

Investment Management and Private Funds: What's Happening Now

Blockchain, Cryptocurrency and ICOs

February 22, 2018

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Presentation Overview

- ▶ Bitcoin & Cryptocurrencies
 - Regulatory Update
 - Recent Developments
- ▶ Blockchain & Initial Coin Offerings
 - Regulatory Update
 - Recent Developments

Bitcoin, Cryptocurrencies and Tokens

Cryptocurrency/Altcoins Snapshot

#	Name	Market Cap	Price	Volume (24h)	Circulating Supply	Change (24h)	Price Graph (7d)
1	 Bitcoin	\$171,805,128,912	\$10,186.10	\$8,544,810,000	16,866,625 BTC	9.41%	
2	 Ethereum	\$91,877,732,404	\$941.04	\$2,858,010,000	97,634,766 ETH	3.02%	
3	 Ripple	\$45,088,021,942	\$1.16	\$1,607,370,000	39,009,215,838 XRP *	6.69%	
4	 Bitcoin Cash	\$23,691,109,310	\$1,396.12	\$513,833,000	16,969,250 BCH	3.84%	
5	 Litecoin	\$12,219,893,578	\$221.25	\$2,039,280,000	55,230,658 LTC	7.32%	
6	 Cardano	\$10,569,170,305	\$0.407650	\$354,292,000	25,927,070,538 ADA *	5.02%	
7	 Stellar	\$8,389,469,382	\$0.455021	\$109,559,000	18,437,543,283 XLM *	1.15%	
8	 NEO	\$8,032,830,000	\$123.58	\$225,041,000	65,000,000 NEO *	3.32%	
9	 EOS	\$6,859,058,265	\$10.22	\$418,826,000	671,219,543 EOS *	3.35%	
10	 IOTA	\$5,954,448,749	\$2.14	\$63,032,900	2,779,530,283 MIOTA *	8.62%	
11	 Dash	\$5,535,332,353	\$701.91	\$114,078,000	7,886,100 DASH	5.73%	

Regulatory Update

- ▶ CFTC: cryptocurrencies are commodities
- ▶ SEC: some cryptocurrencies/tokens are securities
- ▶ IRS: virtual currencies are property
- ▶ States: various licensing regimes may or may not be applicable – are you an issuer or a transmitter

Recent Developments

January

- ▶ CFTC charged three virtual currency operators with fraud
 - Cabbage Tech, Entrepreneurs Headquarters Ltd, My Big Coin
- ▶ CME and Cboe/CFE started trading Bitcoin futures
- ▶ Commissioner J. Christopher Giancarlo (CFTC) and Commissioner Jay Clayton (SEC) wrote op-ed in *Wall Street Journal* on cryptocurrency, blockchain and ICOs

Recent Developments

February

- ▶ Commissioners Giancarlo and Clayton spoke at hearing held by the U.S. Senate Committee on Banking, Housing and Urban Affairs
- ▶ CFTC hosted back-to-back panels on cryptocurrency, blockchain and their regulation
 - approved subcommittees devoted to cryptocurrencies and distributed ledger technology in finance
 - Brian Quintenz, a commissioner at the CFTC, encouraged the cryptocurrency industry to adopt self-regulating standards

Recent Developments

- ▶ CFTC viewed (rightly or wrongly) as more receptive toward token development than the SEC. The CFTC has anti-fraud enforcement power similar to the SEC's, but its reach into the crypto market is slightly more circumscribed.
 - Commissioner Giancarlo during the Senate hearing:
 - “Any proposed Federal regulation of virtual currency platforms should be carefully tailored to the risks posed by relevant trading activity and enhancing efforts to prosecute fraud and manipulation. Appropriate Federal oversight may include: data reporting, capital requirements, cyber security standards, measures to prevent fraud and price manipulation and anti-money laundering and 'know your customer' protections...Overall, a rationalized federal framework may be more effective and efficient in ensuring the integrity of the underlying market.”
 - "We owe it to this new generation to respect their enthusiasm for virtual currencies, with a thoughtful and balanced response, and not a dismissive one."

Blockchain & Initial Coin Offerings

Blockchain

- ▶ When separated from ICOs and cryptocurrency, the technology is viewed positively by regulators
 - Senate hearing:
 - Commissioner Giancarlo gave example of blockchain transaction where soybeans were sold by Dreyfus company to China
 - Commissioner Giancarlo: “distributed ledger technology has enormous potential”
 - Commissioner Clayton: “I hope people pursue it vigorously”

ICOs: How Much Money Was Raised

All-time cumulative ICO funding



Administrator Views

- ▶ Boom in ICO investments
 - Managers seeking the newest technology - returns
 - Strategies shifting to investing more towards ICO's and Pre-sales
- ▶ Monitor to ensure clients are adhering to PPM
 - Clients losing focus on investment objectives
- ▶ Side pockets – Used for Illiquid investments
 - Educate managers how side pockets work and why they are needed
- ▶ Valuation
 - Ensure there is a well thought out policy confirmed by both manager and audit partner – valued at cost (or below) or via a third party firm
- ▶ Fees (both management and performance)
 - Scrutiny around how fees are being calculated and collected for ICO investments

Regulatory Update

- ▶ ICOs and cryptocurrency viewed more skeptically than blockchain technology
- ▶ ICOs now generally considered security offerings – likely to be few, if any, utility tokens
- ▶ States are proposing their own regulations
 - Arizona: two bills introduced in the state legislature
 - A "virtual coin offering" is defined as any token sale where the token is treated as a security as defined by existing Arizona law. Tokens which are not marketed as investments and which the purchaser can utilize or redeem within 90 days would not fall within that definition and would not be securities.
 - Wyoming: four bills introduced to the state legislature
 - A developer or seller of a token will not be considered the issuer of a security if the token has not been marketed as an investment, the token can be exchanged for goods or services, and the seller has not entered into a repurchase agreement or an agreement to locate a buyer for the token.

Recent Developments

December

- ▶ PlexCoin
 - SEC's new Cyber Unit filed charges against Dominic Lacroix and PlexCoins, stating that the ICO was a scam.
- ▶ SEC Chairman Jay Clayton: Statement on Cryptocurrencies and Initial Coin Offerings
 - “Merely calling a token a “utility” token or structuring it to provide some utility does not prevent the token from being a security. Tokens and offerings that incorporate features and marketing efforts that emphasize the potential for profits based on the entrepreneurial or managerial efforts of others continue to contain the hallmarks of a security under U.S. law. ”
 - “By and large, the structures of initial coin offerings that I have seen promoted involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws. Generally speaking, these laws provide that investors deserve to know what they are investing in and the relevant risks involved.”

Recent Developments

- ▶ Munchee: SEC contacted Munchee and shut down its ICO. Munchee did not deliver any tokens and returned the proceeds to investors. 2 major issues were identified by the SEC:
 - Investors could expect a return
 - “Munchee published a blog post on October 30, 2017 that was titled “7 Reasons You Need To Join The Munchee Token Generation Event.” Reason 4 listed on the post was “As more users get on the platform, the more valuable your MUN tokens will become” and then went on to describe how MUN purchasers could “watch[] their value increase over time” and could count on the “burning” of MUN tokens to raise the value of remaining MUN tokens.”
 - Trading on a secondary market
 - “Munchee intended for MUN tokens to trade on a secondary market. In the MUN White Paper, Munchee stated that it would work to ensure that MUN holders would be able to sell their MUN tokens on secondary markets, saying that “Munchee will ensure that MUN token is available on a number of exchanges in varying jurisdictions to ensure that this is an option for all token-holders.”

Recent Developments

January

- ▶ Op-ed in Wall Street Journal on cryptocurrency, blockchain and ICOs
 - “Through statements, reports and enforcement actions the SEC has made it clear that federal securities laws apply regardless of whether the offered security—a purposefully broad and flexible term—is labeled a “coin” or “utility token” rather than a stock, bond or investment contract.”
- ▶ SEC halted ICO of AriseBank
 - Court approved an emergency asset freeze of AriseBank and its co-founders

Recent Developments

February

- ▶ Senate Hearing – Commissioner Clayton on ICOs
 - “These offerings can take different forms, and the rights and interests a coin is purported to provide the holder can vary widely. A key question all ICO market participants - promoters, sellers, lawyers, officers and directors and accountants, as well as investors - should ask: “Is the coin or token a security?” As securities law practitioners know well, the answer depends on the facts. But by and large, the structures of ICOs that I have seen involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws. As noted above, the foundation of our federal securities laws is to provide investors with the procedural protections and information they need to make informed judgments about what they are investing in and the relevant risks involved. In addition, our federal securities laws provide a wide array of remedies, including criminal and civil actions brought by the DOJ and the SEC, as well as private rights of action.”

Recent Developments

February

- ▶ Senate Hearing – Commissioner Clayton on ICOs
 - “A note for professionals in these markets: Those who engage in semantic gymnastics and elaborate structuring exercises...are squarely in the cross-hairs of our enforcement division.”
 - Also raised the possibility of needing additional legislative authority

Tax Issues

- ▶ Taxable Income
 - The proceeds of an ICO are likely considered taxable income by the IRS
- ▶ Virtual Currency
 - The IRS considers the sale or exchange of virtual currency, or the exchange of virtual currency for goods or services, to be a taxable event

Questions & Answers

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- ▶ concentrates his practice in securities law, particularly in representing investment management companies and other clients on matters arising under the Investment Company Act of 1940 and the related Investment Advisers Act of 1940
- ▶ represents hedge funds and other alternative investment funds in fund formation and investment and compliance matters, including compliance audits and preparation work
- ▶ writes and speaks frequently on issues involving investment management, health care and other matters, and is the author of five books on hedge funds, the most recent published in February of 2018



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- ▶ advises on technology transactions and provides general counseling around technology and intellectual property commercialization, including as part of the cross-disciplinary legal services offered under the Technology Group and Pepper's Emerging Company Program
- ▶ a technology enthusiast and avid follower of the industry and related legal trends, including the developments around internet of things (IoT), distributed ledger technology and smart contracts, and machine learning in FinTech, health care technology and a wide range of other industry applications



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- ▶ concentrates his practice in securities and derivatives law and related regulatory matters
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- ▶ advises U.S. and international public and private companies, and private equity, venture capital and blockchain-based clients, in connection with public and private securities-related transactions, mergers and acquisitions, corporate governance and other significant corporate matters
- ▶ prior to joining Pepper, was an associate at an international law firm, where she represented U.S. and European companies in their initial public offerings on U.S. and European stock exchanges, and investment banking clients in various capital markets transactions



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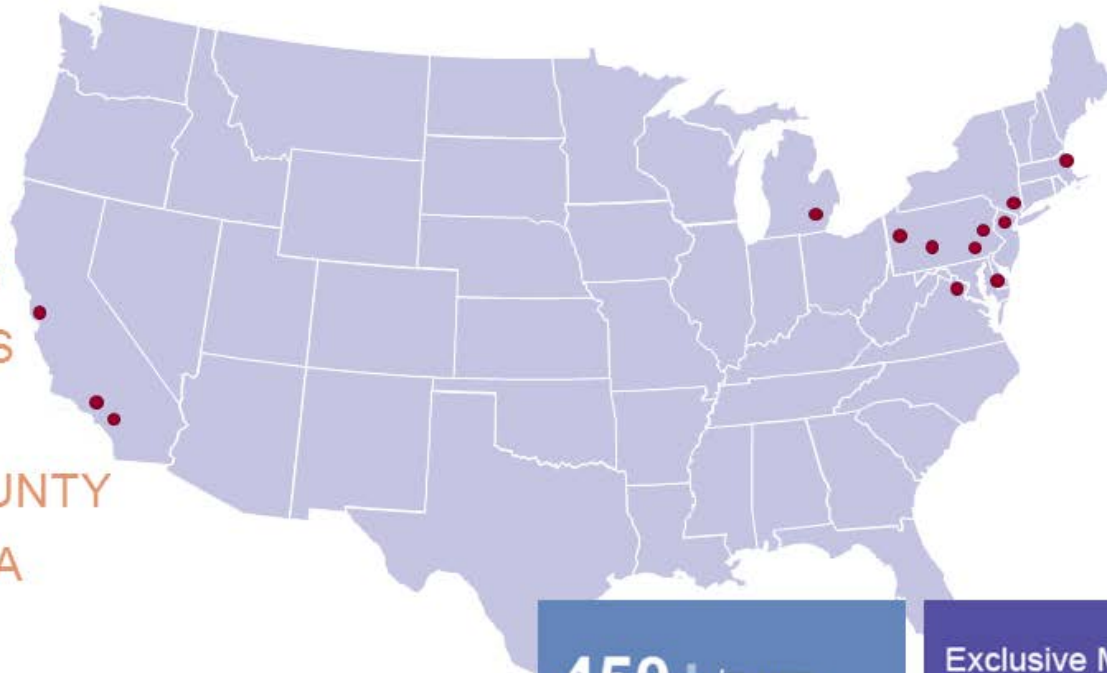
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- ▶ has 20 years' experience in the Financial Services sector having held multiple roles in Accounting, Operations and Relationship Management
- ▶ holds a BBA in Accounting and an MBA in Finance. David focuses on supporting and growing relationships with Trident's investment fund clients



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