (Guideline No. CMG-G01).

address as included today in the named draft law.

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