

Call for Rule-making on ICO

Proposal by ICO Business Research Group

April 5, 2018

Center for Rule-making Strategies
Tama University

I. Preface

In recent years, ICO (Initial Coin Offering), which is a means of issuing tokens in exchange for cryptocurrency, has been drawing a great deal of attention as a new way of capital raising and investment. However, it should be noted that the legal position of ICO is unclear and tax/accounting issues related to ICO remain in a large scale. In some cases, measures for investor protection are not sufficient. Such issues are considered problematic throughout the world.

ICO is still in its infancy and has no industry practices yet. Appropriate rules must be set to enable ICO to obtain public trust and to expand as a sound and reliable financing method. Based on a shared awareness of this necessity, financial institutions, non-financial companies, and venture companies have co-founded the ICO Business Research Group. This report proposes rules needed to establish ICO as a sustainable financing method based on discussions conducted by the research group.

II. Members of the Research Group

The members of the Research Group consist of experts from various industries and specialized fields. The members conducted discussions from November 2017 to March 2018.

| | |
|--------------------------|--|
| Chair: | Toshifumi Kokubun, Professor, Tama Graduate School of Business; Managing Director, Center for Rule-making Strategies |
| General Adviser: | Takuya Hirai, Member of the House of Representatives / Chairman, Special Mission Committee on IT Strategy, LDP |
| Head of the Secretariat: | Yasuyuki Ogyu, Director, Deloitte Tohmatsu Consulting LLC |

Expert Advisers

| | |
|----------------------------|--|
| Legal Adviser: | So Saito, Representative lawyer, So Law Office |
| Accounting / Tax Advisers: | Toshikazu None, Partner, Deloitte Touche Tohmatsu LLC and Yukinori Fujii, Partner, Deloitte Tohmatsu Tax Co. |
| Technical Adviser: | Yuzo Kano, Co-Founder and CEO, bitFlyer, Inc. |

Member companies (in alphabetical order)

CrowdWorks Inc

Dai-ichi Life Holdings, Inc.

Daiwa Securities Group Inc.

GMO Payment Gateway, Inc.

JTB Corp.

Mitsubishi UFJ Financial Group, Inc.

Mizuho Financial Group, Inc.

Nomura Holdings, Inc.

NTT DOCOMO, INC.

Sumitomo Mitsui Financial Group, Inc.

SUMITOMO CORPORATION

Tokyo Electric Power Company Holdings, Inc.

VOYAGE GROUP Inc.

III. Definition of terms

In this report, terms are defined as follows:

- Token : A unit of value which is electronically issued by an issuer to an investor in exchange for payment of cryptocurrency
✓ The paid cryptocurrency does not need one of those defined in the Payment Services Act
- Listing : An act of including a token in the list of tokens that can be traded at a cryptocurrency exchange
- Preliminary sales : An act of issuing tokens to investors before they are listed

Of the acts of issuing tokens to many unspecified investors in exchange for payments of cryptocurrency, ICO refers to the initial issuance of a token (in many cases, when a token is listed at a cryptocurrency exchange) in the strict sense. In this report, however, ICO refers to all financing activities using a cryptocurrency, including preliminary sale activities.



In this report, all financing activities using a cryptocurrency are referred to as “ICO”
= “ICO” in a broad sense

IV. Potential ICO use cases

Currently, the main entities (issuers) conducting ICO are Internet-related venture companies or projects. However, there is a possibility that issuers, purposes and schemes of ICO deals will diversify in the future. Though it is difficult at present to classify whole ICO since many forthcoming but unknown types might exist, there are three potential ICO use cases for the future from the view point of issuers. Of course, these are just use case examples that can be assume at this point and we do not intend to exclude the possibility of the emergence of other new usages in the future.

Currently, main entities (issuers) conducting ICO are:

Pattern 1: Venture Company Type

- Concept: Fund-raising by venture companies through high-risk, high-return investments
- Potential issuers: Small venture companies that have difficulty in access to incumbent capital market, or venture capitals
(E.g.) Local companies
- Potential investors: Investors who are looking for high-risk, high-return investment opportunities other than common equities

Pattern 2: Ecosystem type

- Concept: Fund-raising for collaborative efforts in which multiple corporations such as companies and local governments are engaged
- Potential issuers: Combinations of companies or alliances of companies and local governments that are making concerted efforts to form a new

market through an ecosystem

(E.g.) Hydrogen society initiatives, construction of human rights-conscious supply chains, emissions trading

Potential investors: Companies that wish to participate in an ecosystem when the market is formed (companies which own tokens are entitled to receive an option to participate in the ecosystem with advantageous terms)

Pattern 3: Large company type

Concept: Fund-raising by companies for certain in-house projects with high risk

Potential issuers: Companies that operate high-risk businesses for which feasibility is difficult to evaluate, or those that try to find ways to vitalize buried in-house assets such as technologies
(E.g.) Development of new products, creation of contents such as video game soft

Potential investors: Investors who expect to receive special offer from companies or those who want to express their support or sympathy for projects

V. Proposal on rule-making

For the permeation and development of ICO, it would be desirable to set rules on “issuance of tokens” and “trading of tokens in the issue market.” As for the purchase and sale of tokens in the trading market, there are certain rules set force in the Payment Services Act. However, there are no laws or regulations stipulating explicit rules for issue markets, which leads to cases of misunderstanding between parties and cases of investors being left without protection.

The ICO Business Research Group proposes the following two principles on the issuance of tokens, while paying attention to the viewpoint related to the innovativeness and flexibility of ICO as well as the viewpoint of investor protection:

[Issuance principle 1] Issuers should define and disclose conditions for the provision of conveniences such as services and rules on

the distribution of procured funds, profits, as well as residual assets, to investors of tokens, shareholders, and debt holders.

Note: The above is based on the idea that, although ICO can be designed by issuers at their discretion, potential influences (related to rights and obligations) on token investors, shareholders, and debt holders need to be clearly demonstrated prior to the issuance.

[Issuance principle 2] Issuers should define and disclose a means for tracking the progress of white papers.

Note: The above is based on the idea that issuers need to explicitly define in advance a means to allow token investors to confirm the progress of the plans stated in the white paper. It is considered that the information to be disclosed should not necessarily be financial statements depending on the purpose of issuing tokens or physical strength of the company. In addition, white papers need to be managed in a highly transparent manner: for example, procedures for revising white papers are defined, a revision history is available for viewing, and so on.

In addition, as consequences of the above principles, we propose the guidelines below on requirements related to practical operations.

[Guideline 1] ICOs should be designed to be acceptable to existing shareholders and debt holders

Note: ICO should not become a tool that brings advantage nor disadvantage to specific stakeholders.

[Guideline 2] ICOs should not become a loophole in existing financing methods as equity finance

Note: To enable ICO to gain wide support in the society, a situation where it is abused as a tool for evasion of laws should be avoided

We propose the five principles below to ensure the protection of investors regarding the purchase and sales of tokens.

[Trading principle 1] Token sellers should confirm the identity (Know Your Customer: KYC) and suitability of customers.

- [Trading principle 2] Administrative companies that support the issuance of tokens should confirm the KYCs of issuers.**
- [Trading principle 3] Cryptocurrency exchanges should define and adopt an industry-wide minimum standard on token listing.**
- [Trading principle 4] After tokens are listed, unfair trade practices of such tokens such as insider trading should be restricted.**
- [Trading principle 5] Parties related to the trading of tokens such as issuers, administrative companies, and token exchanges should make efforts to ensure cyber security.**

VI. For the future

The ICO Business Research Group proposes the above principles as the minimum principles that should be satisfied at this time. To enable ICO to be used safely by a wide range of issuers and investors and to be accepted well in the society, more detailed rules may be required. For example, we have proposed that issuers be allowed to design rights and obligations related to ICO at their discretion. However, as more deals launched in the future, some rules may be required to restrict or encourage certain types of deals. In addition, when tokens are issued, rules would contribute to facilitate reaching an agreement that issuers can refer to regarding procedures for obtaining agreements from existing shareholders and debt holders. As for the confirmation of KYC, if no concrete check items or means are specified, it may be difficult to confirm KYCs properly. In addition to all these, it would be indispensable to set fair accounting/taxation standards to reduce uncertainties regarding accounting and tax operations.

Although there are a wide variety of issues to be considered and it would not be easy to find solutions for all of them, we hope the above proposals would contribute to future discussions by each related party.