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Service: Blockchain
Sector: Financial Services, FinTech, IT & Telecommunications

Blockchain Bites: SEC approves Ethereum ETFs, UK Law Commission publishes DAO paper, ASIC deflates pump and dump Telegram scheme, HK outlines stablecoin policy proposals

Michael Bacina, Steven Pettigrove, Jake Huang, Luke Higgins and Luke Misthos of the Piper Alderman Blockchain Group bring you the latest legal, regulatory and project updates in Blockchain and Digital Law.

SEC approves Ethereum ETFs

The Securities and Exchange Commission (SEC) has granted final approval for spot exchange-trade funds (ETFs) that hold Ethereum's ether token (ETH), marking a significant milestone in the crypto investment landscape.

The decision follows the approval of Bitcoin ETFs earlier this year, further integrating major cryptocurrencies intro traditional investment vehicles.

Ethereum ETFs made their debut in Canada in 2021, and various companies have been vying to introduce the popular cryptocurrency into the United States ETF market. Hopeful issuers have been buoyed recently by the SEC's approval of an Ethereum futures ETF in September 2023, as well as heavy hitters from Wall Street indicating their support for the introduction of the ETFs.

The Hong Kong Securities and Futures Commission (SFC) approved the launch of spot Bitcoin and ether ETFs in April, allowing ChinaAMC, Harvest Global and Bosera International to issue ETFs to Hong Kong consumers.

Soon after, in May 2024, the SEC gave the initial green light to Ethereum ETF issuers by approving the "19b-4" forms (the name given to the forms required to be completed and approved before listing a financial product on an exchange).

Now, the SEC has assessed and approved the S-1 documents, filed by the prospected issuers, which provides detailed information about the issuer's financial condition, business operations, and about the specific product being offered.

The latest US ETF news will likely influence further developments in Australia, after the Australian Securities Exchange (ASX) approved its first-ever Bitcoin ETF, following a successful Bitcoin ETF listing at rival exchange Cboe Australia earlier this year.

The SEC's approval of Ethereum ETFs signifies the growing acceptance of cryptocurrency in mainstream finance. As these ETFs begin trading, they are expected to pave the way for increased investment and broader adoption of digital assets.

Written by Michael Bacina and Luke Misthos

UK Law Commission publishes DAO paper

This month, the UK Law Commission published a scoping paper looking into how Decentralised Autonomous Organisations (**DAO**) can be characterised and how the law of England and Wales might accommodate them now and in the future. The paper seeks to identify current issues around DAOs to inform any future law reform or innovations.

What are DAOs and how the current law treats them?

According to the paper, the term "DAO" describes, in very broad terms,

> a new type of online organisation using rules set out in computer code.

DAOs are part of many crypto ecosystems. A DAO will generally bring together a community of participants with a shared goal – whether profit-making, social or charitable – often with some control over governance matters distributed among participants through the use of distributed ledger technology (**DLT**) and smart contracts.

The paper says the term DAO does not necessarily indicate a particular type of organisational structure and, therefore, cannot imply any specific legal treatment. The question of what legally speaking is a DAO can be exemplified by the following:

> For example, does it use a limited company or trust structure? Or, if it has not actively adopted a recognised legal form, how can it be characterised in legal terms? For example, could it be characterised as a general partnership or unincorporated association, or is it simply an arrangement of multilateral contracts between different participants?

There are other follow-up questions around:

- who is liable for the actions of the DAO and how they can be held accountable;
- which jurisdiction's law apply to determine these questions, particularly when the DAO has not adopted a recognised legal structure that links it to a specific jurisdiction;
- to which jurisdiction's tax and regulatory rules is the DAO subject.

Ultimately, the paper says that the answers will depend on where a particular DAO sits on the "spectrum": is it a pure DAO, a digital legal entity, or some hybrid arrangement? The paper provides further details on each of these models on different ends of the spectrum.

The paper goes on to consider the overall attractiveness of England and Wales as a jurisdiction for DAOs, and identifies areas where further work might be useful to accommodate and regulate DAOs:

- There is no current need to develop a DAO-specific legal entity for England and Wales, however, the Government should keep this matter under review.
- The Companies Act 2006 should be reviewed in order to determine whether reform is needed to facilitate the increased use of technology at a governance level where appropriate. The law of other business organisations such as LLPs should also be reviewed with the same aim.
- Further work could be undertaken to determine whether the introduction of a limited liability not-for-profit association with flexible governance options would be a useful and attractive vehicle for organisations in England and Wales, including non-profit DAOs.
- Proceeding with the Law Commission's planned review of trust law under the law of England and Wales. This will consider – in general terms rather than in the DAO context specifically – the arguments for and against the introduction of more flexible trust and trust-like structures in England and Wales.
- Government should consider a review of anti-money laundering regulation in England and Wales to consider whether the same policy objectives can be achieved in a manner more compatible with the use of DLT and other technology.

The legal characterisation and treatment of DAOs has been the focus of many governments and scholars in recent years. This topic has become more important as regulators have sought to apply the existing regulatory perimeter to DAOs (e.g. The US Treasury Department sanctioned the Tornado Cash DAO protocol as an entity) and courts are starting to face these tough questions.

Similar to previous work done by the UK Law Commission, this scoping paper is likely to have a significant influence on how regulators and courts, especially those in the common law world continue to apply and develop the law to accommodate innovative governance models like DAOs.

Written by Steven Pettigrove and Jake Huang

ASIC deflates pump and dump Telegram scheme

Following an ASIC investigation, four individuals have been charged over their alleged involvement in a coordinated Telegram scheme to artificially inflate the price of certain Australian stocks before selling them off at inflated values—a practice known as "pump and dump." These schemes have been a focus point for regulators around the world in recent years.

The four individuals, Syed Yusuf, Larissa Quinlan, Emma Summer, and Kurt Stuart, have been charged with conspiracy to commit market rigging and false trading, facing potential penalties of up to 15 years in prison and fines exceeding AUD$1 million.

ASIC alleges that the defendants formed a private group on the Telegram app to select and discuss penny stocks. These stocks were then announced to a public Telegram group that was humorously and unashamedly named the "ASX Pump and Dump Group", where investors were encouraged to buy, driving up the stock prices. Once the prices were artificially inflated, the defendants sold their shares at these higher prices, profiting at the expense of other investors.

The defendants have also been charged with dealing with the proceeds of crime related to the profits made from these fraudulent activities. This case is being prosecuted by the Commonwealth Director of Public Prosecutions following ASIC's referral in December 2022.

This crackdown follows ASIC's recent warnings about the rising trend of using social media platforms to coordinate pump and dump schemes (having in fact warned a Telegram group in a similar situation back in 2021). ASIC has noted that these activities often involve creating a certain excitement around a stock or spreading false information or news about a stock's prospects to temporarily inflate share prices. Investors who participate in these schemes often suffer losses once the orchestrators sell off their inflated shares, causing the stock prices to drop back down to their pre-artificially inflated price (or even lower).

ASIC Chair Joe Longo emphasised the importance of market integrity in ASIC's media release, stating that:

> Market manipulation is illegal. Pump and dump schemes are a form of financial fraud, eroding investor wealth, threatening the integrity of our markets and potentially the Australian economy more broadly.
>
> Upholding the integrity of Australia's financial markets is a priority for ASIC.
>
> ASIC monitors the cleanliness of our markets, and we take decisive action to disrupt activities that may impact cleanliness. This is why we took the action of entering social media forums and posting directly to issue warnings to members that their actions may be in breach of the law. Coordinated attempts to manipulate the market is a criminal offence.

The recent action is a reminder that seemingly innocent or even humorous trading practices can lead to significant legal (and criminal) consequences when such actions constitute market manipulation. Ethical conduct should be a cornerstone of any investor's or business' operation.

While the alleged offences in this case involved listed securities and related breaches of financial services laws, cryptocurrencies are not immune. US law enforcement has pursued a number of crypto related market conduct cases under general anti-fraud provisions and securities laws. It also an important reminder that the perceived anonymity of chat messaging platforms can be illusory and that regulators may well be lurking in chats and forums or able to hoover up user data later.

ASIC's decisive action against the alleged perpetrators of the pump and dump underscores the regulator's commitment to tackling this problem. Businesses and investors alike should take note of the legal risks associated with market manipulation and prioritise ethical practices and compliance to protect themselves. This case serves as a stark reminder that fraudulent activities will be met with stringent enforcement, highlighting the importance of maintaining clean and transparent markets.

Written by Michael Bacina, Steven Pettigrove and Luke Higgins

Stables in the City: HK outlines stablecoin policy proposals

The Hong Kong Monetary Authority (HKMA) has announced the conclusions of its public consultation on its proposed

regulatory regime for fiat-referenced stablecoins, and the participants in its stablecoin sandbox program.

The consultation began in February 2024 and lasted two months, receiving some 108 submissions. The conclusions will form the foundations of draft stablecoin regulations, which the Financial Services and Treasury Bureau plan to introduce to the Legislative Council later in 2024.

Some noteworthy features of the Consultation Conclusions are outlined below:

Stablecoin issuers must obtain licence

The proposed legislation will require stablecoin issuers to apply for and obtain a licence from the HKMA if they issue stablecoins *in* Hong Kong, reference the Hong Kong dollar, or 'actively market' to Hong Kong users. Any unlicenced issuer can only offer stablecoins to professional investors.

No interest payable

Stablecoins cannot pay interest to holders directly or through arrangements with third parties. However, stablecoin issuers are allowed to offer marketing incentives, so long as they do not relate to the amount of stablecoins held and the duration over which the user holds the balance.

Stablecoins must be fully backed by reserve assets

Stablecoins must be fully backed by reserve assets 'at any given point in time', and issuers must publish monthly confirmations of those assets by an independent auditor.

Reserve assets must be of 'high quality' and 'highly liquid'. The HKMA identified the following assets as being suited to this purpose in particular:

- Cash
- Bank deposits
- Overnight reverse repo agreements with minimal counterparty risk and the same quality backing
- Marketable securities issued by governments, central banks or qualified international organisations with high credit quality
- Tokenised versions of the above assets

Generally, the reserve assets must match the stablecoin's currency unless prior HKMA approval is obtained.

Issuers must hold sufficient capital

The Consultation Conclusions recommend that licenced stablecoin issuers be required to hold the greater of 1% of the stablecoin issuance, or HKD25 million (A$4.8 million), in capital. This was reduced from 2% in an earlier legislative proposal.

Local subsidiary required

Overseas issuers who wish to offer stablecoins in Hong Kong are required to establish a local subsidiary with key personnel based in the city. Some have expressed concerns that this would deter participation by global issuers. The HKMA may consider regulatory cooperation in order to enable cross-border offerings in future.

The Stablecoin sandbox continues

In March 2024, the HKMA announced a sandbox arrangement giving industry players the opportunity to test stablecoin products in a risk-controlled environment. This arrangement also gave HKMA real-world feedback on its regulatory proposals. On 18 July 2024, the HKMA announced the list of participants in that sandbox, which includes JINGDONG Coinlink, RD InnoTech and Standard Chartered Bank, Animoca Brands and HKT.

It is expected that the sandbox arrangement will result in further refinements of the proposed regulations ahead of their introduction into the Legislative Council.

Written by Steven Pettigrove, Jake Huang and Anson Lee