# Anchin Alert

**Anchin, Block & Anchin LLP**
**Accountants and Advisors**

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## SEC Rules that Digital Assets Can Be Treated as Securities, Fall Under Federal Securities Law

Since their launch, cryptocurrencies[1] and other digital assets have operated in a regulatory grey area. Should they be treated as currencies? Securities? As something completely different?

In a July report, the SEC clarified the situation and set a new precedent: Digital assets can be treated as securities and fall under federal securities law.

**ICOs and DAO Tokens**
The SEC report investigated an online organization called The DAO. The DAO raised money to fund its operations by exchanging DAO Tokens for other cryptocurrencies through an Initial Coin Offering (ICO).

In an ICO, organizations working on new types of cryptocurrencies ask for contributions to fund the project, either in cash or other cryptocurrencies. In exchange, people who contribute receive tokens of the new currency, which they can later sell on secondary markets if the new cryptocurrency turns into something valuable.

Companies like the DAO said that they should be exempt from SEC security regulation because they were operating under the Regulation Crowdfunding exemption.[2]

The SEC took an interest in ICOs because there were fraud problems in the past. In some cases, investors were promised they would earn money for participating, even though a positive return could not be guaranteed. In others, people had money and digital assets stolen during ICOs. Fifty million dollars of virtual currency was stolen from investors during The DAO's ICO, according to WIRED.

**SEC Ruling**
After reviewing the situation, the SEC found that the DAO tokens did in fact meet the characteristics of securities and their ICO should have been registered with the SEC.

Even though the DAO claimed they were a "crowdfunding contract," the SEC ruled they did not qualify for the Regulation Crowdfunding exemption because they had not registered as a broker-dealer or a funding portal with the SEC and Financial Industry Regulatory Authority.

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[1] cryptocurrency (noun). : a digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a central bank

[2] Under the Securities Act of 1933, the offer and sale of securities must be registered unless an exemption from registration is available. Title III of the Jumpstart Our Business Startups (JOBS) Act of 2012 added Securities Act Section 4(a)(6) that provides an exemption from registration for certain crowdfunding transactions [2] In 2015, the Commission adopted Regulation Crowdfunding to implement the requirements of Title III. [3] Under the rules, eligible companies will be allowed to raise capital using Regulation Crowdfunding starting May 16, 2016.
www.sec.gov

While the SEC could have pressed charges against DAO for breaking the rules, they chose to issue a warning instead. They wrote their report to set a precedent for the entire blockchain[3] industry.

**When Digital Assets Count as Securities**

The SEC's report states that the offer or sale of digital assets counts as trading securities unless the organization specifically qualifies for an exemption. The SEC will consider the facts of each situation to decide whether a transaction counts as the trade of a security.

It doesn't matter what terms or technology organizations use when they transfer digital assets; it can still count as the offer or sale of securities. Digital assets can also count as securities even if they're just traded for other digital coins or tokens.

**Market Impact**

Firms that issue cryptocurrencies should expect to be under more scrutiny from the SEC. More will need to register under the SEC before launching an ICO. There will also be more disclosure requirements for the sale of digital assets. If an organization does not want to register their digital assets as securities, they will need to formally apply for an exemption.

Investors will find it easier to research cryptocurrencies. Before buying into an ICO, they can check if the ICO has been registered as a security though the SEC's EDGAR database. This way investors can see if a platform is legitimate and there will be more information available.

However, if ICOs start applying for official exemptions, this could block out some investors who were participating before. For most exemptions, income and net worth requirements apply as only accredited investors can participate.

The SEC report clarifies the regulations for digital-asset transactions, an important step as cryptocurrencies and blockchain enter the mainstream.

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[3] A blockchain is a public ledger of all cryptocurrency transactions that have ever been executed. It is constantly growing as 'completed' blocks are added to it with a new set of recordings. The blocks are added to the blockchain in a linear, chronological order. Each node (computer connected to the Bitcoin network using a client that performs the task of validating and relaying transactions) gets a copy of the blockchain, which gets downloaded automatically upon joining the Bitcoin network. The blockchain has complete information about the addresses and their balances right from the genesis block to the most recently completed block. http://www.investopedia.com/terms/b/blockchain.asp#ixzz4saNECtNC

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