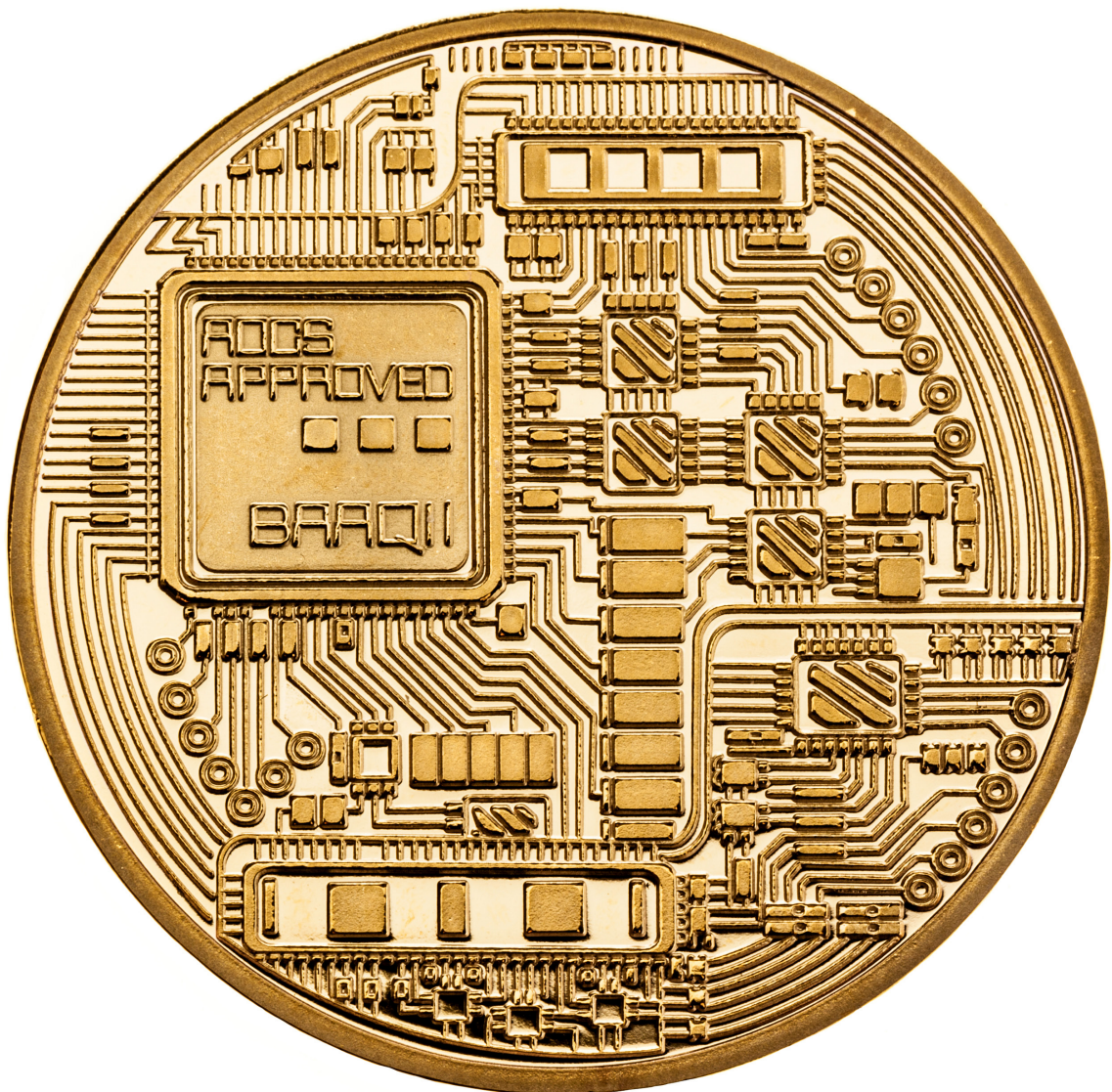


Initial Coin Offerings in the Netherlands

An overview of the regulatory environment



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Introduction

Initial Coin Offerings (“**ICOs**”) seem to be the hype of the virtual currency community. ICOs are means for companies to collect money. Instead of writing long business plans and conducting endless pitches, companies can simply create their own crypto, gather a community behind their project, write a whitepaper and do some marketing.

Currently ICOs operate in an uncertain regulatory environment and are used to raise capital for a variety of projects. Given the speculative success of ICOs, the lack of clear guidance and the pending risks for investors, it comes as no surprise that regulators have increasingly started to focus on ICOs. Investors in the Netherlands were formally warned by the Dutch Authority for the Financial Markets (*Autoriteit Financiële Markten*, “**AFM**”), as well as the Dutch Central Bank (*De Nederlandsche Bank*, “**DNB**”), that they should avoid ICOs. The continuous buzz regarding cryptocurrencies and ICOs led to a hearing in the Dutch House of Representatives on 24 January 2018, to discuss the current and future role of cryptocurrencies and ICOs in the Netherlands.

In this guide we will give an overview of the current regulatory environment for ICOs in the Netherlands and considerations to think about in the ICO process such as tax implications.



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This guide is intended to provide a summary overview of certain important aspects of the law and regulation governing ICOs in the Netherlands. The information contained in this guide is not intended to be used and must not be used as legal or taxation advice.



Glossary

AFM	Dutch Authority for the Financial Markets (<i>Autoriteit Financiële Markten</i>)
AIFMD	Alternative Investment Fund Managers Directive 2011/61/EU
AIFMD Guidelines	Guidelines on key concepts of the AIFMD, ESMA/2013/611
AMF	Autorité des Marchés Financiers
3AMLD	Third Anti-Money Laundering Directive 2005/60/EC
4AMLD	Fourth Anti-Money Laundering Directive 2015/849/EU
5AMLD	Proposal for a Directive of the European Parliament and of the Council amending Directive 2015/849/EU
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
DAO	Decentralized Autonomous Organisation
DCC	Dutch Civil Code
DNB	Dutch Central Bank (<i>De Nederlandsche Bank</i>)
EBA	European Banking Authority
ECB	European Central Bank
EEA	European Economic Area
EMD	E-money Directive 2009/110/EC
EU	European Union
EUR	Euro
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
FINMA	Financial Market Supervisory Authority
FIU	Financial Intelligence Units
FSA	The Dutch Financial Supervision Act (<i>Wet op het financieel toezicht</i>)
GDPR	General Data Protection Regulation 2016/679/EU
ICOs	Initial Coin Offerings
IPOs	Initial Public Offerings
MiFID II	Markets in Financial Instruments Directive 2014/65/EU
Prospectus Directive	Prospectus Directive 2003/71/EC
UCITS	Undertakings for the Collective Investment of Transferable Securities
USD	Dollar
SEC	Securities and Exchange Commission
VAT	Value-added tax

1. ICO: new way of fundraising

1.1 How does an ICO work?

An ICO is an innovative way for companies – usually start-ups – to raise money from the public. In an ICO, a business or individual will issue coins or tokens which are sold in exchange for either traditional currencies such as the euro, or virtual currencies, such as Bitcoin or Ether. Every ICO starts with a whitepaper, comparable to a simplified version of a prospectus, which describes the project's business operations as well as the structure and features of the tokens, providing information on the status of the enterprise and moreover the key team members involved. During the initial subscription process, the participant is usually required to transfer cryptocurrency to the issuer or to the online wallets of the issuer. Once the ICO is completed, a smart contract insures that the tokens will be distributed to the participants' designated addresses or online wallets. In the event that the previously specified minimum amount has not been reached, the smart contract automatically returns the cryptocurrency to the wallet of the sender. ICOs have a cross-border nature: in principle, any person with internet access and a digital wallet can buy these tokens. Last year, 235 ICOs raised approximately USD 3.8 billion through implementation of such alternative fundraising opportunities.¹ During the first quarter of 2018 cryptocurrency market capitalization was more than halved. However, the ICO market continues to develop rapidly, exceeding values of the whole last year, with a total raised amount of USD 5.8 billion in Q1 2018.²

ICO projects use either existing blockchain platforms, e.g. Ethereum, Neo and Waves, or customize their own. Currently, most tokens are generated on the Ethereum blockchain.³ It is also possible to create and use a new blockchain, whereby the goal is to attract miners to the new network and give rewards per transaction confirmation in return.

ICOs are comparable to Initial Public Offerings ("IPOs") on a stock exchange and crowdfunding initiatives, as they raise money from the public, albeit in ICOs investors receive digital tokens instead of equity shares or rewards. Unlike IPOs, ICOs generally are sold into the market before a business around the solution exists.⁴ In this event, ICOs introduce valuable liquidity to companies that are not yet ready to trade their shares on the regulated market or multilateral trading facility. Most of the ICOs

have no customers, no revenue and in most cases, no working product. The ICO system has two major advantages: (i) it can be simpler, cheaper and more efficient than traditional fundraising measures and (ii) it has the flexibility to shape the characteristics of each token sold.

1.2 Why are ICOs a concern?

The Netherlands

Investors in the Netherlands were formally warned by the AFM, as well as DNB, that they should avoid ICOs. The AFM stresses that ICOs are extremely risky and highly speculative investments.⁵ ICOs, depending on how they are structured, may fall outside the scope of supervision. In such case where an ICO does not fall under purview of EU or Dutch law, investors cannot benefit from the protection that comes with regulated investments. The documentation – whitepapers, terms and conditions – supporting token sales are not subject to any law or regulatory provisions and the supervisory authorities have not reviewed the plenitude of their content. Consequently, an ICO whitepaper might be unbalanced, incomplete or misleading. Due to the high complexity of the underlying technology, only experts are able to review and verify the functionality of the respective token as described in the issuer documentation.

ICOs are also prone to facilitating fraud or illicit activities, stemming from their anonymity and capacity to raise large amounts of money in a short timeframe. There is little to no possibility of tracing transactions in cryptocurrency, including tokens in an ICO, to natural persons due to their decentralized and anonymous nature. According to DNB, banks and other financial entities involved in the offer of ICOs or the handling of tokens run the risk to see themselves involved in manipulation, money laundering, terrorism financing and other fraudulent practices.⁶

Dutch Finance Minister Wopke Hoekstra sent a letter to Parliament on 8 March 2018 advocating for an international approach to cryptocurrency regulation.⁷ The Finance Minister stated that the current supervisory framework and instruments are insufficiently tailored to cryptocurrency. He also promised to work with other countries in the EU and promote cooperative research to explore the cross-border nature of the market.

International

Supervisors from different jurisdictions have also issued warnings or guidelines on ICOs, including the UK Financial Conduct Authority ("**FCA**"), the French Autorité des Marchés Financiers ("**AMF**") and the German Bundesanstalt für Finanzdienstleistungsaufsicht ("**BaFin**"),⁸ while the supervisors in China and South Korea have ordered ICO bans.⁹ Other authorities in for instance Singapore, Malta and Switzerland pursue a different approach to this situation by facilitating a friendly environment for cryptocurrencies and ICOs.

G20 Argentina, Buenos Aires

The Financial Stability Board ("**FSB**"), an international body that monitors the global financial system to promote stability and coordinates financial regulation for G20 nations, has recently undertaken a review of the financial stability risks posed by the rapid growth of crypto-assets. In a letter sent to G20 finance ministers and central bank governors just before this year's G20 summit in Argentina, FSB chairman Mark Carney stressed that cryptocurrencies do not represent a threat to the global financial system, because of their small size relative to the financial system and the fact that they are not substitutes for currency and with very limited use for real economy and financial transactions. The FSB stated that *"even at their recent peak, their combined global market value was less than 1% of global gross domestic product"*.¹⁰

1.3 What are the characteristics of tokens?

There is no recognized general classification of ICOs nor of the tokens that result from them, in the Netherlands or internationally. The function of tokens has evolved beyond just being a 'virtual currency', therefore tokens can be classified in various functions and utilities. An ICO can be structured as a security, a utility, or simply as a currency. The tokens that are offered may represent a voucher for a one-time or recurring service or grant the participants a right of some kind. The particular right presented by the token varies. We will categorize the tokens based on underlying economic function. In general, the different tokens can be sorted into three categories. A token may act as a means of payment, confer digital access rights to an application or service, or function as an investment. The Swiss Financial Market Supervisory Authority ("**FINMA**") uses the following terminology:

- **Payment tokens** do not give rise to claims on their issuer. They are rather intended to be used, now or in the future, as a means of payment for acquiring goods or services or as a means of money or value transfer.

- **Utility tokens** are tokens which are intended to provide access digitally to an application or service, usually by means of a blockchain-based infrastructure.¹¹
- **Asset tokens** represent assets such as a debt or equity claim on the issuer. Asset tokens promise, for example, a share in future company earnings or future capital flows. In terms of their economic function, therefore, these tokens are analogous to equities, bonds or derivatives. Tokens which enable physical assets to be traded on the Block-chain also fall into this category.

The most common type is the utility token, which is sold during an ICO for means of payment on a blockchain platform. Other types such as asset or payment tokens are less often used. The individual token classifications are not mutually exclusive. For example, asset and utility tokens can also be classified as payment tokens, also known as hybrid tokens. In these cases, the tokens are deemed to be an investment and means of payment.

1.4 What are the differences between cryptocurrencies, virtual currencies and tokens?

There is no clear distinction between cryptocurrencies and tokens issued by means of an ICO. In practice, both terms are often used interchangeably. The AFM noted that one important distinction to make is that anyone with some understanding of coding can create and issue tokens.¹² Cryptocurrencies are only created by an algorithm with a previously determined set of rules, and are encrypted using cryptography. Cryptography refers to the use of encryption techniques to secure and verify the transfer of transactions. The terminology of 'virtual currencies' encompasses the concept of 'cryptocurrency'. When we use the term 'virtual currency', we refer to the payment-like tokens such as Bitcoin and Litecoin. Virtual currency is distinguished from fiat money, which is the coin and paper money of a country that a government has declared to be legal tender.

Tokens are units on top of an existing blockchain that facilitates the creation of decentralized applications. Tokens can be designed to perform a variety of different functions or grant holders a wide range of privileges. The designers of the tokens are free to determine how many tokens they wish to create, and which other functionalities will be given to the token.

1.5 What is the legal nature of tokens?

The legal status of tokens and ICOs is difficult to ascertain. When evaluating the legal nature of ICO projects, it is becoming increasingly important to define the legal and taxation characteristics of tokens. The legal qualification of a token has practical implications for the legal status of its creator, for requirements with respect to other parties, and for token trading rules. To evaluate the legal status and the regulatory or tax consequences, one should assess: (i) the technological aspects of the tokens, (ii) the economic aspects of the tokens (e.g. distribution model, economic functions of the tokens) and (iii) the token's context (conditions in which a token is to function).

An ICO pursues two objectives: it can either be used for project financing or it can be used to put a new virtual currency in circulation. Depending on the objectives, the analysis might differ. The diversity of the instruments issued may give rise to various governance rights depending on how the ICO is structured. Moreover, there is no specific legal framework for these types of instruments, and there are currently limited legal precedents to help clarify the legal status of tokens. Depending on the nature of the token, different rules will apply and thus, a case-by-case assessment is unavoidable.

In the context of a typical ICO, investors are not granted any ownership rights with respect to the company. However, the issued tokens can be structured very similarly to a share, including voting rights in the project as well as returns from the project. An example of an asset-like ICO is the decentralized autonomous Organisation the (“DAO”). The DAO, created by a German company named Slock.it, can be best described as a “virtual” *Organisation embodied in computer code and executed on a distributed ledger or blockchain*.¹³ The DAO was not registered as a legal entity in any sovereign jurisdiction,¹⁴ nor did the DAO have a board of directors or management team. All features of this Organisation were embodied into the code.¹⁵ One important trend in the current market is that parties issuing an ICO, are registering a legal entity instead of using a DAO, to anticipate to a more regulated and less anonymous ICO field and handle crowd sales as legitimately as possible.¹⁶

On 16 February 2018, FINMA published guidelines, presenting its intentions of applying financial legislations in handling enquiries regarding the applicable regulatory framework for ICOs. FINMA became the first global regulator to provide a detailed and principle-based analysis on how it intends to treat enquiries from ICO organisers. FINMA stated *“In assessing ICOs, FINMA will focus on the economic function and purpose of the tokens (i.e. the blockchain-based units) issued by the ICO organiser. The key factors are the underlying purpose of the tokens and whether they are already tradeable or transferable.”*¹⁷



2. Securities law regulation of ICOs

2.1 What do regulators say about the regulation of ICOs?

In the media one can read about the 'unregulated' environment of ICOs. Currently, there are no specific ICO regulatory requirements. However, ICOs may be subject to existing security regulations. The Securities and Exchange Commission ("**SEC**") stressed this in its 2017 report that investigated the DAO.¹⁸ Also the European Securities and Markets Authority ("**ESMA**") stated in November 2017 that firms involved in ICOs should give careful consideration as to whether their doings constitute regulated activities. According to ESMA's statement, firms involved in ICOs should comply with the following four EU Directives: the Prospectus Directive 2003/71/EC ("**Prospectus Directive**"), the Markets in Financial Instruments Directive 2014/65/EU ("**MiFID II**"), the Alternative Investment Fund Managers Directive 2011/61/EU ("**AIFMD**") and the Fourth Anti-Money Laundering Directive 2015/849/EU ("**4AMLD**"). Any failure to comply with the applicable rules will constitute a breach.¹⁹

The AFM indicated that most ICOs can be structured in a way that they will fall outside of the scope of the Dutch Financial Supervision Act (*Wet op het financieel toezicht*, "**FSA**"). Especially, if it concerns a right for future service of the issuer there will be no supervision. According to the AFM, there is one exception to this if the token for instance represents a share in a project or if the token gives entitlement to a part of the (future) returns of said project. In these cases, the token may qualify as a *security* or a *unit in a collective investment scheme* as defined in the FSA. The AFM will assess on a case by case basis to determine whether the FSA applies.²⁰ Parties that intend to launch an ICO should therefore carefully assess whether their tokens will fall within the scope of the Dutch financial supervision regime.

In this guide we will provide an introduction to the most relevant provisions of the Dutch financial supervision regime. Our focus will be on the national requirements and guidance. However, most of these requirements have been derived from European Directives, i.e. the question whether a token qualifies as a security is relevant for purposes of the Prospectus Directive and the qualification of a token as a unit in a collective investment scheme is prompted by the implementation of the AIFMD.

2.2 What are securities?

The question whether tokens qualify as securities is of importance as the Prospectus Directive provides for the prohibition to offer transferable securities to the public in the European Economic Area ("**EEA**") without publishing a prospectus that has been approved by a competent authority. In the Netherlands, the Prospectus Directive has been implemented in, amongst others, the FSA. The AFM is the competent authority to approve a prospectus within the meaning of the Prospectus Directive in the Netherlands.

Definition FSA

The FSA provides that it is prohibited to offer securities (*effecten*) to the public in the Netherlands, unless a prospectus is generally available in respect of the offer or admission which has been approved by the AFM or by a supervisory authority of another member state. The FSA defines securities as (a) a negotiable share or other negotiable instrument or right considered equivalent and not being an apartment right; (b) negotiable bond or other negotiable debt instrument; or (c) any other negotiable instrument issued by a legal person, corporation or institution by which securities referred to under (a) or (b) may be acquired through exercising the rights attached to this instrument or through conversion, or that can be settled in cash.²¹

Definition Prospectus Directive

The definition of securities in the FSA has *inter alia* been derived from the Prospectus Directive. The definition of transferable securities under the Prospectus Directive refers to transferable securities within the meaning of MiFID II. MiFID II defines transferable securities as those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as (a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares, (b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities, (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.²²

Consequently, the definition of securities in the Prospectus Directive consists of a non-exhaustive list while the definition of securities in the FSA consists of an exhaustive list. The essence of transferable securities within the meaning of the Prospectus Directive is that they are, as a class, negotiable on capital markets.²³

Negotiable

A token must be negotiable in order to qualify as a security within the meaning of the Prospectus Directive and the FSA. The Dutch legislator has clarified the scope of the term negotiability. To determine whether or not an instrument is negotiable, it is decisive whether there is a capital market on which this category of instrument is traded. It is not decisive whether there is a specific market for these instruments, but rather whether the specific instrument is negotiable based on its characteristics. A clear indication that the instrument is negotiable is the extent of standardisation.

The more standardised an instrument is, the more likely it is to be negotiable. Consequently, transferable shares in a Dutch company will probably be considered negotiable even in the event that the transfer of such shares is subject to prior approval or that the shares must be offered to the existing shareholders first.²⁴

The AFM has provided guidance on the concept of negotiability. The AFM uses a wide and economic approach for the term negotiability. All constructions whereby the economic interest of a standardised negotiable instrument or participation is or may be transferred directly or indirectly to a third party qualify as a negotiable instrument or participation.²⁵

It is possible to restrict the negotiability of securities by agreement. This raises the question whether such securities are still negotiable within the meaning of the Prospectus Directive. ESMA has provided guidance on the contractual restriction of securities. ESMA considers that securities whose transferability has been reduced on a contractual basis remain transferable securities. However, if the restrictions are too extensive, the securities may no longer be treated as transferable securities for the purposes of the Prospectus Directive. Whether a security that is subject to a restriction qualifies as a transferable security should be assessed on a case-by-case basis.²⁶

2.3 Do tokens qualify as securities?

Definition

A token can have various forms. In order to assess whether a token qualifies as a security all features should be considered. In order to qualify as a security within the meaning of the FSA, the token should qualify as (a) a negotiable share or other negotiable instrument or right considered equivalent and not being an apartment right; (b) negotiable bond or other negotiable debt instrument; (c) any other negotiable instrument issued by a legal person, corporation or institution by which securities

referred to under (a) or (b) may be acquired through exercising the rights attached to this instrument or through conversion, or that can be settled in cash.

Negotiable

To qualify as a security the token must be negotiable. Although not traded on regulated markets, like NYSE Euronext, most tokens will be traded on an exchange or platform and will be negotiable. Relevant in this respect is also the standardisation. Most tokens will be standardised, especially tokens of the same financing round. It could be argued that if a specific token is designed in a way that the code does not allow for any transfer, these tokens lack transferability and therefore do not qualify as securities.

Negotiable share or other negotiable instrument or right considered equivalent

The FSA does not include a definition of shares or rights considered equivalent. The legislator has stated that negotiable units in a closed-end collective investment scheme, negotiable rights in a partnership and negotiable depositary receipts for shares are in any event considered to be rights equivalent to shares.²⁷

The AFM has provided guidance on the qualification of a token as a security. An important consideration is whether the holders of a token participate in the company's capital and receive a payment for this. This payment must correspond to the return achieved with the invested capital. In this respect any controlling rights are not decisive.²⁸ Interesting in this respect is also the definition of a share of a private limited company (*besloten vennootschap*) in the Dutch Civil Code ("**DCC**"), which provides that rights that neither enclose a voting right nor an entitlement to a distribution of profits or reserves, are not regarded as a share in a private limited company.²⁹

Consequently, from the available guidance can be derived that a negotiable token that provides for a participation in the issuer's capital and an entitlement to a payment which depends on the return achieved with the invested capital will probably qualify as a security within the meaning of the FSA. In the context of ICOs, the qualification of the company's capital will not always be straightforward. It could be argued that a token that does not provide for an entitlement to a payment that depends on the return achieved with the invested capital, or a return as a result of an increase of an index or increase of the token's value, or a distribution of profits or reserves, does not qualify as a security within the meaning of the FSA.

Negotiable bond or other negotiable debt instrument

A token may also qualify as a security if it represents a negotiable bond or debt instrument. In the event that a token consists of a loan to the issuer, and the issuer has the obligation to repay the loan, the token could qualify as a bond or debt instrument. Most tokens do not have these features. However, in the event that a token qualifies as a bond or debt instrument it is also relevant to consider the prohibitions regarding repayable funds. Reference is made to Section 2, *What are redeemable funds?*

Other instrument

A token may also qualify as a security within the meaning of the FSA if a share or bond can be acquired through the exercise of the rights attached to the token or as a result of conversion of these rights. A negotiable token could also qualify as a security if it can be settled in cash whereby the settlement amount depends on an index or standard.³⁰

2.4 What if a token qualifies as a security?

In the event that a token qualifies as a security within the meaning of the FSA, an approved prospectus should be published if these tokens will be offered to the public in the Netherlands, unless the issuer can make use of an exemption. If a token qualifies as a security within the meaning of the FSA, it will also qualify as a financial instrument (*financieel instrument*), which is relevant for the exchange or platform on which the tokens will be issued or traded. Reference is made to Section 4, *Are ICO exchanges, brokers and advisors regulated?*

A prospectus that has been approved by a competent authority can be used as a European passport. This means that the company can use the prospectus that has been approved by the competent authority in its home member state for offerings in other EEA countries without the need to draw up a new prospectus. The 'host' EEA country may only require a translation of the summary of the prospectus.

The company files a request with the competent authority in its home member state to notify the competent authority in the EEA country where the offer is to be made. The competent authority in its home member state then provides the competent authority in the EEA country where the offer is to be made with a statement that the prospectus has been drawn up in accordance with the Prospectus Directive.

Are there exemptions from the requirement to publish a prospectus?

Exemptions from the obligation to issue a prospectus upon an offering include, *inter alia*, (i) offerings addressed solely to qualified investors, (ii) offerings addressed to fewer than 150 non-qualified investors per EU member state, (iii) offerings whose denomination per unit amounts to at least EUR 100,000, (iv) offerings with of which the total consideration value in the EEA does not exceed EUR 5 million, calculated over a period of 12 months, whereby offers of group companies are being aggregated. The prospectus requirement does also not apply to money market instruments with a term of less than 12 months or open-ended collective investment schemes.

Issuers that intend to benefit from the EUR 5 million exemption will have to notify the AFM in advance and need to provide a standardised information document to investors. A mandatory exemption notice should be included in all offer documentation if the issuer makes use of the aforementioned exemptions from the obligation to issue a prospectus, unless the offer is addressed to qualified investors only.

The aforementioned exemptions from the requirement to publish an approved prospectus will not be useful for most ICOs as these are aimed at retail investors with a minimum investment under EUR 100,000 per investor. The tokens will also usually be offered to more than 150 potential investors. The only possibly interesting exemption might be the aforementioned EUR 5 million exemption. However, in practice, we have seen that most of the ICO projects by far exceed this threshold.

2.5 What is a unit in a collective investment scheme?

AIFMD

From a regulatory perspective it is also relevant to assess whether tokens qualify as units in an alternative investment fund, within the meaning of the Alternative Investment Fund Managers Directive 2011/61/EU ("**AIFMD**"). In 2013 the AIFMD was implemented in the Netherlands. It is prohibited to manage a Dutch collective investment scheme (*beleggingsinstelling*) or to offer units in a collective investment scheme in the Netherlands without a license from the AFM, unless the manager can make use of an exemption.³¹

Collective investment scheme

A collective investment scheme is defined as a collective investment undertaking (including investment compartments of such an undertaking), which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors. A vehicle will only be considered to be a collective investment scheme if all of the elements of the definition are present.

In order to determine whether a vehicle qualifies as a collective investment scheme, the AFM refers to the key concepts of AIFMD published by ESMA.³² According to these key concepts of AIFMD (the "**AIFMD Guidelines**")³³ an undertaking will generally be a collective investment undertaking where it exhibits all of the following characteristics:

- a) it does not have a general commercial or industrial purpose;
- b) it pools together capital raised from its investors for the purpose of investment, with a view to generating a pooled return for those investors from investments; and
- c) its unitholders/shareholders, as a collective group, have no day-to-day discretion or control.

General commercial or industrial purpose?

A general commercial or industrial purpose is defined in the AIFMD Guidelines as the purpose of pursuing a business strategy which includes characteristics such as running predominantly a commercial activity, involving the purchase, sale and/or exchange of goods or commodities and/or the supply of non-financial services, or an industrial activity, involving the production of goods or construction of properties, or a combination of the two.

In order to assess whether a vehicle has a general commercial or industrial purpose and/or qualifies as collective investment undertaking, the AFM indicates that

in general parties can continue to use the guidance as included in the Policy Rule Entrepreneurship or Investing (*Beleidsregel ondernemen of beleggen*) that applied before the implementation of the AIFMD. For this assessment it was relevant whether the work carried out with respect to the assets has a direct or indirect effect on the appreciation of the assets. In the event that such work (directly or indirectly) influences such appreciation the activities suggest entrepreneurship while in the event that the appreciation is merely achieved by speculation on such appreciation or generating a cash flow the activities suggest investing. An active appreciation indicates entrepreneurship while a passive appreciation indicates investing. Also the content of marketing material could suggest that the vehicle does not have a general commercial or industrial purpose.

Raise capital

In order to qualify as a collective investment scheme capital should be raised from investors. The AIFMD Guidelines provide that it is immaterial whether the transfer or commitment of capital takes the form of subscriptions in cash or in kind. Consequently, also if tokens can be acquired by using cryptocurrencies as a payment method, the element of raising capital will be fulfilled. Currently, the AFM is of the opinion that securities that qualify as borrowed capital, e.g. bonds, will usually not be covered by the AIFMD.

Defined investment policy

The AIFMD Guidelines provide that an undertaking which has a policy about how the pooled capital in the undertaking is to be managed to generate a pooled return for the investors from whom it has been raised should be considered to have a defined investment policy. The factors that would, singly or cumulatively, tend to indicate the existence of such a policy are (a) the investment policy is determined and fixed, at the latest by the time that investors' commitments to the undertaking become binding on them, (b) the investment policy is set out in a document which becomes part of or is referenced in the rules or instruments of incorporation of the undertaking, (c) the undertaking or the legal person managing the undertaking has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy, including all changes to it, (d) the investment policy specifies investment guidelines, with reference to criteria including any or all of the following criteria, (i) to invest in certain categories of assets, or conform to restrictions on asset allocation, (ii) to pursue certain strategies, (iii) to invest in particular geographical regions, (iv) to conform to restrictions on leverage, (v) to conform to minimum holding periods; or (vi) to conform to other restrictions designed to provide risk diversification.

The whitepapers provided with respect to an ICO will usually include the aforementioned elements of a defined investment policy.

UCITS

Another regulated collective investment vehicle is an Undertakings for the Collective Investment of Transferable Securities ("**UCITS**"). UCITS invests in accordance with certain investment restrictions and diversification requirements. Main features of UCITS are that they can only invest in eligible assets, UCITS must operate on a principle of risk spreading and a UCITS must be open-ended i.e. shares or units in the fund may be redeemed on demand by investors. Most ICO initiatives will not qualify as UCITS.

2.6 Are tokens units in a collective investment scheme?

Tokens could qualify as units in a collective investment scheme if all elements of the definition of a collective investment scheme are fulfilled, i.e. a collective investment undertaking (including investment compartments of such an undertaking), which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors.

The AFM has provided guidance on the qualification of a token as a unit in a collective investment scheme. The AFM stressed that an ICO is subject to financial supervision if it concerns the management and offering of units in a collective investment scheme. This is the case if an issuer of an ICO raises capital from investors in order to invest this capital in accordance with a certain investment policy in the interests of those investors. The funds raised have to be used for the purpose of collective investment so that the participants will share in the proceeds of the investment. An increase in net asset value also qualifies as the proceeds of an investment.³⁴

In the event that the proceeds of an ICO are used for a collective investment and investor returns are generated as a result of an increase in value of the collective investment, the tokens could qualify as units in a collective investment scheme. Collective investment schemes often invest in real estate, baskets of financial products or interests in other companies. ICOs are regularly initiated by startup companies to attract funds from the market to build their business, it could in our view be argued that these ICOs will not qualify as an offering of units in a collective investment scheme as they will have a general commercial or industrial purpose.

The ICO proceeds are used to develop technologies or produce goods. This general commercial or industrial purpose should be reflected in the whitepaper. For this assessment the guidance as provided in the Policy Rule Entrepreneurship or Investing (Beleidsregel ondernemen of beleggen) that applied before the implementation of the AIFMD could be useful.

2.7 What if a token is a unit in a collective investment scheme?

License

In the event that tokens qualify as units in a collective investment scheme, a license should be obtained in the event that these tokens are offered to the public in the Netherlands, unless the issuer can make use of an exemption. Note that units in a collective investment scheme could also qualify as security. Reference is made to Section 2, *What are securities?*

Exemptions and light regime

Exemptions from the requirement to obtain a license in the event that units in a collective investment scheme are offered to investors in the Netherlands, apply to holding companies, pension funds, joint ventures and employee participations or savings schemes. Managers of a collective investment scheme that has its seat in the Netherlands could also make use of the light regime. Under the light regime no license is required but the manager should register with the AFM and needs to comply with certain information requirements. The light regime is *inter alia* available to managers with their registered office in the Netherlands that directly or indirectly manage funds whose total assets under management do not exceed a threshold of EUR 100 million. The light regime also applies to managers offering units to non-professional investors. In addition to the aforementioned conditions, to benefit from the lighter regime, the offer must have a value of more than EUR 100,000 per investor or be offered to less than 150 persons.

The exemptions will not be suitable for most issuers that intend to launch an ICO. Also the light regime will not be useful for most ICOs as these are aimed at retail investors with a minimum investment under EUR 100,000 per investor. The tokens will also usually be offered to more than 150 potential investors.

2.8 What are redeemable funds?

Redeemable funds (*opvorderbare gelden*) are deposits or other repayable funds. Repayable funds has been described as funds that must be repaid at some point, for whatever reason, and of which it is clear in advance what nominal amount must be repaid. It is not allowed in the Netherlands to invite, acquire or have the disposal of redeemable funds from the public in the pursuit of a business.³⁵ Bonds usually qualify as repayable funds. The prohibition does not apply if redeemable funds are attracted or obtained from professional market parties only.³⁶

The AFM stated that this prohibition could be relevant for cryptocurrency service providers, for instance if the service provider that is buying or selling or taking into custody or managing cryptocurrencies also invites deposits or other repayable funds. This may occur if the service provider enables its customers to convert their cryptocurrency holdings into a fiat money holding.³⁷

Furthermore the prohibition to invite, acquire or have the disposal of redeemable funds should be observed in the event that fiat money is used as means of exchange to acquire tokens that have the characteristics of a bond or loan. This prohibition to attract redeemable funds does not apply to parties attracting, obtaining or having the disposal of redeemable funds as the result of offering securities in accordance with the provisions arising from the Prospectus Directive as implemented in the FSA.³⁸ As transferable bonds will probably qualify as securities this exemption could be helpful. It could be argued that also if the issuer makes use of an exemption to publish an approved prospectus, it can make use of this exemption from the prohibition to invite, acquire or have the disposal of redeemable funds as the offering of securities will be in accordance with - because not contrary to - the provisions derived from the Prospectus Directive.



3. Virtual Currencies

3.1 Do crypto's fulfil the economic functions of money? 3.3 Do virtual currencies qualify as money within the meaning of the FSA?

Currently, cryptocurrencies are not considered to fulfil the economic functions of money. From an economic perspective, whether a cryptocurrency may be considered as money depends on three functions of money (a) the extent to which it acts as a store of value, (b) a medium of exchange and (c) a unit of account. DNB stated in 2014 that although virtual currencies were designed to function as money, they have not been able to fully fulfil the aforementioned three functions of money.³⁹ According to a more recent position paper of 24 January 2018, DNB has not changed its position regarding this topic: *"Crypto's do not currently fulfil the role of money – in fact, they are hardly ever used for payment, and they are not a universally accepted and stable medium of exchange, a suitable unit of account or a reliable store of value. Accordingly, they do not have any implications in terms of monetary policy"*.⁴⁰ Also the IMF concluded that virtual currencies do not completely fulfil the three economic roles associated with money.⁴¹

The finance ministers and heads of central banks of the G20 countries have prepared a draft regulatory document that states that crypto-assets *"lack the key attributes of sovereign currencies,"* which implies that cryptocurrencies are not regarded as currencies, but are classified as assets.⁴² Klaas Knot, president of DNB and also the member of FSB's standard committee on assessment of vulnerabilities stated on the G20: *"Whether you call it crypto assets, crypto tokens - definitely not cryptocurrencies - let that be clear a message as far as I'm concerned. I don't think any of these cryptos satisfy the three roles money plays in an economy."*⁴³

3.2 Are virtual currencies a legal tender?

The DCC provides that the currency paid in order to comply with an obligation to pay a sum of money, must at the time of payment be a common currency (*gangbaar geld*) in the country where the payment is made.⁴⁴ The question whether money qualifies as common money, depends on whether it can be determined as a legal tender (*wettig betaalmiddel*). The definition of legal tender in the Netherlands, is limited to euros and other coins issued by the European Central Bank ("**ECB**").⁴⁵ Also, the former Dutch Minister of Finance, Jeroen Dijsselbloem, made clear that the government does not consider the Bitcoin as legal tender.⁴⁶ Currently, cryptocurrencies are therefore not considered to be a legal tender or common currency in the Netherlands.

Money (*geldmiddelen*) within the meaning of Section 1:1 FSA has been defined as cash (*chartaal geld*), scriptural money (*giraal geld*) and electronic money (*elektronisch geld*). Cash is not defined in the FSA but refers to money in the physical form, such as banknotes and coins that are considered a legal tender (reference is made to the question *Are virtual currencies a legal tender?*). The FSA does also not include a definition of scriptural money. In the literature scriptural money is described as a claim that bank account holders have on their bank, due to the availability of credit on their bank accounts. Electronic money has been defined in the FSA as electronically, including magnetically, stored monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions (...), and which is accepted by a natural or legal person other than the electronic money issuer. This definition has been derived from the E-money Directive 2009/110/EC ("**EMD**").

It is prohibited to provide payment services in the Netherlands without a license issued by DNB.⁴⁷ In the event that virtual currency qualify as money within the meaning of Section 1:1 FSA, activities in the context of virtual currencies could qualify as a payment service and trigger the aforementioned license requirement.⁴⁸ Furthermore, any party issuing electronic money in the Netherlands must obtain a license issued by DNB.⁴⁹

Cryptocurrencies are accepted as a way of payment only on a voluntary basis by certain parties. Although their names seem to suggest otherwise, virtual currencies do not qualify as currencies in the sense of legal tender and cannot be considered to be cash (*chartaal geld*). Virtual currency payments use digital 'wallets' in a way that display similarities with a normal bank account. However, unlike a bank account, there is no third party involved to manage and control the transfer of funds. Scriptural money constitutes a contractual base: the account holder can claim monetary value on the giro institution (*giro instelling*), which in turn has a liability towards the account holder.⁵⁰ Virtual currencies do not represent such a claim on a third party, and therefore, virtual currencies cannot be determined as scriptural money (*giraal geld*).

As Bitcoin and other cryptocurrencies are not issued by a central body but are decentralized, they are not classified as e-money. In addition, no one can claim monetary value with Bitcoin. The value of Bitcoin is based on the fact that other people are willing to pay a certain amount of money for a Bitcoin. Cryptocurrencies do not represent a claim on the issuer and they are not necessarily issued in exchange for money. So according to Dutch and European law, cryptocurrencies are not covered under the category electronic money.⁵¹

Consequently, virtual currencies do not qualify as money (cash, scriptural money or electronic money) under Section 1:1 FSA. Activities in the context of cryptocurrencies cannot be considered as a payment service under the FSA, and therefore, no license as a payment service provider is required. Moreover, any party issuing a virtual currency does not need to hold the relevant license for issuing electronic money as an electronic money institution. Currently, when an ICO is structured as a payment-like token, it will probably fall outside the scope of the FSA, unless the tokens qualify as securities or units in a collective investment scheme within the meaning of the FSA. Reference is made to Section 2, *Securities law regulation of ICOs*.

3.4 What does Dutch case law say about virtual currencies?

District court of Overijssel, 14 May 2014, ECLI:NL:RBOVE:2014:2667.

On 14 May 2014, the district court of Overijssel deliberated on the question whether Bitcoin could be treated as 'money' within the meaning of the DCC. The district court assessed whether the delivery of Bitcoins constitutes exchange of a sum of money in Bitcoins. The district court considered that there are similarities between money and Bitcoin. For instance, Bitcoin payments employ digital 'wallets' in a way that resembles a normal bank account. Unlike a bank account, however, no funds transfer organisation manages the wallets, because the users effectively do this themselves. From a legal point of view, the process does therefore not constitute a scriptural money transfer (*girale betaling*) as referred to in the DCC.⁵² The court of Overijssel concluded that the Bitcoin cannot be regarded as money within the meaning of the DCC, but should be regarded as a means of exchange. Since no payment by cashless funds transfer or in cash form is involved, the Bitcoin cannot be viewed as money, but, like gold and silver, as a medium of exchange (*ruilmiddel*).

District court of Amsterdam, 14 February 2018, ECLI:NL:RBAMS:2018:869.

On 14 February 2018, the district court of Amsterdam concluded in favor of a petitioner who was owed 0.591 Bitcoin by a private company called Koinz Trading B.V. The court deliberated on the question whether a claim for payment in Bitcoin should be regarded as a claim that qualifies for verification (*verifieerbare vordering*). The court judgment states that Bitcoin has all the characteristics of a 'property right' (*vermogensrecht*) which means that Bitcoin represents a value and is transferable.

Consequently, a claim to transfer Bitcoin under property rights is valid. According to the court, Bitcoin exists from a unique, digitally encrypted series of numbers and letters stored on the hard drive of the right-holder's computer. Bitcoin is 'delivered' by sending Bitcoins from one wallet to another wallet. Bitcoins are stand-alone value files, which are delivered directly to the payee by the payer in the event of a payment. As a result a Bitcoin represents a value and is transferable. In the court's view, it thus shows characteristics of a property right. A claim for payment in Bitcoin should therefore be regarded as a claim that qualifies for verification.

The court concluded that there was a legal and binding contract between the petitioner and Koinz Trading B.V., and considered the legal relationship as a civil obligation to pay. The court stated that since the obligations were taken in Bitcoin, the amount should also be returned in Bitcoin. The court went on to note that Bitcoin is a legitimate 'transferable value'.

3.5 How are cryptocurrencies defined?

Since cryptocurrency are currently not defined as a currency or money in the legal sense of the term, we ask ourselves under which definition it could fall? The ECB provided the first definition of a virtual currency in October 2012. According to this definition, "*virtual currency represents the unregulated digital money that is issued and subsequently supervised by its creator and used among the members of a special virtual community*". The ECB report was followed by a statement by the European Banking Authority ("**EBA**") in 2014, where it defined virtual currency as a "*digital representation of value that is neither issued by a central bank or public authority nor necessarily attached to a fiat currency, but is used by natural or legal persons as a means of exchange and can be transferred, stored or traded electronically*".⁵³

The European Commission adopted the definition of virtual currencies from the EBA opinion in 2014 and used this definition of virtual currencies for the extension of the scope of the 4AML. As a result of the proposed amendment, the 4AML will also cover the virtual currencies' market players, such as exchange platforms and custodial wallet providers, and declare them as entities that must comply with the 4AML. Reference is made to Section 4.1, *Is the Anti-Money Laundering Directive applicable to virtual currencies?* In most of the member states, including the Netherlands, it would pose the first legal definition of 'virtual currencies', and it will be the first time cryptocurrency will be intended to be covered in law.



4. Other considerations

4.1 Is the Anti-Money Laundering Directive applicable to virtual currencies?

Current regime

In the Netherlands the Money Laundering and Terrorist Financing (Prevention) Act (*Wet ter voorkoming van witwassen en financieren van terrorisme*) and the Sanctions Act 1977 (*Sanctiewet*) apply to financial institutions in order to prevent the financial system from being used for criminal activities. The third European Anti-Money Laundering Directive 2005/60/EC ("**3AMLD**") has been implemented in the Money Laundering and Terrorist Financing (Prevention) Act.

Both DNB and AFM take the view that financial institutions involved in services related to cryptocurrencies and ICOs, may be exposed to serious integrity risks. According to the AFM, the anonymous nature of cryptocurrencies leads to potentially serious conflicts with the following requirements: (a) know your client, (b) reporting of unusual transactions and (c) screening for inclusion on sanction lists.⁵⁴

5AMLD

On 20 December 2017, the Council and the European Parliament⁵⁵ reached an agreement on strengthened EU rules to prevent money laundering and the financing of terrorist activity, which includes a new definition of virtual currencies.⁵⁶ This resulted in the proposal for the fifth Anti-Money Laundering Directive ("**5AMLD**") that will reduce anonymity and increase traceability of transactions by requiring cryptocurrency exchanges and custodian wallet providers in the EU to carry out customer identification and due diligence. The proposed 5AMLD will amend the 4AMLD. Member states are invited to prepare for a speedy transposition of this legislation.⁵⁷ EU member states are expected to implement 5AMLD into national legislation, no later than 18 months after publication. 4AMLD has not yet been implemented into Dutch law. Dutch Finance Minister Wopke Hoekstra's aspiration is that the new rules will enter into force in the Netherlands at the end of 2019.⁵⁸

5AMLD effects that cryptocurrency exchanges (referred to as 'virtual currency exchange platforms') and custodian wallet providers will qualify as 'obliged entities'. As a result hereof these cryptocurrency exchanges and custodian wallet providers will be subject to obligations to implement preventative measures and report suspicious activity, which means these entities have to apply customer due diligence controls when exchanging virtual for fiat currencies.

Established cryptocurrency exchanges and wallets will need to adhere to 'Know Your Customer' protocols⁵⁹ and collect data on users that could be shared with public authorities. These exchanges have the obligation to report suspicious activities to the Financial Intelligence Unit ("**FIU**") and to cooperate with any investigation by relevant public authorities. Currently the authorities are unable to link the transactions to identified persons.

Definition of virtual currencies

5AMLD defines virtual currencies as *"a digital representation of value that is not issued or guaranteed by a central bank or a public authority, is not necessarily attached to a legally established currency, and does not possess a legal status of currency or money, but is accepted by natural or legal persons, as a means of exchange, and which can be transferred, stored and traded electronically"*.⁶⁰ 5AMLD will broaden the scope to custodian wallet providers, which are defined as entities that provide "services to safeguard private cryptographic keys on behalf of their customers, to holding, store and transfer virtual currencies".⁶¹

The 5AMLD contains the first legal definition of 'virtual currency' under EU law, but it does not mention the term 'cryptocurrency'. The definition is broad and not only limited to payment-like tokens such as Bitcoin. The definition will cover various existing and new coins and tokens including for example Bitcoin, Ethereum and Litecoin. However, it is uncertain how cryptocurrencies like Ether, the currency on the Ethereum blockchain, will qualify. Ethers are traded on exchanges, but rarely serve as a means of exchange,⁶² not to mention new tokens appearing every day in various blockchains. Under the 5AMLD, a transfer of money does not include transfers of virtual currencies, which means that the 5AMLD will not apply to these transactions.⁶³ This would imply that 5AMLD includes only those exchange platforms that engage in exchanging between virtual and fiat currencies and that virtual currency to virtual currency exchanges are not covered and regulated under 5AMLD, for example Bitcoin-to-Ether exchanges.

4.2 What are the tax implications of an ICO and token sale?

Individual investors

The tax regime applicable to the investor in the ICO of a Dutch company can be divided in the regime applicable to individual investors and the regime applicable to corporate investors. Dutch tax resident individuals are subject to Dutch personal income tax for their worldwide income. Nonresident individuals are solely subject for their Dutch source income. In the event that the tokens entitle the investor to at least 5% of the profits of the company, i.e. 5% of the beneficial ownership, the income derived from the token is deemed taxable income from a substantial interest and is subject to 25% personal income tax. Such income is also regarded as Dutch source income for which a nonresident taxpayer is subject to Dutch personal income tax derived from the Netherlands for nonresident shareholders.

All other tokens will generally qualify as taxable income from savings and investments. Such income is subject to 30% personal income tax. The underlying taxable income is based on a fictitious yield. The actual income derived upon the assets is of no concern. The fictitious yield ranges from 2.017% to 5.38% and depends on the total value of the assets on 1 January of the relevant year. As of 2018, a net capital value of up to EUR 30,000 per taxpayer is exempt. Taken into account the volatility of tokens, the taxation of the income from savings and investments may result into a disproportionate levy of tax in the event that the value of the token peaks on the reference date on 1 January of the respective year. It must be determined on a case by case basis whether the token is also included in the income derived from the Netherlands for the nonresident investor.

Corporate investors

Resident corporate investors are subject to 25% Dutch corporate income tax for their worldwide income (a step up rate of 20% applies on the first 200,000), nonresident corporate investors for their Dutch income. In the event that the token is deemed a certificate from a civil law perspective, the Dutch participation exemption may apply to the income derived from the tokens if certain conditions are met (such as a minimum beneficial ownership of 5% of the company). All other tokens are taxed as 'regular' assets of the corporate investor and income derived from such tokens is subject to corporate income tax. It must be determined on an individual basis whether the income derived from the token is regarded as Dutch income with respect to a possible nonresident tax liability.

Taxation at the level of the company

The tax consequences at the level of the company that initiates the ICO is fully dependent on the characteristics (and civil qualification) of the token. It is therefore not possible to provide generic guidelines that can be applied to ICO's. In the event that the token is deemed a certificate from a civil law perspective, gains derived from the ICO should be allocated to the shareholders of the shares which have been certified. Distributions to the owners of such tokens will be subject to dividend withholding tax. However, if the token functions as a loan facility (or bond agreement) from a civil law perspective, payments to the investors that can be regarded as interest payments are generally deductible at the level of the company. Tokens that are regarded as regular assets of the company from a civil law perspective are taxed as any other assets, meaning that capital gains derived from the ICO, i.e. the sale of assets, are subject to Dutch (corporate or personal) income tax.

Value-added tax

In the event that an ICO qualifies as a new share issue, it does not constitute a transaction falling within the scope of value-added tax ("VAT"). Hence, no VAT will be due. However, if the tokens of an ICO entitle the investor to additional rights, e.g. entitles the investor to a discount, membership or other functions, the ICO might qualify as a supply of goods and/or services which may trigger VAT. Furthermore, the European Union Court of Justice ("ECJ") has ruled that the services of a Bitcoin exchange (i.e. exchanging Bitcoin for a traditional currency or vice versa) are VAT exempt on the basis of the 'currency' exemption.⁶⁴ The ECJ held that an exchange of Bitcoin fell within the exemption from VAT of transactions 'concerning currency, bank notes and coins used as legal tender'.

Real estate transfer tax

In the event that the tokens entitle the investor rights to beneficial ownership of Dutch real estate, i.e. the token accomplishes that the owner of the token bears any risk of changes in the value of Dutch real estate, the ICO and any other future transfers of the tokens may trigger Dutch real estate transfer tax.

4.3 What are the privacy implications of an ICO and token sale?

Organising an ICO has several privacy implications from a data protection law perspective. The rules regarding the processing of personal data should be observed. These rules are provided for in the General Data Protection Regulation 2016/679/EU ("**GDPR**"), which will be effective as of 25 May 2018. If you process, store or transmit personal data belonging to EU residents, then you will almost certainly need to comply with the GDPR. This means that the GDPR will probably apply during the process of an ICO. The GDPR makes it compulsory that the ICO process is organised in a way that it systematically satisfies the requirements as laid down in the GDPR. A company considering an ICO should deliberate whether it is desirable or a legal requirement to identify participants prior to an ICO. Simultaneously, the GDPR and the Dutch legislation implementing the GDPR impose restrictions on which measures are allowed to be taken to identify these participants. For example, it is not allowed to process a citizen's service number (BSN) without a legal basis to do so. Furthermore, capturing a copy of an identification document is not possible, unless several mitigating measures are taken (such as shielding the BSN and the passport photograph). Failure to comply with the formal and material requirements of the GDPR can lead to significant penalties and liability towards *inter alia* token holders.

4.4 What are the consumer protection implications of an ICO and token sale?

Also in the event that no license or approved prospectus is required for an ICO, there will be supervision if tokens are sold to consumers in the Netherlands. Unfair commercial practices towards consumers are prohibited in the Netherlands. Issuers will have to pay particular attention to the way they communicate with (potential) investors and to provide them with correct and sufficient information. The omission of such information will be regarded as a misleading commercial practice.

4.5 Are ICO exchanges, brokers and advisors regulated?

The AFM indicated that cryptocurrencies are no financial products, meaning that buying and selling of cryptocurrencies or brokerage of these services, or providing services relating to custody or management of balances in cryptocurrencies are not subject to regulation under the FSA.⁶⁵ However this does not imply that there is no supervision on the parties facilitating trading or holding of cryptocurrencies.

Cryptocurrencies service providers could perform regulated activities if they provide the service to exchange cryptocurrencies holdings into fiat money holdings. Also brokerage services with respect to redeemable funds will be prohibited.⁶⁶ Reference is made to Section 2, *What are redeemable funds?*

ICO exchanges, brokers and advisors will probably also perform regulated activities in the event that the tokens qualify as securities or units in a collective investment scheme within the meaning of the FSA. Reference is made to Section 2. In the Netherlands it is prohibited to provide investment services and activities without being licensed by the AFM. Investment services and activities include the performance of the following activities in the course of a profession or business (i) transmission of orders in relation to one or more financial instruments, (ii) execution of orders on behalf of clients, (iii) dealing on own account, (iv) portfolio management, (v) investment advice, (vi) underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis/without a firm commitment basis, (vii) operation of a multilateral trading facility, (viii) operation of an organised trading facility.⁶⁷ This prohibition has been derived from MiFID II. Securities and units in a collective investment scheme within the meaning of the FSA will qualify as financial instruments.

Consequently, in the event that tokens qualify as securities or units in a collective investment scheme and the aforementioned investment services and activities are performed in the Netherlands, the services of ICO exchanges, brokers and advisors will be regulated. The ICO exchanges, brokers and advisors will need to obtain a license as investment firm (*beleggingsonderneming*) to provide these services. Investment firms need to comply with the requirements under the Money Laundering and Terrorist Financing (Prevention) Act. Reference is made to Section 4, *Is the Anti-Money Laundering Directive applicable to virtual currencies?*

5. Conclusion

5.1 How do ICOs and tokens qualify?

Payment-like ICOs and tokens

Each token may assume multiple roles and grant different rights to the holders which makes it difficult to make a comparison with traditional financial instruments. This category of payment-like tokens includes units used as currencies such as Bitcoin and Litecoin; the most widely recognized digital currencies. These cryptocurrencies are virtual alternative currencies that are not issued by any country's government. Payment-like tokens are, unlike normal currencies, not printed or minted, but established in code in digital ledger systems on blockchain, enabling the trading of goods and services.

The argument in favour of cryptocurrencies to be characterized as money is that they are accepted as payment by certain parties. The most famous cryptocurrencies like Bitcoin and Litecoin are more broadly accepted as payment. In theory, cryptocurrencies could serve as money for anybody with an internet-enabled computer or device. However, currently they are mainly regarded as means of exchange for goods or services.

According to DNB, Bitcoin and other cryptocurrencies do not fulfil the three economic functions of money: a store of value, a medium of exchange and a unit of account. Should this change in the future, they might have the potential to fulfill at least some of the functions of money. So far, no country has yet recognized a virtual currency as a legal tender or currency, with the only exception that Japan has implemented a law which recognized virtual currencies as an official method of payment starting from April 2017.⁶⁸ One trend of the recent G20 in Argentina, is the preference to refer to cryptocurrencies as 'crypto-assets'. This highlights the fact that crypto's do not have key attributes of sovereign currencies, which implies that cryptocurrencies are not regarded as currencies, but are classified as assets.

Cryptocurrencies are only accepted as a way of payment on a voluntary basis by certain parties and do not qualify as money (cash, scriptural money and electronic money) under Section 1:1 FSA. According to Dutch case law, cryptocurrencies can only be seen as a means of exchange, a property right or a transferable value. Activities in the context of cryptocurrencies cannot be considered as a payment service under the FSA, and therefore, no license as a payment service provider is required. Moreover, any party issuing a virtual currency does not need to hold the relevant license for issuing electronic money as an electronic money institution. Consequently, when an ICO is structured as a payment-like token, it will probably fall

outside the scope of the FSA, unless the tokens qualify as securities or unit in a collective investment scheme within the meaning of the FSA. Reference is made to Section 2, and *Asset-like ICOs and tokens* below.

Asset-like ICOs and tokens

A token can have various forms and can provide for voting rights or an entitlement to returns. The current trend seems to be moving towards asset-backed tokens. These tokens should be assessed carefully as they could fall within the scope of the FSA. An approved prospectus might be required in the event that the tokens qualify as securities within the meaning of the FSA or a license might be necessary if the tokens qualify as units in a collective investment scheme. In the event that tokens qualify as securities or units in a collective investment scheme this will also impose requirements on the exchange, platform or advisors. Reference is made to Section 4, *Are ICO exchanges, brokers and advisors regulated?*

A negotiable share or other negotiable instrument or right considered equivalent to a share will qualify as a security within the meaning of the FSA. In order to assess if a token qualifies as a security the token should therefore be negotiable. Furthermore, it is relevant to determine whether the holders of a token participate in the company's capital, the holders of a token have voting rights, the holders of a token receive a payment for their participation and whether this payment corresponds to a return achieved with the invested capital. In this respect any controlling rights are not decisive. From the available guidance can be derived that a negotiable token that provides for a participation in the issuer's capital and an entitlement to a payment which depends on the return achieved with the invested capital will probably qualify as a security within the meaning of the FSA.

A collective investment scheme is defined as a collective investment undertaking (including investment compartments of such an undertaking), which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors. A vehicle will only be considered to be a collective investment scheme if all of the elements of the definition are present. In the event that the proceeds of an ICO are used for a collective investment and investor returns are generated as a result of an increase in value of the collective investment, the tokens could qualify as a unit in a collective investment scheme. Collective investment schemes often invest in real estate, baskets of financial products or interests in other companies. Reference is made to Section 2, *Securities law regulation of ICOs*.

Utility-like ICOs and tokens

Utility tokens bear the rights to use or consume products on a blockchain platform created by the issuing company. Most tokens are utility tokens and offer access to platform services. The generation of future cash flow is not the objective of a utility token. The utility token gives functional use to the blockchain product. Pure utility tokens, without any investment element do not have the features of shares or bonds and will not qualify as security or unit in a collective investment scheme. The focus on use, rather than return distinguishes them from investment tokens. Taking Ethereum as example, theoretically, the source of Ether's value is primarily the ability to use it for creating smart contracts. However, in practice, Ether's valuation is largely the outcome of speculation and other factors; even tokens that serve as a utility token will present an investment component, as tokens can be traded at token exchanges after the ICO.

To determine if a utility token can be considered as a security, it is important to focus on the economic function and purpose of the token. Should the function of the token aim to achieve the same economic result as an asset-backed security, it will most likely be determined as an asset token. Reference is made to Section 2, and *Asset-like ICOs and tokens*. If a utility token serves as an investment, or fulfils both a utility and investment purpose, such tokens are likely to qualify as hybrid tokens, and therefore, could be securities under Dutch law. Consequently, tokens which sole purpose is to confer digital access rights to an application or service will probably not qualify as securities. Merely having some 'utility' in a token is not sufficient to avoid the qualification as security. Also in the event that utility tokens will not qualify as security, this does not imply that utility tokens will not be regulated as they will fall within the scope of the consumer protection regulations.



6. Notes

1. According to ICO statistics available on the website coinschedule.com.
2. According to ICO statistics available on the website coinschedule.com, blockchain startups have raised more funds in Q1 alone than the entire 2016-2017. Social messaging app Telegram was the largest ICO of all time raising close to USD 1.5 billion total.
3. Reference is made to ERC20 tokens, these are tokens that have been created using the Ethereum blockchain.
4. Filecoin, a data storage network backed by an application token, is an interesting example, raising USD 200 million within 600 minutes.
5. 'AFM statement on ICOs and cryptocurrencies', AFM, 13 November 2017, available in English at: <https://www.afm.nl/en/nieuws/2017/nov/risico-ico>.
6. 'DNB statement on ICOs and cryptocurrencies', DNB, 13 November 2017, available in Dutch at: <https://www.dnb.nl/nieuws/nieuwsoverzicht-en-archief/nieuws-2017/dnb365473.jsp>.
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12. 'Initial Coin Offerings (ICO's): serious risks', AFM, available at: <https://www.afm.nl/en/professionals/onderwerpen/ico>.
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14. 'The History of The DAO and Lessons Learned', Christoph Jentzsch, 24 August 2016, available at: <https://blog.slock.it/the-history-of-the-dao-andlessons-learned-d06740f8cfa5>.
15. Although the DAO is no longer operational, their initial completely unregulated fund raiser acquired USD 160 million giving rise to the widespread adoption of one of the most controversial corporate funding mechanisms thus far: the "ICO".
16. Among the first ones, Bermuda introduced ICO legislation which includes mandatory disclosures of certain information related to the company, to end the anonymity coming with ICOs (<https://news.bitcoin.com/bermuda-reveals-draft-crypto-regulations-plans-embrace-icos/>).
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21. Section 5:2 and Section 1:1 FSA.
22. Securities within the meaning of the Prospectus Directive are securities as defined in Directive 93/22/EEC with the exception of money market instruments, having a maturity of less than 12 months. Directive 93/22/EEC has been repealed by Directive 2004/39/EC (MiFID I), which has been repealed by Directive 2014/65/EC (MiFID II). Section 94 of MiFID II provides that references to terms defined in Directive 93/22/EEC shall be construed as references to the equivalent term defined in MiFID II.
23. ESMA Q&A prospectuses – 28 March 2018 – question 67, which refers to 'Your questions on MiFID' of the European Commission Services question number 115.
24. Parliamentary Papers II 2005-2006, 29 708, nr. 19, p. 367.
25. Negotiability Policy Rule (Beleidsregel Verhandelbaarheid), p. 4, available at: <https://www.afm.nl/en/professionals/onderwerpen/ico>.
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27. Parliamentary Papers II 2005-2006, 29 708, nr. 19, pages 366-367.
28. 'Initial Coin Offerings (ICO's): serious risks', AFM, available at: <https://www.afm.nl/en/professionals/onderwerpen/ico>.
29. Section 2:190 DCC.
30. 'Initial Coin Offerings (ICO's): serious risks', AFM, available at: <https://www.afm.nl/en/professionals/onderwerpen/ico>.
31. Section 2:65 FSA.
32. 'Frequently asked Questions AIFMD', 17 November 2017, AFM, available at <https://www.afm.nl/nl-nl/professionals/doelgroepen/aifm/aifm/faq>.
33. 'Guidelines on key concepts of the AIFMD', ESMA/2013/611.
34. 'Initial Coin Offerings (ICO's): serious risks', AFM, available at: <https://www.afm.nl/en/professionals/onderwerpen/ico>.
35. Section 3:5 FSA.
36. DNB guidance on the term 'public' <http://www.toezicht.dnb.nl/2/50-236055.jsp>.
37. <https://www.afm.nl/en/professionals/veelgestelde-vragen/innovationhub/cryptovaluta-onder-tz>.
38. The provisions as included in Chapter 5.1 of the FSA.
39. 'Virtual currencies are not a viable alternative', DNBulletin, 8 May 2014, available in English at: <https://www.dnb.nl/en/news/news-and-archive/dnbulletin-2014/dnb307263.jsp>.
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43. 'When is a Bitcoin not a Bitcoin? When it is an asset, says G-20', Bloomberg, 20 March 2018, available at: <https://www.bloomberg.com/news/articles/2018-03-20/when-is-a-bitcoin-not-a-bitcoin-when-it-s-an-asset-says-g-20>.
44. Section 6:112 DCC.
45. Section 10 and 11 of Regulation 974/98 of the European Community.
46. 'Response Minister Dijsselbloem to written parliamentary questions', 19 December 2013, available at: <https://www.rijksoverheid.nl/documenten/kamerstukken/2013/12/19/beantwoording-kamervragen-over-het-gebruik-van-en-toezicht-op-nieuwe-digitale-betaalmiddelen-zoals-de-bitcoin>.
47. Section 2:3a FSA.
48. There are seven types of payment services that require a license. These are listed and defined in the Annex in the Annex to the Europeans Payment Services Directive, the FSA refers to that Annex (Payment Services Directive 2015/2366/EU (PSD 2)).
49. Section 2:10a FSA.
50. Section 6:114 DCC.

51. That cryptocurrencies cannot be characterized as e-money is confirmed in the proposal for the AMLD5: "Virtual currencies should not to be confused with electronic money as defined by Article 2(2) of Directive 2009/110/EC nor with the larger concept of "funds" as defined in point (25) of Article 4 of Directive 2015/2366/EU nor with monetary value stored on instruments exempted as specified in Article 3(k) and 3(l) of the same Directive (...). Whilst they could frequently be used as a means of payment, they may also be used for other different purposes and find broader applications such as means of exchange, investment purposes, store-of-value products or uses in online casinos." (Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC, recital 7a, p. 6.).
52. Section 6:114 DCC.
53. 'EBA Opinion on 'virtual currencies', EBA, 4 July 2014, available at: <https://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf>.
54. 'Initial Coin Offerings (ICO's): serious risks', AFM, available at: <https://www.afm.nl/en/professionals/onderwerpen/ico>.
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56. <http://www.consilium.europa.eu/en/press/press-releases/2017/12/20/money-laundering-and-terrorist-financing-presidency-and-parliament-reach-agreement>.
57. "We invite Member States to prepare for a speedy legislation of this legislation", remarks by Vice-President Dombrovskis at the Roundtable on Cryptocurrencies, 26 February 2018, available at: http://europa.eu/rapid/press-release_SPEECH-18-1242_en.htm.
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59. Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC, article 3 (18), p. 28.
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62. Ether is the cryptocurrency that actually is the fuel of the Ethereum blockchain. Just like a vehicle needs fuel to get propelled similarly to do every single operation on Ethereum's blockchain you require a fuel i.e Ether which powers smart contracts, DApps, and transactions on the Ethereum blockchain.
63. Parliamentary Papers II 2017-2018, 34 808, nr. 6, p. 27.
64. CJEU, judgment in Hedqvist, C-264/14, EU:C:2015:718.
65. <https://www.afm.nl/en/professionals/veelgestelde-vragen/innovationhub/cryptovaluta-onder-tz>.
66. Section 4:3 FSA.
67. Section 2:96 FSA.
68. 'Japan Accepts Bitcoin as Legal Payment Method. What's next?', CCN, 5 April 2017, available at: <https://www.ccn.com/japan-accepts-bitcoin-as-legal-payment-method-whats-next/>. The self-proclaimed free state Liberland has been using bitcoin as its official currency. Other virtual currencies including Bitcoin cash and Ether are also legal tenders in the nation.



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