

Initial Coin Offerings: the latest way for startups to attract investors

Launching an ICO instead of a more conventional investment method allows startups to be more creative, **Andrei Vella** and **Alexia Valenzia** from **Camilleri Preziosi Advocates**, say.

startups are typically well placed to be innovation forerunners though such quest may be smothered by a notorious lack of access to capital.

While in this respect, in recent years we have seen the start of a potential paradigm shift through the onset of crowdfunding and angel investment models, startups remain anathema to traditional financing methods.

An issue that invariably arises when obtaining capital using these methods is that the borrower is unable to substantiate its request for financing by virtue of historical financial performance or at times, to provide collateral for the loan.

Initial Coin Offerings (ICOs) are a new and alternative source of funding which allow startups to approach their customers directly, without the need to obtain a loan from an intermediary institution.

ICOs use blockchain technology to receive funding through cryptocurrency invested by backers. In exchange for this investment, backers will receive digital tokens issued by the startup and these tokens usually provide a benefit to the backer. The type of benefit received is determined at the discretion of the startup.

Unlike investments generated through crowd funding, backers of ICOs have a vested interest in the tokens' success as they are guaranteed to receive a form of return on their investment. Therefore, there is a higher incentive for backers to increase their returns.

It is pertinent to note, however, that although no jurisdiction has yet implemented a regulatory framework specific to ICOs, regulators globally are increasingly focused on them. Although ICOs have various parallels with initial public offerings and similar activ-

ities, digital tokens are currently unregulated under Maltese Law as they are not considered to be 'securities' as defined by the Listing Rules. However, they may still fall into this regulatory perimeter, depending on how they are structured.

To this end, issuers and participants in ICOs are urged to assess whether the proposed activity may be deemed to constitute, for example, deposit-taking or e-money issuance, whilst also being mindful of applicable anti-money laundering regulations.

The uncertainty surrounding ICO classification not only requires issuers and participants in ICOs to keep abreast with regulatory developments and be alert to activities which may be captured within the regulatory net, but also gives rise to a number of legal issues. Unlike the issuance of shares in traditional fundraising activities, the is-



suance of digital tokens permits the backer to invest in the startup without actually owning a share in it. The startup and backer have no fiduciary relationship and, therefore, the backer is able to withdraw from the ICO at any time.

Presently, there are no rules which regulate the sanctions that could be imposed on a backer who terminates his investment prematurely. That said, launching an ICO instead of a more conventional investment method allows startups to be more creative in their ventures as they are free to decide on the way in which they are going to attract their backers.

Carried out correctly, ICOs have the potential to raise large funds in short periods of time while enabling startups to maintain full ownership of the company. Left unregulated, ICOs are prone to business failures and frauds, which is why specific regulation around ICOs is high on the regulators' agenda. This notwithstanding, the hope is that regulators will choose to promote ICOs with appropriate checks and balances, rather than taking a strict approach which would stifle the growth of this novel fundraising process.

(Content provided by **Camilleri Preziosi Advocates**)