



Coin offerings — Understanding and mitigating the risks

By Andrew Doherty and Rob Yellen

Over the past two years, a new method of fundraising has arisen across global financial markets — initial coin offerings (ICO).

Viewed as a more expeditious means to raise funds for new cryptocurrency ventures, ICOs have risen in popularity over the last several years. They have been used by startups, and established firms, to lessen the burdens of the rigorous and regulated capital-raising process required by banks or venture capitalists. The initial assessments by participants and issuers that all ICOs are completely unregulated and not subject to federal securities laws, however, have proven to be incorrect.

Developments in the past year involving ICOs have led the Securities and Exchange Commission (SEC) to increasingly monitor and regulate ICOs and digital currency trading as “securities,” subject to federal securities laws. At least four SEC enforcement actions against ICOs are currently underway. The SEC’s position to date has been that most, if not all, ICOs meet the Howey test, the conditions set out by the Supreme Court in *Securities and Exchange Commission v. W. J. Howey Co. et al* to determine if a transaction is an investment contract and subject to securities laws.

ICO facts

An ICO is a fundraising event in which an entity offers participants a digital “coin” or “token” in exchange for consideration (often in the form of virtual currency).

After an ICO, the coin or token may entitle its holder to certain rights, such as profits, shares of assets, rights to use certain services provided by the issuer, voting rights or even a product.

According to [CoinDesk, Inc.](#), in 2017 there were 343 coin offerings, raising over \$5B. Year-to-date 2018, there have been 460 ICOs, raising over \$14B.

What passes the Howey test?

- An investment of money
- There is an expectation of profits from the investment
- The investment of money is in a common enterprise
- Any profit comes from the efforts of a promoter or third-party

Secured coin offerings (SCO)

In response to litigation and SEC regulatory enforcement actions, some companies considering an ICO are now pivoting toward secured coin offerings (SCO). An SCO is the same type of fundraising event using a coin or token, but is undertaken in compliance with federal securities laws.

Protecting the company and its D&Os

In early 2018, Willis Towers Watson placed a bespoke, first-of-its-kind directors and officers (D&O) liability program for an SCO. In summary:

- A Regulation D offering to institutional and accredited investors with a planned Regulation A+ public offering later in the year.
- Issuing company chose a coin offering over more traditional routes due to lower transactional costs and shortened capital raise timelines.
- Our specialty FINEX practice (financial and executive risks) leveraged its unique analytic tools and expertise in blockchain and coin offerings to educate underwriters and build a customized D&O program.

Subsequent SCO engagements in the U.S. are underway, including a planned Regulation D offering later this summer for a technology company.

Risk management questions

Here are several, critical risk management questions to consider during the planning stages of a coin offering:

- What financial and legal exposures are being created by the particular coin offering? For example, is it an equity offering, a utility/user coin offering (provides users with access to a product or service), or another type (tokenized securities, debt tokens)?
- Is the ICO an attempt to take an unregulated path, avoiding the traditional rigor and class action exposure of public offerings governed by securities laws, or is the intent to proceed as an SCO?
- If the offering does expose the company and its leaders to regulatory scrutiny and potential shareholder (tokenholder) litigation, what forms of risk transfer are available and how should an insurance program be structured?

Consult a trusted advisor

As a leading global broker for coin offerings with experience in placing specialty insurance programs in this emerging intersection of people and risk, Willis Towers Watson is uniquely positioned to help answer questions and provide risk management guidance throughout the coin offering process.

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