PiperAlderman

Article Information

Author: Michael Bacina
Service: Blockchain, FinTech, Regulatory Compliance & Investigations

---

ASX Updates Guidance for Cryptocurrency Projects

The Australian Stock Exchange (ASX) has been lauded globally for their early movement into the distributed ledger technology (DLT) space.

The ASX project to replace the ageing CHESS system, is rightly reported as cutting edge technology which could bring new efficiencies to share trading.

However, the ASX's welcoming of DLT still does not extend to the world of cryptocurrency, with a new compliance update regarding cryptocurrency-related activity being released on 1 August. ASX has previously raised concerns about cryptocurrency-related activities in Listed@ ASX Compliance Update no 09/17 on 30 October 2017 and no 01/18 on 16 February 2018 and continues to strike a very cautionary tone towards crypto-asset and cryptocurrency related projects.

ASX's position remains unchanged, that listing a cryptocurrency-related business will involve satisfying ASX that:-

1. The applicant has a structure and operations appropriate for a listed entity;
2. The business is bona fide;
3. The business will comply with all applicable legal requirements in Australia and in all jurisdictions where it is proposes to carry on business; and
4. Proper disclosure has been made to investors of the risks (including emerging regulatory risks) involved in cryptocurrencies and crypto-assets.

Despite providing some further details, the new guidance remains close to previous ASX updates. ASX considers cryptocurrency-related activities raise *"significant legal, regulatory and public policy issues"*, but notes that there is an ongoing increase in interest from both unlisted and listed entities. ASX states that its *"concerns regarding cryptocurrency-related activities have been reinforced and amplified"* by:

1. the UK's Financial Conduct Authority (**FCA**) releasing its consultation paper 'CP19/3: Guidance on Cryptoassets' in January 2019 (since followed by its policy statement PS19/22);
2. the USA's Commodity Futures Trading Commission publishing a customer advisory 'Use Caution When Buying Digital Coins or Tokens' on 16 July 2018;
3. the (fairly long) list of enforcement actions being undertaken by the USA's Securities and Exchange Commission (**SEC**);
4. China and South Korea banning Initial Coin Offerings (**ICOs**); and
5. a *"number of prominent social media site…"* bans on advertising ICOs.

The FCA's Policy Statement provides a token taxonomy including stating that *"exchange tokens"* which provide *"little to no rights to holders"* were outside the *"regulatory perimeter"* in the UK, but importantly noting that the offer of payment services using such tokens is likely to be regulated (as would be the case in Australia). Further, the FCA states that they consider a *"utility token"*which provides *"consumers with access to a current or prospective product or service and often grant rights similar to pre-payment vouchers"* to be outside of the regulatory perimeter. This categorisation is much clearer than the guidance published by regulators to date in Australia but may assist as our regulatory framework develops.

The SEC has a history of enforcement actions against ICOs, but there has been two no-action letters recently issued and the first regulated ICO under Regulation A+ has occurred. On 27 June 2018, Facebook relaxed its stance on advertising of token offerings in order to allow advertisements from advertisers who had received prior written approval, and in May of this year, Facebook relaxed the approval process further. Twitter and Google maintain a ban on any ICO advertising.

ASX draws attention to INFO225, ASIC's guidance on ICOs and crypto-assets, most recently updated on 30 May 2019, reiterating ASIC's view that many ICOs and Initial Exchange Offerings (**IEOs**) are likely to be managed investment schemes (**MIS**), which requires the issuer to hold an Australian Financial Services Licence (**AFSL**). To demonstrate compliance with ASIC's guidance and the ASX listing rules, ASX *"strongly encourages"* listed entities to seek legal advice from a reputable Australian law firm before engaging in any cryptocurrency-related activity.

ASX has taken the extraordinary step in this guidance of indirectly criticising legal advice which listed entities have provided to ASX, saying:

"ASX is aware of … law firms providing advice that tokens … are not a financial product … The examples ASX has seen … do not appear to have considered all of the issues involved in this complex question … in particular whether or not the ICO or IEO involves an offer of an interest in a managed investment scheme."

ASX offers a hypothetical example to illustrate concerns around value shifting from shareholders to token holders, suggesting:

"*some developers of computer games seek to fund their development by an ICO of tokens that confer a right to play a given number of games, once it has been developed. The number of tokens offered can run into the millions. This means that there will be millions of instances where the game developer potentially will receive little or no revenue from users playing the game.*"

This example appears problematic given the popularity of pre-sales for games in the video gaming industry and the use of crowd-funding pre-sale for game development. Pre-sales of games is sufficiently popular to be the subject of online rankings and could be said to be a significant value generator for shareholders in a game development business since this form of revenue generation avoids debt raising or equity dilution.

Listing Rule Compliance

For listed entities undertaking, or looking to undertake, a cryptocurrency activity, ASX identifies the following three listing rules as its primary areas of concern:

1. Listing Rule 3.1 (Continuous disclosure – general rule);
2. Listing Rule 11.1 (Significant transactions – change to activities); and
3. Listing Rule 12.5 (Ongoing requirements – appropriate structure and operations).

Continuous Disclosure – general rule (LR 3.1)

It is a fundamental obligation that a listed entity must continuously and immediately disclose to ASX any information which might have a material effect on its share price or valuation. On that basis, it is unsurprising that the ASX is concerned about listed entities *"making announcements about proposed cryptocurrency-related activities prematurely and without an appropriate level of detail"*.

Listed entities should not make public announcements about a cryptocurrency-related activity until it can be supported by a reasonable amount of detail. In the context of an ICO or IEO, ASX states that any announcement should include:

1. the proposed timetable for the ICO or IEO;
2. the number of tokens to be offered in the ICO or IEO;
3. the price at which the tokens will be offered;
4. the purposes for which the funds (including cryptocurrencies) raised by the ICO or IEO will be used;
5. the protections in place (if any) to ensure that the proceeds of the ICO or IEO will be used for those purposes and those purposes only;
6. the specific rights that the tokens will confer on their holders;
7. the type of investors (retail or wholesale) who will be offered tokens;
8. the jurisdictions where the tokens are to be offered;
9. confirmation that the entity has legal advice that the ICO or IEO is lawful in those jurisdictions and that the entity has all of the licences, registrations, authorisations and approvals necessary to conduct the ICO or IEO;
10. confirmation that the entity has received tax advice on the tax treatment of the ICO or IEO and disclosed any material tax issues the ICO or IEO will involve;
11. confirmation that the entity has received accounting advice on the accounting treatment of the ICO or IEO and disclosed any material accounting issues the ICO or IEO will involve;
12. details of any agreements the entity has entered into with parties providing advisory, introductory, facilitation or marketing services in relation to the ICO or IEO, including a detailed description of those services and the fees and perquisites (including free or discounted tokens) those parties are to receive for providing those services;

13. whether the tokens are intended to be listed on cryptocurrency exchanges and, if so, which exchanges; and
14. whether any party providing advisory, introductory, facilitation or marketing services in relation to the ICO or IEO has an interest or involvement in a cryptocurrency exchange on which the tokens are intended to be listed and, if so, the nature of that interest or involvement and how the conflicts this creates will be managed.

Listed entities who fail to disclose the above details with enough detail will be suspended by the ASX.

Significant transactions – change to activities (LR 11.1)

If a listed entity is considering undertaking a cryptocurrency-related activity which constitutes a "*significant change in the nature or scale of that entities business*", the entity must inform ASX before it does so, and can be required by ASX to seek shareholder approval before making the change. This guidance makes clear that ASX considers most cryptocurrency-related activity will be a significant change in the nature or scale of the activities of a company for the purposes of this listing rule.

ASX is likely to require an entity which has notified it of a significant change under this listing rule to re-comply with admission requirements, which is likely to be a costly undertaking.

Ongoing requirements – appropriate structure and operations (LR 12.5)

While the ASX has covered this rule in its previous compliance updates, it reiterates that if any entity fails to have a "*structure and operations appropriate for a listed entity*", it may lead to the suspension or termination of the listing.

A bright line for the ASX is cryptocurrency-related activity which is in breach of a law in a country in which that entity is operating, or activity which is fraudulent.

ASX makes clear in this guidance that it can, and will, require a listed entity to provide the legal advice which that entity has relied upon to demonstrate compliance with the laws relating to crypto-assets, and in particular addressing the issues identified by ASIC in INFO225.

ASX has previously provided the following examples of where an entity is unlikely to meet this requirement:

1. the applicant has a vague or ill-defined business model or its business operations do not appear to ASX to have any substance;
2. the applicant's proposed business is little more than a concept or idea; and
3. the applicant has not yet secured the key licences, government approvals, intellectual property rights or other property or rights it will need to operate its business.

Misleading and deceptive conduct as to regulatory approval

The new guidance also highlights that various entities have been seen to be representing that they are "*approved by*" or "*regulated by*" AUSTRAC or ASX. Where the context of these representations shows that they are intended to convey an impression that the entity in question is more legitimate or less risky than other entities undertaking cryptocurrency-related activity because of AUSTRAC's or ASX's oversight, ASX will view this as misleading and suspend the shares of the entity.

Such representations are also likely to constitute misleading and deceptive conduct under the Australian Consumer Law, and may lead to prosecution by ASIC or the ACCC.

Simple Agreements for Future Equity (SAFEs) and Simple Agreements for Future Tokens (SAFTs)

ASX also highlights its concerns about entities using SAFEs and SAFTs. SAFEs (and SAFTs, if the underlying token is a financial product) will almost always constitute the offer a security for the purpose of the listing rules. As such, listed entities using SAFEs or SAFTs need to consider whether:

1. the terms of the SAFE or SAFT are (in ASX's opinion) appropriate and equitable – listing rule 6.1; and
2. they need to obtain shareholder approval before issuing the SAFE or SAFT – listing rules 7.1/10.11.

ASX also suggests that use of SAFEs and SAFTs, whether by the listed entity directly, or its subsidiaries, can support an argument that the listed entity does not have an appropriate structure under listing rule 12.5.

Listing cryptocurrency Listed Investment Companies (LICs), Listed Investment Trusts (LITs) and Exchange Traded Funds (ETF)s

Given the continued interest in investment products involving cryptocurrencies, ASX has repeated its guidance issued in February 2018 that entities intending to list a cryptocurrency LIC, LIT or ETF must satisfy ASX about:

1. their proposed investment strategy, including how and when they will provide a return to investors and, if applicable, how they will hedge the risks in the underlying investments and any related currency risks;
2. if they intend to invest in cryptocurrencies directly, their understanding of the market volatility and liquidity risks associated with cryptocurrencies and how will they manage those risks;
3. if they intend to invest in, or hedge using, cryptocurrency derivatives, their understanding of the margin risks associated with cryptocurrency derivatives and how they will manage those risks (including in particular what liquidity lines they will have available to meet margin calls);
4. the names of the individual fund managers who will be making their investment decisions and otherwise managing their portfolio together with details of:
    1. a copy of their CVs;
    2. how, and for how long, their services have been secured;
    3. their specific knowledge of and experience in cryptocurrencies;
    4. if the applicant intends to invest in cryptocurrencies directly, their experience in managing highly volatile asset portfolios;
    5. if the applicant intends to invest in, or hedge using, cryptocurrency derivatives, their experience in managing highly volatile derivative portfolios; and
    6. why they consider their LIC/LIT/ETF is a suitable investment for retail investors.

Conclusions

In summary, this new compliance update is consistent with the ASX's position in its initial guidance no 09/17, which provided that:

"An applicant seeking to list a business investing in, or making ICOs of, bitcoins or other crypto-currencies will need to satisfy ASX that its business is bona fide, that it has a structure and operations that are appropriate for a listed entity, … that it will comply with all applicable legal requirements in Australia and in all jurisdictions where it is proposes to carry on business, and that proper disclosure has been made to investors of the risks (including emerging regulatory risks) involved."
This guidance helpfully includes further detail on how the ASX intends to apply particularly relevant listing rules, and highlights that ASX is aligned with ASIC in its application of the *Corporations Act 2001* (Cth) to many cryptocurrency projects which seek to raise funds via the sale of cryptographic tokens.

With the steady and ongoing rise of DLT, blockchain and "DeFi", many will no doubt be watching closely for future updates as the ASX's exciting DLT project helps ASX gain a deeper understanding as to how crypto-assets and cryptocurrency projects generate shareholder value and can be a part of listed entities, including whether ASX will consider adopting a view closer to that of the FCA in categorising crypto-assets.