
INITIAL COIN OFFERINGS: AN ANALYSIS OF THE POTENTIAL LEGAL AND REGULATORY CHALLENGES AND FRAMEWORK

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INTRODUCTION

An initial coin offering (“ICO”) is the cryptocurrency industry’s equivalent to an initial public offering (“IPO”). A company looking to raise money to create a new coin, app, or service launches an ICO as a way to raise funds. Interested investors can buy into the offering and receive a new cryptocurrency token issued by the company. This token may have some utility in using the product or service the company is offering, or it may just represent a stake in the company or project.

Generally, ICOs use Distributed Ledger Technology (“DLT”) to offer ‘coins’ or ‘digital tokens’ that confer various rights on the holder/investor.¹ Earlier, ICOs dealt with small amounts of money and were limited to a few investors; however, mainstream businesses have also begun opting for ICOs to raise funds. The ICO market exploded in 2017 and is said to be in a financial bubble as of now. In 2017 alone, a total of 3.5 billion USD was raised via ICOs, crossing the total amount of early stage funding done via Venture Capital.²

Due to the nature of the investments involved, lack of uniform regulations, and misinformation regarding the technology, the legality of ICOs has seen various controversies in different jurisdictions. Some nations like South Korea³ and China⁴ have banned or suspended ICOs.

¹ Zetzche A. Dirk *et al*, *The ICO Gold Rush: it’s a scam, it’s a bubble, it’s a super challenge for regulators*, 63 Harvard International Law Journal.

² Seema Mody, “How the controversial funding vehicles setting the VC world ablaze work”, CNBC, 6 October 2017, <https://www.cnbc.com/2017/10/05/how-icos-setting-the-vc-world-ablaze-work.html>

³ Cynthia Kim, *South Korea bans Raising Money through Initial Coin Offerings*, Reuters, (Sept. 29, 2017). <https://www.reuters.com/article/us-southkorea-bitcoin-idUSKCN1C408N>.

⁴ *China bans Financial, Payment Institutions from Cyptocurrency Business*, Reuters (May 18, 2021). <https://www.reuters.com/technology/chinese-financial-payment-bodies-barred-cryptocurrency-business-2021-05-18/>.

Others, like Malta⁵ and the United Arab Emirates⁶ have made an attempt to regulate ICOs and the cryptocurrency market by forming new rules. In the United States, the Securities and Exchange Commission covers digital tokens issued in ICOs within the definition of ‘security’ under US securities law.⁷ The Commission has also issued a framework for the analysis of digital assets as ‘investment contracts’ and has implemented various other rules for the purpose of regulating ICOs and cryptocurrency.⁸ Due to the wide discrepancies across jurisdictions regarding the legal nature of ICOs and cryptocurrency, there are various dangers of regulatory arbitrariness and uncertainty.

For a discussion regarding potential regulations that can be imposed on ICOs, it is important to first understand the differences between similar financial terms, some fundamental concepts involved in the ICO process, the life cycle of an ICO, and the legal nature of an ICO.

The table below⁹ differentiates between IPOs, crowdfunding, venture capital, and ICOs so as to provide certain clarity regarding what differentiates ICOs from these traditional methods of financing.

	IPO	Crowdfunding	Venture Capital	ICO
Regulatory Compliance	Almost all jurisdictions regulate IPOs using some form of securities regulations.	While most jurisdictions do not regulate crowdfunding, some European and Latin American countries have started regulating them in	Private equity firms are often required to register with securities regulators.	Only those ICOs that are considered securities are regulated in some jurisdictions. There is no bar for entry for

⁵Cryptocurrency Exchange Regulation in Malta, Porat Group, (Jan. 14, 2021). <https://www.porat.com/cryptocurrency-exchange-regulation-in-malta/>.

⁶Hasan Anwar Rizvi, *United Arab Emirates: Initial Coin Offerings in the United Arab Emirates*, Mondaq (Jul. 11, 2019) <https://www.mondaq.com/fin-tech/821846/initial-coin-offerings-in-the-united-arab-emirates>.

⁷Michaels and Vigna, *SEC Chief Fires Warning Shot against Coin Offerings*, The Wall Street Journal, (Nov. 9, 2017), <https://www.wsj.com/articles/sec-chief-fires-warning-shot-against-coin-offerings-1510247148>.

⁸Press Release, Securities and Exchange Commission, *Framework for ‘Investment Contract’ Analysis of Digital Assets*, (2019), <https://www.sec.gov/news/public-statement/statement-framework-investment-contract-analysis-digital-assets>

⁹Alfonso Delgado et al, *Towards a Sustainable ICO Process: Community Guidelines on Regulation and Best Practices* (2016), 26-28

		recent years.		issuing ICOs.
Limits	There is no cap to the amount that can be raised through IPOs.	Crowdfunding have set caps in almost all jurisdictions.	While there are no limits in investment, venture capital funds have a fixed life.	Due to the vacuum of regulations, there are no caps on ICOs.
Investors	Both institutional investors and retail investors invest in IPOs.	Investments are procured from members of the general public.	They are expected to bring managerial and technical expertise along with capital.	Similar to IPOs, both institutional and retail investors invest in ICOs.
Disclosure Requirements	Publication of a detailed and highly regulated prospectus is a pre-requisite for issuing an IPO.	Companies are required to disclose essential information to investors.	Venture capital funds are accountable to their own investors. This provides an incentive to screen and monitor investments carefully	Companies are only required to issue a whitepaper, the contents of which are not regulated.
Secondary Market Instruments	The securities are registered in a stock exchange.	Securities are traded through private means and there is no secondary market to trade them.	There are no secondary markets to facilitate venture capital.	Depending on the structure of the token, some will have a secondary market. This feature could mean in some jurisdictions that the token is a

				security.
Pricing	There are various pricing options available such as Dutch auction, fixed price, or bookbuilding.	The platform that facilitates crowdfunding is responsible for pricing.	Venture capitalists expect returns of 10 times the capital invested in five years.	The issuer has the freedom to determine pricing.
Service/Goods/Items Sold	Shares/equity	Shares/equity	Shares/equity	Coins/tokens, which may or may not be securities.
Accountability	In case of misrepresentations in the prospectus, the law firm involved, underwriters, and the company may be held liable.	The portal facilitating crowdfunding is liable for registration and meeting other requirements according to the regulatory framework.	Venture capital funds are accountable to the investors.	There is rarely any accountability involved since the founders and advisors may sell their tokens at any time.

PART I

UNDERSTANDING FUNDAMENTAL CONCEPTS

There are certain fundamental concepts involved in the ICO process. Understanding these concepts is essential before proceeding with an analysis of the legal and regulatory framework of ICOs. These terms are (a) Blockchain and (b) Cryptocurrency.

BLOCKCHAIN

Blockchain refers to a decentralized digital ledger that stores, connects, and verifies information using blocks generated by many computers. These individual blocks have storage capacities and when filled, they are connected to a previously filled block, which forms a chain of information called blockchain.

Every transaction is a new piece of information that is recorded on a block and chained to the previous chain of transactions, which is then sent via the Internet to be verified by all members of this network, or “miners.” If the integrity of the block is confirmed, it is then broadcasted to the entire network, so that all participants can record it under their own copies of the ledger, as an addition to a series of previously mined blocks that reference their preceded ones like a “chain.”

CRYPTOCURRENCY

Cryptocurrency is a combination of virtual currency and a commodity since it has a fixed supply, is controlled by algorithms, and is a store of value. The value that cryptocurrency holds and its value as a tradable good lies in the high level of trust from the users of the technology and the data security offered by blockchain technology. When firms define their own units of account, some of the common characteristics of currencies are seen and thus cryptocurrency is formed.

Regular currencies derive their value and are reliable because they are backed by central banks. Cryptocurrencies, on the other hand, are considered reliable by users due to the security of their fundamental cryptographic designs. While regular currencies often see a fall in their value due to force majeure events such as wars, natural disasters, etc. the biggest dangers faced by users of cryptocurrency are hacking attacks wherein hackers control more than 50% of the computing power to overwhelm a blockchain system.

LIFECYCLE OF AN ICO

While there are various stages involved in the issuance of an ICO, and these stages differ based on the nature of the offering, there are some steps that are uniform irrespective of the nature of the ICO.

A cryptocurrency start-up, which wishes to raise funds through an ICO, has to first create a whitepaper outlining what the project is, the need of the project, monetary requirements of the project, founders' share of the virtual tokens, and the duration of the ICO campaign. The purpose of a whitepaper is to set out the terms of the offering.

During the campaign, investors buy the project's tokens using fiat or digital currency. These tokens are similar to the shares of a company. If the money raised during the ICO campaign does not meet the funds required by the firm, the money may be returned to the investors. If this happens, the ICO is said to have failed.

There are multiple stakeholders involved in the ICO process. While some of these stakeholders are covered within the existing legal framework, the table below lays down the roles of certain new actors whose rights and duties are not covered under the traditional regime applicable to financial instruments.

Stakeholders	Role in ICO Lifecycle
Developers	They have to produce the code to create the ICO asset while incorporating the conditions that are set out in the white paper.
DLT Network	This network records transactions regarding transfer of assets.
Miners	They are a part of the DLT network. They choose the transactions that have come from authentic sources and verify them. They are paid a fees on the basis of each transaction they verify.
Issuer-appointed digital custodian	They hold the funds of the investors until the process is complete.

Digital Regulator	They approve the criteria specific to ICO issuance.
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CATEGORIZATION OF ICOS

Rather than being one uniform process, there are diverse variations in the nature and kind of ICOs. This is why the legal status of cryptoassets has to be determined on a case to case basis. The European Banking Authority¹⁰, the Financial Conduct Authority¹¹, and the Swiss Financial Market Supervisory Authority FINMA have attempted to categorise coins. While the authorities differ in the terminology used to define them, three main types of categories emerge. These are (a) Exchange/Payment Tokens, (b) Security/Asset Tokens, and (c) Utility Tokens.

- Exchange/Payment Token

These tokens are intended to be used as means of payment for trade of goods and services. They hold a monetary value without giving rise to claims against the issuer. These tokens function independently of the issuer or any underlying business or asset. It has an inherent value and is capable of serving as an alternative to currency. These tokens rely on peer-to-peer trust without the traditional intermediaries. Despite the efficiency of these tokens, they are still not used widely due to various reasons such as the volatility of the crypto market and in part to market inertia. Under the FINMA guidelines, since these tokens are typically used as a means of payment and differ from traditional securities, FINMA does not treat them as securities.

- Security/Asset Tokens

These tokens form a debt or equity claim against the issuer. They greatly resemble securities offered in traditional IPOs. They promise future returns. These tokens also grant the holder some forms of rights in the business. In some instances, the holders may even be entitled to vote on matters concerning the business. Those tokens that enable trade of physical assets on the blockchain also classify as asset tokens. Due to the similarities between security/asset tokens and traditional IPOs, in certain jurisdictions, these tokens are regulated under the existing regulatory perimeter.

¹⁰ European Banking Authority, Report with advice for the European Commission on Crypto Assets, (2019). <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2545547/67493daa-85a8-4429-aa91-e9a5ed880684/EBA%20Report%20on%20crypto%20assets.pdf>

¹¹ Financial Conduct Authority, Guidance on Cryptoassets, Feedback and Final Guidance to CP 19/3 (2019) <https://www.fca.org.uk/publication/policy/ps19-22.pdf>

- **Utility Tokens**

Utility tokens are intended to be used as form of access to the underlying technology application or service of the company issuing them. They are thus a type of access code to the company's services and do not have any intrinsic financial value. The issuer uses the funds received from sale of utility tokens towards the development of the platform. They typically grant the holder early access rights to the platform. They generally do not grant the holder any voting rights in the business unlike securities tokens. Given the limited spending potential of utility tokens, which are only intended to be used within a platform created by the issuer, these cryptoassets typically fall outside the regulatory framework. FINMA does not regulate utility tokens as securities if their only purpose is to confer digital access rights to an application and if the token can only be used as the point of issue. However, if the tokens have an investment purpose, then they are treated as securities.

PART II

EXISTING LEGAL AND REGULATORY FRAMEWORKS

In this part, we shall discuss the different ways the different regulators of the world have handled the initial coin offerings in their respective countries. The ICOs are very specific to the security laws of the country, and hence the country's existing law plays an important role. The different regulatory approaches of the world can be divided into 4 main categories, namely the contractual approach, security token registration approach, comprehensive token registration approach and the ban approach.

CONTRACTUAL APPROACH

In this approach, the ICOs are governed by the law of contracts and not by the securities law of the country. The first step in the creation of ICO, the creation of white paper, plays an important role here since it is the whitepaper itself which is subjected to the law of contracts.

This is primarily for the nations where the definition of securities are in a close knit definition which will not make the regulators enact a new legislation such as Singapore. Countries such as the United States, which requires any sort of thing having substantive economic value to have a regulation, an extra regulation by the lawmakers of the country will be required for the tokens to be specially governed by the contract law.

SECURITY TOKEN REGISTRATION APPROACH

This approach classifies the tokens as security tokens and non-security tokens. If it is a security token, it shall be governed by the securities law of the nation and if it is the non-security token, the token will be governed by the law of contracts.

In the former method, the issuance of tokens will be governed by the laws, regulations, observations, supervisions of the securities regulator of that particular nation. This approach also lays down emphasis on distinguishing the token as a security or a non-security token in the whitepaper itself by the promoters of the token.

COMPREHENSIVE TOKEN REGISTRATION APPROACH

This approach takes away the issue of distinguishing the token by the promoter in the whitepaper and the regulators take it upon themselves to see and take the correct decision with respect to the type of the token. One country to follow this method is that of Mexico.

The issuance of the token has to be made with the regulator and after it's authorization, the security law of the country is applied over the security tokens while also keeping a slight check on the non-security ones.

BAN APPROACH

As per reports, more than 80% of the ICOs in 2017 were scams.¹² Due to this uncertainty and many others, many regulators have even decided to ban ICOs. The ban has been done in several forms. One form is the complete ban of ICO, as in South Korea.

One other form might be banning ICO for certain groups such as retail investors. This might be due to the information disparity. Information plays a key role in the decision making process, and with this process being new, the regulators might want to avoid the inclusion of naive consumers because ICOs can very well be a source of fraud, money laundering and pure opportunistic behavior from the promoters. Another example can be that of banning banks to take part in ICOs since the risks associated with ICOs as of now is too high and the bank invests the money of the general public and that might be considered highly risky.

A complete ban might also be there due to the absence of a regulation governing the purchasing and selling of cryptocurrencies since that is a prerequisite in the ICOs.

ANALYSIS OF THE 4 APPROACHES

The 4 approaches explained above are the approaches that have been used by some of the countries in the world. Even though these approaches have been functioning, none of these approaches are perfect and they have problems of their own. With respect to India's regulators, already joining the bandwagon late, it's important for them to improvise upon the existing

¹² Ana Alexandre, *New Study Says 80 Percent of ICOs Conducted in 2017 were Scams*, Cointelegraph, Jul. 13, 2018, <https://cointelegraph.com/news/new-study-says-80-percent-of-icos-conducted-in-2017-were-scams>

frameworks and then develop a robust mechanism and framework which solves all the current problems as well as the upcoming ones for all the parties involved in the ICO process.

If a country has to deny the emergence of blockchain technology, they may definitely choose to ban the ICO. Here usually the risk of frauds, economic consequences, and information disparity are the primary concerns to name a few with the regulators. The information disparity has been considered a major roadblock. As seen in the ICO of OneCoin, one fraudulent ICO based out of Bulgaria, it capitalised on the information disparity with the investors. It's whitepaper was organised, structured, complicated and difficult for individual investors to investigate. After getting it's initial investors, the only practical way investors could get out profitably was by getting more people involved and did not have any other application without high commissions or costs. It was seen as a Ponzi scheme throughout the world, where the new investors simply added to the revenue of the existing ones, without providing actual economic value.

However, these all can be overcome with the help of regulations and laws which will make the benefit greater than the risk. As far as information is concerned, the only solution to come out of that problem is that of education regarding the same. This is imperative since a complete ban by a country will not help in the long run. That will not only deny access to citizens of the country an investment opportunity, but also companies looking to raise capital in this format. Especially with the majority of the countries taking this up in the future, countries not accepting and riding on this bandwagon will also make the country devoid of various international investments. It is alright if the regulations are taking up time in order to develop a robust regulatory system for the same. For example, the Canadian system was praised for taking it's time during the launch of the Kin token. It was launched by a Canadian firm Kik Interactive. It was purposely structured to not be in compliance with the Canadian laws and hence the promoters restricted the investors to be from Canada. Even though the ICO was successful and it was marketed as a fully transparent ICO, experts agree that more caution should have been maintained just like the Canadian regulators since it was a highly speculative investment.

One regulation to accept these kinds of offerings is through contractual methods. This makes ICOs an attractive method to raise capital since there is a massive reduction in the costs associated with raising an ICO. However, this method is risky for the investors, or the token

buyers. There would be an absence of provisions of the security law, including the mandatory disclosure with respect to some terms and other relevant information. All of this along with the absence of a supervisor, the chances of fraud, economic protection and money laundering would significantly increase. Not everyone can be considered to act in good faith as it happened with the Mastercoin. Mastercoin was the first ICO back in 2013 launched by J. R. Willet. Willet took extreme care and caution before launching this token and even warned the investors against investing in an experimental currency since the idea of giving money to a random stranger through the internet was new at that time. If Willet wanted, he would have ran with all the money he had received because the securities law in the US regarding this had not been put up and this was as of that time being governed by the contract law of the country. This token led to the securities law development of the ICOs in the country.

The third approach discussed above was the security token registration approach. This approach offers a great deal of protection by the regulators, but only to the security token holders. They completely ignore the regulations and hence reduce their burden with respect to non-security token holders. However, there are multiple reasons as to why this approach is wrong. Firstly, the security law of the country has to be amended for a token holder because they cannot be treated as par with a shareholder. Comparison of a token holder along with a shareholder cannot be done because the equity market is far more developed in terms of information, security, control, law and the like. Second, non-security token holders are not being protected. This might lead to many opportunists deceiving the authorities and declaring their token as a non-security token since there is no clear distinction as to whether a token is a security token or a non-security token.¹³ The distinction is made as of from the whitepaper, which is written by the promoter himself. For example, during the launch of ReCoin, another token, supposedly backed by real estate, the promoter simply drafted a false whitepaper claiming it to be a non-security token and with the help of social media, was able to attract investors to it. However, the SEC caught the promoter since every part of the whitepaper was false, the token did not have it's own blockchain technology, meaning the tokens did not even exist.

The fourth approach, or the Mexican approach, provides a solution for this but is something

¹³ SEC v W.J. Howey Co., 328 US 293, 301 (1946).

which the regulators might not like. It is so because all the tokens, whether security or not security, are registered and the regulator examines it. Not only it is consuming more resources from the side of the regulators, but also it is making the whole process of ICO time taking for the promoters with the risk of the increase in cost falling upon them.

TAKEAWAYS

The 4 approaches mentioned above are the approaches which the regulatory bodies have taken up as of now, but currently, none of them are even close to being ideal. Understanding that this is a new sphere and constant upgrades and modifications will be a part of it in the years to come, there are some basic ground rules which we should be able to set with the given history of regulatory mechanisms and its flaws and successes.

First of all, any regulatory mechanism which comes into place should look over the interests of the token holders, uphold the market integrity, conduct the necessary amount of market supervision, and maintain the stability of the financial system.

In order to protect the interests of the token holders, regulations must be brought for both, security tokens as well as the ones without security. Numerous factors make the purchase of tokens risky, including the high probability of scams, the lack of effective devices to protect token holders, the larger asymmetries of disinformation between founders and token holders, and the high risk of irrational decision making that might take place in the crypto markets.¹⁴ To tackle these factors, the regulatory authorities should also spend a lot of resources in educating and warning the potential investors with respect to the risk involved in this kind of investment so that whatever decision is being made, is an informed one and promoters are not able to cheat the people.

¹⁴ Supra, note 9.

PART III

STATUS OF ICOS IN INDIA

RISE OF CRYPTOASSETS IN INDIA

Due to the large size of its population and growing access of the population to internet services, India has not fallen behind in the cryptomarket. Cryptoassets, especially Bitcoin have been available in the Indian market for multiple years. Even in the early days of Bitcoin when transactions were mostly conducted between enthusiasts of the cryptomarket, smallscale Bitcoin transactions were being conducted in India.

By 2013, a number of businesses had started accepting Bitcoin payments. Pioneers like BtcxIndia, Unocoin, and Coinsecure began offering cryptocurrency exchange and trading services in India. Over time, others like Zebpay, Koinex, and Bitcoin-India were added to the list of cryptocurrencies springing up in the country.¹⁵ Apart from online exchanges, multiple over the counter crypto shops also opened in the country.

With the commencement of demonetisation policy in 2016, when 86 percent of the paper currency in circulation in the Country lost its value, people realized the fickle nature of paper currency and started looking towards other alternatives. However, despite the size of the population and the potential of the market, the growth of the cryptomarket has been stifled due to high cryptocurrency prices, and government crackdown on cryptocurrency. Due to this, India only contributes 2 percent of the total global cryptocurrency market capitalization.¹⁶

CHALLENGES TO RISE OF CRYPTOASSETS IN INDIA

Despite the theoretical advantages that cryptocurrencies have over traditional fiat currency, the reason why the cryptomarket has plateaued in India is because of certain financial and security concerns apart certain fundamental problems with the ICO market as can be seen in US's experience with ICOs.

¹⁵ Shailak Jani, *The Growth of Cryptocurrency in India: Its Challenges and Potential Impacts on Legislation*, Institute of Management Research.

¹⁶ Shashi Tharoor & Anil K Antony, *India must not miss the cryptocurrency bus*, The Indian Express, May 31, 2021, <https://indianexpress.com/article/opinion/columns/cryptocurrency-bitcoin-global-economy-7337200/>.

Financial and Security Concerns

While there are multiple potential financial and security concerns, the major concerns in the Indian context have been laid down below.

- a) **Security Threats:** One of the greatest dangers of relying on a currency system backed by trust in peers and security of the system, is the failure of the very security that illicitly such trust. In case hackers gain access to more than 50% of the total computing power of the blockchain system, they can essentially create as much virtual currency as they wish to which shall lead to a fall of the value of the currency and a loss of the value of investments.
- b) **Impact on Traditional Fiat Currencies:** Fearing a fall in the demand for traditional fiat currencies, many people and governments regard cryptoassets hesitantly. Apart from impacting it negatively, when cryptocurrency is traded for fiat currency, it leads to an increase in demand for fiat currency.
- c) **Fluctuation in Value of Virtual Currency:** Due to the high dependence on demand and supply to determine the value of virtual currency without any regulatory authority to mitigate the impact of high fluctuations in demand and supply, the cryptomarket is still based on the popularity of a particular virtual currency. For example, Elon Musk's tweets lead to regular fluctuations in value of Dogecoin and Bitcoin. Due to such instances, people are hesitant towards investing in cryptoassets.

FUNDAMENTAL PROBLEMS IN THE ICO MARKET

It is important to keep in mind the basic differences between the relationship between the investor and issuer of an IPO and an investor and an issuer of an ICO. Due to the very nature of their relationship, there are certain fundamental problems that can be seen with the ICO process and the rights and duties it creates for the parties involved.

The first problem is that the sale of ICO tokens does not make the issuer responsible to the investors. In a traditional IPO, each share guarantees a part of the company's profits to the investor and along with that also creates certain rights over the company such as voting rights, rights for dividends, etc. In a traditional IPO, the company's directors are accountable to investors. However, in case of an ICO, the company can arbitrarily decide the terms and conditions for raising funds through the white paper. Investors are devoid of any rights as

shareholders in the company and cannot expect part of profit, but only a benefit from the increased demand the token might have in the future.¹⁷ Additionally, since investors in an ICO are not owners of shares, they have no control over how the money is to be spent by the Company.

Moreover, due to the overarching rights that a company has while deciding its white paper, ICOs exist in a vacuum where investors are not protected by government rules. Moreover, while developers may write publish descriptive white papers, there are not confirmations for the claims made in the white paper.

Additionally, ICOs formed by start-ups are even more unreliable as there is no prior history of the company available to investors on the basis of which they can make an informed decision. ICO projects generally do not have a lock-up or a vesting period for founders' and advisors' coins. This means that there is nothing tying the founders and advisors to the token and they can make their profit and go whenever.¹⁸

WAY AHEAD: THE SHIFT FROM IPOs TO ICOs

India should accept the ICOs because of the numerous reasons mentioned time and again above. It would act as a wave to make people in India more investment friendly, make them educated about investments, and also bring tremendous opportunities to the country.

With 23 unicorns already coming up in the first 8 months of 2021 as compared to the first 23 coming up in 8 years, the investment field in India is extremely ripe and would love to explore this mechanism of investing as well if the regulatory authorities allow.

The way to go ahead would obviously be to draft laws and regulations regarding cryptocurrency first, but once that is established, the regulations governing ICOs should take precedence.

What we suggest is a formation of a new regulation governing the ICOs. The mechanism and intricacies of the ICO process cannot be governed by the existing company and security laws

¹⁷ Will STOs eventually replace ICOs?, Medium, Dec. 15, 2018, <https://medium.com/platinum-fund/will-stos-eventually-replace-icos-c543699ee4c>.

¹⁸ Aakash Nair & Ashish Mamgain, *What factors predict the success of an Initial Coin Offering?*, HEC Paris (2019).

of India since they will restrict the meaning and open loopholes in the whole process. Certain aspects of the process, as well as the remedies will have to be borrowed from the same, but the process needs to be different.

For example, a security token acts as an asset to the buyer as well as a promoter. But from an accounting point of view, would it be fine to put a token holder as a shareholder in the books of the company? A shareholder gets a plethora of rights in the company after buying a share, what about a token holder? What about the non-security token holders? Should they be classified as long term debenture holders or equity holders or shareholders? Due to such complexities, the existing company and security laws of the nation cannot govern the ICOs without opening up ways for the promoters to skirt the law and take benefit of the investors.

The regulation which should be drafted for the ICOs, should keep the above mentioned problems in mind as well as the foreseeable problems which might come up in the future. A few pertinent issues have been mentioned below, for the upcoming regulation to have this in mind, on an urgent basis.

Accounting Issues

The nature, features, and the application of ICOs should be kept in mind while making the regulation. First off, it becomes important to understand and appreciate the difference between a security and a non-security token. The difference should be understood, not only in a legal perspective but also in an accounting perspective. The way to write in the company's accounts, whether as a token holder, or a shareholder, or an equity holder, is something which should be thought upon and should be clearly mentioned.

Moreover, since the value of the token is volatile and might fluctuate, the regulations should also govern the compulsory writing off in a period of some months otherwise there might be a massive write off after some time which might hamper the economy.

Procedure of raising an ICO

Coming to the raising of the ICO, it would be best if the standard of the whitepaper is set and is referred to a regulator every time. This is the model followed by Mexico and even though it's costs are high, they can be worked upon and brought down in due time. The cost incurred in training people is more preferable than people losing out their money. There should be a

creation of an electronic form governed by the regulator, which will consist of information about the whitepaper and the other statements the company looking to raise an ICO has to submit. The electronic form which will be created by the regulation should mandatorily have the promoter's location, problem and proposed solution, description, blockchain governance, qualifications of the technical team, and risk factors.

By doing this, the regulator will not only benefit from the standardisation, but also from the point of view of analysts and investors to compare and take an informed decision. Moreover, this method will also be able to weed out the fraudulent ICOs which might have come up.

Protection of token holders

The companies raising ICOs should also have a skin in the game. This essentially means that the promoters themselves should be having some tokens, which act as a security to the investors. Even though this strategy makes ICO not feasible by start-ups, this is something which should be there initially as it will help test out the waters. Once more situations have come up and have been analysed, this regulation might be taken off.

The regulation should also work upon the development of a secondary market for tokens, so that the token holders are protected through an easy way of exit just in case if ever they become unsure about their investment.

Development of more market devices should be enacted just like the capital market so that the tokens become more liquid in nature and become more acceptable and accessible.

Non Security Token Holders

As seen in the regulatory framework of the USA and Singapore, the securities law do not protect the non-security token holders. However, this regulation should aim for the protection of them as well. This can be achieved through strategies such as cooling periods, prohibition of certain items and impositions of rules and penalties.

Data Protection

This is an issue which comes along with the blockchain technology and is there due to its distributed nature. There is no central entity working on it and its privacy and hence in ICOs, there are not many strong data protection points. This can be overcome by signing MOUs with respective countries and also accepting the ICOs from those countries only to start off with.

Here, the provisions of the Information Technology Act 2011 will be used in order to protect the data.

Investment Prohibition

While the regulation might be developed by taking examples of other nations, one thing which is specific to India is its population. The ICOs should not be free for all initially and should only be made available to selected inventors who has showcased the required and the prerequisite knowledge. After trying this out with them, it should be opened slowly and slowly to people. This also brings to the point that banks should not be allowed to invest initially due to the kind of risk these ICOs pose.

CONCLUSION

Through this paper, the authors have sought to explain the basic concepts revolving around ICOs and other cryptoassets. Further, the authors have also provided suggestions for legalising and increasing the frequency of ICOs in the Indian context.

For this purpose, in the first part, the authors have first attempted to differentiate between the various traditional forms of fund raising and ICOs. Further, an explanation has been provided of certain fundamental concepts that are essential to understand a discussion surrounding cryptoassets and ICOs.

Next, the authors have differentiated between the types of tokens that can be offered during an ICO and elaborated upon why different regulations are required to govern the different forms of coins.

In the second part, the four approaches that countries have adopted to regulate ICOs have been laid down after which an analysis of those approaches along with the key takeaways have been elaborated upon.

The third part focuses on the introduction of cryptoassets in India and seeks to provide an explanation of why India has not capitalized on the cryptomarket. This part also contains the authors' suggestions towards creating a new legislation for the purpose of regulating cryptoassets and arguments for why a new legislation is required in the first place.

Instead of waiting and following the trend of how countries around the world are dealing with ICOs and cryptoassets, the authors believe that India should capitalise on the uncertainties surrounding ICOs so as to become a hub for cryptocurrencies. This should be done while keeping in mind that when ICOs are properly regulated, they can be beneficial for the company issuing the ICO, the investors, and the State, whereas unregulated ICOs can only benefit the issuers. However, it should also be kept in mind, that despite any number of regulations that may be imposed on ICOs, investors must always conduct due diligence and proper research to ensure that they are getting the worth of their money.