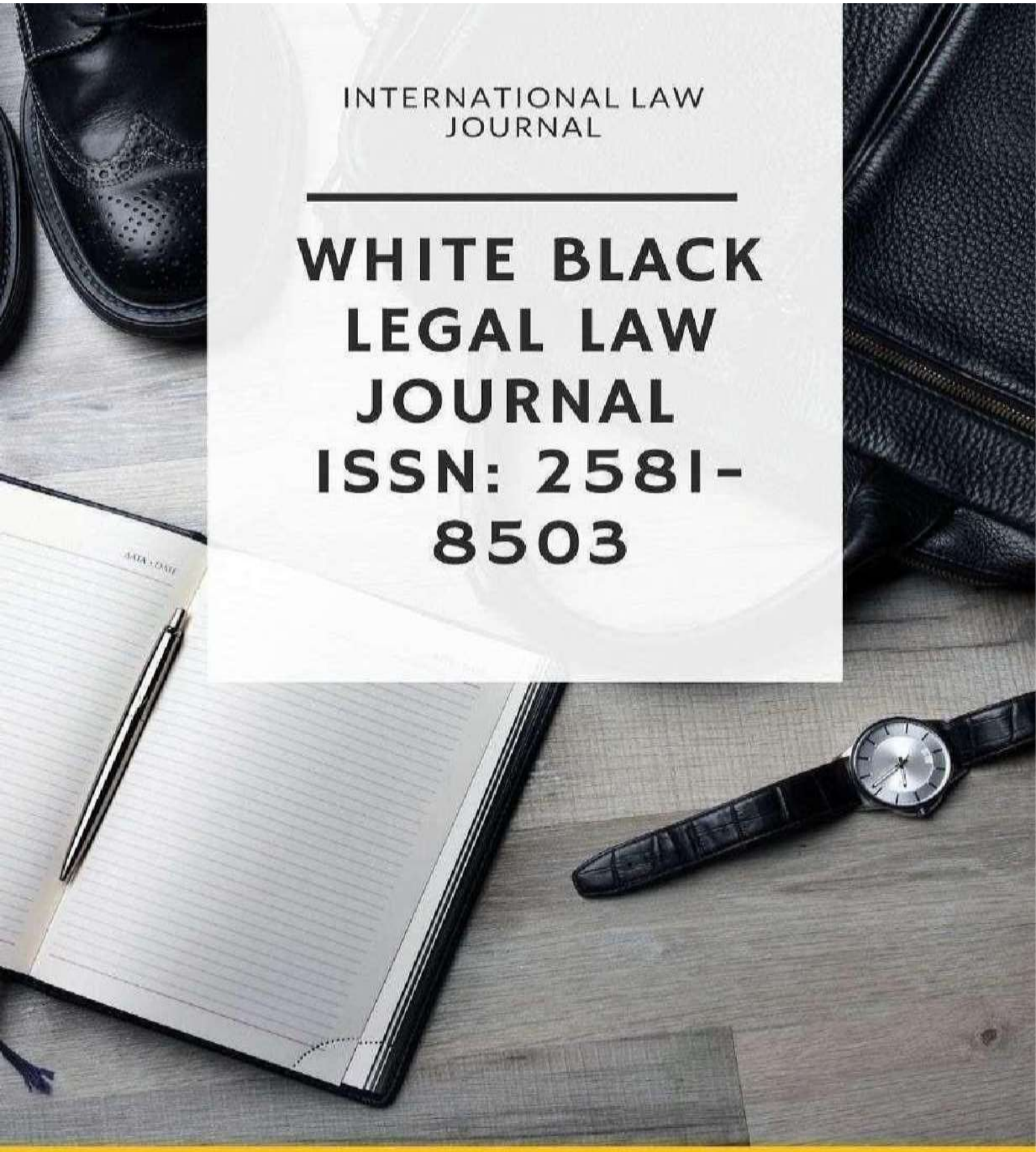

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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

INITIAL COIN OFFERING AND REGULATORY SANDBOX: ISSUES AND CHALLENGES

AUTHORED BY - KESHAV AGARWAL

ABSTRACT

Initial Coin Offerings (ICOs) have emerged as a novel fundraising mechanism within the cryptocurrency ecosystem, presenting unique challenges to regulatory frameworks worldwide. Amidst increasing concerns about transparency and investor protection, regulatory sandboxes have been proposed as a flexible approach to accommodate innovation while safeguarding against potential risks. This research paper delves into the intersection of ICOs and regulatory sandboxes, focusing on transparency as a critical issue and challenge.The paper begins by examining the fundamental concepts of ICOs and regulatory sandboxes, delineating their respective roles in fostering innovation and maintaining regulatory oversight. It then highlights the importance of transparency in ICOs, elucidating the implications of opacity on investor confidence and market integrity.

Furthermore, the paper evaluates the effectiveness of regulatory sandboxes in addressing transparency challenges within the ICO ecosystem. Through comparative analysis and case studies, it explores the experiences of jurisdictions that have implemented regulatory sandboxes for ICOs, assessing the impact on transparency and regulatory compliance.Moreover, the research identifies key obstacles and limitations hindering the attainment of transparency within regulatory sandboxes for ICOs. These include issues related to data privacy, regulatory ambiguity, and the balance between innovation and investor protection.

INTRODUCTION

The emergence of blockchain technology and cryptocurrencies has heralded the advent of initial coin offerings (ICOs) as a novel fundraising avenue, particularly favored by startups seeking capital infusion. Essentially, ICOs enable companies to generate their own digital tokens or currencies, often leveraging blockchain technology, as a means to secure investment from initial backers. This departure from traditional fundraising methods such as venture capital or initial public offerings (IPOs) signifies a more accessible and democratized approach to raising funds.

However, the exponential growth of ICOs has presented a plethora of challenges for regulatory bodies worldwide. Governments and regulatory authorities have grappled with crafting appropriate frameworks to govern ICOs, with approaches ranging from outright bans to establishing ICO-friendly environments. The overarching goal is to strike a delicate balance between fostering innovation and ensuring investor protection. Achieving regulatory clarity is paramount for the legitimacy and sustainability of ICOs, as it aids in distinguishing bona fide projects from fraudulent schemes, while also instilling confidence and providing security for all stakeholders involved.

Countries that proactively and effectively regulate ICOs and digital currency exchanges (DCEs) are poised to attract a larger pool of investors. A robust regulatory framework not only mitigates risks associated with ICO participation but also fosters investor trust and market integrity. Moreover, a well-regulated crypto ecosystem has the potential to integrate cryptocurrencies into mainstream finance, thereby fueling the broader adoption and evolution of blockchain technology and its myriad applications.The exponential growth of ICTs presents major threats to users' right to privacy and the integrity of their data. In light of these risks, the right to data privacy has emerged as a basic human right with the aim of regulating the treatment of individually identifiable information and protecting the interests of the person to whom the data belongs (the data subject). Information that pertains to or may be used to identify a particular living individual is considered personal data. The data or information doesn't have to be secret. While the collection of personal

information by private organizations and government agencies is nothing new, the advent of new technologies has increased the risk to individuals' privacy. Because of technological advancements, it is now much easier to store vast amounts of data, modify data in real time, and transfer data with the click of a mouse.[1] A breach or violation may occur without the data subject even realizing it.

Thus, unrestrained data processing may facilitate violations of human rights, including those pertaining to privacy, dignity, security of person, discrimination, and justice. The widespread dissemination of private data has led to an increase in crimes such identity theft, phishing, fraud, monetary theft, harassment, and stalking. The misuse of private information may potentially lead to widespread violations of human rights.[2] During the Rwandan genocide, for instance, hundreds of Tutsi were killed just because their tribe was included on their identification documents. Therefore, there must be regulations in place to protect people's privacy in the present day.[3] While privacy protections were developed first in the West, the proliferation of ICTs has brought these problems to developing countries like Malawi.

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[2] Esma Aimeur and David Schonfeld, 'The Ultimate Invasion of Privacy: Identity Theft' (Ninth Annual International Conference on Privacy, Security and Trust 2011).

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REGULATIONS OF ICO

The sentiment towards stronger regulation within the blockchain community is often met with skepticism by a significant portion of its members. This skepticism stems from the foundational principles of decentralization, which were originally conceived to challenge centralized authorities and regulatory oversight (Trudex, 2018). However, there's a growing recognition, as articulated by Interviewee III (2018), that unregulated environments may no longer be conducive to sustainable growth. Instead, there's a shift towards favoring regulated markets, particularly for serious ICO projects (Interviewee III).

Transparent policies and clear regulations, as advocated by Trudex (2018), serve to legitimize crypto activities and mitigate the prevalence of scams in the ecosystem. Interviewee III (2018) further posits that such legitimacy can attract new capital from institutional investors, potentially accelerating innovation within the sector.

Following their summit in March 2018, the G20, a global regulatory body responsible for banking and market reforms post the financial crisis, announced a shift in focus towards reviewing existing regulations rather than developing new ones specifically for cryptocurrencies and ICOs. This stance was reaffirmed by the Financial Stability Board (FSB), which oversees financial supervision for the G20 economies. Despite requests from some G20 members for global regulation of cryptographic currencies and tokens, the FSB rejected such calls (G20, 2018).

In a statement released on March 18, 2018, Mark Carney, Chairman of the FSB, clarified that crypto assets currently pose no significant risks to global financial stability. This assessment is primarily attributed to their relatively small size, which is insignificant compared to the global financial system. Even at their peak market value, crypto assets' combined global market value remains below 1% of global GDP. Additionally, their limited use as a substitute for traditional currencies and their restricted involvement in financial and economic transactions further mitigates their systemic impact (FSB, 2018).

At the national level, various efforts are underway to regulate ICOs, reflecting diverse approaches to managing cryptocurrencies and token issuance. EY's research in 2017 indicates that different countries adopt different strategies in this regard. Some jurisdictions opt to regulate ICOs using existing laws, while others develop new guidelines specifically tailored to ICOs, actively supporting blockchain and ICO initiatives.Across different regions, regulatory approaches vary from active discussions and warnings to no formal stance at all. While there isn't a jurisdiction where ICOs are entirely exempt from regulation, there are areas where ICOs face outright bans (EY, 2017).

However, Interviewee I (2018) highlights that it's not only governments and regulatory bodies showing interest in regulating ICOs; the ICO industry and issuing companies themselves are actively seeking clear regulations. This motivation has spurred the establishment of various non-profit organizations, such as the Crypto Valley Association (CVA) in Switzerland. Founded in early 2017, the CVA aims to foster the development and adoption of cryptographic technologies, blockchain, and other Distributed Ledger Technologies (DLTs) by supporting startups and companies both domestically and internationally.Comprising members from the crypto asset industry, the CVA launched a code of conduct for ICOs in Switzerland in January 2018. This initiative seeks to establish a framework guiding ICOs to ensure proper conduct and compliance with legal, moral, and safety obligations (Becker, 2018). Interviewee I (2018) suggests similar efforts are observable in many countries. For instance, in the UK, CryptoUK, a cryptocurrency trading company formed by seven major crypto firms, was established. CryptoUK's mission is to advocate for best practices and collaborate with regulators to achieve self-regulation within the sector. All members commit to a code of conduct, which mandates compliance with ethical principles and enhanced due diligence to more effectively prevent illegal activities (Murphy, 2018).

Interviewee II (2018) emphasizes that legal certainty and understanding how regulators treat tokens are paramount, outweighing the importance of ICO- friendly regulations. Legal ambiguities surrounding cryptocurrencies, including ICOs, pose significant challenges for token developers. According to Hacker and Thomale (2017), the categorization of funds raised through ICOs varies depending

on the ICO's structure. Crowdfunding regulations may not directly apply to ICOs since investors don't always lend money to the issuer of a digital currency.The acquisition of ICO-related tokens can be interpreted as purchases of commodities, rights, or securities, potentially subjecting ICOs and their whitepapers to prospectus or disclosure requirements (Hacker and Thomale, 2017). Such regulatory disparities create substantial uncertainty for ICO projects. Moreover, ICOs face susceptibility to money laundering and terrorist financing due to transaction anonymity and the ability to amass large sums rapidly (Emtseva and Morozov, 2018).

The subsequent chapters delineate the regulatory strategies of Switzerland, the USA, UK, Gibraltar, and Singapore regarding cryptocurrencies and ICOs. As noted by Interviewee I (2018), the crypto asset industry remains in its nascent stages and is subject to rapid evolution. Therefore, this study provides a snapshot analysis as of the first quarter of 2018. Each chapter systematically examines the regulatory landscape within the respective countries, focusing on key regulatory bodies and pertinent issues. The analysis concludes with an assessment of strengths and weaknesses inherent in each regulatory approach, along with a forward-looking perspective on future regulatory endeavors. This includes an exploration of opportunities and risks that may shape the regulatory trajectory of these jurisdictions moving forward.

SWITZERLAND

Switzerland has become a leading destination for ICOs and cryptocurrency ventures due to its supportive regulatory framework and thriving ecosystem. The Swiss approach is known for its flexibility and clarity, with the Swiss Financial Market Supervisory Authority (FINMA) taking a pragmatic stance on ICOs. Instead of imposing strict rules, FINMA focuses on assessing the substance of each ICO to determine its regulatory classification.

In early 2018, FINMA released guidelines that classify tokens issued through ICOs into three categories: payment tokens, utility tokens, and asset tokens. These guidelines have provided much-needed clarity for ICO projects operating in Switzerland. Additionally, Switzerland's Crypto Valley, centered around Zug,

fosters collaboration among industry players and supports startups. The Crypto Valley Association (CVA) plays a key role in advocating for favorable regulations and promoting the growth of the blockchain ecosystem. Switzerland's business- friendly tax policies and political stability further contribute to its attractiveness as a hub for blockchain and cryptocurrency companies. However, challenges remain, particularly regarding money laundering and terrorist financing risks associated with cryptocurrencies. Efforts are underway to enhance anti-money laundering (AML) and know-your-customer (KYC) procedures to address these concerns while maintaining Switzerland's status as a crypto-friendly jurisdiction.

SWISS FINANCIAL MARKET SUPERVISORY AUTHORITY

The Swiss Financial Market Supervisory Authority (FINMA) is the primary regulatory body overseeing financial activities in Switzerland. Established in 2007, FINMA is responsible for supervising banks, insurance companies, securities dealers, collective investment schemes, and other financial intermediaries to ensure the stability and integrity of Switzerland's financial system.FINMA operates independently and autonomously, with its mandate outlined in the Swiss Financial Market Supervision Act (FINMASA). Its primary objectives include protecting creditors, investors, and policyholders, as well as ensuring the proper functioning, integrity, and competitiveness of the Swiss financial markets.

One of FINMA's key roles is the regulation of ICOs (Initial Coin Offerings) and cryptocurrencies. In 2018, FINMA released guidelines outlining how it would classify different types of tokens issued through ICOs, providing clarity and guidance for businesses operating in this space. These guidelines distinguish between payment tokens, utility tokens, and asset tokens, helping to define the regulatory treatment of each type of token.FINMA's approach to ICO regulation is known for its pragmatism and flexibility, focusing on the substance of each offering rather than imposing strict rules. This approach has contributed to Switzerland's reputation as a favorable jurisdiction for ICOs and cryptocurrency ventures.

FINMA differentiates between:

- Payment tokens, commonly known as cryptocurrencies, serve as a medium of exchange for goods and services, akin to digital currency like Bitcoin. Regulatory attention for payment tokens typically centers around anti- money laundering (AML) regulations and know-your-customer (KYC) requirements, as highlighted by FINMA (2018b).
- Utility tokens, also referred to as app tokens, offer users functional utility such as access to a specific application, service, or platform. These tokens are often built using smart contract standards on platforms like Ethereum and are exempt from certain regulatory considerations. However, FINMA (2018b) notes that utility tokens may be reclassified as asset tokens if the associated application is not yet developed.
- Asset tokens encompass tokens representing an investment component, which could entail ownership in a company, cash flow rights, or underlying physical assets. The economic functions of asset tokens resemble traditional financial instruments like shares or bonds. While asset tokens may be categorized as uncertified securities under Swiss law, this classification typically applies to public offerings by third parties and secondary market trading, as outlined by FINMA (2018b).

According to the ICO guideline by FINMA (2018b), tokens can fall into multiple categories, known as hybrid tokens, as their classification is not mutually exclusive. For instance, a token could simultaneously serve as both a security and a means of payment. In such cases, regulatory requirements for both securities and payment methods would apply. Additionally, FINMA emphasizes that the function of a token may evolve over time, leading to potential changes in its classification. Apart from considering the economic function of tokens, FINMA also recognizes different phases of development. These phases include the conceptual, prototype, and operational stages. Understanding the developmental stage of a token project helps regulators assess its regulatory status more effectively and tailor oversight accordingly.

- Conceptual Phase: Tokens in this phase are still at the conceptual stage, where the project is being planned and developed. During this phase,

regulatory scrutiny may be limited as the project has not yet been fully realized.

- Prototype Phase: In the prototype phase, the project has progressed beyond the conceptual stage, and a prototype or minimum viable product (MVP) has been developed. This phase involves testing and refining the product or service, but it may not be fully functional or available to the public yet.
- Operational Phase: Tokens in the operational phase are fully functional and available to the public. The project has been launched, and users can access and use the platform or service as intended. This phase typically attracts greater regulatory attention as the project is actively engaging with users and the market.

TABLE 1 : OVERVIEW OF THE FINMA GUIDELINES

This table summarizes the ICO guidelines published by FINMA in February 2018. It indicates which regulations are relevant for each token in each phase. A dash indicates that there is no regulation in general. Own representation based on MME (2018c).

	PAYMENT TOKEN	**UTILITY TOKEN**	**ASSET TOKEN**
Pre-financing	- / Securities[5]	- / Securities[5]	- / Securities[5]
Pre-sale/ Voucher phase	- / Securities[5]	- / Securities[5]	- / Securities[5]
Pre-operational phase	AML / KYC	- / Securities[6]	Securities
Operational phase	AML / KYC	- / Securities[6]	Securities

DEPOSITORY REGULATIONS IN SWITZERLAND

The Banking Act (BA) serves as the cornerstone of deposits regulation in Switzerland, embodying the nation's commitment to safeguarding the interests of bank customers and ensuring the security of their deposited funds. The BA, enacted to maintain the stability and integrity of the Swiss banking system, establishes a comprehensive regulatory framework that governs various aspects of deposit-taking activities within the country.

Underpinning the BA is the principle of public protection, which forms the bedrock of Switzerland's approach to regulating deposits. The BA sets forth stringent standards and safeguards aimed at upholding the safety and reliability of banking services, thereby instilling confidence among depositors in the Swiss banking sector. Through its provisions, the BA seeks to mitigate risks associated with deposit-taking activities and uphold the trust and credibility of Swiss financial institutions.

Determination of Deposits

- Repayment Claims: Deposits, in essence, entail repayment claims against the deposit-taking institution. Traditional deposit arrangements involve customers entrusting their funds to a bank with the expectation of repayment upon demand or according to agreed-upon terms. However, in the context of emerging financial instruments such as tokens issued through Initial Coin Offerings (ICOs), the determination of whether such instruments qualify as deposits necessitates careful examination. Tokens issued through ICOs may not automatically be deemed deposits if they lack explicit repayment obligations to the holders. In other words, if the tokens do not confer upon their holders the right to claim repayment from the issuer or deposit-taking institution, they may fall outside the scope of traditional deposit arrangements governed by the BA.

- Liability Nature: The classification of tokens as deposits may hinge on their inherent liability nature. Tokens that provide holders with liabilities resembling debt obligations, such as promises of guaranteed returns or fixed interest payments, may be subject to regulatory scrutiny under the BA. In

such cases, where tokens exhibit debt-like characteristics, they could be construed as instruments of deposit-taking, triggering the application of regulatory requirements prescribed by the BA.

REGULATION OF ICO'S IN VARIOUS COUNTRIES:

1. United States:

In the United States, ICOs are subject to oversight from regulatory bodies such as the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). While these agencies primarily focus on investor protection and market integrity, concerns about privacy and disclosure in ICOs have also surfaced. Given the decentralized and often anonymous nature of cryptocurrency transactions, ensuring adequate privacy protections for investors' personal information poses a challenge. Additionally, ICO issuers may face challenges in disclosing comprehensive and accurate information to investors, raising concerns about transparency and investor confidence.

2. **Canada**:

Canada's regulation of ICOs falls under the Canadian Securities Administrators (CSA), comprising provincial and territorial securities regulators. Similar to the US, privacy and disclosure concerns are pertinent in the Canadian ICO landscape. Ensuring adequate privacy protections for investors' personal data and providing transparent disclosures about the ICO project's structure, risks, and objectives are crucial for maintaining investor trust and market integrity.

3. Australia:

In Australia, the Australian Securities and Investments Commission (ASIC) oversees ICO regulation. While ASIC primarily focuses on investor protection and market integrity, privacy and disclosure concerns also play a significant role. ICO issuers are expected to provide clear and transparent disclosures to investors, including information about the project's governance, use of funds, and potential risks. Additionally, ensuring compliance with privacy regulations to protect

investors' personal data is essential in maintaining trust and confidence in the ICO market.

4. Other Jurisdictions:

Various countries, including Singapore, Japan, and members of the European Union, have implemented regulations or guidance on ICOs. Privacy and disclosure concerns are universal in the ICO landscape, with regulators emphasizing the importance of transparent and accurate disclosures to investors. Additionally, ensuring adequate privacy protections for investors' personal data is a key consideration in regulatory frameworks aimed at safeguarding investor interests and market integrity.

EPILOGUE – BLOCKCHAIN LEADING TO OVER- TRANSPARENCY

Blockchain technology has emerged as a potent tool for enhancing transparency and accountability across various sectors. However, as blockchain adoption proliferates, concerns have surfaced regarding the phenomenon of over- transparency. This chapter delves into the concept of over-transparency within the realm of blockchain technology, examining its ramifications and complexities.

UNDERSTANDING OVER-TRANSPARENCY

Over-transparency denotes a scenario where the transparency facilitated by blockchain technology surpasses what is deemed necessary or optimal for specific applications or industries. While transparency is generally perceived positively, excessive transparency can yield unintended consequences such as privacy breaches, security vulnerabilities, and information overload.

IMPLICATIONS OF OVER-TRANSPARENCY

1. Privacy Concerns:

Over-transparency raises significant concerns about compromising individual privacy. The inherent transparency of blockchain entails that all transactions are openly recorded on a public ledger, potentially exposing sensitive personal data to anyone with network access, thereby increasing the risk of privacy infringements and identity theft.

2. Security Risks:

Excessive transparency can also engender security risks within blockchain systems, particularly in public blockchains vulnerable to attacks like 51% attacks and privacy leaks. Relying excessively on transparency without commensurate security measures can undermine the reliability and integrity of blockchain networks, heightening the susceptibility to security breaches.

3. Regulatory Challenges:

Over-transparency poses notable challenges for regulatory compliance, especially in sectors subject to stringent privacy and data protection regulations. Achieving compliance with regulations like the General Data Protection Regulation (GDPR) becomes intricate when dealing with transparent blockchain systems, necessitating a delicate balance between data privacy, transparency, and regulatory compliance.

4. Information Overload:

The copious data generated by transparent blockchain systems can lead to information overload, hindering users' ability to derive meaningful insights from the extensive dataset. Absent effective tools for data filtration and analysis, over- transparency can impede decision-making and productivity, diminishing the efficacy of blockchain technology.

ADDRESSING OVER-TRANSPARENCY

1. Privacy-Enhancing Technologies:

Integration of privacy-enhancing technologies (PETs) into blockchain systems can mitigate privacy concerns arising from over-transparency. Techniques like zero-knowledge proofs and ring signatures enable secure and private transactions on blockchain networks while preserving transparency.

2. Regulatory Frameworks:

Regulatory bodies and policymakers must formulate clear and adaptable regulatory frameworks that strike a balance between transparency and privacy in blockchain applications. These frameworks should offer guidance on data protection, identity verification, and adherence to regulatory standards, fostering innovation while upholding privacy rights.

3. User Education and Awareness:

Educating blockchain users on the implications of over-transparency and the significance of privacy protection is pivotal for promoting responsible blockchain adoption. Empowering users with knowledge about privacy-preserving tools and best practices can help mitigate privacy risks and cultivate a privacy-conscious blockchain ecosystem.

CONCLUSION

In conclusion, while blockchain technology affords substantial benefits in terms of transparency and accountability, over-transparency can pose challenges to privacy, security, and regulatory compliance. Striking a delicate balance between transparency and privacy is imperative to harness the full potential of blockchain while mitigating associated risks. By addressing these challenges through technological innovation, regulatory guidance, and user education, stakeholders can leverage blockchain's transformative capabilities while safeguarding individual privacy rights and fortifying the security and trustworthiness of blockchain networks.

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